Board of Taxation Secretariat
The Treasury
Langton Crescent
Parkes ACT 2600

R&DTI – Review of the dual-agency administration model

Dear Secretariat,

Thank you for the opportunity to contribute to the review of the dual-agency administration model of the R&D Tax Incentive. This submission is made on behalf of the members of the Tech Council of Australia (TCA). As one of the key drivers of innovation, the R&D Tax Incentive (R&DTI) is a policy of key importance to our membership. We are committed to working with the federal government to optimise its application to our high-growth sector.

Overview of the Tech Council and the opportunity to increase the impact of the R&DTI

The TCA is Australia's peak industry body for the tech sector. The Australian tech sector is a pillar of the Australian economy, contributing $167 billion per annum to the Australian economy, and employing 861,000 people. This makes the tech sector equivalent to Australia's third largest industry, behind mining and banking, and Australia's seventh largest employing sector.

The TCA has set three goals for the tech sector in Australia:

- Employ 1 million people in tech-related jobs by 2025
- Contribute $250 billion to GDP from tech-related activity by 2030
- Make Australia the best place to start and scale a company

Working collaboratively with governments, businesses and the community, the Tech Council's focus is on supporting growth and local and global investment in the Australian tech sector, creating more Australian jobs and pathways into them, and partnering to design safe and effective regulation.

In the past Australia has not competed well with other locations with better tech ecosystems and more favourable tax arrangements in converting start ups into larger businesses. However, In the last five years we have quadrupled the number of Australian technology companies worth more than $100 million and a dozen companies have achieved Unicorn status ($1 billion and above).[1] Further, the number of companies being created in each of the last three decades is increasing rapidly, as Table 1 below shows.

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[1] [Australian tech companies valued at $100M+ | by AirTree | AirTree | Aug, 2021 | Medium.com](#)

Table 1: No. of Australian tech firms founded per decade with current valuation of $100m+

Decade of company formation	Current no. of companies founded in that decade presently valued at $100m+	Example companies
2000s	24	Domain, iSelect, Atlassian, Tyro, Health Engine, Finder, Red Bubble, Campaign Monitor, Envato, Hotels Combined, InfoTrack
2010s	67	Canva, Culture Amp, Safety Culture, Skedulo, Airwallex, Deputy, Brighte, 99designs, Airtasker, Koala, Stake, Prospa, Compass, Sendle, Freelancer, Flare, Afterpay, Judo Bank, Shippit
Total	91	

Source: Airtree

It is our intention to ensure that these high-value, fast-growing companies are incentivised to keep their R&D activity here in Australia.

Ensuring that the R&DTI is accessible to these types of firms, at all stages of their growth, requires that both the policy and its administration continues to do what it set out to: help companies innovate and grow.

TCA Recommendations

1. Development of guidance on documentation for evidence of expenditure

The opportunity to drive domestic innovation for the tech sector

The type of R&D activity undertaken by Australian firms is changing. Historically, R&D was primarily concerned with physical sciences. Today, according to the Australian Bureau of Statistics, business expenditure on R&D (BERD) in the field of information and communication sciences is the top area for R&D in Australia across all industries, accounting for 39% of all BERD spend.

This trend reflects the digitisation of the economy, with key non-tech sectors such as banking and mining increasingly undertaking R&D in areas such as software product development and AI. It also reflects Australia's success at producing a stellar pipeline of home-grown software firms, who are developing original and new to the world products.

While good for the economy, this trend is creating challenges for the administration of the R&DTI because the iterative and collaborative nature of software development can be at odds with the linear and proprietary model of scientific experimentation presumed in the R&DTI definitions and claims processes. Ensuring that the R&DTI process is clear and straightforward to follow when applied to software is critical to its future utility, as software and information and computer sciences are now the area of greatest activity.

Critically, software based R&D is also easier to locate in different markets versus capital intensive physical R&D activity. This means that Australia will face increasing global competition to attract and locate high-value R&D activity offshore. Ensuring the administration of the R&DTI is clear, fair and efficient is critical to keep this activity onshore.

This becomes increasingly important when considered alongside the talent challenges of the sector. With travel and access to skilled migration limited due to Australia's closed border, there is greater pressure on Australian firms to consider offshore locations if this enables better access to talent, customers and investors, who are increasingly more able to move freely in other markets. As the tech sector is less capital intensive than other traditional industries such as mining, pharmaceuticals and manufacturing, there are also reduced barriers to taking R&D activity offshore.

Given that a form of border restrictions is likely to be in place for some time, it will become more critical than ever over the next 12 - 18 months to ensure that all other policy settings are geared to incentivising innovation and investment activity locally, to create jobs and economic value in Australia.

