The R&D Tax Incentive

A Guide to Interpretation

POWERING INNOVATION THROUGH SUSTAINABLE R&D INVESTMENT

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### About this Publication

The **R&D Tax Incentive** is a self-assessment programme designed to encourage industry to conduct research and development. The programme provides a tax incentive for industry to conduct experimental activities, in a scientific way, for the purpose of generating new knowledge.

The programme is governed by legislation which includes a definition of what ‘R&D activities’ are for the purposes of registering with the programme. This means that companies, who wish to apply for an incentive, must assess whether their work meets the programme’s definition of ‘R&D activities’.

AusIndustry (on behalf of Innovation Australia) and the Australian Taxation Office (ATO) share responsibility for the administration of the **R&D Tax Incentive**.

This publication has been developed by AusIndustry and it sets out how AusIndustry interprets the key elements of the definition of ‘R&D activities’. It is designed to assist companies of all sizes, across all sectors, to understand and assess whether their work is eligible for the **R&D Tax Incentive**.

We hope that you find this publication useful. If you are an ongoing programme participant, we hope that you use the guide regularly as part of your self-assessment process.

New participants to the programme may wish to read our **Customer Information Guide** before reading this guide. The **Customer Information Guide** provides a broad range of information on the **R&D Tax Incentive** and will help companies to:

- learn more about the programme;
- understand how to register for the programme;
- understand the requirements and obligations of the programme.

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1 Section 355–20 of the *Income Tax Assessment Act 1997*

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### What this guide is not

While the guide is intended to provide useful information for companies self-assessing their activities, it cannot cover every situation and is limited to general advice only.

It is your responsibility, with the assistance of any advice you wish to seek, to satisfy yourself about the eligibility of your activities for the **R&D Tax Incentive**.

Any examples provided are for guidance only and are not finally determinative of whether a particular activity will or will not be eligible for the **R&D Tax Incentive**.

The Commonwealth disclaims all liability for any loss or damage arising from you or anyone else relying on this guide or any statement contained in it.

If you find that you are unsure about the eligibility of your activities, you can request AusIndustry to make an ‘Advance Finding’ on whether your activities are eligible.

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### For further information

Self-Assessment

Under the *R&D Tax Incentive*, you must assess for yourself whether you are eligible to register R&D activities and claim the Incentive in any given year.

In order to claim a tax incentive under the programme, you will need to ask yourself the following self-assessment questions.

<table>
<thead>
<tr>
<th>SELF-ASSESSMENT PROCESS</th>
</tr>
</thead>
<tbody>
<tr>
<td>1 Is your company an ‘R&amp;D entity’? ✓</td>
</tr>
<tr>
<td>2 Have you undertaken eligible ‘R&amp;D activities’? ✓</td>
</tr>
<tr>
<td>3 Can you identify expenditure incurred or assets used in the activities? ✓</td>
</tr>
<tr>
<td>4 Have you kept records which describe: • what you did, • the expenditure you claimed, • the assets you used, and the connection between the expenditure incurred, the assets used and the activities conducted? ✓</td>
</tr>
</tbody>
</table>

The focus of this guide is on step 2 of the self-assessment process. It will help you understand whether you have undertaken eligible R&D activities. If you have undertaken eligible R&D activities, it will help you identify the scope of those activities.

For step 1, the relevant part of the legislation\(^2\) defines an R&D entity, and the ATO also provides guidance.

To identify eligible expenditure, you will need to refer to guidance provided by the ATO or refer directly to the legislation\(^3\). The ATO has a wealth of information on its website which can be found at ato.gov.au.

This will assist you in identifying eligible expenditure and where appropriate, lodging an *R&D Tax Incentive* claim. This includes the R&D schedule and income tax return.

Record-keeping is an essential part of managing your R&D tax claims. While not the primary focus of this guide, we do provide some useful record-keeping advice where appropriate.

Further record-keeping tips and guidance can be found on the business.gov.au and ATO websites.

Here are some key messages:

- You must self-assess whether you have conducted eligible R&D activities
- This guide will help you decide whether you have conducted eligible R&D activities for the purposes of the *R&D Tax Incentive*
- Keep records which show the specific ways in which your R&D activities were carried out

**Eligible R&D Activities**

For the *R&D Tax Incentive*, eligible R&D activities\(^4\) are either core R&D activities\(^5\) or supporting R&D activities\(^6\). In order to register eligible activities, you must have undertaken, or be intending to undertake, at least one core R&D activity. Certain activities are excluded from being core R&D activities. You may be able to register other supporting R&D activities if they meet certain tests.

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2 Section 355–35 of the *Income Tax Assessment Act 1997*
3 Division 355 of the *Income Tax Assessment Act 1997*
4 Section 355–20 of the *Income Tax Assessment Act 1997*
5 Section 355–25 of the *Income Tax Assessment Act 1997*
6 Section 355–30 of the *Income Tax Assessment Act 1997*
The R&D Tax Incentive

ELIGIBLE R&D ACTIVITIES

1. Have you undertaken, or intend to undertake, at least one core R&D activity? ✓

2. Have you checked that the activity is not excluded from being a core R&D activity? ✓

3. Have you undertaken supporting R&D activities? ✓

The next section of the guide will help you to understand whether you have undertaken core R&D activities. Further sections of the guide will assist you in relation to answering points 2 and 3.
Core R&D Activities

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CORE R&D ACTIVITIES

To effectively self-assess the eligibility of your work, you must first understand the basic meaning of certain terms within the definition of core R&D activities.

For the purposes of assessing whether your work meets this definition, it is important that you understand the terms highlighted below. The following extract is taken directly from the legislation.

Core R&D activities are experimental activities:

a. 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:
   i. is based on principles of established science; and
   ii. proceeds from hypothesis to experiment, observation and evaluation, and leads to logical conclusions; and

b. that are conducted for the purpose of generating new knowledge (including new knowledge in the form of new or improved materials, products, devices, processes or services)

For the purpose of this guide, we have broken the definition of core R&D activities into three related requirements. Core R&D activities are experimental activities:

1. Whose outcome cannot be known or determined in advance; but can only be determined by applying a;
2. Systematic progression of work that proceeds from hypothesis to experiment, observation and evaluation, and leads to logical conclusions; and are
3. Conducted for the purpose of generating new knowledge.

These requirements are highlighted because we think they are the most important and useful to consider when assessing your work. It will make it easier for you to understand and to assess whether you are conducting core R&D activities.

It is important to understand that each of the requirements of the legislative definition must be met before you register a core R&D activity with the programme. In other words, the parts are cumulative. Each area of work you assess as being a core R&D activity needs to meet all of these requirements.

If a particular part of your work is not a core R&D activity, it may still qualify as a supporting R&D activity and be eligible under the programme. Supporting R&D activities are covered later in the guide.

