



Getting building and construction R&D Tax Incentive claims right

Specific Issue Guidance

What do companies and their tax advisers need to consider when self-assessing the eligibility of R&D activities in building and construction?

This Guidance should be read in conjunction with the [R&D Tax Incentive: A Guide to Interpretation](#). The *Guide to Interpretation* should be read before and during the assessment of the eligibility of activities.¹

The department publishes guidance on business.gov.au to assist companies and tax advisers understand the eligibility requirements that apply to activities that are supported under the R&D Tax Incentive. Key benefits of following the guidance are:

- enabling companies to self-assess and register eligible R&D from the beginning
- helping companies avoid compliance reviews, which may involve additional legal fees and tax agent fees, and
- helping companies avoid potential repayment of the tax benefit.

Introduction

The purpose of the *R&D Tax Incentive* is to encourage companies to conduct experimental R&D activities that might not otherwise be undertaken.

This guidance highlights key issues that companies and their tax advisors must consider when assessing the eligibility of specific building and construction-related activities for registration under the *R&D Tax Incentive*. In particular, it highlights issues relating to:

- outcomes that can be resolved with existing knowledge
- the application of established engineering techniques, building materials, designs, and processes to local conditions or requirements
- a significant purpose of generating new knowledge
- descriptions in registration applications
- other problem areas that companies and their R&D tax advisers most frequently get wrong.

¹ The department's guidance on the *R&D Tax Incentive*, including the *Guide to Interpretation*, are available on business.gov.au.

To apply to register R&D activities, a company needs to consider each of its activities and assess which of them are:

- eligible core R&D activities²
- eligible supporting R&D activities,³ and
- ineligible activities that cannot be registered with the *R&D Tax Incentive*.

To self-assess the eligibility of their activities, companies must understand and apply the definition of eligible R&D activities under the *R&D Tax Incentive* to each of those activities.

Only activities that are self-assessed as eligible R&D activities can be registered with the Department of Industry, Innovation and Science (the department) under the *R&D Tax Incentive*.

Registrations of activities conducted by companies in the building and construction sector are subject to the same eligibility tests for the *R&D Tax Incentive* as activities conducted in any other sector. However, in claiming expenditure on any registered activities, companies must recognise that **expenditure incurred on acquiring or constructing all or part of a building is specifically excluded.**⁴

² Under section 355-25(1) of the *Income Tax Assessment Act 1997*.

³ Under section 355-30 of the *Income Tax Assessment Act 1997*.

⁴ This includes expenditure incurred on part of a building, extensions, alterations and improvements. The exclusion applies to all expenditure of this kind regardless of who incurs

Summary

Companies must describe in writing their core eligible R&D, in accordance with the definition of a core R&D activity listed in the *Income Tax Assessment Act 1997*. This may involve developing new ways to overcome specific technical or scientific challenges.

Eligible core R&D is not learning how to use existing products, technologies or techniques in the manner in which they are designed to be used. Eligible R&D is not using such products, technologies or techniques in a different location.

Eligible R&D does not involve deciding which of those known technologies to apply to a challenge in the building and construction industry.

When companies choose to register R&D activities relating to the building and construction industry, they must demonstrate for each core R&D activity they wish to register:

- how the experimental activity was carried out
- that the activity was for the development of a new or improved product or process
- that the activity was conducted for a significant purpose of generating new knowledge
- how the activity applied a systematic progression of work, and

it, even if it is incurred on R&D activities, and also regardless of any other detail about the circumstances in which it is incurred. The exclusion is not limited to expenditure on capital account, or to expenditure incurred by the owner or purchaser of the building. See section 355-225 of the *Income Tax Assessment Act 1997*.

- that the outcomes could not be known or determined in advance on the basis of current knowledge, information or experience.

Companies must clearly explain the activities and support the explanation with evidence.

It will not be sufficient for a company claiming a core R&D activity to just rely on propositions such as:

- an activity is experimental with an outcome that cannot be known or determined in advance because it is an application of established engineering techniques, building materials, designs, and/or processes to unique local conditions or requirements
- the design of a structure is experimental because it was developed with the use of predictive modelling software or calculations
- the whole project is eligible because there is a smaller portion of R&D within the project
- the company's internal expertise does not know or cannot determine the outcome of an activity, so the outcome of the activity cannot be knowable or able to be determined in advance.

