Federal Court of Australia

T.D.S. Biz Pty Ltd v Commissioner of Taxation [2023] FCA 710

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| File number: |  |
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| Judgment of: | **BROMWICH J** |
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| Date of judgment: | 29 June 2023 |
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| Catchwords: | **TAXATION** – appeal from a decision the Administrative Appeals Tribunal affirming a decision by the Commissioner of Taxation to disallow an objection to a notice of amended assessment by which a claim for research and development (R&D) tax offsets was not allowed – where the Tribunal also affirmed a decision by the Commissioner to disallow an objection to a notice of assessment of shortfall penalty imposing a 50% administrative penalty – whether the Tribunal erred in the construction and application of ss 355-205 and 355-210 of the *Income Tax Assessment Act 1997* (Cth) – whether the Tribunal erred by denying the applicant procedural fairness and not affording the applicant a reasonable opportunity to present its case – Held: appeal dismissed with costs |
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| Legislation: | *Administrative Appeals Tribunal Act 1975* (Cth) s 39  *Income Tax Assessment Act 1997* (Cth) Pt 3-45, Div 355, ss 355-20, 355-25, 355-25(2), 355-30, 355-30(2), 355-35, 355-100(1)(a), 355-205, 355-205(1), 355-205(1)(a)(ii), 355-210, 355-210(1), 355-210(1)(a), 355-210(1)(b), 355-210(1)(c), 355-210(1)(d), 355-210(1)(e)  *Industry Research and Development Act 1986* (Cth) ss 4, 6, 27A, 27A(1), 27M(4), 28C, 28C(1), 28C(1)(a), 28D  *Tax Administration Act 1953* (Cth) ss 284-75(1), 284-75(1)(b), 284-90(1) |
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| Cases cited: | *Italiano v Carbone* [2005] NSWCA 177  *Lee v Cha* [2008] NSWCA 13  *Moreton Resources Ltd and Industry Innovation and Science Australia (Taxation)* [2022] AATA 3804  *Moreton Resources Ltd v Innovation and Science Australia* [2019] FCAFC 120; 271 FCR 211  *Nathanson v Minister for Home Affairs* [2022] HCA 26; 403 ALR 398  *SZUR v Minister for Immigration and Border Protection* [2013] FCAFC 146; 216 FCR 445 |
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| Division: |  |
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| Registry: |  |
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| Number of paragraphs: | 43 |
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| Date of hearing: | 20 June 2023 |
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| Counsel for the Applicant: | Ms G Edwards |
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| Solicitor for the Applicant: | Gupta & Co Pty Ltd |
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| Counsel for the Respondent: | Mr D Hume |
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| Solicitor for the Respondent: | Australian Taxation Office |

ORDERS

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|  | | NSD 1002 of 2022 |
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| BETWEEN: | T.D.S BIZ PTY LTD ACN 161 327 993  Applicant | |
| AND: | COMMISSIONER OF TAXATION  Respondent | |

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| order made by: | BROMWICH J |
| DATE OF ORDER: | 29 June 2023 |

THE COURT ORDERS THAT:

1. The appeal be dismissed.
2. The applicant pay the respondent’s costs as assessed or agreed.

Note: Entry of orders is dealt with in Rule 39.32 of the *Federal Court Rules 2011*.

REASONS FOR JUDGMENT

BROMWICH J:

1. This is an appeal by the applicant, T.D.S. Biz Pty Ltd (**TDS Biz**), from a decision of the Administrative Appeals Tribunal affirming a decision of the respondent, the **Commissioner** of Taxation, to disallow an objection to a notice of amended assessment by which a claim for research and development (**R&D**) tax offsets was not allowed. The amended assessment gave rise to a notice of assessment of shortfall penalty, imposing a 50% administrative penalty, for which an objection was also disallowed, again affirmed by the Tribunal. The net financial effect on TDS Biz was that its refundable tax offsets were reduced by $701,855.95, and an administrative penalty of 50% of that sum, namely $350,927.95, was imposed.

## The legislative regime

1. The regime for tax concessions for R&D expenditure is set out in a set of provisions in the *Income Tax Assessment Act 1997* (Cth) (**ITAA 1997**) and the *Industry Research and Development Act 1986* (Cth) (**IRD Act**), the relevant portions of which are reproduced below.
2. The relevant provisions of the ITAA 1997 are as follows:
3. Pt 3-45, Div 355 deals with tax offsets for R&D activities;
4. s 355-20 exhaustively defines “*R&D activities*” to mean “*core R&D activities*” or “*supporting R&D activities*”, such that there is no other basis for tax offset entitlements;
5. s 355-25 describes in subs (1) what are, and in subs (2) what are not, core R&D activities;
6. s 355-30 provides (noting that “\*” signifies a defined term wherever it appears):

(1) ***Supporting R&D activities*** are activities directly related to \*core R&D activities.

(2) However, if an activity:

(a) is an activity referred to in subsection 355-25(2); or

(b) produces goods or services; or

(c) is directly related to producing goods or services;

the activity is a ***supporting R&D activity*** only if it is undertaken for the dominant purpose of supporting \*core R&D activities.

