Chapter 1
Quarterly R&D credits

Outline of chapter

1.1 Schedule # to this Bill amends the *Taxation Administration Act 1953* (TAA 1953) to enable taxpayers to claim specified refundable tax offsets in quarterly instalments. Similar to the current Pay-As-You-Go instalment system, quarterly instalments would be reconciled against taxpayers' actual refund entitlements as part of their annual income tax assessment.

1.2 The system initially only applies to the research and development (R&D) refundable tax offset.

1.3 All legislative references in this Chapter are to Schedule 1 to the TAA 1953 unless otherwise indicated.

Context of amendments

1.4 Refundable tax offsets are one means by which the tax law confers special status on certain expenditure. Where enhanced deductions, accelerated deductions and non-refundable tax offsets only reduce tax, or alter its timing, refundable tax offsets can result in a refund to taxpayers, thereby improving their cash flow.

1.5 Currently, any refund resulting from a taxpayer's entitlement to a refundable tax offset occurs as part of their income tax assessment for an income year. However, some entities with low turnover but large immediate expenditure demands would benefit more if their refunds arrived earlier. One area where earlier payment would be particularly helpful is R&D because research-based businesses often conduct their R&D before they begin to derive income.

1.6 Innovation is recognised internationally as an important driver of productivity and economic growth. Innovation is the implementation of a new or significantly improved good, service, process, marketing method, or organisational method. It is a tool to drive growth in productivity, market diversity, and export and employment levels. Significant benefits accrue to business, and to the economy and to society, where a culture of innovation is pursued.

1.7 Recognising that a widespread culture of innovation does provide significant benefits to society as a whole, the Commonwealth has acted to support innovation in a wide range of areas, including workforce skills, venture capital, collaboration, technology uptake, management practices and R&D.

1.8 The 2011 R&D tax offset regime was the biggest reform to Commonwealth support for business innovation for more than a decade. It cut red tape and provided a more targeted incentive for companies to invest in R&D. It significantly improved the incentive for smaller firms to undertake R&D by providing those R&D entities with aggregated turnover under $20 million with access to a refundable tax offset equal to 45 per cent of their R&D expenditure.

Summary of new law

1.9 An entity that satisfies the threshold tests can apply to participate in the quarterly credits system for one or more quarters in an income year. It can participate for any or all of the refundable tax offsets for which it qualifies and that are eligible to be in the system. Initially, only the R&D tax offset is eligible to be in the system.

1.10 If it does participate, the entity receives a payment each quarter towards its expected end-of-year refund from those tax offsets. It can receive either a 'safe harbour' standard amount, based on a previous year's refund, or it can vary to a different amount that better reflects the refund it expects to receive.

1.11 The general interest charge applies if an entity varies to an amount that proves to be excessive when the actual refund entitlement is assessed at the end of the year. This is to discourage entities from varying to excessively high amounts. The interest charge does not apply if the entity uses the 'safe harbour' standard amount.

1.12 The quarterly payments are set off against the actual refund entitlement and any excess paid to the entity if the payments were too low, or repaid by the entity if the payments were too high.

1.13 Allowing taxpayers with an expected entitlement to the R&D refundable tax offset to receive their anticipated refund in quarterly instalments during the year provides additional cash-flow for them to reinvest in their R&D activities and so deliver wider benefits to the Australian economy.

Comparison of key features of new law and current law

New law	*Current law*
R&D entities can apply to anticipate an expected tax offset for their research and development expenditure through quarterly payments. Any difference is made up, either by a further payment or by repaying the excess, when their assessment is made for the year.	R&D entities are entitled to a tax offset, which reduces their income tax liability, for expenditure they incur on research and development. Any unused part of the refundable tax offset is refunded to the entity when its assessment is made after the income year.

Detailed explanation of new law

1.14 It is quite common for entities that undertake research and development (R&D) work to have little or no turnover in their early years. Although they are receiving no revenue, they may be incurring considerable expenditure on their research. In other cases, small and medium companies can be in a tax loss position during a period of significant investment in R&D to transform their business. In all these cases, deductions for R&D expenditure are of no immediate value to the entities, because they have to wait for a future year when the tax loss can be deducted against future income.

1.15 Accordingly, the income tax law was amended in 2011 to provide a refundable tax offset for expenditure on research and development for those companies that have an aggregated annual turnover under $20 million. That means that the R&D entity can receive a refund of its unused offset when its assessment is made instead of having to wait until it has a tax liability to use it against. The R&D tax offset is also set at a level that provides a greater benefit than would a deduction.

1.16 To further encourage entities to undertake research and development, the amendments in this Schedule allow entities to claim quarterly advance instalments in anticipation of their expected refund at the end of the year, instead of having to wait until their assessment. This can improve their cash flow and so allow them to bring forward, or increase, their expenditure on R&D.

1.17 The measure has been designed to balance the compliance burden for businesses in accessing the quarterly credits system for the R&D tax offset, and the need to ensure the integrity of the tax system. The design may mean that an entity is not always able to match the profile of its quarterly credit amounts for an income year with the pattern of its

R&D expenditure for the year. However, this is balanced by the advantage of lower compliance costs for entities who access the quarterly credits system.

1.18 This is the first time that the income tax law has provided for a refundable tax offset to be paid in advance of an assessment. Therefore, the amendments implement a general regime that accommodates the possibility that Parliament may decide in the future that other refundable tax offsets should be paid in quarterly advance instalments. For the moment though, the regime only applies to the R&D refundable tax offset. ***[Schedule #, item 1, section 48-100 and paragraph 48-5(1)(b)]***

Who is eligible to participate in the quarterly credits system?

1.19 An entity participates in the quarterly credits system for particular offsets. It can decide to participate for some of the offsets eligible for the system and not for others, as it chooses. However, it can only participate for a particular offset if it satisfies two tests: the reasonable receipt test and the complying taxpayer test. Special tests may also have to be satisfied for particular offsets. ***[Schedule #, item 1, section 48-100]***

The reasonable receipt test

1.20 The reasonable receipt test requires that it be reasonable to expect that the entity will be entitled to the tax offset for the income year and that the offset will be a refundable tax offset. However, it is not necessary to expect that the entity will actually get a refund from its tax offsets for the year. ***[Schedule #, item 1, section 48-105]***

1.21 A reasonable expectation that an entity will be entitled to the tax offset is the standard that has to be used (rather than actually determining that the entity is entitled to it) because, of course, it is receiving the quarterly payments *before* the end of the year, which may be before it has satisfied the prerequisites for getting the offset.

1.22 That the entity will be so entitled must be 'reasonable to expect'. That means the expectation must be reasonable, as opposed to irrational, absurd or ridiculous (*Attorney-General's Department & Anor. v Cockcroft* [1986] FCA 35 per Bowen CJ and Beaumont J at [29]). There must be real and substantial grounds for thinking that the entity will be so entitled but the matter should not be considered as a question of mathematical probability (*Cockcroft* per Bowen CJ and Beaumont J at [29] and Sheppard J at [12]).

1.23 Although whether it is reasonable to expect something is an objective test, the entity's subjective intentions may still be relevant (*FCT*

v Arklay [1989] FCA 34 at [13]). That will be so, for example, in the case of the R&D tax offset because entitlement to that offset depends in part on whether or not the entity incurs expenditure on relevant research and development. So, what the entity intends to do will be a relevant factor in forming an expectation about the future.

The R&D tax offset

1.24 The real and substantial grounds for thinking that an R&D entity will be entitled to the R&D tax offset for a year would include a clear plan to expend an amount on R&D activities that will be registered under the *Industry Research and Development Act 1986* (IR&D Act 1986). It would also be relevant to be able to demonstrate that any other conditions of entitlement required by Division 355 of the *Income Tax Assessment Act 1997* (ITAA 1997) are, or will be, satisfied and that no conditions exist that would disentitle the entity to the offset under that Division.

1.25 The real and substantial grounds for thinking that the R&D tax offset will be a refundable offset would usually be that the entity's aggregated turnover for the year will be under $20 million (see sections 67-30 and 355-100 of the ITAA 1997).

The complying taxpayer test

1.26 To satisfy this test, an entity must comply with its tax law obligations during the income year and also have an established history of complying with them over the previous five years. It must also be reasonable to expect that the entity will continue to comply with those obligations in the future. ***[Schedule #, item 1, subsections 48-110(1) and (2) and paragraph 48-110(3)(a)]***

1.27 An entity would comply with its obligations so long as it meets every obligation imposed on it by a 'taxation law'. These are Acts of which the Commissioner of Taxation (the Commissioner) has the general administration (such as the income tax law, the GST law and the fringe benefits tax law), the *Tax Agent Services Act 2009,* and the legislative instruments made under those Acts.