KEY MESSAGES

- There are three key requirements for determining a core R&D activity
- Each of the legislative requirements must be met in order to register a core R&D activity under the programme
- If activities are not core R&D activities, they may still be eligible as supporting R&D activities which are described later in the guide

Figure 1 provides an illustration of how each of the three key requirements of the overall core R&D activity test work together. We start by discussing a systematic progression of work because we consider that identifying an experiment (or a set of related experiments) is the most useful place to commence the self-assessment process. It will make it easier for you to determine whether your work meets other requirements of the test.

There are linkages between certain requirements and we will discuss these in more detail as we move through the guide.

Certain activities are excluded from being core R&D activities and these are also discussed in more detail later in the guide.

However, excluded activities and non-experimental activities may be considered as supporting R&D activities in certain circumstances.
Systematic progression of work

Core R&D activities are experimental activities:

a. Whose outcome... can only be determined by applying a systematic progression of work that...

ii. proceeds from hypothesis to experiment, observation and evaluation, and leads to logical conclusions; and

For the purposes of this programme, a systematic progression of work involves four main parts:

• hypothesis
• experiment
• observation and evaluation
• logical conclusions

Figure 2 shows the four parts of a systematic progression of work.

Each of these four parts is an essential component of a process you design to generate new knowledge.

If any of these parts are missing or not aligned with the other parts, then you will not have a systematic progression of work. As a result, your activities will not be eligible as core R&D activities.

An explanation of each of the four parts is set out below.

Hypothesis

A hypothesis is simply a statement that can be proven right or wrong by conducting an experiment.

The hypothesis reflects a particular technical or scientific idea and is commonly expressed as a relationship between variables (or technical features) which can be proven or disproven.

The hypothesis is the idea being investigated through the systematic progression of work. The hypothesis will generally direct the design and conduct of the experiment, observation and evaluation.

FIGURE 2: KEY PARTS OF A SYSTEMATIC PROGRESSION OF WORK
In general, we take the view that a core R&D activity will commence once a hypothesis has been developed and that activities associated with developing a hypothesis are more likely to qualify as supporting R&D activities.

The reason for this is that activities associated with initially developing a hypothesis are often not experimental activities. They may include activities such as literature searches or other background research, to identify possible existing solutions or to inform the design of an experimental activity.

In contrast, work undertaken to test a hypothesis is more likely to be part of a core R&D activity. This includes the design and conduct of the experiment, observation and evaluation of results and the drawing of logical conclusions.

We realise that iterations of a hypothesis may be undertaken. Activities associated with modifying a hypothesis could be considered as core or supporting R&D activities depending on the nature of the work undertaken. For example, an adjustment of a hypothesis based upon the analysis and observation of the experiment could be considered as part of the core R&D activity if a follow-up experiment was conducted. On the other hand, if further research such as literature searches were required in order to refine the hypothesis before conducting another experiment, these research activities would more likely qualify as supporting R&D activities.

It is possible to test multiple hypotheses as part of one core R&D activity if they are variations on the same technical or scientific idea.

It is important that the hypothesis relates to a specific experiment or set of related experiments, and not the project as a whole.

It should be focussed on the technical or scientific area of uncertainty, and not framed in terms of any commercial or economic aims. An ‘overarching’ or ‘commercial’ hypothesis does not help to determine what the experiment is trying to test, or whether the activities are eligible.

✔️ **EXAMPLES OF APPROPRIATE HYPOTHESES**

Applying the Company’s newly-developed data-processing algorithms to astronomical data sets of more than 1 terabyte in size will yield results appropriate for generating 3D visual depictions of areas of outer space in real time,

or

Combining a new polyurethane with metal flakes that have been coated with magnesium fluoride to a general water-based paint will produce a glossy, stable, two-coat, metallic paint without the need for a coat of clear lacquer.

❌ **AN EXAMPLE OF AN INSUFFICIENT HYPOTHESIS**

Whether particular computer software can be developed to include the latest research from the planning community.

In the first examples, the hypotheses can clearly be tested by carrying out experiments and proven true or false. The first examples also clearly set out to investigate the causal relationships between relevant variables. This is a key characteristic of an experimental process.

In the last example, there is no way to disprove the hypothesis through an experimental process. The hypothesis lacks detail and it is unclear what is being tested and what any outcomes might be. It also does not describe or inform the design of a particular experiment.
Generally speaking, statements which contain the following terms will not adequately describe technical or scientific ideas that can be tested through a systematic progression of work:

‘It is uncertain whether we can ...’
‘Whether it is feasible, viable or cost effective to ...’
‘We don’t know whether we can resolve this issue or achieve this result’.

The above statements do not necessarily indicate that a specific experiment or set of experiments has been or will have to be undertaken in order to address a specific technical or scientific challenge – or what that challenge actually is.

**Experiment**

**Identifying your experiment (or set of related experiments) is one of the most important parts of the self-assessment process.**

Once an experiment has been identified, it is much easier to assess whether you have undertaken a systematic progression of work and met the other requirements of the core R&D activity test.

The experiment is what you do to test the hypothesis.

The experiment is set up so that the relationship between relevant variables can be tested and the hypothesis proven right or wrong.

Experiments can take place in virtually any environment – from laboratories to manufacturing plants, to offices, farms and greenhouses. The details of an experiment can vary considerably between different industries and organisations. For example, a food manufacturer may conduct an experiment which seeks to test the shelf life impact of adding a new flavour ingredient to one of its products.

On the other hand, a biotechnology company may conduct an experiment to determine the effect of a particular drug on blood pressure when administered to human patients.

A series of experiments may be grouped as one core R&D activity so long as they are all aimed at testing the same hypothesis or related hypotheses.

For example, a company which is developing a new chemical mixture to extract contaminants out of on-site ground material may have to modify or change the composition of the mixture, and carry out a series of experiments on the effectiveness of different mixtures, as part of its experimental process.

In a similar manner, a company which is developing a new method for digitally scanning built environment structures may have to scan a number of different structures in order to determine the effectiveness of the new scanning method on structures that are made from different materials.

Both of these examples show how similar experiments can be grouped as one core R&D activity when they are attempting to prove the same or similar hypotheses.

**Observation and evaluation**

**Observation and evaluation refers to the observing, measuring and recording of information and results related to the experiment.**

It will include an assessment of the running of the experiment and its outcomes and whether it worked as expected and was thereby able to test the hypothesis.

Whether or not the experiment worked as you expected, this is also where you analyse, consider and evaluate what the outcomes of the experiment actually mean. This phase leads into the drawing of logical conclusions.
**Leads to logical conclusions**

**Drawing of logical conclusions is where you bring together the results of your evaluation and make decisions or findings.**

It refers to the forming of a considered view on whether the experiment showed the hypothesis to be right or wrong.

If your hypothesis was not consistent with your conclusion, do you have to do something differently and try again? Go back to the drawing board? Or, if it was successful, do you now have the knowledge you need to inform the development of the next stage of your new product, service or process? Have you completed your core R&D activity or do you need to do more tests?

**Checklist**

**To understand whether you have undertaken a systematic progression of work, it is important that you ask the following questions.**

If you answer yes to all of these questions, it is likely that you are undertaking a systematic progression of work that meets the definition.

