
BETTER TARGETING THE RESEARCH AND DEVELOPMENT TAX
INCENTIVE

EXPOSURE DRAFT EXPLANATORY MATERIALS

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Glossary

The following abbreviations and acronyms are used throughout this explanatory memorandum.

<i>Abbreviation</i>	<i>Definition</i>
Commissioner	Commissioner of Taxation
Decision-making Principles	<i>Industry Research and Development Decision-making Principles 2011</i>
Incentive	the Research and Development Tax Incentive
IR&D Act	<i>Industry Research and Development Act 1986</i>
ISA	Innovation and Science Australia
ITAA 1936	<i>Income Tax Assessment Act 1936</i>
ITAA 1997	<i>Income Tax Assessment Act 1997</i>
R&D	Research and Development
Review	<i>Review of the R&D Tax Incentive</i>
SES	Senior Executive Service
TAA 1953	<i>Taxation Administration Act 1953</i>

Chapter 1

Better targeting the Research and Development Tax Incentive

Outline of chapter

1.1 Schedule 1 to the Exposure Draft reforms the Research and Development (R&D) Tax Incentive (the Incentive) to better target the program and improve its effectiveness, integrity and fiscal affordability.

Context of amendments

The R&D Tax Incentive

1.2 The Incentive encourages R&D activities that might not otherwise be conducted in cases where the new knowledge gained is likely to have a wider Australian economic benefit. That is, the Incentive is intended to support additionality in R&D activities and spillover benefits to the broader economy.

1.3 Division 355 of the *Income Tax Assessment Act 1997* (ITAA 1997) provides R&D tax offsets to R&D entities for a range of expenses and depreciation costs incurred on R&D activities. There are currently two R&D tax offsets available:

- a 43.5 per cent refundable tax offset available to most small R&D entities – those with an aggregated turnover of less than \$20 million. The refundable offset can be refunded as a cash payment to an R&D entity if it exceeds the entity's income tax liability; and
- a 38.5 per cent non-refundable tax offset available to larger R&D entities and R&D entities controlled by one or more exempt entities. A non-refundable tax offset may be used to reduce an R&D entity's income tax liability for an income year but any remaining excess must be carried forward to be applied in future income years.

1.4 The basis for calculating R&D tax offsets is the concept of a notional deduction. A notional deduction is generally recognised for expenditure (Subdivision 355-D) on R&D activities and depreciation on assets held for R&D purposes (Subdivision 355-E) subject to conditions. These deductions are referred to as notional because they are only used to calculate an R&D entity's entitlement to the Incentive and for some other

discrete purposes (section 355-105). That is, the entitlement to the Incentive for a notional deduction replaces the entitlement to the underlying tax deduction.

1.5 The value of the Incentive (the ‘incentive component’) is the difference between the R&D entity’s tax rate and the R&D tax offset rate (plus the benefit of refundability where it applies). For example, the incentive component of a large R&D entity receiving the 38.5 per cent non-refundable offset and paying the 30 per cent corporate tax rate is 8.5 per cent.

The Enterprise Tax Plan

1.6 Under the Government’s Enterprise Tax Plan, the corporate tax rate will be progressively lowered until it reaches a uniform 25 per cent in 2026-27. Until 2023-24, companies under an increasing aggregated turnover threshold are entitled to a lower corporate tax rate of 27.5 per cent rather than the standard corporate tax rate of 30 per cent.

Table 1.1 Corporate tax rates under the Enterprise Tax Plan

<i>Year</i>	<i>Aggregated turnover threshold</i>	<i>Corporate entities under the threshold</i>	<i>All other corporate entities</i>
2017–18	\$25 million	27.5 per cent	30 per cent
2018–19	\$50 million	27.5 per cent	30 per cent
2019–20	\$100 million	27.5 per cent	30 per cent
2020–21	\$250 million	27.5 per cent	30 per cent
2021–22	\$500 million	27.5 per cent	30 per cent
2022–23	\$1 billion	27.5 per cent	30 per cent
2023–24	No threshold	NA	27.5 per cent
2024–25	No threshold	NA	27 per cent
2025–26	No threshold	NA	26 per cent
2026–27	No threshold	NA	25 per cent

1.7 As the corporate tax rate is lowered and the rate extends to more corporate entities, the incentive component of the R&D tax offsets would increase significantly.

The \$100 million expenditure threshold

1.8 The Incentive is subject to a \$100 million expenditure threshold, sometimes referred to as an expenditure cap. Expenditure on R&D activities (notional deductions) in excess of \$100 million is not eligible for the full rate of the relevant R&D tax offset. Rather, these notional deductions give rise to an offset at the R&D entity’s corporate tax rate.

That is, excess notional deductions give rise to the same benefit as if the expenditure had instead been claimed as an ordinary tax deduction, eliminating any incentive component.

1.9 The \$100 million expenditure threshold and some associated provisions are legislated to sunset on 1 July 2024 under Part 2 of Schedule 1 to the *Tax Laws Amendment (Research and Development) Act 2015*.

Review of the R&D Tax Incentive

1.10 The Government's reforms are made in response to the recommendations of the 2016 *Review of the R&D Tax Incentive* (the Review).

1.11 The Review was commissioned as part of the Government's National Innovation and Science Agenda. The Review Panel was chaired by the Chair of Innovation and Science Australia (ISA), Mr Bill Ferris AC, Australia's Chief Scientist, Dr Alan Finkel AO, and the Secretary to the Treasury, Mr John Fraser. The Review Panel was asked to identify opportunities to improve the effectiveness and integrity of the program, including how its focus could be sharpened to encourage additional R&D activities in Australia.

1.12 The Review found the Incentive was failing to fully achieve its objectives of generating additional R&D activities and was not well targeted, providing benefits for R&D activities that would have been undertaken without the Incentive.

1.13 The Review also found the cost of the Incentive had exceeded initial estimates. The cost of the Incentive was expected to be \$1.8 billion per annum when it was introduced in 2011-12. In 2016-17, it cost around \$3 billion.

1.14 The Review made numerous recommendations to improve the integrity and effectiveness of the program and to promote its objectives. The Review also made recommendations to improve the administration of the Incentive. The ISA 2030 Strategic Plan, published in January 2018, made alternative recommendations, informed by feedback provided on the Review report. A number of the Review's recommendations were adopted by Government in the 2018-19 Budget.

Summary of new law

1.15 Schedule 1 to the Exposure Draft improves the targeting of the Incentive through the following changes:

- increasing the R&D expenditure threshold from \$100 million to \$150 million and making the threshold a permanent feature of the law;
- linking the R&D tax offset for refundable R&D tax offset claimants to claimants’ corporate tax rates plus a 13.5 percentage point premium;
- capping the refundability of the R&D tax offset at \$4 million per annum (however, offset amounts that relate to expenditure on clinical trials do not count towards the cap); and
- increasing the targeting of the Incentive to larger R&D entities with high levels of R&D intensity, reducing the benefits provided to certain entities undertaking R&D activities and increasing the benefit to others.

1.16 In particular, large R&D entities with aggregated turnover of \$20 million or more for an income year are entitled to an R&D tax offset equal to their corporate tax rate plus one or more marginal intensity premiums.

1.17 The intensity premiums apply to notional deductions within a range of R&D intensity where notional deductions are expressed as a proportion of the R&D entity’s total expenditure.

