s22(1)(a)(ii)

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R&D exclusions	Unless used solely or primarily for the purpose of R&D support or in the context of R&D projects, the following are excluded: • Scientific and technical information services • Testing and standardisation • Feasibility studies • Specialised health care • Policy-related studies • Purely R&D-financing activities • Programmatic evaluations • Indirect supporting activities	Unless used primarily as part of (or for the support of) R&D projects, the following are excluded: • Scientific and technical information services • Routine quality control, testing and standardisation • Feasibility studies • Specialised routine medical care • Policy related studies, management studies, efficiency studies and programme evaluations • Purely R&D financing activities • Routine computer programming, systems maintenance or software application	Unless undertaken for the dominant purpose of supporting core R&D activities, the following activities are excluded: • Management studies or efficiency surveys • Developing, modifying, or customising computer software for the dominant purpose of internal administration use • Market research, testing, and development, or sales promotion (including consumer surveys) • Prospecting, exploring, or drilling for minerals or petroleum • Commercial, legal and administrative aspects of patenting, licensing or other activities

		• Consumer surveys, advertising, market research • Prospecting, exploring or drilling for minerals, petroleum or natural gas • Commercial, legal and administrative aspects of patenting, copyrighting or licensing activities • Activities associated with standards compliance • General purpose or routine data collection • Clinical trial phase IV	• Activities associated with complying with statutory requirements or standards • Research in social sciences, arts or humanities • Any activity related to the reproduction of a commercial product or process

s22(1)(a)(ii)

Summary of Approved Program Positions

Contents

Version Control Log

Version	*Action/Update*	*Approver*	*Date*
1.0	First version of RDTI activity assessment principles (includes positions on interpretation and application of the legislation)	David Wilson (GM)	4/8/2015
1.1	Minor amendments following feedback and legal advice Moreton FCA implications	Joanne Mulder GM	12/2/2020
1.2	Minor amendments following feedback and legal advice AF/OF, exclusions and dominant purpose	Joanne Mulder GM	March 2020
1.3	Minor amendments following feedback and legal advice Sectoral issues and evidence	Monica Sapra (A/g GM)	25/5/2020
1.4	Minor amendments following feedback and legal advice Supporting R&D activities, findings, ATO issues, other interpretive issues and evidence	Kelley Wiggins (A/g GM)	7/8/2020
1.5	Version consolidating all minor amendments (February-August 2020)	Kelley Wiggins (A/g GM)	20/11/2020
2	Amendments following legal review	MOP	25/08/2022
2.1	Minor amendments following Moreton remittal decision	Tara Oliver GM	17/11/2022
2.2	Minor amendment and updating simultaneous review of Practice Principles and external guidance materials	Chiara Cirillo (A/g GM)	6/09/2023

This document contains a summary of all approved positions as at the latest date recorded in the Version Control Log. This document serves as a quick guide only. You should refer to the Research and Development Tax Incentive Practice Principles for further guidance on assessment approach.

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Exclusions and Dominant Purpose

s22(1)(a)(ii)

s22(1)(a)(ii)

s22(1)(a)(ii)

s22(1)(a)(ii)

7	***s355-25(2)(b)***	An activity will be excluded under s355-25(2)(b) if: - the activity involves prospecting, exploring or drilling for minerals or petroleum; and - the activity is conducted for one of the listed purposes (s355-25(2)(b)(i – iii)). 'Petroleum' is defined in s40-730 of the ITAA 1997. All other terms are to be given their ordinary meaning.	Assessors to first determine whether an activity involves prospecting, exploring or drilling for minerals or petroleum, and then determine whether the activity was carried out for one (or more) of the listed purposes, i.e. *discovering deposits; determining more precisely the location of deposits; determining the size or quality of deposits.* In considering 'Dominant Purpose', assessors to consider information/evidence that demonstrates that the dominant purpose of an activity was to support a core R&D activity, rather than some other purpose s22(1)(a)(ii)

s22(1)(a)(ii)

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BRIEF

AusIndustry

To: Kirsty Gowans General Manager Research and Development Tax Incentive Program	

For Information

High Court dismissal of special leave application by Coal of Queensland Pty Ltd in relation to an RDTI eligibility decision.

Key Issues

1. On 2 September 2021 the High Court dismissed an application for special leave to appeal a decision of the Federal Court ("FCA") in *Coal of Queensland Pty Ltd v Innovation and Science Australia* ("FCA decision").
2. The FCA decision sets useful precedent for the department and IISA, in that it:
   a. confirms the approach taken by the Department and IISA to examining and making findings only in relation activities actually registered by a company in a given income year;
   b. provides useful commentary on the distinction between the data and results generated by an activity, and the outcome of an activity, which we consider can be extended to other types of activities (and in particular software development and engineering activities); and
   c. provides clarity as to the matters that can be considered when assessing the purpose for which an activity has been undertaken, in particular the predictability of the outcome of the activity.
3. The FCA decision is not considered to have a broader impact on the RDTI program and the way in which it is conducted and managed. The Court's decision affirmed the Tribunal's reasoning and process, and is consistent with the way that IISA assesses the eligibility of R&D activities.
4. The HCA's decision to refuse leave to appeal means the Full Federal Court decision stands. The Litigation Support team will now prepare messaging for the public and RDTI staff about the decision.

Background

5. On 30 January 2020, the Administrative Appeals Tribunal ("the Tribunal") delivered its decision in the matter of *Coal of Queensland Pty Ltd v Innovation and Science Australia* (Nos. 2017/1135 & 2018/0625), affirming the two decisions that were jointly under review – firstly, that none of the Applicant's activities were eligible R&D activities in the 2011-12 income year and secondly, that the Applicant was not allowed an extension of time to pursue an internal review of a negative Advance/Overseas Finding relating to its activities for the 2013-14 to 2015-16 income years.
6. In making its decision about the 2011-12 income year activities, the Tribunal determined that:
   a. The claimed activities were not core activities because of the exclusion in s 355-25(2)(b) of activities which involve prospecting, exploring or drilling for minerals; and
   b. In any event, the requirements in section 355-25(1) of the definition because the activities did not have a systematic progression of work as and were not undertaken for the purpose of generating new knowledge.
7. The Tribunal also observed:
   a. The need for documentation to demonstrate when activities are carried out by applying a systematic progression of work based on principles of established science; that proceeded from hypothesis to experiment, observation and evaluation, leading to logical conclusions.
   b. The term 'hypothesis' is not defined in the ITAA 1997 and should be given its ordinary meaning.

c. The s.355-25(2)(b) exclusion of activities which involve prospecting, exploring or drilling for minerals applies to coal, which is a mineral as commonly understood. 'Mineral', 'exploring' and 'prospecting' should all be given their ordinary meanings.

8. Coal of Queensland then appealed the decision about the 2011-12 activities to the Federal Court of Australia ("the FCA"). It did not appeal the extension of time decision. Coal of Queensland argued that the AAT had made the following errors of law in its decision (Attachment A). That the Tribunal:

- made findings that were not open on the evidence and applied the wrong legal standard when it considered whether the outcome of the activities couldn't be known or determined in advance, and whether the activities were conducted for the purpose of generating new knowledge.
- Misapplied the legislation:
    - when it considered the question of systematic progression of work, by requiring the existence of "R&D plans or documentation"; and
    - by assessing the activities predominantly by reference to those undertaken in the 2012 year as opposed to taking into account the overall project, which would inevitably take several years, and consequently approached the application of the "new knowledge" criterion in the legislative test for core activities from an invalid starting point.
- ignored relevant evidence, and failed to give adequate reasons about why it didn't accept the company's evidence and failed to make findings on material questions of fact.
- failed to consider the company's submission that activities undertaken in the 2011-12 income year should be regarded as "supporting R&D activities":
    - on the basis that they were directly related to and carried out for the dominant purpose of supporting core R&D activities in later years.
    - by characterising the company's argument as being that drilling and survey activities were supporting R&D activities only on the basis that they were undertaken for the dominant purpose of supporting a core R&D activity that was limited to excavation of the costeans.

9. On 23 April 2021 the Full Federal Court handed down its decision. The Full Court dismissed Coal of Queensland's appeal, finding:
    a. There is a distinction to be made between the outcome of an activity, and values data and results generated by an activity, when considering whether the outcome of an activity can be known or determined in advance based on current knowledge, information or experience. While the precise data that an activity may generate may not be able to be known in advance, it does not necessarily follow that the outcome of the activity is not able to be known or determined in advance.
    b. The nature of an activity, and the novelty and predictability of the results of that activity, may assist in determining whether the purpose of the activity is to generate new knowledge.
    c. It is correct to approach the task in s27J of the IR&D Act by considering the eligibility of the activities registered in the relevant income year as core or supporting R&D activities, and not evaluating a multi-year project as a whole.
    d. There is no mutual exclusivity between s355-25(1) and (2) of ITAA – an activity may be conducted for the purpose of generating new knowledge, however if it falls within one of the matters set out in s355-25(2), the exclusion will apply.

