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By email: Justin.Dearness@ato.gov.au

5 March 2021

Mr Justin Dearness
The Australian Taxation Office

Dear Sir,

BOGIATTO DECISION IMPACT STATEMENT - BDO SUBMISSION

BDO refer to the invitation by the Australian Taxation Office (ATO) to provide comments on the ATO's Decision Impact Statement regarding the Federal Court of Australia's decision in *Commissioner of Taxation v Bogiatto*.

BDO is pleased to provide comments on the Decision Impact Statement. In summary, our main concern is that the ATO has not adequately identified why the onus of proof that is on a taxpayer to establish that an assessment is excessive in a review or appeal against an objection decision, would require more record keeping than that required to substantiate the relevant claim by the taxpayer when lodging their income tax return. BDO's detailed comments in this regard are in the attached appendix.

Should you have any questions, or wish to discuss any of the comments made in our submission, please do not hesitate to contact me on 02 9240 9736 or lance.cunningham@bdo.com.au.

Yours sincerely

Lance Cunningham

BDO National Tax Director

APPENDEX

BDO Submission to the Australian Taxation Office
Decision Impact Statement re Bogiatto

BDO understands that the Commissioner's view of the decision in *Commissioner of Taxation v Bogiatto* [2020] FCA 1139 (Bogiatto) has three main points, being:

- That promoter penalty laws apply to bespoke arrangements for individual clients, meeting the broader policy objects of these laws
- The Commissioner may re-test the argument that there can be an unlimited period to commence proceedings for an unimplemented scheme
- The comments in the decision about the relevance of record keeping are specifically directed towards discharge of the onus of proof under the promoter penalty laws.

Whilst not commenting on the first two points, BDO has concerns that in its third point, the ATO's Decision Impact Statement (DIS) purports that Justice Thawley's decision applies only to the narrow circumstances of promoter penalty laws. This view is remiss in neglecting specific comments made about substantiation more broadly in relation to Division 355 of the Income Tax Assessment Act (ITAA) 1997.

Notably, both Division 355 of the ITAA 1997 and the Industry Research and Development Act 1986 (IRD Act) (with which Division 355 operates in conjunction) are silent in regards to record keeping requirements and accordingly, we are left with the general record keeping requirements of s262 and relevant case law to inform consideration of the required level of documentation to support an R&D claim.

Specifically in *Bogiatto*, Justice Thawley addresses The Commissioner's reliance on *Re Ozone Manufacturing Pty Ltd and Federal Commissioner of Taxation* (2013) in addition to s262A(1) of the ITAA 1936 in setting expectations in relation to record keeping of R&D activities, including the inference that if detailed and substantial records do not exist, then it is unlikely that there was a systematic progression of work involving experiment, observation and evaluation, and by extension unlikely that a core R&D activity was undertaken.

In contrast to the Commissioner's view, His Honour opines at paragraph 100 that "*entitlement to the tax offset is not dependent on keeping records to 'substantiate that the claimed R&D expenditure was incurred on R&D activities that have been registered with AusIndustry'*". He confirms that entitlement is dependent on the taxable facts and that whether those can be proven is a different issue. Furthermore, at paragraph 101, His Honour comments that it is a misconception on the Commissioner's behalf that documentary evidence is the only evidence that can substantiate the taxable facts, and notes that witness statements, statutory declarations and oral testimony may also support the taxable facts, irrespective of whether documentary evidence is produced. At paragraph 102, his honour explicitly rejects the Commissioner's submission that the R&D claims in question were not reasonably arguable at law because the '*taxpayer did not have adequate or contemporaneous records to substantiate that the claimed R&D expenditure was incurred on R&D activities that had been registered with AusIndustry*'.

Justice Thawley's approach is consistent with previous Federal Court case law, such as *Goodman Fielder Wattie Ltd v Federal Commissioner of Taxation* 91 ATC 4438. Specifically, this case established that even in instances where evidence for expenditure on scientific research is not as detailed as it might wish to be, it does not follow that the threshold burden of proof has not been satisfied. Instead, a principle has been adopted by the courts of considering the balance of probabilities, and the evidence that is available which can extend beyond documentation.

