

Administration of the Research and Development Tax Incentive

Industry Innovation and Science Australia

Department of Industry, Science, Energy and Resources

Australian Taxation Office

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Senior Executive Director
Corporate Management Group
Australian National Audit Office
GPO Box 707
Canberra ACT 2601

Or via email:

communication@anao.gov.au.



Canberra ACT
25 November 2021

Dear Mr President
Dear Mr Speaker

In accordance with the authority contained in the *Auditor-General Act 1997*, I have undertaken an independent performance audit in Industry Innovation and Science Australia; the Department of Industry, Science, Energy and Resources; and the Australian Taxation Office. The report is titled *Administration of the Research and Development Tax Incentive*. I present the report of this audit to the Parliament.

Following its presentation and receipt, the report will be placed on the Australian National Audit Office's website — <http://www.anao.gov.au>.

Yours sincerely



Grant Hehir
Auditor-General

The Honourable the President of the Senate
The Honourable the Speaker of the House of Representatives
Parliament House
Canberra ACT

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For further information contact:
Australian National Audit Office
GPO Box 707
Canberra ACT 2601

Phone: (02) 6203 7300
Email: ag1@anao.gov.au

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<http://www.anao.gov.au>

Audit team

Nathan Callaway
Barbara Das
Evan Lee
Johanna Bradley
Matthew Rigter
Omer Shaikh
Stevan Serafimov
Supriya Benjamin
Peta Martyn

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Audit snapshot

Auditor-General Report No.10 2021–22

Administration of the Research and Development Tax Incentive



Why did we do this audit?

- ▶ The Research and Development Tax Incentive (R&DTI) is a tax offset available to entities that undertake R&D. It is the Australian Government's key tool for encouraging additional business investment in R&D that benefits Australia and might not otherwise take place.
- ▶ Reviews of the R&DTI in 2016 and 2019 identified issues relating to the management of the program.



Key facts

- ▶ The R&DTI has been in existence since 1 July 2011 and is established in legislation.
- ▶ The R&DTI is jointly administered by Industry Innovation and Science Australia (IISA) supported by the Department of Industry, Science, Energy and Resources (Industry), and the Australian Taxation Office (ATO).
- ▶ In the 2018–19 Budget, the Australian Government announced changes aimed at better targeting the R&DTI to improve the program's integrity and fiscal affordability.



What did we find?

- ▶ IISA, Industry and the ATO's administration of the R&DTI was largely effective.
- ▶ IISA and Industry's communication and registration of activities were largely effective. The ATO had largely effective communication and claims processing.
- ▶ IISA and Industry had a partly effective approach to compliance. The ATO had a largely effective compliance approach. There were weaknesses in joint compliance approaches.
- ▶ IISA and Industry had largely effective R&DTI performance frameworks, and effective evaluation arrangements.



What did we recommend?

- ▶ Two recommendations were made to IISA and Industry, aimed at improving processes around advance findings and examinations, and one recommendation was made to the ATO relating to establishing monitoring and reporting arrangements for its compliance activities.
- ▶ The ATO, IISA and Industry agreed to the recommendations.

\$18.2 bn

Australia's business expenditure on R&D in 2019.

\$1.36 m

Average value of R&D registered for the R&DTI in 2019–20.

12,330

Number of registrations for the R&DTI in 2019–20.

Summary and recommendations

Background

1. The Research and Development Tax Incentive (R&DTI) program (the Program) aims to encourage research and development (R&D) that: might otherwise not be conducted because of uncertain return from the activities; and is likely to benefit the wider Australian economy.¹
2. The R&DTI is established in the *Industry Research and Development Act 1986* (IRD Act) and the *Income Tax Assessment Act 1997* (ITA Act). Industry Innovation and Science Australia (IISA, supported by the Department of Industry, Science, Energy and Resources — referred to as Industry in this report) and the Australian Taxation Office (ATO), jointly administer the R&DTI.
3. Entities self-assess the eligibility of their R&D activities to claim the R&DTI, register their R&D activities with IISA, and claim the tax offset through the ATO. IISA and the ATO undertake compliance activity in recognition of the need to support program integrity and maintain appropriate tax revenue.

Rationale for undertaking the audit

4. The R&DTI program is the Australian Government's key tool for encouraging companies to invest in R&D that benefits Australia and might not otherwise take place. All industry sectors may access the R&DTI, which is an uncapped, demand-driven program that resulted in approximately \$4.5 billion in tax offsets in 2019–20. While the Program uses R&D entities' self-assessments of eligibility, both Industry and the ATO undertake compliance activity in recognition of the need to support program integrity and maintain appropriate tax revenue.
5. Reviews in 2016 and 2019 found issues relating to the management of the Program. Following the 2016 review, Industry and the ATO commenced a program of changes to address issues that were identified (see Box 1). The R&DTI topic was included in the ANAO's 2020–21 annual audit work program and was identified by the Joint Committee of Public Accounts and Audit as an audit priority of the Parliament.

Audit objective and criteria

6. The objective of the audit was to assess the effectiveness of IISA's, Industry's and the ATO's administration of the R&DTI program.
7. To form a conclusion against the audit objective, the following criteria were adopted:
 - Did IISA, Industry and the ATO have effective communication, registration and claims processing arrangements?
 - Did IISA, Industry and the ATO have effective compliance arrangements?
 - Did IISA, Industry and the ATO have effective performance monitoring, reporting and evaluation arrangements?

1 Division 355 of the *Income Tax Assessment Act 1997*.

Conclusion

8. IISA, Industry and the ATO's administration of the R&DTI program was largely effective.

9. IISA, Industry and the ATO were largely effective in undertaking communication, registration and claims processing activities for the Program. Industry was aiming to streamline processes and increase its capacity to conduct advance and overseas findings, with the aim of reducing timeframes and costs. There was also a high incidence of overseas findings being overturned on subsequent review. Weaknesses were identified in the ATO's processes in withholding taxpayer refunds for verification. While communication approaches had improved since July 2017, the agencies had not assessed the effectiveness of their communication.

10. Industry had a partly effective approach to compliance as its approach was not clearly aligned with compliance risks and its examination processes did not meet timeframe targets and did not always result in an outcome. The ATO had a largely effective approach to compliance, using its enterprise-wide processes, however, its monitoring and reporting on R&DTI compliance was not commensurate with risk. There were also weaknesses in the joint approach to compliance for the Program.

11. IISA, Industry and the ATO had largely effective performance monitoring, reporting and evaluation arrangements. Industry's external R&DTI performance measure did not indicate if the R&DTI was meeting its legislated objectives and both this and the ATO's external R&DTI performance measures lacked targets.

Supporting findings

Communication (see paragraphs 2.3 to 2.37)

12. IISA (and Industry on its behalf) and the ATO were largely effective in communicating the Program. Both Industry and the ATO had communication strategies in place in July 2021, however, there were substantial periods between 1 July 2017 and 30 June 2021 where strategies were not in place. Both agencies targeted their communication towards improving the integrity of the Program. The agencies should evaluate the impact of their communication activities, and continue to prioritise targeting communications towards potential R&D entities.

Registrations and advance and overseas findings (see paragraphs 2.38 to 2.65)

13. IISA (and Industry on its behalf) had largely effective registration arrangements and processes for advance and overseas findings. The identification of potential non-compliance as early as possible could be improved by continuing to refine the risk-based components of the registration process. Industry has been working to streamline processes for advance and overseas findings, although it is too early to assess whether recent developments have had the desired effect. Internal service standards for the timeliness of processing advance and overseas findings were not being met and there was a high incidence of overseas R&D activities being found to be ineligible, and then subsequently overturned in an internal review.

Processing offsets (see paragraphs 2.68 to 2.81)

14. The ATO was largely effective in processing offsets, with the offsets processed using the ATO's enterprise-wide tax return processes. The ATO's processing of offsets within service

commitments has improved since 2014–15, although it was not meeting service commitments. For higher risk tax R&DTI claims, the ATO may decide to withhold a tax refund in order to verify information. There were instances where the ATO could not demonstrate that it had met the relevant legislative requirements in deciding to withhold a tax refund.

Industry's compliance arrangements (see paragraphs 3.2 to 3.24)

15. Industry's compliance approach aims to be based on the risks and behaviours of Program participants, although it is not always clear how the planned compliance activities align with compliance risks. Industry follows its processes for undertaking examinations, although examinations on average do not meet the processing timeframe target and do not always result in an outcome.

ATO's compliance arrangements (see paragraphs 3.25 to 3.43)

16. The ATO had largely effective compliance arrangements, using enterprise-wide processes for the R&DTI. Between 73 per cent and 76 per cent of the ATO's R&DTI compliance activities from 2017–18 to 2019–20 led to the identification of non-compliance. However, compliance activities often take longer than target timeframes. Since 2018 the ATO has identified the R&DTI as higher risk, but has not had reporting arrangements in place that were commensurate with monitoring this level of risk.

Joint compliance arrangements (see paragraphs 3.44 to 3.54)

17. Industry and the ATO had partly effective joint compliance arrangements. Industry and the ATO had joint compliance strategies in 2016–17 and from 1 July 2021, otherwise there was not a joint strategy in place between 1 July 2017 and 30 June 2021. The agencies did not have a coordinated approach to the delivery of a 2018 Budget measure that included increased funding to implement stronger compliance and the ATO had not used this funding in accordance with its commitments to government. There was also a lack of monitoring and reporting on joint compliance.

Performance frameworks (see paragraphs 4.2 to 4.29)

18. IISA and Industry established largely effective internal R&DTI performance frameworks. Industry had a partly adequate external R&DTI performance measure. Industry's R&DTI external performance measure did not indicate the extent to which the R&DTI was meeting its legislated objectives and lacked a target to inform performance reporting. Industry had implemented a framework to support internal operational program monitoring. The ATO's R&DTI external performance measures were largely adequate, although they lacked targets.

Monitoring, reporting and evaluation (see paragraphs 4.30 to 4.58)

19. IISA and Industry had largely effective Program monitoring, reporting and evaluation. Industry presented reports to its R&DTI governance committees, although reports to IISA from October 2019 have not provided sufficient information to support effective oversight. The ATO had largely effective Program monitoring and reporting. While the ATO did not produce separate internal reporting on the R&DTI at the program level, it included R&DTI results in its aggregated reporting across programs, consistent with its enterprise-wide approach.

Recommendations

- Recommendation no. 1**
Paragraph 2.65
- To further improve processes relating to advance findings, IISA and Industry:
- (a) undertake analysis to better understand why entities do and do not apply for advance findings;
 - (b) develop a strategy to encourage entities who are most uncertain about the eligibility of their activities to apply for an advance finding; and
 - (c) set public service standards relating to the timeliness of processing advance and overseas findings (and other statutory assessments).

Industry Innovation and Science Australia response: *Agreed.*

Department of Industry, Science, Energy and Resources response: *Agreed.*

- Recommendation no. 2**
Paragraph 3.18
- IISA and Industry improve examination processes in order to give entities greater certainty and reduce the potential for future duplicative compliance action by:
- (a) reducing the time taken to undertake examinations;
 - (b) reducing the instances where examinations are discontinued; and
 - (c) issuing a finding of ineligibility if activities are ineligible.

Industry Innovation and Science Australia response: *Agreed.*

Department of Industry, Science, Energy and Resources response: *Agreed.*

- Recommendation no. 3**
Paragraph 3.43
- The ATO establish monitoring and reporting arrangements to assess the effectiveness of its compliance approach for the R&DTI program, including implementation of the 2021 R&DTI compliance strategy, high risk refund process and other R&DTI compliance activities.

Australian Taxation Office response: *Agreed.*

Summary of entity responses

20. IISA, Industry and the ATO's summary responses to the report are provided below and their full responses are at Appendix 1.

Industry Innovation and Science Australia

Industry Innovation and Science Australia acknowledges the Australian National Audit Office's conclusion that the IISA and the Department of Industry, Science, Energy and Resources is largely

effective in its administration of the R&D Tax Incentive, and agrees to implement its recommendations in consultation with the Department.

IISA will continue to collaborate with the Department to strengthen our oversight role of the R&DIC [Research and Development Incentives Committee] to provide the most effective support to the administration of the R&D Tax Incentive program.

IISA acknowledges the comment in the Report at paragraph 19 that “reports to IISA from October 2019 have not provided sufficient information to support effective oversight”. To address this, IISA and the Department have taken steps to address ANAO’s observation and implement good governance and regular reporting to ensure IISA has sound oversight of the R&D Tax Incentive Program and Committee.

Department of Industry, Science, Energy and Resources

The Department of Industry, Science, Energy and Resources welcomes the Australian National Audit Office’s conclusion that the Department is largely effective in its administration of the R&D Tax Incentive, and agrees to implement its recommendations.

Since the 2016 review of the R&D Tax Incentive, we have implemented significant reforms to our administration of the program, focused on strengthening program integrity, an education-based compliance approach, increasing stakeholder engagement, improving registration and assessment processes and timeframes, and improving the consistency and transparency of our decision-making processes. We have done all of this with a focus on helping stakeholders better understand the program’s eligibility requirements to get their applications right, and clarifying what they can expect from the department and their participation in the program.

The Department agrees that more analysis and further reform is needed to keep improving our findings and examinations processes. We are committed to continuous improvement across all aspects of our administration of the R&D Tax Incentive program.

Australian Taxation Office

The Australian Taxation Office (ATO) welcomes the review and considers the report supportive of our approach to co-administration of the Research and Development Tax Incentive. The review found the ATO has been largely effective in our administration, recognising the work the ATO has undertaken whilst acknowledging the work that has commenced to further enhance our co-administration of the program.

The report makes one recommendation for the ATO, for which the Office agrees, to improve our monitoring and reporting of compliance activities. The ATO have already commenced work to address the recommendation and will continue to work towards ongoing improvements.

21. Appendix 2 sets out improvements observed by the ANAO during the course of the audit.

Key messages from this audit for all Australian Government entities

22. Below is a summary of key messages, including instances of good practice, which have been identified in this audit and may be relevant for the operations of other Australian Government entities.

Governance and risk management

- Regulators should use information and intelligence collected as part of program administration to assess the level of risk across the breadth of their regulatory activity, and then target compliance activities at those areas assessed to have the highest level of risk.
- Entities should establish program compliance plans and strategies, and monitor and report on progress against those plans and strategies, in order to assess whether the desired objectives are being achieved.

Program implementation

- Effective communication is important when individuals or organisations self-assess their eligibility for a publicly funded program. Communication should be clear, consistent, targeted and up to date.
- For programs jointly administered by multiple Commonwealth entities, the underpinning governance framework should be documented so that there is a clear understanding of respective roles and responsibilities and there is agreement on any shared approaches to program administration. The framework should be reviewed and updated when required.

Performance and impact measurement

- To facilitate a meaningful assessment of progress and achievement, entities should ensure they are monitoring, evaluating and reporting on their effectiveness in achieving program objectives.

Audit findings

1. Background

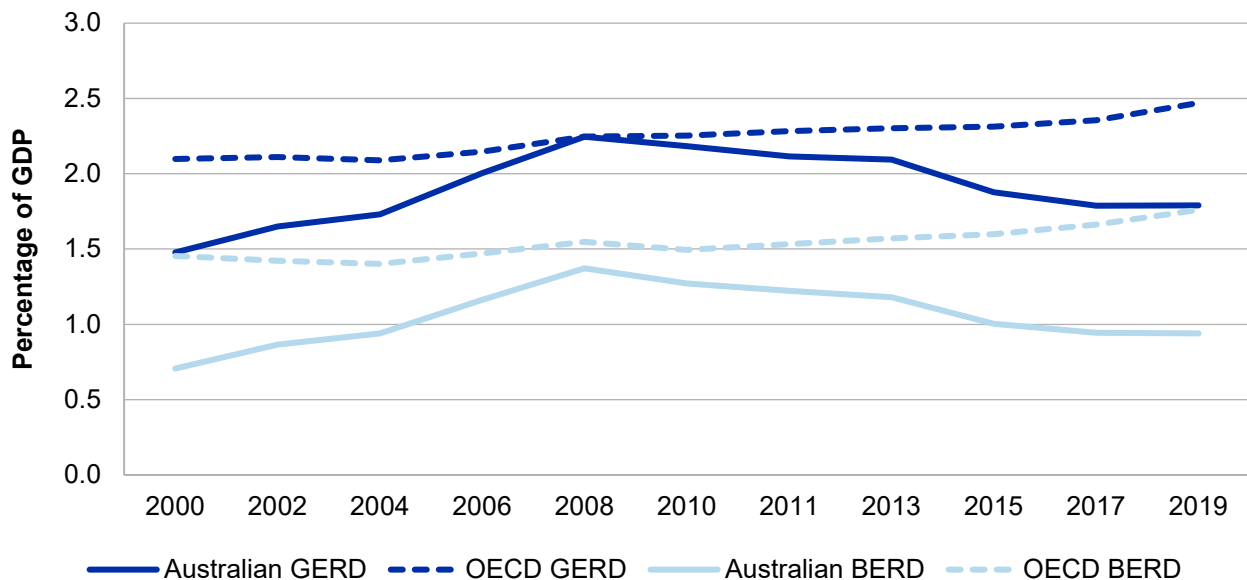
Introduction

1.1 Research and development (R&D) supports innovation in industry, which leads to technological and productivity improvements and increased economic growth.² Companies may underinvest in R&D due to uncertainty over the success of R&D. They may also underinvest because their R&D may benefit not just them but the wider economy, including their competitors.

1.2 Figure 1.1 illustrates Australia's investment in R&D between 2000 and 2019 compared to the Organisation for Economic Cooperation and Development (OECD) average.³

- In Australia, gross expenditure on R&D (GERD) was \$35.6 billion in 2019, amounting to 1.79 per cent of gross domestic product (GDP). Australian business expenditure on R&D (BERD) was \$18.2 billion in 2019 (0.94 per cent of GDP).
- Australian GERD and BERD, as a proportion of GDP, peaked in 2008 at 2.25 per cent and 1.37 per cent of GDP, respectively. Since then, these figures have declined and have been below the OECD average.

Figure 1.1: GERD and BERD in Australia vs the OECD average, 2000 to 2019



Note: Australian data is reported every two years, except in 2010 and 2011.

Source: ANAO based on data from OECD, *OECD Science Technology and Innovation Scorecard* [Internet], available from <https://www.oecd.org/sti/scoreboard.htm> [accessed 6 August 2021] and from Australian Bureau of Statistics, *Research and Experimental Development, Businesses, Australia* [Internet], available from <https://www.abs.gov.au/statistics/industry/technology-and-innovation/research-and-experimental-development-businesses-australia/latest-release#key-statistics> [accessed 7 September 2021].

2 Industry, Research and Development Tax Incentive [Internet], available from <https://www.industry.gov.au/funding-and-incentives/research-and-development-tax-incentive> [accessed 22 September 2021].

3 Australia's data is updated biennially and was last updated in 2021 to include 2019 data.

1.3 The *Australian Business Investment in Innovation* (January 2020) report noted the following.⁴

- The decline of BERD since 2008–09 has been brought about by two primary factors: the reduced R&D undertaken by the mining industry; and economic structural changes within Australia (particularly the shift from manufacturing to services).
- Australia's BERD is lower than other OECD countries, primarily due to Australia's industry mix. In particular, Australia's manufacturing and information media and telecommunications industries are smaller than those of other OECD countries. These industries tend to contribute significantly to R&D.
- Determining the impact of the Research and Development Tax Incentive (R&DTI) on the overall BERD rate is difficult, and the report was not conclusive in this regard.

1.4 Industry Innovation and Science Australia's (IISA) *Driving effective Government investment in innovation, science and research* notes that government investment in innovation, science and research aims to:

underpin a strong research and intellectual capital base, support translation and innovation, maintain Australia's comparative and competitive advantages, ensure the Government's own national and sovereign needs are met and ensure Australia has the human capital and physical infrastructure to deliver on its objectives... Recent events have served to reinforce the critical importance of ISR [innovation, science and research] to Australia's response to, and recovery from, crises.⁵

The R&D Tax Incentive Program

1.5 The R&DTI is a tax offset available to entities which undertake R&D. It is the Australian Government's key tool for encouraging additional business investment in R&D. The legislative basis for the R&DTI program (the Program) is set out in the *Industry Research and Development Act 1986* (IRD Act) and the *Income Tax Assessment Act 1997* (ITA Act). Defined in the ITA Act, the objective of the Program is to:

encourage industry to conduct research and development activities that might otherwise not be conducted because of an uncertain return from the activities, in cases where the knowledge gained is likely to benefit the wider Australian economy.⁶

1.6 The Program's objective is often delineated between two aspects: additionality (encouraging R&D that might otherwise not occur without the Program); and spillovers (broader knowledge likely to benefit the wider economy).⁷

4 Report prepared for the Office of Industry Innovation and Science Australia by AlphaBeta, *Australian Business Investment in Innovation* [Internet], January 2020, pp. 16–19, available from <https://www.industry.gov.au/sites/default/files/2020-02/australian-business-investment-in-innovation-levels-trends-and-drivers.pdf> [accessed 8 September 2021].

