

Attachment A

The Proposed Bills and EM: Changes since the Second Exposure Draft & Inconsistencies in the Interpretation of the New Definition

This attachment provides a summary of the changes in the Bills from the Second Exposure Draft, a more detailed analysis of the feedstock provisions, a discussion on the inconsistencies in the EM examples of the interpretation and application of the new definitions of R&D and finally a table listing all of the errors in the EM that should be corrected.

Summary of the Changes

The key changes in the Bills from the Second Exposure Draft are as follows:

- the inclusion of the feedstock provisions (s 355-460 to 355-475)

A detailed analysis of the feedstock provisions is detailed below.

- the reduction of the list of activities excluded as core R&D activities (s 355-25(2))

It is submitted that this will have little impact on the program as the activities removed were unlikely to qualify as core R&D activities under the Credit (and, furthermore, would be unlikely to qualify as core R&D activities under the Concession).

- the softening of the software exclusion as core R&D activities (the requirement is now that the dominant purpose not the sole or primary purpose is relevant) (s 355-25(2)(h))

Whilst we believe this will have little impact on the eligibility of claims we acknowledge that a dominant purpose test is an easier test than a sole purpose test.

- a partial return to an unlimited amendments period (s 355-710(3))

Section 355-710 (3) reintroduces unlimited amendment periods for the ATO to amend a taxpayer's assessment when a "key decision" is made by the Administrative Appeals Tribunal and the courts, as well as Innovation Australia. This extends an unlimited amendment period to decisions made by Innovation Australia and thereby elevating this administrative body to the equivalent of a tribunal or court.

- the addition of new compliance requirements when Innovation Australia asks for more information (s 27E, s 27G and s 28H)

These three provisions have been amended to extend AusIndustry's powers further. AusIndustry would have the power to require information provided to be restructured in an "approved form". This may impose additional compliance costs on the taxpayer.

Apart from the feedstock provisions, none of the changes are a result of public responses to either the First or Second Exposure Drafts.

Analysis of the Feedstock Provisions

The concerns we have with the proposed Credit are as follows:

- (a) The calculations required under s 355-465 and s 355-470 will impose sharply increased compliance costs on taxpayers compared to those that exist in the calculation of the feedstock expenditure under the Concession program;
- (b) The calculations will be impossibly complex to apply for taxpayers that make more than a handful of finished products or for those taxpayers that use sequential processing steps involving separate R&D activities;
- (c) The calculations will have distortional and inequitable effects, especially following the Government's announcements with regards to the Henry Review;
- (d) The calculations could be used to duplicate deductions; and
- (e) The provisions can eliminate more expenditure eligible for support than the Concession provisions because;
 - o what is meant by "the expenditure" in s 355-465(1)(b)(i) is unclear. It is unclear if this is all of the expenditure to obtain the resultant R&D product or just the expenditure on feedstock input. Under the Concession, the feedstock provisions do not eliminate costs incurred in a production trial other than raw materials and energy, even if they produce a saleable product. The Bills provide that the relevant costs to eliminate are "the expenditure". For the feedstock provisions in the Bills to be a restatement of the existing law, the wording in s 355-465(1)(b)(i) should change to "for the expenditure on feedstock inputs". Whilst Paragraph 3.138 of the EM indicates that this is the intent, we submit that it is vital the legislation is clear and unambiguous to provide greater certainty to taxpayers.
 - o the intent of the existing Concession legislation is that **feedstock inputs** are processed or transformed into **feedstock outputs**. The intention of the parliament under the Concession was never to eliminate all materials and goods that were transformed or processed in an R&D activity, but only those that were processed or transformed into feedstock output by the R&D activity. The wording in s 355-465(1)(a) however can be interpreted as expanding this to include not just costs on the raw materials or goods processed or transformed but also to include the cost of consumables, maintenance materials etc. that are merely transformed or processed in R&D activities and, importantly, are items that do not become part of the feedstock outputs.

We will provide a more detailed explanation of these unresolved issues, however first it is appropriate to provide a more detailed explanation of the calculations that are required under the Concession and the proposed calculations required under the Credit and then provide an example to illustrate the operation of these calculations.

What Calculations are Required?

