

TAX INSIGHTS

R&D UPDATE



R&D YEAR END PLANNING DURING AN UNPRECEDENTED TIME

In what has been an unprecedented year so far around the world, business and life in Australia have never been more different. At a time when there is economic uncertainty and cashflow is critical, it is more important than ever to plan for the R&D Tax Incentive and to ensure robust documentation is in place to secure much needed R&D funds.

Further, over the past 12 months significant activity has been witnessed in the administration of the R&D Tax Incentive and in R&D tax law. Understanding these developments is important to maximising the potential from the upcoming 2020 R&D claim.

Our summary below outlines the key items to look out for and documents to prepare leading up to year end. Summaries and links to more detailed articles have also been provided to recent developments in the R&D Tax space.



RECENT DEVELOPMENTS IN R&D TAX

What a year it has been in the R&D Tax space! Key events have included the first case law on core eligibility definitions and a broad, sweeping review of the R&D Tax Incentive by the Australian Small Business and Family Enterprise Ombudsman ("the ASBFEO"), amongst others. Arising from these actions, the compliance landscape and the lens from which R&D Tax program should be viewed has changed dramatically. A key summary of recent developments are as follows:

The Landmark Moreton Resources Case and other cases

The landmark case of *Moreton Resources Ltd v Innovation and Science Australia* [2019] FCAFC 120 ("Moreton Resources") was handed down by the Full Bench of the Federal Court in August 2019. The case brought with it legally binding principles on interpretation of some of the key concepts for eligibility under the R&D Tax Incentive program. The case overturned the previous position of Innovation and Science Australia and the Administrative Appeals Tribunal position in relation to concepts such as the meaning of the word "experiment" and what constitutes "new knowledge". A link to the detailed RSM analysis is available [here](#).

Since *Moreton Resources*, two decisions have been handed down by the Administrative Appeals Tribunal in the mining and resources sector. Both of these decisions went against the taxpayer and both considered the legal principles introduced in the *Moreton* case. This should serve as a reminder to claimants that whilst the Full Federal Court may have ruled against the narrow interpretation on some of the concepts for eligibility, it is still imperative to ensure that the fundamental governance and documentation processes are adhered to for the purpose of the R&D Tax program. [Click here](#) to read the detailed RSM analysis on the recent Administrative Appeals Tribunal cases.



The Small Business Ombudsman Report

In December 2019, the office of the ASBFEO concluded a detailed review of the R&D Tax Incentive program, in particular the administration of the program by AusIndustry and the ATO. This was undertaken over many months and included interviews with government administrators, accounting and tax professionals, R&D advisors, Australian innovators and participants in the program.

From the study, the ASBFEO outlined a large number of recommendations to improve administration of the program and to deliver a more collaborative approach between participants and administrators to avoid some of the well reported controversial outcomes for R&D claimants, some of which involved repaying millions of dollars in cash retrospectively. Since its release, both government administrators have publicly declared a willingness to review the recommendations. On the ground, the manner in which the program is now being administered has clearly involved incorporation of some of the ASBFEO recommendations, including a new compliance framework being released by AusIndustry and the reversal of negative findings against companies such as Northern Minerals, Ardent Minerals and Xped.

Furthermore, ongoing State Reference Group and National Roundtable meetings are being held between advisors, industry stakeholders and government officials to discuss any issues in real time. RSM has been an active participant in each of these forums and has observed a proactive and collaborative approach from the government administrators to improving the outcomes of the R&D Tax Incentive and its access to eligible entities. [Click here](#) to read the ASBFEO Report. [Click here](#) to read the new AusIndustry Compliance Framework.

Government Response to COVID-19

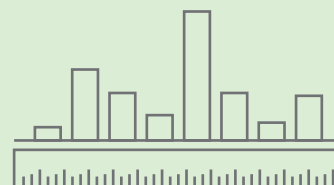
With the government introducing measures to address COVID-19 and to boost economic activity and cashflow, various additional benefits are now available under the R&D Tax Incentive program. From Instant Asset Write-offs to accelerated depreciation, assets used for R&D can be included at much higher amounts than previously. Further good news was released in June 2020, with the Instant Asset Write-offs to be extended until December 2020. Legislation is to be released on this. For further details, please visit the RSM article on recent cases and COVID-19 measures by [clicking here](#).