5 Industry Innovation and Science Australia, *Driving effective Government investment in innovation, science and research* [Internet], 2021, p. 3, available from <https://www.industry.gov.au/data-and-publications/driving-effective-government-investment-in-innovation-science-and-research> [accessed 22 July 2021].

6 Division 355 of the *Income Tax Assessment Act 1997*.

7 See for example B Ferris AC, A Finkel AO and J Fraser, *Review of the R&D Tax Incentive*, 2016, p. 3.

1.7 The Program incentivises investment in R&D by reducing costs through a tax offset.⁸ Offsets are available to R&D entities carrying out R&D activities costing more than \$20,000, or for any value of activities if carried out through a registered Research Service Provider.⁹ The offset is available for R&D expenditure of up to \$150 million (\$100 million until 1 July 2021) each financial year. For annual R&D expenditure above the threshold, entities can receive a tax offset at the prevailing company tax rate. The offset rate depends on the aggregate annual turnover of the R&D entity and the offset is either refundable or non-refundable depending on the entity's turnover. Changes to the offset rates came into effect on 1 July 2021 (see Table 1.1).

Table 1.1: Research & Development Tax Incentive offset rates

	R&D entity turnover below \$20 million	R&D entity turnover \$20 million and above
Is the tax offset refundable or non-refundable?	Refundable If the tax offset reduces the entity's tax liability below zero, it is eligible for a refund.	Non-refundable If the offset reduces the entity's tax liability below zero, it will not pay any company tax, but it is not eligible for a refund.
Offset rate before 1 July 2021	43.5%	38.5%
Offset rate from 1 July 2021	Company tax rate plus 18.5% premium.	For R&D intensity up to and including 2%^a: Company tax rate plus 8.5% premium. For R&D intensity above 2%: Company tax rate plus 16.5% premium.

Note a: R&D intensity is the amount of R&D expenditure as a proportion of total expenditure for the year.

Source: Department of Industry, Science, Energy and Resources, *Overview of the R&D Tax Incentive* [Internet].

1.8 In the 2018–19 Budget, the Australian Government announced changes to the R&DTI in response to the 2016 *Review of the R&D Tax Incentive*¹⁰ (see Box 1).

Box 1: Overview of changes to the R&DTI

The changes to the R&DTI started in 2018, with all changes due to be delivered by June 2022. The changes aim to achieve four outcomes.

- Business can more easily understand and access the R&DTI.
- The R&DTI focuses on the most beneficial areas of R&D.
- Enhanced integrity of the R&DTI.
- Improved transparency of access to the Incentive.

The changes include administrative and legislative changes.

⁸ Tax offsets (sometimes referred to as rebates) directly reduce the amount of tax payable on taxable income. Unlike most tax offsets, the R&DTI has a refundable component such that if the amount of tax is reduced below zero then the taxpayer will receive a refund.

⁹ Industry maintains a list of Research Service Providers with specialist staff or infrastructure for R&D activities, available from <https://business.gov.au/grants-and-programs/research-and-development-tax-incentive/getting-help-from-a-research-service-provider> [accessed 6 August 2021].

¹⁰ B Ferris AC, A Finkel AO and J Fraser, *Review of the R&D Tax Incentive*, 2016.

- The May 2018 Budget included funding for administrative changes largely relating to: improved guidance and litigation; enhanced compliance activities; and ICT system improvements.
- The Treasury Laws Amendment (Making Sure Multinationals Pay Their Fair Share of Tax in Australia and Other Measures) Bill 2018 was introduced to Parliament on 20 September 2018 and lapsed on 11 April 2019.
- The Treasury Laws Amendment (Research and Development Tax Incentive) Bill 2019 was introduced in December 2019 and did not proceed. The 2020–21 Budget measure, *JobMaker Plan—Research and Development Tax Incentive—supporting Australia’s economic recovery*, superseded the Bill’s provisions and modified the proposals it contained.
- In October 2020, legislative changes to the R&DTI were passed by Parliament in the *Treasury Laws Amendment (A Tax Plan for the COVID-19 Economic Recovery) Act 2020* and most of the changes took effect from 1 July 2021. The changes were around: IISA determinations; extensions of time; expenditure thresholds and other expenditure provisions; the R&DTI rates; and transparency.

Program governance

1.9 IISA¹¹ is a statutory board established under the IRD Act. In December 2020, IISA received a Statement of Expectations from the (then) Minister for Industry, Science and Technology that outlined the Australian Government’s policies, objectives and priorities for IISA. In relation to the R&DTI, IISA is responsible for making decisions under Part III of the IRD Act and oversight of the Program. Administratively, IISA is supported by the Office of Industry Innovation and Science Australia (OIISA) within the Department of Industry, Science, Energy and Resources (Industry). The Chief Executive Officer (CEO) of OIISA is appointed by the Minister. The membership of the IISA Board is listed in Appendix 3. The Commissioner of Taxation is responsible for the general administration of the ITA Act, as set out in sections 1–7. This includes applying and paying tax offsets under the R&DTI.

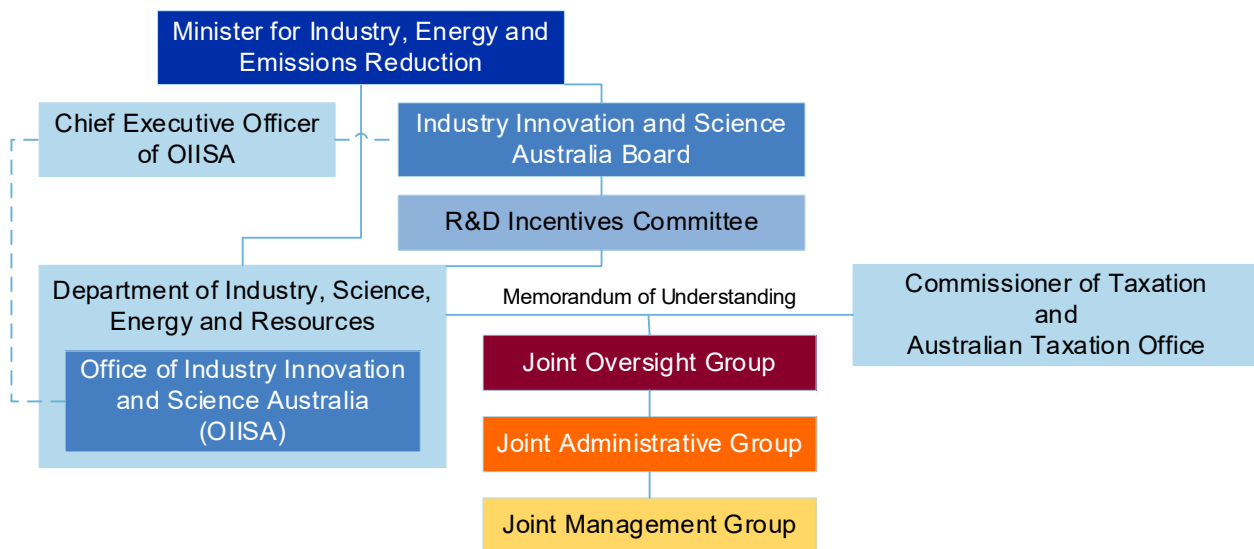
1.10 IISA delegates its functions and powers in respect of the R&DTI to the Research and Development Incentives Committee (R&DIC — membership listed in Appendix 3) or its delegates. R&DIC then sub-delegates its functions and powers to staff in Industry. On behalf of IISA, Industry registers R&D entities and determines the eligibility of R&D activities. The R&DTI is managed within the AusIndustry Division in Industry, and Industry reports to R&DIC for the purposes of administering the R&DTI.

1.11 Industry and the Australian Taxation Office (ATO) entered into a Memorandum of Understanding (MoU) for the provision of services in December 2017. Arrangements for the joint administration of the R&DTI are set out in a schedule to the MoU. IISA is not a party to the MoU, or to the schedule.

1.12 Figure 1.2 illustrates the governance arrangements for the Program.

11 In October 2020, Innovation and Science Australia was renamed Industry Innovation and Science Australia. For simplicity, this report refers to IISA throughout.

Figure 1.2: Governance framework for the R&DTI program



Source: ANAO adaptation of Industry diagram.

1.13 Industry and the ATO have established joint governance arrangements for the Program (depicted in Figure 1.2).

- The Joint Oversight Group is co-chaired by an Industry Deputy Secretary, and the ATO Second Commissioner Client Engagement Group. The Group's role is to provide high-level joint oversight of the Program.
- The Joint Administrative Governance Group is co-chaired by the General Manager for the R&DTI within Industry¹² and the ATO Assistant Commissioner of Technical Excellence Services, Private Wealth. The Group's role is to: oversee implementation of the MoU; provide strategic direction, guidance and assurance to the Joint Oversight Group; and monitor the treatment of Program risks.
- The Joint Management Group consists of Executive Level managers from relevant areas of Industry and the ATO, and its role is to: manage implementation of joint strategies; coordinate implementation arrangements for the MoU; monitor, discuss and develop risk management strategies; and be a forum for sharing information.

Eligibility, registration, claims and compliance

Eligibility

1.14 Entities wanting to access the R&DTI self-assess their eligibility. There are three components to eligibility for the Program, outlined in Box 2 (further detail in Appendix 4).

Box 2: Eligibility criteria for the R&DTI

- R&D entities — defined under section 355–35 of the ITA Act, eligible R&D entities must be Australian-based or meet specified incorporation and tax residency criteria, including having a permanent establishment of Australian operations.

¹² The General Manager for the R&DTI is the head of the branch responsible for the R&DTI. This position is also the program sponsor for the Program.

Box 2: Eligibility criteria for the R&DTI

- R&D activities — defined under section 355–25 of the ITA Act, eligible R&D activities must include at least one ‘core R&D activity’ that is not an ‘excluded activity’ (as specified in sub-section 355–25(2)) and may include ‘supporting R&D activities’.
 - Core R&D activities are experimental activities whose outcome cannot be determined in advance but can only be determined by applying a systematic progression of work based on scientific method proceeding from hypothesis to conclusion, and are conducted for the purpose of generating new knowledge.
 - Supporting R&D activities are directly related to core R&D activities or, in particular circumstances, undertaken for the dominant purpose of supporting core R&D activities.
- R&D expenditure — defined under section 355–C of the ITA Act, eligible expenditure is expenditure on R&D activities and can include the decline in the value of assets.

Registration

1.15 R&D entities generally conduct their R&D, self-assess their eligibility and then apply to IISA to register for the Program. R&D entities may apply for a determination about the eligibility of their R&D activities from IISA (termed a ‘finding’) before registering.

- Entities may apply for an advance finding about the R&D activities to be conducted or being conducted in order to gain certainty that their activities are eligible.
- Entities must receive an overseas finding before undertaking their R&D, if a component of their R&D project is to be conducted overseas.

1.16 R&D entities must apply to register their R&D activities with IISA within 10 months of the end of their income year. There are circumstances where an entity may seek an extension to apply for registration.¹³ IISA must decide whether to register or refuse to register the activities.¹⁴ Under the ITA Act, the Commissioner of Taxation is bound by IISA’s decisions to register activities and by any findings made by IISA in relation to the eligibility of activities.

Claiming the offset

1.17 R&D entities claim for the R&DTI through income tax returns. Entities must provide their R&DTI registration number from IISA and detail their expenditure on eligible R&D activities. Under section 8AAZLGA of the *Taxation Administration Act 1953*, the ATO is able to withhold refunds that it considers are higher risk in order to verify information.

Compliance

1.18 Both agencies are responsible for upholding the integrity of the R&DTI and the management of risk in achieving program objectives. IISA (and Industry on its behalf) is responsible for compliance activities related to the eligibility of R&D activities. The ATO is responsible for compliance activities related to the eligibility of R&D expenditure on activities and the eligibility of the R&D entities.

13 Information about extensions is available on Industry’s website, available from <https://business.gov.au/grants-and-programs/research-and-development-tax-incentive/request-an-extension-or-variation> [accessed 6 August 2021].

14 Under section 27A of the IRD Act.

Program participants

1.19 The R&DTI is an uncapped, demand-driven program that has operated in its current form since 2011 and in various other forms from 1985. Table 1.2 sets out the number of registrations for the R&DTI and the registered R&D expenditure for 2018–19, the most recent year for which complete data was available. The average value of R&D registered for 2018–19 was \$1.36 million.

Table 1.2: Program performance, 2018–19

	Number of registrations	Registered R&D expenditure (\$m)
Refundable — entities with <\$20 m turnover	10,990 (88%)	\$6110 (50%)
Non-refundable — entities with \$20 m or greater turnover	1518 (12%)	\$6230 (50%)
Total	12,508	\$12,340

Source: Industry data.

1.20 All industry sectors may access the R&DTI. A breakdown by sector of R&DTI registrations and R&D expenditure is provided in Table 1.3.

Table 1.3: R&DTI breakdown by industry sector, 2018–19

Industry sector	Number of registrations	Registered R&D expenditure (\$m)
Services	7255 (58%)	\$5994 (49%)
Manufacturing	3769 (30%)	\$3969 (32%)
Mining	452 (4%)	\$1264 (10%)
Agriculture	528 (4%)	\$601 (5%)
Energy, gas, water and waste services	257 (2%)	\$322 (3%)
Construction	247 (2%)	\$187 (2%)
Total	12,508	\$12,340

Source: Industry data.

Previous audits and reviews

1.21 The ANAO audited the predecessor to the R&DTI (the R&D Tax Concession) in 2003 and concluded that, while individual agencies managed the program well, better coordination was needed in governance and performance management, and that performance information could be improved.

1.22 The 2016 *Review of the R&D Tax Incentive* found ‘that the programme falls short of meeting its stated objectives of additionality and spillovers’.¹⁵ The review noted the growth in the scale of the Program was placing increasing strain on its administrative and compliance model. The review also identified a need for clearer guidance around the scope of eligible R&D activities and to strengthen program integrity and recommended changes to the tax rates and structures.

¹⁵ B Ferris AC, A Finkel AO and J Fraser, *Review of the R&D Tax Incentive*, 2016, p. 3.

1.23 The 2019 *Review of the R&D Tax Incentive*¹⁶ by the Australian Small Business and Family Enterprise Ombudsman recommended improvements to the Program's governance and administrative coordination, guidance and compliance, and the oversight of tax agents.

Rationale for undertaking the audit

1.24 The R&DTI program is the Australian Government's key tool for encouraging companies to invest in R&D that benefits Australia and might not otherwise take place. All industry sectors may access the R&DTI, which is an uncapped, demand-driven program that resulted in approximately \$4.5 billion in tax offsets in 2019–20.¹⁷ While the Program uses R&D entities' self-assessments of eligibility, both Industry and the ATO undertake compliance activity in recognition of the need to support program integrity and maintain appropriate tax revenue.

1.25 Reviews in 2016 and 2019 found issues relating to the management of the Program. Following the 2016 review, Industry and the ATO commenced a program of changes to address issues that were identified (see Box 1). The R&DTI topic was included in the ANAO's 2020–21 annual audit work program and was identified by the Joint Committee of Public Accounts and Audit as an audit priority of the Parliament.

Audit approach

Audit objective, criteria and scope

1.26 The objective of the audit was to assess the effectiveness of IISA's, Industry's and the ATO's administration of the R&DTI program.

1.27 To form a conclusion against the audit objective, the following criteria were adopted:

- Did IISA, Industry and the ATO have effective communication, registration and claims processing arrangements?
- Did IISA, Industry and the ATO have effective compliance arrangements?
- Did IISA, Industry and the ATO have effective performance monitoring, reporting and evaluation arrangements?

1.28 The audit examined the period from 1 July 2017 to 30 June 2021.

16 Australian Small Business and Family Enterprise Ombudsman, *Review of the R&D Tax Incentive*, 2019.

17 ATO, *Annual Report 2019–20*, p. 55, available from <https://www.ato.gov.au/about-ato/commitments-and-reporting/annual-report-and-other-reporting-to-parliament/annual-report/> [accessed 6 August 2021].

Audit methodology

1.29 The audit methodology included:

- review of documentation such as strategies, plans, processes, meeting minutes and papers, reporting and other internal briefings;
- analysis of data from Industry and ATO systems;
- sample testing of two key compliance processes;
- examination of previous reviews and audits of the Program; and
- interviews with internal and external stakeholders, and review of submissions to the audit.

1.30 The ANAO received four citizen contributions to the audit.

1.31 The ANAO did not examine the planning and delivery changes to the R&DTI (see Box 1). However, the ANAO has examined certain changes where they relate to the audit objective and criteria.

1.32 The audit was conducted in accordance with ANAO Auditing Standards at a cost to the ANAO of approximately \$427,127.

1.33 The team members for this audit were Nathan Callaway, Barbara Das, Evan Lee, Johanna Bradley, Matthew Rigter, Omer Shaikh, Stevan Serafimov, Supriya Benjamin and Peta Martyn.

2. Communication, registration and claims processing

Areas examined

This chapter examines whether Industry Innovation and Science Australia (IISA), the Department of Industry, Science, Energy and Resources (Industry) and the Australian Taxation Office (ATO) had effective communication, registration and claims processing arrangements for the Research and Development Tax Incentive (R&DTI) Program (the Program).

Conclusion

IISA, Industry and the ATO were largely effective in undertaking communication, registration and claims processing activities for the Program. Industry was aiming to streamline processes and increase its capacity to conduct advance and overseas findings, with the aim of reducing timeframes and costs. There was also a high incidence of overseas findings being overturned on subsequent review. Weaknesses were identified in the ATO's processes in withholding taxpayer refunds for verification. While communication approaches had improved since July 2017, the agencies had not assessed the effectiveness of their communication.

Areas for improvement

The ANAO made one recommendation aimed at Industry improving its processes for advance findings.

The ANAO also suggested that:

- Industry and the ATO continue to better target their communication activities and evaluate the impacts of their communication;
- Industry considers developing metrics to assess the performance of the risk-based elements of the registration process; and
- IISA and Industry determine the reasons for the high incidence of overseas findings being subsequently overturned and address the causes.

2.1 Effective communication is important for the Program, as communication material supports entities to self-assess their eligibility and promotes the Program objective to encourage additional investment in research and development (R&D). There is a two-stage process for companies to access the R&DTI:

- register with IISA and Industry under the *Industry Research and Development Act 1986* (IRD Act); and
- submit an R&D expenditure schedule to the ATO as part of its company tax return.

2.2 IISA and Industry are also responsible for processing advance and overseas findings to determine the eligibility of activities.

Did IISA, Industry and the ATO effectively communicate the program to potential and actual program participants to promote uptake and to support self-assessment?

IISA (and Industry on its behalf) and the ATO were largely effective in communicating the Program. Both Industry and the ATO had communication strategies in place in July 2021, however, there were substantial periods between 1 July 2017 and 30 June 2021 where strategies were not in place. Both agencies targeted their communication towards improving the integrity of the Program. The agencies should evaluate the impact of their communication activities, and continue to prioritise targeting communications towards potential R&D entities.

2.3 A function of IISA is ‘to promote investment in industry, innovation, science and research’, including promoting the R&DTI.¹⁸ Industry (on behalf of IISA) and the ATO communicate to support self-assessment of eligible activities and expenditure, and to encourage participation in the Program.

Communication strategies and plans

2.4 Given the importance of promoting the Program to encourage R&D, and clearly communicating the Program requirements to support its integrity, communication activities need to be planned and monitored. A communication strategy defines the communication priorities for the Program and identifies the key messages to be communicated to different stakeholders.

Industry

2.5 Between 1 July 2017 and February 2019, Industry did not have a communication strategy for the Program. Since February 2019, Industry has developed three communication strategies, two with detailed work plans to support implementation and evaluation plans, as shown in Table 2.1.

Table 2.1: Industry communication strategies, 2017–18 to 2020–21

Strategy	Supporting work plan?	Supporting monitoring and evaluation plan?
Stakeholder Communications and Engagement Strategy: RDTI Program 2019–21	✓	✗
Interim Communication Strategy (June 2020)	✗	✓
Research and Development Tax Incentive Communication Strategy (Long-term Communication Strategy, September 2020)	✓	✓

Source: ANAO analysis of Industry information.