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**SYSTEMATIC PROGRESSION OF WORK CHECKLIST**

<table>
<thead>
<tr>
<th></th>
<th>Question</th>
<th>Complete?</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Did you conduct an experiment?</td>
<td>✔</td>
</tr>
<tr>
<td>2</td>
<td>Did your experiment investigate and test a hypothesis?</td>
<td>✔</td>
</tr>
<tr>
<td>3</td>
<td>Was your hypothesis testable (i.e. could it be proven or disproven)?</td>
<td>✔</td>
</tr>
<tr>
<td>4</td>
<td>Are you investigating why something is happening (i.e. investigating the causal relationships between variables)?</td>
<td>✔</td>
</tr>
<tr>
<td>5</td>
<td>Was your hypothesis about a technical or scientific idea?</td>
<td>✔</td>
</tr>
<tr>
<td>6</td>
<td>Did you observe the results and evaluate whether the hypothesis was right or wrong?</td>
<td>✔</td>
</tr>
<tr>
<td>7</td>
<td>Were the parts of the systematic progression of work aligned to test the hypotheses?</td>
<td>✔</td>
</tr>
<tr>
<td>8</td>
<td>After evaluating the results of the experiment, did you draw logical conclusions about the hypothesis and what it meant to your project?</td>
<td>✔</td>
</tr>
</tbody>
</table>
CORE R&D ACTIVITIES

ACTIVITIES THAT DO NOT ESTABLISH A SYSTEMATIC PROGRESSION OF WORK

- **Tests that only collect data**
  Why?
  Activities that collect data alone don’t contain all the parts of a systematic progression of work – there isn’t always an evaluation or a conclusion, and they don’t necessarily test a hypothesis. However, where they meet the required tests, data collection activities may qualify as supporting R&D activities as part of a broader project.

- **Tests that use ‘trial and error’ alone**
  Why?
  Trial and error alone may not contain all the parts of a systematic progression of work because it doesn’t test a hypothesis about the relationship between variables.

- **An activity that is not designed to prove or disprove a hypothesis**
  Why?
  Because a hypothesis is a key part of the definition and is required in order to undertake a systematic progression of work.

RECORD KEEPING TIPS

- You should document and keep:
  - The design of your experiment including your hypothesis
  - The results of your experiment
  - Your evaluation of the results
  - Your conclusions about whether the results proved your hypothesis and what this means for your project

It must be clear from your documentation that the four parts operate together as a systematic progression of work to generate, or to try to generate, the new knowledge that you need.
Core R&D activities are experimental activities:

a. 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...

Outcome cannot be known or determined

This section of the guide explores the related concepts of whether an outcome cannot be known or determined in advance and whether the outcome can only be determined by applying a relevant systematic progression of work.

The outcome referred to in this part of the definition is whether the hypothesis (the technical or scientific idea) you are testing in the relevant systematic progression of work is true or false.

When self-assessing, you should focus upon the technical or scientific ideas and what is being done to investigate those ideas. In other words, those parts which investigate the ‘causal relationships among relevant variables’.

If it is possible to know or determine whether the hypothesis is true or false without having to conduct an experiment (as part of a relevant systematic progression of work), then the outcome can be known or determined in advance.

When can the outcome be known or determined in advance without conducting a systematic progression of work?

Whether an outcome can be known or determined in advance without applying a relevant systematic progression of work is judged by:

• whether a competent professional in the field knows or can determine the outcome (i.e. whether the hypothesis is true or false), without conducting an experiment as part of a systematic progression of work;
• on the basis of knowledge, information or experience that is publicly available or reasonably accessible, anywhere in the world.

The test is an objective test that applies equally to all companies. The test is not solely whether you know the outcome or are able to determine the outcome in advance.

Rather, an outcome is known or can be determined in advance if a competent professional in the field knows, or can determine, whether the hypothesis is true or false, without having to undertake a systematic progression of work. This may be based on the professional’s knowledge and experience, or based on information to which they can reasonably gain access.
What does a competent professional look like?

A competent professional is a person who:

• is knowledgeable and experienced in the relevant field and technology;
• possesses the relevant qualifications (if appropriate) and experience necessary to participate in the relevant field with a reasonable level of skill;
• keeps up to date with developments in the relevant area, and
• has access to knowledge around the world, including access to publically and generally accessible resources, for example the internet, relevant industry journals and other professionals in the area.

How will I know if the knowledge, information or experience is available?

If the technical or scientific idea being investigated is in an area in which you are familiar with technical developments then you may already be aware whether the knowledge, information or experience is available.

In conducting any research into existing solutions you may have identified material that gives an indication of the current state of knowledge in the area. Your enquiries may have included:

• conducting research into the available information in the scientific, technical or professional literature in the relevant area; and
• seeking advice from an expert(s) in the field. This could be someone in your company, or industry sector, a consultant or an academic expert in the field.

If, based on the outcomes of your research into the current state of knowledge, you consider that you have the information or knowledge you require to resolve the issue, then it is more likely that the outcome can be known or determined in advance on the basis of current knowledge, information or experience.

On the other hand, if you need to design and conduct an experiment to progress your work, then it is more likely that the outcome cannot be known or determined in advance on the basis of current knowledge, information or experience.

Knowledge and information that is commercially sensitive, held closely by a competitor, and is not available to the general public, is not considered to be ‘reasonably accessible’.

<table>
<thead>
<tr>
<th>OUTCOME CANNOT BE KNOWN CHECKLIST</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Did you consider that your hypothesis might already be known or able to be determined by a competent professional in the field without the need to conduct a systematic progression of work?</td>
</tr>
<tr>
<td>2. How did you answer this question:</td>
</tr>
<tr>
<td>i. What enquiries did you make?</td>
</tr>
<tr>
<td>ii. Where did you look for the answers?</td>
</tr>
<tr>
<td>iii. Were there other enquiries you could have made?</td>
</tr>
</tbody>
</table>
ACTIVITIES THAT DON'T SATISFY THE OUTCOME CANNOT BE KNOWN OR DETERMINED

× Activities which are an Australian first application of existing technologies, processes or methods
  Why? Because the test relates to information that is reasonably available anywhere in the world, not just in Australia. It might be different if there were significant differences between the Australian environment compared to overseas, that is relevant to what are being tested through the systematic progression of work because some change must be made to the technology or process.

× Activities where the applicant company does not know the outcome, but where a competent professional would know or could determine the outcome
  Why? Because the test is whether the outcome is known or able to be determined by a competent professional with access to all publically and reasonably available information. The test is not whether the company undertaking the activity knows the answer itself.

RECORD KEEPING TIPS
You should document and keep records of:
✓ What enquiries you decided to make
✓ The results of those enquiries
✓ What your technical challenges were and why they couldn’t be resolved without undertaking a systematic progression of work
Core R&D activities are experimental activities:

b. that are conducted for the purpose of generating new knowledge (including new knowledge in the form of new or improved materials, products, devices, processes or services)

For an activity to be a core R&D activity you must be conducting your experimental activity for the purpose of generating new knowledge. This section of the guide is designed to help you understand what is meant by the purpose and new knowledge.