Activities that are eligible under the R&D Tax Incentive

Core R&D activities

Role of the experiment and hypothesis

Activities that are eligible for support under the *R&D Tax Incentive* fall into two categories: core R&D activities⁵ and supporting R&D activities.⁶

Core R&D activities are activities that involve an experiment that is conducted in a systematic and planned manner. They will be designed around a specifically targeted and developed problem statement—called a hypothesis—that proposes a relationship between variables which would be proven right or wrong by observing and evaluating the results after conducting the experiment.

A core building and construction-related R&D activity could include, for example,⁷ experiments necessary to develop and test new or improved products or processes in:

- construction materials or fittings materials
- waste disposal or treatment
- decontamination treatments.

⁵ For the words used in the legislation see section 355-25(1) of the *Income Tax Assessment Act 1997*.

⁶ For the words used in the legislation see section 355-30 of the *Income Tax Assessment Act 1997*.

⁷ These examples are not prescriptive and are only offered for illustrative purposes. The full eligibility criteria must be considered for each activity that is being self-assessed for eligibility as a core R&D activity.

Generating new knowledge

Core R&D activities must be undertaken for at least a significant purpose of generating new knowledge about whether the hypothesis is right or wrong.

A competent professional in the relevant field must not be able to know or determine the outcome of a core R&D activity in advance with the current knowledge, information or experience reasonably available to them.

1. Outcomes that can be resolved with existing knowledge

The existence of a technical challenge in a project does not necessarily identify a need for R&D that meets the requirements of the legislation. In many cases technical challenges can be resolved by applying existing engineering or scientific knowledge and expertise (e.g. through activities of ‘design’, or ‘predictive modelling’, without conducting experiments). These cannot be core R&D activities.

The experiments in core R&D activities are undertaken because there is no other way to discover the knowledge that is needed to resolve a technical problem.

When companies are self-assessing activities to determine whether the outcome of an experiment could be known or determined in advance, it is important that the department’s guidance is consulted. On the topic of outcome, the department’s *Guide to Interpretation* states:

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 (p11).*

If the outcome of a proposed core R&D activity can be determined without conducting an experiment, then it will not be an eligible core R&D activity. This applies to outcomes that can be determined by existing predictive modelling software; that is, the outcome is determined by the algorithms in the software which themselves form part of the existing knowledge base (i.e. the outcome is determined by existing knowledge).

2. Applying established engineering techniques, building materials, designs or processes, to local conditions or requirements

Activities that only apply established building materials, designs, or processes to local conditions or requirements are unlikely to qualify as core R&D activities. This is because they are part of the established knowledge base available to a competent professional in the field and the outcome of their application is known or able to be determined in advance. There is generally no new knowledge created through the application of established techniques to new sites. A competent professional would be expected to be able to resolve these challenges through the application of

existing knowledge, information and experience.

3. Not having a significant purpose of generating new knowledge

Building and construction activities are generally undertaken for profit. This differs from the purpose of undertaking experimental activities (to gain new knowledge) and thus it should be easy to distinguish between the two.

While commercial and knowledge discovery purposes can co-exist in an activity, companies need to ensure that their ordinary business activities are separated from any R&D activities and that only R&D activities are claimed.

In addition to a purpose of generating new knowledge, companies may have commercial or other purposes for conducting core R&D activities. However, core R&D activities are required to have at least a significant purpose of generating new knowledge. The Administrative Appeals Tribunal found that:

... the purpose of generating new knowledge must be more than an insubstantial purpose; it must be substantial enough to enable the activity to be accurately characterised as conducted for that purpose [JLSP and Innovation Australia [2016] AATA 23 (22 January 2016) at 52].

Activities that are core R&D activities will be able to demonstrate coherent and planned design and execution, along with an identifiable and relevant knowledge gap. They are activities that were known or planned to be R&D activities at the time they were conducted. If the company

was not intending to conduct R&D at the time the activities were carried out, then they will not have the requisite purpose.