2.6 Although the Stakeholder Communications and Engagement Strategy 2019–21 was to apply for two years, a work plan to support implementation of the strategy was only developed for 2019–20. Industry recognised communication challenges associated with uncertainty in the market in 2020 due to coronavirus disease 2019 (COVID-19), and developed the Interim Communication Strategy to meet those challenges. The Long-term Communication Strategy builds on the Interim

¹⁸ Paragraph 7 (ac) of the *Industry Research and Development Act 1986*

Strategy, with certain deliverables in the long-term strategy prioritised and delivered, while other lower-priority actions are on hold while resourcing is finalised.

2.7 Industry has developed a plan to concurrently monitor and evaluate the implementation of the interim and long-term strategies, as set out in its R&DTI Communications Research Framework. This framework is described as a key component in the delivery of the Long-term Communication Strategy that will provide insight to inform any future adjustments necessary to support achievement of the strategy's goals and objectives. It sets out a range of surveys and qualitative interviews to be undertaken and other data and research inputs to be used to assess the delivery of the communication strategy. This program of activities was to occur over a 12 month period from November 2020, including three pulse surveys of website visitors and two sets of interviews with ongoing participants by September 2021. As at September 2021, none of the planned activities had been undertaken.

2.8 Since the 2019–21 Stakeholder Communications and Engagement Strategy, Industry's communication strategies have sought to encourage R&D and improve R&D entities' knowledge about the Program. Industry advised that the 2019–21 strategy represented a shift in compliance attention to focus on providing clear guidance material to assist entities to self-assess eligibility. The interim and long-term communication strategies aim to position the joint administrators as the source of accurate information on the Program, and seek to make the guidance material more user-friendly.

ATO

2.9 Between July 2017 and June 2021, the ATO did not have an R&DTI communication strategy. In late 2019, the ATO drafted a communication strategy that focused on the R&DTI and included other ATO programs but it was not finalised or implemented. The ATO advised that it was not finalised and implemented because all ATO program communication was centralised in early 2020 to manage the impact of bushfires and then COVID-19.

2.10 In July 2021 the ATO finalised a communication strategy for the Program, documenting how it will seek to achieve ATO and joint outcomes for the Program. As at November 2021, the ATO was developing a plan to deliver the July 2021 strategy.

Joint

2.11 The Memorandum of Understanding (MoU) (see paragraph 1.11) requires both agencies to develop a joint communication strategy to support communication priorities for the Program. The strategy is to cover: marketing; communication; guidance; and stakeholder engagement and education activities. A joint communication strategy was drafted for 2017–18 but there is no evidence it was finalised. A joint communication strategy was also drafted for 2018–19 however this was not signed off by the ATO. There was no joint communication strategy from 2019 until 2021.

2.12 Industry and the ATO approved a joint communication strategy in January 2021 (encompassing work performed in 2020–21), and established a Joint Communications Working Group in October 2020 to oversee the implementation of the strategy.¹⁹ In June 2021 responsibility

¹⁹ The Working Group consisted of seven ATO staff from the Innovation Taxes, Public Groups and International Branch, and ATO Communications; and five Industry staff from the R&DTI Branch. The Working Group was disbanded in June 2021 and its functions rolled into the Joint Management Group.

for overseeing implementation of this strategy was transferred to the Joint Management Group (see paragraph 1.13). Industry advised the ANAO in August 2021 that evaluation work occurring as part of the R&DTI Communications Research Framework will include evaluating the implementation of the joint strategy, in addition to Industry's R&DTI Communication Strategy.

2.13 In July 2021 the agencies approved a Joint Overarching Strategy to set out how common outcomes for the Program would be achieved, including a new communication strategy. A work plan is to be developed to implement the strategy. The Joint Management Group is overseeing the implementation of this strategy.

2.14 For periods when there were no joint communication strategies in place, there was a risk the agencies were not working towards common strategic communication objectives for the Program. Industry and the ATO should ensure they continue to update joint strategies and have appropriate implementation and monitoring arrangements in place for Program communication strategies.

Targeted communication

Targeting areas of compliance risk

2.15 Both agencies have recognised the importance of targeting communication to reduce compliance risk in recent joint communication strategies. For example, the January 2021 Joint Communications Strategy aimed 'to support Industry's R&DTI Integrity Framework and its educative focus'.

Industry

2.16 Industry's 2018–22 Compliance Strategy (discussed from paragraph 3.2) outlines the aim of providing further guidance material to assist R&D entities to self-assess the eligibility of their activities. Since the first version of the 2018–22 Compliance Strategy was issued, Industry has placed a greater emphasis on guidance and education in improving compliance outcomes than on using compliance activities to identify ineligible activities (as discussed in paragraph 2.8). Communication strategies developed in 2019 and 2020 do not explicitly reflect this relationship with the compliance strategies but do include an objective of improving customer knowledge to assist self-assessment.

2.17 Industry identified a range of compliance risk areas in Program Integrity Management Frameworks²⁰ and Risk Assessment and Treatment Plans. Industry did not explicitly link the delivery of communication products to addressing areas of compliance risk, however it identified instances where communication has targeted compliance risks. For example, Industry:

- released a podcast during 2021 addressing poor quality and incorrect registration applications; and
- updated guidance products such as a fact sheet on the R&DTI changes (July 2021), e-bulletins and podcasts (since August 2020) to be more accessible for small and medium enterprises.

2.18 Industry had not evaluated whether the communication products reduced compliance risks.

20 Integrity Management Frameworks outline Industry's approach to managing risks associated with R&D entities not complying with eligibility requirements. See Box 4 for more detail.

ATO

2.19 The ATO also aims to target areas of compliance risk with communication products, as outlined in its July 2021 communication strategy. The strategy reflects the ATO's aim to positively influence Program participants through targeted communication and has an objective of 'targeted, timely and relevant guidance'.

2.20 Similar to Industry, ATO strategy documents did not explicitly link the delivery of communication products to addressing areas of compliance risk. However, the ANAO identified several instances where the ATO's communication was seeking to improve compliance. For example, the ATO:

- provided advice on its website in 2016 about software development, ordinary business activities, agriculture and building and construction; and
- issued joint taxpayer alerts with Industry in 2017 aimed at software development, construction, agriculture and ordinary business activities.

2.21 The ATO had not evaluated the impact of communication products in reducing compliance risk.

Joint

2.22 The July 2021 Joint Overarching Strategy includes a communications objective that, 'tailored messaging and guidance supports program participants'. The strategy intends to assess performance through a 'change in key/target behaviours'. This evaluation should inform the targeting of future communication activities towards areas of greatest risk to improve the integrity of the Program.

Targeting potential program participants

2.23 For the R&DTI to meet its objective of encouraging industry to conduct R&D activities that might not otherwise be conducted (see paragraph 1.5), Program communication should be targeted at entities which are considering conducting R&D. The 2016 review of the Program (discussed at paragraph 1.22) noted that start-ups, small and medium enterprises, and R&D intensive companies may be the optimal entities to target to improve additionality.²¹ Industry data shows that the proportion of Program participants which are small entities (19 employees or less) has increased each year since 2012–13. Industry identified this as evidence that the Program is targeting the participation of smaller entities.

2.24 The Program changes (outlined in Box 1) aim to increase business participation in the Program and improve guidance to potential Program participants. Since 2018, Industry has identified the need to promote the Program in various strategies. For example, Industry identified communicating with stakeholder groups (the Roundtable and State Reference Groups²² and tax

21 B Ferris AC, A Finkel AO and J Fraser, *Review of the R&D Tax Incentive*, 2016.

22 The Roundtable and State Reference Groups are hosted and co-administered by Industry and the ATO. The Roundtable meets three times a year with a rolling membership. Members invited to participate in the Roundtable include intermediaries (consultants and tax agents from the major R&D consulting companies), industry associations, and some R&D entities. State Reference Groups meet two to three times a year and are state-based groups of tax agents who discuss the outcomes from the Roundtables, providing an opportunity to discuss program administration at local and regional levels. Information about the Roundtable and State Reference Groups is available from www.business.gov.au/grants-and-programs/research-and-development-tax-incentive/information-sessions [accessed 11 August 2021].

industry associations) as an important mechanism for raising awareness of the Program to promote additionality. Most recently, the 2020 Interim and Long-term Communication Strategies both included an objective to ‘raise awareness of the Program and promote the benefits of conducting eligible R&D and additional investment and spillover’.

2.25 Further information was to be provided through the R&DTI Communications Research Framework that includes planned activities of surveying potential participants through an online survey, to gauge the level of satisfaction in the guidance material. As discussed at paragraph 2.7, these activities have not occurred.

2.26 The ATO’s 2021 R&DTI Communications Strategy states that it will ‘take proactive action to provide guidance in areas where program participants are struggling to “get it right”, including actively marketing the program to companies that are entitled to claim the R&DTI’. Under this strategy, communications that support the aim of actively marketing the Program include engaging with the Roundtables and State Reference Groups, engaging with external consultants and industry associations, and engaging directly with companies.

2.27 The ANAO suggests that Industry and the ATO evaluate the impact of their communication activities in increasing additionality and spillovers and inform the development of approaches to targeting communication towards potential Program participants.

Consistent and coordinated communication

2.28 The MoU between Industry and the ATO requires the agencies to share drafts of marketing, guidance and education products, and consult one another during any changes to their website content. This is to ensure the guidance and marketing products released by both agencies are ‘complementary, consistent and support the R&D Programme’s objectives in the most efficient and effective ways possible’. This is important as Program communication material is delivered across two websites (business.gov.au for Industry, and ato.gov.au for the ATO). While both agencies advised that they share drafts and website updates as appropriate, they do not fulfil the full requirements of the MoU and were seeking to revise the requirements to better align with the agreed practice for sharing joint compliance material.

2.29 As outlined above in paragraphs 2.11 to 2.14, there have been periods since 1 July 2017 when Industry and the ATO have not had joint communication strategies in place. This created a risk of not having a coordinated approach to Program communications. More recent joint strategies provide a stronger basis for coordinated communication. For example, the January 2021 Joint Communication Strategy outlines an intention to undertake an audit of communication content to identify gaps and overlaps in guidance material between the two agencies.

2.30 Despite the absence of joint communications strategies for periods, the ANAO observed that the agencies have collaborated on communication products since 2017. Although there was no joint strategy for 2019–20, there was evidence of both agencies continuing to work together on communication activities and products, including some publicly released material that was jointly branded.²³ In addition, the Joint Communications Working Group met eight times between October 2020 and May 2021 to focus on joint communication activities.

23 The Roundtable Summaries were jointly branded during 2019, available from www.business.gov.au/grants-and-programs/research-and-development-tax-incentive/information-sessions [accessed 12 August 2021].

Updating communication material

2.31 Communication material should be kept up-to-date to reflect legislative changes and any outcomes of Federal Court of Australia and Administrative Appeals Tribunal (AAT) decisions that result in Program changes, or where they provide useful interpretive guidance on how to apply the legal definitions of R&D. Industry's communication strategies developed during 2020 had a focus on communicating about the Program changes (outlined in Box 1). The 2021 ATO R&DTI Communication Strategy includes plans for periodic reviews to ensure currency and accuracy of online guidance material.

Program changes

2.32 The draft Joint Communications Strategy 2018–20 identified a communication priority was to 'effectively communicate the budget and proposed legislative reform changes with a joint approach for key messages and communication'. The aim at the time was to focus on communicating about the intended outcomes of the changes.

2.33 Industry reported to the R&D Incentives Committee (see paragraph 1.10) one month after the 2020–21 legislation was passed²⁴ (in October 2020) that a range of updates had been made available on the Program website (business.gov.au). For example, Industry prepared a factsheet on the changes with input from the ATO.

2.34 As at August 2021, the ATO had not updated its website with information about the legislative changes announced in October 2020. The ATO advised this was to limit confusion as the changes will not affect R&D claims until the 2021–22 financial year.

Court rulings

2.35 There have been two Federal Court rulings relating to the R&DTI since 2017: one relating to IISA; and the other relating to the ATO. Both agencies released communication products that addressed these rulings.

2.36 In July 2019 the Federal Court made a ruling in *Moreton Resources Ltd v IISA*.²⁵ The day after the decision, Industry released an e-bulletin that noted that the matter was returning to the AAT.²⁶ In the March 2020 e-bulletin, Industry noted that the decision provided clarification on the definition of core R&D activities.²⁷ A summary of the decision and IISA's response was also uploaded

24 *Treasury Laws Amendment (A Tax Plan for the COVID-19 Economic Recovery) Act 2020* implemented many of the changes announced in the May 2018 Budget (Budget 2018–19 Budget Measures Budget Paper No 2 2018–19). See Box 1 for an outline of the changes.

25 The court overturned an AAT decision, finding that the AAT erred in its interpretation of parts of the definition of 'core R&D activities' and referred the decision back to the AAT. Further information available from <https://www.judgments.fedcourt.gov.au/judgments/Judgments/fca/full/2019/2019fcafc0120> [accessed 10 August 2021].

26 The e-bulletin is available at <https://mailchi.mp/industry/rd-tax-incentive-e-bulletin-july-317873> [accessed 17 August 2021].

27 The e-bulletin is available at <https://mailchi.mp/industry/rd-tax-incentive-e-bulletin-december-318441> [accessed 17 August 2021].

to the website.²⁸ Industry reported to IISA in October 2019 that it had been communicating about the impact of this judgement as part of the State Reference Groups.

2.37 In August 2020 the Federal Court ruled on *Commissioner of Taxation v Bogiatto*.²⁹ In February 2021 the ATO released a Decision Impact Statement³⁰ on its website noting future updates to ATO guidance products.³¹ The ATO advised that the Decision Impact Statement was not released earlier because it was awaiting a decision on penalties from the court.

Did IISA and Industry have effective registration, and advance and overseas findings processes?

IISA (and Industry on its behalf) had largely effective registration arrangements and processes for advance and overseas findings. The identification of potential non-compliance as early as possible could be improved by continuing to refine the risk-based components of the registration process. Industry has been working to streamline processes for advance and overseas findings, although it is too early to assess whether recent developments have had the desired effect. Internal service standards for the timeliness of processing advance and overseas findings were not being met and there was a high incidence of overseas R&D activities being found to be ineligible, and then subsequently overturned in an internal review.

Registrations

2.38 R&D entities must register their R&D activities with IISA within 10 months of the end of the financial year in which they conduct their activities.³² Table 2.2 provides the number of registrations for 2017–18 to 2019–20.

28 Industry website, *Federal Court of Australia judgement — Moreton Resources Ltd v Innovation and Science Australia* [Internet], available from <https://business.gov.au/grants-and-programs/research-and-development-tax-incentive/external-appeals/federal-court-of-australia-judgement-moreton-resources-ltd-v-innovation-and-science-australia> [accessed 10 August 2021].

29 The court found that Bogiatto was promoting an R&DTI exploitation scheme.

30 The ATO releases Decision Impact Statements to advise the community on the implications of a particular court or tribunal decision.

31 ATO website, *Decision Impact Statement — Commissioner of Taxation v Bogiatto* [Internet], available from <https://www.ato.gov.au/law/#Law/table-of-contents?docid=LIT/ICD/NSD1839of2018/00001> [accessed 10 August 2021].

32 For example, if the activities were conducted in 2020–21, R&D entities must register by 30 April 2022. There are exceptions for entities with a substituted accounting period and entities may apply for extended time to register.

Table 2.2: Number of registrations, 2017–18 to 2019–20

Outcome	2017–18	2018–19	2019–20 ^a
Registered	12,519	12,510	12,330
Registration refused ^b	13	2	0
Application revoked (withdrawn) by the entity	64	49	40
Total	12,596	12,561	12,370

Note a: Data as at 30 June 2021. The registration period with extensions and for entities with substituted accounting periods ends 30 September 2021.

Note b: IISA may refuse to register if it determines the R&D activities being registered do not meet the requirements of the ITA Act.

Source: Industry data.

2.39 To register, entities submit an application form online.³³ The form requires entities to provide information such as the: type of entity applying for the offset; proposed R&D activities; and entity turnover and employment.

2.40 In order to support decision-making, Industry applies risk flags and risk filters to registration applications to assist with the identification of potential non-compliance with requirements relating to the eligibility of activities. These flags and filters provide an indication of potential compliance risks within the registration application. As the Program is based on R&D entities self-assessing their eligibility, having points throughout the registration process to identify higher-risk applications (in terms of non-compliance) is important.

2.41 Industry uses risk flags to highlight particular applications (such as first-time registrants) that may warrant attention. The flags do not generate a risk score. Risk filters are similar to risk flags, except that risk filters generate a risk score. As at August 2021, there were 36 risk filters related to: sectors; financial information; and information about specific issues.

2.42 In 2020 Industry found from a random sample of 2019–20 R&DTI applications (discussed further at paragraph 3.7) that there was little relationship between risk scores and eligibility outcomes. However, at the same time Industry staff considered that the risk filters had a high success in identifying eligibility issues. Industry undertook follow-up analysis and found that the top eight filters were more accurate at predicting risk and that filters are often best used in combination with each other.

2.43 Combining the registration system risk filters with the judgement of Industry staff and other Program intelligence (such as referrals from the ATO), IISA may decide to conduct a pre-registration risk assessment to better assess the likelihood of non-compliance. Between 2019–20 and 2020–21, IISA undertook 42 pre-registration risk assessments. The outcomes of these risk assessments were: register with no further action — 22; escalate to compliance activity — 16; withdrawn — two; and not identified — two.

2.44 The 16 risk assessments that were escalated to a compliance activity went through a pre-registration examination. Examinations (discussed further at paragraphs 3.11 to 3.17) allow IISA to make a determination about the eligibility of the R&D activities associated with the

³³ Until July 2021, the application form was a PDF smart form. In July 2021, Industry introduced a new registration portal to more closely align the form with the legislation and to make the questions clearer.

registration.³⁴ IISA escalates cases from a risk assessment to an examination if there remains sufficient risk of non-compliance. Between 2019–20 and 2020–21, IISA undertook 16 pre-registration examinations (all escalated from risk assessments discussed at paragraph 2.43). Comparatively, IISA undertook 130 post-registration examinations in the same period. Of the 16 pre-registration examinations, nine were found to be eligible and seven were found to be ineligible.

2.45 Risk assessments and examinations are discussed further below — paragraphs 3.10 to 3.16.

Support for R&D entities and timeliness of processing

2.46 Industry's website for the Program provides information for entities who want to register. This information includes a pre-registration checklist to assist entities to assess if they are eligible.³⁵ Between October 2017 and April 2021, Industry received 10,971 phone, email or web inquiries about the Program. Of these, about 50 per cent were inquiries about the registration process.

2.47 A survey with 84 responses conducted by Industry between September and October 2020 found that:

- 36 out of the 78 respondents (46 per cent) did not find it straightforward to assess the eligibility of activities;
- 34 out of 78 respondents (44 per cent) did not find it straightforward to complete the registration application; and
- 11 out of 48 respondents (23 per cent) were either unsatisfied or very unsatisfied with the responsiveness of Program staff to questions during the registration process.³⁶

2.48 If conducted periodically, the survey results will provide a benchmark for Industry to assess its performance over time.

2.49 In the same survey, 37 out of 77 respondents (48 per cent) spent more than 40 hours completing the registration application. Industry advised that metrics related to its new registration portal (released 5 July 2021) are positive in terms of the time entities are taking to register. As at August 2021, of the 1222 registration applications that have been submitted in the portal the three longest times captured to complete a registration were: 22 hours 44 minutes; 15 hours 37 minutes; and 12 hours five minutes.

2.50 Industry's service standards for processing registrations are: 40 business days for first time registrants; 20 business days for registrants that have applied within six months after the end of the income period; 80 business days for registrations submitted from six to 10 months after the end of the income period. In 2019–20, Industry reported that it processed 99 per cent of registration applications within these timeframes. In this period, IISA on average processed registrations in five days with 43 registrations (0.3 per cent) taking longer than 20 days to process.

34 IISA conducts pre-registration examinations under section 27B of the IRD Act.

35 Industry, *Apply to register with the R&D Tax Incentive* [Internet], available from <https://www.business.gov.au/grants-and-programs/research-and-development-tax-incentive/apply-to-register-with-the-randd-tax-incentive> [accessed 5 July 2021].