1.18 In addition, Schedule 2 to the Exposure Draft makes a number of amendments to improve the integrity of the Incentive and Schedule 3 to the Exposure Draft makes a number of amendments to improve the administration and transparency of the Incentive. See Chapters 2 and 3 of these Explanatory Materials for more information.

Comparison of key features of new law and current law

<i>New law</i>	<i>Current law</i>
<i>The expenditure threshold</i>	
The R&D expenditure threshold is increased to \$150 million.	The R&D expenditure threshold applies to eliminate the incentive component of the R&D tax offset in relation to notional deductions in excess of \$100 million.
The R&D expenditure threshold is a permanent feature of the law.	The R&D expenditure threshold is legislated to cease on 1 July 2024.

<i>New law</i>	<i>Current law</i>
<i>The R&D Tax Offset for small R&D entities</i>	
The amount of a refund that an R&D entity can receive is capped at \$4 million per annum. Offset amounts that relate to expenditure on clinical trials do not count towards the cap and remain refundable.	R&D entities with aggregated turnover of less than \$20 million are entitled to a tax refund for any R&D tax offset they receive in excess of their income tax liabilities.
R&D entities with aggregated turnover of less than \$20 million are generally entitled to an R&D tax offset rate equal to their corporate tax rate plus a 13.5 per cent premium.	R&D entities with aggregated turnover of less than \$20 million are generally entitled to an R&D tax offset rate of 43.5 per cent.
<i>The R&D Tax Offset for large R&D entities</i>	
R&D entities with aggregated turnover of \$20 million or more are entitled to an R&D tax offset equal to their corporate tax rate plus a premium based on the level of their incremental R&D intensity for their R&D expenditure.	R&D entities with aggregated turnover of \$20 million or more are entitled to a non-refundable R&D tax offset at a rate of 38.5 per cent.

Detailed explanation of new law

Increasing the expenditure threshold

1.19 The \$100 million expenditure threshold is increased to \$150 million per annum. *[Exposure Draft, Schedule 1, item 11, subsection 355-100(3) of the ITAA 1997]*

1.20 The increase allows R&D entities to claim additional amounts of R&D tax offset on R&D activities. The purpose of this amendment is to increase the incentive for large R&D entities to continue to engage in R&D activities as their R&D expenditure exceeds \$100 million.

1.21 The current law provides that the expenditure threshold will cease on 1 July 2024 and requires the Government to conduct a review of the threshold after 5 March 2020. In light of the 2016 Review and the changes to the threshold adopted by the Government, the requirement for the review is repealed and the increased threshold is made a permanent feature of the law. *[Exposure Draft, Schedule 1, items 16, 20 and 21, section 355-750 of the ITAA 1997, table item 3 in subsection 2(1) of the Tax Laws Amendment (Research and Development) Act 2015 and Part 2 of Schedule 1 to that Act]*

The refundable R&D tax offset for small R&D entities

1.22 An R&D entity with aggregated turnover of less than \$20 million for an income year is generally entitled to a refundable R&D tax offset equal to their corporate tax rate plus 13.5 percentage points. *[Exposure Draft, Schedule 1, item 6, table item 1 in subsection 355-100(1) of the ITAA 1997]*

1.23 This offset does not apply to an R&D entity controlled by one or more exempt entities. These R&D entities are instead entitled to the non-refundable R&D tax offset available to large R&D entities. *[Exposure Draft, Schedule 1, item 7, table item 2 in subsection 355-100(1) of the ITAA 1997]*

The cap on refundable R&D tax offsets for small R&D entities

1.24 Only the first \$4 million of any R&D tax offset is a refundable tax offset. Any excess amount of R&D tax offset must be carried forward as a non-refundable tax offset. *[Exposure Draft, Schedule 1, item 4, subsection 67-30(1A) of the ITAA 1997]*

1.25 However, amounts of the R&D tax offset arising from R&D activities that are or form part of clinical trials do not count towards the \$4 million cap and may be included in a refundable tax offset. *[Exposure Draft, Schedule 1, item 4, subsections 67-30(1A) and (1B) of the ITAA 1997]*

1.26 Non-refundable R&D tax offsets are applied in priority to refundable R&D tax offsets (table items 35 and 40 in subsection 63-10(1) of the ITAA 1997). This ensures an R&D entity's refund cap is not affected by amounts of taxable income the entity would have but for the application of the R&D tax offsets.

Example 1.1 The refund cap and expenditure on clinical trials

In 2018-19, Aperture Research has aggregated turnover of \$15 million. Without taking into account its R&D activities, Aperture Research has an income tax liability of \$500,000.

Aperture Research has incurred \$20 million on R&D activities. Of this expenditure, \$5 million is incurred on clinical trials.

Aperture Research is entitled to a combined R&D tax offset of \$8.2 million: \$20 million multiplied by the entity's R&D tax offset rate of 41 per cent (the entity's corporate tax rate of 27.5 per cent plus 13.5 percentage points).

\$2.05 million of the tax offset (41 per cent of \$5 million) is attributable to clinical trials.

\$6.15 million of the tax offset (41 per cent of \$15 million) is attributable to other R&D activities.

Aperture Research is entitled to a refundable tax offset of \$6.05 million. Because the value of the offset not attributable to clinical trials exceeds \$4 million, Aperture Research's refundable tax

offset is the offset attributable to its R&D activities involving clinical trials (\$2.05 million) plus \$4 million.

The remaining \$2.15 million is a non-refundable tax offset.

The \$2.15 million non-refundable tax offset is applied in priority to the refundable tax offset.

\$500,000 of the non-refundable tax offset can be applied to reduce Aperture Research's income tax liability for the 2018-19 income year to nil. The value of the remaining \$1.65 million non-refundable tax offset is not lost, as it can be carried forward and is available to be applied against assessable income in future income years.

After applying the non-refundable tax offset against its income tax liability for the 2018-19 income year, Aperture Research is able to apply the refundable tax offset to obtain a cash refund of \$6.05 million.

1.27 A clinical trial is a planned study of the safety or efficacy in humans of an intervention (including a medicine, treatment or diagnostic procedure) with the aim of achieving at least one of the following:

- the discovery, or verification, of clinical, pharmacological or other pharmacodynamic effects;
- the identification of adverse reactions or adverse effects;
- the study of absorption, distribution, metabolism or excretion.

1.28 This definition only applies for the purposes of the Incentive and does not affect the meaning of the term 'clinical trial' as used in other legislation. [*Exposure Draft, Schedule 1, items 4 and 17, subsections 67-30(1C) and 995-1(1) (definition of 'clinical trial') of the ITAA 1997*]

1.29 A clinical trial is not relevant for the purposes of the R&D tax offset unless an R&D entity has registered an R&D activity that forms part of the clinical trial. Similarly, expenditure on clinical trials is not relevant for the purposes of the R&D tax offset unless it is expenditure on R&D activities registered with ISA.