4. Specific problem areas

Registrations that the department has found to be ineligible include activities that were claimed to be core R&D activities however:

- the outcomes of the claimed 'experiments' could have been known or determined in advance by a competent professional
- the claimed core R&D activities applied well-known engineering techniques, processes and/or materials to particular sites
- the activities were purely for profit and did not have a significant purpose of discovering new knowledge.

Projects are not eligible

Eligible activities must be specific activities; eligibility does not apply to projects.

When conducting research and development, companies tend to think in terms of projects and project outcomes rather than in terms of the specific activities that the company conducts within and as a component of a project. However, the eligibility criteria under the *R&D Tax Incentive* require eligibility to be assessed at the level of specific activities.⁸

During the self-assessment process, companies must be careful to recognise that eligibility under the *R&D Tax*

⁸ The *R&D Tax Incentive* is governed by Division 355 of the *Income Tax Assessment Act 1997* and sections 26 to 32 of the *Industry Research and Development Act 1986*. The eligibility criteria for

activities are set out in sections 355-20 to 355-30 of the *Income Tax Assessment Act 1997*. Activities should be described in detail on the *R&D Tax Incentive* registration form.

Incentive is based on specific activities and not based on whole projects or large parts of projects.

It is very unlikely that all of the activities being conducted in a building and construction project would be eligible R&D activities. While companies may conduct some R&D activities as part of a project, that does not make the entire project an eligible R&D activity.

Self-assessment must identify specific experiments and separate any experimental activities, and activities that directly support them, from routine construction activities.

1. Specific problem areas

The department has reviewed a number of registered building and construction activities and found they were not eligible for the *R&D Tax Incentive*.

In many cases, companies registering their activities describe their projects, and related commercial or operational problems, without providing sufficient details of R&D activities to meet legislative requirements under the *R&D Tax Incentive*.

Self-assessment and registration

1. Vague and non-specific descriptions in registration applications

Activity descriptions in registration applications must be specific, clear and detailed to enable the department and the ATO to apply the legislation⁹ to those

⁹ The department administers the legislation concerning the definitions of eligible R&D activities and findings on activities, while the ATO administers the remainder of the taxation law, including whether expenditure is connected with a registered activity and whether it is eligible expenditure.

activities. Descriptions should be written in such a manner that a reader will be able to immediately and clearly understand what the applicant has done, for both core and supporting R&D activities. Using the headings in the legislation should help companies to explain how their activities meet the eligibility criteria.

Vague and non-specific descriptions of activities are not compliant with the department's Specific Issue Guidance [How should companies group R&D activities?](#)¹⁰ which states:

The most important point for a company to address in its registration is to specify what constitutes the activities, in a way that an independent person can understand what the activities consist of. The completeness of the description is critical to claiming because companies can only claim expenditure they have incurred on [eligible] registered activities. The more significant a component of an activity is in terms of eligibility or expenditure, the more important it is for the company to describe it clearly.

Vague and non-specific descriptions may result in a compliance review and associated delays in assessment of claims.

2. Failure to describe a relevant 'systematic progression of work'

The activity descriptions that describe core R&D activities must include a clearly described and relevant systematic progression of work. Under the law,¹¹ core R&D activities proceed from

¹⁰ The department's guidance products, including *How should companies group R&D activities?*, are available on business.gov.au.

¹¹ Section 355-25 of the *Income Tax Assessment Act 1997*.

hypothesis to experiment, observation and evaluation, and lead to logical conclusions as to whether a hypothesis is true or false (the 'systematic progression of work'). This must be evident and understandable in the registration application.

Identifying a relevant, systematic progression of work in a company's activities forms the basis of the self-assessment process to assess the eligibility of the company's activities for registration.

For activities being considered for eligibility as core R&D activities, self-assessment must focus on identifying the specific experiments that:

- investigate a clearly identifiable scientific or technical knowledge gap
- test a problem statement (the hypothesis) that aims to identify causes and effects relevant to solving the scientific or technical problem
- lead to conclusions about the idea being tested that were not able to be known or determined in advance by a competent professional in the field without conducting a hypothesis-driven experiment
- can be clearly characterised as being undertaken for a significant purpose of generating new knowledge to resolve the scientific or technical problem, and
- are more than collecting data but use a scientific approach that provides confidence that the experimental

outcomes, the conclusions about the idea that is being tested, are sound.

