

Taxation (Research and Development Tax Credits) Bill

Commentary on the Bill

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Introduction

OVERVIEW

The Taxation (Research and Development Tax Credits) Bill (the Bill) proposes to introduce a research and development tax credit (R&D tax credit) to incentivise businesses to perform research and development (R&D). It does so by amending the Income Tax Act 2007 (ITA) and the Tax Administration Act 1994 (TAA).

The Government's goal is to increase the amount of business R&D undertaken in New Zealand. It has set a target of raising the amount of R&D undertaken in New Zealand to two percent of gross domestic product (GDP) by 2028.

By providing a tax incentive in the form of a tax credit, the Government will lower the cost to businesses of performing R&D. This will create an incentive for firms already performing R&D to do more, and for other firms to start undertaking R&D.

The rationale for providing R&D tax credits to businesses is that there is under-investment by businesses in R&D because the investing firm does not capture all the benefits of the investment. The wider societal benefits of knowledge created through business R&D tends to be distributed widely rather than staying with the firm. The Government considers the wider benefits to New Zealand when businesses invest in R&D warrant the provision of a subsidy.

A tax credit has been selected as the instrument for providing the subsidy because of the wide reach of the tax system. The tax system also provides certainty because firms are able to access support based on predefined rules.

The Bill sets out the conditions which need to be satisfied for a firm to receive an R&D tax credit. The corollary of providing an incentive for R&D is ensuring that firms that are not performing R&D do not receive R&D tax credits. The Bill therefore establishes boundaries around categories of expenditure so that routine business as usual expenditure does not qualify for the R&D tax credits. The Bill also introduces the ability for the Government to set rules by Order in Council, to ensure business as usual expenditure does not qualify.

A discussion document on the proposed policy was released in April 2018. Submissions on that document have influenced the policy. The Government has also been guided by the New Zealand experience of an R&D tax credit in 2008–09 (2008 regime), changes in the business environment since then, and how such schemes operate in other countries. The Government will monitor operation of the R&D tax credit regime and adjust it to ensure it continues to meet the policy intent.

For more detail on the policy underpinning the Bill, see the Ministry of Business, Innovation and Employment's website,¹ which has links to various policy documents. This includes briefing documents and submissions on the discussion document. If you have any questions about the proposals, you can also send them to R+Dincentive@ird.govt.nz.

¹ <https://www.mbie.govt.nz/info-services/science-innovation/funding-info-opportunities/rd-tax-incentive/pdf-and-document-library/comparison-with-discussion-document.pdf>

For a high level overview of how the R&D tax credit will be administered see appendix 1. For the core components of the policy and how they operate see the flow charts in appendix 2.

Application dates

The credit will apply from the 2019–20 income year.

The in-year approval requirements of the Bill apply from the 2020–21 income year.

Summary of key features

Eligibility

There are various tests that must be satisfied before a person can receive an R&D tax credit. The tests cover:

- the person who is claiming the credit;
- the type of activity that qualifies as eligible R&D; and
- the type of expenditure that qualifies as eligible R&D expenditure.

Defining an eligible person

The Bill proposes requirements for who is eligible for an R&D tax credit. The key requirements are that a person:

- performs a core research and development activity (“core activity”) in New Zealand, or a contractor performs a core activity on their behalf;
- carries on a business through a fixed establishment in New Zealand; and
- has R&D controlling rights over their research and development activities (“R&D activities”).

It is also proposed that the person must satisfy one of the following to be eligible:

- the person owns the results of their R&D activities;
- the person is able to use the results of their R&D activities for no further consideration; or
- a company in the person’s corporate group owns the results of the person’s R&D activities, and the company is resident in a jurisdiction with which New Zealand has a double tax agreement.

Defining R&D activity

There must be a core activity for an R&D activity to be eligible. A core activity is an activity that:

- is conducted using a systematic approach;
- has the purpose of creating something new; and
- has the purpose of resolving scientific or technological uncertainty.

An activity that is not a core activity will only be eligible if it is in support of a core activity. Some activities are explicitly excluded from being core or supporting activities.