1.30 Amendments are made to the *Industry Research and Development Act 1986* (IR&D Act) to provide the Board of ISA with the power to make findings binding on the Commissioner of Taxation (the Commissioner) about whether an R&D entity's activities satisfy the definition of clinical trials. The Board of the ISA may make these findings as part of the registration process for the R&D entity's R&D activities more generally or as an advance finding on application by the entity. A finding by the Board of the ISA as to whether a particular R&D activity is or forms part of a clinical trial is binding on the Commissioner. [*Exposure Draft, Schedule 3, items 4 and 6 to 13, subsection 4(1) (definition of 'clinical trial'), paragraphs 27B(1)(e) and (f), 27J(1)(e) and (f), and 28A(1)(ca) and (cb), section 28, Note 2 to subsection 27B(1), Note 3 to subsection 27E(2), Note 3 to subsection 277H(2), and Note 2 to subsection 27J(1) of the IR&D Act*]

1.31 The Board of the ISA may also make public determinations that are not specific to a particular R&D entity but that provide general guidance, including in relation to the activities it will consider clinical trials (see paragraphs 3.26 to 3.41).

Intensity-based R&D tax offset for large R&D entities

1.32 R&D entities with aggregated turnover of \$20 million or more for an income year are entitled to an R&D tax offset equal to their corporate tax rate plus marginal intensity premiums determined with reference to the R&D intensity of their R&D expenditure on an incremental basis. [*Exposure Draft, Schedule 1, items 7 and 9, table item 3 in subsection 355-100(1) and subsection 355-100(1A) of the ITAA 1997*]

1.33 The intensity premiums apply to notional deductions within a range of R&D intensity for R&D expenditure where notional deductions are expressed as a proportion of the R&D entity’s total expenditure:

Table 1.2 R&D tax offset intensity premiums

<i>Tier</i>	<i>R&D intensity range</i>	<i>Intensity premium</i>
1	Notional deductions representing up to 2 per cent of total expenditure	4 percentage points
2	Notional deductions representing greater than 2 and up to 5 per cent of total expenditure	6.5 percentage points
3	Notional deductions representing greater than 5 and up to 10 per cent of total expenditure	9 percentage points
4	Notional deductions representing greater than 10 per cent of total expenditure	12.5 percentage points

Example 1.2 The R&D tax offset for large R&D entities

Contrast Industries has notional deductions of \$160 million in the 2018-19 income year, exceeding the \$150 million expenditure threshold. In the same income year, Contrast Industries had expenditure of \$1 billion. Its aggregated turnover exceeds \$20 million.

Contrast Industries has an R&D intensity of 15 per cent (\$150 million divided by \$1 billion). The portion of the R&D tax offset calculated in relation the excess \$10 million is calculated separately (see paragraph 1.36).

Contrast Industries' R&D tax offset for the income year is calculated as follows:

<i>Tier</i>	<i>Intensity range</i>	<i>R&D premium</i>	<i>Notional deductions applied</i>	<i>Offset amount</i>
Tier 1	0-2%	4%	\$20m	\$6.8m
Tier 2	2-5%	6.5%	\$30m	\$10.95m
Tier 3	5-10%	9%	\$50m	\$19.5m
Tier 4	10+%	12.5%	\$50m	\$21.25m
Excess	NA	Nil	\$10m	\$3m
		Totals:	\$160m	\$61.5m

R&D intensity

1.34 To calculate its R&D tax offset, a large R&D entity must determine its R&D intensity. That is the proportion of its expenditure spent on R&D expenditure for the income year:

$$R\&D\ intensity = \frac{Notional\ deductions}{Expenditure}$$

1.35 This is intended to provide a higher rate of support for incremental expenditure to R&D entities that devote a significant portion of their overall operations to R&D eligible for support under the Incentive.

Notional deductions

1.36 Notional deductions in excess of the \$150 million expenditure threshold do not attract an intensity premium and are not counted for the purposes of calculating an R&D entity's R&D intensity (see Example 1.2). *[Exposure Draft, Schedule 1, item 11, paragraph 355-100(3)(a) of the ITAA 1997]*

1.37 If an R&D entity's notional deductions for an income year are less than \$20,000, the entity's notional deductions for the purposes of calculating the entity's R&D tax offset only includes the notional deductions that satisfy the criteria in subsection 355-100(2): that the expenditure was incurred to a research service provider registered under Division 4 of Part III of the IR&D Act or was incurred under the Cooperative Research Centre Program. *[Exposure Draft, Schedule 1, item 10, subsection 355-100(2) of the ITAA 1997]*

Expenditure

1.38 An R&D entity's expenditure is worked out by reference to accounting standards and other pronouncements issued by the Australian Accounting Standards Board. *[Exposure Draft, Schedule 1, item 12, section 355-115 of the ITAA 1997]*

1.39 An R&D entity's notional deductions are always included in its expenditure. If an amount of notional deductions is not included under the accounting standards, an adjustment is made to nevertheless include it. *[Exposure Draft, Schedule 1, item 12, paragraph 355-115(2)(b) of the ITAA 1997]*

Consequential amendments

1.40 Cross-references to the expenditure threshold are amended to reflect the increase of the threshold from \$100 million to \$150 million. *[Exposure Draft, Schedule 1, items 5, 13, 14, 15, 18 and 19, the headings to subsections 355-100(1) and 355-525(4), the heading to section 355-720, the note to subsection 355-720(1) of the ITAA 1997, and the heading to subsection 355-325(4A) and section 355-720 of the Income Tax (Transitional Provisions) Act 1997]*

1.41 A number of amendments are made to section 355-100 of the ITAA 1997 to accommodate and explain the introduction of subsection 355-100(1A) to the calculation of the R&D tax offset. *[Exposure Draft, Schedule 1, items 8 and 10, Note 2 to subsection 355-100(1) and subsection 355-100(2) of the ITAA 1997]*

1.42 Similarly, subsection 35-100(3) is amended to reflect both the increased expenditure threshold and the changes to subsection 355-100(1). In turn, a consequential amendment is made to subsection 67-30(1). *[Exposure Draft, Schedule 1, items 2 and 3, subsection 67-30(1) of the ITAA 1997]*

1.43 Consequential amendments are made to explain that the amount of an R&D tax offset in excess of the \$4 million refund cap is a non-refundable tax offset. *[Exposure Draft, Schedule 1, items 1 and 8, table item 35 in subsection 63-10(1) and Note 1 to subsection 355-100(1) of the ITAA 1997]*

Application provisions

1.44 The amendments commence on the first day of the quarter following Royal Assent. *[Exposure Draft, section 2]*

1.45 The amendments in Schedule 1 apply to income years starting on or after 1 July 2018. *[Exposure Draft, Schedule 1, item 22]*

Chapter 2

Enhancing the integrity of the Research and Development Tax Incentive

Outline of chapter

2.1 Schedule 2 to the Exposure Draft enhances the integrity of the Incentive by ensuring R&D entities cannot obtain inappropriate tax benefits and by clawing back the benefit of the Incentive to the extent an entity has received another benefit in connection with an R&D activity.

Context of amendments

Recoupments

2.2 Where an R&D entity benefits from a government recoupment (such as a grant or reimbursement) in relation to expenditure that is also eligible for the R&D tax offset, a clawback applies to reverse the double benefit that arises (Subdivision 355-G). In this context, only the ‘incentive component’ of an R&D tax offset is intended to be clawed back.

2.3 The clawback takes the form of an additional tax on the recoupment (and any other expenditure required as a condition of the recoupment) at a rate of 10 per cent (sections 12B and 31 of the *Income Tax Rates Act 1986*). The 10 per cent rate was initially selected as a simplicity measure by making the assumption that the R&D entity obtained the initial lower offset rate of 40 per cent (now 38.5 per cent) rather than the higher rate of 45 per cent (now 43.5 per cent). The 10 per cent tax rate also assumes a fixed 30 per cent corporate tax rate for all R&D entities.