10. Coal of Queensland then sought special leave to appeal to the High Court.

11. On 2 September 2021 the High Court announced its decision on Coal of Queensland's application for special leave (Attachment B). The High Court refused leave to appeal on the basis that the application for special leave did not raise any question of general principle sufficient to warrant the grant of special leave.

Recommendation

12. We recommend you note that the High Court decision. Messaging will be prepared for both the RDTI program staff and the public regarding:

    a. the outcome of the High Court application for special leave;
    b. the AAT decision; and

c. the Full Federal Court judgment

Noted: _____ Date _____

Attachments

A Executive briefing points (28 April 2021)

B HCA Disposition (2 September 2021)

Signature – **sent by email** Date 7 September 2021

s22(1)(a)(ii)

Manager, Administrative Review
Research & Development Tax Incentive Branch

AAT Decision – Havilah Resources Ltd v Innovation & Science Australia (16 April 2020).

On 16 April 2020, the Administrative Appeals Tribunal (AAT) handed down its decision in the matter of **Havilah Resources Ltd v Innovation & Science Australia.** The AAT affirmed the decision of ISA that the Applicant was not conducting any eligible R&D activities.

The matter was heard by Deputy President Britten-Jones in the Adelaide AAT Registry.

The Applicant has until **14 May 2020** to seek a review of the AAT decision in the Federal Court.

Matter background

The Applicant is a mining company and held an exploration permit for areas in the north east of South Australia. The Applicant undertook a series of claimed activities to investigate the nature and economic viability of mining gold, iron ore and copper-gold. The claimed activities related to three different projects undertaken at three different mine sites (named Portia, Maldorky and Kalkaroo).

The activities involved:

1. hydrogeological drilling, sampling and pumping tests and subsequent routine groundwater modelling tasks.
2. hydrogeological and geotechnical investigations into the feasibility and optimisation of a tailings storage facility for a proposed mining development, and
3. investigations of gold in tertiary clays above a bedrock ore body.

The objectives for the Portia and Maldorky sites included designing and developing mining processes where groundwater issues impacted on commercially viability. At Kalkaroo the project focused on investigating the shallow gold mineralisation and its potential to bring forward revenue in the early stages of mining.

The substantive issues for determination in these proceedings were whether for 2012-2013 and 2013-14 income years:

- the registered core activities were core R&D activities pursuant to section 355-25(1) of the *Income Tax Assessment Act 1997* (ITAA 1997); and whether
- the registered core activities were excluded by either of paragraphs 355-25(2)(b) or 355-25(2)(f) of the ITAA 1997 from being core R&D activities.

Key points from the AAT decision:

- The AAT affirmed the decision of ISA that none of the Applicant's claimed core activities were eligible core R&D activities in the 2012-2013 and 2013-14 income years.

- This is the second AAT decision involving mining activities since the Full Federal Court decision in *Moreton Resources v Innovation and Science Australia* [2019] FCAFC 120. Both AAT decisions have affirmed the ISA decision (although we note that the other AAT decision is now on appeal to the Federal Court).

- The AAT determined that the claimed core R&D activities did not satisfy the requirements of s.355-25(1) of the ITAA 1997, including that the activities:

- did not have an outcome that can only be determined by applying a systemic progression of work that proceeds from hypothesis to experiment, observation and evaluation and leads to logical conclusions;
- did not involve hypothesis testing, and also noted that mostly there was no evidence of a hypothesis at the time of the claimed activities;
- were not conducted for the purpose of generating new knowledge; and
- involved routine sampling, testing or investigations and any new knowledge generated was not the outcome of experimental activities.

- In addition, the AAT made findings that the activities all fell within an exclusion in s.355-25(2) of the ITAA 1997 and so were excluded from being eligible core R&D activities. The AAT determined that:

  - the hydrogeological, geotechnical, groundwater modelling and tailing storage facility activities at Portia and Maldorky were activities that came within the exclusion in paragraph 355-25(2)(f) because they related to work subject of the statutory requirements and standards contained in the *Ministerial Determination 005* gazetted on 12 July 2012 at paragraphs 2.9 (hydrology), 2.10 (groundwater), 3.5.5 (mine dewatering) and 3.9 (tailings storage facility).
  - investigating gold in tertiary clays at Kalkaroo were activities within the exclusion in paragraph 355-25(2)(b) because exploring and drilling for gold in the tertiary clays was for the purpose of determining more precisely the location, size and quality of deposits in those tertiary clays.

- The AAT also made the following key observations in the decision:

  - The lack of documentation evidencing a hypothesis created *"a real evidentiary difficulty for Havilah because it is required to establish a systematic progression of work that proceeds from hypothesis to experiment in a scientific way*." [at para 34]
  - "*There is no express legislative obligation requiring the hypothesis to be expressed in writing, but there is a requirement that the outcome of the experimental activities 'can only be determined by applying a systematic progression of work….' … The inclusion of the words 'in a scientific way' suggest that the systematic progression of work should be recorded so as to achieve that standard*". [at para 35]
  - The term 'new knowledge' takes its meaning in the context of the Object for Division 355 of the ITAA 1997. At paragraph 25, the AAT observed: *"It is important to understand the meaning of new knowledge in the context that the knowledge gained is likely to benefit the wider Australian economy. Further, new knowledge must be construed in the specific context in which it appears, namely, as a feature of 'experimental activities.' In order to satisfy the second element of core R&D activities in s 355-25(1)(b) one needs to establish more than the generation of new knowledge. It is not merely the generation of new knowledge that gives rise to an entitlement to the tax incentive; there must be experimental activities conducted in a scientific way for the purpose of generating new knowledge".*
  - The term 'deposit' in the paragraph 355-25(2)(b) exclusion of activities (which involve prospecting, exploring or drilling for minerals) is not defined in the ITAA 1997. The AAT applied a definition for mineral deposits from the Geology Australia website: "*Mineral deposits are naturally occurring accumulations or concentrations of metals or minerals of sufficient size and concentration that might, under favourable circumstances, have economic value*" [at paragraph 150].

s42(1)

Havilah Resources Ltd and Innovation and Science Australia

AAT Decision

- On 16 April 2020 the Administrative Appeals Tribunal handed down its decision in the matter brought by Havilah Resources Ltd (the Company).
- The full AAT decision can be found here
- The AAT affirmed ISA's decision and found that none of the claimed activities were eligible R&D activities.
- The company had until 14 May 2020 to seek a review of the AAT decision in the Federal Court and has not done so.

Background

The Applicant is a mining company and held an exploration permit for areas in the north east of South Australia. The Applicant undertook a series of claimed R&D activities to investigate the nature and economic viability of mining gold, iron ore and copper-gold at three different mine sites (named Portia, Maldorky and Kalkaroo).

The claimed activities involved:

1. hydrogeological drilling, sampling and pumping tests and subsequent routine groundwater modelling tasks;

2. hydrogeological and geotechnical investigations into the feasibility and optimisation of a tailings storage facility for a proposed mining development, and

3. investigations of gold in tertiary clays above a bedrock ore body.

Talking Points

- The AAT found that each of the claimed core R&D activities at each of the three sites did not satisfy the legislative test (being s.355-25(1) of the Income Tax Assessment Act 1997.

- The AAT found that each of the claimed core R&D activities for the Maldorky and Portia sites were excluded from being core R&D activities pursuant to s.355-25(2)(f) – that is, that the activities were 'associated with' complying with statutory requirements or standards and so were not eligible R&D activities.

- The claimed core R&D activities conducted at Kalkaroo were excluded by operation of s.355-25(2)(b). This is where activities are excluded from being eligible if they are for a purpose of either discovering deposits or determining the location, size or quality of deposits.

If asked:

Why did the claimed core R&D activities not satisfy the legislative test of s355.25(1) of the IR&D Act?

The AAT found that the activities were not testing hypotheses and so none of the activities formed part of a systematic progression of work proceeding from hypothesis to experiment, observation and evaluation, leading to logical conclusions.

What is the relationship between paragraphs (a) and (b) in the definition of "core R&D activities"?

ISA's current position is that each limb (requirement) of s.355-25(1) is to be assessed separately.

This approach is consistent with the Moreton Federal Court authority, which generally warned against conflating separate parts of the definition.

What is the evidentiary burden – what documents and/or evidence?