1.28 Examples of complying with obligations would include:

- lodging tax returns on time,
- providing all requested information on time and in the required form,
- paying tax debts by the required time,

- not having been convicted of any tax offence or subject to tax law administrative penalties.

1.29 An entity would not have failed to comply with its obligations merely because it has received a quarterly credit amount for a quarter that later proved to be excessive, even if the excess was large enough for it to have had to pay general interest charge. An entity is not under an obligation to vary its quarterly credit amounts to any particular amount, although the general interest charge exists to encourage it to vary to a broadly reasonable amount. However, not paying the general interest charge on time would be failing to comply with its tax law obligations.

1.30 Real and substantial factors in forming a reasonable expectation that an entity will continue to comply with its obligations would include:

- whether the entity is solvent and so likely to be able to continue meeting its tax debts;

- whether there is a history of non-compliance before the previous five years (and whether, in the case of companies and similar entities, the responsible personnel have changed); and

- whether the entity has had to be excused from a large number of instances of non-compliance in the past.

1.31 Not only does the entity seeking to be in the quarterly credits system for a particular offset have to pass the complying taxpayer test, so to do a number of related entities. This avoids the possibility of a taxpayer who would not pass the test from conducting its activities through a related entity that could pass it. It also deals with cases where the entity conducting the activities for tax purposes is not a legal entity at all (for example, partnerships and trusts). In such cases, the legal entities behind the notional entity must also pass the test. ***[Schedule #, item 1, subsection 48-110(2)]***

1.32 The entities that must also pass the test include:

- entities connected with the main entity and entities that are affiliates of the main entity. These are entities that control, or are controlled by, the main entity, or that are controlled by the same entity that controls the main entity, or that can be expected to act as the main entity wishes (or in concert with it) or vice versa; ***[Schedule #, item 1, paragraphs 48-110(3)(b) and (c)]***

- the partners of the main entity if it is a partnership, or the general partners of the main entity if it is a corporate limited partnership; ***[Schedule #, item 1, paragraphs 48-110(3)(d) and (e)]***

- the members of the main entity's committee of management if it is an unincorporated association or body, but only in their capacity as members (that is, it does not matter if a member has not passed the test in his or her personal, or in some other, capacity); ***[Schedule #, item 1, paragraph 48-110(3)(h)]***

- the trustees of the main entity if it is a trust, but only in their capacity as trustees; and ***[Schedule #, item 1, paragraph 48-110(3)(f)]***

- individuals who are directors of the main entity (or of any related entity that must also pass the complying taxpayer test) if it is a body corporate, but only in their capacity as directors. ***[Schedule #, item 1, paragraph 48-110(3)(g)]***

1.33 As well as complying with their obligations under the taxation laws, the main entity, and the related entities, may also need to have met their obligations under some other laws before the main entity can participate in the quarterly credits system for particular tax offsets. ***[Schedule #, item 1, subparagraph 48-110(2)(a)(ii)]***

1.34 For the purposes of the R&D tax offset, the entities must also satisfy their obligations under Part III of the IR&D Act 1986. Part III of that Act relates to Innovation Australia's role in the eligibility of an entity's activities for the R&D tax offset. The relevant obligations an entity must satisfy under that Part would include providing information in the required form and not providing Innovation Australia with misleading information in its applications or in response to requests for further information. ***[Schedule #, item 1, subsection 48-110(4)]***

Exemption from the complying taxpayer test

1.35 The Commissioner can excuse an entity from breaching an obligation for the purposes of the complying taxpayer test for a year. This provides the flexibility to overlook minor infractions that do not indicate the likelihood of future non-compliance, or infractions by related entities that do not bear on the suitability of the main entity to participate in the quarterly credits system. ***[Schedule #, item 1, subsections 48-110(1) and 48-115(1)]***

1.36 In deciding whether to excuse an entity, the Commissioner must take into account the consequences of past non-compliance, the likelihood of future non-compliance and the consequences of such future non-compliance. If the non-compliance is with a law other than a taxation

law, the Commissioner must also take into account the views of the agency that administers that law. ***[Schedule #, item 1, subsection 48-115(2)]***

1.37 The Commissioner can only excuse an entity that has applied to be excused from the breach. The entity can do so when it applies to participate in the quarterly credits system. It can also apply at a later time if it does so within 14 days after the breach started (or later if the Commissioner extends the time). An application at one of those later times must be in the approved form. ***[Schedule #, item 1, subsections 48-115(1) and 48-120(1)]***

1.38 An entity does not fail the complying taxpayer test immediately upon breaching a tax obligation. It fails the test only once it is no longer possible to excuse the breach. So, if the entity is still within time to apply to be excused, or if the entity has applied to be excused but the Commissioner has not yet decided whether to excuse the breach, the entity has not yet failed the complying taxpayer test. This delay ensures that the entity is not required to withdraw from the quarterly credits system before it knows whether its breach has been excused. ***[Schedule #, item 1, paragraph 48-110(1)(b)]***

1.39 When the Commissioner makes a decision on an entity's application to be excused, the entity must be notified. If the Commissioner refuses to excuse the entity, the entity must also be notified of the reasons for doing so. The entity can object against a decision to refuse its application. ***[Schedule #, item 1, subsection 48-115(4) and section 48-700]***

1.40 The Commissioner can ask the entity for more information about its application to be excused. This might be necessary to inform the Commissioner about the matters the Commissioner must have regard to in making the decision but is not limited to those matters. The Commissioner can require the information to be given in the approved form (which would affect the way in which the information can be provided) and can specify a time within which the information must be provided (but it must be at least 14 days). ***[Schedule #, item 1, subsection 48-120(2) and (3)]***

1.41 A failure to provide the requested information within time is itself a basis for the Commissioner to refuse the application to be excused, although the Commissioner could still allow the application if he or she considered it appropriate to do so. ***[Schedule #, item 1, subsection 48-115(3)]***

1.42 Once excused, a particular instance of non-compliance continues to be treated as excused. So, an entity could not be treated as failing the complying taxpayer test simply because it had an instance of non-compliance in the past that was excused. However, past instances of non-compliance that were excused could still be taken into account in

deciding whether to excuse future instances and in deciding whether the entity is likely to comply with its obligations in the future. ***[Schedule #, item 1, subsection 48-115(5)]***

Special tests

1.43 Special tests may need to be satisfied to participate in the quarterly credits system for a particular tax offset. ***[Schedule #, item 1, paragraph 48-100(c)]***

The history test

1.44 To participate in the quarterly credits system in a year for the R&D tax offset, the special test an entity must satisfy is the history test. This test requires the entity to have satisfied all the requirements for obtaining the R&D tax offset provided by Division 355 of the ITAA 1997 in one or more of the previous five income years. Requiring a history with the R&D tax offset helps to maintain the integrity of the quarterly credits system by, for example, reducing the risks that can arise through the activities of phoenix companies. It also increases the likelihood that an R&D entity will have a better capacity to anticipate the effect of the R&D tax offset in its end-of-year position. ***[Schedule #, item 1, section 48-100 (table item 20)]***

Example 1.1: Passing the history test

> Spencer Sensible Shoes Pty Ltd expects to get the R&D tax offset for 2016-17 for its expenditure on developing a machine that manufactures shoes in half the normal time. It also incurred expenditure on developing a new shoe polish in 2013-14 and got the R&D tax offset in that year.
>
> Spencer applies to participate in the quarterly credits system for the R&D tax offset for 2016-17. Because it got the same offset in 2013-14, only three years earlier, it passes the history test.

1.45 It is not necessary that the entity participated in the quarterly credits system for the R&D tax offset for the earlier year. It is also not necessary that its offset was refunded in that year, or even that the offset was a refundable tax offset in that year. It is enough if the entity got the same offset in one of those five years that it now wants to participate in the quarterly credits system for. ***[Schedule #, item 1, section 48-100 (table item 20)]***

1.46 The R&D tax offset in its current form was only enacted in 2011. It replaced an R&D concession that worked as an enhanced income tax deduction (although there was an option for some taxpayers to convert their deduction into an offset). An entitlement to the deduction (or to the optional tax offset) under that previous concession is not sufficient to

satisfy the history test to participate in the quarterly credits system with the R&D tax offset. To satisfy the history test, an entity must have obtained the R&D tax offset under the provisions in Division 355 of the ITAA 1997. ***[Schedule #, item 1, section 48-100 (table item 20)]***

How to participate in the quarterly credits system

1.47 An entity must apply to participate in the quarterly credits system for an income year. It can apply to participate for some quarters or for all quarters and for some eligible refundable tax offsets or for all eligible refundable tax offsets. ***[Schedule #, item 1, subsection 48-5(1)]***

1.48 The entity's application must be in the approved form, which determines what information is required and the way it is to be provided to the Commissioner. The latest day that an entity can apply to participate for a particular quarter is the 14th day after the end of the quarter. ***[Schedule #, item 1, subsection 48-15(1)]***

1.49 The Commissioner can disallow the entity's application, and must do so if aware that the entity does not satisfy the tests it needs to satisfy to be able to participate. The Commissioner must also disallow the entity's application if it has already withdrawn from participating in the system for the same quarter and for the same offset. ***[Schedule #, item 1, subsections 48-5(1) and 48-10(1)]***

1.50 The Commissioner can ask the entity for further information to decide whether or not to disallow its application to participate in the system. The Commissioner can ask for the information to be in the approved form and may set a time limit for providing the information (but must allow at least 14 days). The Commissioner can disallow the application if the information is not provided within the time limit. ***[Schedule #, item 1, paragraph 48-10(2)(a) and subsections 48-15(2) and (3)]***

1.51 If an entity is applying to participate in the quarterly credits system for the R&D tax offset for a quarter in a year, the Commissioner can also disallow the application:

- if the entity has not given Innovation Australia information it has requested for that year under section 28H of the IR&D Act 1986 (which is information relevant to findings about the entity's R&D activities); or

- if Innovation Australia has refused to make a finding about whether the entity's activities are core R&D activities or supporting R&D activities under subsection 28A(1) of that Act.