Example 2.1 Recoupments

Cross Innovations receives a \$1 million grant to undertake R&D activities. In addition to the grant, Cross Innovations must spend an additional \$1 million of its own money as a condition of the grant. Cross Innovations receives an offset of \$870,000 (applying the 43.5 per cent offset rate). Cross Innovations would have otherwise been entitled to a deduction worth \$550,000 at the 27.5 per cent corporate tax rate. The incentive component of the offset is the difference: \$320,000.

In the same income year, the recoupment rules clawback \$200,000: 10 per cent of the total \$2 million spent under the terms of the grant. Cross Innovations keeps the remaining \$120,000 of the offset

incentive. However, the grant alone is intended to constitute sufficient incentive without the need for the R&D Tax Incentive to continue to apply.

2.4 The recoupment rules also apply where an R&D entity receives a recoupment for expenditure incurred by another entity to which it is connected or affiliated (subsection 355-450(4)). In these situations, the entity receiving the recoupment is subject to the clawback tax even though the other entity obtained the financial benefit of the R&D tax offset.

Feedstock adjustments

2.5 Feedstock adjustments apply to recoup the benefit of the Incentive to the extent it relates to goods, material or energy used to produce marketable products sold or applied to the R&D entity's own use (Subdivision 355-H).

2.6 The intended net outcome is that the Incentive is effectively enjoyed on feedstock expenditure to the extent that it is not offset by feedstock revenue. This is achieved by basing the adjustment on the lesser of feedstock expenditure and feedstock revenue.

- where feedstock revenue exceeds the feedstock output's related feedstock expenditure, the feedstock adjustment will be based on the feedstock expenditure — because the effective net cost of the feedstock inputs and energy was nil.
- where feedstock revenue is less than the feedstock output's related feedstock expenditure, the feedstock adjustment will be based on the feedstock revenue — because the effective net cost of the feedstock inputs and energy was reduced by that amount.

2.7 The adjustment is implemented by including one third of the lesser of feedstock expenditure or feedstock revenue in the R&D entity's assessable income (subsection 355-465(2)). As with the recoupments in Subdivision 355-G, the one third formula is intended to recoup 10 percentage points of the Incentive (based on a standard 30 per cent corporate tax rate).

2.8 In contrast to the other recoupment provisions, this recoupment is incorporated into the income tax equation in section 4-10 and does not create a new tax.

Example 2.2 Feedstock adjustments

Wayland Enterprises, a large R&D entity, spends \$100,000 on the development of a new product, producing one tangible product, which it then sells for \$110,000. Wayland Enterprises is entitled to a \$38,500 offset (with an in incentive component of \$8,500).

\$33,333 is included in Wayland Enterprises' assessable income (one third of the feedstock expenditure). After applying the corporate tax

rate to the amount included in assessable income, the feedstock adjustment would claw back 10 per cent of the offset: \$10,000, which is more than the incentive component.

However, if Wayland Enterprises was a small R&D entity in the same position, it would claim an offset of \$43,500 (with an incentive component of \$16,000).

The \$33,333 included in assessable income and taxed at the 27.5 per cent corporate tax rate. The feedstock adjustment would claw back just $9\frac{1}{6}$ per cent of the offset: \$9,166.67.

2.9 The feedstock rules also apply where an entity receives feedstock revenue in relation to an R&D tax offset obtained by another entity to which it is connected or affiliated (section 355-75). However, in these situations, the R&D entity originally entitled to the R&D tax offset is subject to the feedstock adjustment rather than the entity receiving the feedstock revenue. This represents a further inconsistency between the tax treatment of feedstock revenue and recoupments.

Summary of new law

2.10 Schedule 2 to the Exposure Draft improves the integrity of the Incentive by:

- extending the general anti-avoidance rules in the tax law to R&D tax offsets directly; and
- making the rate at which the offset is recouped more accurate in situations where the offset would otherwise result in a double benefit.

Comparison of key features of new law and current law

<i>New law</i>	<i>Current law</i>
<i>Schemes to obtain an R&D tax benefit</i>	
The Commissioner may also deny a tax benefit in the form of an amount of R&D tax offset that an R&D entity seeks to obtain from a tax avoidance scheme.	The Commissioner may deny a tax benefit in the form of a deduction or notional deduction that an R&D entity seeks to obtain from a tax avoidance scheme.

<i>Clawback of recoupment amounts and feedstock adjustments</i>	
Recoupment amounts and feedstock adjustments give rise to an amount of assessable income equal to the value of the incentive component of associated amounts of R&D tax offset.	Recoupment amounts are subject to a standalone tax of 10 per cent.
	One third of feedstock adjustments are included in an R&D entity's assessable income.
An amount is included in the assessable income of the R&D entity that received or is entitled to the R&D tax offset in relation to a recoupment amount or feedstock revenue received by a related entity.	In cases involving related entities, the entity receiving a recoupment is subject to recoupment tax.
	In cases involving related entities, the R&D entity entitled to the R&D tax offset is subject to a feedstock adjustment if the related entity receives feedstock revenue.

Detailed explanation of new law

Schemes to obtain an R&D tax benefit

2.11 Part 1 of Schedule 2 to the Exposure Draft explicitly extends the concept of tax benefits in the general anti-avoidance rule in Part IVA of the *Income Tax Act 1936* (ITAA 1936) to include the R&D tax offset. These amendments ensure the Commissioner can apply Part IVA to prevent R&D entities from being able to obtain tax benefits by entering into artificial or contrived arrangements to access the R&D tax offset. *[Exposure Draft, Schedule 2, items 2 to 10, paragraphs 177C(1)(bd) and (h), 177C(2)(f), 177C(3)(cc) and (i), 177CB(1)(f), 177F(1)(f), 177F(3)(g) and subsection 177C(3) of the ITAA 1936]*

2.12 Part IVA of the ITAA 1936 applies in situations where a scheme or arrangement is entered into in order to obtain a tax benefit. These rules allow the Commissioner to cancel the relevant tax benefit where the conditions under Part IVA are satisfied. For example, this can include situations where an R&D entity enters into an arrangement with a dominant purpose of securing a tax benefit that is an R&D tax offset.

Clawback for recoupments and feedstock revenue

2.13 Part 2 of Schedule 2 to the Exposure Draft remakes and consolidates Subdivisions 355-G and 355-H of the ITAA 1997 (about the clawback of R&D recoupments and feedstock adjustments respectively) into a new Subdivision 355-G and introduces a new uniform clawback rule that applies for both recoupments and feedstock adjustments. The amendments ensure that an R&D entity must disgorge the entire benefit of an R&D tax offset to the extent it (or a connected entity or an affiliate

entity) receives a recoupment amount or a feedstock adjustment because of the offset. [*Exposure Draft, Schedule 2, item 15, section 355-430 of the ITAA 1997*]

2.14 Current Subdivisions 355-G and 355-H only partially reverse the benefit of an R&D tax offset in some circumstances where a recoupment amount or a feedstock adjustment is involved. In light of the amendments discussed in Chapter 1, the current recoupment and feedstock rules would produce more anomalous outcomes if they are not amended. The amendments ensure the full benefit of the R&D tax offset is reversed, to remove the double benefit that arises in such situations.