At least a ‘significant’ purpose

There can be multiple purposes for conducting an experiment as part of a systematic progression of work. While the activity must have been undertaken for the purpose of generating new knowledge, it does not have to be the only purpose.

However, the purpose of generating new knowledge needs to be a significant purpose. In other words, the generation of new knowledge must be important to the company and a driving force for undertaking the activity.

If there are multiple purposes, knowledge generation does not have to be the most important purpose but it must be a significant purpose when compared to ‘other’ purposes.

You need to weigh up, based on a review of your documentation, what the various purposes of undertaking the experimental activities actually were. You can then decide if generating new knowledge was a significant purpose when compared to ‘other’ purposes.

As long as the generation of new knowledge is a significant reason for undertaking the activities, that will satisfy the purpose test for being a core R&D activity.

How will you tell if you have a significant purpose?

The purpose test refers to the actual purpose you had in undertaking the activities. You should keep documents which provide evidence of what your purpose was at the time.

Contemporaneous documents that identify how and why the activities are being conducted are the best evidence of what your purpose was at the time the activities were being carried out.

If the purpose of the activity was to generate new knowledge, this will generally be reflected in project documents. Because the purpose directs attention to why you undertook the experimental activities, it should be evident from documents created before and during the activities.

For example, records of the experimental activities including plans and designs, the results and analyses, project management documentation, board minutes, internal memos, media releases and other corporate publications might all provide useful evidence of your purpose.
When does a company need to have the requisite purpose?
It is the purpose at the time it undertakes the activities that is important. It is not enough to undertake activities for another purpose only later to discover that the activities were useful because they also happened to generate new knowledge.

What is ‘new knowledge’?
New knowledge is knowledge that is not already available in the public arena at the time the activities were conducted. For the purposes of this programme it is knowledge that can only be generated by undertaking an experiment as part of a systematic progression of work. If you are able to access the knowledge without needing to undertake a systematic progression of work, then it will not be new knowledge.

It follows that if the knowledge of whether something is scientifically or technically possible, or how to achieve it in practice, is deducible by a competent professional in the relevant field, then it will not be new knowledge.

Checklist
If you answer yes to questions 2 to 6 opposite, it is likely that your activities were undertaken for the purpose of generating new knowledge.

THE PURPOSE AND NEW KNOWLEDGE CHECKLIST

<table>
<thead>
<tr>
<th>Question</th>
<th>Answer</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. What purposes did you have in undertaking the experimental activities?</td>
<td>✔️</td>
</tr>
<tr>
<td>These need to be purposes you had at the time you conducted the activities.</td>
<td></td>
</tr>
<tr>
<td>2. Was one of these purposes to generate new knowledge?</td>
<td>✔️</td>
</tr>
<tr>
<td>3. Is this purpose significant when compared to other purposes for undertaking the activity?</td>
<td>✔️</td>
</tr>
<tr>
<td>4. Was the knowledge being generated new to you?</td>
<td>✔️</td>
</tr>
<tr>
<td>5. Was the knowledge being generated new in that it was not already available in the public arena and not reasonably accessible on a world-wide basis?</td>
<td>✔️</td>
</tr>
<tr>
<td>6. Could the knowledge have only been generated by undertaking an experiment as part of a systematic progression of work?</td>
<td>✔️</td>
</tr>
</tbody>
</table>
**ACTIVITIES THAT ARE UNLIKELY TO HAVE THE PURPOSE OF GENERATING NEW KNOWLEDGE**

**Activities involving ordinary production runs which are in excess of what is required to conduct the experiment, test the hypothesis and generate new knowledge, where a smaller production run would suffice**
*Why?*
Because the only significant purpose of conducting a production run in excess of what is required to generate new knowledge is to produce goods for sale.

**Activities undertaken for the purpose of quality assurance**
*Why?*
Activities conducted for the purpose of assuring product or service quality are unlikely to have a significant purpose of generating new knowledge.

**Activities where any knowledge that might be generated has already been developed and its existence is commonly known**
*Why?*
Because the solution to a technical challenge can be resolved using existing knowledge and information. It is unlikely that a systematic progression of work in these circumstances will generate new knowledge.

**Tests that simply collect data alone**
*Why?*
Because tests that simply collect data don’t usually have the purpose of generating new knowledge.

**RECORD KEEPING TIPS**

✔ Keep records of activity descriptions that include details of how your activities are seeking to answer questions through an experimental process.

✔ Keep records of planning, designing and conducting the experiment including observations and the evaluation of the results of the experiment. These records are likely to be the most useful for providing evidence of your purpose.

✔ Other project documentation which may be useful includes board or management meeting minutes and internal notes and memos.

✔ Good evidence of purpose is likely to be recorded before or around the time you conducted the activities.
Supporting R&D Activities
SUPPORTING R&D ACTIVITIES

1. Supporting R&D activities are activities directly related to core R&D activities.
2. However, if an activity:
   a. is an activity referred to in subsection 355-25(2); or
   b. produces goods or services; or
   c. is directly related to producing goods or services;
the activity is a supporting R&D activity only if it is undertaken for the dominant purpose of supporting core R&D activities.

Once you have established that you have conducted, or will be conducting activities that satisfy the definition of core R&D activities, you can then identify any activities that satisfy the definition of supporting R&D activities.

There are two key aspects to consider when assessing whether your activities are supporting R&D activities.

• all supporting R&D activities must be directly related to a core R&D activity; and
• in addition, if the activity is an excluded activity\(^8\) or produces goods or services, or is directly related to producing goods or services, the activity must be undertaken for the dominant purpose of supporting a core R&D activity.

When self-assessing and keeping records you need to identify which core R&D activities the supporting R&D activity is related to and how it supports them. This might include identifying its relationship with the parts of a relevant systematic progression of work including:

• the design, set-up or conduct of the experiment
• the observation and evaluation of the experiment; or
• the drawing of logical conclusions about the experiment.

Examples of how supporting R&D activities can be directly related to core R&D activities

• A literature search on durability testing which informed the design of the experiment to effectively test the hypothesis;
• The supporting R&D activity produced a test rig used in the experiment;
• The supporting R&D activity manufactured a small batch of new design syringes which were used in the experiment.

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8 The categories of excluded activities are listed in subsection 355-25(2) of the *Income Tax Assessment Act 1997*.

(a) Note that software development activities that are excluded from being core R&D activities under the software developed for internal business administration exclusion cannot be supporting R&D activities.

(b) You will also need this information to complete the registration form.
Supporting R&D activities must be directly related to a core R&D activity

In order to be a supporting R&D activity, each activity must be directly related to one or more core R&D activities. In other words, the activity must have a direct, close and relatively immediate relationship with one or more components of the relevant systematic progression of work. In assessing your activities you should identify and record what that relationship is. Activities that make a direct contribution to the conduct or evaluation of the experiment are likely to meet this requirement.