1. s 355-35 provides that an “*R&D entity*” is a body corporate either incorporated under an Australian law, or a body corporate incorporated under a foreign law that is an Australian resident;
2. s 355-100(1)(a) provides that an R&D entity is entitled to a tax offset for R&D expenditure for an income year equal to a percentage set out in the table to that subsection of the total of the amounts that the entity can deduct for the income year under s 355-205;
3. s 355-205(1) relevantly provides:

An \*R&D entity can deduct for any income year (the ***present year***) expenditure it incurs during that year to the extent that the expenditure:

(a) is incurred on one or more \*R&D activities:

(i) for which the R&D entity is registered under section 27A of the *Industry Research and Development Act 1986* for an income year; and

(ii) that are activities to which section 355-210 (conditions for R&D activities) applies …

1. s 355-210(1) relevantly provides:

An \*R&D activity covered by one or more of the following paragraphs is an activity to which this section applies:

(a) the R&D activity is conducted for the \*R&D entity solely within Australia,

…

(d) the R&D activity is:

(i) conducted for the R&D entity solely outside Australia; and

(ii) covered by a finding in force under paragraph 28C(1)(a) of the *Industry Research and Development Act 1986*;

(e) the R&D activity consists of several parts, with:

(i) some parts being conducted for the R&D entity solely within Australia, and

(ii) the other parts being conducted for the R&D entity outside Australia while covered by a finding in force under paragraph 28C(1)(a) of the *Industry Research and Development Act 1986*.

Note: An activity can be covered by a finding under paragraph 28C(1)(a) of the *Industry Research and Development Act 1986* if the activity cannot be conducted in Australia.

1. The relevant provisions of the IRD Act are as follows:
2. s 4 defines “*Board*” to mean Industry Innovation and Science Australia, established by section 6, also commonly referred to as **AusIndustry**, which is the title used by the Commissioner in the decisions under challenge and in these reasons;
3. s 27A(1) provides:

The Board [that is, AusIndustry] must, on application by an R&D entity, decide whether to register or refuse to register the entity for either or both of the following for an income year:

(a) one or more specified activities as core R&D activities conducted during the income year;

(b) one or more specified activities as supporting R&D activities conducted during the income year.

1. s 28C(1) provides:

The Board [that is, AusIndustry] must, on application by an R&D entity for a finding under this subsection about an activity, do one or more of the following:

(a) find that all or part of the activity is an activity (the ***overseas activity***) that meets the conditions in section 28D;

(b) find that all or part of the activity is not an activity that meets the conditions in section 28D;

(c) if justified in accordance with the decision-making principles—refuse to make a finding about all or part of the activity.

1. s 28D sets out four cumulative conditions for a finding that overseas activities cannot be conducted in Australia, being that the activities (1) must be an R&D activity; (2) must have a significant scientific link to Australian core activities; (3) must be unable to be conducted within Australia; and (4) the expenditure must be less than that incurred on Australian core activities.

## The claiming and disallowing of an R&D activity tax offset

1. In the financial year ended 30 June 2014, TDS Biz commenced designing and developing an electric tricycle. In January, February and May 2018, TDS Biz received three invoices from companies in China totalling $1,613,462. The January and May invoices were for vehicle components and the February invoice for electrical components.
2. On 23 August 2018, TDS Biz lodged an R&D tax incentive application form to AusIndustry which included a description of its R&D activities and expenditure for the year ended 30 June 2018. TDS Biz did not register any supporting R&D activities for the 2018 income year at that time, although as detailed below, an incentive registration variation was submitted to AusIndustry in July 2019, soon after being notified of disallowance of the claimed tax offset.
3. On 27 August 2018, AusIndustry issued a notice of registration for TDS Biz under s 27A of the IRD Act for the year ended 30 June 2018. On 14 September 2018, TDS Biz lodged an income tax return for the year ended 30 June 2018 and its research and development tax incentive schedule for the same year, obtaining a refund of $748,476.23.
4. On 2 July 2019, following a review of TDS Biz’s tax return, the Commissioner advised that an amended assessment would be issued whereby $1,613,462 of TDS Biz’s R&D notional deductions would be reclassified as general deductions, being the sum of the three invoices referred to above at [5]. The Commissioner noted that TDS Biz did not have a finding under s 28C(1) of the IRD Act in respect of overseas activities conducted during the year ended 30 June 2018. As a result, an amended notice of assessment for the year ended 30 June 2018 was issued on 10 July 2019. The following adjustments were made:
5. accounting expenditure subject to the R&D tax incentive was decreased from $1,720,635 to $107,173, a decrease of $1,613,462 (being the sum of the three invoices);
6. refundable tax offsets was decreased from $748,476.23 to $46,620.28, a decrease of $701,855.95;
7. a notice of assessment of shortfall penalty (**penalty notice**) for the year ended 30 June 2018 was issued, imposing an administrative penalty 50% of the shortfall amount of $701,855.95 of $350,927.95.
8. The rate of 50% for the administrative penalty was the “*base penalty amount*” provided for making a false statement recklessly, by item 2 of the table in s 284-90(1) of the *Tax Administration Act 1953* (Cth) (**TAA 1953**). The liability for the penalty arose under s 284-75(1) of the TAA 1953, because TDS Biz claimed amounts in the 2018 income year to which the Commissioner considered it was not entitled, and which the Commissioner considered constituted making a false statement in a material particular for the purposes of s 284-75(1)(b) of the TAA 1953.
9. On 11 July 2019, TDS Biz prepared and submitted an R&D tax incentive registration variation to AusIndustry (**variation request**), registering its supporting R&D activities, and reclassifying the construction cost of the prototype from a “*core R&D activity*” to a “*supporting R&D activity*”, making no mention of any supporting R&D activities being conducted overseas to furnish components for the prototype.
10. On 21 August 2019, AusIndustry approved TDS Biz’s variation request in relation to its R&D tax incentive registration for the year ended 30 June 2018. That registration was taken always to have existed as varied: s 27M(4) of the IRD Act.
11. By way of an email sent on 26 August 2019, TDS Biz objected to the amended notice of assessment, both as to not allowing the tax offset claim and as to the administrative penalty. On 23 September 2020, the Commissioner issued an objection decision advising that the objection to both the notice of amended assessment and the penalty notice were disallowed. TDS Biz sought a review of this decision by the Tribunal. The Tribunal affirmed the two objection decisions.