The Concession provisions require that a taxpayer who, in undertaking an R&D activity, processes or transforms feedstock inputs including energy into a feedstock output that is sold or available for sale, exclude the cost of these inputs. The taxpayer can add back any loss they have made on feedstock inputs compared to that feedstock output. This loss is based on either the actual sale price of the feedstock output or the market value of the feedstock outputs in the year the R&D activity produced the feedstock output. This is a relatively simple process.

The Bills will move this calculation both in terms of where and when it will be measured. Instead of being measured at the point the feedstock output is produced by the R&D activity, it will be calculated at the point at which the final product(s) is(are) sold or used by the taxpayer for their own use. And the timing of that calculation will move to the year(s) that this sale occurs or when the product is used by the taxpayer.

The impact of these changes to the feedstock calculations will require the use of new and complex formulas to apportion the costs. These formulas are arbitrary and will increase compliance costs for any taxpayer that has more than a simple linear relationship between the *feedstock input*, *feedstock output* and *marketable products* made. The issue that we see is that many taxpayers make multiple final products from the same intermediate feed. As such, instead of measuring the product from an R&D activity against the inputs into it, such taxpayers may need to look at the value of tens, hundreds or even thousands of marketable products made from the feedstock output. This is for many taxpayers, a massive increase in compliance costs that may be extremely complex.

A Simple Example

The following example demonstrates the complexity of the calculation required under the Bills.

Company A has a simple manufacturing process where it makes ten products with two processes.

- Process 1 makes two products that can be sold or used as feed for Process 2.
- Process 2 can make four products from each of the products made in Process 1 ie. eight products in total.

During a tax year, process development R&D activities are undertaken in two separate projects; a Carbon reduction project on Process 1 and a water reduction project on Process 2. The R&D activities were not specific to any product but to the two processes. The R&D activities all resulted in saleable feedstock output. Sales to customers are a mix of products made by normal production processes and those produced by the R&D activities.

What then is the impact of the feedstock provisions under the Concession?

- the taxpayer will be required to make a feedstock calculation for each R&D activity. This requires two simple calculations to be performed only when Company A makes a loss on the value of feedstock output (or the ten products) compared to feedstock inputs. The calculation for each of the two activities would be:

$$= \text{Feedstock Output of the activity} - (\text{Feedstock Inputs} + \text{Energy Inputs of the activity})$$

What, however, is the impact of the feedstock provisions contained in the Bills?

- the answer is not so straightforward. Instead of just needing to know the value of feedstock output from each activity, the taxpayer will need to:
 - a) determine the feedstock output value of the Carbon reduction project at the point (and time) each of the final two products from Process 1 are sold
 - b) determine the feedstock output value of the Carbon reduction project at the point (and time) each of the final two products from Process 1 that are used in Process 2
 - c) determine the feedstock inputs for the Carbon reduction project

- d) determine the feedstock output value of the water reduction project at the point (and time) each of the final eight products from Process 2 are sold
- e) determine the relevant feedstock inputs for the water reduction project component in Process 2
- f) calculate the feedstock adjustment
- g) prepare these calculations for each income year in which the ten products are sold as a result of the Carbon reduction project
- h) prepare these calculations for each income year in which the ten products are sold as a result of the water reduction project

Ultimately this would result in 44 different calculations for Company A.

In total, up to 44 different calculations are required to be made to calculate the feedstock adjustment under the Credit in this example. Whilst on the face of it, this example appears to be simplistic, it clearly illustrates the complexity of the feedstock provisions in the Bills.

We submit that such a convoluted exercise is just the tip of the iceberg. As the complexity of a taxpayer's process increases, the number of calculations required will grow geometrically. We are aware of manufacturing processes with up to 75 processing steps, each of which could include R&D.

Issues with the Feedstock Provisions

As we outlined above, our key concerns with the feedstock provisions under the Credit can be described as follows:

(a) Increased Compliance Costs

The type of tracking required under the Bills is vastly more than required to meet Australian Generally Accepted Accounting Standards under A-IFRS (the Australian version of the International Financial Reporting Standards).

As the simple example demonstrates, compliance costs will rapidly become so great that many businesses may choose to stop making R&D claims. Under the Concession, if tracking the feedstock adjustment becomes too complex, a taxpayer can choose to ignore just the adjustment and only forego part of their R&D claim. However, under the proposed legislation, this is not an option.