[Schedule #, item 1, paragraph 48-10(2)(b)]

1.52 The Commissioner must notify the entity whether its application to participate in the system for particular quarters and particular tax offsets has been allowed or disallowed. If the application is disallowed, the Commissioner must also provide reasons why. ***[Schedule #, item 1, subsection 48-5(2)]***.

1.53 An entity that is dissatisfied with the Commissioner's decision whether to allow it to participate in the quarterly credits system for a quarter can object to it. ***[Schedule #, item 1, section 48-700]***

How much is the quarterly credit amount?

1.54 An entity that is participating in the quarterly credits system for a quarter can either be paid the standard amount for the quarter or can apply to vary the amount. ***[Schedule #, item 1, section 48-200]***

1.55 Using the standard amount provides a 'safe harbour' that protects the entity from any liability for the general interest charge if the amount is too high by comparison with the reconciled amount at the end of the year. If the entity uses a varied amount for a quarter, it is not protected from a liability for the general interest charge if the amount is excessive. Once an entity uses a varied amount for a quarter, it cannot access the 'safe harbour' for later quarters in that year.

The standard amount

1.56 For the tax offsets for which the entity is participating in the quarterly credits system, the standard amount for a quarter is the lesser of:

- 25 per cent of the total of those tax offsets for the *most recent* income year in which it was assessed as being entitled to any of them; and
- 25 per cent of the refund from all its refundable tax offsets that was assessed to the entity for that year.

[Schedule #, item 1, subsection 48-205(1)]

1.57 The idea underlying this approach is that the refund the entity got for the same offsets last time is a sufficiently reliable predictor of what it will get this time. To ensure the standard amount is based on the entity's recent activities, the relevant year must be one of the past two income years. Therefore, an entity that did not have the relevant refundable tax offsets, or got no refund from its refundable tax offsets, in either of the past two years would get a standard amount of nil. Such an entity could choose to use a varied amount instead. ***[Schedule #, item 1, paragraph 48-205(1)(c) and subsection 48-205(2)]***

1.58 The tax offsets must also have been refundable tax offsets in that earlier year. In rare cases, this may be affected by legislative changes to the status of a particular tax offset. But the more typical case involves a tax offset that involves the taxpayer satisfying a condition before it is a refundable tax offset. For example, the R&D tax offset is only refundable in an income year for taxpayers whose aggregated turnover in that year is under $20 million (see subsection 67-30(1) of the ITAA 1997). ***[Schedule #, item 1, paragraph 48-205(1)(b)]***

1.59 For most taxpayers, the amount of their refund for an income year will be assessed during the second quarter of the next year (that is, *after* the end of the first quarter). That will mean that the standard amount for that first quarter of the next year will be based on the refund assessed for two years earlier but the standard amount for the later quarters of the year will be based on the new assessment. This could result in the standard amount changing, perhaps to a smaller amount, or even to zero.

Example 1.2: Standard amount

In 2015-16, Beetroot Broadband Services has a basic income tax liability (before applying its tax offsets) of $10 million. Beetroot has three refundable tax offsets for that year: tax offset A comes to $3 million, tax offset B to $4 million and tax offset C to $5 million. After they reduce its basic income tax liability to zero, the remaining $2 million of the offsets is paid to Beetroot as a refund.

In 2016-17, Beetroot has a basic income tax liability before applying its tax offsets of $12 million. Beetroot has two refundable tax offsets for that year: tax offset A, which comes to $5 million and tax offset B, which comes to $6 million. Those offsets reduce its basic income tax liability to $1 million. There is no excess, so no amount is refunded.

In 2017-18, Beetroot participates in the quarterly credits system for tax offset A. In the first quarter, the standard amount will be worked out by reference to the 2015-16 income year because that is the most recently assessed year in which Beetroot got a refundable tax offset (the assessment for 2016-17 not yet having been made). The standard amount will be 25 per cent of the lesser of 2015-16's $3 million for tax offset A and that year's $2 million refund. $2 million is less than $3 million, so the standard amount will be 25 per cent of the $2 million, or $500,000.

For the second, third and fourth quarters, the standard amount will be worked out by reference to the 2016-17 income year because that year has now been assessed and so is the most recently assessed year in which Beetroot got a refundable tax offset. Because there was no refund for 2016-17, the standard amount for those quarters will be zero. To be paid a quarterly credit amount for those quarters, Beetroot would have to vary from the standard amount.

1.60 The standard amount for the second, third and fourth quarters will usually remain constant. One exception would be where an entity withdraws from the quarterly credits system but only for some tax offsets. Because the standard amount for the tax offsets participating in a quarter is calculated by reference to the amount of *those offsets* for the most recently assessed year, changing which offsets are participating can change the standard amount for a quarter. ***[Schedule #, item 1, subsection 48-205(1)]***

Varied amounts

1.61 An entity can apply to vary its credits for a quarter and for the remaining quarters of the year instead of using the standard amount. Once it makes that choice (and if the Commissioner does not disallow the application), it cannot access the standard amount 'safe harbour' for the rest of the year. Instead, it would continue to use those varied amounts (or later varied amounts) for the affected quarters. A 'safe harbour' would be available again in the first quarter of the following year. ***[Schedule #, item 1, section 48-200 and subsections 48-210(1) and (2)]***

1.62 The choice of varying amounts allows entities to receive credit amounts that more accurately reflect the refund they expect to receive for the current year than would the standard amount (which is based on an earlier year's refund). An entity could vary amounts to bring the total credits it receives for the year closer to its expected final refund (as the amount of that final refund becomes clearer). For example, if it received too much for an early quarter, it could reduce the amount for later quarters to bring the current total back to where it should be. If necessary, it could drop an amount to nil, or even to a negative amount to achieve that. Varying to a negative amount for a quarter would mean that the entity had to pay that amount back to the Commissioner. ***[Schedule #, item 1, subsection 48-210(2)]***

1.63 An entity can apply to vary amounts more than once during a year but each application must propose a varied amount for each remaining quarter in the year. The amounts could be the same for each of those quarters or they could differ. ***[Schedule #, item 1, paragraph 48-215(1)(a)]***

1.64 An application to vary amounts must be in the approved form and must be made on or before the 14th day after the end of the first quarter to be varied by the application. ***[Schedule #, item 1, subsection 48-220(1)]***

1.65 In determining the appropriate amount to vary to, an entity should only have regard to its likely total refund at the end of the year, not to the actual pattern of its expenditure, or other amounts that gave rise to its offset entitlement, during the year. So, for example, that an R&D

entity only incurs its R&D expenditure during the first quarter of the year does not mean that it can 'front load' its quarterly credits for that year.

1.66 To discourage entities from deliberately 'front loading' their credit amounts to get what would effectively be an interest-free loan that they would repay by varying to lower amounts in later quarters, the general interest charge can apply to excessive quarterly amounts.

Disallowing applications to vary amounts

1.67 The Commissioner is able disallow an application to vary amounts in order to ensure that the Commonwealth is not exposed to an unacceptable risk. The Commissioner cannot partially disallow an application for some quarters and allow it for others; he or she can only disallow an application in its entirety. ***[Schedule #, item 1, subsections 48-210(3) and 48-215(1)]***

1.68 The Commissioner must disallow an application to vary amounts if it does not propose an amount for each remaining quarter in the year. ***[Schedule #, item 1, paragraph 48-215(1)(a)]***

1.69 The Commissioner must also disallow an application if, for any quarter it affects, the total amount for that quarter and the previous quarters in the year would be negative. In other words, varying to a negative amount cannot do more than repay the year's earlier quarterly credits. ***[Schedule #, item 1, paragraph 48-215(1)(b)]***

Example 1.3 Disallowing a negative amount

Robinson Robotic Instruments is in the quarterly credits system and has received credit payments of $500 and $600 for the first two quarters. It applies to vary the amounts for quarters 3 and 4 to -$750.