36 A subset of the 84 respondents answered each question.

Monitoring and reporting

2.51 Industry produces an internal Registrations and Expenditure Report for the Operations and Performance Group³⁷ that provides information and trends about the types of registrations and R&D entities. Similarly, other internal reporting is focussed on providing trends and numbers of registrations. Industry has also included additional metrics in its recently developed Performance Metrics Framework (discussed Chapter 4) including: average time taken to process registrations; proportion of businesses that receive a new registrant information pack; and proportion of registrants reporting a positive experience at point of application.

2.52 The monitoring activities on registrations do not explicitly assess the performance of the risk-based elements of the process. This includes the risk flags, risk scores, risk assessments and other engagement with the R&D entities. The ANAO suggests that Industry consider developing metrics to routinely assess the risk-based elements of the registration process.

Advance and overseas findings

2.53 Under the IRD Act, R&D entities may apply to IISA to receive an advance finding or an overseas finding (see Box 3 for explanation of these two types of findings).

Box 3: Advance and overseas findings

An *advance finding* (made under section 28A of the IRD Act) is a determination of whether R&D activities being conducted or to be conducted are eligible. It is not mandatory for R&D entities to seek an advance finding but is an option for entities who want certainty about the eligibility of their R&D activities.

An *overseas finding* (made under section 28C of the IRD Act) is a determination of whether R&D activities conducted outside Australia, as part of an Australian R&D project, are eligible. If there are overseas activities as part of the R&D project, an overseas finding is mandatory before claiming the tax offset.

2.54 Table 2.3 shows the number of advance and overseas findings completed by IISA between 1 July 2017 and 31 June 2021, and the outcomes of those findings.

³⁷ The Operations and Performance Group is an internal oversight group that focusses on service delivery, integrity issues and program administration optimisation.

Table 2.3: Number of advance and overseas findings completed and outcomes, 1 July 2017 to 30 June 2021

Outcome	Number of advance findings (% of total)	Number of overseas findings (% of total)
Total	95	608
Applications for a finding withdrawn before finding made	47 (49%)	131 (22%)
Findings completed with an outcome	48 (51%)	477 (78%)
Of the findings completed with an outcome:		
• Eligible	27 (56%)	354 (74%)
• Partially eligible	5 (10%)	22 (5%)
• Ineligible	13 (27%)	92 (19%)
• Finding refused ^a	3 (6%)	9 (2%)

Note a: For both advance findings and overseas findings, IISA may refuse to make a finding under certain circumstances as outlined in the *Industry Research and Development Decision-making Principles 2011*. For example, IISA may refuse a finding because the entity who has requested the finding has not submitted a complete application form or failed to provide requested information.

Source: ANAO analysis of Industry data.

2.55 For advance findings, many applications were withdrawn before a finding was made (49 per cent). Industry advised that entities may withdraw their applications: to self-assess out of the Program as they identify that their R&D is not eligible; if they decide that it is too early in the planning and delivery of their R&D to seek a finding; or if they consider the findings process to be too onerous. There were 48 (on average 12 per year) advance findings completed with an outcome and, of these, 37 per cent were found to be partially eligible or ineligible.³⁸ Industry has not undertaken analysis to understand the types of entities that apply for advance findings and the associated types of R&D activities. The numbers of ineligible applications indicate that the advance finding process could be a potentially useful mechanism in identifying ineligible R&D activities early.

2.56 Industry has identified that if any entity withdraws its application for an overseas finding, the reasons for withdrawing are the same as for withdrawing an application for an advance finding, as outlined in paragraph 2.55. In addition, there has been a high incidence of overseas findings being overturned by subsequent internal reviews.³⁹ Between 2019–20 and 2020–21 there were 37 internal reviews of ineligible overseas findings. Of these, 25 (68 per cent) were subsequently found to be eligible (where the original decision was overturned).⁴⁰ This rate is high compared to advance findings (no decisions were overturned by an internal review) and examinations/IISA initiated findings (15 per cent were overturned by an internal review). These results warrant attention and suggest that IISA and Industry should determine the reasons for the high incidence of overseas findings being subsequently overturned and address the causes.

38 For the remaining six per cent, a finding was refused.

39 Under Part III Division 5 of the IRD Act, certain decisions are reviewable, and the R&D entity may request that a decision is reviewed internally by IISA.

40 This equates to 11 per cent of all overseas findings made during this period being overturned by subsequent review.

Timeliness

2.57 IISA and Industry do not have external service level standards relating to processing times of advance and overseas findings, although Industry has identified that findings should be completed within 90 calendar days.⁴¹ Industry advised in August 2021 that work had commenced to develop internal service level standards with the aim of completing 80 per cent of advance and overseas findings within 90 days.

2.58 On average, advance and overseas findings took significantly longer than 90 calendar days to complete between 1 July 2017 and 30 June 2021. This analysis, however, does not take into account the time taken by entities in responding to IISA's requests and potential delays as a result of requested information not being provided by the entity, as Industry did not have a mechanism to record this elapsed time in its case management system.

- The average time taken to process advance findings with a completed finding was 224 days⁴², with the shortest taking 56 days and the longest taking 409 days. Of the 95 advance findings, 20 (21 per cent) were completed within 90 days and seven (seven per cent) took more than one year to complete.
- The average time taken to process an overseas finding with a completed finding was 195 days, with the shortest taking 26 days and the longest taking 726 days. Of the 608 overseas findings, 68 (11 per cent) were completed within 90 days and 34 (six per cent) took more than a year to complete.

2.59 The survey conducted by Industry between September and October 2020 also found that 25 out of the 39 respondents to the relevant question (64 per cent) spent more than 40 hours completing the advance and overseas findings application form.

2.60 The lengthy time periods and investment involved in applying for and receiving an advance finding may be a barrier for R&D entities in applying for a finding. The length of time to receive overseas findings may also be problematic for R&D entities as they have to receive the finding before registering for the Program.

Streamlining advance and overseas findings

2.61 Industry's 2018–22 Compliance Strategy stated that it would review and streamline all statutory processes as part of Program changes, including advance and overseas findings. In this context, one of Industry's projects is about using an external provider to conduct assessments for advance and overseas findings.⁴³

2.62 In February 2019, Industry initiated a multi-stage procurement process for an external provider. The first stage involved an Expression of Interest to test the market followed by an invitation to suitable potential suppliers to a subsequent Request for Tender.

41 Industry documentation notes that the 90 calendar days does not take account of delays as a result of requested information not being provided by the entity.

42 The annual average time taken to process advance findings with a completed finding was: in 2017–18, 218 days; in 2018–19, 200 days; in 2019–20, 258 days; and in 2020–21, 214 days.

43 In December 2019, the Australian Small Business and Family Enterprise Ombudsman recommended that 'Innovation Science Australia should better utilise advance findings through their wider promotion, expediting processes and publicising decisions'. Australian Small Business and Family Enterprise Ombudsman, *Review of the R&D Tax Incentive*, December 2019, p. 6.

2.63 Between March and November 2020, Industry undertook a pilot project with an external provider, BellchambersBarrett, that had been selected from this procurement process. The aim was to reduce costs and timeframes by 25 per cent⁴⁴ for undertaking the assessment and increase the department's capacity to undertake these findings. The external provider achieved efficiency in processing the findings.⁴⁵ However, the external provider did not complete all assessments under the contract and Industry assessed the provider's processing of more complex assessments to be less effective.

2.64 In March 2021, Industry entered into a contract with another provider, Proximity, from the original procurement process to conduct a second pilot of outsourcing the assessments. The objective of the second pilot is to further test whether the outsourcing model can work in practice, or whether the issues from the first pilot were as a result of the model. The second pilot is expected to be finalised in December 2021.

Recommendation no. 1

2.65 To further improve processes relating to advance findings, IISA and Industry:

- (a) undertake analysis to better understand why entities do and do not apply for advance findings;
- (b) develop a strategy to encourage entities who are most uncertain about the eligibility of their activities to apply for an advance finding; and
- (c) set public service standards relating to the timeliness of processing advance and overseas findings (and other statutory assessments).

Industry Innovation and Science Australia response: *Agreed.*

Department of Industry, Science, Energy and Resources response: *Agreed.*

2.66 *The Department agrees that more analysis can be done to better understand why entities do not apply for advance findings and to encourage entities who are uncertain about eligibility to apply for an advance finding.*

2.67 *The Department is committed to continuing efforts to reduce assessment timeframes. The Department will publish service standards relating to timeliness in the 2022–23 financial year.*

Did the ATO have effective processes to apply the tax offset?

The ATO was largely effective in processing offsets, with the offsets processed using the ATO's enterprise-wide tax return processes. The ATO's processing of offsets within service commitments has improved since 2014–15, although it was not meeting service commitments. For higher risk tax R&DTI claims, the ATO may decide to withhold a tax refund in order to verify information. There were instances where the ATO could not demonstrate that it had met the relevant legislative requirements in deciding to withhold a tax refund.

44 Industry estimated that, on average, it cost \$22,000 to undertake an assessment and 126 days to complete an assessment.

45 For standard assessments, costs were reduced by 35 per cent and timeframes were reduced by 31 per cent. For complex assessments, costs were reduced by 17 per cent and timeframes were reduced by 20 per cent.

Processing offsets

2.68 As a self-assessment program, R&D entities' claims are generally processed without query prior to a tax assessment being issued. The ATO can require that entities provide records and information to support claims made in a tax return.

2.69 Table 2.4 provides an overview of the number of offsets processed and the value of those offsets between 2017–18 and 2020–21.

Table 2.4: Number and value of offsets, 2017–18 to 2020–21

Offset type	2017–18		2018–19		2019–20		2020–21	
	Number	Value (\$bn)	Number	Value (\$bn)	Number	Value (\$bn)	Number	Value (\$bn)
Refundable	11,402	\$2.5	10,819	\$2.3	10,017	\$2.3	11,638	\$2.7
Non-refundable	1754	\$2.9	1600	\$2.7	1468	\$2.1	1488	\$2.2
Total	13,156	\$5.4	12,419	\$5.0	11,485	\$4.4	13,126	\$4.9

Source: ATO annual reports.

2.70 R&D entities must complete the R&D Tax Incentive Schedule (Schedule) as part of their income tax return when claiming the offset. The ATO advised that it uses this information to determine whether an entity is eligible. Entities must self-assess whether they are applying for the refundable or non-refundable tax offset (see Table 1.1). The ATO advised that it verifies the R&D entity's reported turnover if it is selected for a high risk refund review (discussed from paragraph 2.76) or other compliance activity.

2.71 As discussed above, R&D entities must have registered with IISA before claiming the R&DTI, and must provide this registration number to the ATO on the Schedule. Industry uploads registration information to a secure extranet site and the ATO can access this information for processing of the offsets, and integrity and compliance checks at the point of lodgement. The ATO's income tax return processing system does not automatically check whether a Schedule has a valid registration number.

2.72 The ANAO examined the 153 registration revocations (see Table 2.2), and identified a total of four cases where an entity had registered with Industry and then submitted a claim for the R&DTI through its tax return, the ATO applied and paid the offset, and the entity subsequently revoked its registration with Industry. Reasons for revocation can include that the entity: is no longer undertaking the R&D activities; or needs to submit a revised registration application due to any changes to any information in the registration, as it is not possible to modify a registration. Industry had not advised the ATO of two of these four revocations. Industry had advised the ATO of the other two revocations, however, the ATO had not reversed the offset. None of the four entities had re-registered or self-amended their tax return. These four cases were valued at \$978,075.

2.73 The ATO's service commitments between 2017–18 and 2020–21 include that it aims to process: 94 per cent of electronic tax returns within 12 business days; and 80 per cent of paper tax returns within 50 business days. The ATO's reported performance in processing offsets within service commitments has improved since 2014–15 when 51.4 per cent of offsets were processed

within service standard. In 2019–20, 85.6 per cent of offsets were processed within the service standard (see Figure 4.4 and paragraph 4.40 for further discussion).

2.74 The ATO has an enterprise-wide risk assessment process, part of which uses the ATO's Integrated Core Processing system⁴⁶ to run risk filters over the information supplied by a taxpayer in the Schedule. For the R&DTI, the ATO's risk approach includes the use of risk filters — both R&DTI specific risk filters and ATO generic risk filters.

2.75 In July 2021, there were 78 R&DTI specific risk filters which incorporated ATO R&D risk rules and joint risk rules identified by the ATO and Industry. The ATO advised that there are no documented processes regarding the inclusion and review of the R&DTI risk rules. As at July 2021, the ATO advised that the joint risk rules had not been updated for more than two years and that this was due to Industry developing a new case management system.

High Risk Refunds

2.76 The R&DTI high risk refund (HRR) process is the ATO's primary tool to provide integrity over the refundable offset. It is used in real time before a refund is paid. If the ATO's risk processes identify that there are risks with the tax return, the ATO can withhold the tax refund to verify the information provided in the tax return.⁴⁷

2.77 As shown in Table 2.5, from 2017–18 to 2020–21, between 4.9 per cent and seven per cent of refundable offsets were flagged for review through the HRR process.⁴⁸ The HRR process covered between 23 per cent and 28 per cent of the total value of annual processed offsets. The average processing time for HRR reviews has ranged between 20 days and 42 days.

Table 2.5: High Risk Refunds, 2017–18 to 2020–21

	2017–18	2018–19	2019–20	2020–21
Number of refundable tax offsets	11,402	10,819	10,017	11,638
Number of refundable offsets flagged for HRR process	633 (5.6%)	527 (4.9%)	682 (6.8%)	818 (7.0%)
Value of refundable tax offsets	\$2.5 bn	\$2.3 bn	\$2.3 bn	\$2.7 bn
Value of refundable offsets flagged for HRR process	\$696 m (28%)	\$528 m (23%)	\$565 m (25%)	\$658 m (24%)
Average time to complete a HRR review	41 days	26 days	42 days	20 days
Percentage of HRR reviews that took longer than 90 days ^a	13%	6%	10%	5%

Note a: The ATO is required to process HRRs within an administratively reasonable time. The ATO has not set a standard in this regard, but the ANAO used 90 days for analytical purposes.

Source: ANAO analysis of ATO data.

⁴⁶ The Integrated Core Processing System is the ATO's primary system for processing tax returns.

⁴⁷ Under the *Taxation Administration Act 1953* (section 8AAZLGA), the ATO can withhold a taxpayer's tax refund in order to verify information that has been provided by the taxpayer. The ATO has developed a Practice Statement Law Administration (PSLA 2012/6) — *Exercise of Commissioner's discretion to retain a refund* — to guide its approach to undertaking HRRs [Internet].

⁴⁸ A case may be flagged for review and then immediately released following review by an ATO officer.

2.78 In 2019–20 there were 682 HRR cases involving a claim for an offset. Of these, 482 (71 per cent) were finalised with no further action and 199 cases (29 per cent) were escalated for further compliance action.⁴⁹ The ATO has also undertaken analysis on the strike rate of HRR cases by looking at the percentage of HRR cases that are escalated to review or audit and that lead to an adjustment. In 2019–20, 85 per cent of escalated HRR cases led to an adjustment.

2.79 The ANAO selected a sample of 58 HRR cases⁵⁰ to examine whether the ATO has effective HRR processes.⁵¹

- Records for four (seven per cent) of the 58 cases could not be located.
- In five (nine per cent) of the remaining 54 cases, the ATO's records did not provide evidence that it had informed taxpayers about the HRR process, in accordance with the *Taxation Administration Act 1953* (TAA) and the associated Practice Statement Law Administration.
- In 14 (26 per cent) of 54 cases, the ATO had not documented its consideration of the 10 factors (see Appendix 5 for a list of the 10 factors) as required under subsection 8AAZLGA(2) of the TAA in making a decision to withhold the refund.
- In 51 (94 per cent) of the 54 cases, the ATO documented who made the HRR decision. One HRR case was in progress at the time of analysis. For two cases (four per cent), it was not clear who made the decision. The ANAO was not able to determine if decisions were made by the appropriate officers, as the ATO had not documented a delegation framework. The ATO advised that procedures will be updated to document delegations for processing HRR cases.
- The average time to process the sampled HRR cases was 51 days. Nine cases (17 per cent) took longer than 90 days to finalise.

2.80 In July 2020 in the context of the COVID-19 pandemic, the ATO introduced revised procedures for the HRR process with the aim of speeding up the release of tax refunds, introducing a 'daily triage meeting' to make decisions about whether to: release a refund; complete a full HRR review; or to undertake further analysis to inform a decision. The ATO did not monitor whether the revised procedures had the desired impact, however, as shown in Table 2.5 HRR processing times were faster in 2020–21 compared to 2019–20.

2.81 The ATO does not regularly monitor and report on the HRR process covering the R&DTI. In the absence of regular monitoring and reporting on the HRR process and outcomes, it is difficult for the ATO to demonstrate that the HRR process is operating effectively as the primary tool to ensure the integrity of the refundable offset. In July 2021, the ATO developed a compliance strategy for the Program that includes a potential performance indicator around the timeliness of the HRR process.

49 One case was still in progress.

50 The ANAO selected 58 high risk refund activities for assessment, using a representative sampling approach. As this testing was not the only source of evidence to assess this sub-criterion, the confidence level is 80 per cent and the confidence interval is five per cent.

51 Detail of the ANAO's analysis criteria is provided in Appendix 5.

3. Compliance arrangements

Areas examined

This chapter examines whether Industry Innovation and Science Australia (IISA), the Department of Industry, Science, Energy and Resources (Industry) and the Australian Taxation Office (ATO) had effective compliance arrangements for the Research and Development Tax Incentive (R&DTI) Program (the Program).

Conclusion

Industry had a partly effective approach to compliance as its approach was not clearly aligned with compliance risks and its examination processes did not meet timeframe targets and did not always result in an outcome. The ATO had a largely effective approach to compliance, using its enterprise-wide processes, however, its monitoring and reporting on R&DTI compliance was not commensurate with risk. There were also weaknesses in the joint approach to compliance for the Program.

Areas for improvement

The ANAO made two recommendations aimed at IISA and Industry improving examination processes, and the ATO establishing monitoring and reporting for its compliance activities.

The ANAO also suggested that Industry and the ATO continue to improve the joint compliance approach.

3.1 The R&DTI is based on entities self-assessing whether their R&D and associated expenditure is eligible. IISA, Industry and the ATO are jointly responsible for the integrity of the R&DTI and, in that context:

- IISA and Industry are responsible for conducting compliance relating to the eligibility of the R&D activities; and
- the ATO is responsible for compliance relating to the eligibility of expenditure and the eligibility of the entities.

Did IISA and Industry have effective compliance arrangements?

Industry's compliance approach aims to be based on the risks and behaviours of Program participants, although it is not always clear how the planned compliance activities align with compliance risks. Industry follows its processes for undertaking examinations, although examinations on average do not meet the processing timeframe target and do not always result in an outcome.

Compliance strategy

3.2 Industry's compliance approach for the Program is made up of several elements, as outlined in Box 4. Through this approach, Industry aims to align its compliance activities with risks and to be able to measure the performance of its compliance approach.

Box 4: Industry's compliance approach for the Program

- The *Integrity Management Framework*, revised annually, outlines Industry's approach to managing risks associated with R&D entities not complying with the eligibility requirements. This includes the *R&D Tax Incentive: Integrity Framework* which outlines how Industry aims to take into account integrity risks and behavioural factors in its compliance approach.
- The *Integrity Management Plan*, also updated annually, seeks to align compliance activities with compliance risks and priorities.
- The *2018–22 Compliance Strategy* sets out the department's targeted approach to compliance between 2018 and 2022 and comprises six pillars around: guidance and education; company engagement and compliance; large expenditure reviews; random sampling; data analytics and digital capability; and behavioural insights. This strategy was developed following the May 2018 Budget announcement of funding for improved compliance and integrity management.
- The *Compliance Strategy Road Map 2018–22* sets out the deliverables in supporting the implementation of the 2018–22 Compliance Strategy.

3.3 The Integrity Management Framework and Integrity Management Plan were updated annually between 1 July 2017 and 30 June 2020. Industry did not finalise the 2020–21 Integrity Management Framework until May 2021 and did not develop an Integrity Management Plan for 2020–21. Industry advised that was due to other priorities related to COVID-19.

3.4 In July 2021, Industry advised that work had not commenced on development of an Integrity Management Framework and associated Integrity Management Plan for 2021–22 as the focus had been on operationalising the new Program case management system.

3.5 Industry's approach to compliance aims to be based on risks and the behaviours of R&D entities.⁵² For example, Industry aims to deter those who deliberately choose not to comply through targeted compliance activity. On the other hand, if Industry determines that the entity is trying to do the right thing, then the department may have, what it calls, a high-risk discussion with the entity to discuss the eligibility issues.