If an activity being considered by a company for registration as a core R&D activity includes activities that:

- have outcomes that could have been known or determined in advance by a competent professional
- do not clearly define an experimental process that could lead to conclusions about cause and effect in relation to a scientific or technical problem
- do not involve a hypothesis that addresses technical unknowns rather than simply commercial success or failure¹²
- do not have a significant purpose of generating new knowledge at the time they were conducted, and
- lead to conclusions about the hypothesis that could have been made by applying existing expertise or knowledge

there is a high probability that these activities will not be eligible for the *R&D Tax Incentive*.

It is critical that records are kept to show how the self-assessment process was undertaken and how the company concluded that the activities were eligible R&D activities.

3. Specific problem areas

Some companies and their advisors are:

knowledge (a technical unknown) rather than commercial risk. The *R&D Tax Incentive* does not support activities where a significant focus of those activities is not on generating information to address a technical or scientific unknown.

¹² All industry R&D is directed to resolving technical problems for implementation in commercial outcomes. However, the purpose of the *R&D Tax Incentive* is to support genuine experimental R&D where the inherent risk is due to a current limitation of technical or scientific

- providing vague and non-specific activities in their registration applications which fail to describe what the company is doing and how the activities meet the eligibility criteria
- lodging registrations where the systematic progression of work required for a core R&D activity is not described, or not clearly described.

Some activities are excluded

Some activities are excluded from being core R&D activities by the legislation.¹³ Excluded activities may still qualify as supporting R&D activities if they meet the relevant requirements and are also undertaken for the *dominant purpose*¹⁴ of supporting a core R&D activity.

1. Associated with regulatory compliance or standards exclusion

During the course of building and construction projects, activities will be undertaken for the purpose of complying with regulations and standards. These activities are explicitly excluded from being core R&D activities. The *Guide to Interpretation* advises how broadly this exclusion applies:

This exclusion will cover any activity carried out to meet a requirement in:

- *legislation*
- *regulations, or*
- *standards.*

... 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. (p33)

If a company is undertaking activities to comply with legislation, regulations or standards, they cannot be core R&D activities. However, they may be considered for eligibility as supporting R&D activities where they are directly related to a core R&D activity and undertaken for the dominant purpose of supporting that core R&D activity.

2. Specific problem areas

Some activities that have been registered involve conducting tests to show that a particular design complies with a relevant required standard, such as meeting provisions of the National Construction Code.

Supporting R&D activities

Supporting R&D activities are activities that have a direct, close and relatively immediate relationship with a core R&D activity.

Activities that make a direct contribution to the conduct or evaluation of the experiment are likely to meet this requirement. Where an activity is:

¹³ See section 355-25(2) of the *Income Tax Assessment Act 1997* for the list of excluded activities.

¹⁴ The meaning of 'dominant purpose' is explored more fully on page 20 of the *R&D Tax Incentive: A Guide to Interpretation* which may be found on business.gov.au.

- excluded from being a core R&D activity
- one that produces goods or services, or
- one that is directly related to producing goods or services

that activity 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.

Examples of where a supporting R&D activity may be identified in the building and construction sector, where the correlating core R&D activity exists, could include the:

- manufacture of prototype materials for experimental testing
- transportation of materials for the purpose of experimental testing
- use of predictive modelling software activities that inform the design of an eligible experimental activity.¹⁵

Some activities are excluded from being core R&D activities by the legislation. However, some excluded activities may in fact be supporting activities, but only in certain circumstances.

1. Specific problem areas

Some activities that are claimed to be supporting R&D activities in registrations are not described with sufficient clarity to understand how those activities meet the

¹⁵ These examples are not prescriptive and are offered for illustrative purposes only. The full eligibility criteria must be considered for each activity that is being self-assessed for eligibility as a supporting R&D activity, including, where necessary, whether the dominant purpose test is satisfied.

eligibility requirements. These requirements are described below.