Dual administration: good in theory, opportunities to optimise in practice

The TCA understands the need for dual administration of the R&DTI and is supportive of it continuing, subject to some changes to optimise the model.

The roles of IISA and the ATO are distinct, and allow each body to contribute differing expertise to the regime. The challenge for dual administration is that the two agencies do not always have a clear and shared understanding of the lived experience of R&D practices in modern businesses. This understanding is vital to ensure that processes undertaken by each are complementary, consistent and do not duplicate each other.

This is most problematic for smaller tech firms who are less likely to retain government relations or specific tax expertise resources at hand to support engagement with the scheme. If a firm does not have these resources in-house, and cannot afford to engage a consulting firm who knows and understands the system more intimately, it is more likely to become cost-prohibitive to engage with the scheme.

It is for this reason, and following a number of facilitated workshops with IISA, ATO and Industry, we recommend that the dual administrators should issue better guidance for companies making software claims under the scheme. This is intended to serve three main purposes:

1) Build-on existing dialogue between industry, IISA and ATO on understanding R&D practices in tech firms
2) Agree and define the application of this shared understanding of R&D processes in tech firms
3) Increase accessibility for software claims

We believe that in the absence of a software specific scheme, this guidance will better optimise the dual-agency administration of the scheme pertaining to software companies, in turn contributing to the growth of the sector.

This guidance could cover:

- Case studies developed with tech firms incorporating how they have navigated the process
- Examples of downloadable documents/templates created by firms to gather evidence across the lifespan of an activity
- Examples of what does, and what does not constitute good evidence of expenditure

The documentation would offer examples of good practice, rather than being prescriptive, to accommodate different ways firms can gather evidence.

Responses to consultation questions

Current administration model

1. **Do you consider that the roles and responsibilities of the two administrators (ATO and IISA/DISER) are distinct and clearly understood? If not, how might they be enhanced?**

We consider that the roles and responsibilities are distinct, but there is not a clear understanding of their distinct responsibilities amongst tech firms, especially smaller firms. Greater transparency about the role of each agency could be provided upfront when claimants register their activity. This would help reduce the risk of duplication or double handling of work as claimants increase their understanding of what they need to provide to the different bodies at all steps of the process.

Dealings with the current administration model

H Tech Council

3. **Have you experienced any difference in the way the program has been administered in response to previous reviews? We would like to hear what has been improved and/or any additional challenges that have been experienced.**

Following previous reviews the software development sector guide has been released. This has increased the accessibility of the scheme for software claimants. However, it has not increased the understanding by the regulator of how software R&D is carried out. This means it is still creating a burdensome level of clarifications from the ATO around the documentation of evidence for activity expenditure.

An example of the challenges faced can be seen in the way the R&D activities were reviewed as part of the STAR of one of the TCA members.This company had contemporaneous documentation, strong relationships and understanding of their business and R&D roadmaps, access to detailed financial data and engaged external advisors to help interpret the guidelines of the R&DTI and apply the rules to their claim. Despite this, a low assurance rating was applied to their R&D profile.The points of contention were around the differing interpretations of the allocation methodology and what constitutes eligible expenditure. This highlights that even when a company has sufficient resources to prepare a R&DTI claim, taxpayers and the administrators of R&DTI can be far apart in a mutual understanding of how to apply the provisions.

4. **What is the cost to businesses in claiming the R&DTI? Where have businesses encountered complexity in the process?**

For firms that do not have taxation or government relations expertise in-house, the cost is immediate and can be prohibitive. Engaging external consultants, while reducing the risk of the claim being denied, can be higher than the value of the claim smaller firms in particular would make.

Further, smaller firms are almost exclusively focussed on researching and developing their service and or product and building enterprise value. The opportunity cost of having valuable engineering teams stop and focus on the firm's complex R&DTI claim can be seen as too high at this juncture of their lifecycle.

Some aspects of the R&DTI requirements - such as the need to prove that the work is novel - can be particularly onerous for a smaller firm to substantiate, particularly without open access to academic research.

The complexities often lie in the self-assessment element of the claim. Without the expertise, or the time to build the expertise (of which many start up firms can not afford), the risk is too high for smaller firms to warrant attempting a claim.

Our view is that the complexity and cost of the reporting is deterring smaller firms from claiming, and also leading to under-reporting of BERD in Australia.

An additional cost to consider is the risk cost of an R&D claim being denied. As claimants are required to self assess if an activity is eligible, a contrary decision by a regulator could be received 2 years + after the claim is made, resulting in exorbitant penalties and interest where there is genuine error or difference in interpretation.