Defining eligible research and development expenditure

Eligible research and development expenditure (eligible expenditure) is expenditure incurred on an R&D activity, and includes things like employee salaries, expenditure on consumables used in an R&D process, and depreciation loss for assets used in R&D.

A person may claim an R&D tax credit where they contract another party to undertake R&D on their behalf. Ineligible expenditure must be removed from the contracted amount. Also, the remaining total is reduced by twenty percent. Where R&D is performed on contract, only the party (that is, the principal) paying for the work may claim the credit.

Primarily, R&D tax credits are only available for expenditure on R&D that occurs in New Zealand. Nevertheless, up to ten percent of an R&D claim can be for eligible expenditure incurred on R&D activities that are performed outside New Zealand.

Where expenditure is incurred on an R&D activity performed in the course of commercial production, a person's claim is limited to the additional expenditure incurred because of that R&D activity.

Calculating R&D tax credits

The R&D tax credit regime operates with a minimum threshold and an expenditure cap. In general, to be eligible for R&D tax credits, the Bill stipulates that a person must have at least \$50,000 of eligible expenditure in a given income year. The maximum expenditure that is eligible for R&D tax credits is \$120 million, unless a person has obtained the Commissioner's approval to exceed the cap.

The R&D tax credits a person receives are equal to 15% of their eligible expenditure.

Orders in Council

The Bill adds two schedules to the ITA. The first is a schedule of activities that are ineligible for the R&D tax credit regime. The second is a schedule of categories of eligible and ineligible expenditure.

To ensure these schedules remain current as the type of R&D performed by businesses changes over time, and to close off problem areas that could impact on the fiscal sustainability of the R&D tax credit regime, the Bill allows the Governor-General, by Order in Council made on the joint recommendation of the Minister of Revenue and the Minister of Research, Science and Innovation, to amend the schedules.

Evaluation

The Bill requires the Minister of Research, Science and Innovation to commission a review of the R&D tax credit regime every five years to evaluate the regime in terms of the delivery of the policy intent, the compliance costs, and the administration of the regime.

Communication by Inland Revenue to other government departments and agencies

The Bill allows for Inland Revenue to communicate information to relevant people within specific state sector agencies so that they can evaluate, administer, report on, and develop policy for the R&D tax credit regime.

In-year approval

Starting from the 2020–21 income year, persons wanting to receive a tax credit will be required to seek approval that their R&D activities meet certain criteria in the year they are undertaking or contracting for the R&D activities. If granted, this approval will be binding on the Commissioner.

A person who expects to spend more than \$2 million on R&D activities, or is part of a group of companies that expects to spend more than \$2 million on R&D activities in a given year, can opt out of the general approval process.

A person who opts out of the general approval process must notify the Commissioner of their intention to opt out, and is required to submit an R&D certificate alongside their R&D supplementary return.

Refunding R&D tax credits

When a person has more R&D tax credits than their income tax liability, their R&D tax credits are refunded up to a maximum of \$255,000, provided the person meets certain criteria. R&D tax credits that are not refunded are carried forward, subject to the same continuity rules as apply to losses in the ITA.

The criteria that define eligibility for refunds have been taken from the R&D tax loss cash out regime (in subpart MX of the Income Tax Act 2007). Apart from this linkage, in the first year the R&D tax credit regime and this scheme will operate separately. The Government is committed to further work examining the policy on refunds and harmonisation of the two regimes, with potential changes effective from 1 April 2020.

Eligibility

ELIGIBLE PERSONS

Clause 10 (proposed new section LY 3)

Summary of proposed amendment

The Bill proposes that people must satisfy certain general criteria to be eligible for R&D tax credits. Certain persons are excluded from the R&D tax credit regime.

Application date

From the 2019–20 income year.

Key features

General eligibility criteria

Proposed new section LY 3 provides the general criteria that a person must satisfy to be eligible for R&D tax credits. These criteria are in addition to the requirements that a person's activities must be R&D activities (see proposed new section LY 2) and their expenditure must be eligible (see proposed new sections LY 4, 5, 6, and 7).

