**Australian Government**

**Department of Industry, Science and Resources**

# Software-related activities and R&D Tax Incentive

A guide to help you assess whether your software-related R&D is eligible for the R&D Tax Incentive

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# Copyright

# Disclaimer

# Contents

# Acknowledgement of Country

Our department recognises the First Peoples of this Nation and their ongoing cultural and spiritual connections to the lands, waters, seas, skies, and communities.

We Acknowledge First Nations Peoples as the Traditional Custodians and Lore Keepers of the oldest living culture and pay respects to their Elders past and present. We extend that respect to all First Nations Peoples.

# Overview

## What is the R&D Tax Incentive?

The Research and Development Tax Incentive (R&DTI) is a government program which encourages businesses to conduct research and development (R&D) activities likely to generate new knowledge for the benefit of the Australian economy.

It does this by offering:

- a refundable tax offset for entities with an annual turnover of under $20 million

- a non-refundable tax offset for entities with an annual turnover of more than $20 million.

The R&DTI is jointly administered by the Department of Industry, Science and Resources (the department), on behalf of Industry, Innovation and Science Australia (IISA), and the Australian Taxation Office (ATO).

The R&DTI supports eligible R&D activities you conduct in Australia. It may also support eligible R&D activities you conduct overseas. You must apply for and receive an Overseas Finding before you can claim for expenditure on overseas R&D activities.

You can also apply for an Advance Finding if you want to be sure your R&D activities are eligible. A favourable Advance Finding gives you assurance that your registered R&D activities will be eligible for claiming under the R&D Tax incentive.

Find out more about applying for an advance finding.

## About this guide

This guide has been developed to help you assess whether your R&D related to software development is eligible for the R&DTI.

This document provides guidance around:

- the criteria for eligible R&D activities

- what these criteria mean

- how to interpret these criteria in order to determine eligibility.

You should read this guide if you conduct or plan to conduct R&D activities related to software development and need help to assess your activities against the legislative requirements.

The content in this guide reflects the way we apply the legislation in sections 355–25 and 355–30 of the *Income Tax Assessment Act 1997* (ITAA 1997). This is informed, where applicable, by decisions from tribunals and courts.

Throughout the guide we refer to relevant sections of the legislation and explain key terms in these sections. When we quote from the legislation, we provide the relevant section reference.

You'll see the term 'eligible' used throughout this guide. We use the term 'eligible' to mean entities, activities or expenditure that meet the legislative requirements of the R&DTI program.

This guide supplements the Guide to Interpretation, which is our primary guide explaining key terms of the R&DTI and how we apply the legislation. It is strongly advised that you read the Guide to Interpretation before reading this (or any other) guide.

# Before reading this guide

- Check if your business is eligible for the R&DTI

- Read the Guide to Interpretation.

# We're here to support you

If you read this guide and are still unsure about the eligibility of your software-related activities, contact us on 13 28 46. We also encourage you to attend one of our information sessions.

For more information, visit our website at business.gov.au - Research and Development Tax Incentive.

# Disclaimer

This guide is intended to provide general guidance only. You need to refer to the legislation and consider your particular circumstances when assessing your eligibility.

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

Important note: Examples we provide are for guidance only. Even if your activities appear like the examples, they still might not be eligible for the R&DTI. Your activities must meet all of the legal requirements for R&D activities to be eligible R&D activities. You need to consider your specific and individual circumstances and must always assess your activities against the legislation.

# Software-related R&D activities

## Eligible R&D activities

Before we begin, it is important to understand that 'R&D activities' have a specific statutory definition which is set out in subsection 355–25(1) of the ITAA 1997. This definition may not be the same as the ordinary commercial, engineering or accounting definition of research and development activities. Not all innovation falls within the definition of R&D activities.

The program's definition of R&D activities is designed to ensure that the incentive is directed towards activities that are unlikely to be done by business in the absence of government support.

The R&DTI applies to eligible R&D activities that you conduct and register. Activities are the building blocks that make up a project. When you register for the R&DTI, we expect you to describe specific activities you conduct within your project with reasonable detail to allow us to understand how those activities meet the eligibility requirements. It is likely that not all activities within an innovation project will meet the requirements for being R&D activities.

### Example

You may plan a project to develop a new or improved software application. This application may form part of a product or device, or enable service delivery. Alternatively, you might develop software to control a process. As part of your software project, you may conduct eligible R&D activities that you can register for the R&D Tax Incentive.