Moreover, we note the Commissioner's reference under the first point in the DIS to the policy objectives of the law in relation to promoter penalties. The Commissioner should also therefore acknowledge the policy objectives of the law in relation to the R&D Tax Incentive. Specifically, the object of Division 355 of the ITAA 1997 is to encourage "*industry to conduct research and development activities that might otherwise not be conducted because of an uncertain return from the activities, in cases where the knowledge gained is likely to benefit the wider Australian economy"rev*. For the Division to function and meet its objectives, companies must have some confidence that they are complying with the requirements, without being expected to keep a degree of records that erodes the benefit of accessing the scheme. With this in mind, we interpret His Honour's comments in relation to record keeping to be reflective of the object of the scheme. The record keeping provision at s262A(1) of the ITAA 1936 is taken to apply, and this provision includes no requirement for a taxpayer's records to be more detailed or prescriptive in relation to an incentive program than that for managing their general business affairs.

Other incentive programs that do require specific documentation, such as the Export Market Development Grant, include these requirements in their respective legislative instruments (such as the Export Market Development Grants Administrative Guidelines, which are given statutory power to do so by the Export Market Development Grants Act 1997). In contrast, additional evidence created by a taxpayer's R&D activities may serve as supplemental evidence in respect of arguing their claim in the event of a review or audit but is not a prescribed legislative requirement of the scheme. In our view, this interpretation is supported by the evolution of Australia's R&D Tax Incentive from the prior R&D Tax Concession, as the Tax Laws Amendment (Research and Development) Act 2011 removed the requirement for claimants to maintain 'R&D Plans'.

Finally, we note that the ATO has limited jurisdiction in relation to an entity's R&D activities and expenditure compared to Innovation and Science Australia (ISA) that has the power to assess whether an entity has undertaken core or supporting R&D activity and empowers ISA to make findings in relation to a taxpayer's R&D activities. Similarly to the documentation requirements on taxpayers pursuant to Section 262A of the ITAA, s27E of the IRD Act (supported by the Guidelines to the IRD Act) merely specifies that taxpayers accessing the scheme must provide 'information' if requested by ISA. The implicit distinction between 'information' and 'evidence' or 'documentation' aligns with Justice Thawley's approach, as information may constitute further written or verbal explanation, with any contemporaneous documentation adding weight and persuasiveness, but not being a legislative requirement. From a practical perspective, Justice Thawley's approach makes sense as it would be logical that a taxpayer that can support the eligibility of their claim through means of witness statements, statutory declarations or the giving of oral testimony, irrespective of whether the review of the claim is being undertaken by either the ATO, ISA, the AAT or a Court. Accordingly, the contrary

view being advanced by the ATO through not recognising the Section 355 implications of Justice Thawley's comments is not sustainable.

Conclusion

BDO submits that the ATO should amend the DIS to delete the statement that the views of Thawley J regarding the record keeping requirements "have no relevance to the onus of proof that is on a taxpayer to establish that an assessment is excessive in a review or appeal against an objection decision under Part IVC of the TAA".

As highlighted above, Thawley J does specifically comment, at paragraphs 100 and 101 of his judgement, on the record keeping requirements under section 262A ITAA 1936. This includes the comments that: "A taxpayer who kept inadequate records but who, nonetheless, was able to substantiate the various matters required by the statutory scheme, would still be entitled to the tax offset."

The ATO has not adequately identified why the onus of proof that is on a taxpayer to establish that an assessment is excessive in a review or appeal against an objection decision under Part IVC of the TAA would require more record keeping than that required to substantiate the claim as required under section 262A ITAA 1936. If a taxpayer has sufficient record keeping or other evidence to justify making a claim in their Income tax return they should be able to comply with the onus of proof required for a review or appeal in relation to the claim. To require otherwise would put an inappropriate retrospective record keeping requirement on taxpayers that are involved in a review or appeal into their tax claims.