



TA 2017/2 - Claiming the Research and Development Tax Incentive for construction activities

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This Alert has been jointly developed by the Australian Taxation Office (ATO) and Department of Industry, Innovation and Science.

The Research and Development (R&D) Tax Incentive is jointly administered by Innovation and Science Australia (supported by AusIndustry within the Department of Industry, Innovation and Science) and the ATO.

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Taxpayer Alert

TA 2017/2

Claiming the Research and Development Tax Incentive for construction activities

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Alerts provide a summary of our concerns about new or emerging higher risk tax or superannuation arrangements or issues that we have under risk assessment.

While an Alert describes a type of arrangement, it is not possible to cover every potential variation of the arrangement. The absence of an Alert on an arrangement or a variation of an arrangement does not mean that we accept or endorse the arrangement or variation, or the underlying tax consequences.

Refer to [PS LA 2008/15](#) for more about Alerts. See [Alerts](#) issued to date.

Description

The ATO and AusIndustry are reviewing the arrangements of certain building and construction industry participants that are claiming the R&D Tax Incentive where some (or all) of the expenditure:

- is incurred on building or construction activities which are expressly excluded from being taken into account in calculating an R&D tax offset, or
- does not otherwise relate to eligible R&D activities.

The arrangements under review concern claimants of the R&D Tax Incentive who are involved in either: acquiring buildings, or extensions, alterations or improvements thereto (the acquirer); or whose business it is to construct, extend, alter or improve buildings (the builder).

These types of arrangements exhibit some or all of the following features:

- A contract is entered into between the acquirer and the builder to construct, extend, alter or improve a building or buildings (construction).
- The contract is a standard construction contract and is not for the provision of R&D services and does not specify that R&D will be carried out by the builder.

- The acquirer or the builder registers one or more activities associated with the construction of the building for the R&D Tax Incentive, identifying the structure or construction techniques as purportedly involving untested or novel elements.
- Some or all of the activities registered are broadly described and non-specific. For example, whole construction projects may be registered rather than the specific activities which are being undertaken.
- Some or all of the registered activities are ordinary construction activities that are directed to fulfilling the requirements of the building or construction contract, or relate to expenditure that is expressly excluded from being taken into account in calculating an R&D Tax Incentive.
- Frequently, the expenditure which is incurred relates to construction methods or techniques that are already known within the building industry, or involve the mere adaptation or integration of existing technology.
- The acquirer or the builder claims the R&D Tax Incentive for expenditure that is not on eligible R&D activities, or for expenditure which is expressly excluded.

Background

The Australian Government supports companies that undertake eligible R&D activities through the R&D Tax Incentive.

Eligibility for the R&D Tax Incentive is based on specific R&D activities rather than on entire commercial projects.

In order to be eligible, there must be an experiment or experiments being carried out for the purpose of generating new knowledge. The outcome of the experiments cannot be able to be known or determined in advance by a competent professional in the field. The experiments being carried out must be based on principles of established science and must seek to prove whether specific technical hypotheses are right or wrong to resolve specific technical issues or risks.

Supporting activities may also be eligible if they are directly related to eligible experimental activities. It is not sufficient that these activities are related to the project more generally. Additionally, in some circumstances supporting activities must also be conducted for the dominant purpose of supporting the experimental activities.

Ordinary business activities are not generally carried out for the purpose of generating new knowledge. Such activities may include solving business problems using established products and existing knowledge, expertise or methodologies. Further, activities that produce or are directly related to producing goods or services are not usually undertaken for the dominant purpose of supporting experimental activities.

Under the R&D Tax Incentive, companies self-assess the eligibility of their activities and register through AusIndustry. Companies then claim a tax offset (the R&D Tax Incentive) for their 'notional deductions' relating to eligible expenditure through the annual company tax return. The registration of activities does not, by itself, render the activities described in a registration as eligible R&D activities for the purposes of the R&D Tax Incentive. The ATO and AusIndustry may review the eligibility of activities or expenditure after registration.

The R&D Tax Incentive claimed in a company's tax return must relate only to expenditure on eligible R&D activities. Further, certain types of expenditure are specifically excluded from being taken into account in calculating an R&D Tax Incentive claim.

What are our concerns?

The operators of some affected companies may believe (or have been advised) that their activities constitute eligible R&D activities. However, we are concerned that:

- Activities may not fit within the stringent requirements of the laws that govern the R&D Tax Incentive.
- Expenditure claimed may not relate to eligible R&D activities or may be specifically excluded from the calculation of the R&D Tax Incentive.
- Taxpayers may not be applying adequate levels of governance and review to the registered activities and the claims made for the R&D Tax Incentive.

Activities

We have observed a number of cases where the acquirer and/or the builder of a building have registered construction activities with AusIndustry which are, or appear to be, ineligible for the R&D Tax Incentive. The reasons these types of activities have been found to be ineligible include:

- The activities are undertaken by the builder in the ordinary execution of the construction contract and are not undertaken for a significant purpose of generating new knowledge.
- Project management, environmental, commercial or economic risks are mistaken for technical risks.
- The activities are not experimental but rather involve solving issues by applying existing knowledge or methodologies and a suitably qualified and competent professional in the building and construction industry could have known or worked out the outcomes without conducting an experiment. For example, using and applying existing (even if they are quite new) building materials, designs, processes or modelling techniques to the local conditions or customer requirements.