The general criteria in section LY 3(1) require a person to:

- perform a core activity in New Zealand, either themselves or through an R&D contractor;
- carry on a business in New Zealand through a fixed establishment in New Zealand; and
- have R&D controlling rights in relation to their core activity.

In addition, the person, or a member of the person's corporate group that is situated in a jurisdiction with which New Zealand has a double tax agreement (DTA), must own the results of the person's R&D activities.

If the person (or a member of their corporate group) does not own the results of the person's R&D activities, then the general criteria are nevertheless satisfied provided the person has the right to use the results of their R&D activities for no further consideration.

Eligible persons

All types of New Zealand businesses are eligible, whether they are incorporated or not. This includes individuals, companies, partnerships, charities, levy bodies, and trusts. For partnerships and look-through companies (LTCs), sections HB 1 and HG 2 (the transparency provisions) apply unless otherwise specified.

Ineligible persons

Excluded entities

A person is excluded from the R&D tax credit regime if:

- they receive a Callaghan Innovation Growth Grant (Growth Grant) for the relevant income year;
- they are an R&D contractor in relation to the relevant R&D activity;
- they are, or are associated with or controlled by, a Crown research institute, district health board or tertiary education organisation; or
- they are a partner in a partnership or an owner of an LTC, and they are not a New Zealand tax resident for the relevant income year.

Failure to file causing ineligibility

A person is ineligible for R&D tax credits for an income year if they fail to file an income tax return within one year of the latest date for them to file their income tax return.

Background

General eligibility criteria

Core activity performed by an R&D contractor

A person is eligible even if their core activity is performed by an R&D contractor, because the person is funding and directing the R&D activities. Also, in the absence of the person contracting their core activity to the R&D contractor, it is unlikely that the R&D contractor would have performed the core activity.

Carry on a business and have a fixed establishment in New Zealand

R&D tax credits are intended to be offset against the income tax liability of persons making claims. To ensure R&D tax credits are only provided to persons with some presence in New Zealand, a person is required to carry on business in New Zealand through a fixed establishment in New Zealand to be eligible for the R&D tax credit regime.

R&D controlling rights

The R&D controlling rights requirement is intended to ensure that R&D contractors are not able to claim for R&D activities they are being contracted by another person to perform. It is expected that only principals will have R&D controlling rights.

Ownership of the R&D results

Similar to the R&D controlling rights requirement, the ownership and right to use requirements are intended to ensure that R&D contractors are excluded from the R&D tax credit regime to the extent they perform R&D activities for other people.

Where the ownership requirements are not met, the right to use requirement ensures a person is able to nevertheless access the results of their R&D for no further consideration at a future date. It is envisaged that people will, for the most part, satisfy the ownership requirements. It is expected that most people will either own the results of their R&D themselves or the results will be owned by someone in their corporate group that is located in a jurisdiction with which New Zealand has a DTA.

The right to use and ownership requirements are similar to the requirements of the 2008 regime. The requirements in proposed new LY 3(1) are more inclusive than 2008. This is to ensure that R&D performed by a person that leads to results owned by someone else in the person's corporate group is nevertheless eligible for the R&D tax credit regime.

No explicit risk requirement

There is no explicit requirement for a person to bear the financial risk associated with their R&D activities. This means that R&D activities undertaken by a New Zealand subsidiary at the request of, and on a fee for service basis for, its foreign parent will be eligible.

Ineligible persons

Filing deadline

R&D supplementary returns are due within 30 days of the usual date prescribed by section 37 of TAA for income tax returns.

A person may not apply for R&D tax credits if they have not filed an income tax return for the relevant income year (containing their R&D tax credit claim) within one year after the latest date for them to file their income tax return. As a result, where a person files their return late, it may only be up to a year late if the person wishes to claim an R&D tax incentive.

The rationale for this rule is to reduce taxpayers' ability to retrospectively reclassify expenditure. See the section on *Deadlines for filing and amending assessments* (page 91) for more information.