This guide may assist you if the main focus of your business is software development, or if you are conducting software development activities as part of your business or R&D.

**Software-related research and development activities must meet all of the legislative requirements for being R&D activities to be eligible for the R&DTI.**

There are two types of R&D activities – core R&D activities and supporting R&D activities.

# Core R&D activities

To be eligible for the R&D Tax Incentive you must be undertaking or plan to undertake at least one core R&D activity in Australia. Section 355–25(1) of the ITAA 1997, the law that applies to the program states:

> **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).

Your activities must meet the criteria at both (a) and (b) to be eligible as core R&D activities.

They also must not be excluded activities. Section 355–25(2) of the ITAA 1997 lists excluded activities (see the section Software activity exclusions).

After you assess that you have conducted or plan to conduct at least one core R&D activity, you can then assess whether your project includes any activities that meet the definition of supporting R&D activities. Supporting R&D activities must be directly related to a core R&D activity. In some circumstances you must also conduct them for the dominant (most prevailing or most influential) purpose of supporting a core R&D activity.

Detailed information about the eligibility requirements for core and supporting R&D activities is provided in the Guide to Interpretation.

## Do I have a core R&D activity?

✅ The outcome of my core R&D activity cannot be known or determined in advance from current knowledge, information or experience

✅ The outcome of my core R&D activity can only be determined by applying a systematic progression of work

✅ My systematic progression of work is based on principles of established science and proceeds from hypothesis to experiment, observation and evaluation and leads to logical conclusions

✅ I conduct my core R&D activity to generate new knowledge

✅ My activity is not excluded from being a core R&D activity

# Core R&D activities criteria explained

## Outcome cannot be known or determined in advance

For your activity to be eligible as a core R&D activity, the outcome of that activity:

- cannot be known or determined in advance, and

- can only be determined by applying a 'systematic progression of work' (see the section Systematic progression of work).

This means that before you start your activity, you must establish that it has an unknown outcome based on current knowledge, information or experience. You need to be able to show how you establish this and why it can only be determined by applying a 'systematic progression of work'.

## Example

A company intends to develop a new Health Management System to manage patient health records. To support optimal health outcomes for patients the company wants to include the health tracking capabilities of wearable fitness devices and diet apps available in the market.

### Challenge

The company identifies a number of popular health tracking products that capture relevant data for its new Health Management System. Each product uses different sub-systems that are not inter-operable. Many of the device platforms also don't use an Application Programming Interface (API) to access the data they collect. The company's key challenge is to work out how to integrate several different operating systems and health data sources.

### Unknown outcome

A relevant solution was not identified from product and code repository searches or consultation with industry experts. The company then decided to undertake systematic research and development to determine if the challenge could be solved.

You are expected to search widely for current knowledge information or experience and keep records to show how you did this search.

When assessing whether there is an unknown outcome, you need to consider:

- whether an outcome is scientifically or technologically possible, or how it can be determined

- whether existing knowledge or capability can be adapted to solve a problem

- where limitations in the current state of technology hinder the development of a new or improved capability

- a technological constraint that needs to be overcome, with unknowns arising in relation to:

  – whether the output will meet desired specifications such as response time, reliability or cost

  – how the desired specifications can be achieved amongst possible alternative methodologies or solutions

- the use of known processes, technologies and methodologies where the result or outcome is unknown

- system unknowns, where the components of a system and their interactions are known, but the outcome result of the system cannot be deduced from the outset

- where something has already been shown to be possible but needs further work to make the technology more cost-effective, reliable or reproducible.

Eligible R&D activities may take place regardless of whether the unknown outcome is successfully determined by the systematic progression of work. However, the activity must not be an excluded activity (see the section [Software activity exclusions](#)).

## How can I know when information is not available?

Information that is not reasonably accessible is not available. This may include information that is commercially sensitive and held by a competitor, such as a trade secret.

If the technical or scientific idea you are testing is in your area of expertise, you may know if relevant knowledge, information or experience is available. Even if you or someone in your organisation is an expert in the field, you should research other sources to confirm that knowledge of how to achieve your outcome does not exist worldwide.

You are expected to make reasonable and thorough inquiries before you conclude that an activity has an unknown outcome.