For the third quarter, the total payments would come to $350 ($500 + $600 – $750). For the fourth quarter, the total payments would come to -$400 ($500 + $600 – $750 – $750). Since that would make the total payments a negative amount, the Commissioner must disallow Robinson's application.

1.70 The Commissioner must also disallow an application if, for any quarter it affects, the total amount for that quarter and the previous quarters in the year would be likely to significantly exceed the part of the eventual refund of tax offsets for the year (or, the eventual total of participating offsets for the year if that is less) that relates to those quarters. ***[Schedule #, item 1, paragraph 48-215(1)(b) and subsection 48-215(2)]***

1.71 The Commissioner normally cannot disallow an application if the varied amount it proposes for each quarter is lower than (or equal to)

the amount that would otherwise apply for that quarter. The purpose of providing a power to disallow the amount is to protect the Commonwealth revenue against unacceptable risks. Therefore, it should not be disallowed if the varied amounts are each lower than the amount that would otherwise apply because lowering the amount decreases any risk to the revenue. ***[Schedule #, item 1, subsection 48-215(4)]***

Example 1.4 Limit on disallowing a varied amount application

> Public relations firm 'Goodwin's Good Vibes' is in the quarterly credits system. It takes the standard amount for quarter 1 but then applies to vary to $5,000 for quarters 2 and 3 and $4,500 for quarter 4. The Commissioner does not disallow the application.
>
> Goodwin receives the $5,000 credit amount for quarter 2 but then applies to vary the amounts for quarters 3 and 4 again to $4,000 each. Since those amounts are below the $5,000 and $4,500 respectively that otherwise would have applied for those quarters, the Commissioner cannot disallow the new application.

1.72 The Commissioner can request further information from the entity to help decide whether to disallow an application for varied amounts. If the entity does not provide the information within the period allowed, the Commissioner can disallow the application, even if the proposed amounts are lower than the amounts they would replace. ***[Schedule #, item 1, subsections 48-215(3) and 48-220(2) and paragraph 48-215(4)(a)]***

1.73 The Commissioner can require the information to be provided in the approved form and can set a time limit on when it must be provided (but must allow at least 14 days). The Commissioner might provide more time where the particular information requested would necessarily be difficult to obtain within 14 days or where the entity asks for more time because it knows of, or encounters, obstacles in obtaining the information. An extension would not usually be granted simply because providing the information at that time would be inconvenient for the entity. ***[Schedule #, item 1, subsection 48-220(3)]***

1.74 If the Commissioner disallows an application, he or she must notify the entity in writing of that decision and of the reasons for it. ***[Schedule #, item 1, subsection 48-210(4)]***

1.75 An entity that is dissatisfied with the Commissioner's decision to disallow its application to vary amounts can object against it. ***[Schedule #, item 1, section 48-700]***

Paying the quarterly credit amount

1.76 The quarterly credit amount for a quarter is usually to be paid by the 28th day after the end of the quarter. The Commissioner can of course pay the amount before the payment date. ***[Schedule #, item 1, paragraph 48-225(1)(a)]***

1.77 If the quarter ends in December, it must instead be paid by the 28th of February of the following year. This mirrors the timing of PAYG instalments and allows for delays caused by the end of year holiday period. ***[Schedule #, item 1, paragraph 48-225(1)(b)]***

1.78 If the Commissioner sought further information about the entity's application to participate in the quarterly credits system, or about varied amounts the entity has proposed, within the 21 days before the normal payment date (or the 28th of February for a December quarter), the payment date is instead the 28th day of the month after the information is provided. ***[Schedule #, item 1, paragraphs 48-225((1)c) and (2)(a)]***

1.79 In the case of the R&D tax offset, if Innovation Australia sought information for making a finding about the nature of the entity's activities under subsection 28A(1) of the IR&D Act 1986 within the 21 days before the normal payment date (or the 28th of February for a December quarter), the payment date is also changed to the 28th day of the month after the information is provided. ***[Schedule #, item 1, paragraphs 48-225((1)c) and (2)(b)]***

Interest on late credit payments

1.80 An entity is entitled to interest for each day the quarterly credit payment to it is late. If the amount is allocated to a running balance account and, on the day the quarterly credit amount is payable, there is a surplus in that account that the Commissioner is required to refund, interest is payable on the amount of that refund. ***[Schedule #, item 48, section 12BA and subsection 12BB(1) of the Taxation (Interest on Overpayments and Early Payments) Act 1983]***

1.81 The interest is worked out from the day after the payment was due until the refund is paid or the entity's assessment for the year is made, whichever comes first. The interest rate for each day in that period is the monthly average yield of 90-day Bank Accepted Bills, as published by the Reserve Bank of Australia for the middle month of the previous quarter. ***[Schedule #, item 48, subsection 12BB(2) and sections 12BA and 12BD of the Taxation (Interest on Overpayments and Early Payments) Act 1983]***

1.82 If a quarterly credit amount is not allocated to a running balance account, but is paid to the entity after it was due, interest is payable to the entity for each day from the day after it was due until it is paid, or until the entity's assessment for the year is made if that comes first. The interest

rate used is the same as for the running balance account case. ***[Schedule #, item 48, sections 12BA, 12BC and 12BD of the Taxation (Interest on Overpayments and Early Payments) Act 1983]***

1.83 No interest is payable if, instead of paying the amount to the entity, the Commissioner applies it towards paying another of the entity's tax liabilities. ***[Schedule #, item 48, paragraphs 12BB(1)(d) and 12BC(1)(c) of the Taxation (Interest on Overpayments and Early Payments) Act 1983]***

Paying negative varied amounts

1.84 An entity can vary to a negative amount for a quarter in order to make up for having received excessive quarterly credits for earlier quarters in the year. It might do that to reduce the general interest charge that would apply to an excessive amount. If an entity varies to a negative amount, it must pay that negative amount to the Commonwealth. ***[Schedule #, item 1, subsection 48-230(1)]***

1.85 The payment is due on the day that would have been the payment day had the Commissioner owed a quarterly credit amount to the entity. ***[Schedule #, item 1, subsection 48-230(2) and section 48-235]***

1.86 General interest charge is imposed if the amount is not paid by that day. ***[Schedule #, item 1, subsection 48-230(3)]***

Reconciling the credit amounts at the end of the year

1.87 Quarterly credit amounts are advance payments an entity gets in anticipation of its *expected* refund of refundable tax offsets, which would normally be paid to it after its income tax assessment was made. Therefore, the quarterly credit payments must be reconciled with the year's *actual* refund of the refundable tax offsets (that is, the amount remaining after those offsets have reduced the tax liability to nil). This occurs when the assessment is made.

1.88 This reconciliation is achieved by creating a debt equal to the amount of the credits paid to the entity for the year (less any part of those amounts that has been repaid). The Commissioner must notify the entity of the debt. ***[Schedule #, item 1, section 48-300]***

1.89 The entitlement to a refund for the tax offsets for the year will still be assessed in the normal way. That refund entitlement and the debt equal to the quarterly credit amounts that were paid will then be offset against each other and only the difference be paid or received:

- If the debt for the quarterly credits paid is an exact reflection of the year's refund, no amount will actually be paid in

relation to the refundable tax offsets, either by the Commissioner or by the entity.

- If the debt for the total credit amounts *exceeds* the refund, the entity will pay the excess to the Commissioner. In effect, it will be repaying the overpaid amount of the year's quarterly credits.

- If the debt for the credit amounts is *less than* the refund, the Commissioner will pay the excess to the entity. In effect, this payment is the amount by which the credits paid understated the entity's actual refund entitlement.

Example 1.5: Reconciling the credit amounts

Mohr Exciting Holidays Pty Ltd participates in the quarterly credits system for 2014-15. It uses the standard amount of $1 million for the first quarter of the year but varies to $1.5 million for the second, third and fourth quarters, for total quarterly credit amounts of $5.5 million.

Mohr has a basic income tax liability of $4 million for the year. Its refundable tax offsets are assessed at $9 million. The excess $5 million is a refund payable to Mohr. The $5.5 million in quarterly credit amounts paid to Mohr becomes a debt it owes to the Commissioner. The two are set off against each other.

The $500,000 by which the debt exceeds Mohr's refund entitlement is the actual amount that Mohr will have to pay back to the Commissioner.