Clawback amounts

2.15 Current Subdivision 355-G is remade into a single section and reference to the payment of extra income tax (a recoupment tax) is removed. Instead, the remade provision identifies an amount (a clawback amount) that represents the amount of notional deductions an R&D entity received or is entitled to receive in relation to a recoupment. [*Exposure Draft, Schedule 2, item 15, section 355-440 of the ITAA 1997*]

2.16 Current Subdivision 355-H is remade into a single section and the reference to the inclusion of an amount in assessable income is removed. Instead, the remade provision identifies an amount (a clawback amount) that represents the amount of notional deductions an R&D entity received or is entitled to receive in relation to a feedstock adjustment. The clawback amount is the lesser of the feedstock revenue received or the notional deductions attributable to the feedstock output. [*Exposure Draft, Schedule 2, item 15, section 355-445 of the ITAA 1997*]

2.17 The clawback amount is relevant for working out the amount that must be included in an R&D entity's assessable income to disgorge the benefit of an R&D tax offset. The clawback amount reflects the amount of R&D expenditure (notional deductions) tainted by the operation of the recoupment or feedstock rules. The amendments calculate the amount of R&D tax offset tainted by the tainted expenditure. The incentive component of the tainted R&D tax offset, in turn, is the benefit to be clawed back.

2.18 The clawback amount picks up the amount worked out under each of Subdivisions 355-G and 355-H in the current law immediately before adjustments are made to bring it to account: applying tax to it in the case of recoupments and including a third of the amount in assessable income in the case of feedstock. It is primarily these adjustments in the current law that are producing inappropriate outcomes and are subject to the amendments.

Example 2.3 Clawback amounts

In Example 1.2, Contrast Industries had the following amounts in the 2018-19 (the offset year):

- aggregated turnover in excess of \$20 million;
- expenditure of \$1 billion;
- notional deductions of \$160 million; and
- a non-refundable R&D tax offset of \$61.5 million.

Further to this example, in the 2020-21 income year (the present year), Contrast Industries sells a tangible product developed during its 2018-19 R&D activities. The tangible product is sold for \$20 million but costed \$25 million to develop.

The clawback amount is the lesser of the market value of the tangible product on sale (feedstock revenue) and the tangible product's cost. Here, Contrast Industries has a clawback amount of \$20 million.

2.19 Except as outlined in this Chapter, the remaking of Subdivisions 355-G and 355-H is not intended to alter the way recoupment amounts and feedstock adjustments (a clawback amount in these amendments) are calculated. For further information on the operation of these provisions, refer to the Explanatory Memorandum to the Tax Laws Amendment (Research and Development) Bill 2011, and existing guidance materials and rulings issued by the Commissioner.

The taxing point

2.20 Consistent with the existing law, the uniform clawback rule will include an amount in assessable income in the year the clawback amount is received (the present year). The underlying offset entitlement, whether in the same year or in an earlier year or years (an offset year) is unchanged. *[Exposure Draft, Schedule 2, item 15, section 355-435 of the ITAA 1997]*

2.21 The entity receiving the recoupment or feedstock revenue could be the R&D entity entitled to the R&D tax offset or an entity affiliated with or connected to the R&D entity. *[Exposure Draft, Schedule 2, item 15, subsections 355-440(5) and 355-445(5) of the ITAA 1997]*

2.22 The amendments unify the taxing point in cases involving related entities: where one entity has the R&D tax offset entitlement and the other entity receives the recoupment or feedstock revenue. The R&D entity that has received or is entitled to receive the R&D tax offset is the entity with the clawback amount and must include an amount in its assessable income. *[Exposure Draft, Schedule 2, item 15, section 355-435 and subsections 355-440(1) (2) and (5), and 355-445(5) of the ITAA 1997]*

Example 2.4 Related entities and clawbacks

It would not change the outcome in Example 2.3 if, instead of Contrast Industries selling the tangible product itself, the tangible product was sold by a related entity.

The amount included in assessable income

2.23 When the clawback applies, the R&D entity entitled to the R&D tax offset includes an amount in assessable income in relation to each offset year in which it claimed an offset related to the recoupment amount or feedstock adjustment. [*Exposure Draft, Schedule 2, item 15, section 355-450 of the ITAA 1997*]

2.24 The amount included in assessable income is worked out as follows:

$$\frac{\text{Starting offset} - \text{Adjusted offset} - \text{Deduction amount}}{\text{R\&D entity's corporate tax rate for the present year}}$$

2.25 Each of the components of this formula are explained below.

Calculating the offset portion subject to the clawback

2.26 The first step in applying the formula is to calculate the portion of the R&D tax offset the R&D entity received that relates to the clawback amount. If the R&D entity received the R&D tax offset in multiple offset years in relation to the clawback amount that arises in the present year, the formula must be applied in relation to each offset year.

2.27 The primary way of working out the portion of the offset to be clawed back in an offset year is to compare the actual amount of the R&D tax offset in that year (the starting offset) with the amount of the offset the R&D entity would have received if its notional deductions were reduced by the portion of the clawback amount that relates to the offset year (the adjusted offset). [*Exposure Draft, Schedule 2, item 15, subsection 355-450(1) (definitions of 'adjusted offset' and 'starting offset') of the ITAA 1997*]

2.28 This targets the clawback to the highest tiers of the R&D entity's offset entitlement (i.e. those received for the highest intensity expenditure, the last dollars the entity spent). If an R&D entity had notional deductions in excess of the \$150 million expenditure threshold, the excess deductions would be reduced first, limiting the difference between the starting and adjusted offset. This - when combined with the operation of the deduction amount - is equivalent of the outcome achieved under table items 2 and 3 in subsection 355-720(2) in the current law.

Example 2.5 The starting offset and the adjusted offset

Further to Example 2.3, the portion of Contrast Industries' 2018-19 R&D tax offset that is subject to the clawback is worked out by subtracting the entity's adjusted offset from its starting offset.

Contrast Industries has a starting offset of \$61.5 million, the amount of the offset it received in 2018-19.

Contrast Industries has an adjusted offset calculated as if its notional deductions for 2018-19 were reduced from \$160 million to \$140 million by the value of the clawback amount. The entire clawback amount is included in the reduction because the entire amount relates to the 2018-19 income year. The adjusted offset is calculated as follows:

<i>Tier</i>	<i>Intensity range</i>	<i>R&D premium</i>	<i>Notional deductions applied</i>	<i>Offset amount</i>
Tier 1	0-2%	4%	\$20m	\$6.8m
Tier 2	2-5%	6.5%	\$30m	\$10.95m
Tier 3	5-10%	9%	\$50m	\$19.5m
Tier 4	10+%	12.5%	\$40m	\$17m
Excess	NA	Nil	Nil	Nil
		Totals:	\$140m	\$54.25m

The adjusted offset amount reflects that \$10 million has been removed from the excess tier and \$10 million has been removed from tier 4, the highest tier Contrast Industries reached on its level of R&D intensity.

The difference between the two amounts is \$7.25 million.

Recursive calculations for multiple clawback amounts

2.29 The situation is more complex where an R&D entity’s offsets in a particular offset year are clawed back multiple times because the entity receives multiple clawback amounts in relation to it. In these circumstances, the clawback rule works in a recursive manner.