## The Commissioner’s reasons

1. In light of the Tribunal’s reasons for affirming both objection decisions, and the grounds of appeal in this Court from the Tribunal’s decision set out in full below, alleging:
2. a denial of procedural fairness and error in the interpretation of the legislation summarised above in not allowing the tax offset claim for expenditure on the overseas invoices; and
3. a denial of procedural fairness in relation to the imposition of the 50% administrative penalty,

the Commissioner’s reasons for each decision are illuminating. Reproduction of the relevant portions in full is warranted.

1. The Commissioner’s reasons for disallowing the objection to the amended assessment and the tax offset claim are as follows (emphasis added):

**Element (c)** - Activities to which section 355-210 (conditions for R&D activities) applies

Your R&D application indicated that your R&D project was conducted solely within Australia and no overseas expenses had been claimed under the R&D tax incentive for the income year. However, you have advised that components were sourced from overseas for the R&D project.

Post audit, the Commissioner disallowed R&D notional deductions in an amount of 1,613,462 for contract expenditure incurred. In his decision report, the Commissioner advised that the supporting documentation and information provided demonstrated that your client conducted significant R&D activities outside Australia. These R&D activities were not covered by an Overseas Advanced finding as per the IRDA 1986 legislation (“IRDA”).

Claiming expenditure on an overseas activity requires two things:

* a finding that the activity is eligible; *and*
* that the activity is registered.

Overseas activities can be ***either*** core R&D activities or supporting R&D activities and are subject to the same eligibility criteria previously described. The components sourced from China are produced by overseas activities and are therefore classified as ***overseas*** supporting activities.

Paragraph 355-210(1)(e) of the ITAA explains that some activities can be conducted in Australia and other activities can be conducted overseas. However, the overseas activities must be covered by an overseas finding.

Whilst companies are able to claim overseas R&D activities, it’s generally reserved for companies that can prove that Australia can’t offer all the necessary R&D expertise, research facilities or manufacturing capacity to meet industry needs. A higher cost factor in Australia is not an acceptable justification for the supporting R&D activities to be conducted overseas.

It’s also a legal requirement for the majority of project costs i.e. greater than 50%, to be spent on Australian based R&D activities. As per the R&D schedule, the majority of your expenditure purportedly incurred was from overseas i.e. 93.77% and therefore fails the majority cost test.

On 21 August 2019, you lodged a ‘Variation to the R&D Tax Incentive Registration’ application to AusIndustry to alter the categories and amounts of your R&D claims. However, the application therein fails to mention a critical fact that 94% of your supporting R&D activities were conducted overseas to produce the components for the prototype in Australia.

**Your supporting documentation and statements demonstrate that you conducted significant R&D activities outside Australia; however, you did not have a finding in force under the provisions of the IRDA.**

**We have therefore not allowed expenditure in relation to R&D activities conducted overseas, as these activities require an Overseas Finding from Innovation Australia.**

1. The Commissioner’s reasons for imposing the 50% administrative penalty are as follows (emphasis added):

**Penalty**

Division 284 of the TAA 1953 [*Taxation Administration Act 1953* (Cth)] imposes penalties for various situations, including where an entity:

* makes a statement which is false or misleading in a material particular; subsection 284-75(1) TAA 1953; and/or
* takes a position under an income tax law that is not reasonable arguable subsection 284-75(2) TAA 1953.

Liability to penalty for false or misleading statement

Subsection 284-75(1) of Schedule 1 to the TAA 1953 provides that you will be liable to an administrative penalty if:

* You make a statement to the Commissioner or to an entity that is exercising powers or performing functions under a taxation law, and
* The statement is false or misleading in a material particular, whether because of things in it or omitted from it.

You claimed amounts in the 2018 income year to which you were not entitled. We considered that you have made a false statement in a material particular for amounts in the 2018 income year for the purposes of paragraph 284-75(1)(b) of the TAA 1953. As such you are liable to an administrative penalty for making a false or misleading statement. The statement resulted in a shortfall amount.

Section 284-80(1) of the TAA 1953 provides that a taxpayer has a shortfall amount if an item in the table applies to them. In your circumstances, item 2 of the table in 284-80(1) of the TAA 1953 applies as an amount that the Commissioner was obliged to pay or credit to you under a taxation law for the 2018 income year was more than it would have been if the statements were not false or misleading. Further, the amount of the shortfall is the amount by which the payment or credit is more than it would otherwise have been had the statement not been false or misleading.

As such, the shortfall resulting from the false or misleading statement is as per the table below.

|  |  |  |
| --- | --- | --- |
| **Claimed** | **Amended** | **R&D only Shortfall** |
| $748,476 | $46,620 | $701,855 |

Base penalty amount for making a false or misleading statement

Where a false or misleading statement results in a shortfall amount, the base penalty amount (BPA) is worked out according to the level of care taken by the taxpayer, which led to the shortfall (see section 284-85(1) TAA 1953 and the table in section 284-90(1) of the TAA 1953).

Additionally, as you are responsible for the authorised actions of your representatives, their behaviour may also be relevant to determining your behaviour for penalty purposes.

Under section 284-90 of Schedule 1 to the TAA 1953 the BPA is:

* 75% of the shortfall amount if the shortfall resulted from intentional disregard of a taxation law.
* 50% of the shortfall amount if the shortfall resulted from recklessness as to the operation of a taxation law, or
* 25% of the shortfall amount if the shortfall resulted from a failure to take reasonable case to comply with a taxation law.