Our guidance to companies is that we expect them to keep records contemporaneously (and that these will be most valuable to support eligibility of their activities). This is consistent with this AAT decision, where clearly the AAT would have expected the company to have kept contemporaneous records documenting how the activities were carried out in a scientific way (as part of the scientific method).

It is important to note that the absence of contemporaneous records is not determinative of ineligibility. Assessors need to go through each of the elements of s.355-25(1) to assess the eligibility of the claimed core R&D activities to reach their decision.

How were the statutory exclusions relevant to this AAT decision?

- **Statutory requirements exclusion – s.355-25(2)(f)**

The Havilah decision adopted a similar approach to this exclusion as previous AAT decisions (being Moreton and Mount Owen), in that the AAT has interpreted "associated with" to be very broad.

The exclusion applies to <u>any</u> activities that are associated with, not just specifically conducted to meet ongoing and existing statutory requirements.

The AAT found activities were subject to statutory requirements because the source of the requirement was in the legislation covering mining activities in South Australia. This is consistent with our program position, which is that the exclusion only applies to activities that a statute requires.

- **Prospecting, drilling or exploring mineral exclusions – s.355-25(2)(b)**

It is the **purpose** not the outcome of the activity that is relevant in determining whether the exclusion applies.

The existence of another purpose does not preclude one of the purposes in s.355(2)(b)(i), (ii) or (iii) being present to exclude an activity.

Detailed information on the Havilah AAT decision for case managers (Internal-Use-Only) is found in the Staff Guidance Note in the July 2020 RDTI External Appeals Bulletin.

For more information contact: Quality Assurance and Engagement: s22(1)(a)(ii) /
s22(1)(a)(ii) .

Cleared by LAAB on 27 July 2020.

Mining CoP Newsletter….

December 2020

s22(1)(a)(ii)

Our main focus in 2021 will be on excluded core R&D activities and how they relate to the mining industry. In this newsletter we set the scene for an investigation into s355-25(2)(b). s22(1)(a)(ii)

s22(1)(a)(ii)

In this Issue:

s22(1)(a)(ii)

Excluded core R&D activities

- We begin our investigation into exclusions related to the mining industry with a focus on s355-25(2)(b).

s22(1)(a)(ii)

s22(1)(a)(ii)

s22(1)(a)(ii)

s22(1)(a)(ii)

s22(1)(a)(ii)

Excluded core R&D activities

The department's approach to assessing claimed activities is to methodically work through each requirement of s355-25(1) and to then consider whether any of the exclusions in s355-25(2) apply. highlighted that, '*we should be more confident in applying exclusions*'. The Program Position is: '*Where there is clear evidence that a claimed core R&D activity fits into one of the exclusions, it should be assessed as such*'.

However, the language of the exclusions is broad and open to some interpretation. This can lead to trepidation in confidently applying the exclusions. Even a recent AAT decision appeared uncertain in applying the exclusion, conceding that the application of the exclusion '*could be wrong*'.[4]

With this in mind, we are intending to spend some time during the Mining CoP meetings/newsletters in investigating the exclusions as they pertain to the mining sector. Our intention is to create discussion and foster confidence in applying the exclusions when appropriate.

In this edition, we will begin with a spotlight on s355-25(2)(b) and how this exclusion has been applied in recent AAT decisions. We will then present a practical example of the application of the exclusion during a recent meeting with a customer and their representative.

[4] ***Havilah Resources Ltd and Innovation and Science Australia (Taxation)*** **[2020] AATA 933**

SPOTLIGHT ON s355-25(2)(b)

Of particular importance for the mining industry is s355-25 (2)(b) which excludes the following from being core R&D activities:

s355-25 (2) However, none of the following activities are core R&D activities:

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

AAT Decisions

Recent mining related AAT decisions have made a determination on s355-25(2)(b):

***Coal of Queensland Pty Ltd and Innovation and Science Australia (Taxation)* [2020] AATA 126 at para 82:**

> *We note the exclusion in s355-25(2)(b) is for a defined purpose, namely that exploration, prospecting or drilling is for the purpose of determining more precisely the location of deposits, discovering deposits, or determining the size or quality of deposits.* ***The terms "exploring" and "prospecting" for minerals are not defined and should be given their ordinary meaning in this context.*** *The Macquarie Dictionary relevantly defines the terms "exploring" and "prospecting" as follows:*
>
> > *Exploring*
> > …
> > *2. to look into closely; scrutinise; examine.*
> > ...

Prospecting

1. the exploration of a region in search of precious metal, as gold, silver, etc.

At para 91:

We are satisfied the activities undertaken by the applicant up to and including the A&B Mylec and Sedgman results were ***focused on determining the size and quality of the FCCM coal deposit and were aimed at determining more precisely the expected variability in quality.*** *They were all generic exploration activities undertaken in the initial exploration stages which a company with a mining tenement would undertake in order to ascertain the location, quality and size of the coal resources so it can progress to a point of being able to mine the coal. Accordingly, we find the core activities registered and conducted during the 2011-2012 year, namely the 2D seismic survey, the SkyTEM survey, the drilling to validate the survey results and provide samples to A&B Mylec and Sedgman for analysis, and the A&B Mylec and Sedgman analysis, were not core R&D activities and all come within the exception in s 355-25(2)(b) of the ITA Act.[emphasis added]*

Havilah Resources Ltd and Innovation and Science Australia (Taxation) **[2020] AATA 933 at paras 150 – 154** focuses on the term "deposit"**:**

The word 'deposits' is not defined in the ITAA 1997, but Dr Giles accepted in cross examination [94] the definition in the Geoscience Australia website that:

> *Mineral deposits are naturally occurring accumulations or concentrations of metals or minerals of sufficient size and concentration that might, under favourable circumstances, have economic value.*

Havilah has avoided using the word 'deposit' to describe the gold in the tertiary clays, instead referring variously to 'the distribution of gold', 'the gold mineralisation', 'secondary mineralisation', 'some sort of secondary accumulation' and 'subeconomic levels of gold' in the clay subsurface.

I find that the 'significant gold mineralisation' found in the tertiary clays comes within the definition of a deposit and it follows that it is appropriate to describe the gold in the tertiary clays as a deposit. The elements of the exclusionary provision in s355-25(2)(b) are satisfied because Havilah was exploring and drilling for gold in the tertiary clays for the purpose of determining more precisely the location, size and quality of deposits in the tertiary clays.

I accept the evidence from Havilah that there was another purpose for this activity namely to determine if the presence of gold in the tertiary clays was an indicator of gold in the bedrock below;

but the existence of this purpose does not preclude the 'exploring or drilling for minerals' purpose that I have found. I also accept that, having explored for gold in the tertiary clays for the requisite purpose, Havilah determined that the extraction of the gold was uneconomic. The fact that the deposit was uneconomic does not mean that the exclusion cannot be satisfied. It is the purpose, and not the outcome, of the exploration that is relevant.

It is unnecessary for me to determine if the claimed activities are experimental activities pursuant to s 355-25(1) because the exclusion in s 355-25(2)(b) has been established. ***Nevertheless, in case I am wrong about the application of the exclusion****, I will go on to consider whether the claimed core R&D activities are experimental activities [emphasis added].*

s22(1)(a)(ii)

Case study

The purpose of this case study is to take a closer look at a recent conversation with an Oil and Gas company regarding the s355-25(2)(b) core activity exclusion. While you are reading, you may identify other eligibility issues that would be relevant during an examination. That is to be expected, but in the interests of making this case study as short as possible we've chosen to remove a lot of information pertaining to other aspects of eligibility.

s22(1)(a)(ii)

s22(1)(a)(ii)

s22(1)(a)(ii)

s22(1)(a)(ii)

s22(1)(a)(ii)

AAT Decisions – Coal of Queensland Pty Ltd and Havilah Resources Ltd

General points about our AAT decision summaries

We are providing summaries of the AAT's decisions, focusing on the overall outcomes for each company's application for review. Our summaries do not provide a detailed analysis of the AAT reasons for their decision. Links to the published AAT decisions are provided to allow the AAT decisions to be read in full.

Coal of Queensland Pty Ltd

AAT decisions in *Coal of Queensland Pty Ltd and Innovation and Science Australia* provides clarification about the eligibility of core R&D activities and extensions of time for internal reviews are not available when companies fail to lodge applications for reasons that are its fault and within its control.

The AAT's decisions affirmed the two decisions made by ISA that were jointly under review:

- firstly that none of the Applicant's activities were eligible R&D activities in the 2011-12 income year, and
- secondly, that the Applicant was not allowed an extension of time to pursue an internal review of the negative Advance/Overseas finding relating to its activities for the 2013-14 to 2015-16 income years.