2.30 In recursive applications of the rule, the R&D entity must compare the offset amount that could have been claimed under the last counterfactual calculated and the amount that could have been claimed under a new counterfactual. In calculating the new counterfactual, the R&D entity must incorporate all previous reductions to the notional deduction amount and make a further reduction for the new clawback amount. *[Exposure Draft, Schedule 2, item 15, subsection 355-450(2) of the ITAA 1997]*

Example 2.6 Recursive clawback

Flying Fox Innovations has an R&D tax offset entitlement based on \$100 million of notional deductions. The entity receives two recoupment amounts: one of \$10 million and one of \$20 million.

For the first recoupment, the clawback is calculated by reference to the difference between the R&D tax offset calculated on \$100 million of notional deductions and the offset calculated on \$90 million. For the second recoupment, the clawback is calculated by reference to the

difference between the R&D tax offset calculated on \$90 million and the offset calculated on \$70 million.

Allowing the benefit of the deduction

2.31 Regardless of whether the primary or recursive rule is applied in calculating the difference, once the difference is identified, it is not appropriate to bring the entire difference to account as tax. Only the incentive component (or premium) is brought to account. Therefore, the second step of the above formula requires that the difference between the starting offset and the adjusted offset be reduced by the product of the portion of the clawback amount that relates to the offset year and the R&D entity's corporate tax rate in the offset year. This allows the R&D entity to retain the benefit of the R&D tax offset for the clawback amount to the extent it replaced the benefit of a deduction for the same expenditure. [*Exposure Draft, Schedule 2, item 15, subsection 355-450(1) (definition of 'deduction amount') of the ITAA 1997*]

Example 2.7 The deduction amount

Further to Example 2.5, Contrast Industries has a deduction amount equal to its clawback amount (\$20 million) multiplied by its corporate tax rate in the offset year (30 per cent): \$6 million.

The \$7.25 million figure reached in Example 2.5 is reduced by the \$6 million deduction amount to complete the numerator of the above formula. The resulting \$1.25 million represents the additional amount of tax Contrast Industries must pay to disgorge the incentive component of the R&D tax offset associated with the development of the sold tangible product.

Bringing the amount to account

2.32 The R&D entity must bring the amount to account as assessable income in the year in which the entity received the clawback amount. The amount calculated up to this point represents the full dollar-value of the incentive component of the R&D tax offset the R&D entity obtained in connection with the clawback amount. The amount of tax the R&D entity is required to pay equals this amount. As such, this amount is divided by the R&D entity's current corporate tax rate to ensure its value is maintained when taxed.

Example 2.8 The denominator

Further to Example 2.7, Contrast Industries must divide the \$1.25 million by its current corporate tax rate (30 per cent).

The resulting \$4.167 million is included in the assessable income of Contrast Industries in 2020-21. Disregarding other assessable income and deductions, this will increase the income tax liability of Contrast Industries by the appropriate \$1.25 million once the corporate tax rate applies to the entity's taxable income.

2.33 Bringing the amount to account as assessable income (rather than through a standalone tax) allows R&D entities to apply deductions from the current year and carried-forward losses against the clawback. Loss-making R&D entities that only obtained a non-refundable R&D tax offset in the offset year can apply the carried-forward offset against the amount included in assessable income. This ensures the clawback rule recovers the correct amount but does not have an unintended negative cash flow impact on R&D entities.

Consequential amendments

2.34 A definition of ‘R&D tax offset’ linked to Division 355 of the ITAA 1997 is inserted into the dictionary of Part IVA of the ITAA 1936. [*Exposure Draft, Schedule 2, item 1, subsection 177A(1) of the ITAA 1936 (definition of ‘R&D tax offset’)*]

2.35 Consequential amendments are made to the remaking of the recoupment and feedstock provisions, and the introduction of the uniform clawback rule. These includes removing redundant provisions associated with the recoupment tax and repealing parts of subsection 355-720(2) that dealt with the interaction between the expenditure threshold and the old recoupment and feedstock rules. These functions are now consolidated in the new clawback rule. [*Schedule 2, items 11 to 14, and 16 to 21, sections 4-25 and 10-5, table item 4A in subsection 9-5(1), table item 10 in section 20-5, paragraph (b) of the note to section 355-510, table items 2 and 3 in subsection 355-720(2), the notes to subsection 355-720(2) and subsection 995-1(1) (definition of ‘feedstock revenue’) of the ITAA 19997, subsection 12(7), and sections 12B and 31 of the Income Tax Rates Act 1986*]

2.36 As part of the remaking of Subdivision 355-G, the cap on recoupment amounts is amended to clarify the meaning of the numerator in the formula. [*Exposure Draft, Schedule 2, item 15, subsection 355-440(4) (definition of ‘R&D expenditure’) of the ITAA 1997*]

Application provisions

2.37 The amendments commence on the first day of the quarter following Royal Assent. [*Exposure Draft, section 2*]

2.38 The amendments to Part IVA of the ITAA 1936 apply in relation to R&D tax benefits obtained on or after 1 July 2018, regardless of when the relevant scheme was entered into or carried out. [*Exposure Draft, Schedule 2, subitems 22(1) and (2)*]

2.39 The amendments to the recoupment and feedstock rules, and the new clawback rule, apply in relation to income years starting on or after 1 July 2018. The new clawback rule may apply in an income year starting on or after 1 July 2018 in relation to an R&D tax offset received in an

income year starting before that date. *[Exposure Draft, Schedule 2, subitem 22(3)]*

Chapter 3

Improving the administration and transparency of the Research and Development Tax Incentive

Outline of chapter

3.1 Schedule 3 to the Exposure Draft improves the administrative framework supporting the Incentive by making information about R&D expenditure claims transparent, enhancing the guidance framework to provide certainty to applicants and streamlining administrative processes.

Context of amendments

3.2 The Incentive is jointly administered by the Australian Taxation Office (under the authority of the Commissioner) and the Board of the ISA.

3.3 One of the conditions of an expense giving rise to a notional deduction is that the R&D entity is registered under section 27A of the IR&D Act (for example, subparagraph 355-205(1)(a)(i) of the ITAA 1997).

3.4 Under Part III of the IR&D Act, the Board of ISA may make findings about whether an R&D entity's activities are R&D activities. A finding binds the Commissioner for the purpose of working out an R&D entity's R&D tax offsets (section 355-705 of the ITAA 1997).

3.5 The Department of Industry, Innovation and Science and its staff assist the Board of ISA to perform its functions. The Board and its committees may delegate their functions to a Senior Executive Service (SES) employee (subsections 21(1) and 22A(1) of the IR&D Act). The Government has decided to broaden the delegation power to allow delegation to all Australian Public Service employees assisting the Board.

Extensions of time

3.6 Part 3 of the *Industry Research and Development Decision-making Principles 2011* (the Decision-making Principles) – made under section 32A of the IR&D Act – regulates the ability of the Board of ISA to grant extensions of time under the IR&D Act. This includes extensions

of time for registrations, providing requested information and applications for reviews (see subsection 3.1(1) of the Decision-making Principles).

3.7 The Board of ISA must grant extensions of up to 14 days if it is necessary and may grant a longer period if the applicant's ability to meet the deadline is impaired by events outside the applicant's control (section 3.2 of the Decision-making Principles). These extensions apply on top of the time limits in the IR&D Act (for example, registrations under section 27D must be made within 10 months of the end of the income year unless otherwise extended).

3.8 The Government has observed that very long extensions for registration applications are available, with applications often made and accepted a number of years after the relevant R&D activities were undertaken. This practice is inconsistent with the nature of the Incentive as expenditure that occurs without a business being aware of the Incentive would have occurred in the absence of the Incentive being available.