Risk identification

3.6 The 2020–21 Integrity Management Framework provides limited information about how Industry assesses the risk of R&D entities not complying with the eligibility requirements for the Program. The previous framework (for the 2019–20 period) indicated that risks are identified through: registration data and other analysis; and tax return data and other intelligence.

52 Industry's *R&D Tax Incentive: Integrity Framework* outlines the department's differentiated approach to compliance based on risks and behaviours, available from <https://business.gov.au/grants-and-programs/research-and-development-tax-incentive/how-we-monitor-rd-tax-incentive-applications#our-integrity-framework> [accessed 20 July 2021].

3.7 Industry undertook a project to better understand the compliance risk across the Program for registrations relating to 2019–20. There were limitations because of the small sample size⁵³ and it ended early because of COVID-19, however the project found that:

- there is no widespread sorting of the Program;
- engagement with R&D entities reduces the level of risk;
- certain industries and fields of research may present greater compliance risk; and
- smaller businesses seem more likely to carry significant risk of non-compliance.

Compliance risk treatment

3.8 Industry's 2019–20 Integrity Management Framework outlines six categories of activities to treat compliance risk including: awareness raising and stakeholder engagement; guidance and education; risk reviews; findings; internal reviews and litigation. The first two — awareness raising and stakeholder engagement, and guidance and education — are discussed above at paragraphs 2.16 to 2.18. Internal reviews⁵⁴ and litigation are largely reactive activities. For this reason, the focus of this section is on risk reviews and findings.⁵⁵

- Risk reviews aim to evaluate and resolve compliance risks early and with minimum impact. Risk reviews may identify issues that require further analysis.⁵⁶
- Findings are decisions by IISA about the eligibility of an R&D entity's activities. The process to arrive at a finding is called an examination (or statutory assessment) (discussed further at paragraph 3.11).

3.9 Integrity Management Plans in 2018–19 and 2019–20 set targets for the number of risk reviews and examinations to be undertaken, but it was not clear how the specific targets were set or how these related to treating compliance risks. Industry advised that the targets factored in discretionary activities (initiated by Industry) and non-discretionary activities (such as advance and overseas findings, and internal reviews). The ANAO found that these targets were not all achieved, potentially indicating that compliance risks were not being mitigated in accordance with plans (see Table 3.1).







53 Phase one had a sample size of 137 registrations and phase two had a sample size of 69. There were 12,330 registrations in 2019–20.


54 Under Part III Division 5 of the *Industry Research and Development Act 1986* (IRD Act).

55 This section of the audit focusses on section 27B (pre-registration) and section 27J (post-registration) findings of the IRD Act.

56 Industry is also introducing triage and engagement reviews at the pre-registration and post-registration stages. These are conducted on a random sample of registrations to identify potential compliance risks. The reviews do not involve a written report and may lead to a case being escalated to a formal risk review.

Table 3.1: Targets for risk reviews and findings, 2017–18 to 2020–21

Compliance activity	2017–18		2018–19		2019–20		2020–21	
	Target	Actual	Target	Actual	Target	Actual	Target ^a	Actual
Risk reviews completed	513	456 	201	278 	289	222 	NA	79 ^b
Examinations completed	211	153 	261	162 	220	125 	NA	17

Legend:  — Target achieved

 — Target not achieved

NA — not available

Note a: Industry did not set targets for 2020–21.

Note b: In addition to risk reviews, Industry undertook 372 triage processes to understand risk prior to undertaking a formal risk assessment.

Source: ANAO analysis of Industry reporting.

Risk reviews

3.10 Risk reviews can be conducted pre-registration or post-registration. If, following the risk review, the registration is considered low or medium risk then no further action is undertaken. If the risk review identifies high or significant risks, then Industry may refer the registration for further compliance action, such as an examination (discussed below). Of the 579 risk reviews conducted between 2018–19 and 2020–21⁵⁷, 71 (12 per cent) were pre-registration and 508 (88 per cent) were post-registration. The outcomes of these reviews were: 302 (52 per cent) no further action; 273 (47 per cent) referred for compliance action; and four (one per cent) withdrawn or outcome not identified.

Examinations and resulting findings

3.11 Examinations can also be conducted pre-registration or post-registration to make a finding about the eligibility of R&D activities. An examination is the primary compliance activity to respond to R&D entities who are unwilling to comply (entities who either have chosen not to comply or are knowingly high risk).

3.12 As show in Table 3.1, IISA undertook 457 examinations between 1 July 2017 and 30 June 2021. Of these:

- 283 (62 per cent) were finalised and a finding issued;
- 150 (33 per cent) were terminated by IISA; and
- 24 (five per cent) were withdrawn by the R&D entity before a finding was made.

3.13 IISA generally only completes an examination and issues a finding if some aspect of the R&D activities is ineligible. Of the 283 findings issued: 272 were ineligible; eight were partially eligible; and three were eligible. The total value of R&D expenditure that was found ineligible was \$3.4 billion between 1 July 2017 and 30 June 2021.

⁵⁷ Results were not available for 2017–18.

3.14 If during the examination, IISA determines that the R&D activities are eligible (or that the risk of ineligibility has been reduced to an acceptable level), it will generally terminate the assessment. Industry advised that it prefers to discontinue an examination rather than make a positive finding (a finding that the activities are eligible), as a positive finding is binding on the ATO (see paragraph 1.16).

3.15 The *R&DTI Service Commitments and Standards*, an Industry internal document, sets guidance for how long an examination should take — 90 calendar days.⁵⁸ The ANAO found that examinations took, on average, 200 days.⁵⁹ Out of 457 examinations between 1 July 2017 and 30 June 2021, 49 took more than one year to complete. These included 12 examinations where Industry terminated the assessment (determined that there was enough evidence to reduce the risk of ineligibility). The ANAO also found that examinations terminated by Industry were, on average, terminated after 208 days, potentially indicating that Industry was quite far into the process and may have been able to complete the examination with little additional effort in order to issue a positive finding.

3.16 The ANAO examined a sample of 53 examinations⁶⁰ covering registrations with a total R&D expenditure of \$760 million that were finalised between 1 July 2017 and 30 June 2021. Forty-four examinations were initiated by IISA/Industry, eight commenced as a result of ATO referrals and one commenced as a result of joint information. Of the 53 examinations: 28 resulted in a finding (53 per cent)⁶¹; 14 were terminated before a finding was made (26 per cent); and 11 were finalised following the entity withdrawing their registration (21 per cent). The results were as follows.

- There was evidence that Industry (on behalf of IISA) had informed the entity of the commencement of the examination in 49 cases (92 per cent) — for three of the remaining four examinations (six per cent) documentation was unavailable and for one case (two per cent) this was not applicable. Industry informed the entity of the outcome in 51 cases (96 per cent) and documentation was unavailable for the remaining two cases (four per cent).⁶²
- Examinations commenced, on average, 573 days (1.6 years) after the date of registration. Of the 53 examinations, six examinations (11 per cent) commenced more than three years after the registration. Thirty-five examinations (66 per cent) took more than 90 days to complete.
- Industry develops a Statement of Issues to outline its range of concerns for the entity, and then later in the process produces an Examination of Evidence report to support its decision around the eligibility of the R&D activities. Statement of Issues were unavailable

58 Industry advised in August 2021 that work had commenced to define a service commitment for examinations. At that time, it was proposed that the commitment would be that 80 per cent of examinations should be completed within 90 days.

59 An Industry survey conducted in 2020 found that 52 per cent of survey respondents (22 of 42 respondents) were not satisfied with the timeframe in which the compliance process was finalised.

60 The ANAO selected 53 examinations for assessment, using a representative sampling approach. As this testing was not the only source of evidence to assess this sub-criterion, the confidence level is 80 per cent and the confidence interval is five per cent.

61 Of the 28 cases with a finding, three were partially eligible and 25 were ineligible.

62 There were four cases where the entity withdrew their registration and have not been included here.

for nine examinations (17 per cent). All of the 42 examinations that should have had an Examination of Evidence report had a report.

- For the 28 examinations that resulted in Industry making a finding, 19 (68 per cent) had documentation demonstrating that it had been peer reviewed. Industry advised that all assessments are peer reviewed before the delegate makes a decision, although this may not always be documented. It is unclear if a peer review has been a mandatory step for every examination, however, the revised procedures from July 2021 now include this as a step to ensure that the eligibility recommendation is supported by the evidence.
- For the 42 examinations that led to a finding or were terminated by Industry, 41 (98 per cent) had delegate approvals documented and one (two per cent) did not.

3.17 As outlined, the ANAO sample included 14 examinations that Industry terminated before issuing a finding. Documentation for seven of those that were terminated (50 per cent) indicates that the activities were most likely ineligible, but that Industry decided not to make a finding of ineligibility because the entity had tried to comply with the law. The following is an extract from the assessment report for one of these cases.

Information provided by the [Company] in its registration... does not demonstrate eligibility of activities against the legislative requirements. As such, it is considered the activities represent a high risk of non-compliance.

However, the [Company] has provided evidence verbally whereby it considered the legislative requirements when self-assessing its activities, and that it kept records which it believed supported its self-assessment. Because the [Company] has demonstrated an attempt to comply with the legislative requirements of the program, and it has not had any prior guidance or compliance activity from the Department, a meeting was held with the [Company representative] on [date] to advise it of the issues with the activities in the registration. At the meeting, [Company representative] confirmed that it understood the issues with the registration, and confirmed that it would carefully consider these issues before submitting any future applications for registration.

It is therefore recommended that the current examination of the [Company's] 2016 and 2017-18 registrations be discontinued at this time, and the [Company] be notified in writing that: the issues have been recorded against the [Company's] file; future applications will be reviewed to ensure issues have been addressed; and if the identified issues are not addressed in future applications, the [Company] will be subject to compliance action.

Recommendation no. 2

3.18 IISA and Industry improve examination processes in order to give entities greater certainty and reduce the potential for future duplicative compliance action by:

- (a) reducing the time taken to undertake examinations;
- (b) reducing the instances where examinations are discontinued; and
- (c) issuing a finding of ineligibility if activities are ineligible.

Industry Innovation and Science Australia response: *Agreed.*

Department of Industry, Science, Energy and Resources response: *Agreed.*

3.19 *The Department has already implemented reforms to reduce examination timeframes, and improve consistency and transparency in our decision-making processes. We are committed to making further improvements.*

3.20 *While the Department agrees that examinations should generally be completed, in some cases new information may come to light that mitigates the risk attributed to a registration. In these circumstances, the department will work with R&DTI participants to ensure that when examinations are discontinued, doing so is in the best interests of the participant, and does not contribute to ongoing uncertainty about the eligibility of registered R&D activities.*

3.21 *The Department's Integrity Framework guides its engagement with registrants, focusing on education and guidance to help them understand their eligibility for the program and get their applications right. In line with the Integrity Framework, the Department will undertake an examination if we have identified compliance risk. Examinations are rarely discontinued if the Department has cause to conclude the activities are ineligible.*

Monitoring and reporting on compliance

3.22 The 2019–20 Integrity Management Plan specifies that monitoring and reporting on the plan would be undertaken on a monthly basis to monitor the compliance cases and provide timely reporting of their progress. The plan outlines targets in terms of the number of compliance activities to be undertaken annually (see for example Table 3.1).

3.23 Industry produces reporting on compliance activities for the Research and Development Tax Incentives Committee and the Operational Performance Group. Reporting to the Research and Development Tax Incentives Committee provides an overview of key issues in relation to compliance and includes a compliance activities summary. Since June 2019, reports to the Operational Performance Group have been produced about monthly, with the exception of between 1 January 2020 and 30 June 2020 when two reports were produced. The reporting to this group covers the numbers of compliance activities in progress and undertaken, as well as the outcomes of completed activities.

3.24 In its Performance Metrics Framework (discussed Chapter 4), Industry is developing additional performance metrics regarding its compliance activities. Examples include: proportion of compliance activities which lead to revoked, varied or withdrawn registrations; value of registrations found to be ineligible, revoked, varied or withdrawn; and timeliness of compliance activities.

Did the ATO have effective compliance arrangements?

The ATO had largely effective compliance arrangements, using enterprise-wide processes for the R&DTI. Between 73 per cent and 76 per cent of the ATO's R&DTI compliance activities from 2017–18 to 2019–20 led to the identification of non-compliance. However, compliance activities often take longer than target timeframes. Since 2018 the ATO has identified the R&DTI as higher risk, but has not had reporting arrangements in place that were commensurate with monitoring this level of risk.

Compliance strategy

3.25 In 2018–19, the ATO developed the Research and Development Tax Incentive Strategy Report (the strategy report). The strategy report provided an overview of the R&DTI risk management strategy, its impact and its future direction. The strategy report identified the ATO's role in relation to the integrity of the Program as: seeking to ensure the R&D notional deductions claimed are for only eligible registered R&D activities; seeking to ensure the R&D consultants and tax agents who provide R&D advice to companies do so in accordance with the legislation; and assisting Industry with their compliance activities over the R&D activities. The ATO also outlined the additional funding it received in the 2018–19 Budget (see Box 6) to improve compliance for the R&DTI. The ATO advised that although the strategy report was intended to be implemented over three years, it was not implemented due to the bushfires in 2020 and COVID-19.

3.26 Between June 2019 and June 2021, the ATO did not have a specific compliance strategy for the Program. This is despite having received funding in the 2018–19 Budget and over the three-year forward estimates to improve compliance on the R&DTI.

3.27 In July 2021, the ATO finalised the ATO Strategy: R&DTI — Compliance to support integrity over the Program. The strategy outlines a range of areas of concern, some of which will require joint action with Industry. As at August 2021, the ATO advised that it was in the process of developing a plan to support implementation and monitoring of the strategy.

3.28 Since 2017, the ATO has assessed R&DTI compliance risks and has generally found that there are significant risks associated with the R&DTI, as set out in Box 5.

Box 5: ATO risk assessments related to the R&DTI

A 2017–18 planning document identified that the refundable tax offset is subject to abuse as the refund is paid even if the company is not in the receipt of income. At the time, the ATO estimated that 10 per cent of the offset was at risk. The overall risk rating for the R&DTI was moderate. Key areas of concern for the ATO were around: building and construction; software development; mining; agriculture; ordinary business activities; R&D consultants; and fraud.

In February 2018, the ATO completed a risk assessment related to the behaviour of taxpayers in the Privately Owned and Wealthy Groups population. The focus was on assessing whether there was a risk of 'inappropriate access to concessions, offsets, incentives, deductions and entitlements which results in a tax advantage, impacting the willing participation in the tax and superannuation systems'. The risk rating for the R&DTI was high.

The 2018–19 strategy report identified that one of the Program risks related to fraud. The report noted that there is a high incidence of fraudulent behaviour and the inappropriate claiming of refunds.

In March 2019, an internal ATO briefing stated that the R&DTI had been listed with the Serious Financial Crime Taskforce as a program that is a higher risk of fraud.

3.29 As outlined in paragraphs 2.74 to 2.75, the ATO’s enterprise approach to risk management is the ATO’s risk-based approach to compliance for the Program.

Compliance risk treatment

3.30 The February 2018 risk assessment identified three groups of controls for the R&DTI — guidance material; taxpayer alerts; and risk rules. The assessment found these controls were only partially effective.

3.31 The ATO’s July 2021 compliance strategy outlines six areas of concern⁶³ but does not directly align specific activities to mitigate these areas of concern. The compliance strategy includes five objectives⁶⁴ and 16 planned deliverables, such as engagement with companies or tax agents and providing tailored guidance, as well as undertaking concurrent compliance action with Industry where appropriate. The ATO advised that these deliverables are intended to address these six areas of concern.

3.32 The ATO advised that compliance activities for the Program may also be undertaken as part of a range of broader ATO compliance strategies, such as the Top 500, Next 5000 and Medium and Emerging strategies within the Private Wealth sector.

3.33 The data presented in the following three tables is based on data produced by the ATO for reporting to the Senate. The data includes compliance cases in the Integrated Compliance, Private Wealth and Small and Medium Business areas. The ATO advised that it may not include all R&D compliance cases, for example those relating to entities in the Public Groups and International sector. Data on compliance activities for these entities was not readily available. Further, the ANAO identified anomalies in R&DTI data sets (see paragraphs 3.41 to 3.42).

3.34 Table 3.2 presents an overview of the ATO’s compliance activities that were completed on the R&DTI between 2017–18 and 2019–20. The table also shows the number and percentage of cases that led to a nil outcome (did not find non-compliance) or resulted in a liability being raised (found non-compliance). Reviews were the most common compliance activity between 2017–18 and 2019–20. Across all compliance activities, between 73 per cent and 81 per cent of activities resulted in the ATO identifying non-compliance and associated liabilities.

63 The six areas of concern are: eligibility of entities claiming the R&D tax offset; lack of substantiation and poor record keeping; claiming business-as-usual expenditure as R&D notional deductions; overestimating and overclaiming of expenses or claiming excluded expenditure; fraudulent claims; and poor or incorrect advice given by intermediaries.

64 These objectives are: support business to get it right through targeted engagement; provide certainty to business through assurance; present a ‘one agency’ representation when interacting with business; influence and treat consultant’s/tax agent’s inappropriate behaviour; and identify, detect and treat serious behaviours of concern.

Table 3.2: ATO's R&DTI completed compliance activities, 2017–18 to 2019–20

Compliance activity	2017–18	2018–19	2019–20
Compliance engagement	5 (2%)	1 (<1%)	2 (1%)
Review	262 (84%)	211 (79%)	193 (84%)
Audit and enforcement	43 (14%)	51 (19%)	34 (15%)
Investigate and prosecute	0	1 (<1%)	1 (<1%)
Not identified in data ^a	2 (1%)	2 (1%)	0
Total	312	266	230
Outcome			
Early exit	8 (3%)	3 (1%)	11 (5%)
Nil	74 (24%)	46 (17%)	44 (19%)
Liability raised	227 (73%)	215 (81%)	175 (76%)
Not identified in data	3 (1%)	2 (1%)	0

Note a: The compliance activity undertaken by the ATO was not identified in the data as there was nothing recorded in the corresponding data field.

Source: ANAO analysis of ATO data.

3.35 Table 3.3 presents the total value of liabilities raised from the ATO's compliance activities on the R&DTI between 2017–18 and 2019–20. It also shows the value of cash collected from R&DTI activities during this period.

Table 3.3: ATO's R&DTI compliance activities — liabilities raised and audit yield, 2017–18 to 2019–20

	2017–18 (\$m)	2018–19 (\$m)	2019–20 (\$m)	Total (\$m)
Liabilities raised	\$105.3	\$139.1	\$70.1	\$314.6
Audit yield ^a	\$45.7	\$55.9	\$37.9	\$139.4

Note a: Audit yield is a measure of the collection of specifically identified liabilities raised from ATO audit and enforcement activities. These liabilities are directly connected to an ATO adjustment, and payment can occur after the conduct of an audit. It also includes interest and penalties.

Source: ATO data.

3.36 Table 3.4 presents information about the timeliness of the ATO's R&DTI compliance activities between 2017–18 and 2019–20. The results show that compliance activities took, on average, between 187 days and 219 days to complete, not including days where the ATO was waiting for responses to requests for information. The ATO did not meet its target timeframes for completing compliance activities between 42 per cent and 62 per cent of the time (the ATO had 11 compliance activity types, and target timeframes ranged from 10 days for simple reviews to 540 days for complex audits).

Table 3.4: ATO's R&DTI compliance activities — timeliness

	2017–18	2018–19	2019–20
Average number of days to complete compliance activities — elapsed days ^a	219	197	187
Percentage of cases that were outside the ATO's target timeframes	62%	42%	44%

Note a: The elapsed days calculation does not include the period of time where the ATO is waiting for information to be provided.

Source: ANAO analysis of ATO data.

Monitoring and reporting on compliance

3.37 The ATO does not regularly monitor and report on R&DTI compliance activities. The ATO advised that the 2018–19 strategy report is the most recent report to bring together reporting on the compliance activities for the R&DTI; however, this is not a regular activity and the strategy was not implemented. The strategy report outlined that success would be when non-compliance was limited to only those who chose not to comply and identified a range of success indicators.

3.38 The ATO provided four examples of regular reporting across ATO business areas involved in undertaking compliance activities on the R&DTI. One of these examples, from the Private Wealth business area, included specific R&DTI reporting on the 2018 Budget measure, *Better targeting the Research and Development Tax Incentive* (discussed in Box 6).