The Tribunal found that the claimed core R&D activities:

- all fell within the exclusion in paragraph 355-25(2)(b) of the Income Tax Assessment Act 1997 (ITAA 1997) which extends to "prospecting, exploring or drilling for minerals", as the activities were focused on determining the size and quality of the coal deposit and were aimed at determining more precisely the expected variability in coal quality. Since there was no eligible core R&D activity, there was no supporting R&D activity in the 2011-12 year"
- also did not meet the definition in paragraphs 355-25(1)(a) and (b) of the ITAA 1997, as none of the activities formed part of a systematic progression of work proceeding from hypothesis to experiment, observation and evaluation, leading to logical conclusions, and were not undertaken for the purpose of generating new knowledge.

The Tribunal also found that the failure of the Applicant to seek internal review of the Advance/Overseas finding decision within the statutory timeframe was the result of an oversight on the Applicant's part, which was entirely the fault of the Applicant and within its control.

Read the full report on Coal of Queensland Pty Ltd and Innovation and Science Australia (Austlii)

Talking Points

The AAT referred to the Federal Court of Australia's judgment on Moreton Resources Ltd in its decision

The tribunal determined that the claimed core R&D activities fell under the mining exclusions in subsection 355-25(2) and were not core R&D activities. For completeness, the tribunal also then determined that the activities did not have a systematic progression of work as required by paragraph 355-25(1)(a), and were not undertaken for the purpose of generating new knowledge.

In making its decision the tribunal:

- determined that the activities in 2011-12 were excluded from being core R&D activities before deciding that the activities also did not meet the requirements in section 355-25
- determined that an extension of time could not be granted to pursue an internal review of the negative Advance/Overseas finding because the failure to apply was entirely the fault of the Applicant and within its control

- also made observations about the following:
  - The need for documentation to demonstrate when activities are carried out by applying a systematic progression of work based on principles of established science; that proceeded from hypothesis to experiment, observation and evaluation, leading to logical conclusions.
  - Applying an ordinary meaning to undefined terms in the statutory text

The company has appealed the decision about the 2011-12 activities to the FCA, but has not appealed the extension of time decision

Havilah Resources Ltd

AAT decisions in *Havilah Resources Ltd and Innovation and Science Australia* provides clarification about the eligibility of core R&D activities.

The AAT's decision affirmed the decisions made by ISA that none of the Applicant's activities were eligible R&D activities in the 2012-13 and 2013-14 income years.

The Tribunal found that the claimed core R&D activities:

- did not meet the definition in subsection 355-25(1) of the ITAA 1997, as the activities were not testing hypotheses and so none of the activities formed part of a systematic progression of work proceeding from hypothesis to experiment, observation and evaluation, leading to logical conclusions.
- all fell within the exclusion in subsection 355-25(2) of the ITAA 1997– activities at two sites falling under paragraph 355-25(2)(f) as the activities were 'associated with' complying with statutory requirements or standards ; and activities at a third site falling under paragraph 355-25(2)(b) which extends to activities for a purpose of either discovering deposits or determining the location, size or quality of deposits.

Read the full report on Havilah Resources Ltd and Innovation and Science Australia (Austlii)

Talking Points

The AAT referred to the Federal Court of Australia's judgment on Moreton Resources Ltd in its decision

The tribunal determined that the claimed core R&D activities did not have a systematic progression of work as required by paragraph 355-25(1)(a), and were not undertaken for the purpose of generating new knowledge. The tribunal also determined the activities fell under the exclusions in subsection 355-25(2).

In making its decision the tribunal:

- determined the major elements in section 355-25 were not met because the activities:
  - did not have an outcome that can only be determined by applying a systemic progression of work that proceeds from hypothesis to experiment, observation and evaluation and leads to logical conclusions
  - did not involve hypothesis testing, and also noted that mostly there was no evidence of a hypothesis at the time of the claimed activities.
  - were not conducted for the purpose of generating new knowledge
- determined the activities were excluded and so could not be core R&D activities.
- also made observations about the following:
  - The need for documentation to establish a systematic progression of work that proceeds from hypothesis to experiment in a scientific way was conducted.
  - The standard for recording the systematic progression of work.

The company has until 14 May 2020 to appeal the decision to the FCA

Australian Government
Department of Industry, Innovation and Science

Business

AusIndustry – Industry Capability and Research

RDTI External Appeals Bulletin – December 2019

(Issue 1)

s22(1)(a)(ii)

s22(1)(a)(ii)

s22(1)(a)(ii)

s22(1)(a)(ii)

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A spotlight on two matters:

1. Moreton Resources Ltd v Innovation and Science Australia (FCA)

Moreton Resources Ltd vs Innovation and Science Australia (ISA) was an important matter as it was the first Federal Court decision on the RDTI legislation. In this matter, the Full Federal Court set aside the AAT's decision and clarified the interpretation of 'core R&D activities' under the Incentive.

As outlined in the s22(1)(a)(ii) document:

- The Court found that the term "experimental activities" has very little, if any, work to do in the definition of "core R&D activities" (i.e. it is not an additional test under the legislation) and

- The Court found that the application of existing technology to a new site, can generate new knowledge.

s22(1)(a)(ii)

The *Moreton Resources Ltd (Moreton) v Innovation and Science Australia* proceedings are now with the AAT for reconsideration, according to the correct construction of the law. It remains for the AAT to make findings of fact by applying the law as decided by the Court.

For a detailed overview of the Moreton internal and external review outcomes and its impact on program administration, the following internal guidance product is provided:

Moreton Resources Ltd - Decision Impact Statement (DIS) – **FOR RDTI INTERNAL USE ONLY**

s22(1)(a)(ii)

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s22(1)(a)(ii)

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[1] Section 37 of the AAT Act requires ISA to provide a s37 statement and all relevant material to the AAT (T-documents).

s22(1)(a)(ii)

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s22(1)(a)(ii)

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s22(1)(a)(ii)

s22(1)(a)(ii)

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Australian Government
Department of Industry, Science, Energy and Resources

Business

AusIndustry – Industry Capability and Research

RDTI External Appeals Bulletin – July 2020

(Issue 2)

s22(1)(a)(ii)

s22(1)(a)(ii)

s22(1)(a)(ii)

s22(1)(a)(ii)

s22(1)(a)(ii)

s22(1)(a)(ii)

1. Coal of Queensland Pty Ltd v Innovation and Science Australia (AAT)

Coal of Queensland Pty Ltd vs Innovation and Science Australia (ISA) is the first AAT decision involving mining activities since the Full Federal Court decision in Moreton Resources.

The decision by the AAT affirms the two decisions that were jointly under review – firstly that none of the Applicant's activities were eligible R&D activities in the 2011/12 income year and secondly, that the Applicant was not allowed an extension of time to pursue an internal review of the negative Advance/Overseas finding relating to its activities for the 2013/14 to 2015/16 income years.

The AAT referred to the Federal Court of Australia's judgment on Moreton Resources in its decision.

The AAT determined that the claimed core R&D activities fell under the mining exclusions in subsection 355-25(2) and were not core R&D activities. For completeness, the AAT also then determined that the activities did not have a systematic progression of work as required by paragraph 355-25(1)(a), and were not undertaken for the purpose of generating new knowledge.

In making its decision the AAT:

- determined that the activities in 2011-12 were excluded from being core R&D activities before deciding that the activities also did not meet the requirements in section 355-25(1);
    - The Applicant has appealed this AAT decision to the Federal Court.

- determined that an extension of time could not be granted to pursue an internal review of the negative Advance/Overseas finding because the failure to apply was entirely the fault of the Applicant and within its control (the Applicant has not appealed this decision); and

- also made observations about the following:
  - The need for documentation to demonstrate when activities are carried out by applying a systematic progression of work based on principles of established science; that proceeded from hypothesis to experiment, observation and evaluation, leading to logical conclusions.
  - The term 'hypothesis' is not defined in the ITAA 1997 and should be given its ordinary meaning.
  - The s.355-25(2)(b) exclusion of activities which involve prospecting, exploring or drilling for minerals applies to coal, which is a mineral as commonly understood. 'Mineral', 'exploring' and 'prospecting' should all be given their ordinary meanings

2. Havilah Resources Ltd vs Innovation & Science Australia (AAT)

Havilah Resources Ltd vs Innovation and Science Australia (ISA) is the second AAT decision involving mining activities since the Full Federal Court decision in Moreton Resources.

The AAT's decision affirmed the decisions made by ISA that none of the Applicant's activities were eligible R&D activities in the 2012-13 and 2013-14 income years.