For example, you could:

• undertake a search of Computer Science Journals, major open-source code repositories (such as GitHub) and/or technology blogs

• conduct an analysis of current technology capabilities, or products currently on the market

• consult with your professional network and ask questions on a technology forum

• seek advice from experts within your company, or from specialists in the field, including at a university or research centre.

You are not expected to have access to information that is commercial-in-confidence or is the unpublished intellectual property of another company.

You are expected to keep evidence of your enquiries.

# Competent professional

For an activity to be a core R&D activity, a competent professional in the relevant field cannot know or determine the outcome of the activity in advance.

A competent professional is a person who:

• has the relevant knowledge, skills and experience

• has qualifications or can otherwise act with a reasonable level of skill

• keeps up to date with developments

• has access to knowledge and resources around the world, for example, online resources, relevant industry journals and other competent professionals in the field.

A competent professional might be you or someone else in your organisation, a consultant or an academic expert.

You need to assess that a competent professional cannot know or determine the outcome:

• of the core R&D activity without carrying out a systematic progression of work

• based on knowledge, information or experience that is publicly available or reasonably accessible, anywhere in the world.

An activity will qualify as a core R&D activity when a competent professional cannot determine the outcome of that activity without applying a systematic progression of work that is based on principles of established science.

## Systematic progression of work

The outcome of each core R&D activity needs to be one that you can only determine by applying a systematic progression of work that is based on principles of established science.

The principles for research in information technology and communications areas are not necessarily different to the principles of established science.

You have to show how your systematic progression of work proceeds from hypothesis to experiment(s), observation and evaluation, and leads to logical conclusions. The following sections describe how these stages might be undertaken when conducting eligible R&D activities related to software development.

When registering your R&D activities, you will be required to document those activities in your application for registration accessed from the R&D Tax Incentive portal.

For some R&D activities, the systematic progression of work may progress over multiple years. Registrations that run over multiple years should show a progression of work over that period, outlining how the R&D activities have changed and progressed over time.

We expect you to record:
- the hypothesis that you are testing
- what the experiment, or set of related experiments, was and how it was conducted
- what the results of the experiments were, and
- what conclusions were drawn from the results.

While the R&D Tax Incentive is a self-assessment program, we may review the activities in your application. Should a review take place, you will be asked to provide records of your activities. We expect that records you make before or around the time you conduct your activities will show that the activities took place in the year of claim, and meet the legislative requirements. See the 'What records do I need to keep' section of this guide for further information.

Each of the elements of a systematic progression of work is explained further in the following sections, together with how the concept applies to software development methodologies.

## How the program applies to software development methodologies

If you are conducting R&D activities using methodologies like Agile, Waterfall, Rapid and similar, you will need to show that the outcome could not be determined in advance and that your methodologies were either used as part of a systematic progression of work (as defined in section 355–25) that you applied when conducting a core R&D activity, or were used in supporting R&D activities that are directly related to a core R&D activity.

You may conduct some of the following activities when you conduct experiments to test your hypothesis:
- system testing
- requirements testing
- data mapping and data migration testing
- testing the efficiency of different algorithms that are already known to work
- testing websites in operation by measuring the number of hits

- digital transformation activities – transforming predominantly manual processes to digital
- upgrading technology
- routine computer and software maintenance
- data manipulation.

If you do not conduct these activities within a systematic progression of work as part of a core R&D activity, they may be supporting R&D activities. In this case, they would need to be directly related to a core R&D activity, and if required be conducted for the dominant purpose of supporting a core R&D activity.

We expect your records to show how these activities are part of a systematic progression of work or otherwise directly related to core R&D activities.

We recognise that some routine testing activities, such as debugging (identifying and fixing errors in codes) and beta testing, can be part of a core R&D activity where they constitute part of a systematic progression of work as required by the legislation. Your activities must meet all requirements of section 355–25 of the ITAA 1997 to be eligible as core R&D activities.

## What is a hypothesis?

A hypothesis is:

- your idea to achieve a particular result, and
- how you might achieve that result.

We expect you to show how you formed your hypothesis based on your research into the current available knowledge. There should be a clear link between the goal you want to achieve, the activity you are conducting and why you think that activity could achieve your goal.

Your hypothesis proceeds to, and will direct the design and conduct of, your experiment. Make sure you develop your hypothesis before you start your R&D activities.

## Example

A hypothesis such as "We hypothesise that the integration of health tracking data from heterogenous and disparate health data sources can be achieved to ensure consistent user experience in terms of features, data quality, security, and reliability" lacks sufficient details.