PRE-30 JUNE 2020 CHECKLIST

With the 30 June 2020 year end rapidly approaching, it is a critical time to collate and review key R&D processes and documentation within your business. The requirement for contemporaneous documentation to substantiate R&D activities and expenditure is ongoing and is the cornerstone of any robust R&D claim.

Prior to 30 June 2020, RSM highly recommends the following considerations:

1. Examine available supporting R&D documentation for technical/scientific components of the R&D claim, as well as timesheets and financial information to specifically evidence costs and time spent on R&D activities. We recommend that you collate such documentation, and record any further information not yet recorded with clear timestamps to evidence documentation has been kept within the income year.
2. If you are commencing new R&D activities, you must ensure the correct governance framework and templates are in place. With existing R&D activities, documentation and templates should reflect why ongoing R&D is required and the technical unknowns remaining. Please contact us immediately if you require assistance in this regard.
3. Examine associate relationships and pay outstanding R&D amounts incurred to associates prior to year-end. As explained below, this could materially impact your R&D claim.
4. Contact RSM immediately if you have any questions regarding the above or require additional templates to compile the relevant information.



CONTEMPORANEOUS DOCUMENTATION

Recent focus of the R&D Tax Incentive programme administrators (i.e. AusIndustry and the ATO) has centred around the ability of companies to demonstrate, through documentation maintained during the R&D activities, that their registered R&D activities and use associated expenditure rather than deductions to comply with all requirements of the legislation. This is not an optional requirement and the lack of such documentation leads to a significant risk that the R&D claim will be overturned in the event of a review.

Regarding activity eligibility, such a review could include an examination of records held by a company that show, for example:

- State of the art assessments / technology and competitor reviews conducted at the start of a project that establish the existing knowledge base, and subsequently identify a technical knowledge gap;
- Planning documents that describe a hypothesis and demonstrate a systematic progression of work;
- Test results and experiment logs that detail the work conducted throughout the year, what experimental outcomes were achieved and what new knowledge was generated.

Financial records are equally as important and will typically include:

- Timesheets that demonstrate who worked on what activities, when, and for how long;
- Contracts and invoices that demonstrate the actual cost of the activities and that R&D activities conducted by third parties were conducted for the applicant entity;
- Documents that demonstrate how relevant overheads were allocated to R&D activities.

As the current financial year is almost over, we would recommend that all companies review available documentation that will be used to support R&D claims and begin to collate these documents to facilitate a speedy R&D claim process and a prompt receipt of potential R&D Tax Offsets.

PAYMENTS TO ASSOCIATES

A company can only claim a notional deduction for R&D expenditure incurred to an associate in the year that the amount is physically paid (i.e. being 'incurred' in accordance with ordinary tax principles, or 'accrued' per accounting principles will not be sufficient). In this regard, it is important to pay any associates prior to 30 June 2020 if these amounts are intended to be included in the R&D Tax Incentive claim.

If an amount of R&D expenditure incurred to an associate remains unpaid as at 30 June 2020, an R&D entity may choose to:

- Carry the amount forward and receive an R&D Tax Offset for the amount in the year that payment is made; or
- Forgo the accelerated deduction available under the R&D Tax Incentive programme and claim the deduction under the normal tax provisions.

Broadly, an entity is an associate of another entity if they have "majority voting interest" or can "sufficiently influence" the other entity. Common associates of a company can include founders/co-founders or Directors with significant unvetted control over the business. It is worth noting that the recent High Court case of BHP Billiton Limited v Commissioner of Taxation [2020] HCA 5 ruled on the meaning of "sufficient influence". Whilst the case was very fact specific, the legal principles out of the High Court and previously the Federal Court suggests that the test of sufficient influence can be broad. Care should be taken to evaluate whether any of the employee or contractor payments included in the R&D claim are to associates of the entity.

Common associate amounts that could be eligible under the R&D Tax provisions include salaries/contractor payments for personnel engaged in R&D activities, or overhead items (e.g. rent) incurred to related entities such as a family trust. Payment of an amount to an associate may also include making a constructive payment under the direction of the associate, or a constructive set-off of mutual liabilities between two associate entities.

FOR FURTHER INFORMATION

If you have any questions, please contact your local R&D expert today by [clicking here](#).