3.39 The July 2021 ATO Strategy: R&DTI — Compliance identifies potential performance criteria and indicators. As at July 2021, the ATO had not finalised its performance monitoring arrangements for this strategy. Monitoring and reporting against the ATO's R&DTI strategies is discussed further in Chapter 4 (paragraph 4.24).

3.40 The ATO's current internal monitoring and reporting on compliance activities is limited in terms of:

- understanding whether compliance risks have been appropriately mitigated;
- identifying any weaknesses in performance or processes; and
- providing an assessment of the extent to which any compliance strategy is being implemented.

3.41 The ANAO requested data of all R&DTI claims processed and compliance cases between 1 July 2017 and 30 June 2020. There were anomalies with this extracted data when compared to other data sets, including data extracted for reporting to the Senate (see paragraph 3.33).

3.42 To identify R&DTI cases, the ATO uses SQL queries to either link data sets to derive relationships or search text strings. This is because the ATO's systems have no standardised way to categorise a tax return or compliance as being specifically linked to the R&DTI. Using SQL queries in this way reduces the reliability of data reported. The SQL queries are not necessarily consistent or fully documented and relying on such SQL queries to undertake core business reporting increases the risk that inaccuracies are not identified or interpretations made by data analysts are not fully explained. The ATO has implemented some controls over data reporting, but they have not been consistently applied.

Recommendation no. 3

3.43 The ATO establish monitoring and reporting arrangements to assess the effectiveness of its compliance approach for the R&DTI program, including implementation of the 2021 R&DTI compliance strategy, high risk refund process and other R&DTI compliance activities.

Australian Taxation Office response: *Agreed.*

Did IISA, Industry and the ATO have effective joint compliance arrangements?

Industry and the ATO had partly effective joint compliance arrangements. Industry and the ATO had joint compliance strategies in 2016–17 and from 1 July 2021, otherwise there was not a joint strategy in place between 1 July 2017 and 30 June 2021. The agencies did not have a coordinated approach to the delivery of a 2018 Budget measure that included increased funding to implement stronger compliance and the ATO had not used this funding in accordance with its commitments to government. There was also a lack of monitoring and reporting on joint compliance.

Joint compliance strategy

3.44 The MoU between Industry and the ATO includes that the agencies will develop and agree on joint risk and compliance strategies that will identify and prioritise joint compliance risks and agree to strategies to manage these risks. The aim is to establish a well-coordinated joint risk approach that applies available resources of both agencies in the most effective and efficient way.

3.45 In 2016–17, the agencies developed a Joint Risk and Compliance Strategy⁶⁵ with strategies around risks relating to: fraud; construction; mining; software; consultants; agriculture; and normal business activities being claimed as R&D. The strategy set out key deliverables including the development of a protocol on how joint priority risks would be identified and managed. It is unclear the extent to which Industry and the ATO consider these strategies were implemented, as they did not monitor and report on implementation.

3.46 The 2021 Joint R&DTI Overarching Strategy (see paragraph 2.13) includes a joint compliance strategy. This strategy includes a focus on ‘one agency representation when interacting with business’ and working together to mitigate compliance risks and ensure integrity and fairness across the program.

Joint compliance activities

3.47 Industry and the ATO can undertake joint compliance activities if, for example there is: a compliance risk involving a consultant or tax agent of concern; a risk of fraud or a systemic risk to the Program; or both activity and expenditure risks. There was no evidence that Industry and the ATO had undertaken joint compliance activities between 1 July 2017 and 30 June 2021. Industry

⁶⁵ The purpose of the Joint Risk and Compliance Strategy was to ensure that the entities were working towards achieving common outcomes for the program in the area of risk and compliance management.

advised that its new case management system (implemented in July 2021) would more readily track whether joint compliance was undertaken.

3.48 Industry and the ATO hold workshops⁶⁶ about every month⁶⁷ focussed on the referral of cases for compliance activity. These meetings primarily involve the ATO referring cases to Industry for review.

3.49 In 2019, the ATO outlined that, while it can provide assurance over the expenditure claims on R&D, it cannot provide assurance of the registered R&D activities. Making assessments around the eligibility of R&D activities is the role of IISA and Industry. The ATO proposed having Industry staff seconded to the ATO to work with ATO teams on R&D activities⁶⁸, however, this was deemed impractical for logistical reasons at the time. In August 2021, Industry advised that it was considering seconding staff to ATO to work on large business reviews.

Additional funding for compliance activities

3.50 In the May 2018 Budget, Industry and the ATO received funding for additional compliance and integrity activities. The funding was received as part of aggregate funding to deliver a range of changes (outlined in Box 1). Industry received a total of \$69.36 million, and the ATO received \$16.43 million. The Budget did not allocate funding to specific changes, including for the additional compliance and integrity activities. The ATO, however, outlined that most of its funding was for additional compliance and integrity activities.

3.51 The ANAO found that there had not been a coordinated approach to the delivery of the additional compliance and integrity activities funded through the May 2018 Budget, and the ATO had not met its commitments to government (see Box 6).⁶⁹

Box 6: Delivering the May 2018 Budget funding for *Better Targeting the Research and Development Tax Incentive*

The May 2018 Budget included a measure *Better targeting the Research and Development Tax Incentive*. The Government stated it would further improve the integrity of the Program by implementing stronger compliance and administrative improvements, which was supported by increased funding for Industry and the ATO.

The funding proposal did not specify how the agencies would allocate the funding in terms of compliance activities. Each agency received separate funding and there was no evidence of a joint decision between Industry and the ATO on how this funding would be allocated. However, ATO documentation indicates that there was an understanding that Industry would increase its compliance activities with a resultant increase in compliance case referrals to the ATO and the need for the ATO to undertake additional reviews and audits. It was also expected that there would be additional joint compliance activities.

66 The ATO and Industry Referrals Workshop.

67 The ATO advised that the meetings are scheduled every two weeks but may be cancelled if there are no agenda items.

68 At the time, there were 19 ATO secondees at Industry.

69 The ANAO has previously audited the ATO's effectiveness in meeting Budget-funded commitments to government: Auditor-General Report No. 15 2016–17 *Meeting Revenue Commitments from Compliance Measures*, 12 September 2016, available from <https://www.anao.gov.au/work/performance-audit/meeting-revenue-commitments-compliance-measures> [accessed 24 September 2021].

ATO reporting between 2018–19 and 2020–21 shows that the ATO has not been meeting its planned targets associated with the funding. For 2020–21, the ATO raised \$2.94 million in liabilities (against a target of \$100 million) and collected \$3.21 million in additional revenue (against a target of \$60 million). The reason for this, from the ATO's perspective, is that it has not had referrals from Industry as anticipated in the funding proposal. The ANAO notes that these targets were in excess of business-as-usual R&DTI compliance results. Liabilities raised between 2017–18 and 2019–20 on business-as-usual R&DTI compliance ranged from \$70.1 million to \$105.3 million per year.

In the second quarter of 2020–21, the ATO decided to reallocate all planned R&D work from business-as-usual funding to the Budget funding. This means that all R&D compliance results will now be linked to the Budget funding with the ATO essentially acknowledging that it would not be able to meet the commitment to government for additional compliance activities.

The ATO raised concerns with Industry about meeting commitments to government for this Budget measure, including at the Joint Administrative Governance Group in July 2018.

In August 2021, Industry advised the ANAO that it:

used additional funding to improve integrity to enhance its approach to compliance. This involved greater scrutiny of registration applications, alternative resolution of cases through behavioural change and early engagement with companies accessing the program. Rather than requiring retrospective examinations and findings, these initiatives led to the earlier identification and treatment of non-compliant behaviour in many cases.

3.52 As part of Program changes, Industry and the ATO are developing a joint system to improve the use of data and intelligence to inform shared Program administration, including compliance activities.⁷⁰ The system will aim to support a better understanding of risks within the Program and is due to be delivered by December 2021. The ANAO suggests that continuing to improve the Program joint compliance approach should be a priority for Industry and the ATO.

Joint monitoring and reporting on compliance

3.53 The Joint Management Group was responsible for implementing the 2016–17 Joint Risk and Compliance Strategy and was to report to the Joint Administrative Governance Group. There was limited evidence that these governance groups had monitored the implementation of the strategy, including its effectiveness in mitigating joint priority risk areas. There were two joint risk reports presented to the Joint Administrative Governance Group between 1 July 2017 and 30 June 2021.

3.54 There was limited monitoring and reporting on the delivery of the 2018–19 Budget funding at the joint governance groups. This was limited to discussions around the development of the joint system for data and intelligence and issues relating to the delivery of the commitments to government.

⁷⁰ The 2016 review found 'in order to improve programme administration, it is vital to enhance data management by having a single programme database'.

B Ferris AC, A Finkel AO, J Fraser, *Review of the R&D Tax Incentive*, April 2016, p. 45.

4. Performance monitoring, reporting and evaluation

Areas examined

The ANAO examined whether Industry Innovation and Science Australia (IISA), the Department of Industry, Science, Energy and Resources (Industry) and the Australian Taxation Office (ATO) established effective performance monitoring, reporting and evaluation arrangements for the Research and Development Tax Incentive (R&DTI) program (the Program).

Conclusion

IISA, Industry and the ATO had largely effective performance monitoring, reporting and evaluation arrangements. Industry's external R&DTI performance measure did not indicate if the R&DTI was meeting its legislated objectives and both this and the ATO's external R&DTI performance measures lacked targets.

Area for improvement

The ANAO suggested that the ATO consider including targets in its external performance measures.

4.1 Under the Commonwealth Performance Framework⁷¹, entities must demonstrate how public resources have been applied to achieve their purposes.⁷² Performance monitoring frameworks help to assess progress towards achieving program objectives, identify what is working or may need change and provide accountability for government expenditure.⁷³

Did IISA, Industry and the ATO establish effective program performance frameworks?

IISA and Industry established largely effective internal R&DTI performance frameworks. Industry had a partly adequate external R&DTI performance measure. Industry's R&DTI external performance measure did not indicate the extent to which the R&DTI was meeting its legislated objectives and lacked a target to inform performance reporting. Industry had implemented a framework to support internal operational program monitoring. The ATO's R&DTI external performance measures were largely adequate, although they lacked targets.

4.2 The Commonwealth Performance Framework requires entities to develop Portfolio Budget Statements (PBS) and corporate plans that include performance measures, and annual performance statements in annual reports.⁷⁴ The Department of Finance guidance notes:

71 The framework is set out in section 37 of the *Public Governance, Performance and Accountability Act* (PGPA) 2013 and PGPA Rule 16EA.

72 Department of Finance, Resource Management Guide No. 131, *Developing good performance information*, [Internet], available from <https://www.finance.gov.au/government/managing-commonwealth-resources/developing-good-performance-information-rmg-131> [accessed June 2021].

73 *ibid.*, gives relevant guidance.

74 Entities are required to keep records supporting their performance measurement, including records of the types of performance measures used, data sources, collection methods, procedures and data calculations.

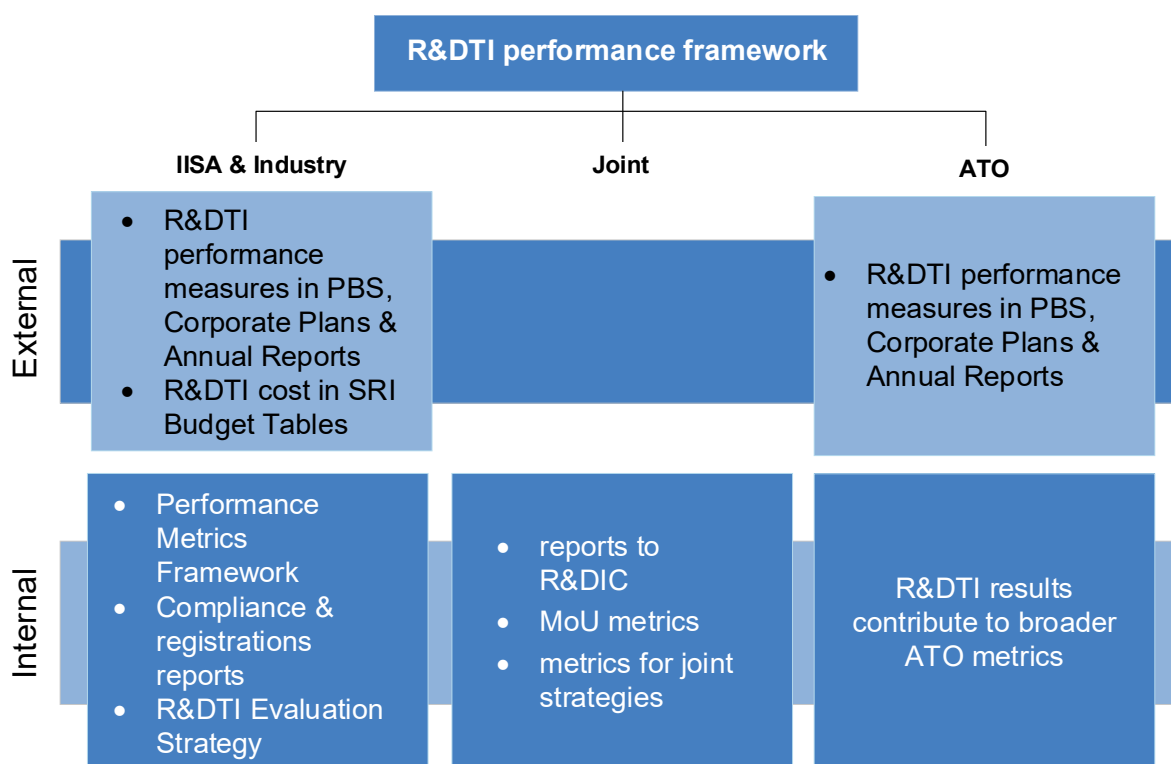
There is no one-size-fits-all approach for all entities — entities need to develop a performance framework that is appropriate to its purposes and activities.⁷⁵

4.3 As noted at paragraph 1.9, IISA, as a statutory board, receives a Statement of Expectations from the Minister for Industry, Science and Technology, setting out the Australian Government's policies, objectives and priorities for IISA. IISA reports R&DTI 'key outcomes' in its annual reports, in accordance with section 46 of the *Industry Research and Development Act 1986* (IRD Act).

4.4 Industry and the ATO include performance measures for the Program in their PBS and corporate plans, and publish results in annual reports (see Table 4.1). Industry and the ATO have also established internal and joint-agency metrics to contribute to management oversight of Program performance.

4.5 Figure 4.1 provides an overview of the performance frameworks in place for the Program.

Figure 4.1: R&DTI performance framework



Source: ANAO.

4.6 As shown in Figure 4.1, the R&DTI performance framework includes evaluation. IISA is responsible, under section 7 of the IRD Act, for evaluating and advising the Minister about the operation of the R&DTI. The Research and Development Incentives Committee (R&DIC) assists and informs IISA in performing these functions.

⁷⁵ Department of Finance, *Developing good performance information*, p. 5.

External performance measures

4.7 IISA measures R&D expenditure covered by the Program and the number of registrations and registrants. Industry measures R&D expenditure registered by entities. The ATO's measures address the value and number of R&DTI claims processed, and its timeliness in claims processing.

4.8 IISA's annual reports include the results against the following R&DTI measures:

- amount of registered R&D expenditure;
- number of registrations, and number of entities these represent;
- number of registrations for small to medium companies and number of companies represented by these registrations; and
- number of companies registered that were new to the Program.

4.9 Industry's and the ATO's measures for 2020–21 are set out in Table 4.1.

Table 4.1: 2020–21 performance measures for the R&DTI

Entity	Entity program	Performance criteria	Target
Industry	Outcome 1 — Enabling growth and productivity for globally competitive industries through supporting science and commercialisation, growing business investment and improving business capability and streamlining regulation.		
	1.2 — Growing innovative and competitive businesses, industries and regions.	R&D expenditure registered by entities with the department in order to claim the R&DTI through their annual tax returns.	N/A ^a
ATO	Outcome 1 — Confidence in the administration of aspects of Australia's taxation and superannuation systems through helping people understand their rights and obligations, improving ease of compliance and access to benefits, and managing non-compliance with the law.		
	1.10 — Research and Development Tax Incentive.	Value of claims processed for companies claiming the: <ul style="list-style-type: none"> • non-refundable R&D tax offset — 38.5% of notional R&D deductions (non-refundable R&D tax offset); and • refundable R&D tax offset — 43.5% of notional R&D deductions (refundable R&D tax offset). 	N/A ^a
		Number of claims processed for companies claiming the: <ul style="list-style-type: none"> • non-refundable R&D tax offset; and • refundable R&D tax offset. 	
		Proportion of offsets processed within service standard timeframes.	

Note a: Industry and the ATO have not set targets for their measures. Industry's PBS states that the R&DTI is a demand-driven program, therefore the department does not have forward estimates. The ATO's PBS states that the ATO aims to administer the Program in accordance with the law.

Source: ANAO, based on Industry and ATO PBS and annual reports.

4.10 The measures set out in Table 4.1 have been in place since 2017–18. However, Industry had two additional measures for the number of entities registering for the R&DTI, and the timeliness of

processing registration applications up until 2020–21. The measures were removed under a new outcome and program structure in response to an Industry Executive Board's request in November 2019 to 'significantly reduce the number of performance measures we report on while increasing their quality'.

4.11 Industry released its Corporate Plan 2021–22 in August 2021. Industry replaced its 2020–21 R&DTI external performance measure with the following efficiency measures of the timeliness of its processing of registration applications:

- 40 business days for first time registrants;
- 20 business days for registrants that have applied within six months after the end of the income period; or
- 80 business days for registrations submitted from six to 10 months after the end of the income period.

4.12 Industry has set a target of 95 per cent of companies processed within the allotted timeframes. Industry previously reported against this measure in its 2019–20 Annual Report.

Adequacy of external performance measures

4.13 The ANAO assessed the adequacy of Industry's and the ATO's performance measures for the Program against the requirements of the Commonwealth Performance Framework and accompanying guidance. The ANAO did not assess the appropriateness of Industry's or the ATO's entity-wide suite of performance measures, but only reviewed the adequacy of the measures directly relating to the Program.

4.14 PGPA Rule 16EA requires an entity's performance measures, in the context of the entity's purposes or key activities, to:

- (a) relate directly to one or more of those purposes or key activities;
- (b) use sources of information and methodologies that are reliable and verifiable;
- (c) provide an unbiased basis for the measurement and assessment of the entity's performance;
- (d) where reasonably practicable, comprise a mix of qualitative and quantitative measures;
- (e) include measures of the entity's outputs, efficiency and effectiveness if those things are appropriate measures of the entity's performance; and
- (f) provide a basis for an assessment of the entity's performance over time.⁷⁶

4.15 Under subsection 16E(2) item 5 of the PGPA Rule, an entity's corporate plan should specify targets for each of those performance measures for which it is reasonably practicable to set a target.

4.16 As set out in Table 4.2 below, the ANAO assessed whether Industry's and the ATO's performance measures were related and measurable, using the criteria derived from 16EA and subsection 16E(2) item 5 of the PGPA Rule.

⁷⁶ The ANAO did not consider the requirements of Rule 16EA(d) or 16EA(e) as the audit is only concerned with the R&DTI program-level activity measures, not Industry's or the ATO's whole Outcome or the entire suite of measures.

Table 4.2: Assessment of external R&DTI performance measures

Entity	Performance measure	Related ^a	Measurable ^b
Industry	R&D expenditure registered by entities with the department in order to claim the R&DTI through their annual tax returns.	▲	▲
ATO	Value of claims processed for companies claiming the: <ul style="list-style-type: none"> non-refundable R&D tax offset — 38.5% of notional R&D deductions (non-refundable R&D tax offset); and refundable R&D tax offset — 43.5% of notional R&D deductions (refundable R&D tax offset). 	▲	◆
	Number of claims processed for companies claiming the: <ul style="list-style-type: none"> non-refundable R&D tax offset; and refundable R&D tax offset. 	◆	◆
	Proportion of offsets processed within service standard timeframes.	▲	◆

Legend: ◆ Fully and/or mostly meets the requirements of section 16EA of the PGPA Rule.

▲ Partially meets the requirements of section 16EA of the PGPA Rule.

Note a: Related refers to the requirement of subsection 16EA(a) of the PGPA Rule 2014, as amended. In applying the related criterion, the ANAO assessed whether the entity's performance measures relate directly to one or more of the entity's purposes or key activities.