Growth Grants

A person who receives a Callaghan Innovation Growth Grant for the whole, or a part, of an income year is not eligible for the R&D tax credit regime for that year. This is a broad exclusion and even applies to R&D expenditure for which the person hasn't received a Growth Grant. The R&D tax credit regime serves as a replacement to the Growth Grant regime. For administrative and compliance reasons, firms currently receiving a Growth Grant must choose which scheme they operate under. For more

information about transition from the Growth Grant regime, see Callaghan Innovation's website.²

R&D contractors

A person who is an R&D contractor, and is paid to perform an R&D activity on behalf of another person, is ineligible for R&D tax credits in relation to that activity. The intent is that only principals receive the credit. Principals decide whether to invest in R&D activities, so it is appropriate for principals to receive R&D tax credits to recognise their investment in R&D and to incentivise further R&D.

An R&D contractor may be eligible if they are acting in a different capacity. For example, if a person contracted to perform R&D was also doing some R&D that they were not contracted to perform, then they would not be an R&D contractor in relation to that second activity and may be eligible to receive an R&D tax credit as a principal.

Certain Crown entities and their associates

Crown research institutes (CRIs), district health boards (DHBs) and tertiary education organisations (TEO), their associates and entities controlled by them are not eligible for R&D tax credits. The R&D tax credit regime is designed to target private sector business R&D. The Government has more effective and appropriate ways to increase the amount of R&D that CRIs, DHBs, and TEOs undertake.

The policy to exclude CRIs, TEOs, and DHBs from the R&D tax credit regime would be ineffective if associates of these entities were not excluded.

While these entities are excluded, they are able to nevertheless perform R&D for other people as R&D contractors. It is expected that some of excluded entities will apply to be approved research providers. See the section on *Approved research providers* (page 65) for more information.

Non-resident partners and non-resident owners of LTCs

A person who is a partner in a partnership, or an owner of an LTC, must be a tax resident for the relevant income year to claim an R&D tax credit for that year. This is to ensure that only people with sufficient presence in New Zealand receive R&D tax credits.

Detailed analysis

General eligibility criteria

Carry on a business in New Zealand

To be eligible, a person must carry on a business in New Zealand through a fixed establishment in New Zealand. This requires their activities to be a profession, trade, manufacturing, or undertaking and they must have an intention to make a pecuniary profit. Charities and levy bodies, which are referred to as “non-business researchers”

² <https://www.callaghaninnovation.govt.nz/news-and-events/rd-tax-incentive-final-design-announced>

in the Bill, are treated as carrying on a business in New Zealand through a fixed establishment in New Zealand.

It is important to note that this requirement does not require a person's R&D to relate to their New Zealand business. It is sufficient if the person carries on a business in New Zealand through a fixed establishment. This is different from the 2008 rules, which required a person's R&D to relate to their New Zealand business.

Example 1: R&D does not relate to existing New Zealand business

PONZ Ltd is a New Zealand-based company with clothing manufacturing facilities in Hamilton. It has been asked by its Australian parent company, which owns other companies that sell parachutes, to branch out into making parachutes. PONZ Ltd needs to do some R&D before producing parachutes because it needs to ensure its parachutes have an "edge" to distinguish them from other parachutes already on the market.

PONZ Ltd satisfies the "in business" and fixed establishment requirements in proposed new section LY 3. It does not matter that PONZ Ltd's R&D does not relate to its existing clothing manufacturing business.

R&D controlling rights

R&D controlling rights include the sole right to start, stop, or change the direction of a core activity. They also include the sole right to choose whether results are followed up on.

R&D ACTIVITIES

Clauses 10 (proposed new section LY 2), 21(6), 21(14) and 21(16)

Summary of proposed amendment

The Bill proposes that R&D activity is defined to mean core activities and supporting activities.

Application date

From the 2019–20 income year.

Key features

Proposed new section LY 2 defines an R&D activity to include core activities and supporting activities.

Core activity

Proposed new section LY 2(1) defines a core activity as an activity that is:

- (a) conducted using a systematic approach;
- (b) has a material purpose of creating new knowledge, or new or improved, processes, services, or goods;
- (c) has a material purpose of resolving scientific or technological uncertainty; and
- (d) has its day to day management conducted in New Zealand.