A much stronger hypothesis would be:

"We hypothesise that the integration of health tracking data from heterogenous and disparate health data sources can be achieved" (what result company wants to achieve).

"We will achieve this by collecting data at end users' devices" (how the company will achieve).

"This method will allow us to get as close as possible to the data source and tap into its data directly, overcoming the lack of APIs from each vendor" (why the company think it will achieve).

"Our background research indicates that this agent-based architecture method for data collection can be suitable for accessing data from various sources reliably" (background research).

# What is an experiment?

An experiment is a planned activity you undertake to test your hypothesis. For software-related activities, the experiment might be, for example, the application of different iterations of proposed code solutions to a problem.

We expect you to explain how you conduct or plan to conduct your experiment. For example, you might describe the parameters you vary, those you hold constant, and those you observe or measure.

You need to keep track of key information about your experiments when developing software. This could include comparisons of the experimental results, work undertaken to identify the factors affecting software performance and how you decided to select the version that best achieves the intended goal. We expect you to be able to provide experiment-related information such as the:

• experiment's hypothesis or objective

• experimental variables and other parameters

• experimental observations

• evaluation method.

Where experiments do not yield usable results, the inputs to the experiments (such as software code or design parameters) may be varied and further experiments repeated and completed until such time that the outcome is known or able to be determined.

The activities of a failed or abandoned experiment may also be eligible if the necessary legislative criteria are met. It is understood that there is a risk of failure when conducting R&D activities.

# Observation and evaluation

Observation is where you observe, measure and record information and results that relate to your experiment. Such information can be qualitative (descriptive) or quantitative (numerical data).

Evaluation is where you assess and analyse the results of your experiments. You need to consider what the results of your experiment mean.

We expect your records to show what information you measure and record. You also need to show how you evaluate the results of your experiment to understand why and how you achieve or do not achieve your desired outcome.

# Leads to logical conclusions

You need to form logical conclusions about why your results do or do not support your hypothesis. Your logical conclusion may be that you need to investigate different solutions and develop and test a new hypothesis.

# Purpose to generate new knowledge

You may decide to conduct R&D for several reasons and activities in your R&D could also be conducted for different reasons. To be eligible as a core R&D activity, you need to show the activity is carried out to generate new knowledge. You can still carry out an activity to generate new knowledge even if you have other reasons for your R&D.

**The purpose for conducting each of your claimed core R&D activities will be apparent from the evidence.**

New knowledge is knowledge that did not already exist, or is not publicly available or reasonably accessible from anywhere in the world (for example, a trade secret).

New knowledge can be general or applied. It may be a new theoretical or practical understanding of a subject. New knowledge can be in the form of new or improved materials, products, devices, processes or services; and/or in the form of facts, information, skills and understanding (including about how to produce new or improved materials, products, devices, processes or services).

An activity that only generated new knowledge by accident is unlikely to be eligible. There must be an intention to generate new knowledge at the time the activity was commenced; not just a by-product of normal commercial activity.

In most cases, if you are able to demonstrate that the outcome from conducting your activities could not have been known or determined in advance, those activities will have been conducted for the purpose of generating new knowledge.

# Software activity exclusions

Before registering any R&D activities, you need to check whether they are excluded from being core R&D activities. A list and detailed explanation of excluded activities is contained in the Guide to Interpretation.

If an activity is not excluded, you still need to assess if it meets all the requirements for being a core R&D activity.

The legislation, at subsection 355–25(2) of the ITAA 1997, lists activities that cannot be core R&D activities for the R&DTI. Some specific software-related activities are excluded from being core R&D activities:

| Software exclusion |
| --- |
| (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; and |
| (iii) an *affiliate of the developer, or an entity of which the developer is an affiliate. |

If you conduct activities to develop, modify or customise computer software, you need first to assess if the software is for use by you, an entity connected with you, or an entity affiliated with you. If it is, you then need to assess if the dominant purpose of using the software is for either your (or that entity's) internal administration, or the internal administration of your (or that entity's) business functions.

Activities that you conduct to develop, modify or customise computer software include those to:
- design software
- write new code or modify existing code
- test software
- customise an off-the-shelf software package. For example, to make the software perform a different function.

Internal administration functions include but are not limited to:

- business applications such as payroll and accounting, invoicing, ordering, quality control reports and information management
- management information systems
- enterprise resource planning.