The AAT found that the claimed core R&D activities:

- did not meet the definition in subsection 355-25(1) of the ITAA 1997, as the activities were not testing hypotheses and so none of the activities formed part of a systematic progression of work proceeding from hypothesis to experiment, observation and evaluation, leading to logical conclusions.
- all fell within the exclusion in subsection 355-25(2) of the ITAA 1997– activities at two sites falling under paragraph 355-25(2)(f) as the activities were 'associated with' complying with statutory requirements or standards; and activities at a third site falling under paragraph 355-25(2)(b) which extends to activities for a purpose of either discovering deposits or determining the location, size or quality of deposits.

Team leaders and case managers are invited to read Havilah guidance note for a detailed review of the AAT decision. This INTERNAL USE ONLY guidance note is for our assessor network to assist you with understanding the AAT decision and the department's approach to assessing activities.

s22(1)(a)(ii)

s22(1)(a)(ii)

s22(1)(a)(ii)

s22(1)(a)(ii)

s22(1)(a)(ii)

s22(1)(a)(ii)

Dear Duncan

AAT Decision – Coal of Queensland v Innovation & Science Australia (30 January 2020).

On 30 January 2020, the Administrative Appeals Tribunal (AAT) handed down its decision in the matter of **Coal of Queensland v Innovation & Science Australia.** The AAT affirmed the decision of ISA that the Applicant was not conducting any eligible R&D activities and that the Applicant was not allowed an extension of time to pursue an internal review of the negative Advance/Overseas finding relating to its activities.

The activities related to the design and development of new mining and beneficiation processes.

The project was titled "*Design and development of a new mining and beneficiation process".*

The project objective was to develop new mining and beneficiation processes that had the potential to transform the economics of the coal mining industry and make deposits within the Applicant's permit commercially viable.

The substantive issues for determination in these proceedings were whether for 2011-2012 year:

- all or part of each of the registered core activities were core R&D activities within the meaning of that term in s 355-25 of the Income Tax Assessment Act 1997 (ITAA 1997); and
- the registered supporting activity was a supporting R&D activity within the meaning of the term in s355-30 of the ITAA 1997.

Key points from the decision are set out below:

- The Administrative Appeals Tribunal (AAT) delivered its decision in the matter of Coal of Queensland Pty Ltd v Innovation and Science Australia (Nos. 2017/1135 & 2018/0625), affirming the two decisions that were jointly under review – firstly that none of the Applicant's activities were eligible R&D activities in the 2011/12 income year and secondly, that the Applicant was not allowed an extension of time to pursue an internal review of the negative Advance/Overseas finding relating to its activities for the 2013/14 to 2015/16 income years.

- The Applicant is a mining company and the claimed activities related to the design and development of a new coal mining and beneficiation process. The Applicant held an exploration permit covering an area in central Queensland known to contain coal deposits that were commercially unviable to mine. The Applicant undertook a series of activities to investigate the nature and economic viability of mining the coal deposit within their permit.

- This is the first AAT decision involving mining activities since the Full Federal Court decision in *Moreton Resources*.

- The AAT found that the core R&D activities all fell within the exclusion in s.355-25(2)(b) of the Income Tax Assessment Act 1997 (ITAA 1997) which extends to "prospecting, exploring or drilling for minerals", as the Applicant's activities were focused on determining the size and quality of the coal deposit and were aimed at determining more precisely the expected

variability in coal quality. As there was no eligible core R&D activity, there was no supporting R&D activity in the 2011-12 year.

- Some of the claimed core R&D activities in this case involved an application of existing/known technology in a new context/environment (for example, the use of existing survey technology that had not previously been used in a coal mining environment). The AAT observed that the requirement that activities be conducted for the purpose of generating new knowledge could be met, depending on the circumstances, by activities which apply existing technology at a new site, referring to *Moreton Resources.* In this particular case, the activities were found to fall within the exclusion in s.355-25(2)(b) of the ITAA 1997 and so were not eligible R&D activities.

- In its decision, the AAT noted that the Applicant's project extended over a number of income years but the AAT observed that it was not tasked to consider the multi-year project as a whole. Rather, their task was to evaluate the activities as registered and conducted in the income year in question (namely the 2011/12 year). They commented: *"Regard is not to be had to the whole project but rather to the actual registered activities conducted in the relevant registration year".*

- The AAT also made the following observations: (i) the term 'hypothesis' is not defined in the ITAA 1997 and should be given its ordinary meaning; and (ii) the s.355-25(2)(b) exclusion of activities which involve prospecting, exploring or drilling for minerals applies to coal, which is a mineral as commonly understood. 'Mineral', 'exploring' and 'prospecting' should all be given their ordinary meanings.

- In addition to finding that the activities were excluded, the AAT also made findings that the claimed core R&D activities in the 2011/12 year did not meet the definition in subparagraphs 355-25(1)(a) and (b) of the ITAA, as none of the activities formed part of a systematic progression of work proceeding from hypothesis to experiment, observation and evaluation, leading to logical conclusions, and were not undertaken for the purpose of generating new knowledge. However, the Tribunal did not undertake the same analysis for the activities in 2012/13 and 2013/14 (except for the costeaning) as they were not within the scope of the review.

- As noted above, there was a second set of proceedings determined by the AAT in this matter – this related to ISA's decision to refuse the Applicant an extension of time to seek an internal review of the negative Advance/Overseas finding relating to its activities for the 2013/14 to 2015/16 income years. The Applicant was notified of the decision on 16 December 2014. They failed to request an internal review of the decision within 28 days (the statutory timeframe). Instead, they sought an extension of time to request an internal review on 29 September 2017. Part of the Applicant's argument was that ISA, through its actions and correspondence with the Applicant, led the Applicant to believe that the 2011/12 registration compliance review and the advance/overseas finding decision would be considered together which was why they didn't seek an internal review of the decision within time. They also argued that their representatives at the time failed to take appropriate action on their behalf. The AAT rejected the Applicant's arguments and found that the failure of the Applicant to seek internal review of the Advance/Overseas finding decision within the statutory timeframe was the result of an oversight on the Applicant's part, which was entirely the fault of the Applicant and within its control.

- We also note that the Applicant ran an alternative argument in this matter. The Tribunal rejected the Applicant's alternate argument, that its drilling and surveying activities were supporting activities to a future core activity, being excavation of costeans, on the basis that there was no evidence that digging costeans satisfies any of the requirements of a core R&D activity.

A separate application in proceedings to review a decision to not grant the applicant an extension of time to apply for internal review of an advance/overseas finding decision was made relating to its activities for the 2013/14 to 2015/16 income years. The AAT rejected the Applicant's arguments and found that its failure to make a request for internal review of the advance/overseas finding decision within the statutory timeframe was its fault and within its control.

The matter was heard by Deputy President McCabe and Senior Member Poljak in the Brisbane AAT Registry.

Please let us know if you would like to discuss or require further information.

Kind regards

AAT Decisions – Coal of Queensland Pty Ltd and Havilah Resources Ltd

Coal of Queensland Pty Ltd – background information (for **Internal Purposes only**)

On 30 January 2020, the Administrative Appeals Tribunal (AAT) delivered its decision in the matter of *Coal of Queensland Pty Ltd v Innovation and Science Australia* (Nos. 2017/1135 & 2018/0625), affirming the two decisions that were jointly under review – firstly that none of the Applicant's activities were eligible R&D activities in the 2011/12 income year and secondly, that the Applicant was not allowed an extension of time to pursue an internal review of the negative Advance/Overseas finding relating to its activities for the 2013/14 to 2015/16 income years.

The company has appealed the decision about the 2011-12 activities to the Federal Court of Australia, but has not appealed the extension of time decision. Given the current appeal to the Federal Court, it would be inappropriate for you to comment in detail about the AAT decision relating to eligibility.

Set out below is some background information on the AAT case – for your internal purposes and understanding only. Following this section, we have set out some high level talking points for you which can be publicly discussed if necessary at the webinar with Deloitte. Although, we do recommend caution in how much you discuss this case given the ongoing appeal to the Federal Court.

The Applicant is a mining company and the claimed activities related to the design and development of a new coal mining and beneficiation process. The Applicant held an exploration permit covering an area in central Queensland known to contain coal deposits that were commercially unviable to mine. The Applicant undertook a series of activities to investigate the nature and economic viability of mining the coal deposit within their permit.

The AAT found that the core R&D activities all fell within the exclusion in s.355-25(2)(b) of the Income Tax Assessment Act 1997 (ITAA 1997) which extends to "prospecting, exploring or drilling for minerals", as the Applicant's activities were focused on determining the size and quality of the coal deposit and were aimed at determining more precisely the expected variability in coal quality. As there was no eligible core R&D activity, there was no supporting R&D activity in the 2011-12 year.