Expenditure

We have also observed that often some or all of the expenses included in the calculation of the R&D Tax Incentive claim are not correct because:

- The expenditure is specifically excluded from the R&D Tax Incentive, on the basis that it is incurred to acquire or construct:
 - a building or part of a building, or
 - an extension, alteration or improvement to a building.¹
- The expenditure included in the calculation of the R&D Tax Incentive is not for amounts that are incurred on eligible R&D activities; for example production costs of products sold to the market in the ordinary course of business.²
- Expenditure is being apportioned between R&D activities and (ineligible) ordinary business activities in an unreasonable manner. For example:

¹ See paragraph 355-225(1)(a) of the *Income Tax Assessment Act 1997*.

² Note, specific legislation applies to feedstock; see section 355-465 of the *Income Tax Assessment Act 1997* or refer to the ATO Factsheet on Feedstock.

- Expenditure is included as part of overall overhead expenses which does not relate to R&D activities, for example advertising and sales expenses.
- Overhead expenses are apportioned using a method that allocates an unreasonably large amount to R&D.
- The activities are conducted under contract for the acquirer or owner of the building and not for the builder itself, resulting in activities that are not conducted on the builder's own behalf. Consequently, the expenditure incurred by the builder may not be at risk, as is required under the legislation.³

Corporate Governance

Companies are expected to distinguish eligible R&D activities from ineligible ordinary business activities at the time of registration and throughout the conduct of the activities. Proper, detailed and contemporaneous records must be kept to support the registration application and the claim for the R&D Tax Incentive.

We are also concerned that some companies are not applying adequate levels of governance and review to the R&D activities that have been registered and to the claims that are subsequently made for the R&D Tax Incentive on their behalf. For example, we have observed:

- Suitably qualified company officers or employees who understand the relevant activities failing to undertake reviews and approvals of the company's R&D registration applications.
- Company management deferring responsibility for distinguishing ordinary business activities from R&D activities to external advisors, without checking whether the external advisors' understanding of the eligible activities aligns with that of the company's officers or employees.
- Accounting systems or records being kept which do not contemporaneously or adequately segregate R&D expenses from other expenses.

We have observed that these practices can result in activities being registered as R&D activities and expenditures being claimed under the R&D Tax Incentive that should not be.

What are we doing?

The ATO and AusIndustry are working together to alert taxpayers and their advisors to practices that may result in increased risk of registering ineligible activities and incorrectly claiming the R&D Tax Incentive.

We will be contacting companies directly to advise them of our concerns with their registered activities and/or their R&D Tax Incentive claims if:

- Advisors who may apply high risk practices are involved in the preparation of the registration application and/or claim.
- The registration of R&D activities continues with the use of broad descriptions that fail to distinguish them from ordinary business activities.
- The level of expenditure claimed for the R&D Tax Incentive is high for the industry or stage of business.

³ See paragraph 355-210(1)(a) of the *Income Tax Assessment Act 1997*.

Innovation and Science Australia will continue to issue Findings to companies confirming whether activities qualify for the R&D Tax Incentive.

We have developed a Specific Issue Guidance product to assist companies engaged in the construction industry, and their accountants and advisors, to correctly identify and document eligible R&D activities in that industry. This product is available on www.business.gov.au

What should you do?

You should consider whether our concerns apply to you. The onus is on you to ensure that your registration and claim for the R&D Tax Incentive are correct. We encourage you to:

- Review your registration to ensure you are registering only eligible R&D activities.
- Ensure your claim for the R&D Tax Incentive is correct and that you are not claiming expenditure related to ineligible activities.
- Have the records to demonstrate the R&D activities being undertaken and support the associated R&D Tax Incentive claim.

If you consider that our concerns apply, you may want to:

- Phone us at the contact details provided below.
- Seek independent professional advice.
- Ask the ATO for our view through a private ruling or apply for a Finding from Innovation and Science Australia.
- Apply to AusIndustry to amend or withdraw your registration or make a voluntary disclosure to the ATO or amend your tax return.

Penalties may apply if you have incorrectly claimed the R&D Tax Incentive but will be significantly reduced if you make a voluntary disclosure. Generally, the reduction is greater if you make the disclosure before we notify you of an examination of your tax affairs.

Sanctions under criminal law may apply to fraudulent claims.

Registered tax agents, including R&D consultants, advising companies to incorrectly claim ordinary business activities may be referred to the Tax Practitioners Board to consider whether there has been a breach of the *Tax Agent Services Act 2009*. Promoter penalty laws may also apply under Division 290 of Schedule 1 to the *Taxation Administration Act 1953* for promoters of schemes to access the R&D Tax Incentive for ineligible activities.

For more information about eligible R&D activities, what can be claimed under the R&D Tax Incentive and recordkeeping, refer to [Research and development tax incentive](#)

Do you have information?

To provide information about this type of arrangement, or a promoter of this or another arrangement:

- phone us on **1800 177 006** (after the initial messages, wait for the 'Taxpayer Alert' option then press **1**), or
- *complete the* [ATO Tip-Off Form](#)

References

Legislative References:

Income Tax Assessment Act 1997

- 355-210(1)(a)
- 355-225(1)(a)
- 355-465

Tax Agent Services Act 2009

Taxation Administration Act 1953

- Div 290 of Sch 1

Related Taxpayer Alerts:

- TA 2017/3

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