(b) Increased Complexity

The simple example illustrates the complexity associated with the calculations required under the Credit. Not only are there significantly greater calculations that must be made but the shift from measuring feedstock output to the value of the marketable output after all further transformation creates complexity. Furthermore, these calculations must be made not just in the income year the R&D activities are undertaken.

(c) Distortional and Inequitable Effects

The calculations in s 355-465(2) and s 355-470 assume that for all taxpayers the corporate tax rate is 30% and the R&D tax credit is 40% so the adjustment is $\frac{1}{3}$ rd of the tax rate. Already, this is incorrect for two reasons;

1. For many taxpayers, the Credit rate will be 45% so, if there is no loss, 5% of feedstock input and energy costs will not be fully clawed back; and

2. The shift to a final sales focus from an R&D activity focus in calculating the adjustment includes an assumption that revenue in multi-step processes is earned exactly equally for each dollar spent in these processes. If this assumption is incorrect then the allocation formulas will not properly clawback the feedstock input costs. This will eliminate genuine R&D costs or leave taxpayers with a windfall gain they currently cannot enjoy.

In effect, R&D projects with high value feedstock inputs and energy costs will receive more support and encouragement than R&D on low energy or low feed processes. This will be inequitable as it will put an otherwise equal taxpayer who is seeking to use less energy and feed at a disadvantage. These effects will only get worse following the Government's announcements in regards to the Henry Review. As the corporate tax rate falls then the proposed provisions will become less and less accurate.

There is also the issue that may provide a windfall gain to taxpayers which we believe is not the intent of the Government. The feedstock provisions under the Credit can operate to provide a zero interest loan from the Government when a taxpayer sells the marketable product which is the result of the R&D activities in subsequent years after the feedstock input expenditure is incurred. In long maturing industries or for slow moving stock industries such as the wine, spirits or cheese industries, this could be quite a lengthy and significant loan. Furthermore, if the tax rate falls, then all taxpayers will retain a net benefit as well as the timing benefit. Australian companies are entering a period of falling corporate tax rates. Under these circumstances, effective tax planning dictates that a company has more encouragement than normal to put off recognising taxable income until future years. We believe that this coupled with the feedstock provisions under the Credit create a distortional and unintended effect.

(d) Potential for Deduction Duplications

The methodology required to make the calculations is not only a compliance nightmare but it can duplicate deductions. The effect of these provisions on a sequential chain of R&D activities is to require the taxpayer to include the feedstock inputs of each R&D activity for each step in the chain and then only make one feedstock adjustment in relation to the feedstock output from the final R&D activity in the chain. Therefore, the legislation can result in a taxpayer claiming feedstock inputs costs multiple times but only clawing back these costs once at the end. This deduction duplication is not possible with the current legislation because the adjustment is a net adjustment that is applied on a trial-by-trial basis. We believe this is an unintended outcome of the feedstock provisions in the Credit.

Inconsistencies in the Examples of the EM

Below is an analysis of the examples in the EM that highlight the inconsistencies in the interpretation and application of the new definition of R&D.

The EM fails to comprehend the significant distinction between '*the knowledge that something can be done*' as opposed to '*the knowledge of how to do it*.' A consistent theme emerges throughout the examples in the EM in which a product or process is known to exist; there is a clear intent to characterise any experimental activities relating to known products or processes as resolving inadequacies within the current realm of understanding, rather than for the purpose of developing new knowledge. This interpretation fails to recognise that, in a commercial environment, it may be necessary for a business to undertake R&D activities to develop their own know-how as the intellectual property behind the product or process may not be commercially accessible or specifically applicable to the claimant company's circumstances.

Our analysis concludes that the examples mischaracterise key concepts, such as the scientific method, leading to confusing and inconsistent results. A number of the examples, but not all,

classify what would be core experimental activities under the current Concession as supporting, presumably in order to subject these activities to the more restrictive *dominant purpose test* in production scenarios. The inconsistency in the classification of R&D activities in the EM will create an unacceptable level of uncertainty for taxpayers.

Furthermore, except for a couple of examples which highlight unlikely production realities, it is difficult to fathom how any supporting activities that 'piggy-back' off production activities are likely to satisfy the dominant purpose test.