An activity is excluded if the knowledge required to resolve the uncertainty in (c) is:

- publicly available; or
- deducible by a competent professional in the relevant scientific or technological field.

Activities performed outside New Zealand cannot be core activities. There is also a schedule of activities that cannot be core activities. For more information see schedule 21, part A, and the section on *Excluded activities* (page 19).

Supporting activity

An activity is a supporting activity (proposed new section LY 2(3)) if it is only or mainly for the purpose of, required for, and integral to, a core activity. Activities listed in schedule 21, part B are excluded from being supporting activities.

Background

Core activity

The core activity definition is expected to apply to a wide range of R&D activities in a variety of industries, and is not limited to basic research. It draws on elements of the R&D core and supporting activity definitions from comparable jurisdictions, the OECD's Frascati manual, the definition from the 2008 regime, and Callaghan Innovation's experience with its R&D grants regime.

Requiring the use of a systematic approach instead of a scientific method

The proposed core activity definition is broader than the 2008 definition. This is to address concerns that many New Zealand businesses conducting R&D do not follow traditional scientific methods. Requiring the use of a systematic approach recognises the different methods used by these businesses while still requiring a planned, logical approach to R&D.

Reference to "advance science or technology" removed

The 2008 core activity definition required "an advance in science or technology by resolving scientific or technological uncertainty". The proposed core activity definition does not explicitly require an advance in science or technology, but does imply an advance through the inclusion of limbs (b) and (c).

The requirement for (b) contemplates an intended advance, because people are required to undertake an activity for a material purpose of creating:

- new knowledge; or
- new or improved processes, goods or services.

The requirement for (c) also contemplates an intended advance, because it requires an activity to have a material purpose of resolving scientific or technological uncertainty. If an activity resolves uncertainty, it must also by implication advance science or technology.

New requirements: performed in New Zealand and day to day management in New Zealand

An R&D activity's day to day management must be conducted in New Zealand. This is consistent with the requirement that core activities must be performed in New Zealand.

Supporting activity

The supporting activity definition ensures a very high level of connection between a person's core and supporting activities.

Detailed analysis

Core activity

Systematic approach (limb (a))

A person will need to demonstrate that their R&D process followed a planned, logical progression of work. A systematic approach includes scientific methods, so may involve hypothesis, experiment, observation and evaluation. An agile approach to R&D (such as the approach used in some software R&D) may also be considered a systematic approach, provided the R&D activity is planned, occurs logically, and tests whether a proposed solution (or solutions) resolves what is scientifically or technologically unknown.

Prototyping, and the type of planned and logical testing that occurs in a test kitchen or similar environment, may also be sufficiently systematic to meet the requirements for a systematic approach. The requirement for a systematic approach will, however, exclude anything discovered or produced as a result of random trial and error.

Creating new things (limb (b))

To qualify as core activities, R&D activities must be undertaken for a material purpose of creating new knowledge or creating new or improved processes, goods or services. The material purpose test means that the R&D need not be successful to qualify for the credit.

To establish whether something is new, it should be compared with what is already available in the public arena on a reasonably accessible worldwide basis at the time in the relevant field.

A person may satisfy this requirement where another firm is undertaking the same R&D simultaneously but independently. An R&D activity may also satisfy this requirement where another firm has already created the new knowledge but has kept it secret, and the person is undertaking the R&D to create equivalent knowledge.

Improvements to existing products or processes may qualify as R&D. In addition to improving a product or process, the core activity definition requires a claimant to have a purpose of resolving scientific or technological uncertainty, so any improvements must go beyond routine maintenance to be eligible as core activities.

Scientific or technological uncertainty (limb (c))

Scientific or technological uncertainty exists when a competent professional who has access to the publically available information on a topic does not know whether something is possible. The uncertainty can relate to whether something is possible or achievable at all, or whether something is achievable within constraints such as cost.

If a competent professional can deduce an answer or can identify an approach to take in advance, without a systematic process of testing, analysis or prototyping, there is no technological or scientific uncertainty.