Supporting R&D activities may be conducted before, during or after a core R&D activity is conducted. The key is that they must be directly related to the conduct of a core R&D activity.

- **Before:** An example of a supporting R&D activity that is likely to be able to demonstrate a directly related connection to a later core R&D activity would be a literature review to inform the design of the core R&D activity. The production of a prototype for experimentation in a core R&D activity is another example.

- **During:** The cleaning, maintenance and monitoring of aquaculture tanks that are used to keep fish stock for the development of a new feed pellet is an example of a supporting R&D activity that is likely to be directly related to a core R&D activity that is conducted concurrently.

- **After:** The deconstruction of equipment and the disposal of waste items used in the experiment are examples of activities that are likely to be directly related to the core R&D activity.

The following examples are common types of activities which could be directly related to one or more core R&D activities. Whether a particular activity is directly related to a core R&D activity will depend on the specific circumstances.

**ACTIVITIES WHICH COULD BE DIRECTLY RELATED TO A CORE R&D ACTIVITY**

- Literature searches or reviews that help design the experiment
- Planning the experiment
- Designing and producing test subjects to be used in the experiment
- Designing and producing equipment to be used in the experiment
- Disassembling the experiment
- Disposing of waste products

**KEY MESSAGES**

- There may be multiple supporting R&D activities in relation to each core R&D activity, so long as each satisfies the necessary requirements.
- Supporting R&D activities can take place before, during or after the relevant core R&D activity as long as the activity is directly related to the core R&D activity.
SUPPORTING R&D ACTIVITIES

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ACTIVITIES THAT ARE UNLIKELY TO BE DIRECTLY RELATED TO CORE R&D ACTIVITIES

- Constructing infrastructure to access the site for the experiment
- Using the knowledge generated in a completed core R&D activity to produce commercial goods or services
- Commercial activities undertaken as part of the same project as the core R&D activity that don’t contribute to or impact upon the experiment or the relevant systematic progression of work
- Publishing the results of an experiment

To determine what the dominant purpose was for conducting an activity, you will need to consider all of the purposes you had for conducting the activity. You will also need to consider the strength of each purpose. That is, how important each purpose was compared to the other purposes. These questions should be considered by weighing up the particular circumstances and the answers should be supported by appropriate evidence and documentation.

The purpose is assessed at the time you undertake the activity. In other words, what did you have in mind as the reason you were undertaking the activity at the time you were doing it and did one of those outweigh all the others?

The factors that need to be considered will vary depending on the particular circumstances of each activity. However, the following questions may be relevant:

1. **Is the activity a routine activity that is normally undertaken for non R&D purposes?**
   If an activity is routinely undertaken for a non R&D purpose, it is likely that the activity is not being undertaken for the dominant purpose of supporting the core R&D activity.

2. **Would the activity have occurred in the absence of the core R&D activity?**
   Where an activity would have been undertaken even if no core R&D activity took place, it is likely that it was not performed for the dominant purpose of supporting the core R&D activity.

**Dominant purpose**

In addition to being directly related to a core R&D activity, some activities also have to be undertaken for the dominant purpose of supporting core R&D activities in order to be supporting R&D activities. An activity that is:
- an excluded activity; or
- one which produces goods or services; or
- one that is directly related to producing goods or services,
will only be a supporting R&D activity if it is undertaken for the dominant purpose of supporting a core R&D activity.

**Dominant purpose** means the ruling, prevailing, or most influential purpose.

The dominant purpose does not need to be more important than all of the other purposes combined, but it does need to be the most important of any of the purposes.

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9 See the section of the guide on ‘exclusions’ for more detail.
3. **To what extent are normal production practices disrupted for the core R&D activity?**
   Where normal production practices are extensively disrupted in order to accommodate the core R&D activity, those production activities may satisfy the dominant purpose requirement.

4. **How great is the risk that production outcomes will be significantly compromised as a result of the core R&D activity?**
   Where the experiment affects the saleability of the production outputs, it is likely that the production run activities will satisfy the dominant purpose requirement.

5. **Was there a purpose, other than supporting core R&D activities, for infrastructure developed in the activity?**
   Where an activity produces infrastructure that will be used in both core R&D activities and other activities, the relative importance of the infrastructure to each of these purposes needs to be considered.

6. **Will the activity facilitate future activities that are not core R&D activities?**
   Where an activity facilitates both core R&D activities and future activities that are not core R&D activities, the relative importance of each of these purposes needs to be considered.

   However, where it is possible to restrict the scope of the activity so that only actions and expenditure that relate to the period in which the core R&D activity is taking place, the dominant purpose is more likely to be for supporting core R&D activities.

   The fact that an activity is necessary in order for core R&D activities to occur is not sufficient to show that it is undertaken for the dominant purpose of supporting core R&D activities. Nor will the test be satisfied merely because the activity occurs in close proximity (either time or location) to the core R&D activities.

   Companies must keep evidence to support the decisions that they make when self-assessing their activities. It is not adequate for a company to simply assert that the prevailing or most important purpose in conducting an activity was to support core R&D activities. They must retain documentation that supports this assessment.

**PRODUCTION ACTIVITIES**

Production activities include all activities that involve goods or services being made or manufactured. An activity will be directly related to producing goods or services if it has a direct, close and relatively immediate link to manufacturing or other activities involving goods or services being made.

The following examples indicate the types of activities that are likely to be undertaken for the dominant purpose of supporting core R&D activities. However, whether a particular activity is undertaken for the dominant purpose of supporting a core R&D activity will depend on the specific circumstances.
### Activities Likely to Be Undertaken for the Dominant Purpose of Supporting Core R&D Activities

- Activities that have no other purpose than to assist or facilitate the core R&D activity.
- Activities that clearly support the core R&D activities and where any direct commercial benefit from the activity is insignificant.
- Activities producing items that are used up in the experiment or anticipated to be used up in the experiment.
- Constructing a component to be used in a core R&D activity (such as part of the experimental apparatus), particularly where the component will be used solely in the experiment or where it serves no other immediate purpose.

### Activities That Are Unlikely to Be Supporting R&D Activities

- Constructing a road to access a mine site where the only core R&D activity is conducted in the mine.
  - **Why?**
  - Building the road to reach the site does not have a direct, close and relatively immediate link with the experimental activity. Constructing the road is directly related to producing goods and is unlikely to be done for the dominant purpose of supporting core R&D activities, as the dominant purpose would be to facilitate mining.

- Production runs conducted as part of the company’s normal business operations to produce goods for sale.
  - **Why?**
  - Production runs as part of a company’s regular business are unlikely to have as their most important purpose supporting a core R&D activity. Instead they are more likely to have been undertaken for commercial purposes. It may be that a limited number of production runs are undertaken for the dominant purpose of supporting a core R&D activity (such as to test a newly developed process or component in the production line), but once the outcome is known, any additional production runs will not have the required dominant purpose.