To determine if the dominant purpose is use by you, or entities connected or affiliated with you, for internal business administration, you need to consider which entities the software is being developed, modified or customised for, and then how those entities will use that software. You then need to consider the strength of each purpose and how important each is compared to the other purposes for using the software.

**There may be several purposes for using software, but you can only have one dominant purpose. If the dominant purpose for the software's use is internal business administration or internal administration of a business function by you, a connected entity or an affiliated entity, then the activities to develop, modify or customise the software cannot be core R&D activities.**

If the dominant purpose for the software's use is not for the internal administration by you, a connected entity or an affiliated entity, then the activities are not excluded by s 355–25(2)(h) from being core R&D activities. This may include software that:

- forms part of an electrical or mechanical device, such as industrial equipment or consumer products
- is used to collect and analyse data from experiments
- is used by your customers and is unrelated to your internal administration.

Activities that are excluded from being core R&D activities may still qualify as supporting R&D activities. To meet the requirements to be a supporting R&D activity, you need to demonstrate that the activity is directly related to one or more core R&D activities and also has a dominant purpose of supporting at least one of those activities.

## Example

You may need to modify some of your internal administration software in order to conduct a core R&D activity to develop software that provides a service to your customers. If you were not conducting the R&D activity, you would not modify the internal administration software. As the modifications are for the dominant purpose of supporting the core R&D activity, the activity may be a supporting R&D activity, if it is also directly related to the core R&D activity.

The exclusion in the s 355–25(2)(h) is the most relevant exclusion to consider when you conduct software R&D activities.

Other potential exclusions that may apply in software R&D include:

- management studies or efficiency surveys
- research in social sciences, arts or humanities.

## Example

You are developing software that helps manage the productivity of employees for big firms. During development, you would need to evaluate the performance of the developed algorithm by measuring or evaluating time and motion of a group of employees. This measurement and evaluation is excluded as a core R&D activity as it falls under exclusion (c) – management studies or efficiency surveys.

While this efficiency survey would not be a core R&D activity it may be eligible as a supporting R&D activity. To be a supporting R&D activity it must be directly related to the core R&D activity and have the dominant purpose of supporting a core R&D activity.

You should refer to the full list of exclusions to ensure that none of your core R&D activities are excluded from being core R&D activities.

You can read more about excluded activities in the [Guide to Interpretation](#).

# Supporting R&D activities

When you conduct software-related activities that meet the requirements for being core R&D activities, you may also conduct supporting R&D activities.

A supporting R&D activity is one that is directly related to one or more core R&D activities. This includes activities such as: setting up testbeds, coding algorithms created using existing knowledge that will be used in an experiment, or collating a data sample that will be used to conduct a relevant experiment.

The legislation at s 355–30 of the ITAA 1997 states:

> **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.

## When the dominant purpose test applies

Supporting R&D activities must be directly related to a core R&D activity to be eligible.

Activities that:
• are excluded from being core R&D activities
• produce goods or services, or
• are directly related to producing goods or services.

must also be conducted for the dominant purpose of supporting at least one of your core R&D activities to be claimed as eligible supporting R&D activities for the R&DTI.

In any of these circumstances, you need to assess the dominant purpose of conducting the activity. Dominant purpose means your prevailing or most influential purpose. Your main purpose for conducting your activities must be to support a core R&D activity.

You may have several purposes for conducting the supporting R&D activity (for example, supporting a core R&D activity and a commercial purpose), but you can only have one dominant purpose. To determine the dominant purpose of the activity, you need to consider all the purposes you have to conduct that activity. You then need to consider the strength of each purpose and how important each is compared to your other purposes.