Note b: In applying the 'measurable' criterion, the ANAO assessed whether the entity's performance measures were:

- reliable and verifiable — use sources of information and methodologies that are reliable and verifiable; and
- free from bias — provide an unbiased basis for the measurement and assessment of the entity's performance.

Source: ANAO based on Resource Management Guide No. 131.

4.17 Industry's R&DTI 2020–21 measure is partly adequate and the ATO's R&DTI 2020–21 measures are largely adequate. The measures are related to Industry's and the ATO's purposes, but they do not assess the achievement of the Program objective. Industry's measure does not provide insight into its performance in administering the Program or the R&DTI policy impact.

4.18 Industry's and the ATO's supporting data sources and methodologies are reliable, verifiable and free from bias, although the ATO's methodology documentation was not complete (see paragraph 4.33) and the measures lack targets. While the measures report output results, they do not give insight into performance — adding a target, complementary measure, comparative figure or trend data would provide context and meaning. In particular, the absence of a target for the ATO's measure, 'proportion of offsets processed within service standard timeframes', and the lack of explanation of which of the ATO's service standard timeframes apply to the R&DTI, limits the transparency of the ATO's performance reporting. Neither agency demonstrated that it was not practicable to include a target for the performance measures. Targets were included in Industry's prior-year annual reports for 2011–12, 2012–13 and from 2015–16 through to 2018–19.

4.19 Noting that Industry replaced its 2020–21 external performance measure for 2021–22, the ANAO suggests the ATO consider including targets in its external performance measures.

Internal performance metrics

Industry

4.20 In November 2020, Industry implemented a Performance Metrics Framework (PMF) to provide a ‘comprehensive, accessible and timely view of R&DTI administration activities’. The PMF includes 31 metrics with sub-metrics, grouped across three reporting domains of effectiveness, efficiency and enablers. The PMF metrics within the effectiveness domain do not assess how well the Program is meeting its legislated objectives, but are intended to answer the performance questions in Box 7 relating to effectiveness.

Box 7: Performance Metrics Framework — effectiveness performance questions

In assessing effectiveness, Industry identified metrics to answer these performance questions.

- Are businesses aware of the Program and its eligibility requirements?
- Does the Program adequately engage target businesses?
- Are we increasing the proportion of compliant businesses and are non-compliant businesses identified and appropriately managed?
- Are businesses satisfied with the services delivered by the Program?

4.21 Industry developed the PMF between 2019 and 2021 to replace previous iterations that had been developed in 2015 and 2017. In March and April 2021, Industry further developed the PMF to support further updates to reporting of results data in an interactive, online dashboard display. Industry’s management reporting is discussed from paragraph 4.42.

ATO

4.22 The ATO has not established R&DTI internal performance metrics. Reporting on compliance activities across the ATO included, but did not separately identify, R&DTI results. The ATO had an entity-wide quality framework, although reporting was also aggregated and results were not separated for the R&DTI.

4.23 The 2018–19 Research and Development Tax Incentive Strategy Report (discussed at paragraph 3.25) identified strategy success indicators, and collated results on a number of metrics on R&DTI performance, for example:

- offsets processed and paid by market segment;
- rates of assurance for R&DTI claims indicated by various compliance activities’ outcomes;
- R&DTI compliance data, including compliance case numbers, numbers and types of R&D audits and reviews by business line; and
- numbers of objections, disputes, complaints and ministerials.

4.24 In July 2021, the ATO developed R&DTI strategies for: communications; compliance; data, intelligence and reporting; debt; disputes; intermediaries; and law advocacy and reform. The strategies document a range of goals, deliverables and activities and links these to performance criteria and potential performance indicators. The communications, debt, disputes and intermediaries strategies include some supporting metrics. The potential performance indicators presented in the remaining strategies will require further definition to support monitoring and reporting. The strategies indicate that the ATO intends to report on an annual or biannual basis on

the deliverables and effectiveness of the strategies to joint ATO–Industry governance groups. The ATO’s internal reporting is discussed from paragraph 4.45.

Joint

4.25 Industry and the ATO had joint performance metrics for management reporting on the:

- Memorandum of Understanding (MoU) between Industry and the ATO; and
- supporting joint strategies.

4.26 The MoU sets out metrics relating to meeting the response times for data and information requests between Industry and the ATO. For example, Industry is to provide registration applications for individual companies within five days of request.

4.27 Between 1 July 2017 and 30 June 2021, Industry and the ATO developed the following joint strategies for the Program:

- Joint R&DTI Overarching Strategy Statement (June 2016);
- R&DTI Joint Communication & Marketing Strategy 2017–18⁷⁷;
- High Risk R&D Consultants Strategy (November 2018); and
- R&DTI Joint Risk and Compliance Strategy (May 2016).

4.28 Three of these strategies included measures to assess performance: the Joint R&D Tax Incentive Overarching Strategy Statement; the R&DTI Joint Communications & Marketing Strategy 2017–18; and the High Risk R&D Consultants Strategy.

4.29 The revised July 2021 Joint R&DTI Overarching Strategy (see paragraph 2.13) sets out Industry’s and the ATO’s strategic goals for the R&DTI and introduces the other supporting joint strategies. The document outlines evaluation methods and tools for its supporting strategies, and will require performance metrics to be developed to enable monitoring. Joint reporting is discussed from paragraph 4.47.

Did IISA, Industry and the ATO effectively monitor, evaluate and report on program outcomes?

IISA and Industry had largely effective Program monitoring, reporting and evaluation. Industry presented reports to its R&DTI governance committees, although reports to IISA from October 2019 have not provided sufficient information to support effective oversight. The ATO had largely effective Program monitoring and reporting. While the ATO did not produce separate internal reporting on the R&DTI at the program level, it included R&DTI results in its aggregated reporting across programs, consistent with its enterprise-wide approach. Industry and the ATO had identified joint internal R&DTI metrics but work remained to refine these and fully implement joint monitoring arrangements.

77 An R&DTI Joint Communications Strategy 2018–19 was also developed but, as discussed previously, was not approved by both agencies.

Defining and collecting data and information for performance monitoring

4.30 Department of Finance guidance outlines that entities should have sufficient documentation of ‘the types of performance measures used, of data sources, collection methods, procedures, and clear management trails of data calculations’.⁷⁸

4.31 Industry and the ATO documented supporting methodology details for their 2020–21 R&DTI performance measures, including definitions of terms and time periods used in the measures and relevant data sources.

4.32 Industry’s and the ATO’s documented performance measure methodologies identified the source IT systems used to collect and store data from applications and income tax returns used in measurement. The agencies’ methodology documentation included links to templates for reporting (which referenced specific fields of data).

4.33 Documentation for the ATO’s measure, ‘the proportion of offsets processed within service standard timeframes’, did not set out which of the ATO’s service standards applied to the R&DTI and did not reflect the ATO’s advice to the ANAO during the audit that reporting against processing timeliness for R&DTI claims excludes time spent on HRR reviews.

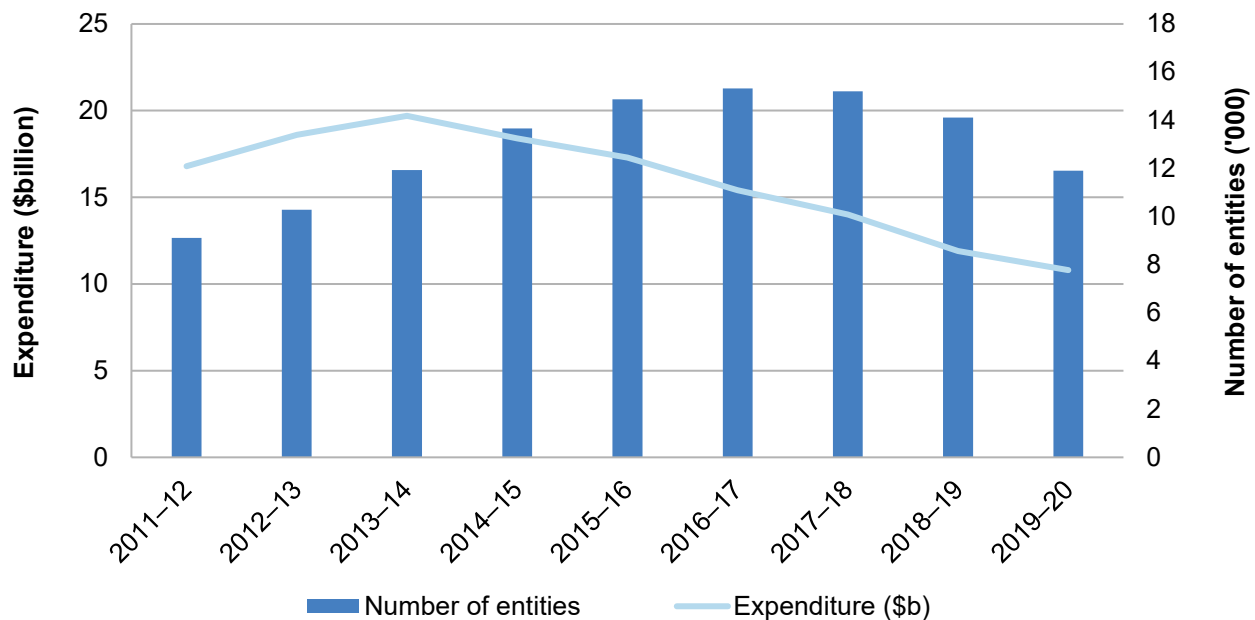
4.34 Industry and the ATO informed the ANAO that they obtained Senior Executive endorsement of reported analysis and results.

Public R&DTI performance reporting

4.35 IISA and Industry reported the value of R&D expenditure registered and number of registered R&D entities in annual reports. IISA’s annual reports also reported on new registrants and proportions of registrants that were small to medium enterprises. Figure 4.2 sets out results from 2011–12, when the R&DTI replaced the R&D Tax Concession (the predecessor program to the R&DTI), to 2019–20.

78 Department of Finance, *Developing good performance information*, p. 5.

Figure 4.2: Total registered value of R&D expenditure and number of entities, 2011–12 to 2019–20



Note: Data reported to 30 June each financial year is incomplete as companies may continue to register up until 30 September for the year.

Source: ANAO based on Industry annual reports.

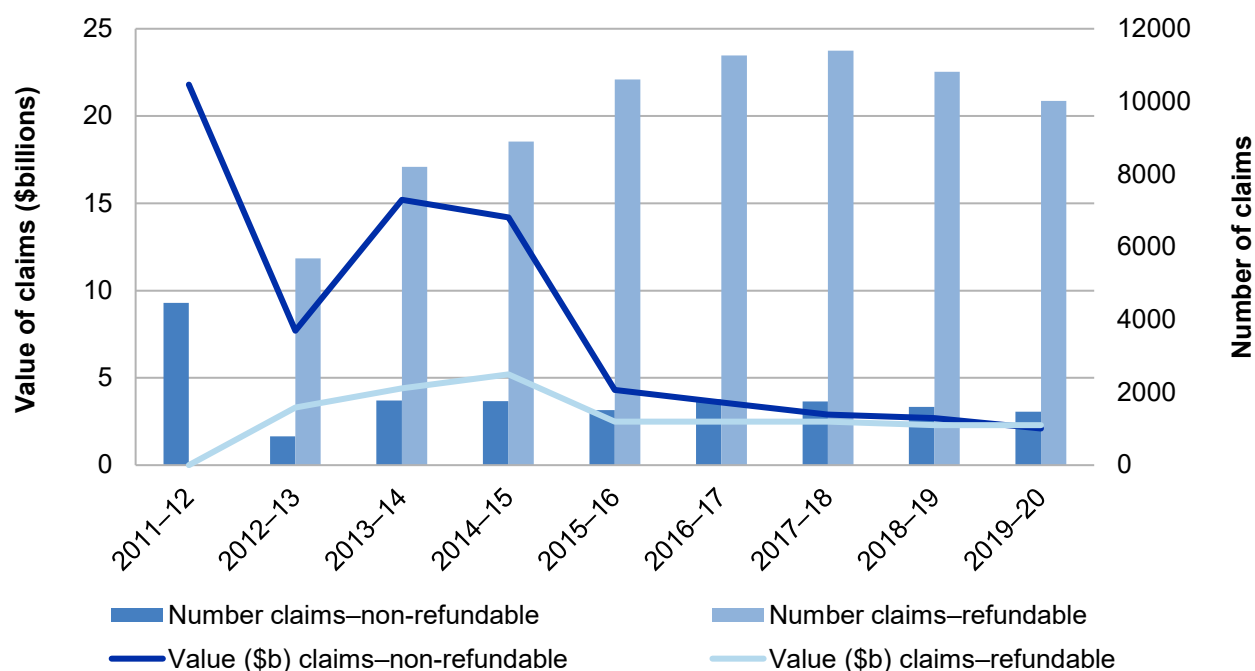
4.36 Figure 4.2 shows a decline in registered R&D expenditure over the period 2013–14 to 2019–20. IISA reported:

The downward trend in registered R&D expenditure (when compared year-on-year) is particularly notable for the mining, construction and manufacturing sectors. This corresponds broadly to the structural transformation of the Australian economy towards the services sectors since the Global Financial Crisis (GFC).⁷⁹

4.37 Between 2011–12 and 2016–17, Industry reported in its annual reports that the R&D expenditure presented in Figure 4.2 included the R&DTI and the R&D Tax Concession, despite the R&DTI replacing the R&D Tax Concession in 2011–12. There was an increase in the number of small to medium entities using the R&DTI which partly explains the increase in entities, but reduction in expenditure. Finally, policy changes may also have contributed to reducing the R&D expenditure covered by the Program, for example, the introduction of the \$100 million threshold from 1 July 2014 and reduction in the applicable R&D tax offset rates.

4.38 The ATO's annual reporting against its performance measures is set out in Figure 4.3 and Figure 4.4.

⁷⁹ IISA, *Annual Report 2017–18*, p. 27.

Figure 4.3: Total value and number of R&D tax offset claims, 2011–12 to 2019–20

Source: ANAO based on ATO annual report data.

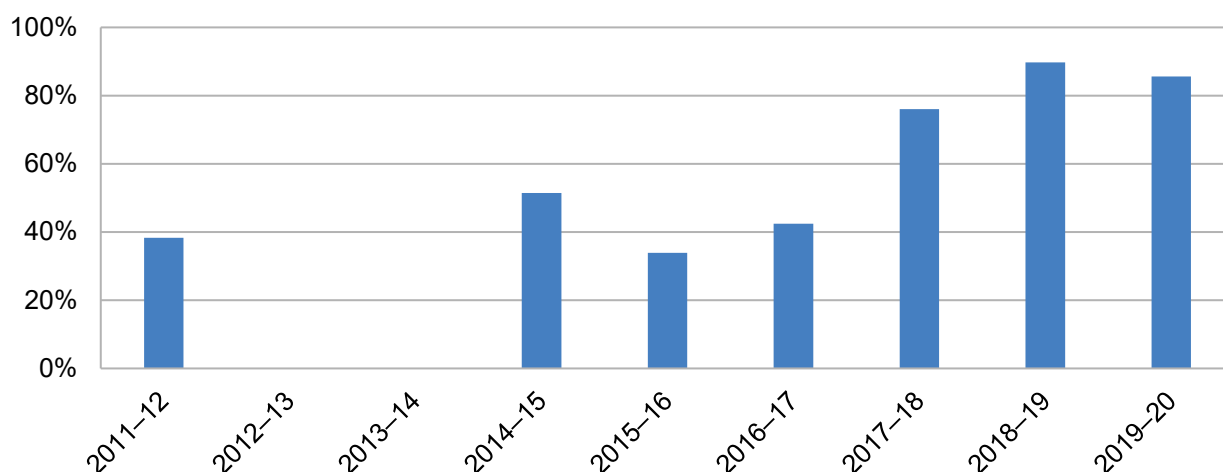
4.39 The value of claims processed by the ATO for the R&DTI has declined, consistent with the reduction since 2011 of total R&D expenditure registered with Industry. Other changes reflected in Figure 4.3 are due to changes in ATO’s performance measure methodology.

- In 2011–12, the ATO reported value and number of claims included both the R&D Tax Concession and the R&DTI. This accounted for a significant change in the value of claims from 2011–12 to 2012–13. From 2012–13 the ATO reported on the R&DTI separately.
- The ATO’s 2015–16 and subsequent year results are not directly comparable with earlier year results. The ATO reported that:

The methodology for reporting the research and development tax incentive from 2015–16 has changed to express the measure as research and development tax offsets claimed and used, rather than research and development expenditure claimed.⁸⁰

80 ATO, *Annual Report 2015–16*, p. 73.

Figure 4.4: ATO reporting against the R&DTI service standard ‘proportion of offsets processed within service standard timeframe’, 2011–12 to 2019–20



Note: The ATO did not report against this measure in 2012–13 or 2013–14.

Source: ANAO based on ATO annual report data.

4.40 Figure 4.4 shows the ATO’s results against its performance measure, ‘proportion of offsets processed within service standard timeframe’ were over 75 per cent from 2017–18 onwards. Prior year results showed that less than 50 per cent of offsets were completed within the service standard timeframe.

4.41 The ATO reported in annual reports that the results against this measure in these years were due to the high-risk refund (HRR) compliance process (discussed paragraphs 2.76 to 2.81) taking precedence, to validate income tax returns. However, the ATO advised that it does not count the number of days where tax returns are stopped for validation through the HRR process. As the ATO’s documentation supporting the calculation of this measure was not clear (discussed at paragraph 4.33), it was not possible to assess the extent to which reported results from 2016–17 onwards reflect improved ATO timeliness, or a change in the reporting methodology to exclude the lapsed time for validation through the HRR process.

Management information reporting

Industry

4.42 From July 2017, Industry produced regular internal reports for Program governance groups as set out in Table 4.3.

Table 4.3: Industry internal reporting on the R&DTI

Group	Report	ANAO comment
IISA	<p>Program report from R&DIC and papers presented on topic/exception basis.</p> <ul style="list-style-type: none"> Annual program update from R&DIC Chair and Industry. Annual meeting of all IISA committee chairs, including R&DIC Chair. 	<p>IISA meets four to five times per year and received the program report for the majority of its meetings from July 2017 to August 2019. The report provided updates on topical R&DIC and Program activities; Program data relating to the numbers and value of registrations; and progress of compliance activity commenced and completed against the yearly target.</p> <p>Since October 2019, R&DTI presentations and papers to IISA have been provided on a topic or exception-basis. The report for each meeting includes a short exception-based update on the R&DTI. In advance of IISA meetings, the Program area within Industry is asked to provide a short briefing document to support the Board reporting process.</p> <p>In addition, IISA received an annual Program presentation from the R&DIC Chair and held a separate annual meeting with program chairs, including the R&DIC Chair.</p>
R&DIC	Joint Program Performance Report; program compliance report; litigation report; and topical updates and discussions on operational matters.	R&DIC received reports at 24 of 26 meetings between 1 July 2017 and 30 June 2021. The reports provided information on: Industry registration and ATO offset claim trends; numbers, status and age of integrity and compliance activities underway; and management strategies for specific R&DTI matters subject to Administrative Appeals Tribunal or court proceedings.
OPG ^a	Registrations and Expenditure Report; National Level Integrity Management Plan Report; litigation report; topical papers and updates; and PMF dashboard results.	<p>OPG, chaired by the Industry General Manager for the R&DTI branch, received reports at 19 of 20 meetings that supported its focus on R&DTI service delivery and compliance.</p> <p>The PMF interactive dashboard is available for OPG to supplement current reporting, but is not yet widely used and data has not been updated as intended.</p>

Note a: The R&DTI Operations and Performance Group (OPG) was formed in May 2019. Industry's prior executive group, the Program Assurance Committee, received a Program Performance Report setting out qualitative R&DTI risk and issue reporting against a range of risk categories for 13 meetings from July 2017 to November 2019, when the Program Assurance Committee stopped meeting.

Source: ANAO analysis of Industry documents.

4.43 Reporting to IISA from October 2019 has not provided the consistent coverage of the Program required to maintain oversight of R&DTI operations and effectiveness — it is reliant on the Office of Industry Innovation and Science Australia⁸¹ and R&DIC to identify matters for reporting. Reports to R&DIC were regular and provided information to support oversight of the Program. Existing reports to OPG also supported its focus on R&DTI service delivery and compliance.

4.44 Industry had intended for the PMF dashboard to support more streamlined reporting to OPG, with various data located in one repository. The dashboard, while operational, is not yet widely used. As at June 2021, Industry had not updated the results presented monthly from April 2021 and intended users had limited experience and training in using the dashboard.