It is worth noting that the Bills EM has eschewed all references to the new feedstock provisions in the examples. The EM needs to acknowledge that, in many of the circumstances where eligible claims are identified in the examples, the feedstock provisions will be applicable and will reduce or eliminate the support offered by the Credit.

Finally, we believe that some of the examples of ineligible projects are already ineligible under the Concession, thereby limiting the usefulness of the discussion. These examples are similar to the two examples being publicly presented as to how the current Concession is able to be abused. Namely, a mining company that does \$20 million worth of R&D being able to claim \$500 million for normal mine operations and exploration associated with the R&D, and a construction company that does \$15 million worth of R&D on air-conditioning systems being able to claim the \$100 million cost of construction of the whole building. In both cases, it is difficult to envisage any scenarios under the current Concession which would allow for such an expansive definition of supporting activities.

Turning to the specific examples:

EcoStartup

Examples 2.1 and 2.2 examine the application of the proposed exclusion of production activities that are considered to be supporting activities and the classification of activities as part of the experimental core activities. The Credit seeks to restrict the definition of R&D to just experimental activities to gain new knowledge and required supporting activities that do not have a dominant purpose of production or are excluded activities. This excludes any work to actually complete the R&D by developing processes and products. That is, the eligible costs of R&D under the Credit cease before they may have ceased under the Concession.

Example 2.1 seeks to apply a very narrow definition of core activities that is unrealistic. In fact, the EM fails to clearly define a single eligible *core activity* (other than the idea itself which does not constitute an activity). The activities that are not considered to be *core experimental activities* clearly include activities that are part of the experimental process. This includes preparing the fuel and fuel additive and the equipment that will measure the results. The justification for the exclusion of these as *core* activities in the Second Exposure draft was '*that these activities do not lead via logical progression to experimental results*'. This illogical and incorrect interpretation has been removed from the Bills EM confirming that these activities are in fact part of the experimental process. However, inexplicably in the Bills EM, these activities remain characterised as supporting activities. Clearly the intent is to funnel most activities that make up the experiment itself into the supporting activity category where the highly restrictive dominant purpose production test can be applied, most likely resulting in genuine experimental costs being excluded.

Example 2.2 seeks to demonstrate how R&D activities that are also production activities can be shown to be undertaken for a dominant purpose other than R&D. This example has been amended from the Second Exposure Draft to include '*EcoStartup is not in the business of producing and selling fuel*' to solidify the argument that the dominant purpose was R&D, rather than commercial, even though the activity was conducted in a production environment. There are a paucity of real world examples where the premise this example draws on to satisfy the dominant purpose test actually occurs. Companies do not undertake production based R&D on

products and processes that they do not intend to commercialise. This example demonstrates how improbable it will be for any company undertaking R&D in a production environment, within their core business competencies, to confidently satisfy the dominant purpose test for supporting R&D activities.

Smartread

Example 2.3 continues the exploration into R&D activities that are also production activities. Where core experimental activities are performed on normal production lines, these will be considered supporting activities. This is because the definition of R&D is restricted to only the knowledge creation research subset of the Frascati definition.

The Smartread example describes a situation that is highly unlikely in reality. If Smartread manufactures tyres, and undertakes R&D on new compounds to make tyres, then it is impossible to make the statement that “the production aspects of the compound (such as how they function during the moulding process) were not at issue for Smartread’s tests”. In developing a new product manufactured using new materials, the company would always be interested in both the manufacturing aspects of the new compound *and* the performance of the new product manufactured from it. Under the Concession, this aim of this project would be the development of the new tyre, and would certainly include the development of the new or improved process to manufacture the new tyre. The two are inextricably linked. In this simple example, the tyres were not sold so the manufacturing costs are included as R&D. In most real world examples, the production output would be sold or re-worked. The proposed Credit would exclude these activities as having a production dominant purpose.

This example is driven by the erroneous assumption that if a business does something for a financial gain then it is not R&D. This is a mixing of the concepts of expenditure and revenue. There is no causal link between the incurring of R&D expenditure and revenue from sales. Genuine R&D expenditure is a cost. Ultimately, revenue creation is the objective of all business R&D. It is the goal of government as much as business. With some R&D, the revenue comes simultaneously with the R&D activities, sometimes subsequently. It is a horizontal inequity if one business gets full support for their R&D because they get revenue subsequently, whilst another business doing equally valid R&D is punished because their revenue is received simultaneously.