A competent professional:

- is knowledgeable about the relevant field;
- possesses the relevant qualifications and/or experience to participate in the relevant field with a reasonable level of skill;
- is aware of the current state of knowledge in the field; and
- has access to publicly available knowledge from around the world such as the internet, relevant industry journals, and to other professionals.

The requirement to resolve uncertainty also assists in defining the extent of the R&D activity. As a general rule, the R&D activity will finish once the uncertainty has been resolved.

The test is an objective test on a worldwide basis. It is not enough that the business does not have the knowledge or that no one in New Zealand has yet done what the business is trying to do.

Day to day management in New Zealand (limb (d)) and activity performed in New Zealand

A person must have a fixed establishment in New Zealand and must manage their R&D activities from New Zealand. Day to day management is separate from the R&D controlling rights specified in proposed new section LY 3(1)(c)(i) to (iv). Day to day management is intended to encompass smaller decisions that the person must make to perform their R&D activities effectively. R&D controlling rights refer to more substantive decisions, such as the right to start or stop an activity, or change its direction.

A person satisfies this requirement if, for example, they are deciding how their R&D activity is carried out in their New Zealand based factory. Limb (d) aims to ensure that an activity that qualifies as a core activity is actually carried out in New Zealand and, in conjunction with proposed new section LY 2(1)(c), means that R&D activities carried out overseas cannot qualify as core R&D activities.

Supporting activities

Supporting activities are activities that are only or mainly for the purpose of, required for, and integral to a core activity. If “supporting” activities are not in support of a core activity, they are not eligible R&D activities for the R&D tax credit regime.

- *Mainly* requires that at least seventy five percent of a supporting activity is for the purpose of, required for, and integral to, a core activity.
- *Required for* means a supporting activity must be only to the degree necessary to support a core activity. For instance, once a core activity is complete, other activities will not be supporting activities because scientific or technological uncertainty has been resolved.
- *Integral to* means that a supporting activity must be essential to a core activity. That is, the core activity could not be performed or completed without the supporting activity.

An activity that is conducted overseas cannot be a core activity, but may be eligible as a supporting activity if it satisfies the supporting activity definition.

Indirect activities, such as cleaning and administrative activities, may be eligible as supporting activities.

Examples of supporting activities include:

- mathematical analysis or modelling used to analyse the results of experiments;
- development of specialised software to assist in the design of the experiments;
- planning core activities, developing hypotheses, defining technological objectives, and planning trials; and
- constructing prototypes for use in testing.

EXCLUDED ACTIVITIES

Clause 22 (proposed new schedule 21, part A and part B)

Summary of proposed amendment

The Bill proposes that certain activities are expressly excluded from the R&D core and supporting activity definitions.

Application date

From the 2019–20 income year.

Key features

Proposed new schedule 21 excludes certain activities from the core and supporting activity definitions. Part A provides for exclusions from the core activity definition and part B provides exclusions from the supporting activity definition. The table summarises the exclusions and whether they apply to core and supporting activities.

#	Activity exclusion	Core	Supporting
1.	Preproduction activities, including demonstration of commercial viability and tooling up.	Excluded	
2.	Routine de-bugging of existing computer software.	Excluded	
3.	Supporting or making minor improvements to existing computer software, using known methods.	Excluded	
4.	Routine software and computer maintenance.	Excluded	
5.	Prospecting for, exploring for, or drilling for, minerals, petroleum, natural gas, or geothermal energy.	Excluded	
6.	Market research and market testing.	Excluded	Included
7.	Market development or sales promotion, including consumer surveys.	Excluded	
8.	Commercial, legal, or administrative aspects of patenting, licensing, or other similar activities.	Excluded	
9.	Activities involved in complying with statutory requirements or standards for existing processes, services, or goods.	Excluded	
10.	Activities involved in complying with statutory requirements or standards for new processes, services, or goods.	Excluded	Included
11.	Management studies.	Excluded	
12.	Activities relating to organisational design.	Excluded	
13.	Internal software development relating to ordinary administrative functions of a business.	Excluded	