1.90 The part of the debt that is offset by tax offset refunds is payable to the Commissioner on the day of the assessment (the same day that the entitlement to the refund arises). Any remaining part is payable at the same time as an income tax debt would be payable (see section 5-5 of the ITAA 1997). The general interest charge may apply if the debt is not paid by that time. ***[Schedule #, item 1, section 48-305]***

The general interest charge

1.91 The general interest charge can apply in a number of cases under the quarterly credits system. An entity is liable for the general interest charge if it does not pay a negative varied amount on time. ***[Schedule #, item 1, subsection 48-230(3)]***

1.92 If an entity's quarterly credits paid for a year exceed the refund for the year from refundable tax offsets, the entity will have to pay the difference back to the Commissioner. If that amount is not paid on time,

the general interest charge will also apply in the same way as it does for an unpaid tax debt. ***[Schedule #, item 1, subsection 48-305(4)]***

1.93 If an entity is paid a quarterly credit amount for a quarter and it later withdraws from participating in the quarterly credits system for that quarter, or its participation is revoked, it will be liable for the general interest charge until it repays the credit amount. ***[Schedule #, item 1, subsection 48-420(3)]***

General interest charge for excessive varied amounts

1.94 The general interest charge also applies for quarters during the year if the credit paid for the quarter is excessive (except for quarters when the standard amount 'safe harbour' applies). It does not matter if the total credits for the year are not too high; it only matters if the credits are excessive for that quarter. This ensures that entities cannot unreasonably increase their credits for the early quarters in the year and make up the difference by reducing or repaying their credits for the later quarters; in effect getting an interest-free loan for the year. ***[Schedule #, item 1, subsection 48-350(1)]***

1.95 The general interest charge is payable on the excess amount for the quarter. The excess is the total credits paid for the quarters so far in the year less the total reconciled amounts for those quarters in which the entity participated in the system. If those total reconciled amounts are at least 85 per cent of those total credits paid, no general interest charge is payable for the quarter. ***[Schedule #, item 1, subsections 48-350(1) and (2) and section 48-355]***

1.96 The reconciled amount for a quarter is worked out by taking 25 per cent of the total of the refundable tax offsets participating in the system for the year, or 25 per cent of the year's refund of tax offsets if that is less. The amount is then multiplied by the number of participating quarters to that point in the year (for example, it is multiplied by 2 for the second quarter of the year). ***[Schedule #, item 1, paragraph 48-355(b)]***

1.97 However, the reconciled amount for a quarter can never be less than the total standard amounts for the participating quarters so far. That ensures that an entity is not subject to the general interest charge merely for using the standard amount for a quarter, or for varying to an amount that is below the standard amount. ***[Schedule #, item 1, paragraph 48-355(a)]***

Example 1.6: Working out the reconciled amounts

> Elliott is participating in the quarterly credits system for one refundable tax offset. In the first quarter, Elliott uses the $500 standard amount. In the second quarter, he varies to $1,000. In the third

quarter, he realises that $1,000 was too high and varies to $750. In the fourth quarter, he varies downwards again to $500.

On assessment for the year, Elliott has an income tax liability of $6,000 remaining after allowing for his non-refundable tax offsets. He has refundable tax offsets worth $8,400 (of which $3,000 comes from the offset in the quarterly credits system). Elliott will therefore have a $2,400 refund.

Assuming that the standard amount for each quarter stays unchanged at $500, the reconciled amount for the first quarter will be the greater of $600 (because 25 per cent of the $2,400 refund is less than 25 per cent of the $3,000 in participating tax offsets) and the $500 standard amount. So, the reconciled amount for the first quarter will be $600. For the second quarter, it will 2 x $600 = $1,200. For the third quarter, it will be $1,800 and, for the fourth quarter, it will be $2,400.

1.98 The general interest charge is payable for the period from the time the credit for the quarter was due until the next time a credit amount is due for a quarter in the year (or until the time the year's assessment is made if the entity has withdrawn from the system for all later quarters). ***[Schedule #, item 1, subsection 48-350(3)]***

Example 1.7: The amount subject to general interest charge

Continuing the previous example, Elliott is subject to no general interest charge for the first quarter because he used the standard amount for that quarter.

For the second quarter, the total credits paid in the first two quarters come to $1,500 and the reconciled amount to $1,200. As the reconciled amount is not at least 85 per cent of the total credits paid, the excess subject to general interest charge is $300 and the charge is payable for the period from 28 October until 28 February (because the second quarter ended in December, the due date is a month later than usual).

For the third quarter, the total amount paid in the first three quarters comes to $2,250 and the reconciled amount to $1,800. Again, the reconciled amount is not at least 85 per cent of the total credits paid, so the $450 excess is subject to general interest charge and the charge is payable for the period from 28 February until 28 April.

For the fourth quarter, the total amount paid in all four quarters comes to $2,750 and the reconciled amount to $2,400. The excess that would be subject to general interest charge is $350 and the charge would be payable for the period from 28 April until the day Elliott's assessment for the year was made. However, for this quarter, Elliott's reconciled amount is over 85 per cent of his total credit payments for the year. Therefore, no general interest charge is imposed for this quarter.

1.99 After the Commissioner makes an entity's assessment for a year, he or she will notify the entity of the amount of general interest charge that has been worked out for excessive quarterly credit amounts. ***[Schedule #, item 1, subsection 48-350(4)]***

1.100 The entity must pay the charge within 14 days after being notified. If it is not fully paid by then, a further amount of general interest charge will accrue on a daily basis on the unpaid amount. ***[Schedule #, item 1 subsections 48-350(4) and (5)]***

1.101 As with other amounts of general interest charge, the Commissioner has a broad power to remit some or all of it in special circumstances (see section 8AAG of the *Taxation Administration Act 1953* (TAA 1953). The Commissioner has published guidelines on the exercise of this remission power and, to the extent that they are relevant, it can be expected that they would also apply in this case.[1]

Leaving the quarterly credits system

Withdrawing from the system

1.102 An entity that is participating in the quarterly credits system can choose to leave the system for any quarter in the year. It can withdraw from the system for some quarters and not others. It can also withdraw for some tax offsets and not for others. ***[Schedule #, item 1, subsections 48-400(1) and (3)]***

1.103 A withdrawal from a quarter, once made, is irrevocable but the entity could apply to re-enter the system for a later quarter of the year, or for a quarter in a later year. ***[Schedule #, item 1, subsection 48-400(4)]***

1.104 An entity withdraws from the quarterly credits system by giving the Commissioner notice of the withdrawal in the approved form up to the 14th day after the end of the income year containing the withdrawn quarter. ***[Schedule #, item 1, subsection 48-400(2)]***

1.105 An entity that fails one of the tests that is necessary for it to participate in the quarterly credit system for a particular tax offset *must* withdraw from the system for that tax offset for all affected quarters. This will usually mean that the entity will have to withdraw from the system for all quarters of the year because most of the tests relate to the whole year. ***[Schedule #, item 1, subsection 48-405(1)]***

[1] See ATO Practice Statements PS LA 2006/8 and PS LA 2011/12 and Taxation Ruling TR 2000/3.

Example 1.8: Compulsory withdrawal

The McCabe-Miller Corporation is participating in the quarterly credits system for the R&D tax offset. It has claimed the R&D tax offset for the previous three years, since the time it was incorporated, but the Commissioner has recently issued amended assessments disallowing its claims for the R&D tax offset for each of those years. McCabe-Miller no longer passes the history test that is necessary to participate in the quarterly credits system for the R&D tax offset. Accordingly, it must withdraw from the system for the R&D tax offset for all quarters of the year.

1.106 An entity does not have to withdraw if it fails a test that is not *necessary* for its participation in the system. In particular, if the Commissioner has excused the entity from having to satisfy certain obligations for the purposes of the complying taxpayer test, failing to meet one of those excused obligations would not mean that it has to withdraw. If it had not been excused, it would have to withdraw if it did not meet that obligation. ***[Schedule #, item 1, paragraph 48-405(1)(b)]***

1.107 An entity must withdraw within 28 days of failing a test unless the Commissioner has already revoked its participation. ***[Schedule #, item 1, paragraphs 48-405(1)(c) and (d)]***

Penalty for not withdrawing

1.108 If an entity is required to withdraw from the quarterly credits system, and does not do so within time, it commits an offence for which it can be prosecuted. The offence carries a maximum penalty of 60 penalty units. A penalty unit is currently $170 (see subsection 4AA(1) of the *Crimes Act 1914*). ***[Schedule #, item 1, subsection 48-405(2)]***

1.109 If the entity participating in the quarterly credits system is not a legal entity (for example, if it is a partnership), existing provisions of the law ensure that the obligation to withdraw falls on legal entities behind the entity (see Division 444 of Schedule 1 to the TAA 1953).