**Whether you conduct an activity for the dominant purpose of supporting a core R&D activity will depend on your specific circumstances.**
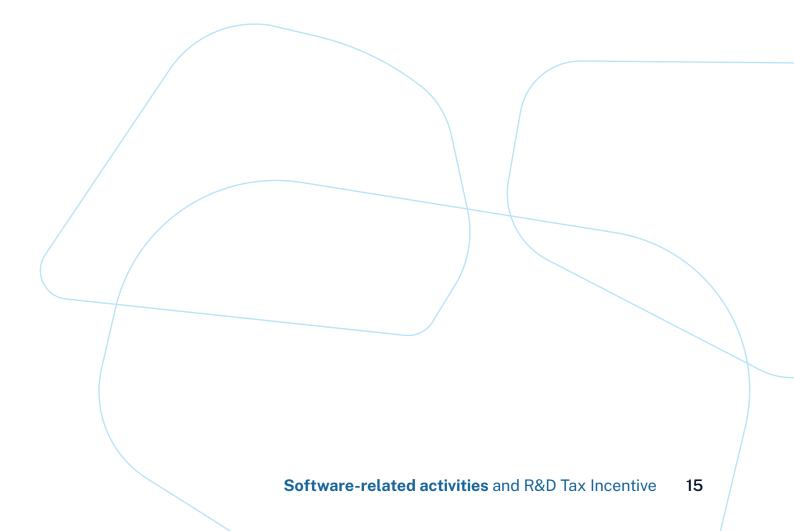
## Example

You might customise software on a production line to facilitate an experiment in an eligible core R&D activity. As this activity is directly related to producing goods or services, you must show you conduct it for the dominant purpose of supporting a core R&D activity.

You must only claim activities that have the required dominant purpose to the extent they support your core R&D activities. For example, you cannot claim parts of activities that produce, or are directly related to producing, goods or services, if they are not used to support core R&D activities.

If you sell or use those goods or services produced by a supporting R&D activity, you may also need to consider 'feedstock adjustment rules' (available on the ATO website) and include the necessary feedstock adjustment amount in your income tax return.

We expect you to document the dominant purpose of supporting R&D activities.

Please refer to the Guide to Interpretation for more information about dominant purpose.

# How to claim the R&D tax incentive?

Only R&D entities can apply to register for the R&D Tax Incentive. The term R&D entity is defined in s 355–35 of the ITAA 1997.

You are an R&D entity if you lodge your tax return as an Australian resident company. You may also be an R&D entity in other limited situations.

You are not eligible for the R&DTI if you are:

- an individual including a sole trader
- a corporate limited partnership
- an exempt entity (where your income is exempt from income tax) for example a not for profit organisation or a university
- a trust (other than a public trading trust with a corporate trustee).

You need to apply to register within 10 months of the end of the income year in which you conduct your eligible R&D activities. Once you have registered your eligible R&D activities, you can claim for expenditure that you incurred on your eligible R&D activities through the ATO.

The ATO is responsible for the rules about what expenditure is allowed by the program. The information below will give you a general idea of what expenditure is allowed.

What you can claim will depend on your particular situation. The kinds of expenses that are more commonly seen with software-related R&D activities include:

- wages, salaries, contractor fees
- overhead expenditure
- equipment and raw materials.

Expenses you claim are not limited to these categories.

You may also claim the decline in value of a tangible depreciating asset used for R&D activities.

For each item, you can only claim the proportion of expenditure and depreciation that you incurred on eligible R&D activities. You must be able to show how you worked this out if you are asked.

There are certain expenses that cannot be claimed under the R&D Tax Incentive, with some examples being:

- 'core technology': the cost of technology that you have purchased or licensed for the purpose of developing it further is not an allowable expense. The costs associated with further developing the core technology or other technology that is required to conduct experiments may still be eligible if the relevant criteria are met (see examples below).
- expenditure that your company does not ultimately bear the risk of expending (e.g. expenditure on activities done to fulfil a contract where payment occurs regardless of the results).

These should be considered under the normal deduction provisions of the income tax law because you may still be able to deduct these amounts from your assessable income.

If you would like to know more, you should see the information on the [ato.gov.au - Research and Development Tax Incentive](#).

## Core technology examples

You purchase a licence to use smart phone simulator software and you will further develop the source code to create a better smart phone simulator package. This would be core technology and the expenditure on the licence would not be eligible under the R&D Tax Incentive. This is because you will conduct activities to further develop the base simulator software code to improve the product or to develop new software services based on that simulator.

You purchase a licence to use smart phone simulator software and you want to use it to experiment with an app in a smart phone environment. The expenditure on the licence could be eligible as you do not plan to further develop or adapt the technology. You will merely use the technology to assist with your experiments.

# Can I claim for R&D activities conducted overseas?

The R&D Tax Incentive generally supports eligible R&D activities you conduct in Australia. When certain conditions are met it may also support eligible R&D activities you conduct overseas.