- Activities that occur as part of developing a product but that do not directly support the core R&D activity.
  - **Why?**
  - Because they are not directly related to the core R&D activities. Activities that don’t assist a company in undertaking the activities necessary to resolve the technical or scientific uncertainty in the hypothesis are not directly related to core R&D activities.

The following are activities that are unlikely to be undertaken for the dominant purpose of supporting core R&D activities.
RECORD KEEPING TIPS

You should:

✔ Record and keep descriptions of your supporting R&D activities including any relevant details to show how it meets the above requirements

✔ Record why the activities were undertaken and how they support the core R&D activities. This will assist in showing that excluded activities and production activities had the required purpose

✔ Keep plans and reports which show why and how the supporting R&D activities were undertaken. This may assist in showing that you had the required purpose when undertaking excluded or production activities

SUPPORTING R&D ACTIVITIES CHECKLIST

1. Does the activity have a direct, close and relatively immediate link to one or more core R&D activities?

2. If your activity is:
   - an excluded activity
   - a production activity or
   - an activity that is directly related to a production activity,
   was the most significant purpose of undertaking the activity to support one or more core R&D activities?

3. Was the purpose of supporting that core R&D activity the most significant purpose you had at the time the activity was undertaken?
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## Excluded Core R&D Activities

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EXCLUDED CORE R&D ACTIVITIES

Activities that are not core R&D activities

There are certain activities which cannot be core R&D activities. We refer to these activities as excluded activities. There are various reasons why the R&D Tax Incentive doesn’t support these activities as being core R&D activities.

For example, market research and market testing are excluded on the basis that they would not normally occur as part of an experiment. As such, these types of activities would not satisfy the core R&D activities definition.

Others, such as activities relating to the development of computer software for use in your internal business administration, are excluded on the basis that they are likely to be undertaken by a business without an incentive.

Activities that are excluded from being core R&D activities may still qualify as supporting R&D activities if they are directly related to core R&D activities and undertaken for the dominant purpose of supporting core R&D activities.

The concept of dominant purpose is discussed in more detail under the section ‘software development for use in internal administration’. Dominant purpose has also been previously discussed under supporting R&D activities.

This section of the guide is aimed at helping you assess whether any of your activities are excluded activities for the purposes of registering core R&D activities with the R&D Tax Incentive.

KEY MESSAGES

- If an activity is an excluded activity, it cannot be a core R&D activity
- Excluded activities may still be supporting R&D activities if they meet the relevant tests
The following is a direct extract from the legislation\(^9\) which lists those activities which cannot be core R&D activities for the purposes of registering with the programme.

2. ...[N]one of the following activities are core R&D activities:

a. market research, market testing or market development, or sales promotion (including consumer surveys);

b. prospecting, exploring or drilling for minerals or petroleum* for the purposes of one or more of the following:
   i. discovering deposits;
   ii. determining more precisely the location of deposits;
   iii. determining the size or quality of deposits;

c. management studies or efficiency surveys;

d. research in social sciences, arts or humanities;

e. commercial, legal and administrative aspects of patenting, licensing or other activities;

f. activities associated with complying with statutory requirements or standards, including one or more of the following:
   i. maintaining national standards;
   ii. calibrating secondary standards;
   iii. routine testing and analysis of materials, components, products, processes, soils, atmospheres and other things;

g. any activity related to the reproduction of a commercial product or process:
   i. by a physical examination of an existing system; or
   ii. from plans, blueprints, detailed specifications or publically available information;

h. developing, modifying or customising computer software for the dominant purpose of use by any of the following entities for their internal administration (including the internal administration of their business functions):
   i. the entity (the developer) for which the software is developed, modified or customised;
   ii. an entity connected with the developer;
   iii. an affiliate of the developer, or an entity of which the developer is an affiliate.

\(^{*}\) ‘Petroleum’ is a defined term under section 40-730(6) of the Income Tax Assessment Act 1997

\(^{†}\) ‘Connected with’ is a defined term under section 328-125 of the Income Tax Assessment Act 1997

\(^{‡}\) ‘Affiliate’ is a defined term under section 328-130 of the Income Tax Assessment Act 1997
Market research, testing and development

...[N]one of the following activities are core R&D activities:
  a. market research, market testing or market development, or sales promotion (including consumer surveys);

This exclusion is concerned with activities that are conducted to discover consumers’ or potential consumers’ interest in products or services, or to investigate the characteristics or features of products or services, or the market for them.

It is also concerned with activities that seek to encourage the consumption of products or services. These types of activities are unlikely to be experimental.

The exclusion covers both current and prospective products and services.

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If you have answered yes to any of the three questions above, then your activity is likely to be caught by this exclusion and cannot be a core R&D activity.
Prospecting, exploring or drilling for minerals or petroleum

...[N]one of the following activities are core R&D activities:

b. prospecting, exploring or drilling for minerals or petroleum* for the purposes of one or more of the following:
   i. discovering deposits;
   ii. determining more precisely the location of deposits;
   iii. determining the size or quality of deposits;

This exclusion is focused on certain activities undertaken to search for, characterise, analyse or obtain minerals or petroleum for one of the purposes listed in the exclusion.

When activities are excluded
An activity will be excluded under this clause if both of the following apply:
• The activity involves prospecting, exploring or drilling for minerals or petroleum; and
• The activity is undertaken for one of the listed purposes.

Meaning of ‘purposes’
The purpose refers to a significant purpose that you had at the time the activity was taking place. If you are undertaking your activity for a significant purpose for any of the listed reasons, your activity will be excluded from being a core R&D activity.

Examples of activities likely to be excluded as core R&D activities:
• Searching for a mineral or for petroleum or gas (regardless of whether you actually find it or not)
• Drilling for samples for analysis of the deposit

Examples of activities unlikely to be excluded as core R&D activities:
• Experimenting with new exploration techniques in areas where relevant geological, mineralogical or petrological characteristics are known
• Experimenting with new geo-sensing techniques in areas where relevant geological, mineralogical or petrological characteristics are known
• Non-routine testing of a sample that has been extracted as a result of drilling

CHECKLIST

1. Does the activity involve prospecting, exploring or drilling for a mineral or petroleum?
2. Was the activity undertaken for the purpose of discovering or determining the location, or of determining the size or quality of minerals or petroleum?

If you have answered yes to both of the questions above, then your activity is likely to be caught by this exclusion and cannot be a core R&D activity.

* ‘Petroleum’ is a defined term under section 40-730(6) of the Income Tax Assessment Act 1997
Management studies or efficiency surveys

...[N]one of the following activities are core R&D activities:

c. management studies or efficiency surveys;

This exclusion focuses on activities that are conducted to provide information to assist management decision-making about efficient and effective business operations.

For example:

• A study of manufacturing processes to determine optimal machine settings or the best factory floor plan;
• An investigation into the efficient or effective conduct of the business, or a part of the business; and
• An investigation into potential cost savings.

The scope of this exclusion covers all activities of this type, whether or not they are called ‘management studies’ or ‘efficiency surveys’. These activities tend not to be experimental in nature.