1.110 The offence is one of strict liability. That means that it is not a defence that the entity did not intend to commit the offence. This is necessary to protect the Commonwealth from making payments to a taxpayer of amounts the taxpayer ought to have known it was not entitled to. However, the defence of mistake of fact is still available for entities who had a reasonable (albeit mistaken) belief that they were not required to withdraw from the system in the circumstances (see sections 6.1 and 9.2 of the *Criminal Code Act 1995*). ***[Schedule #, item 1, subsection 48-405(2)]***

1.111 There is an alternative administrative penalty of 20 penalty units for not withdrawing. That amount is consistent with other administrative

penalties for this sort of infringement. The normal rules about the application and remission of administrative penalties apply to this administrative penalty (see Subdivision 298-A). ***[Schedule #, items 1 and 46, subsection 48-405(3) and paragraph 298-5(c)]***

1.112 The administrative penalty and the offence are alternative penalties; a person convicted of the offence cannot also be subject to the administrative penalty and is entitled to repayment of any administrative penalty it has already paid (see section 8ZE of the TAA 1953).

Revoking participation

1.113 The Commissioner can revoke participation in the quarterly credits system if he or she becomes aware that the entity has failed a test necessary for it to participate. As with the withdrawal case, the key word here is 'necessary'. The Commissioner cannot revoke participation if the entity fails a test that was not necessary and, in particular, the Commissioner cannot revoke an entity's participation for a failure to comply with an obligation under a law that the Commissioner has excused it from for purposes of the complying taxpayer test. ***[Schedule #, item 1, subparagraph 48-410(1)(a)(i)]***

1.114 A revocation affects the quarters the Commissioner specifies. The Commissioner would usually revoke participation only for the affected quarters. However, because the tests usually affect the entity's entitlement to be in the system for the whole year, most revocations would be for all quarters of the year. ***[Schedule #, item 1, subsections 48-410(1) and (2)]***

1.115 The Commissioner can revoke participation for the R&D tax offset if Innovation Australia has refused to make a finding about whether the entity's activities are core R&D activities or supporting R&D activities under subsection 28A(1) of the IR&D Act 1986. Innovation Australia can only refuse to make a finding for reasons set out in the *Industry Research and Development Decision-Making Principles 2011*, which are relevant to whether an entity satisfies the eligibility tests for the R&D tax offset to participate in the quarterly credits system. This would be relevant to whether the entity satisfies the complying taxpayer test. Further, in the absence of such a finding, it might not be reasonable to expect that the entity was entitled to the R&D tax offset. ***[Schedule #, item 1, subparagraph 48-410(1)(a)(ii)]***

1.116 The Commissioner can also revoke participation for all quarters of an income year if the entity does not lodge that year's income tax return on time. Lodging an income tax return on time is an obligation under a tax law, so would be relevant to whether the entity has complied with its tax law obligations. However, the obligation to lodge a return for an income year usually arises *after* the year has ended and so is not an

obligation that counts for purposes of the complying taxpayer test for that year. Lodging the year's return is nevertheless vital for working out the entitlement to a refund of tax offsets, and therefore for knowing whether any of the quarterly credit payments need to be recovered. For that reason, the Commissioner can revoke participation if the return is not lodged, allowing the payments to be recovered. ***[Schedule #, item 1, paragraph 48-410(1)(b)]***

1.117 The Commissioner must notify the entity in writing of a revocation and must provide reasons for doing so. ***[Schedule #, item 1, subsections 48-410(1) and (3)]***

1.118 An entity that is dissatisfied with the Commissioner's decision to revoke its participation can object against it. ***[Schedule #, item 1, section 48-700]***

Recovering excess payments on leaving the system

1.119 A quarterly credit payment made to an entity for a quarter must be repaid if the entity later ceases to participate in the quarterly credits system for that quarter. ***[Schedule #, item 1, subsection 48-420(1)]***

1.120 The repayment is due on the same day it was originally paid to the entity, reflecting the fact that the entity was not entitled to the payment. This means that the repayment will usually be late. The general interest charge applies for each day that the payment is late. ***[Schedule #, item 1, subsections 48-420(2) and (3)]***

Negative quarterly credit amounts

1.121 If an entity used a negative quarterly credit amount for a quarter (for example, to repay an excessive amount from a previous quarter of the year), it is entitled to be repaid that amount if it later ceases to participate in the system for that quarter. The amount is payable to the entity 14 days after it ceases to participate and interest is payable to it if the amount is not repaid by that time. ***[Schedule #, items 1 and 48, section 48-425, and sections 12BA, 12BB and 12BC of the Taxation (Interest on Overpayments and Early Payments) Act 1983]***

Alternative constitutional basis

1.122 These amendments have been prepared on the basis that the payment of a quarterly credit to an entity is supported by the Constitution. Nevertheless, specific reading down rules are included to ensure the widest possible operation of the quarterly credits system if the High Court were to find that the payment of quarterly credits is not fully supported by the Constitution.

1.123 The reading down rules replicate the rules included with the legislation that enacted the R&D tax offset and the rules that empowered the making of regulations for a quarterly credits system.

1.124 The reading down rules ensure that the system would continue to apply in relation to foreign corporations, financial corporations, trading corporations and corporations that are incorporated within a Territory, or that have their registered offices or principal places of business within a Territory. These are matters over which the Commonwealth's legislative power is clear (see paragraph 51(xx) and section 122 of the Constitution). ***[Schedule #, item 1, subsection 48-800(1)]***

1.125 The reading down rules also ensure that the quarterly credits system would continue to apply in relation to activities conducted only within a Territory and/or outside of Australia, or for the dominant purpose of supporting core R&D activities conducted (or to be conducted) solely within a Territory. Again, these are matters over which the Commonwealth's legislative power is clear. ***[Schedule #, item 1, subsection 48-800(2)]***

Amendments to the *Industry Research and Development Act 1986*

Role of Innovation Australia

1.126 An R&D entity is eligible to participate in the quarterly credits system for the R&D tax offset for an income year it passes these tests (discussed earlier) for the year:

- it has the necessary history with the R&D tax offset; and
- it is a complying taxpayer; and
- it reasonably expects to receive the R&D refundable tax offset.

1.127 Companies will self-assess their eligibility to participate in the quarterly credits system for the R&D tax offset. Innovation Australia's role is to contribute to the integrity of the quarterly credits system through risk assessment and compliance work in relation to an R&D entity's self-assessment of certain activities as eligible R&D activities. Innovation Australia's risk assessment and compliance work in relation to quarterly credits will feed into the existing compliance continuum for the R&D tax incentive more broadly.

1.128 To facilitate that role, the amendments give Innovation Australia new powers. The new powers are not limited to R&D quarterly credits, but are available to Innovation Australia in its role as an administrator of

the R&D tax incentive more broadly. This minimises complexity and saves Innovation Australia from having to deal with quarterly credits separately to the R&D tax offset more broadly.

Innovation Australia may initiate advance findings

1.129 Innovation Australia is given the power to make advance findings about activities and R&D entities before registration, of its own volition or at the request of the Commissioner. These powers are in addition to Innovation Australia's power to make advance findings at the request of an R&D entity. An advance finding is a decision by Innovation Australia about whether the activities an R&D entity conducts (or will conduct) are R&D activities as defined by section 355-20 of the ITAA 1997. Advance findings provide certainty for both R&D entities and administrators as to the nature of the activities ahead of registration of those activities. R&D entities that disagree with a finding may request an internal review of the finding by Innovation Australia. ***[Schedule #, items 8 and 9, sections 28A and 28AA of the IR&D Act 1986]***

1.130 Advance findings made by Innovation Australia are in force, and binding on the Commissioner, for three income years. The first income year in which the Commissioner is bound is either the income year for which Innovation Australia starts considering whether to make an advance finding or, under certain circumstances, the most recently completed income year. The first income year is the most recently completed income year if:

- an R&D entity has applied for the finding or the Commissioner has requested the finding; and
- the application or request specifies that the most recently completed income year is the first income year which the finding is relevant to; and
- the R&D entity has yet to apply for registration under section 27A of the IR&D Act 1986 in relation to the most recently completed income year.

The Commissioner is also bound for the two income years following the initial income year for which the advance finding is in force. ***[Schedule #, item 8, subsections 28A(2) and (3) of the IR&D Act 1986]***

1.131 The changes to the times when an advance finding is in force and is binding on the Commissioner are to ensure that the Commissioner can request advance findings about activities relevant to quarterly credits even if the income year in which those activities were conducted has been completed. Without this amendment, there would be a gap between the

end of the income year and the date on which the R&D entity applied for registration under section 27A of the IR&D Act 1986, preventing the Commissioner from requesting findings during this period. The changes also mean that R&D entities have additional time to apply for advance findings in relation to a particular income year. That is, an R&D entity can apply after the end of the income year and before registration for that income year. ***[Schedule #, item 8, subsections 28A(2) and (3) of the IR&D Act 1986]***

1.132 If an R&D entity participating, or seeking to participate, in the quarterly credits system for the R&D tax offset for an income year is found by Innovation Australia to have no eligible R&D activities in the year, the Commissioner will exclude it from the system for that offset. The R&D entity would not satisfy the reasonable receipt test because it could not reasonably expect to undertake eligible R&D activities in the income year and therefore could not reasonably expect to become entitled to the R&D tax offset.