To [claim the R&D Tax Incentive for overseas activities](#), you must apply for and receive a positive ['Overseas Finding'](#). This application must be made before the end of the income year in which you conduct the activities. Late applications or requests for an extension of time cannot be accepted.  You must also separately register the activities from your overseas finding application.

Activities conducted overseas must meet all four of the following conditions:
- your overseas activity must have an advance finding that it is an eligible R&D activity
- there must be a significant scientific link to an Australian core R&D activity
- the overseas activity must not be able to be conducted in Australia or its external territories for one of the specified reasons set out in the legislation
- the costs for overseas R&D activities must be less than the costs of related R&D activities undertaken solely in Australia (this is worked out using the formula in the legislation).

If you do not have a positive Overseas Finding, you must be able to demonstrate that the work was carried out in Australia and not subcontracted out or otherwise performed overseas, and it otherwise meets the criteria to be an eligible R&D activity.

While the conditions for an Overseas Finding may have been met, you are still required to meet the conditions for claiming expenditure.

The proposed R&D activity may require access to expertise not available in Australia.

To demonstrate this, you should be able to show that you conducted a reasonable Australia-wide search and/or advertising campaign and provide evidence in the form of independent advice from research organisations, industry associations or other relevant organisations or individuals addressing the lack of available expertise and records of the advertising campaign.

The other criteria for a positive Overseas Findings must also be met.

# If I end my activity or project early, can I still claim?

If you terminate an activity or project after completing a supporting R&D activity, but not the core R&D activity it supports, you can still claim that activity if you can clearly demonstrate with records that you had an intention to conduct the relevant core R&D activity and that it would have been eligible as a core R&D activity if it was conducted.

If this intention is not evident, then the supporting R&D activity may not be eligible.

It is also not necessary for your experiments to produce the desired result. If an experiment returns a 'negative' result, this might be an outcome that could not be known or determined in advance, and may still be successful in generating new knowledge.

# Evidence

## What records do I need to keep?

We expect you to keep records and be able to provide them to us if we review your application for the R&D Tax Incentive.

R&D entities may be able to support their R&D Tax Incentive applications by providing information, documents and other material that can substantiate the facts or accuracy of their claims.

Your systems and processes that identify, evaluate and record your eligible R&D activities and expenditure will form part of the evidence to support your claim. You can make use of less formal records, such as screenshots, instant messaging histories, and exported content from task tracking or project management tools.

To support a claim for the R&D Tax Incentive, we expect you to be able to provide evidence that your core and supporting R&D activities meet each and all of the requirements of the legislation. Records need to demonstrate more than just that you did something. They need to demonstrate that what you did and how you did it meets the requirements of the R&D Tax Incentive program. Examples of evidence that may support eligibility are set out below.

Record keeping is distinct from what you include in each year's registration. The records should relate to the point in time when the activities occurred. R&D entities are not expected to reiterate all records from past years in each new registration.

The department and the ATO provide further guidance on record keeping requirements:

- R&D Tax Incentive: Record-Keeping and R&D Planning
- Australian Taxation Office: Keeping R&D records

## Table 1. Evidence for core R&D activities

| Eligibility requirement | Examples of evidence |
|---|---|
| The outcome of the experiments (whether the hypotheses were true or false) could not have been known or determined in advance.<br><br>This requirement is assessed using the concept of a competent professional on the basis of the knowledge, networks, and information they could reasonably gain access to, and whether with this knowledge they would be able to predict the outcome of the activity in advance. | • records of literature reviews<br>• communications with industry experts (emails, minutes, notes and similar)<br>• screenshots of questions posted on tech blogs<br>• details of failed attempts to use existing technology |