Boulevard Mining

In Example 2.4, *Boulevard Mining I*, the EM states that the application of the scientific method is required to address the knowledge gap on how the new truss design interacts with various tunnel widths and shapes on an unmined fork in a coal seam at the Evans Range mine. However, in this example, the tunnelling of the various shapes and widths in the coal seam has been inexplicably classified a supporting activity when it clearly meets the definition of a core R&D activity as defined in Paragraph 2.11 of the EM. In this example, tunnel shape and width are unquestionably the variables under test as per the hypothesis for which the causal relationship is being sought by way of experimentation. Therefore, the tunnelling to specific shapes and widths forms a key element of the experiment itself. Paragraph 2.11 acknowledges this test may take place in a range of settings including an otherwise normal production scenario as is the case in this example.

Boulevard Mining II (Example 2.5) is used to illustrate the distinction between what are considered experimental activities conducted for the purpose of producing knowledge as opposed to what is considered subsequent customised applications of knowledge gained from prior experimentation. The EM argues, that although trial and error that is systematically conducted and monitored is required, the activities undertaken by *Boulevard Mining II* do not constitute R&D activities because they do not demand the application of the scientific method. The technical justification for this distinction is wrong and demonstrates a complete misunderstanding of what constitutes the scientific method. The scientific method is regarded as containing an element of trial and error in its formulation and testing of hypotheses. Trial

and error is a universally accepted scientific problem solving technique that is particularly advantageous in scenarios where the aim is to find a single solution to a single problem. Scientists routinely adopt this technique as it does not require the experimenter to have detailed knowledge of the problem at the outset. In this example, where current knowledge and/or practice are deemed inadequate, then experimental activities (eg. the systematic trial and error of potential solutions) *will be* required to achieve the desired outcome. To argue this is not R&D on the basis that it does not warrant the application of the scientific method is totally misguided.

Furthermore, it is hard to see how the *Boulevard Mining II* example is any different from the example in *Boulevard Mining III* (Example 2.7). In *Boulevard Mining III*, the company was unsure whether the truss design could be used to significantly increase widths in “crumbly coal” seams. In both examples, the company was unsure of the answer to the technical questions hypothesised and therefore was required to undertake experimental activities as per the scientific method to resolve the knowledge gap (ie. acquire new knowledge as opposed to merely applying knowledge as asserted in the example).

Boulevard Mining IV (Example 2.8) concerns the eligibility of road, access tunnel construction and construction of “a lengthy railway spur line to the mine and coal train loading facilities”. Insufficient information has been provided to establish an argument as to how these activities would be eligible under the existing Concession where a direct nexus needs to be established to satisfy the definition of such supporting activities. Furthermore, it is unclear how the road and supply of light and ventilation would not need to satisfy the dominant purpose test given these activities should be classified as production activities if the logic in the earlier examples is followed. Therefore this example provides very little in the way of meaningful illustration of the application of the proposed Credit regime and provides a contradictory application of the definition.

Mimic Mining

The *Mimic Mining* (Example 2.6) concludes that these activities do not constitute eligible R&D activities as they are not undertaken for the purpose of generating new knowledge as the company has declined an offer to purchase the designs from Boulevard Mining. The evidence to sustain this argument is based on an addition to the Bills EM that “*this information is available to Mimic Mining on a reasonably accessible basis*” due to the opportunity to purchase this from Boulevard Mining for a commercially reasonable sum. It is unclear from this conclusion whether these activities would now be considered eligible if the commercial offer to purchase the design did not exist. In the Second Exposure Draft, it was concluded that, if certain knowledge exists, any activities to develop additional knowledge by conducting one's own experiments fail the test for eligible R&D despite the fact this “additional information” will be new.

This example is of particular concern as in a commercial environment it is very rare a rival company will be willing to on-sell the knowledge gained through R&D activities in order to maintain a competitive advantage. Furthermore, what would be considered a ‘commercially reasonable sum’ is highly contentious and should not be a basis for eligibility. Notwithstanding, even if the results were commercially accessible, the experimentation related to the application of the new truss design in the *Mimic Mining* scenario may need to be significantly different to what was conducted at Boulevard's mine sites due to local circumstances such as prior mine history (eg. proximity of old workings), ore body orientation, mining methodology, equipment and numerous geotechnical factors. In fact, the example acknowledges unique circumstances will be faced by *Mimic Mining* but provides no rationale for the argument that the problem can be easily resolved by purchasing the design from a rival company. If these activities were not necessary to resolve technical issues or a robust technical solution could be cost-effectively purchased from another company then the need for costly and time-consuming experimental activities would be superfluous and not undertaken.