The Commissioner’s views on the concepts of reasonable case, recklessness and intentional disregard are detailed in Miscellaneous Tax Ruling MT 2008/1: *Penalty relating to statements: meaning reasonable care, recklessness and intentional disregard.*

Intentional disregard

*Intentional disregard* involves knowing what a particular tax obligation is, and then specifically choosing to ignore it.

At objection the Commissioner is of the view that your shortfall did not result from intentional disregard and will not be discussed here.

Lack of reasonable care

*A failure to take reasonable case* is a failure to take the same level of case that a reasonable, ordinary person would in fulfilling their tax obligations taking into account their circumstances, knowledge, experience, education, skill and other such factors.

The following paragraphs provide our analysis and decision with regards to the level of care taken by you at the time of, and leading up to, the making of the false or misleading statements in your 2018 tax return.

According to paragraph 28 of MT 2008/1:

The reasonable care test requires an entity to take the same care in fulfilling their tax obligations that could be expected of a reasonable ordinary person in their position. This means that even though the standard of care is measured objectively, it takes into account the circumstances of the taxpayer.

Some of the relevant factors to be considered as per Mt 2008/1 include:

* personal circumstances;
* level of knowledge, education and skill;
* class of the entity (for example, a salary and wage earner as opposed to an entity that conducts business);
* understanding of tax laws;
* records keeping systems and procedures;
* the size of the shortfall amount; and
* the likelihood that a statement is false or misleading.

**Further, the standard of care is measured objectively and, accordingly, the actual intentions of the taxpayer are not relevant (paragraphs 28 and 34 of MT 2008/1).**

In your circumstance, a tax agent was engaged for preparing and lodging your 2018 income tax return. Amy, your director, is not new to the tax system or the R&D tax offset requirements. She claimed R&D refunds in the 2015, 2016 and 2017 years and also sought Jamie Collins (R&D consultant) to assist with the eligibility and registration requirements for the R&D tax offset.

The failure to take reasonable care test requires an entity to take the same care in fulfilling their tax obligations that could be expected of a reasonable ordinary person in their position.

**Given the above, we would expect a higher standard of care taken to reflect that of a reasonable businessperson with experience. Further, given the significant size of the amount claimed it is expected that steps would have been taken to ensure that there was an entitlement to the claim. This is stated noting that the requirement for an overseas finding is not complex or difficult to ascertain.**

**For the purpose of 284-75(1) of the TAA 1953, you went beyond the failure to take reasonable care to comply with a taxation law for the 2018 income year.**

**Your behaviour indicates recklessness where it falls significantly short of the standard of care expected of a reasonable person in the same circumstances as the entity. Although the test for determining whether recklessness is shown is the same as that applied for testing a want of reasonable care, it is the extent or degree to which the conduct of the entity falls below that required of a reasonable person that underscores a finding of recklessness.**

Recklessness

At audit, an administrative penalty was applied under section 284-75 for displaying behaviour that was reckless in the 2018 income year. At objection, as stated in the preceding paragraph above, your behaviour was reckless which assumes that your behaviour in question showed disregard of or indifference to a risk that is foreseeable by a reasonable person.

Safe harbour

Subsection 284-75(6) of the TAA 1953 states that the taxpayer is not liable to an administrative penalty if they engaged a registered tax agent all of the relevant taxation information, the registered agent has made a statement that is false or misleading nature whilst the statement did not result from intentional disregard or recklessness by the agent.

This exception applies to statements made on or after 1 March 2010.

In your circumstances the penalty has been decided as reckless and the safe harbour provisions do not apply.

Penalty for taking a position that is not reasonably arguable

If a taxpayer makes a statement to the Commissioner which treats an income tax law as applying in a way that is not reasonably arguable and item 4, 5 or 6 of the table in subsection 284-90(1) of the TAA 1953 applies to you, you are liable to an administrative penalty. Items 4, 5 and 6 of the table in section 284-90(1) TAA 1953 only applies to a taxpayer if their statement results in a shortfall which exceeds the threshold test.

The relevant threshold is a shortfall greater than $10,000 or 1% of the income tax payable on the income tax return for that year, as per paragraph 284-90(3)(a) of the TAA 1953.

Your shortfall amount of $701,855 for the 2018 income year which exceeds this threshold. Therefore, it is necessary to establish whether you have a reasonably arguable position.

Section 284-15 of the TAA 1953 defines a matter as reasonably arguable if it would be concluded in the circumstances, having regard to relevant authorities, that what is argued for is about as likely to be correct as incorrect, or is more likely to be correct that incorrect.

On 21 August 2019, you lodged a ‘*Variation to the R&D Tax Incentive Registration’* application to AusIndustry to alter the categories and amounts of your R&D claims. However, your application therein fails to mention a critical fact that 93% of your supporting R&D activities were conducted overseas to produce the components for the prototype in Australia.

Accordingly, we do not consider your position regarding your claim for the R&D tax offset for the 2018 year to be reasonably arguable.

If more than one item in the table in subsection 284-90(1) of the TAA 1953 applies, the item that has the higher base penalty amount is to be applied in determining the amounts of the penalty. In your case, recklessness (50%) and no reasonably arguable position (25%) of the table apply.

Under subsection 284-90(2) of the TAA 1953 therefore, your base penalty amount is 50% of the shortfall for the 2018 income year.

Does penalty relief apply?

Penalty relief is about helping small business and individuals who are trying to get their tax right to get back on track when they do make an error.