Summary of new law

3.9 Schedule 3 to the Exposure Draft makes a number of amendments to improve the administration and transparency of the Incentive. These include:

- publicising information about Incentive claimants and R&D expenditure;
- allowing the Board of ISA to make binding determinations;
- broadening the scope of the Board of ISA's delegation powers; and
- imposing a three-month limit on extensions of time available from when applications, registrations and reviews are due.

3.10 These legislative changes complement other aspects of the Government's reforms to the administration of the Incentive, including additional resourcing for additional compliance and legal activity, and the creation of improved guidance products for claimants.

Comparison of key features of new law and current law

<i>New law</i>	<i>Current law</i>
<i>Transparency of R&D claimants and activities</i>	
As soon as practicable after the end of the income year, the Commissioner must publish information about the R&D entities that have claimed notional deductions for R&D activities, including the amount claimed.	No equivalent
<i>ISA determinations</i>	
The Board of ISA may also make determinations about the circumstances and ways in which it will exercise its powers, or perform its functions or duties in relation to the Incentive. These determinations are binding on the Board of ISA.	The Board of ISA may make findings specific to an R&D entity's circumstances, including whether certain activities of the entity are R&D activities. Findings are binding on the Commissioner.
<i>ISA delegations</i>	
The Board of ISA and its committees may delegate their powers to any member of Australian Public Service staff assisting them.	The Board of ISA and its committees may delegate their powers to SES employees assisting them.
<i>Extensions of time</i>	
The Board's ability to grant an extension of time is subject to a cap of three months on the total extension available, unless the extension is granted to allow an applicant to wait for the outcome of a pending decision.	The Board of ISA must grant extensions of time for registrations and the provision of information of up to 14 days if it is necessary and may grant a longer period if an applicant's ability to meet the deadline is impaired by events outside the applicant's control.

Detailed explanation of new law

Transparency of R&D claimants and expenditure

3.11 As soon as practicable after the end of the income year, the Commissioner is required to publish information about the R&D activities of R&D entities claiming the R&D tax offset. This will improve public accountability for R&D claimants and encourages voluntary compliance

with the requirements of the program. *[Exposure Draft, Schedule 3, item 1, subsections 3G(1) and (2) of the Taxation administration Act 1953 (TAA 1953)]*

3.12 The Commissioner must publish the following information:

- the R&D entity's name;
- the R&D entity's Australian Business Number, or Australian Company Number if that is the only number available; and
- an amount representing the R&D entity's notional deductions claimed taking into account any feedstock adjustments for the year.

3.13 As noted in paragraph 2.16, an R&D entity's feedstock adjustment (if it has one) is the lesser of the entity's feedstock revenue or associated feedstock expenditure and is deducted from the entity's notional deductions. *Exposure Draft, Schedule 3, item 1, subsections 3G(3) and (4) of the TAA 1953]*

3.14 The criteria for the publication and the information published are based on concepts defined in the ITAA 1997. *[Exposure Draft, Schedule 3, item 1, subsection 3G(8) of the TAA 1953]*

Source of information

3.15 The publication requirement will not apply in relation to R&D entities that do not lodge income tax returns. In the case of consolidated groups and multiple entry consolidated groups, the information published will be that reported by the head company in its income tax return.

3.16 In determining whether the Commissioner is required to publish information about a specific R&D entity, the Commissioner can only have regard to the information that the entity has reported to the Commissioner in its relevant income tax return.

3.17 Similarly, the Commissioner may only publish amounts that the R&D entity reports in its tax returns, subject only to simple calculations. The Commissioner is not permitted to substitute his or her own assessment of an R&D entity's information for the purposes of determining the figures to be published. However, the Commissioner may verify an R&D entity's identity before publication to ensure that the correct entity is identified.

Time of publication

3.18 The amendments do not prescribe a period within which the Commissioner must publish the information, allowing a flexible approach that accommodates organisational capabilities and priorities.

3.19 It is envisaged that the Commissioner will publish one annual report encompassing all relevant R&D entities. This would likely be released several months after the date for the lodgement of the final

company income tax returns for an income year. The Commissioner may give advance public notice of his or her intention to make the publication at a particular time.

3.20 Many companies operate under substituted accounting periods for tax purposes. This means that some companies' income years do not align with the standard 1 July to 30 June financial year.

Correction of errors

3.21 Provision for the correction of errors is an important safeguard.

3.22 The Commissioner may correct errors that are made in a publication in two circumstances: where the Commissioner has made an error and on the initiative of the relevant R&D entity.

3.23 Where the Commissioner has made an error, he or she has power to publish a correction. The correction must be made from the information the R&D entity has returned. *[Exposure Draft, Schedule 3, item 1, subsection 3G(7) of the TAA 1953]*

3.24 The Commissioner may also make information publicly available that corrects an error that the R&D entity has brought to the Commissioner's attention. This covers a range of circumstances where an R&D entity makes a further, special or amended tax return. *[Exposure Draft, Schedule 3, item 1, subsections 3G(5) and (6) of the TAA 1953]*

3.25 The Commissioner has discretion in deciding whether to publish a correction, including discretion as to the time and form of the publication.

Determinations about the performance of the Board of ISA's functions

3.26 The Board of the ISA may, by notifiable instrument, make a determination about how it will exercise its powers, and perform its functions and duties. However, a determination cannot relate to the exercise of powers, or the performance of functions or duties, in a particular case or in relation to a particular R&D entity. *[Exposure Draft, Schedule 3, item 14, section 31C and subsections 31D(1) and (2) of the IR&D Act]*

3.27 The Board of the ISA must exercise its powers, and perform its functions and duties, in accordance with any determinations it makes. This means determinations are binding on the Board of the ISA when it makes entity-specific findings or registration decisions. However, determinations do not prevent an R&D entity challenging a decision of the Board. *[Exposure Draft, Schedule 3, item 14, subsection 31D(3) of the IR&D Act]*

3.28 The ability to make determinations binding on itself allows the Board of the ISA to provide certainty to R&D claimants and helps ensure R&D entities do not unintentionally misinterpret the meaning of the law.

3.29 Determinations are intended to operate in a similar manner to a taxation ruling issued by the Commissioner. Determinations are not binding on R&D entities. R&D entities may continue to self-assess their eligibility for the Incentive in a manner that is inconsistent with a determination but risk ISA contesting their position.

3.30 Determinations seek to augment the existing program guidance by allowing the Board of the ISA to publicly state its position on the application of its functions and its interpretation of the legislation, including the definition of R&D activities, the definition of clinical trials or any other administrative matters where specific guidance would reduce the compliance burden for R&D entities.

3.31 This is intended to make compliance easier for R&D entities, as they will be able to better understand what is required to demonstrate eligibility for the Incentive. For example, the Board of the ISA may make a determination about the validity of particular forms of evidence for R&D activities, thereby providing registrants with increased clarity on how to best evidence their R&D activities in their registration applications. This would improve compliance and reducing administrative workloads.

3.32 Determinations are notifiable instruments rather than legislative instruments (see sections 8 and 11 of the *Legislation Act 2003*). This reflects the fact they are not binding on R&D entities and the long-standing recognition that taxation rulings are not legislative instruments (section 7 of the *Legislation (Exemptions and Other Matters) Regulation 2015*). [*Exposure Draft, Schedule 3, item 14, subsection 31D(1) of the IR&D Act*]

3.33 Making determinations notifiable instruments increases the certainty they provide to registrants. The disallowable nature of legislative instruments would undermine the Board's ability to produce determinations that can be relied on by R&D entities. A disallowance period would create uncertainty about the validity of a determination until that period had ended.