Some of the claimed core R&D activities in this case involved an application of existing/known technology in a new context/environment (for example, the use of existing survey technology that had not previously been used in a coal mining environment). The AAT observed that the requirement that activities be conducted for the purpose of generating new knowledge could be met, depending on the circumstances, by activities which apply existing technology at a new site, referring to Moreton Resources. In this particular case, the activities were found to fall within the exclusion in s.355-25(2)(b) of the ITAA 1997 and so were not eligible R&D activities.

In its decision, the AAT noted that the Applicant's project extended over a number of income years but the AAT observed that it was not tasked to consider the multi-year project as a whole. Rather, their task was to evaluate the activities as registered and conducted in the income year in question (namely the 2011/12 year). They commented: "Regard is not to be had to the whole project but rather to the actual registered activities conducted in the relevant registration year".

The AAT also made the following observations: (i) the term 'hypothesis' is not defined in the ITAA 1997 and should be given its ordinary meaning; and (ii) the s.355-25(2)(b) exclusion of activities which involve prospecting, exploring or drilling for minerals applies to coal, which is a mineral as commonly understood. 'Mineral', 'exploring' and 'prospecting' should all be given their ordinary meanings.

In addition to finding that the activities were excluded, the AAT also made findings that the claimed core R&D activities in the 2011/12 year did not meet the definition in subparagraphs 355-25(1)(a) and (b) of the ITAA, as none of the activities formed part of a systematic progression of work proceeding from hypothesis to experiment, observation and evaluation, leading to logical conclusions, and were not undertaken for the purpose of generating new knowledge. However, the Tribunal did not undertake the

same analysis for the activities in 2012/13 and 2013/14 (except for the costeaning) as they were not within the scope of the review.

s22(1)(a)(ii)

We also note that the Applicant ran an alternative argument in this matter. The Tribunal rejected the Applicant's alternate argument, that its drilling and surveying activities were supporting activities to a future core activity, being excavation of costeans, on the basis that there was no evidence that digging costeans satisfies any of the requirements of a core R&D activity.

Read the full AAT decision on Coal of Queensland Pty Ltd and Innovation and Science Australia (Austlii)

Coal of Queensland Pty Ltd – talking points

The company has appealed the AAT decision about the eligibility of the 2011-12 activities to the Federal Court, but has not appealed the extension of time decision. Given the current appeal to the Federal Court, it would be inappropriate for you to comment in detail about the AAT decision relating to eligibility.

This is the first AAT decision involving mining activities since the Full Federal Court decision in Moreton Resources.

The AAT referred to the Federal Court of Australia's judgment on Moreton Resources in its decision.

The AAT determined that the claimed core R&D activities fell under the mining exclusions in subsection 355-25(2) and were not core R&D activities. For completeness, the AAT also then determined that the activities did not have a systematic progression of work as required by paragraph 355-25(1)(a), and were not undertaken for the purpose of generating new knowledge.

In making its decision the AAT:

- determined that the activities in 2011-12 were excluded from being core R&D activities before deciding that the activities also did not meet the requirements in section 355-25(1);
- determined that an extension of time could not be granted to pursue an internal review of the negative Advance/Overseas finding because the failure to apply was entirely the fault of the Applicant and within its control; and
- also made observations about the following:
  - The need for documentation to demonstrate when activities are carried out by applying a systematic progression of work based on principles of established science; that proceeded from hypothesis to experiment, observation and evaluation, leading to logical conclusions.
  - The term 'hypothesis' is not defined in the ITAA 1997 and should be given its ordinary meaning.
  - The s.355-25(2)(b) exclusion of activities which involve prospecting, exploring or drilling for minerals applies to coal, which is a mineral as commonly understood. 'Mineral', 'exploring' and 'prospecting' should all be given their ordinary meanings.

Havilah Resources Ltd – background information (for **Internal Purposes only**)

Set out below is some background information on the AAT case – for your internal purposes and understanding only. Following this section, we have set out some high level talking points for you which can be publicly discussed if necessary at the webinar with Deloitte. Although, we do recommend caution in how much you discuss this case given the Applicant still has until 14 May 2020 to appeal the decision.

The AAT decision in *Havilah Resources Ltd and Innovation and Science Australia* provides clarification about the eligibility of core R&D activities.

The AAT's decision affirmed the decisions made by ISA that none of the Applicant's activities were eligible R&D activities in the 2012-13 and 2013-14 income years.

The Tribunal found that the claimed core R&D activities:

- did not meet the definition in subsection 355-25(1) of the ITAA 1997, as the activities were not testing hypotheses and so none of the activities formed part of a systematic progression of work proceeding from hypothesis to experiment, observation and evaluation, leading to logical conclusions.
- all fell within the exclusion in subsection 355-25(2) of the ITAA 1997– activities at two sites falling under paragraph 355-25(2)(f) as the activities were 'associated with' complying with statutory requirements or standards ; and activities at a third site falling under paragraph 355-25(2)(b) which extends to activities for a purpose of either discovering deposits or determining the location, size or quality of deposits.

In making its decision the AAT:

- determined the elements in paragraph 355-25(1)(a) were not met because the claimed activities:
  - did not have an outcome that can only be determined by applying a systemic progression of work that proceeds from hypothesis to experiment, observation and evaluation and leads to logical conclusions;
  - did not involve hypothesis testing, and also noted that mostly there was no evidence of a hypothesis at the time of the claimed activities.
- determined the purpose test in paragraph 355-25(1)(b) was not met because the activities:
  - could not be accurately characterised as being conducted for the purpose of generating new knowledge;
  - weren't for generating the type of new knowledge required when the statutory text is read in context, which is limited by the object of Division 355 of the ITAA 1997 to that likely to benefit the wider Australian economy;
- determined the activities were excluded and so could not be core R&D activities.
- also made observations about the following:
  - The need for documentation to establish a systematic progression of work that proceeds from hypothesis to experiment in a scientific way was conducted.
  - The standards expected for the recording/documenting of a systematic progression of work.
  - Reading the statutory text in context, including the context provided by the object of Division 355 of the ITAA.
  - Construing "new knowledge" in its specific context—as a feature of "experimental activities" of the type described by paragraph 355-25(1).

Key extracts from the AAT decision:

- in relation to the meaning of experimental activities:
  - The AAT relied on the interpretation by the Full Federal Court in *Moreton Resources Limited v Innovation and Science Australia* [2019] FCAFC 120 as well as the explanatory memorandum for the Tax Laws Amendment (Research and Development) Bill 2010

- in relation to new knowledge:

- *"It is important to understand the meaning of new knowledge in the context that the knowledge gained is likely to benefit the wider Australian economy. Further, new knowledge must be construed in the specific context in which it appears, namely, as a feature of 'experimental activities.' In order to satisfy the second element of core R&D activities in s 355-25(1)(b) one needs to establish more than the generation of new knowledge. It is not merely the generation of new knowledge that gives rise to an entitlement to the tax incentive; there must be experimental activities conducted in a scientific way for the purpose of generating new knowledge"* [at paragraph 25]

- in relation to Havilah's lack of documentation:
  - "*There is no express legislative obligation requiring the hypothesis to be expressed in writing, but there is a requirement that the outcome of the experimental activities 'can only be determined by applying a systematic progression of work….' … The inclusion of the words 'in a scientific way' suggest that the systematic progression of work should be recorded so as to achieve that standard*" [at paragraph 35]

- in relation to the exemption in s 355-25(2)(f):
  - *"as to whether the claimed activities were associated with complying with environmental statutory requirements or standards, the use of words 'associated with' suggests the exclusion is to have a broad operation"* [at paragraph 27]

- in relation to the exclusion in s 355-25(2)(b):
  - *"the fact that the deposit was uneconomic does not mean that the exclusion cannot be satisfied. It is the purpose, and not the outcome, of the exploration that is relevant"* [at paragraph 153]

Read the full AAT decision on Havilah Resources Ltd and Innovation and Science Australia (Austlii)

Havilah Resources Ltd – talking points

This AAT decision has only recently been handed down and the Applicant has until 14 May 2020 to decide whether to appeal the AAT decision in the Federal Court. Given this appeal period is current, it would be inappropriate for you to comment on the AAT decision in detail. Also, given this is a very recent decision, ISA is still reviewing and considering the decision. At an appropriate time, ISA will update its public guidance material which will take account of these recent AAT decisions.

This is the second AAT decision involving mining activities since the Full Federal Court decision in Moreton Resources.