This only applies to errors or genuine mistakes that would attract up to the 25% false or misleading statement base penalty - that is failure to take reasonable care or where a client takes a position that is not reasonably arguable.

As the penalty rate applied is for the behaviour of recklessness, penalty relief will not be applicable.

Conclusion

In conclusion the Commissioner maintains the penalty audit decision.

## Before the Tribunal

1. The Tribunal identified the issues for determination as being:
2. whether TDS Biz was entitled to the R&D tax incentive in relation to its supporting R&D activities for the year ended 30 June 2018, finding it was not so entitled;
3. whether TDS was liable to an administrative penalty, finding it was so liable;
4. whether remission of the penalty in whole or in part was warranted, finding that no remission was so warranted.
5. The key findings of the Tribunal leading to the primary conclusion as to a lack of entitlement to the R&D tax incentive were as follows:

[19] The [Commissioner] accepts that the [TDS Biz]’s supporting R&D activities *do* constitute ‘supporting R&D activities’ for the purposes of section 355-30 of the ITAA 1997. This is consistent with the approved variation request on 21 August 2019.

[20] [TDS Biz] now appears to contend that the approved supporting activities were the mere supply of parts and components from China for the dominant purpose of supporting the core R&D activities, which were solely conducted in Australia. In other words, that an overseas finding was not applicable as no R&D activities were conducted outside Australia. [TDS Biz] also contends that its overseas activities cannot meet the conditions in section 28D of the IRDA 1986.

[21] In the variation request, [TDS Biz] described the supporting R&D activities to be ‘[t]he design, development and fabrication and/or supply of components for the assembly of the project’s prototypes are for the dominant purpose of supporting the core R&D activities…’

[22] [TDS Biz]’s Response to ATO Review request for further information dated 20 November 2018, provides an explanation of the work conducted overseas. Relevantly, the [TDS Biz] describes some of the work as:

*…*

*Molds*

*Fabrication/machining of plastic body component molds for external body elements,*

*e.g. roof, sides, front, rear, door and interior panels and dashboard.*

*…*

*CAD Drawings*

*Preparation computer aided design (CAD) drawings to ensure dimensional control, shape and fit of individual components.*

*Metal Fabrication*

*Fabrication of items such as chassis, side sections, door sections, wheel chair turntable/ramp/restraint, computer numerically controlled (CNC) bending/profiling of tubing for vehicle side sections.*

*…*

*Electrical assemblies*

*Assembly of Australian Design Rule (ADR) compliant wiring harnesses for the prototypes.*

*…*

*Assembly of prototypes*

[23] In a response to the ATO dated 28 August 2020, [TDS Biz] stated:

*The Chinese company HK Flistar produced fabricated components, e.g. chassis, etc. from designs provided by the company derived from the new knowledge established from the Australian core R&D activities.*

*Hefei Kelly supplied ‘off-the-shelf’ items, e.g. motor controller, etc. which were required for the construction/assembly of the prototypes in Australia to enable the continuation of the core R&D activities in Australia as specified in 1.1 Electro- mechanical design.*

*…*

*The supporting activity could not have been undertaken in Australia as the cost of fabrication of components would have been commercially prohibitive and the parts (motors, controllers, ADR compliant components, etc.) are not manufactured in Australia.*

[24] Contrary to [TDS Biz]’s contentions, [TDS Biz]’s supporting R&D activities are not the mere supply of components. The approved supporting R&D activities plainly go beyond the mere supply of components.

[25] As such, [TDS Biz]’s supporting R&D activities are not covered by paragraphs 355-210(1)(d) or 355-210(1)(e) as these activities are conducted overseas and [TDS Biz] does not have an overseas finding.

[26] For these reasons, I find that notional deductions under section 355-205 of the ITAA 1997 do not arise from [TDS Biz]’s $1,613,462 expenditure on the supporting R&D activities during the year ended 30 June 2018. [TDS Biz] is not entitled to a tax offset in respect of this expenditure.

## The grounds of appeal

1. The grounds of appeal before this Court are as follows:

[1] The applicant was denied procedural fairness and not afforded a reasonable opportunity to present its case where:

i. it was a self-represented litigant which provided a witness schedule, brought witnesses to the hearing, yet the Tribunal did not invite any witnesses to give evidence nor explain the consequences of the failure to provide any evidence and that submissions are not evidence;

ii. the respondent’s solicitor advocate advised the Tribunal that the respondent had a “strong view” that “any” oral evidence proposed by the applicant was “irrelevant” to the proceedings and a “waste of the Tribunal’s time and resources”; and

iii. the Tribunal made adverse findings of fact which led to the assessment of a 50% administrative penalty pursuant to s. 284- 75(1) without any evidence from the applicant on the issues in dispute.

[2] The Tribunal erred in the construction and application of s. 355-205 and s 355-210 of the *Income Tax Assessment Act 1997* regarding the applicant’s purchase of the components from China.

1. It is convenient first to address ground 2 as to the asserted error in the construction and application of ss 355-205 and 355-210 of the ITAA 1997, because that gives context to the assertion of a denial of procedural fairness and TDS Biz not being afforded a reasonable opportunity to present its case in ground 1.