3.34 Determinations are to be co-designed and developed in consultation with relevant stakeholders, including administrators, subject matter experts, tax advisors and peak bodies representing R&D entities by size and sector. Merits review (under Division 5 of the IR&D Act) and judicial review is available for R&D entities in the event of a dispute over a determination. The development process is intended to ensure that determinations are stable and reliable forms of guidance that can be relied upon by R&D entities over long periods of time.

Amending or revoking a determination

3.35 Subsection 33(3) of the *Acts Interpretation Act 1901* provides that a power to make an instrument includes the power to revoke or vary the instrument.

3.36 These amendments provide specific circumstances when the Board of the ISA must amend or revoke a determination by notifiable instrument. The amendments clarify that this does not limit the application of subsection 33(3) of the *Acts Interpretation Act 1901* in relation to the power to make a determination. That is, the Board of the ISA may amend or revoke a determination in a broader range of circumstances than those specified in the legislation. *[Exposure Draft, Schedule 3, item 14, subsection 31E(3) of the IR&D Act]*

3.37 A determination has no effect to the extent of any inconsistency with the IR&D Act, the *Industry Research and Development Regulations 2011* or the Decision-making Principles. If such inconsistency exists, the Board of the ISA must revoke or amend the determination to remove any inconsistency. *[Exposure Draft, Schedule 3, item 14, subparagraph 31E(1)(b)(iii) and subsections 31D(4) and 31E(2) of the IR&D Act]*

3.38 If the Board of ISA makes a finding specific to an R&D entity it must be consistent with any relevant determinations. An R&D entity may still challenge a specific finding under Division 5 of the IR&D Act on the basis that the finding is incorrect and the underlying determination is similarly incorrect. An R&D entity may also challenge a finding on the basis that it is inconsistent with a determination.

3.39 In the event that a determination is found to be incorrect in a review decision or must be regarded as incorrect following a review decision, the Board of the ISA must revoke or amend the determination so it is no longer incorrect. *[Exposure Draft, Schedule 3, item 14, paragraph 31E(1)(a) and subsection 31E(2) of the IR&D Act]*

3.40 The Administrative Appeals Tribunal may review an internal review decision of the Board of the ISA. If a determination is inconsistent with a decision of the Administrative Appeals Tribunal, the Board of the ISA must revoke or amend the determination so it is no longer inconsistent. *[Exposure Draft, Schedule 3, item 14, subparagraph 31E(1)(b)(ii) and subsection 31E(2) of the IR&D Act]*

3.41 The Board of the ISA must also revoke or amend a determination that is inconsistent with a decision of a court. *[Exposure Draft, Schedule 3, item 14, subparagraph 31E(1)(b)(i) and subsection 31E(2) of the IR&D Act]*

Board of ISA delegations

3.42 The Board of ISA and its committees may delegate some or all of their functions to a member of the Australian Public Service staff

assisting the Board. This expands the existing delegation power that authorised the Board to delegate to SES employees. *[Exposure Draft, Schedule 3, items 16 and 17, subsection 22A(1) and paragraph 21(1)(e) of the IR&D Act]*

3.43 The current limit on the delegation power has proved to be impractical and a significant barrier to the Board of ISA carrying out its functions necessary to the operation of the Incentive. These functions include the annual processing of around 14,000 registration applications as well as hundreds of compliance activities. It is unsustainable and impractical for a small number of SES delegates to be responsible for this volume of decision making.

3.44 The expansion of the delegations powers allows additional staff to be delegated responsibility for a number of administrative program tasks. This includes, but is not limited to, high-volume, low-risk functions such as the approval to grant an extension of time to submit applications, or the ability to request information on an application. Prior to the introduction of the current SES limit, a broader delegation power was used effectively and efficiently on a long-standing basis.

3.45 The expansion of the delegations powers also acknowledges the continual growth in the size of the Incentive and the consequent growth in resourcing needed to carry out the functions necessary for the Incentive's effective administration.

Extensions of time

3.46 Extensions of time granted under the IR&D Act may relate to an application to register R&D activities, provide further information requested by the Board of the ISA, a form to continue registration as a research service provider or an application for review of a reviewable decision. An extension will apply on top of the time limits in the IR&D Act.

3.47 The Board of the ISA must not grant extensions of time under the IR&D Act to a person in excess of three months. *[Exposure Draft, Schedule 3, item 18, subsection 3.2(3) of the Decision-making Principles]*

3.48 Restricting extensions to three months mitigates the risk that long extensions granted by the Board of the ISA result in applications being accepted a number of years after the relevant R&D activities are undertaken. Such timeframes are inconsistent with the objectives of the Incentive as expenditure that occurs without a business being aware of the Incentive would have occurred in the absence of the Incentive being available.

Further extensions for pending decisions

3.49 This restriction does not apply if the subject matter of the extension relates to a pending decision on another matter. That is, the restriction does not apply if the extension relates to a matter corresponding with the subject of a decision relating to the person where that decision has not been finalised. *[Exposure Draft, Schedule 3, item 18, subsection 3.2(4) of the Decision-making Principles]*

3.50 This allows the Board of the ISA to grant an extension in excess of three months where this is necessary to provide a deadline due after the pending decision is made in relation to decisions of the Board of ISA under Division 2, 3 or 5 of Part III of the IR&D Act. This facilitates more administratively efficient outcomes.

Example 3.1

Doppler Dynamics seeks a review of an unfavourable registration decision in relation to the 2018-19 income year. The review (including appeals) is finalised in May 2021.

During the course of the review, Doppler Dynamics needs to consider applying for registration in subsequent years for the same ongoing activities subject to the review. It would not be efficient for it to lodge applications that may need to be varied or that may lead to decisions that need to be set aside following the outcome of the review.

In these circumstances, it is reasonable for the Board of the ISA to exercise its discretion to grant an extension of time until after the pending decision is made.

Consequential amendments

3.51 A note is amended to explain that the publication of R&D entities' R&D tax offset claims is not affected by the taxpayer secrecy provisions. *[Exposure Draft, Schedule 3, item 2, note to section 355-50 in Schedule 1 to the TAA 1953]*

3.52 The simplified outline of Part III to the IR&D Act is amended to reflect the Board of ISA's new power to make determination about how it will exercise its powers, and perform its functions and duties. *[Exposure Draft, Schedule 3, items 5, section 26A of the IR&D Act]*

3.53 Other amendments are made to the IR&D Act to reflect the introduction of findings about clinical trials (see paragraph 1.30).

Application provisions

3.54 The amendments commence on the first day of the quarter following Royal Assent. *[Exposure Draft, section 2]*

3.55 The transparency amendments apply to income years starting on or after 1 July 2018. *[Exposure Draft, Schedule 3, item 3]*

3.56 The Board of ISA's power to make determinations applies in relation to the exercise of powers, and the performance of functions and duties, by the Board of the ISA on or after commencement. *[Exposure Draft, Schedule 3, item 15]*

3.57 The amendments to the Board of ISA's delegation and extension of time powers apply to delegations and extension of time decisions made on or after commencement. *[Exposure Draft, section 2]*