2. Directly, close and relatively immediate relationship to a core R&D activity

When identifying a supporting R&D activity, a company needs to consider whether the activity has a direct, close and relatively immediate relationship with one or more components of the systematic progression of work in an eligible core R&D activity. Activities that make a direct contribution to the conduct or evaluation of the experiment are likely to meet this requirement.

‘Directly related’ means more than simply being in the same project or supporting the same project. The relationship must be directly associated with the experimental activity.

Activities that generally support the construction project do not become supporting R&D activities simply because a core R&D activity is undertaken as part of the same construction project.

The description in the registration form must clearly explain what the claimed supporting R&D activity is and how it is directly related to the systematic progression of work in an eligible core R&D activity.

3. Undertaken for the dominant purpose of supporting a core R&D activity

Activities conducted in the building and construction industry mostly produce goods and services¹⁶ or are directly

¹⁶ In the context of the legislation the term ‘services’ refers to the application of a person’s professional expertise, such as professional advice on a topic. It does not refer to transport, communications or to municipal services such as electricity, water or sewage.

related to the production of goods or services. This means that for an activity to be a supporting R&D activity it is very likely that it will also need to meet the dominant purpose test. This test requires the company to identify and genuinely assess all its reasons for conducting the activity. If the dominant reason is to genuinely support a core R&D activity, then the activity will have passed this test. As with all criteria under the *R&D Tax Incentive*, documentation generated at the time must be maintained to show how the company arrived at its conclusion.¹⁷

Where a claimed supporting R&D activity is required to meet the dominant purpose test, the description in the registration form needs to provide sufficient detail to enable the reader to understand the scope of the activity so that the department's consideration of the dominant purpose can commence.

Documentation generated at the time and record keeping

If a company does not have evidence that was generated at the time an activity was conducted, or before in the case of planning documents, showing that it met all the eligibility criteria, then that activity is not eligible. This is a basic step in any company's self-assessment of eligibility.

The Administrative Appeals Tribunal has consistently found that claimed R&D activities without evidence that substantiates eligibility are not eligible. For example, it has stated that an 'applicant cannot succeed in establishing [the eligibility] requirements in the absence of detailed documentation recording the process of each activity as it develops' (*Docklands Science Park Pty Ltd*

v Innovation Australia [2015] AATA 973 at 63).

When a company is self-assessing whether activities are eligible R&D activities, it cannot simply assert or effectively argue that it thinks an activity was eligible if it does not have evidence to support its self-assessment. If it does not have evidence to substantiate eligibility of an activity, then it will not be reasonably justifiable to register that activity or claim expenditure for it.

Documentation and records must demonstrate that all eligibility requirements are met and particularly:

- show how the experiments were undertaken
- show how the company assessed that the outcome of the activities could not be known or determined in advance
- be sufficient to verify the:
 - amount of the expenditure incurred on the registered activities, and
 - relationship of the expenditure to the activities
- show how non-experimental activities directly support experiments and, where necessary, were conducted for the dominant purpose of supporting experiments
- show how expenditure was apportioned between eligible R&D activities and non-R&D activities.

It is the company's responsibility to demonstrate that it has used reasonable methods to differentiate between expenditure on R&D activities and expenditure on non-R&D activities.

¹⁷ More information on the dominant purpose test is available in the [R&D Tax Incentive: A Guide to](#)

[Interpretation](#) which is available on business.gov.au.

Further assistance

To assist companies properly address their self-assessment obligations, both the department and the Australian Taxation Office provide detailed guidance about eligibility and record-keeping requirements necessary to support eligibility:

- [R&D Tax Incentive: A Guide to Interpretation](#)
- [R&D Tax Incentive: Record-Keeping and R&D Planning](#)
- [Research and development tax incentive: keeping records and calculating your notional deductions](#)

Disclaimer

This guideline document is intended to provide useful information for companies considering accessing the R&D Tax Incentive. However, it is not exhaustive and it is not legal or financial advice. 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* as set out in the *Income Tax Assessment Act 1997*. The Commonwealth disclaims all liability for any loss or damage arising from you or anyone else relying on this document or any statement contained in it.