

Ramifications, fines and penalties – what are the potential consequences if I get it all wrong?

Common misconceptions that can get you into trouble

- 1) The development of a new product, process or service does not necessarily mean you are undertaking eligible R&D activities for the purposes of the R&D Tax Incentive. The incentive is not designed to reimburse your business for learning something new or to offset normal business development costs, in absence of high levels of technical or scientific risk requiring experimental activities to generate new knowledge the development work would not be considered eligible.
- 2) A software start-up with no revenue is trying to automate a process and therefore believes it's all eligible R&D. If the automation requires the development of new algorithms which are deductible and within the scope of a competent professional in the field based upon existing knowledge it is not eligible R&D, in this instance the only risk being undertaken by the start-up is associated with the potential success of the business, business model risk is not to be confused with high levels of technical or scientific risk.
- 3) A new R&D company is incorporated to undertake R&D activities which involve high levels of technical or scientific risk and assume that everything cost associated with the business is eligible, the R&D Tax Incentive is a activity based program which excludes any activities that are

not deemed eligible as either "core" or "supporting" R&D activities, any activities that relate to administration of the business, accounting, capital raising, patenting, marketing etc are ineligible.

- 4) My company has successfully claimed benefits under the R&D Tax Incentive for many years but the project activities today are merely customisations, bug fixes and minor upgrades etc – every time a new update or version is released on the market requires a claimant to meet the eligibility criteria again as if starting a new project with eligible activities, you cannot simply continue to claim so called supporting activities which are broadly linked to a core activity which occurred in prior year/s.

What type of audits or reviews are conducted by AusIndustry or the ATO?

1) AusIndustry

(a) Pre-registration review

Your application for registration is analysed against possible indicators of non-compliance risk by the department. The department may or may not contact you during this process. This could be by reference to industry averages,

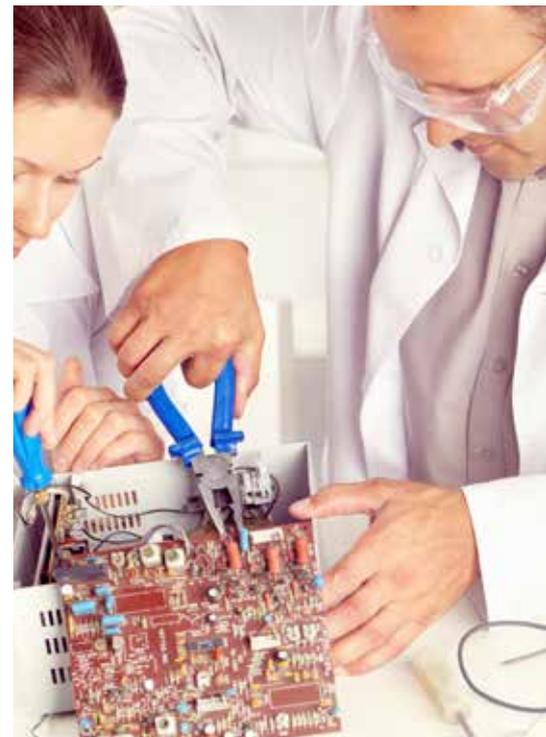
(b) Registration review

Applications are being reviewed at the time of lodgement. Previously this was a relatively pro forma process. There has been a

significant increase in the requirements to justify the eligibility of applications at this stage. Oddly, this is the best time to get picked up as there are no financial penalties incurred if you need to withdraw an application at this stage. During peak process times earlier this, the ATO actually provided staff to the AusIndustry processing team to ensure that reviews during this time were not too slowly processed however, once questions are raised the audit process can take up to 2-3 months before an outcome is reached.

(c) AusIndustry desk reviews

AusIndustry can also review applications after the lodgement process is complete. They are called



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“Requests for Information” (RFI) which they highlight are not audits. However, if you don’t successfully answer all questions in an RFI then it will escalate into a fuller review. RFI’s can often lead to a review of a claimant’s prior year/s applications if found wanting, if claimants fail these reviews they will be required to amend all prior year tax returns and repay incorrectly claimed amounts with interest and penalties.

(d) AusIndustry activity reviews

Further reviews can be undertaken to get clarification of your R&D activities. This can include a site visit

2) Australian Tax Office reviews/audits

ATO R&D Tax specific reviews have evolved into something much more comprehensive than those originally envisaged. Traditionally, these audits were only concerned with reviews of expenditure. Now, they are reviewing the eligibility of expenditure associated with eligible activities which allows them to indirectly look at the activities as well. These audits can be very intensive and involve responding to over 80 information request questions as outlined in the “ATO review questions revealed”. The ATO may also review your participation in claiming benefits under the R&D Tax Incentive under a general tax audit so if you are caught out on another matter you may find your R&D claims also on the radar.

Penalties and Interest

If a claim is found to be ineligible, not only do you need to adjust your tax return and repay the funds provided over how many years the matter relates to but you will also find that the following penalties may apply depending upon the ATO’s view on the level of intent:

- 1) **Failure to take reasonable care:** The base penalty is 25% of the shortfall amount. Generally, you fail to take reasonable care if you have not done what a reasonable person in the same circumstances would have done.
- 2) **Recklessness:** The base penalty is 50% of the shortfall amount. You are reckless if a reasonable person in your circumstances would have been aware that there was a real risk of a shortfall amount arising and you disregarded, or showed indifference to, that risk.
- 3) **Intentional disregard:** The base penalty is 75% of the shortfall amount. You intentionally disregard the law if you are fully aware of a clear tax obligation and you disregard the obligation with the intention of bringing about certain results (underpaying tax or over-claiming an entitlement).

What about safe harbour?

Firstly, what is it? Safe Harbour applies when an error is caused by your tax agent. You may not be liable to an administrative penalty for making a false or misleading statement that results in a shortfall amount if all the following apply:

- the statement was made by your registered agent
- you gave your agent all the relevant tax information to enable the statement to be made correctly (you or your agent will need to prove that this information was provided)
- the shortfall amount was due to your agent’s lack of reasonable care

Sounds good! However, most agents are much more familiar with safe harbour provisions than their clients. If your R&D Tax or external accountant relies on the information provided by the client and lodges it on your behalf on that basis then safe harbour provisions will not apply.

If you are undertaking R&D activities please call (as above) or email:

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