#	Activity exclusion	Core	Supporting
14.	Research in social sciences, arts, or humanities.	Excluded	Included
15.	Quality control or routine testing of processes, services, or goods.	Excluded	Included
16.	Routine collection of information.	Excluded	Included
17.	Minor adaption of, or improvement to, existing processes, services, or goods.	Excluded	Included
18.	Testing.	Excluded	Included
19.	Converting existing systems to new software platforms.	Excluded	Included
20.	Making cosmetic or stylistic changes to processes, services or goods.	Excluded	Included
21.	Reproduction or a commercial product or process by a physical examination of an existing system or from plans, blueprints, detailed specifications, or publicly available information.	Excluded	Included
22.	Carrying out routine operations on data, including presentation of data.	Excluded	Included
23.	An activity that hasn't been approved by the Commissioner under section 68CB of the Tax Administration Act 1994.	Excluded	Not applicable

Background

Certain activities are routinely excluded from R&D tax incentives.

An activity may be excluded from an R&D tax credit regime for a number of reasons, including:

- To clarify that the activity does not amount to R&D because the knowledge required to resolve the uncertainty the activity is seeking to resolve is publicly available or deductible by a competent professional.
- To clarify that the activity does not amount to R&D because it occurs before any scientific or technological uncertainty is identified, or after any uncertainty has been resolved.
- There are inadequate spill over benefits.
- The fiscal cost associated with the activity is too high.
- The Government may not want to incentivise the activity through an R&D tax credit regime.
- Incentives other than an R&D tax credit regime may be better suited to supporting the activity.

Comparison with 2008 core activity exclusions

The following items have been added to the core activity exclusions list since 2008:

- routine debugging of existing computer software;

- supporting or making minor improvements to existing computer software, using known methods;
- routine software and computer maintenance;
- activities relating to organisational design;
- internal software development relating to ordinary administrative functions of a business;
- minor adaptation of, or improvement to, existing processes, services, or goods;
- bug, beta, system requirements, user acceptance and data integrity testing;
- data mapping and data migration testing;
- testing or comparing the efficiency of algorithms that are already known to work;
- testing security protocols or arrangements;
- converting existing systems to new software platforms;
- carrying out routine operations on data, including presentation of data; and
- an activity that has not been approved by the Commissioner under section 68CB of the Tax Administration Act 1994 (if a person is required to obtain general approval).

The list of excluded core activities demonstrates the greater prevalence of software-related activities compared with the situation in 2008. The core activity definition has been amended to more explicitly incorporate software activities, but in turn the exclusions clarify what is not R&D.

New supporting activity exclusions

The 2008 excluded activity list only applied to core activities. Proposed new schedule 21 also contains a list of supporting activity exclusions. Excluding activities from the supporting activity definition provides clarity on which activities are ineligible for the R&D tax credit regime, so is expected to reduce compliance and administrative costs.

Detailed analysis

Exclusions from both the core and supporting activity definitions

Preproduction activities, including demonstration of commercial viability and tooling up (parts A and B, clause 1)

Preproduction activities typically occur after R&D is complete but before a product is made publicly available. In general, they are not undertaken to resolve scientific or technological uncertainty, and are unlikely to satisfy the core or supporting activity definitions. They have been included in schedule 21 for clarity.

Examples of preproduction activities include:

- demonstrating commercial viability;
- tooling-up;
- planning the production process;
- developing control systems; and
- undertaking start-up procedures.

If a problem arises during preproduction activities that a competent professional working in the relevant field cannot resolve, a separate R&D activity might commence.

Routine software and computer activities (parts A and B, clauses 2 to 4)

Schedule 21 excludes:

- routine debugging of existing computer software;
- supporting or making minor improvements to existing computer software, using known methods; and
- routine software and computer maintenance.

These activities are considered business as usual activities, so are excluded from both the core and supporting activity definitions. A competent professional would be expected to resolve any uncertainty presented by these activities through the application of publicly available knowledge, including identifying in advance the approach to adopt, and/or by deductive reasoning.