Matryoshkoala

Matryoshkoala I (Example 2.10) illustrates a preoccupation with the location of the activities as a basis for the core/supporting split rather than the correct application of the scientific method to identify the split of R&D activities. In this example, operating a diversionary stage of the production line where the test dolls are coated with the glaze is considered part of the experiment and logically characterised as a core activity. However, conducting a similar activity on an alternative glaze on the production line itself, whilst also acknowledged as an experiment, is conversely classified as a supporting activity where the dominant purpose test is applied to prevent the activity being claimed. The apparent intention here is to prevent any business (small or large) accessing the Credit for R&D activities which are 'piggy-backed' onto production activities. This point is explicitly made in the analysis of *Matryoshkoala III* in which it is concluded that the company "*quite sensibly, took the economic opportunity to piggyback the experiment onto a production run*" but likewise is unable to claim R&D costs due to the dominant purpose test to exclude the activity. This approach fails to recognise that whenever R&D activities are necessarily performed on normal production equipment, the cost of this production process is a genuine cost of R&D.

Hayk Hockey Stix

Example 2.13 explores the core/supporting split in a manufacturing example. Unlike the *Smartread* and *Matryoshkoala* examples, the core experiments are accepted as including the production runs. Otherwise, this example is consistent with current practice. Had the activities been classified consistently with *Smartread* and *Matryoshkoala* then these costs would have been excluded as supporting activities with a production-related dominant purpose.

Tabby Marine

Examples 2.14, 2.15 and 2.16, *Tabby Marine*, illustrate the application of the definition to activities to manufacture a catamaran with a novel combination of steering rudder and propeller screw as a marketable product.

An objective reading of these examples would lead to the logical conclusion that the *Tabby Marine* examples are analogous to the mining examples of *Boulevard Mining*, *Mimic Mining* and *Grandheap Mining* in that *Tabby Marine II* and *Tabby Marine III* are interested in applying technology in a different way to acquire new knowledge. Whilst such an application for the mining examples (eg. *Boulevard Mining II* and *Mimic Mining*) was seen to be ineligible, in *Tabby Marine* this application of known technology was seen to be eligible. No explanation is provided on what distinguishes the two sets of examples. This inconsistent application renders much of the *Tabby Marine* examples meaningless.

It is also concerning that the *Tabby Marine* examples (as is the case for most of the examples in Chapter 2 of the EM) define directly related supporting activities as requiring, *inter alia*, a "close and relatively immediate relationship" with eligible core activities. There is nothing in the Bills that indicates the need to demonstrate a location and/or temporal proximity to a core activity to establish that the supporting activity is directly related. All of the examples in Chapter 2 infer there is a requirement for this location and timing nexus; a nexus that is not made clear in the Credit legislation. This further demonstrates the lack of clarity associated with the new definition.

The application of the supporting activity definition is confusing in the *Tabby Marine* examples. In *Tabby Marine I*, the dominant purpose is apparently satisfied based on the outcome rather than the original intention of the activity of fabricating the rudder-screw assembly. Because the outcome of the trials was a failure, and because there was no possible commercial use for the assembly, the conclusion is reached that the fabrication of the rudder-screw assembly was not a production activity. However, it is argued that, in the same way it was for the fitting out and construction activities, the dominant purpose at the outset of the trial of the rudder-screw assembly would have been to assist completing the boat for eventual sale and would therefore constitute a production activity. This focus on the outcome rather than the intention is at odds

with the interpretation applied to the dominant purpose test in other examples (eg. the mining examples). In addition, in *Tabby Marine III*, the example completely overlooks the requirement to establish the dominant purpose for the production activity of constructing the modified monohull. Given this contradictory application, the *Tabby Marine* examples cannot be seen as providing a reliable illustration of the R&D tests.

Whist Construction

The *Whist Construction* example provides a contradictory interpretation of the definition of R&D to a fact scenario involving the development of an innovative approach to anchoring a bridge into a type of rock with known weaknesses.