Experimental activities conducted to test technical variables that impact on the technical efficiency of a new system are unlikely to be excluded by this section.

For example, the experimental development of a heat recovery system in a manufacturing plant to increase energy efficiency through the recycling of heat would not fall within this exclusion.

CHECKLIST

1. Does the activity seek to generate information that assists with management decisions about whether something can be, or is being, conducted effectively, efficiently and/or economically?

If you have answered yes to this question then your activity is likely to be caught by this exclusion and cannot be a core R&D activity.
Research into social sciences, arts or humanities

...[N]one of the following activities are core R&D activities:

- research in social sciences, arts or humanities;

This exclusion is focused on research and experiments in the subject areas of social science, arts and humanities.

**Scope of ‘social sciences, arts or humanities’**

In broad terms, ‘social sciences, arts and humanities’ refer to activities that are concerned with the:

1. study of individuals, society and/or human social function or relationships;
2. design, production or performance of human artistic expressions; and
3. study or production of literature.

Activities that conform to any of these areas are likely to fall within the scope of this exclusion.

Some examples of areas where research will be excluded under this section include:

- Economics
- Anthropology
- Sociology
- Psychology
- Politics
- Literature
- History
- Philosophy
- Fine art
- Theatre
- Music, and
- Dance.

Activities may fall under the scope of this exclusion whether or not they are described as research into ‘social science, the arts or humanities’. The key is whether the activities themselves fall within scope of these areas.

The exclusion does not include activities that are technology based but which are still connected to the subject matter of ‘social sciences, arts or humanities’. For example, software development activities that seek to create new algorithms to interrogate very large datasets would not be excluded under this category simply because the datasets were composed of social media data.

**What does ‘research’ include?**

You will be conducting research if your activity involves gathering and/or comparing information or conducting an experiment or some other inquiry or investigation into the areas of ‘social sciences, arts or humanities’.

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If you have answered yes to both of these questions, then your activity is likely to be caught by this exclusion and cannot be a core R&D activity.
Patenting, licensing or other activities

...[N]one of the following activities are core R&D activities:

   e. commercial, legal and administrative aspects of patenting, licensing or other activities;

This exclusion is concerned with the commercial, legal and administrative activities associated with:

• Taking steps to protect your own intellectual property;
• Acquiring rights to use or access intellectual property; and
• Granting rights to another party to use or access your intellectual property.

The scope of the exclusion covers all types of intellectual property including patents, trademarks, designs and plant breeder’s rights.

Examples of activities excluded by this section include:

• researching, preparing and filing applications for intellectual property registrations; and
• licensing, including the cost of any fees paid for those rights, and any legal and/or administrative costs in negotiating the licence and all associated paperwork.

This exclusion does not prevent patent searches that are undertaken to discover the existing state of the art or knowledge. These types of searches are most likely, where they meet the relevant tests, to be supporting R&D activities.

**CHECKLIST**

1. Was the activity undertaken so that the company could register, or otherwise protect, its intellectual property?  
   ✔️

2. Was the activity undertaken so that the company could use or access someone else’s intellectual property?  
   ✔️

3. Was the activity undertaken so that the company could grant or allow another company access to its intellectual property?  
   ✔️

If you have answered yes to any of these questions, then your activity is likely to be caught by this exclusion and cannot be a core R&D activity.
Complying with statutory requirements or standards

...[N]one of the following activities are core R&D activities:

f. activities associated with complying with statutory requirements or standards, including one or more of the following:
   i. maintaining national standards;
   ii. calibrating secondary standards;
   iii. routine testing and analysis of materials, components, products, processes, soils, atmospheres and other things;

This exclusion aims to exclude activities that are undertaken by a company to meet a legislative requirement or an industry or other standard.

What does statutory requirements and standards cover?
This exclusion will cover any activity carried out to meet a requirement in:
• legislation
• regulations, or
• standards.

These may be either Australian or overseas (for example where a product must meet regulatory standards for intended sale in other countries).

Standards are not legislative requirements, rather they are published documents setting out specifications and procedures designed to ensure products, services and systems are safe, reliable and consistently perform the way they were intended to. Standards can be guidance documents and include Australian Standards®, International Standards and Joint Standards, codes, specifications and industry guidelines.

If a standard is only optional or ‘good practice’, rather than mandatory, then compliance with this standard will not come within this exclusion.

When are activities associated with compliance?
This exclusion is not limited to activities which, for example, are necessary or essential in order to comply, but extends to cover activities associated with complying. For example, activities working out how to comply with a standard would be activities associated with complying.

This exclusion is not intended to exclude experimental activities that are undertaken to develop a new product or service which must incidentally meet some regulatory requirement or standard. For example, consider a company that has designed and developed a new motorcycle helmet that incorporates a new ventilation system for improving the release of toxic exhaust gases that are known to build up. Activities associated with developing and testing the new ventilation system will not fall under this exclusion. However, once the motorcycle helmet has been developed, routine testing activities associated with demonstrating compliance of the motorcycle helmet with the relevant standards, to gain the relevant certification or for the purpose of meeting the relevant safety requirements, will fall within the scope of this exclusion.

This exclusion is also not intended to exclude conducting Phase I, II and III clinical trials, even though it is necessary to have carried these out in order to gain subsequent regulatory approvals.
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**CHECKLIST**

1. Was the activity undertaken as a requirement under legislation or under a regulation?

2. Was the activity undertaken to comply with a requirement under Australian Standards®, International Standards and Joint Standards, codes, specifications and industry guidelines or similar for the particular product or area?

- If you have answered *yes* to either of the two questions opposite, then your activity is likely to be caught by this exclusion and cannot be a core R&D activity.
Reproduction of a commercial product or process

...[N]one of the following activities are core R&D activities:

g. any activity related to the reproduction of a commercial product or process:
   i. by a physical examination of an existing system; or
   ii. from plans, blueprints, detailed specifications or publically available information;

This exclusion is concerned with activities that seek to recreate an existing product or process by examining:
   • the actual item, or
   • documentation that shows how the item works, or how to make it.

This exclusion also applies to anything that is related to any of these activities. For example, activities involving locating plans or acquiring a sample of the item to be reproduced.

This exclusion does not affect activities which involve the original development of products or processes that are intended to improve on, or develop a different way of creating, an existing product or process.

For example, you are a food manufacturer and your competitor has a flavour that you would like to have for a product line. Your activities will be caught by the exclusion if you try to acquire the knowledge to reproduce the recipe by examining documentation on the competitor’s product or by physically studying it. Your activities will not be caught if you are creating a flavour through your own experimental process.
Software development for use in internal administration

...[N]one of the following activities are core R&D activities:

h. developing, modifying or customising computer software for the dominant purpose of use by any of the following entities for their internal administration (including the internal administration of their business functions):
   i. the entity (the developer), for which the software is developed, modified or customised;
   ii. an entity connected with the developer;
   iii. an affiliate of the developer, or an entity of which the developer is an affiliate.