| Eligibility requirement | Examples of evidence |
|---|---|
| The outcome of the activities could only be determined by applying a systematic progression of work that proceeds from hypothesis to experiment, observation and evaluation, and leads to logical conclusions.<br><br>It is important to show that you conduct specific experiments to test your hypotheses.<br><br>We expect you to keep records of experiments and their outcomes at or around the time you conduct them. | • records of each step of your experimental activity, e.g. what the hypothesis was, how you tested it, the data from your experiment, how it was analysed, whether the hypothesis was proven true or false, and how these results were used to further develop existing or create any new hypotheses<br><br>• project plans detailing how the systematic progression of work is to occur<br><br>• code repositories or software versions with comments including weaknesses that were identified and rectified in successive versions<br><br>• testing strategy and approach documents<br><br>• project management documentation including plans and charts |
| Experiments are conducted for the purpose of generating new knowledge. | • minutes of board, project or team meetings where the need to conduct experiments was discussed |
| Expenditure is clearly incurred on an eligible R&D activity.<br><br>The expenditure you can claim as R&D expenditure is limited to the extent it is incurred on R&D activities. Therefore, you must show that the amounts you are claiming on your tax return have been incurred on the core and supporting R&D activities you have registered with the department.<br><br>Your records must be sufficient to verify the amount of the expenditure incurred on R&D activities, the nature of the R&D activities and the relationship of the expenditure to the activities.<br><br>You must use reasonable methods to differentiate between expenditure on eligible R&D activities and other activities. Where contractors are undertaking some or part of the work, you need to keep written agreements that set out the work to be undertaken, who performed the work and where it took place. If this applies to you, you should also look at 'For whom are the R&D activities conducted' on the ATO website. | Working papers demonstrating how the R&D claim was calculated, including:<br><br>• exported content from task tracking or project management tools (demonstrating the actual time that staff worked on eligible activities)<br><br>• contracts, schedules and invoices for any work, or parts of the work, undertaken by contractors<br><br>• design and scoping documents showing how purchased items were used in experiments<br><br>• how you determined the time your utilities (excluding capital costs) were used for eligible R&D activities<br><br>• working papers demonstrating how particular items of expenditure were allocated to each of the registered core and supporting R&D activities, and how the R&D claim was calculated |

# Table 2. Evidence for supporting R&D activities

| Eligibility requirement | Examples of evidence |
|---|---|
| Supporting R&D activities directly related to an eligible core R&D activity. | • technical records showing how and why the supporting R&D activity is directly related to one or more core R&D activities<br><br>• for example:<br> – why a graphical user interface that is being claimed was necessary to conduct the experiments in a core R&D activity<br> – conduct technical background research<br> – set up and facilitation of experiments<br> – building of proof of concepts/ prototypes<br> – internal testing and user testing |
| Where supporting R&D activities:<br>• are excluded from being core R&D activities<br>• produce goods or services, or<br>• are directly related to producing goods or services<br><br>The dominant purpose of conducting these activities must be to support a core R&D activity rather than this support being of secondary importance. To satisfy the dominant purpose test supporting the core R&D activity must be the most important purpose.<br><br>This is often a requirement where software has been developed to facilitate an experiment in an eligible core R&D activity on a production line.<br><br>You must only claim expenditure incurred on those goods or services which are used in the eligible R&D activities and not for commercial production runs, and your documents should support this. R&D entities that sell or use the product of their eligible R&D need to consider the 'feedstock adjustment rules' (which are available on the ATO website) and include the necessary feedstock adjustment amount in their income tax returns. | • where manufacturing takes place in conjunction with software-related activities, your evidence may be production run sheets and quality control sheets that identify which units were used for experiments and which were to be sold<br><br>• where saleable goods are produced in an activity, your records need to show that you produced sufficient numbers for the experiments and not so many goods that this demonstrates a dominant commercial purpose<br><br>• we expect you to document how that activity supports the core R&D activity and satisfies the dominant purpose requirement<br><br>• where software development occurs in a manufacturing or production environment, we also refer you to the 'Manufacturing sector guide for the R&D Tax Incentive' |

# For more information

- Contact the department via telephone on 13 28 46 or visit Business.gov.au/contact-us.

- For assistance with claiming expenditure for R&D activities, visit ato.gov.au - Research and Development Tax Incentive.

- Subscribe to the R&D Tax Incentive Insider or the R&D Tax Incentive Insider Plus newsletter to receive updates on guidance, taxpayer alerts, program trends, and topical news.

- Attend an R&D Tax Incentive information session to learn more about the R&D Tax Incentive and how to apply. Register to attend or be notified about an upcoming information session for businesses and tax agents.

- The law that sets out the conditions for overseas activities is in the Industry Research and Development Act 1986.

  – Read the legislation. This guide is an overview intended to help you more easily and quickly determine your eligibility. This guide does not cover every situation and is limited to general advice only.

  – You must always assess your activities against the criteria in the legislation. The definition of 'R&D activities' is contained in the R&D section (Division 355 in the *Income Tax Assessment Act 1997*)

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

- It is ultimately your responsibility to seek and obtain your own advice about the eligibility of your activities for the R&D Tax Incentive.