In *Whist Constructions*, the development and finalisation of the design, the installation, the load testing and the monitoring of the initial test anchors meet the definition of a core activity, yet the tunnelling of the various shapes and widths in *Boulevard Mining I* was not seen to meet the definition. There is no explanation as to why there is a distinction between the installation of anchors and tunnelling material underground. It would seem the two are analogous yet the examples illustrate a varied application of the definition of core activities.

In applying the supporting activity definition, the construction of the bridge and the fabrication and sourcing of the anchors (excluding the initial anchors) are logically considered to be production activities and fail to meet the dominant purpose test. Yet, no mention is made as to why the fabrication and sourcing of the initial set of anchors is not a production activity. It appears both the initial and subsequent anchor fabrication and sourcing are both undertaken for the same dominant purpose: the construction of the bridge and not the R&D. This contradiction of the application within the same example also renders the *Whist Construction* example not useful.

Two Wheels, EC Plus and Sanctuary

Examples 2.18 (*Two Wheels*), 2.19 (*EC Plus*) and 2.20 (*Sanctuary*) are all meant to provide an illustration of the application of the definition to software development activities. However, as with the examples elsewhere, they represent puzzling applications of the definition.

In *Two Wheels*, the software activity is logically concluded not to be a core activity. However, when assessing whether this activity is an eligible supporting activity, no explanation is provided as to why the software development activity isn't seen as a production activity given the software development is part of the development of the new gearboxes that will be intended to be sold. Given the interpretation of the production in the other examples, it would follow that the software development activity in this example would be considered a production activity and would also fail the dominant purpose test. Yet the example states the activity would be an eligible supporting activity.

In *Sanctuary*, the activities relating to customer accounts are not eligible supporting activities because the dominant purpose of those activities is a commercial one. However, additional modification made to customer accounts systems to test the new payments system is eligible because the dominant purpose is apparently the R&D and not a commercial one. There is no explanation as to what the distinction is between the two. We contend that both sets of activities would be undertaken for the dominant purpose of a commercial activity to manage customer accounts.

Errors in the EM

The EM contains the following errors:

Paragraph	Reference	Error
2.12	Schedule 1, item 1, paragraph 355-25(a)	There is no s 355-25(a)

2.16	Schedule 1, item 1, paragraph 355-25(b)	There is no s 355-25(b)
2.23	Schedule 1, item 1, paragraph 355-35(2)(a)	This paragraph is about residents of foreign countries not dominant purpose
2.32	Schedule 1, item 1, paragraph 355-35(2)(a)	This paragraph is about residents of foreign countries not dominant purpose
3.3	Part 3 of Schedule 3 (2 nd reference)	This is a wrong description of what Chapter 4 explains
3.18	Schedule 1, item 1, section 355-40	There is no s 355-40
3.19	Schedule 1, item 1, section 355-40	There is no s 355-40
3.24	Schedule 1, item 1, section 355-40	There is no s 355-40
3.46	Schedule 1, item 1, section 355-115	There is no s 355-115
3.49	Schedule 1, item 1, paragraph 355-220(a)	There is no s 355-220(a)
3.49	Schedule 1, item 1, paragraph 355-220(b)	There is no s 355-220(b)
3.57	Schedule 1, item 1, paragraph 355-210(1)(a)	This paragraph is where R&D is conducted not about permanent establishments
3.57	Schedule 1, item 1, subsection 355-210(2)	This paragraph is about R&D that is not conducted by an eligible entity not about permanent establishments
3.61	Schedule 1, item 1, subsection 355-20(2)	There is no s 355-20(2)
3.82	Schedule 1, item 1, section 355-305(d)	There is no s 355-305(d)
3.83	Schedule 1, item 1, section 355-305	This section is not about notional application of Division 40
3.131	Schedule 1, item 54, section 4-25	There is no item 54 in Schedule 1
3.157	Schedule 3, item 44, subsection 136AB(2)	There is no s 136AB(2) in item 44
3.205	Schedule 1, item 1, section 355-699	There is no s 366-699

5.111	Schedule 2, item 1, subsection 27A(2)	This subsection is not about being bound to an assessment nor about other entities not being able to rely on this
5.151	Schedule 2, item 1, subsection 30C(3)	This subsection is not about what information the Board is able to rely on