81 In accordance with the IRD Act, the Secretary of Industry makes departmental staff available to IISA to assist in performing its functions. These staff are within the Office of Industry Innovation and Science Australia.

ATO

4.45 Consistent with the ATO's enterprise-wide approach of reporting program results at an aggregated level, it had not established internal R&DTI performance metrics and it did not produce internal reporting on the Program. Across the ATO, various business areas carry out compliance activities on tax returns that include R&DTI claims. The ATO's internal reports from these business areas included, but did not separately identify, results of compliance activities on R&DTI claims.

4.46 The only ongoing reporting on the R&DTI was against the May 2018 Budget measure for compliance funding (see Box 6). The ATO's Private Wealth business area report for the ATO's Client Engagement Group executive included reporting on the Budget measure, supplemented by qualitative commentary on the Program during the relevant period.

Joint reporting

4.47 Industry and the ATO contribute elements of their respective Program metrics to a Joint Program Performance Report for R&DIC. The report includes Industry's and the ATO's external R&DTI performance measures and provides trends in registrations and value, comparisons of registration volumes against claim volumes, and comparisons of the value of registered expenditure against the value of offsets. The report includes various breakdowns by, for example, company size, year, sector and state/territory. While the report provides indicative trends, the output measures provide limited insight into the effectiveness of the Program and its administration.

4.48 The Joint Management Group (JMG, see paragraph 1.13) was responsible for monitoring progress against Industry and the ATO's joint strategies. JMG discussed the joint strategies throughout 2017, but there was limited evidence to demonstrate it having reviewed the strategies from 2018 to 2021. However as noted previously (paragraph 4.27), there were no joint strategies for much of this period.

4.49 The JMG was responsible for reporting to the Joint Administrative Governance Group (JAGG, see paragraph 1.13) on performance on a quarterly basis. The JAGG was responsible for reviewing the strategies annually. Between July 2017 and June 2021, joint reports were provided to three JAGG meetings, and there were four JAGG meetings with records of discussion of the development and establishment of the joint strategies.

4.50 As at November 2021, Industry and the ATO were reviewing the R&DTI performance metrics with the aim of improving performance information. The agencies had prepared a draft plan to evaluate the effectiveness of the new Joint R&DTI Overarching Strategy, and its supporting strategies, annually. The first evaluation report is expected to be approved by JAGG in October 2022 and presented to the Joint Oversight Group in December 2022.

Program evaluation

4.51 Evaluation supports accountability for program performance as well as continuous improvement.⁸² The Department of Finance describes evaluations as:

82 Auditor-General, *Performance Measurement and Monitoring – Developing Performance Measures and Tracking Progress, Audit Insights* [Internet], available from <https://www.anao.gov.au/work/audit-insights/performance-measurement-and-monitoring-developing-performance-measures-and-tracking-progress> [accessed 20 August 2021].

systematic assessments of the design, implementation and outcomes of an activity. Evaluations typically examine the significant elements that affect performance, and can generate both quantitative and qualitative information about the performance of an activity.⁸³

4.52 Industry had evaluation strategies in place for the Program from 1 July 2017 to 30 June 2021, including plans to conduct an:

- R&DTI delivery evaluation in 2018–19; and
- R&DTI impact assessment⁸⁴ in 2020–21.

4.53 Industry intends for the Program to be evaluated every four to five years. Industry did not evaluate the Program in 2018–19 as planned, as a major evaluation completed in 2016 prompted the Australian Government to announce changes to Program legislation that were not enacted until October 2020. The impact assessment planned for 2020–21 was underway during the audit and Industry advised that it expects it to be completed by January 2022.

4.54 Table 4.4 sets out the major evaluations (internal and external) of the Program since 2016, and is expanded on in Appendix 6.

Table 4.4: Evaluations of the Program

Report date	Evaluation title	Internal/external	Focus of review	R&DTI ^a
Feb 2016	<i>The Additionality of R&D Tax Policy in Australia</i>	Internal	Quantitative analysis of the R&DTI's impact on additionality.	●
Mar 2016	<i>R&D Tax Incentive Programme Review</i>	Internal	Qualitative analysis of the R&DTI's administrative delivery and quantitative analysis of its impact on additionality.	●
Apr 2016	<i>Review of the R&D Tax Incentive</i>	External ^a	Assessment of the R&DTI's administrative delivery and quantitative impact on additionality.	●
Sep 2016	<i>Survey of Research Service Providers registered under the R&D Tax Incentive Programme</i>	Internal	Research into profiles of Research Service Providers and collaboration with industry through the R&DTI program.	●
Oct 2016	<i>R&D Tax Incentive. Stage 1: Discovery – User Research Report</i>	Internal	Qualitative research into Program delivery.	○

Legend: ● Reviewed Program objectives

● Partly reviewed objectives

○ Did not review objectives

Note a: The Australian Government commissioned the *Review of the R&D Tax Incentive*; by Mr Bill Ferris, Dr Alan Finkel and Mr John Fraser.

Source: ANAO analysis of evaluations.

83 Department of Finance, *Developing good performance information*, p. 33.

84 Industry defined impact assessments as large and more complex evaluations that measure medium-term and long-term outcomes.

4.55 In 2016, there were five evaluations of aspects of the Program, four of which were internal. Two of the internal evaluations involved quantitative analysis of the Program's impact on additionality, and one involved qualitative analysis of the Program's administrative effectiveness. The April 2016 evaluation was external and utilised the results of two internal evaluations.

4.56 The April 2016 *Review of the R&D Tax Incentive*⁸⁵ found that the R&DTI was not fully meeting its legislated objectives of inducing additional R&D and spillovers, and recommended improvements to the Program's administration. In May 2018, a change program (see Box 1) commenced to address the findings of the April 2016 evaluation.

4.57 As at July 2021, Industry was undertaking the 2021 R&DTI impact assessment that includes research to support assessment of the Program in meeting its objectives. The research reached interim reporting stage⁸⁶ in June 2021 and was due for completion in December 2021.

4.58 In addition to the reviews outlined above, Industry contributed to international Organisation for Economic Cooperation and Development research into the impact of R&D tax incentives in encouraging R&D and undertook evaluations of R&DTI operational trial projects, including, for example, a trial outsourcing of initial registration processing activity and a 2019 pilot project for outsourcing advance and overseas findings to a private contractor.



Grant Hehir
Auditor-General

Canberra ACT
25 November 2021

85 B Ferris AC, A Finkel AO and J Fraser, *Review of the R&D Tax Incentive*, 2016.

86 The interim report included a literature review and details of the methodology and modelling approach to be used. The next stage of the evaluation involves integration of R&DTI data into the broader Australian Bureau of Statistics' dataset for results and analysis to be prepared.

Appendices

Appendix 1 Entity responses



CHAIR

Mr Grant Hehir
Auditor General
Australian National Audit Office
38 Sydney Avenue
Forrest ACT 2603

Dear Mr Hehir

Thank you for your correspondence of 11 October 2021 seeking comment from the Industry, Innovation and Science Australia Board (IISA) on the proposed audit report for the performance audit of the Administration of the Research and Development Tax Incentive.

As the ANAO notes, the R&D Tax Incentive is the Australian Government's key tool for encouraging additional investment in R&D innovation that benefits Australia. IISA welcomes the ANAO's finding that IISA, Industry and the ATO's administration of the R&D tax incentive was largely effective and we agree to the recommendations.

IISA, through the *Industry Research and Development Act 1986* (IR&D Act) has responsibility for six innovation programs, with the R&D Tax Incentive being one. IISA has delegated the administration of the R&D Tax Incentive to the R&D Investment Committee which is supported by the Department of Industry, Science, Energy and Resources. IISA oversees the work of R&DIC through regular engagement with and reporting by, the R&DIC Chair and the Department..

We continue to look for ways to further improve our R&D Tax Incentive oversight role, including through continued collaboration with the Department of Industry, Science, Energy and Resources.

I would like to thank the ANAO for their work in undertaking this audit. The audit complements the R&D Tax Incentive reform efforts and will be a valuable contribution to future work programs.

Attached is IISA's summary response and response to the relevant recommendations.

Yours sincerely

2 November 2021

Phone: 02 6213 7400 - Email: secretariat@iisa.gov.au - www.industry.gov.au/IISA
10 Binara Street, Canberra City, ACT 2601 - GPO Box 2013 Canberra ACT 2601 - ABN: 74 599 608 295



Australian Government
Department of Industry, Science,
Energy and Resources

OFFICE OF THE SECRETARY
DAVID FREDERICKS PSM

Mr Grant Hehir
 Auditor General
 Australian National Audit Office
 38 Sydney Avenue
 Forrest ACT 2603

Dear Mr Hehir

Thank you for your correspondence of 11 October 2021 seeking comment from the Department of Industry, Science, Energy and Resources on the proposed audit report for the performance audit of the Administration of the Research and Development Tax Incentive.

As the ANAO notes, the R&D Tax Incentive is the Australian Government's key tool for encouraging additional investment in R&D innovation that benefits Australia. The Department welcomes the ANAO's finding that IISA, Industry and the ATO's administration of the R&D tax incentive was largely effective, and we agree to the recommendations.

Since 2019, we have been implementing a wide-ranging program of reforms focused on improving the administration of this important program. The Department has invested significantly in early engagement with R&D entities to help companies better understand the program's eligibility requirements and get their applications right. We have improved consistency and transparency of our decision-making processes, and refined the way we measure and assess our performance to ensure we are as effective as we can be. We are proud of our progress in improving registration and compliance practices but acknowledge that we have more to do to.

We continue to look for ways to further improve our findings and examination processes, including through reduced assessment timeframes and providing greater clarity and certainty to our stakeholders about what to expect from the Department and participation in the program.

I would like to thank the ANAO for their work in undertaking this audit. The audit complements our reform efforts and will be a valuable contribution to future work programs.

Attached is the Department's summary response and response to the relevant recommendations.

Yours sincerely

5 November 2021



Australian Government
Australian Taxation Office

Second Commissioner of Taxation

Mr Grant Hehir
Auditor-General
Australian National Audit Office
GPO Box 707
CANBERRA ACT 2601

Dear Mr Hehir

**Re: ANAO s19 draft report for on Administration of the Research and Development
Tax Incentive – 11 October 2021**

Thank you for your letter dated 11 October 2021 and for the opportunity to provide comments on the s19 draft report for the Administration of the Research and Development Tax Incentive (R&DTI).

The Australian Taxation Office (ATO) agrees with the one recommendation as presented in the section 19 report.

Attached is the ATO response to the recommendation (Annexure 1) and a summary of our comments to be included in the report (Annexure 2).

I would like to thank the Australian National Audit Office team for their co-operative, understanding and professional approach throughout the audit.

If you require any further information or if we can be of continued assistance, please don't hesitate to contact Jade Hawkins, Assistant Commissioner, Private Wealth Technical Leadership and Advice on (02) 9374 2542.

Yours sincerely

Jeremy Hirschhorn
Second Commissioner

8 November 2021

T +61 (0)2 6216 1111 PO Box 900 Civic Square ACT 2608 Australia ato.gov.au

Appendix 2 Improvements observed by the ANAO

1. The existence of independent external audit, and the accompanying potential for scrutiny improves performance. Improvements in administrative and management practices usually occur: in anticipation of ANAO audit activity; during an audit engagement; as interim findings are made; and/or after the audit has been completed and formal findings are communicated.

2. The Joint Committee of Public Accounts and Audit has encouraged the ANAO to consider ways in which the ANAO could capture and describe some of these impacts. The ANAO's 2021–22 Corporate Plan states that the ANAO's annual performance statements will provide a narrative that will consider, amongst other matters, analysis of key improvements made by entities during a performance audit process based on information included in tabled performance audit reports.

3. Performance audits involve close engagement between the ANAO and the audited entity as well as other stakeholders involved in the program or activity being audited. Throughout the audit engagement, the ANAO outlines to the entity the preliminary audit findings, conclusions and potential audit recommendations. This ensures that final recommendations are appropriately targeted and encourages entities to take early remedial action on any identified matters during the course of an audit. Remedial actions entities may take during the audit include:

- strengthening governance arrangements;
- introducing or revising policies, strategies, guidelines or administrative processes; and
- initiating reviews or investigations.

4. In this context, the below actions were observed by the ANAO during the course of the audit. It is not clear whether these actions and/or the timing of these actions were planned in response to proposed or actual audit activity. The ANAO has not sought to obtain assurance over the source of these actions or whether they have been appropriately implemented.

- In July 2021, the ATO finalised the development of seven strategies for the R&DTI program around: communications; compliance; data, intelligence and reporting; debt; disputes; intermediaries; and law advocacy and reform (see paragraph 4.24).
- In July 2021, Industry and the ATO finalised the refresh of joint strategies for the Program including an overarching strategy supported by strategies for communications, compliance and data and intelligence sharing (see paragraph 4.29).
- As part of refreshing joint strategies for the Program, the agencies have also refreshed the joint governance frameworks and recommenced meetings through the joint governance bodies.
- ATO advised that it intends to update its procedures for the High Risk Refund process (paragraph 2.79).
- Industry replaced its external performance measure in its 2021–22 Corporate Plan (paragraph 4.11).

Appendix 3 Industry Innovation and Science Australia and Research and Development Incentives Committee membership — July 2021

Industry Innovation and Science Australia Board membership	Research and Development Incentives Committee membership
<p>IISA's website states that Board members are high-profile entrepreneurs, investors, researchers and educators with extensive local and global experience. The members include:</p> <ul style="list-style-type: none"> • Mr Andrew Stevens (Chair, New South Wales); • Dr Catherine Foley (Deputy Chair, New South Wales); • Professor Elanor Huntington (Australian Capital Territory); • Professor Raoul Mortley (Queensland); • Ms Lauren Stafford (Western Australia); • Mr Patrick Houlihan (Victoria); • Mr Scott Farrell (New South Wales); • Ms Sarah Nolet (New South Wales); • Dr Alexander Grant (South Australia); • Ms Glenys Beauchamp PSM (Australian Capital Territory); and • Mr David Fredericks PSM (ex-officio, Australian Capital Territory). 	<ul style="list-style-type: none"> • Ms Julie Phillips (Chair, New South Wales). • Mr Lachlan James (Australian Capital Territory). • Dr Michelle Perugini (South Australia). • Ms Julia Sloman (Queensland). • Mr Mark Stevens (Western Australia). • Ms Joanna Mulder (Department of Industry, Science, Energy and Resources, Australian Capital Territory).

Source: Industry Innovation and Science Australia website, available from <https://www.industry.gov.au/policies-and-initiatives/industry-innovation-and-science-australia/industry-innovation-and-science-australia-board-members>; and <https://www.industry.gov.au/sites/default/files/2018-10/rdic-membership-and-terms.pdf> [accessed 22 July 2021].

Appendix 4 Eligibility criteria of the Research and Development Tax Incentive

The following table outlines the eligibility criteria for the Research and Development Tax Incentive, as defined in Division 355 of the *Income Tax Assessment Act 1997* (ITA Act).

Criteria	Explanation
R&D entities	<p>Only an R&D entity may claim the R&DTI. Defined under section 355–35 of the ITA Act, an R&D entity (i.e. eligible entity) is:</p> <ul style="list-style-type: none"> • incorporated under an Australian law; • incorporated under a foreign law, but is an Australian resident for income tax purposes; or • incorporated under a foreign law, but meets certain conditions outlined in a double tax agreement.
R&D activities	<p>Eligible R&D activities are either core R&D activities or supporting R&D activities. These terms are defined under section 355–25 of the ITA Act. Core R&D activities are experimental activities:</p> <ul style="list-style-type: none"> • whose outcome cannot be known or determined in advance on the basis of current knowledge, information or experience, but can only be determined by applying a systematic progression of work that: <ul style="list-style-type: none"> – is based on principles of established science; and – proceeds from hypothesis to experiment, observation and evaluation, and leads to logical conclusions; and • that are conducted for the purpose of generating new knowledge (including knowledge in the form of new or improved materials, products, devices, processes or services).
R&D expenditure	<p>Division 355–C of the ITA Act defines the expenditure that can be claimed as part of the R&DTI. Eligible expenditure includes:</p> <ul style="list-style-type: none"> • expenditure incurred on eligible R&D activities; • the decline in the value of assets used for conducting R&D activities; • balancing adjustments for assets used only for conducting R&D activities; • expenditure in relation to goods and materials transformed or processed during R&D activities to produce marketable products (feedstock expenditure); and • monetary contributions under the Cooperative Research Centres program.

Source: Division 355 of the *Income Tax Assessment Act 1997*.

Appendix 5 Criteria for assessing ATO's high risk refund process

Testing criterion	Explanation
Did the ATO inform taxpayers in accordance with the TAA and the PSLA 2012/6?	<p>The Commissioner must inform the entity that he has retained the refund amount under subsection 8AAZLGA (3) within 30 days.</p> <p>If the Commissioner fails to inform the entity in accordance with the <i>Taxation Administration Act 1953</i> (TAA) requirements, the Commissioner must release the tax return.</p> <p>Practice Statement Law Administration 2012/6 (PSLA 2012/6) sets out guidance for ATO officers in exercising the Commissioner of Taxation's discretion to retain a refund.</p>
Did ATO document their consideration of the 10 factors outlined in the TAA in making the decision to withhold the refund?	Subsection 8AAZLGA (2) of the TAA outlines 10 factors that the Commissioner must have regard to in making a decision to withhold an entity's refund.
Were decisions to withhold the refunds in accordance with ATO delegations?	<p>The ATO did not have a defined delegations framework.</p> <p>From 2020, the Triage Panel (discussed at paragraph 2.80) was the decision-making body.</p> <p>The Deputy Commissioner is the decision maker in terms of whether to escalate a HRR to a case (review or audit).</p>
Were HRRs processed within required timeframes?	<p>The Commissioner may withhold the refund until either:</p> <ul style="list-style-type: none"> • it is no longer reasonable to require verification; or • there is a change in the amount that the Commissioner is required to refund under an assessment.

Source: Section 8AAZLGA of the TAA and ATO guidance

Appendix 6 Evaluations of the R&DTI program

The following table sets out the methodology and recommendations of significant R&DTI program evaluations that have occurred since 2015–16.

Date	Prepared for (by)	Evaluation methodology & recommendations
Feb 2016	Industry (contracted providers)	<p><i>The Additionality of R&D Tax Policy in Australia</i></p> <ul style="list-style-type: none"> Methodology — quantitative (econometric) analysis of additionality under the Program. Recommendations — change policy and legislative base for the R&DTI to encourage greater additionality and spillovers from relevant R&D activity; and improve Program administration.
Mar 2016	Industry (contracted provider)	<p><i>R&D Tax Incentive Programme Review</i></p> <ul style="list-style-type: none"> Methodology — stakeholder consultations; literature review; survey of R&DTI recipients; and statistical analysis and economic modelling. Recommendations — lower compliance costs through administrative change; seek to increase additionality rate through policy change; and enhance the information base for future reviews.
Apr 2016	Australian Government (Mr Bill Ferris, Dr Alan Finkel, Mr John Fraser, with support from Industry officials)	<p><i>Review of the R&D Tax Incentive</i></p> <ul style="list-style-type: none"> Methodology — reviewed direct submissions; and analysis using the above reports prepared for Industry. Recommendations — retain current scope of eligible activities and improve guidance; introduce a collaboration premium for large companies; introduce a cap on annual refunds with the remainder treated as non-refundable offsets; introduce an intensity threshold for non-refundable element (in which case, increase the R&D expenditure threshold); and investigate options for improving administration of R&DTI and additional resourcing for improvements.
Sep 2016	Industry (contracted provider)	<p><i>Survey of Research Service Providers [RSPs] registered under the R&D Tax Incentive Programme</i></p> <ul style="list-style-type: none"> Methodology — online census of RSPs to obtain a profile of RSPs and RSP views on collaboration with industry and program satisfaction. Key findings — the majority of RSPs are satisfied with registration; and barriers to research collaboration with industry include financing, lack of industry awareness of R&D benefits or available services.
Oct 2016	Industry, Treasury and ATO (entity officials)	<p><i>R&D Tax Incentive. Stage 1: Discovery – User Research Report</i></p> <ul style="list-style-type: none"> Methodology — desktop process reviews and interviews, to build user profiles and maps, with existing and potential customers, specialist consultants, accountants and Industry and ATO staff. Recommendations — identified areas for immediate work to improve program delivery (e.g. education, application steps); and potential areas for future improvement.

Source: ANAO analysis of entity documentation.