The AAT determined that the claimed core R&D activities did not have a systematic progression of work as required by paragraph 355-25(1)(a), and were not undertaken for the purpose of generating new knowledge. The AAT also determined the activities fell under the exclusions in subsection 355-25(2).

The AAT found that the claimed core R&D activities:

- did not meet the definition in subsection 355-25(1) of the ITAA 1997, as the activities were not testing hypotheses and so none of the activities formed part of a systematic progression of work proceeding from hypothesis to experiment, observation and evaluation, leading to logical conclusions.
- all fell within the exclusion in subsection 355-25(2) of the ITAA 1997– activities at two sites falling under paragraph 355-25(2)(f) as the activities were 'associated with' complying with statutory requirements or standards ; and activities at a third site falling under paragraph 355-25(2)(b) which extends to activities for a purpose of either discovering deposits or determining the location, size or quality of deposits.

DOCUMENT 12

ATTACHMENT C

Points for IISA and RDIC

Lakes Oil NL v Innovation and Science Australia – Administrative Appeals Tribunal (AAT) decision

- On 14 April 2023, the AAT handed down its decision in Lakes Oil v ISA (as it then was). The AAT affirmed ISA's decision that none of Lakes Oil's claimed activities were eligible R&D activities in the 2013/14 and 2014/15 income years.

- Lakes Oil is engaged in oil and gas exploration activities in the Gippsland and Otway Basin areas in Victoria. The company's resource holdings in those areas are all 'tight gas' deposits, meaning that the gas deposits are trapped within deep layers of dense shale rock, making extraction of commercially viable gas difficult.

- The claimed R&D activities relate to proposed fraccing (ie work associated with determining the potential of hydraulic fracturing to achieve commercial flow rates at certain depths). Activities were claimed in respect of 2013/14 (2 core, 2 supporting, described in the decision as 'Project 1') and 2014/15 (1 core, 1 supporting, described in the decision as 'Project 2'). The claimed core activities were 'fraccing beyond one hundred metres', 'prototype test preparation and trials' and 'multifactor analysis'. s22(1)(a)(ii)

- ISA contended that the claimed activities did not meet the definition of either core or supporting R&D activities. In addition, ISA contended that the activities fell within an excluded category of activities that included exploring, prospecting or drilling (section 355.25(2)(b), ITAA 1997). The AAT agreed with ISA's position and preferred ISA's expert witness evidence over that relied on by Lakes Oil.

- This matter commenced in the AAT in May 2018. The final hearing took place in late 2020 / early 2021.

- The decision confirms that the RDTI legislative test requires claimed activities to be conducted in a scientific way and that a valid hypothesis ('which must have a scientific basis') is an important starting point in determining whether the claimed activities were experimental activities satisfying each criteria of the legislative test for eligibility. The importance of contemporaneous documentation to support claims for the R&D is also reinforced by this decision.

- The decision mainly focuses on the application of the exclusion in s.355-25(2)(b) of the ITAA 1997 (the exploring, prospecting or drilling exclusion) and whether there was a valid hypothesis.

- Lakes Oil's evidence was that its intention with Project 1 was to develop strategies to identify 'sweet spots', within the known gas field [136]. Its expert said no exploration was needed to do this [161]. The AAT accepted IISA's expert evidence that *'obtaining a proper understanding of the location of sweet spots within the field was essential information that would inform any subsequent decisions about extraction, including the development of extraction methods'* [161]. The AAT held that the Project 1 activities qualified as 'prospecting, exploring or drilling', even if they also served other purposes. The AAT held the exclusion applies and the Project 1 activities are not eligible activities [170].

- On hypothesis, the AAT said it is clear that *'an hypothesis must have a scientific basis'* [204] and noted that *'identifying the aim of the project is not the same thing as testing a hypothesis'* [184] and *'Having an aim or end in mind does not, of itself, amount to a hypothesis. It just confirms the goal was a commercial one*' [187]. At [191], the AAT also agreed with IISA's expert as to what a hypothesis involves, including: "*a hypothesis is more than speculative – it is a proposition which is evidence based – it must be substantiated. There must be material pointing towards a hypothesis that can provide a basis for the proposition which is then tested"* and *"a hypothesis cannot be verified prior to experimentation".* The AAT found that in this case *"there was no evidence of any scientific basis behind the hypotheses. Rather, Lakes Oil knew the best return on investment would occur if it could frac a half-length of 100m. This is not a hypothesis".*

- There is useful commentary on the importance and utility of evidence from a competent professional in the field. The AAT commented that *'It is uncontroversial that whether an outcome can only be determined through the application of systematic progression of work based on scientific principles involves an objective determination from the perspective of a competent professional in the field'* [209].

- The AAT also steps through each criteria of the legislative test for eligibility and so there is consideration and commentary on the application of the scientific method (systematic progression of work) and new knowledge. At [200], the AAT notes that the objects of the IRD Act are to be achieved in a scientific way and cites sections from the Explanatory Memorandum as to the scientific method. At [203], the AAT commented *"the emphasis on the centrality of concepts of science in the legislation means experts like Professor Bedrikovetsky are well-qualified to comment upon what is known in his world as an hypothesis and what is required to conduct a scientific experiment or investigation".*

- As to the meaning of new knowledge, the AAT says at [226]: "*What is meant by "new knowledge"? The term "new knowledge" is not defined in the Act and therefore the ordinary meaning should be applied. The phrase "new knowledge" is found within the section concerned with experiments being conducted where the outcome could not be known in advance by a competent professional in the field… On that basis, it is reasonable to conclude "new knowledge" means not previously known by a competent professional in the field".* This is the first time the concept of the "competent professional in the field" has been applied to the new knowledge aspect of the legislative test.

April 2023

s42(1)

s42(1)

DOCUMENT 16

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Research and Development Tax Incentive Practice Principles

Version Control Log

Version	***Action/Update***	***Approver***	***Date***
1.0	First version of RDTI activity assessment principles	David Wilson (GM)	4/8/2015
1.1	RDTI practice principles updated post Moreton (FCA) and considering other AAT decisions	Kelley Wiggins (A/g GM)	10/11/2020
2.0	Amendments following legal review	Managers Operation and Performance Group (MOP)	25/08/2022
2.1	Amendments following legal review, Moreton AAT remittal decision, and update with Program Positions and external documents	Chiara Cirillo (A/g GM)	6/09/2023

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Excluded activities can be supporting R&D activities

Activities that are excluded from being core R&D activities may qualify as supporting R&D activities. Such activities must be directly related to at least one core R&D activity and the R&D entity must conduct them for the dominant purpose of supporting that core R&D activity (see s22(1)(a)(ii)).

You must assess claimed or registered core or supporting R&D activities that fall within one of the listed exclusions (s355-25(2)) against all requirements of s355-30 of the ITAA 1997.

You need to determine whether the activities are directly related to one or more core R&D activity and whether the R&D entity conducts them for the dominant purpose of supporting that core R&D activity or activities.

Generally, the dominant purpose will be shown if the need for the excluded activity arises when the entity plans or conducts a core R&D activity. It may also arise when a potential need for the excluded activity is envisaged by the R&D entity during the planning or conduct of a core R&D activity.

Excluded activities – s355-25(2) of the ITAA 1997

Some activities are excluded from being core R&D activities. Those activities are listed at s355-25(2) of the ITAA 1997 (and in the table below). In this section, you will find information to help you assess:

- the circumstances in which each exclusion could apply to an activity
- whether an activity, if excluded, could be a supporting R&D activity conducted for the dominant purpose of supporting a core R&D activity

S355-25(2) of the ITAA 1997

However, none of the following are core R&D activities:

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

(b) prospecting, exploring or drilling for minerals or *petroleum for the purposes of one or more of the following:

- i) discovering deposits;
- ii) determining more precisely the location of deposits;
- iii) determining the size or quality of deposits

(c) management studies or efficiency surveys;

(d) research in social sciences, arts or humanities;

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

(f) activities associated with complying with statutory requirements or standards, including one or more of the following:

- i) maintaining national standards;
- ii) calibrating secondary standards;
- iii) routine testing and analysis of materials, components, products, processes, soils, atmospheres and other things;

(g) any activity related to the reproduction of a commercial product or process:

- i) by a physical examination of an existing system; or
- ii) from plans, blueprints, detailed specifications or publically available information;

(h) developing, modifying or customising computer software for the dominant purpose of use by any of the following entities for their internal administration (including the internal administration of their business functions):

- i) the entity (the developer) for which the software is developed, modified or customised;
- ii) an entity *connected with the developer;
- iii) an *affiliate of the developer, or an entity of which the developer is an affiliate.