## Ground 2 – the construction and application of ss 355-205 and 355-210 of the ITAA 1997

1. Unfortunately, the argument advanced by TDS Biz as to error on the part of the Tribunal depends upon a misreading of the legislative regime summarised above and articulated both in the Commissioner’s objection reasons and the Tribunal’s reasons.
2. First, TDS Biz contends that the Tribunal failed to apply s 27M(4) of the IRD Act, which provides that for the purposes of that Act and the ITAA 1997, the effect of a variation of its registration under s 27A was taken always to have existed as varied. This argument cannot be sustained because the Tribunal stated at [19] that the Commissioner accepted that TDS Biz’s supporting R&D activities do constitute “*supporting R&D activities*” for the purposes of s 355-30 of the ITAA 1997, being consistent with the variation request approved on 21 August 2019.
3. Secondly, TDS Biz contends that it did not require a finding under s 28C of the IRD Act because it did not undertake any R&D activities outside Australia, pointing to the distinction between the core R&D activities carried out in Australia, and the purchase of parts and components outside of Australia that were required for the dominant purpose of the Australian activities, which it describes as not being R&D activities at all. This argument involves a misunderstanding of the legislative regime, in part apparently due to a misreading or misunderstanding of an AusIndustry guide to interpretation and of comments made by a senior tax official, neither of which convey this mistaken understanding. Reliance upon such secondary sources was, in any event, never any substitute for reading the somewhat complex, but otherwise clear, legislative provisions.
4. The regime for R&D tax concessions summarised earlier in these reasons is that it only applies to expenditure on R&D activities, as defined, which means expenditure on core R&D activities or expenditure on supporting R&D activities that are sufficiently connected to core R&D activities. If an activity does not fall into one of those two categories, there is no basis for claiming any R&D tax offset.
5. Additionally, supporting R&D activities do not necessarily have to involve any actual research and development if other criteria are met as set out in s 355-30(2), reproduced above. So long as supporting R&D activities are directly related to core R&D activities, they may extend to activities that are not themselves core R&D activities as listed in s 355-25(2) or to activities that produce goods or services, or to activities directly related to producing goods or services, provided they are undertaken for the dominant purpose of supporting core R&D activities.
6. To the extent that expenditure takes place on any overseas activities capable of falling within one of the two categories of R&D activities – core R&D activities or supporting R&D activities – that will only be able to be the subject of a claim for a tax offset if those overseas activities are also covered by a finding in force under s 28C(1)(a) of the IRD Act that those activities cannot be conducted in Australia, meeting all four conditions in s 28D for such a finding. TDS Biz accepted that it cannot meet several of the conditions in s 28D, so it could not have obtained that necessary finding. It did so without apparently appreciating that this meant that it could not meet this indispensable requirement for eligibility for an R&D tax offset in relation to the overseas expenditure. It is not to the point that the core R&D activity took place in Australia, for which a tax offset could be, and was, claimed, and upheld. At all times, the issue was eligibility to claim a tax offset for the overseas component of the expenditure, for which a s 28C(1)(a) finding was required.
7. Thirdly, TDS Biz makes reference to the Tribunal failing to refer to the Commissioner not having the power to make a finding on the eligibility of R&D activities. It is not clear what is meant by this submission, nor how it assists TDS Biz’s case. It is clear that the Tribunal understood the role of AusIndustry in registering entities, and making findings, for the purposes of eligibility to claim R&D tax offsets.
8. Fourth, TDS Biz correctly asserts that the Tribunal emphasised s 355-210(1)(d) and (e), but incorrectly asserts that they were inapplicable because there was no s 28C(1)(a) finding applied to them. That inverts the operation of s 355-205(1)(a)(ii) and s 355-210(1). The fact that one of the criteria for the application of either of s 355-210(1)(d) or (e) could not be met did not mean that they did not apply, but rather that this could not be a basis for meeting either of those conditions.
9. There was no suggestion made by TDS Biz that any of s 355-210(1)(b) or (c) applied. That left only s 355-210(1)(a), which in oral argument TDS Biz asserted did apply. As reproduced above at [3(h)], s 355-210(1)(a) provides that one of the conditions for eligibility for a tax offset is that “*the R&D activity is conducted for the \*R&D entity solely within Australia*”. Section 355-210(1)(a) entitled TDS Biz to apply for and obtain a tax offset for its core R&D activities conducted in Australia, but it plainly did not entitle TDS Biz to apply for and obtain a tax offset for the expenditure on supporting R&D activities carried out on its behalf in China. Thus, there was no applicable condition by which TDS Biz could obtain a tax offset in relation to the expenditure on supplies from China, as reflected in the three invoices referred to at [5].
10. Finally, TDS Biz relies upon the reasoning in another Tribunal case of *Moreton Resources Ltd and Industry Innovation and Science Australia (Taxation)* [2022] AATA 3804, after the matter was remitted in 2019 following the successful appeal in *Moreton Resources Ltd v Innovation and Science Australia* [2019] FCAFC 120; 271 FCR 211. However, that case, which apparently turned on the meaning of “*directly related*” in the phrase “*[s]upporting R&D activities are activities directly related to \*core R&D activities*” in s 355-30(1) of the ITAA 1997, and the meaning of “*dominant purpose*” in s 355-30(2) of that Act, does not assist TDS Biz. The issue in this case was not whether the supporting R&D activities overseas were sufficiently related to the core R&D activities in Australia, nor whether the dominant purpose test was met, neither of which was apparently in doubt. Rather, it was whether the necessary finding had been made under s 28C(1)(a) of the IRD Act in order that the only applicable s 355-210 conditions could be met, namely those in either s 355-210(1)(d) or (e).
11. As no error on the part of the Tribunal has been established, ground 2 must fail.