1.133 A negative advance finding about some but not all of the activities relating to an R&D entity's application would be considered when determining whether the entity meets the reasonable receipt test.

1.134 Innovation Australia may refuse to make an advance finding for certain reasons specified in the decision-making principles that guide the way it performs its role. If Innovation Australia has initiated the advance finding itself, it might not make a finding if that is justified by those decision-making principles. A refusal to make a finding is reviewable. ***[Schedule #, item 9, subsection 28AA(2) and paragraph 28AA(1)(d) of the IR&D Act 1986]***

1.135 If Innovation Australia's refusal to make a finding relates to a Commissioner-requested, or self-initiated, finding in relation to R&D quarterly credits, the R&D entity may fail the complying taxpayer test or the reasonable receipt test, and may be prevented from participating in the quarterly credits system on that basis. ***[Schedule #, item 1, subparagraphs 48-10(2)(b)(ii) and 48-410(1)(a)(ii)]***

Innovation Australia to update Commissioner on progress of findings

1.136 The timeframes associated with quarterly credits are such that there might not always be adequate time to obtain sufficient information and complete compliance work, including advance findings, conducted by Innovation Australia before the next quarterly credit due day. To assist the Commissioner pay quarterly credits amounts to, or withhold quarterly credits amounts from, particular R&D entities appropriately, Innovation Australia will update the Commissioner on a regular basis in relation to findings being undertaken in relation those R&D entities. ***[Schedule #, item 10, section 28BA of the IR&D Act 1986]***

1.137 Innovation Australia will update the Commissioner when:

- Innovation Australia is in the process of making a finding it initiated itself, or that was requested by the Commissioner, about an activity and the R&D entity for which the activity is conducted; and
- the R&D entity is participating in the quarterly credits system for an instalment quarter; and
- the finding is relevant to the R&D entity's participation in quarterly credits (for example, if the finding relates to activities being conducted in the income year relevant to the R&D entity's quarterly credits participation); and
- Innovation Australia realises that it will complete the finding on or after the update cut-off day.

[Schedule #, item 10, subsection 28BA(1) of the IR&D Act 1986]

1.138 In the update, Innovation Australia will inform the Commissioner of any incomplete findings processes, and, when relevant, that concerns remain about the eligibility of the activities of the relevant R&D entities. This will provide the Commissioner with a basis for withholding a quarterly credits amount after the time when the amount is due to be paid to those R&D entities. ***[Schedule #, item 10, subsection 28BA(1) of the IR&D Act 1986]***

1.139 After updating the Commissioner on the progress of Innovation Australia's work on findings and other compliance work, Innovation Australia may stop the process. This would be appropriate should, for example, its update to the Commissioner state that Innovation Australia has no reason to believe that an R&D entity is not conducting eligible R&D activities, and that it is therefore unnecessary to progress to making a full advance finding to determine whether the R&D entity is conducting R&D activities. This feature of the update process is designed to reduce as much as possible the number of instances where the Commissioner withholds, due to compliance work that is underway, quarterly credit amounts from R&D entities that are entitled to those amounts. Innovation Australia cannot stop a process if the Commissioner has requested that it continue. ***[Schedule #, item 10, subsection 28BA(2) of the IR&D Act 1986]***

1.140 This does not mean that Innovation Australia would cease work on an advance finding that has been applied for by an R&D entity (or an entity acting on behalf of an R&D entity under section 28B of the IR&D Act 1986). Innovation Australia would only cease work on an application for an advance finding if the applicant asked it to do so in writing.

1.141 Innovation Australia may not use the update process to determine that an R&D entity is not conducting R&D activities. In order to make such a determination, Innovation Australia must complete the findings process and issue a finding that states that the activities of the R&D entity are not eligible R&D activities.

1.142 Innovation Australia must update the Commissioner by the 21st day of the month after the end of the instalment quarter (or 21 February if the instalment quarter ended in December). This timing gives the Commissioner seven days before the normal payment day to notify an R&D entity that its quarterly credit amount will be withheld because of concerns about its eligibility for the quarterly credits amount. ***[Schedule #, item 10, subsection 28BA(4) of the IR&D Act 1986]***

1.143 Should Innovation Australia make a finding after issuing an update to the Commissioner, it is not bound to align the finding with any statements made in the update; it can make a finding that is contrary to any of those statements. For example, Innovation Australia might state in an update that it has no reason to believe that an R&D entity is not conducting eligible R&D activities but later make a finding that none of the activities conducted by the R&D entity are eligible R&D activities. A finding takes precedence over any statement in an update. ***[Schedule #, item 10, subsection 28BA(3) of the IR&D Act 1986]***

Innovation Australia may initiate overseas findings

1.144 It is not necessary for overseas findings to be in place before an R&D entity can participate in the quarterly credits system for an R&D tax offset based on activities conducted outside Australia and its territories. However, an R&D entity is still obliged to apply for and receive a positive overseas finding about overseas activities in order for the expenditure on those activities to be eligible for the R&D tax offset and so for it to participate in the quarterly credits system.

1.145 To ensure Innovation Australia's scope to conduct compliance activities extends to activities conducted outside Australia and its territories, the amendments give Innovation Australia the power to initiate and make findings about activities conducted outside Australia and its territories, of its own volition or at the request of the Commissioner. ***[Schedule #, items 11 and 12, section 28DA, and subsection 28C(1) of the IR&D Act 1986]***

1.146 Innovation Australia may refuse to make an overseas finding for reasons specified in the decision-making principles or, if it has initiated the advance finding itself, not make the finding if such a decision is justified by the decision-making principles. A decision to refuse to make an overseas finding is reviewable. ***[Schedule #, item 12, section 28DA of the IR&D Act 1986]***

Other amendments to the IR&D Act

Definitions

1.147 New definitions have been included in the IR&D Act 1986 as a consequence of quarterly credits. The defined terms 'instalment quarter' and 'quarterly credits system' are defined by reference to their meaning in the *ITAA 1997*, while 'update cut-off day' refers to the time by which Innovation Australia must provide updates to the Commissioner. ***[Schedule #, items 2 to 4, subsection 4(1) of the IR&D Act 1986]***

Simplified outlines

1.148 The simplified outlines for Part III of the IR&D Act 1986 and Division 3 of Part III of the IR&D Act 1986 are amended to reflect the ability of Innovation Australia, of its own volition or at the request of the Commissioner, to initiate findings that were previously only initiated on application by an R&D entity. ***[Schedule #, items 5 to 7, sections 26A and 28 of the IR&D Act 1986]***

Amendments to core technology findings

1.149 Innovation Australia can initiate core technology findings under existing legislation, so the amendments to the core technology provisions are largely a restructuring of the provisions to align them with the other findings that may be made by Innovation Australia under Division 3 of the IR&D Act 1986. However, as with the other Division 3 findings, Innovation Australia's ability to refuse to make a finding is expanded. Innovation Australia may now refuse to make a finding requested by the Commissioner if justified by the decision-making principles. ***[Schedule #, items 13 to 15, section 28EA and subsections 28E(1), (3) and (4) of the IR&D Act 1986]***

Amendments to notice requirements and applications for Division 3 findings

1.150 Amendments are made to the mechanics of seeking and notifying findings about R&D related matters to reflect Innovation Australia's additional capacity to initiate advance and overseas findings, and the restructure of the provisions relating to advance findings, overseas findings and core technology findings. Those amendments do not change the substantial requirements for notices or applications for findings under Division 3 of the IR&D Act 1986. ***[Schedule #, items 16 to 22, sections 28F and 28G of the IR&D Act 1986]***

Innovation Australia may request information

1.151 The amendments give Innovation Australia the power to request further information from an R&D entity in order to carry out compliance work in relation to its participation in the quarterly credits system for the

R&D tax offset. It can require this information to be provided in the approved form, and within 30 days after the request was given or any further period allowed (in accordance with the decision-making principles). Innovation Australia may request information either from the R&D entity, or from an entity acting on behalf of the R&D entity (as permitted by section 28B of the IR&D Act 1986). For example, Innovation Australia will request information in the latter case where the entity is a Research Service Provider conducting R&D activities on behalf of multiple R&D entities. ***[Schedule #, items 23 to 27, section 28H of the IR&D Act 1986]***