S355-25(2)(b) - Prospecting, exploring or drilling for minerals or petroleum

Activities that are prospecting, exploring or drilling for minerals or petroleum, *and* which the R&D entity conducts for the purpose of: discovering deposits; determining more precisely the location of deposits; or determining the size or quality of deposits, cannot be core R&D activities for the RDTI as they are excluded.

When you assess these activities, first assess whether the activity constitutes prospecting, exploring or drilling for minerals or petroleum. Then assess whether the R&D entity conducts the activity for one (or more) of the listed purposes. That is, discovering deposits; determining more precisely the location of deposits; determining the size or quality of deposits.

An activity will be excluded if it is conducted for any one of the purposes listed, even if that purpose is only one of multiple purposes. It is the purpose of the exploration, and not the outcome of the exploration, that will be relevant. It is noted that while s 355-25(2)(b) does impose a 'purpose test', the fact that an activity may have been found to be conducted for the purposes of generating new knowledge in satisfaction of s 355-25(1)(b), will not preclude the exception from applying. Petroleum is defined in section s40-730 of the ITAA 1997 as:

(a) any naturally occurring hydrocarbon or naturally occurring mixture of hydrocarbons, whether in a gaseous, liquid or solid state; or

(b) any naturally occurring mixture of:

> (i) one or more hydrocarbons, whether in a gaseous, liquid or solid state; and
>
> (ii) one or more of the following: hydrogen sulphide, nitrogen, helium or carbon dioxide; whether or not that substance has been returned to a natural reservoir.

When assessing activities, give terms not defined by the law their ordinary meaning.

Activities this exclusion covers include prospecting, exploring or drilling activities to:

- find deposits of minerals or petroleum
- pinpoint a more exact location of deposits
- find out how much of a mineral or petroleum is in a location
- analyse how pure a mineral or petroleum deposit might be (e.g. characterisation)
- determine the commercial value of a deposit

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s22(1)(a)(ii)

s22(1)(a)(ii)

s22(1)(a)(ii)

s22(1)(a)(ii)

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Decision impact statement – FOR RDTI INTERNAL USE ONLY

Moreton Resources Limited v Innovation and Science Australia

Court Citation(s):	
Administrative Appeals Tribunal	Full Federal Court
[2018] AATA 3378	[2019] FCAFC 120
Heard before:	
Deputy President S A Forgie	Davies, Moshinsky and Steward JJ
Decision made:	
10 September 2018	25 July 2019
Outcome:	
Favourable to Respondent, Finding decision affirmed	Partially favourable to the Applicant and remitted to the AAT for further review

Impacted Guidance

Relevant Guidance:

- Guide to Interpretation
- Getting mining R&D Tax Incentive claims right
- All other guidance as required

ISA is reviewing the impact of this decision on related guidance products.

Synopsis

Moreton Resources (Moreton) registered activities for the R&D Tax Incentive and its predecessor, the R&D Tax Concession, relating to its project to develop a pilot underground coal gasification facility in Kingaroy, Queensland.

The pilot project tested the viability of using Underground Coal Gasification (UCG) technology to produce UCG synthesis gas (syngas) that would then be cleaned and stabilised for production of electricity using gas turbines. Statutory approval from the Queensland Government was required for Moreton to carry out the pilot project.

In March 2010 the pilot project failed when the facility broke down and caused underground water contamination. The Queensland Government subsequently banned UCG because of its environmental impact. Moreton was required to undertake remediation activities in accordance with the terms of the Environmental Authority under the *Environmental Protection Act 1994 (Qld)* that applied to the pilot project after the facility broke down.

Since 2011-12 and subject to eligibility conditions, "R&D entities" are eligible for the R&D tax incentive for eligible "R&D activities" in accordance with Division 355 of the *Income Tax Assessment Act 1997* (the **ITAA 1997**). Up to and including 2010-11 a tax concession for "research and development activities" with different eligibility requirements was available under section 73B of the *Income Tax Assessment Act 1936*.

R&D entities must register activities for the R&D tax incentive with AusIndustry, on behalf of Innovation and Science Australia (**ISA**), in accordance with Part III of the *Industry Research and Development Act 1986* (the **IR&D Act**). ISA may make findings as to whether registered activities were, or were not, "core R&D activities" or "supporting R&D activities" as defined in the ITAA 1997. Those findings bind the Commissioner of Taxation (the **Commissioner**) for the purposes of the ITAA 1997

Moreton had registered activities in relation to the pilot plant project under the R&D tax concession (including in 2010-11), and the remediation activities following the project's failure under the R&D tax incentive (2011-12 to 2013-14).

On review, ISA made findings that none of the activities registered under the R&D tax incentive were "core R&D activities" or "supporting R&D activities" as defined in the ITAA 1997. Moreton appealed the finding decision to the Administrative Appeals Tribunal (AAT).

AAT decision

On 10 September 2018 the AAT affirmed ISA's findings regarding the eligibility of core R&D activities.

Relevantly the AAT found that:

1. The expression "experimental activities" in the opening line of the definition of "core R&D activities" did not cover activities that are conducted for the purpose of demonstrating a known fact. [at 187-188]
2. The outcome and the purpose of conducting activities should not be emphasised at the expense of the nature of the experimental activities themselves—
   "'*Core R&D activities are experimental activities' that are of the sort described in s 355-25(1)(a) and conducted for the purpose described in s 355-25(1)(b)*".
   Having an unknown outcome is not sufficient by itself for "activities" to be "core R&D activities" and the adjective "experimental" in the opening words of subsection 355-25(1) should not be overlooked or omitted. [at 196 and 197]
3. The more robust definition for core R&D activities, with unknown outcomes and conducted for the purpose of generating new knowledge, does not encompass compliance activities with a specified outcome for the purpose of meeting statutory requirements or standards. [at 222]
4. There is a statutory requirement for the holder of an Environmental Authority (**EA**) to comply with its conditions if carrying out mining activities under it. Therefore, activities associated with complying with the conditions of an EA are activities associated with complying with a statutory requirement within the meaning of s 355-25(2)(f) of ITAA 1997 and are therefore excluded from consideration as core R&D activities. [at 221 and 234]
5. The pilot project as a whole were not "experimental activities"—
   "*It was not an activity that it needed to do in order to solve a problem, develop a new product or improve a process. It was testing the application of existing technology at a particular site and nothing more*." [at 262]

Moreton appealed the decision to the Full Federal Court of Australia (the Court).

Federal Court Decision

On 25 July 2019, the Court handed down a judgment concerning Moreton's registered activities for the R&D tax incentive relating to its project to develop a pilot underground coal gasification facility. The Court decided to set aside the earlier decision of the AAT, finding it had erred in its interpretation of part of the definition of "core R&D activities" and ordering that the matter be remitted to the AAT for determination according to the law.

It decided that there was a substantial overlap between the 10 questions of law in Moreton's appeal, and similarly that the grounds of appeal also overlapped. The Court dealt with the questions of law (and grounds) together rather than separately and considered the issue "whether the Tribunal erred in its construction of the definition of "core R&D activities" in s 355-25(1) of the ITAA 1997 or in the application of that construction to the activities constituting the pilot project."

The Full Federal Court found errors in the Tribunal's decision. In particular:

The Tribunal erred in its construction of the definition of "core R&D activities" in s 355-25(1) of the ITAA 1997 (in particular, the words "experimental activities" in the opening line of the subsection).

- The Tribunal's construction was that the word "experimental" in the opening line of s 355-25(1) narrowed the types of activities that could qualify as "core R&D activities" beyond the requirements of paragraphs (a) and (b). Under the Tribunal's approach, the words "experimental activities" in the opening line of the provision have real work to do; and do not merely refer to activities of the type described in paragraphs (a) and (b).

The Tribunal misconstrued the words "experimental activities" in the opening line of s 355-25(1) by treating these words as not covering activities having the purpose of generating new knowledge with respect to the application of an existing technology at a new site.

- The Tribunal's construction of the words "experimental activities" in s 355-25(1) was influenced by the terms of paragraph (b), which states that the activities "are conducted for the purpose of generating new knowledge (including new knowledge in the form of new or improved materials, products, devices, processes or services)". The Tribunal construed the words "experimental activities" as not covering activities having the purpose of generating new knowledge with respect to the application of an existing technology at a new site.

The Tribunal's construction of the words "experimental activities" is not supported by the text, context or purpose of subsection 355-25(1).

Administrative Treatment

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Remittal back to AAT

The *Moreton Resources Ltd v Innovation and Science Australia* proceedings have been remitted to the AAT for reconsideration according to the correct construction of the law.

The Federal Court decision did not make any findings of fact in relation to Moreton Resources' claimed R&D activities. It remains for the AAT to make findings of fact by applying the law as decided by the Court.