## Ground 1 – denial of procedural fairness

1. The essence of TDS Biz’s complaint as to a denial of procedural fairness may be summarised in some detail as follows, exposing the lack of content directed to the live issue of the need for an overseas finding for TDS Biz to be entitled to claim an R&D tax offset as detailed in relation to ground 2 considered above:
2. TDS Biz filed a hearing certificate indicating it intended to call three witnesses, Mr Jamie Collins, Mr Anthony Elliott and Ms Amy Huang (as it transpired, Ms Huang was not available to be called as a witness);
3. the application for review of the Commissioner’s decision was set down by the Tribunal for a two-day hearing on 21 and 22 July 2022;
4. the hearing commenced at approximately 10:04 am on the first day and, including a 15-minute break, and concluded at 12:03 pm without any witness being called or examined;
5. TDS Biz did not have any legal representation;
6. TDS Biz’s external R&D consultant, Mr Collins, made submissions on its behalf, but was not sworn as a witness;
7. Mr Elliott, TDS Biz’s engineer and project developer, only spoke four words during the entire two-hour hearing;
8. it was originally anticipated that Mr Elliott would be called as a witness, with the only issue being that he had been incorrectly identified as an expert witness in the hearing certificate;
9. the issue of TDS Biz’s witnesses providing evidence at the hearing went awry, referring to the hearing transcript where Mr Collins referred to Mr Elliott being an integral part of the business, that he undertook the R&D activities, and his evidence was to illuminate the activities that he undertook in Australia, being the primary purpose of him being there. (However, it should be noted that the Tribunal member had Mr Collins confirm that there was no intention that Mr Elliott would speak without being prompted, but he was available in case there were technical questions that needed to be addressed.);
10. there were some additional exchanges between Mr Collins and the Tribunal member which are relied upon to infer that TDS Biz did not fully understand or appreciate the practice or procedure of the Tribunal, with no witness outlines ever being filed or served and Mr Collins reciting his prior professional experience despite not being sworn as a witness;
11. Mr Collins also expressed concern that Mr Elliott’s evidence would cause boredom, which is relied upon to support an inference that TDS Biz did not understand questions from the Tribunal about “*formal evidence*” or that Mr Collins’ submissions were not evidence;
12. the asserted denial of procedural fairness and the opportunity to present TDS Biz’s case was exacerbated by the Commissioner objecting to any oral evidence from Mr Elliott or Mr Collins (noting that this objection by the Commissioner was evidently based upon the statutory construction questions addressed in relation to ground 2 above);
13. while the *Administrative Appeals Tribunal Act 1975* (Cth) (**AAT Act**) provides that the Tribunal carry out its review quickly and informally, the basic procedure of a final hearing should not be abandoned, citing:
    1. *Italiano v Carbone* [2005] NSWCA 177 at [35]-[36]; and
    2. *Lee v Cha* [2008] NSWCA 13 at [48]-[49] on the obligation for a trial judge in criminal proceedings to take appropriate steps to ensure that a party appearing unrepresented has sufficient information about the practice and procedure of the court as is reasonably practicable for the purpose of ensuring a fair trial with the application of the principle depending upon the circumstances of the case;
14. s 39 of the AAT Act imposes an obligation on the Tribunal to ensure that every party to a proceeding before it is given a reasonable opportunity to present his or her case;
15. while there was some preliminary discussion regarding TDS Biz’s witnesses, the Tribunal appeared to abandon the ordinary procedure of the hearing and proceed with submissions from the parties;
16. TDS Biz disagreed with the Commissioner’s submission to the Tribunal that the evidence of Mr Elliott and Mr Collins would have been irrelevant and a waste of the Tribunal’s time and resources;
17. Mr Elliott’s evidence would have been highly relevant in assisting the Tribunal regarding the details surrounding the component purchases from the Chinese companies, how the components were utilised for the R&D activities conducted in Australia, the details of the R&D conducted in Australia, and that no false or misleading statements were made, and the evidence existed that TDS Biz had a reasonably arguable position regarding the R&D tax offset;
18. Mr Elliott was not invited to give this critical evidence under oath or affirmation, and be cross-examined upon it; and it was appropriate in the circumstances for the Tribunal to give TDS Biz assistance to fulfil its duty as that evidence would have been relevant to the principal issue surrounding the R&D activities, the purchase of the components from China, and the determination of any administrative penalty;
19. while Mr Collins and Mr Elliott were highly qualified engineers, they were unaware of the Tribunal’s practice and procedure and the “*resulting miscarriage*” that would result from not providing any evidence in the witness box on the relevant issues;
20. while the Tribunal noted it did not have any other evidence beyond Mr Collins’ limited and brief statement [in fact affidavit] from February 2022, the Tribunal should have informed TDS Biz that its submissions were not evidence, and without evidence, its appeal would necessarily fail;
21. the Tribunal therefore did not ensure that TDS Biz had a reasonable opportunity to present its case, therefore failed to discharge the statutory obligation imposed by s 39 of the AAT Act.
22. TDS Biz relies upon a number of authorities dealing with unrepresented litigants, including *SZUR v Minister for Immigration and Border Protection* [2013] FCAFC 146; 216 FCR 445, a case dealing with an unrepresented litigant who did not speak English, who was not advised that the Court would not act on statements from the bar table made through an interpreter and that his allegations would fail in the absence of evidence. For reasons that will shortly become apparent, the reliance upon that and other like cases was misplaced given the very different circumstances in this case, turning as they do upon a state of affairs that could not be changed by any evidence that could have been given, or any submissions that could have been made.
23. TDS Biz also relies upon ***Nathanson*** *v Minister for Home Affairs* [2022] HCA 26; 403 ALR 398, per Kiefel CJ, Keane and Gleeson JJ at paragraphs 1, 2, 7-9, 12, 15, 33 and 39, and Gageler J at paragraphs 46-47, 51-53 and 56. That was a visa revocation case in which the appellant was not given an opportunity to give or adduce evidence or to make submissions on the way in which two domestic violence offences could affect the Tribunal’s consideration of one of the primary considerations as to whether there was “another reason” (apart from the character ground for mandatory visa cancellation in the first place) why a visa cancellation should or should not be revoked, namely, in that case, the need for protection of the Australian community. The issue was whether or not the error in not having the appellant give evidence was material so as to constitute a jurisdictional error having regard to the terms of the *Migration Act 1958* (Cth).
24. The practical test for materiality is substantially the same, at least in this context, as the familiar test of whether there was a reasonable possibility that the absent evidence, submissions or other information, deprived the party affected of the realistic possibility of a different outcome. Applying the reasoning in *Nathanson* to this case, the question is whether any submissions or evidence advanced by TDS Biz could realistically have produced any different outcome. For the following reasons, the answer to that question is a decisive and unambiguous “No”, given the undisputed absence of an overseas finding which was indispensable for TDS Biz to be eligible to claim the R&D tax offset, and the statutory provisions dealing with the imposition of an administrative penalty for falsely claiming such an entitlement.
25. The vital springboard for TDS Biz’s assertion of a denial of procedural fairness and a proper opportunity to be heard depends upon a misinterpretation of the legislative regime applicable to an entitlement to a tax offset for R&D expenditure. The claim of a denial of procedural fairness is incapable of being made out, because the evidence that was not called and not heard, and any related submissions that might have been made, essentially concerning R&D activities in Australia, and the use that would be made of the materials supplied from China, could not possibly have made any difference to the determination that the objection decision should be affirmed. That is because, after summarising key aspects of the documentary evidence from TDS Biz concerning the activities of the suppliers in China, the Tribunal correctly made the following determinative findings:

[25] As such, the [TDS Biz]’s supporting R&D activities are not covered by paragraphs 355- 210(1)(d) or 355-210(1)(e) as these activities are conducted overseas and the [TDS Biz] does not have an overseas finding.

[26] For these reasons, I find that notional deductions under section 355-205 of the ITAA 1997 do not arise from the [TDS Biz]’s $1,613,462 expenditure on the supporting R&D activities during the year ended 30 June 2018. The [TDS Biz] is not entitled to a tax offset in respect of this expenditure.

1. There was no evidence (or submissions) that could have been put before the Tribunal, and identified in the written or oral submissions for TDS Biz in this Court, that could possibly have changed the conclusion by the Tribunal that TDS Biz did not have the necessary finding under s 28C(1)(a) of the IRD Act, as required for any of the ITAA 1997 conditions in s 355-210 to be met, as clearly required by s 355-205(1)(a)(ii). In those circumstances, there was no injustice in the Tribunal not providing for irrelevant evidence to be adduced, or equally irrelevant submissions to be made, even if there was any obligation to do so, which is doubtful, at least in the circumstances of this case. The merits review application to the Tribunal in relation to the disallowance of the objection to the amended income taxation was at all times doomed to fail, as indeed were the objections to the amended notice of assessment, the penalty notice and this appeal.
2. The whole tenor of TDS Biz’s case before the Tribunal was not that of apologising for, or otherwise explaining, making a false claim, but rather of doubling down on why it was not false at all. It was not for the Tribunal to give TDS Biz or its representatives legal advice. That is especially so when the reasons given for the Commissioner disallowing the objection, reproduced above at [14], made abundantly clear why that decision had been made in relation to the key and determinative issue of meeting one of the conditions in s 355-210 of the ITAA 1997.
3. In all the circumstances, it is clear that there was no denial of procedural fairness in relation to the Tribunal’s review of the disallowance of the objection decision in relation to the notice of amended assessment.
4. On the question of the administrative penalty imposed, the Commissioner’s reasons for disallowing the objection were thorough and detailed. TDS Biz faced a steep hurdle in showing that anything they could have said or done could realistically have made any difference to the Tribunal’s decision to affirm the disallowance of the objection to the penalty notice. A generalised assertion of a denial of procedural fairness to vitiate the Tribunal’s decision to affirm the disallowance of the objection as to the penalty imposed could not suffice.
5. No real attempt was made in this Court to explain how any evidence that could have been adduced on this topic before the Tribunal (or any submission could have been made) that could possibly have made a difference to the Tribunal’s decision to affirm the disallowance of the objection to penalty. That is especially so when regard is had to the careful application by the Tribunal of apparently sound and well-established principles.
6. Nor could the evidence that was sought to be adduced on the question of eligibility to claim the tax offset conceivably have made any difference to the Tribunal’s decision to affirm the disallowance of the objection to the penalty decision. To the contrary, the evidence which it is contended should have been facilitated being adduced by TDS Biz concerning the core R&D activities in Australia would have shown the extent of the failure to appreciate the correct meaning of the legislation and what was required to claim a tax offset for the supporting R&D activities in and from China. Adducing that evidence could not possibly have made the false statement by omission of failing to refer at all to the overseas nature of that work other than reckless, so as to warrant the 50% penalty, nor realistically could it have affected the decision of the Commissioner not to remit that penalty in whole or in part.
7. It follows that there was no denial of procedural fairness in the approach taken by the Tribunal. It follows that ground 1 must also fail.

## Conclusion

1. As both grounds of appeal have failed, the appeal by way of an originating application must be dismissed. TDS Biz must pay the Commissioner’s costs.

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| I certify that the preceding forty-three (43) numbered paragraphs are a true copy of the Reasons for Judgment of the Honourable Justice Bromwich. |

Associate:

Dated: 29 June 2023