1.152 If information is not provided to Innovation Australia within the time allowed, the R&D entity's participation in quarterly credits may be refused or revoked (on the basis that the R&D entity has failed to meet the complying taxpayer test). ***[Schedule #, item 1, subparagraph 48-10(2)(b)(i), subsection 48-110(4) (table item 20), and subparagraph 48-410(1)(a)(ii)]***

Amendments to reviewable decisions

1.153 The table of decisions that are reviewable is amended to reflect the restructure of the provisions relating to advance findings, overseas findings and core technology findings. ***[Schedule #, item 28, section 30A (table items 11 to 13A) of the IR&D Act 1986]***

Amendments to scope of decision-making principles

1.154 The amendments expand the potential scope of the decision-making principles. The Minister is now able to make decision-making principles establishing the basis on which Innovation Australia may refuse to make findings that it has initiated or that the Commissioner has requested under Division 3 of the IR&D Act 1986. The decision-making principles provide guidance to Innovation Australia and transparency and clarity for R&D entities. ***[Schedule #, item 29, paragraph 32(A)(d) of the IR&D Act 1986]***

Disclosure of protected quarterly credits information

1.155 The confidentiality rules of the IR&D Act 1986, which prevent Innovation Australia and its staff from disclosing information relating to matters covered by that Act, are amended to ensure disclosure of information can occur for the purposes of performing functions relating to the quarterly credits scheme. ***[Schedule #, items 30 and 31, paragraph 47(2A)(c) of the IR&D Act 1986]***

1.156 Reciprocal protected information sharing arrangements are been amended to clarify that the Commissioner can share protected information relating to the R&D tax incentive, including quarterly credits. ***[Schedule #, item 47, subsection 355-65(4) (table item 6) of the TAA 1953]***

Application and transitional provisions

Application provisions

1.157 The amendments apply to instalment quarters starting on and after 1 January 2014. For most entities, this will be the last two quarters of the 2013-14 income year, so they will only be able to receive half of their expected refund for the year in quarterly instalments. ***[Schedule #, sub-item 51(1)]***

1.158 The amendments to the IR&D Act 1986 generally apply from the same time as the other amendments. However, the amendments providing Innovation Australia with the ability to make advance findings about the status of an entity's R&D activities for an earlier income year, as a result of an application by an R&D entity or the Commissioner, only applies if the findings process starts in the 2013-14, or a later, income year. ***[Schedule #, sub-item 51(3)]***

1.159 The technical clarification of the income tax R&D provisions in Division 355 of the ITAA 1997 (discussed later) applies to assessments for income years starting on or after 1 July 2013. ***[Schedule #, sub-item 51(2)]***

Transitional provision

1.160 Any findings made under Division 3 of the *IR&D Act 1986* that were in force immediately before the amendments commence have effect as though they were made under the relevant provision as amended. That is, the findings are treated as though the law, as amended for quarterly credits, was in place at the time the findings were originally made. This transitional arrangement ensures that the amendments arising as a result of the quarterly credits system do not create mechanical issues, either for the internal the operation of the *IR&D Act 1986* or for its interaction with the *ITAA 1997*. ***[Schedule #, item 52]***

Consequential amendments

Technical clarification

1.161 The R&D provisions provide that R&D entities that are controlled by exempt entities are entitled to an R&D tax offset equal to 40 per cent of their relevant deductible expenditure on R&D (rather than the 45 per cent offset that applies for taxable entities whose aggregated turnover is under $20 million for the year). Doubts have been raised about whether the reference to an entity being controlled by exempt

entities requires the entity to have been controlled for the whole year, only at the end of the year, or at any time during the year. The amendments clarify that the provisions apply to an entity that is controlled by an exempt entity *at any time* during the year. ***[Schedule #, item 34, subsection 355-100(1) of the ITAA 1997 (table item 2)]***

Record keeping

1.162 The income tax record keeping provisions are amended to ensure that an entity participating in the quarterly credits system that chooses to vary its quarterly credit amount must keep records that explain its decision whether or not it is carrying on a business. Records must normally be kept for five years. ***[Schedule #, item 32, subsection 262A(2AAF) of the ITAA 1936]***

Order in which tax offsets are used

1.163 Tax offsets must be applied in a particular order. The order is broadly designed to be of most advantage to taxpayers, so that offsets that are more useful are only used up after tax offsets that are less useful. Refundable tax offsets, which are the most useful of any tax offsets, are now divided into two classes: those within the quarterly credits system and those that are not. Consistent with the general approach of ordering offsets in the most useful way for taxpayers, the amendments provide that tax offsets in the quarterly credits system are used up only *after* refundable tax offsets that are not in the system. ***[Schedule #, item 33, subsection 63-10(1) of the ITAA 1997 (table items 40 and 42)]***

Amendments to the R&D tax offset

1.164 Amendments to the R&D provisions provide that advance findings made by Innovation Australia bind the Commissioner for the period they are in force. They also ensure that the restructured findings provisions in Division 3 of Part III of the IR&D Act 1986 interact properly with the ITAA 1997. ***[Schedule #, items 35 to 37, section 355-705 of the ITAA 1997]***

Definitions

1.165 The defined terms ‘quarterly credit amount’, ‘quarterly credit due day’ and ‘quarterly credits system’, which are created for the purposes of the quarterly credits system, are added to the Dictionary of the ITAA 1997 (which is also used as the Dictionary for Schedule 1 to the TAA 1953). ***[Schedule #, items 38 to 40, subsection 995-1(1) of the ITAA 1997 (definitions of ‘quarterly credit amount’, ‘quarterly credit due day’ and ‘quarterly credits system’)]***

1.166 The definition of 'tax offset refund' is amended to reflect the change in the order in which tax offsets are used. ***[Schedule #, item 41, subsection 995-1(1) of the ITAA 1997 (definition of 'tax offset refund')]***

Guide material

1.167 A non-operative index of the tax law provisions that deal with a liability to the general interest charge is updated to include the extra liabilities created by the amendments. ***[Schedule #, item 42, subsection 8AAB(4) of the TAA 1953 (table items 44A to 44D)]***

1.168 The non-operative list of the tax liabilities covered by Part 4-15 of Schedule 1 to the TAA 1953 (which provides for the collection and recovery of various taxation liabilities) is also amended to include the liabilities to repay the excess quarterly credit amounts that arise on reconciliation at the end of a year, or because an entity leaves the quarterly credits system for a quarter it has already been paid for, or because an entity varies its quarterly amount to a negative amount. ***[Schedule #, item 43, subsection 250-10(2) (table items 135A to 135C)]***

Avoiding double administrative penalties

1.169 An entity that is required to withdraw from the quarterly credits system for a tax offset because it has failed a test necessary for its participation is liable to an administrative penalty if it does not withdraw. That penalty is discussed earlier in this Chapter. An entity withdraws by notifying the Commissioner in the approved form. However, there is already an administrative penalty for not providing the Commissioner with a required notice or other document (see section 286-75).

1.170 To ensure that there is no possibility of an entity being subjected to a double administrative penalty, the amendments make clear that the existing penalty does *not* apply to failing to give the Commissioner notice of withdrawal from the quarterly credits system. ***[Schedule #, items 44 and 45, subsection 286-75(2)]***

Confidentiality of taxpayer information

1.171 The Commissioner and other Australian Taxation Office staff are generally required to keep taxpayer information confidential. There are a number of exceptions to that general rule. These exceptions accommodate cases where there is a higher duty or a greater competing public policy.

1.172 They also accommodate cases where the Commissioner needs to provide the information to other agencies that are performing important roles in the taxation system. One of these agencies is Innovation Australia, which has a role under the *Venture Capital Act 2002* that can

affect the capital gains treatment of a company's investments. Therefore, the Commissioner can currently provide information to Innovation Australia for the purpose of administering the venture capital laws.

1.173 The amendments clarify that the Commissioner is also able to provide information to Innovation Australia for the purpose of administering a law relating to research and development. That ensures that Innovation Australia can get the information it needs from the Commissioner to properly carry out its role in deciding whether an entity's expenditure qualifies for the R&D tax offset and whether the entity is eligible to participate in the quarterly credits system for the R&D tax offset. ***[Schedule #, item 47, subsection 355-65(4) (table item 6)]***

R&D quarterly credits regulations

1.174 When the R&D tax offset was enacted in 2011, provision was made for a quarterly credits system to be achieved by making regulations. The Treasurer was required to recommend to the Governor-General before 1 January 2014 that regulations be made to give effect to a quarterly credits system. The need for regulations to achieve that result now being supplanted by the quarterly credits system in this Bill, the provisions for the making of regulations are repealed. ***[Schedule #, items 49 and 50, subsection 2(1), and Schedule 3A, to the Tax laws Amendment (Research and Development) Act 2011]***