5. **Would you provide any real-life examples of businesses that have recently navigated the R&DTI application process? Were there issues, challenges or frustrations encountered in the process?**

Many of our members participate in the R&DTI and the areas that are most challenging focus on two parts of the process: developing a common understanding of R&D terms and identifying eligible expenditure.

At its most basic level, there is a gap between what R&D means in the tech sector versus what is R&D as defined under the R&DTI. R&D in the tech sector moves fast and can be a result of many different decisions such as planned roadmaps, the need to pivot to address a newly identified gap in the market / feature in a product or as a result of integrating new code through an acquisition.

The R&DTI requires evidence of current knowledge or lack thereof to prove the activity is experimental and documentation must show the systematic progression of work undertaken. It is the nuances associated with these requirements that often become burdensome. For example, do all parts of the systematic progression (hypothesis -> experiment -> observation -> evaluation -> logical conclusion) need equal degrees of evidence / supporting documentation? Does every attempt / nuance need to be captured with evidence of observation and logical conclusion when multiple, minor iterations are performed?

The other pain point encountered by some members is being able to identify and accurately attribute R&D expenditure to the eligible activities. There is a lack of practical guidance around allocation methodologies and which one is acceptable under different scenarios. For example, where a cost driver is used to apportion expenditure how do you prove it is reasonable? How do you determine if a cost has an appropriate nexus to the activity?

There is an opportunity cost to devoting resources to navigate the R&DTI requirements which is amplified when confidence around the outcome is low. Taxpayers struggle with knowing if they have done enough and have understood the requirements correctly.

6. Does the current administrative process impact the decision to apply for the R&DTI? How has it affected the decision to apply?

Feedback from TCA member companies is that it is not necessarily the administrative process itself that impacts the decision to apply for R&DTI. Our members have not raised any issues with the registration process, or even with submitting the documented evidence with their tax return. However, the self-assessment nature of the claim means there is a perceived higher risk, particularly for software claims, that a claim will be scrutinised in the future and smaller firms may be unsure of how best to evidence their expenditure.

The lack of clarity and transparency around how to document experimentation and expenditure associated with it we believe means that many firms do not see the reward being worth the risk.

Improvements and efficiencies

8. What changes could be made to simplify the administrative and compliance obligations for taxpayers, whilst maintaining the integrity of the program?

The creation of a "playbook" to provide guidance on how best to conduct and document your activity, made available to claimants at the point of registration, or incorporation and identification as a tech or software company, would ensure that claimants could build into their business processes the documentation of this evidence, with the confidence of having a standard they can measure their processes against.

9. What opportunities can you identify to reduce duplication between the two administrators?

The administrators do not duplicate each other's functions, but can interpret situations differently which leads to confusion and rework on the part of firms. For example, if the ATO audits claims without a clear and shared understanding of how R&D processes occur in tech firms, the scrutinising of evidence effectively leads to a redefinition of acceptable activity.

We have confidence that the process of creating the playbook would create the right dialogue between industry and the ATO to ensure that greater consistency is created in the way evidence is provided in claims, and in turn the way claims are assessed.

International models and experience

11. Our review includes an examination of the international R&D administration models. From your international experiences with similar programs abroad, is there any jurisdiction in particular that you consider to be appropriate for us to focus on for further analysis?

We would like to reference analysis done by Austrade (appendix 1) to benchmark country settings and appeal to attract FDI for R&D activity (including product development). Of these jurisdictions we believe it is worth paying particular attention to the settings of the Singapore scheme.

The Singapore R&D scheme is known as being easy to navigate for taxpayers and providing a high degree of certainty - and obtaining certainty is probably the greatest fears start-up tech companies have, as an amended assessment two years down the track could bankrupt a tech start up with limited cash reserves.

For example, to provide upfront certainty for Singapore R&D claims, IRAS has implemented a Pre-claim Evaluation scheme for large and complex R&D projects. This is a structured evaluation process which allows taxpayers to submit details of their R&D projects to IRAS for evaluation before the commencement or during the conduct of the projects.

Research & Development is a cornerstone of innovation in any economy, and to further support the rapid growth of the tech sector in Australia we believe there lies an opportunity of great impact to further optimise the incentive to ensure accessibility and smooth treatment of claims from the sector. Increasing the dialogue between AusIndustry, the ATO and Industry will ensure greater shared understanding of practices in high-growth tech firms and ensure they are better represented and supported through our scheme.

Thank you for the opportunity to make a submission to the R&DTI Joint Administration Review. We would be pleased to further discuss any of our comments.

Yours sincerely,

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