Figure 3 shows a flow diagram of the self-assessment process for the internal administration exclusion.

Certain software development activities are specifically excluded from being core R&D activities. Developing, modifying or customising software for use in the day-to-day administration of a business, or in the administration of its business functions, may be excluded from being a core R&D activity.

Where relevant, this would include designing the software, writing the code and undertaking any required testing. Computer software also includes software developed for use in a smartphone or tablet.

There are two key questions to consider when assessing whether your activities fall into this category.

Was the software being developed:
1. for the purpose of using the software in your internal administration (including the internal administration of your business functions), or for the internal administration of a company that is connected with, or affiliated with your company?
2. and if so, was that the dominant purpose for undertaking those activities?

Software development activities will be excluded from being core R&D activities if you answer yes to the two questions above.

FIGURE 3: INTERNAL ADMINISTRATION SELF-ASSESSMENT PROCESS

Are you undertaking software development activities? 
Will the software be used in the internal administration of your business or that of an affiliate?
Was this the dominant purpose for undertaking those activities? 
YES
NO
Activities are excluded Activities are not excluded

11 The word ‘development’ is used throughout the guidance for this exclusion to refer to development, modification or customisation activities.
**Will the software be used for the purpose of ‘internal administration’?**

The exclusion applies to software development activities that are undertaken for the purpose of use in the internal administration of a business. It is not intended to exclude activities involving software developed in-house that is of an applied nature. For instance, the development of software that forms part of an electrical or mechanical device, such as industrial equipment or consumer products.

In addition, the exclusion is not designed to capture software development activities where the dominant purpose is to sell the product on a commercial basis, even if it is business administration software.

The exclusion is designed to capture software development activities relating to the day-to-day administration of the business. Such activities would likely be undertaken by the business without an incentive. There is also unlikely to be any public benefit from subsidising such activities.

Of course, software development activities can be undertaken for multiple purposes, one of which may include internal administration. In order to determine whether the software development activities will be used in internal administration, it is helpful to consider the questions below.

1. Are the software development activities related to the delivery of services to customers? If yes, then it’s not for use in your business’ internal administration.
2. Is it administrative software? Does it help administer business functions of the sort that any business would need to administer? If yes, then it’s for use in the business’ internal administration.

Software development activities that are focussed on the delivery or improvement of services offered to customers are by their nature, unlikely to be used for internal administrative purposes because they are predominantly focussed on providing or improving a service to the customer.

On the other hand, examples of software development activities that are used in the day-to-day administration of a business include activities that develop:

- business applications (payroll and accounting, invoicing, ordering, quality control reports and information management);
- management information systems; and
- enterprise resource planning software.

These types of software applications are not used for the delivery of services to customers.

Figure 4 (p.38) highlights the concept of when an activity will be used for internal administration.

**IMPORTANT NOTE**

It is important to understand that each part of the software that is being developed through the activities should be considered in terms of whether it will be used for internal administration and whether that is the dominant purpose for developing that part of the software.

This reflects the fact that software that delivers services to customers may also have functionality that performs internal administrative tasks. Only the internal administration parts are relevant to this exclusion.
Is the purpose for undertaking the software development for use in internal administration the dominant purpose?

You must determine what the purpose of undertaking the activities actually was at the time they were undertaken. If your activities were undertaken for the dominant purpose of developing software for use in your internal administration then your activity will fall within this exclusion.

An important indicator of purpose will be the nature of the software and the activities. Contemporaneous documents that identify how and why the activities are being conducted are often the best evidence of what your purpose was at the time the activities were conducted.

*Dominant purpose means the ruling, prevailing, or most influential purpose.*

To determine what the dominant purpose was for conducting an activity, you will need to consider all of the purposes you had for conducting the activity. Next, you will need to consider the strength of each purpose. That is, how important that reason was compared to the other reasons. These questions should be considered by weighing up the particular circumstances and the answers should be supported by appropriate evidence and documentation.

You will then be in a position to decide on which purpose is the ruling, prevailing or most influential purpose. If the dominant purpose is to use the software in the administration of your company’s business, then the development of that software cannot be considered as a core R&D activity.
Of course, where a project involves the development of computer software as one of its elements, this exclusion will only apply to those activities containing the development, modification or customisation of the software.

Similarly, each part of the ‘software development activity’ will need to be considered in terms of the above requirements. That is, whether the dominant purpose of undertaking that part of the activity was to use the software for internal administration.

In any given project, it may be that you conducted some software development activities for the dominant purpose of internal administration and not others. The relevant dominant purpose may also change over the course of time.

For example, at one point in time, the dominant purpose may be for use in internal administration. At a later time, the dominant purpose may be to sell the software. What is important is what the dominant purpose was at the time of undertaking the activity.

Documents that support your conclusion as to your dominant purpose for undertaking the activities that were prepared before or at the time the activities were being undertaken would assist you to meet this requirement.

**When is your company connected to or affiliated with another company?**

These terms are defined by tax legislation. Your company is considered to be connected with another company if either company controls the other, or if both are controlled by a third company. Your company is regarded as affiliated with another company if that company acts or can be expected to act to suit the directions or wishes of your company. This does not extend to a company’s commercial relationships with other companies.

**IMPORTANT NOTE**

Normally, activities that are excluded from being core R&D activities may still qualify as supporting R&D activities. This is not the case for software development activities that are excluded on the basis of the requirements set out above.

This is because to be a supporting R&D activity, an excluded activity must be undertaken for the dominant purpose of supporting the core R&D activity.

However, if an activity has been excluded in line with the requirements set out above, then the dominant purpose of that activity has already been established as being for its use in the internal administration of the business.

There can only be one dominant purpose for undertaking an activity. As such, an activity undertaken for the dominant purpose of internal administration cannot also be for the dominant purpose of supporting a core R&D activity.

The checklist on the following page will help you determine whether you have undertaken software development activities which are excluded activities and which cannot be considered as either core R&D activities or supporting R&D activities for the purpose of registering with the programme.
The R&D Tax Incentive

EXCLUDED CORE R&D ACTIVITIES

SOFTWARE DEVELOPMENT FOR INTERNAL ADMINISTRATION CHECKLIST

1. Have you conducted software development activities? ✓
2. Will the software be used for the purpose of your, or a connected or affiliated company’s, internal administration? ✓
3. Was internal administration the dominant purpose at the time the activity was undertaken? ✓

If you have undertaken software development activities that you have assessed as being core R&D activities which are not subject to this exclusion, you will need to retain evidence which supports your assessment around the key areas of internal administration and dominant purpose.
Further Guidance

AusIndustry has released a range of guidance including the R&D Tax Incentive Customer Information Guide and industry sector guides that illustrate the application of the key terms of the R&D Tax Incentive legislation through hypothetical case studies.

Guides have been developed for the industry sectors listed below and are available on business.gov.au.

These guides may be of use to you even if you aren’t working in these sectors.

- ICT
- Biotechnology
- Agrifood
- Manufacturing
- Energy
- Built Environment