Mining activities (parts A and B, clause 5)

Mining activities include prospecting, exploring, or drilling for:

- minerals;
- petroleum;
- natural gas; or
- geothermal energy.

Prospecting, exploring, and drilling activities in and of themselves are unlikely to satisfy the core activity definition. “Looking for stuff” does not resolve scientific or technological uncertainty. Therefore, the activities are excluded from both the core and supporting activity definitions.

Market development or sales promotion, including consumer surveys (parts A and B, clause 6)

Market development, sales promotion, and consumer surveys are excluded from the core and supporting activity definitions. They are undertaken to assist with commercial decision making and objectives rather than resolving scientific or

technological uncertainty. Such activities are likely to take place once an R&D project is complete, or is nearing completion. They may signal that scientific or technological uncertainty has come to an end.

Note that market research and market testing have only been excluded from the core activity definition. They may be permitted as supporting activities.

Commercial, legal, or administrative aspects of patenting, licensing, or other activities (parts A and B, clause 7)

Patenting and licensing activities would not, even in the absence of the exclusion, qualify as core activities. They have a commercial or legal focus and do not seek to resolve scientific or technological uncertainty.

Activities involved in complying with statutory requirements or standards for pre-existing processes, services, or goods (parts A and B, clause 8)

Activities involved in complying with statutory requirements or standards for pre-existing processes, services, or goods do not qualify as core activities as they do not resolve scientific or technological uncertainty. These activities are also ineligible as support activities because they are not required to resolve scientific or technological uncertainty. Activities involved in complying with statutory requirements or standards for new products are covered below.

Management studies and activities relating to organisational design (parts A and B, clauses 9 and 10)

Management studies and activities related to organisational design do not qualify as core activities. They are not the types of activities that the R&D tax credit regime is intended to incentivise. Even without this exclusion, many management studies would be excluded because their subject is the social sciences.

Internal software development relating to ordinary administrative functions of a business (parts A and B, clause 11)

This clause is covered in the section on *Internal software development* (page 27).

Exclusions from the core R&D activity definition only

Market research and market testing (part A, clause 6)

Market research and market testing have been excluded from the core activity definition as they are undertaken to support commercial objectives.

Market research and market testing may be eligible as support activities where they are used to check whether the scientific or technological objectives of an R&D project have been achieved. In the food industry, for example, consumer testing to determine the sensory properties of a product may be an eligible supporting R&D activity.

Activities involved in complying with statutory requirements or standards (part A, clause 8)

Activities involved in testing compliance with statutory requirements or standards do not qualify as a core activity as they do not resolve scientific or technological uncertainty.

Activities to test compliance with the relevant standards for new processes, services or goods may be eligible as a support activity if compliance with the relevant standard is necessary to validate that the scientific or technological objectives of the R&D have been met.

Research in social sciences, arts, or humanities (part A, clause 12)

Research in social sciences, arts or humanities is excluded (research in social sciences) from the core activity definition but can qualify as a supporting activity. Most other jurisdictions exclude research in social sciences. The focus of the R&D tax credit regime is on scientific and technological R&D. Research in other areas is funded by other means.

The exclusion covers areas such as economics, classics, languages, literature, music, philosophy, sociology, anthropology, history, religion, as well as visual and performing arts. Examples of activities excluded include psychological and sociological research, the study of the historical development of a language, the role of family in society, or writing a novel. A business developing a product for use in the arts or humanities may qualify despite the exclusion.

For example:

- If a business develops computer software for use in the film industry, in a process that satisfies the core activity definition, the software development may be eligible.
- If a business develops and manufactures innovative ceramic glazes for use in the visual arts, the development may be eligible.

Research in social sciences is excluded from being a core activity only. If, for example, research into human behaviour is required for product development that meets the test of a core activity, the research may be an eligible supporting activity.

Quality control or routine testing of processes, services, or goods (clause 13)

Quality control and routine testing of processes, services or goods are excluded as core activities because the activities do not resolve scientific or technological uncertainty in and of themselves. The development of new or improved quality control or testing methods may qualify as a core activity, however, provided the R&D activity satisfies the core activity definition.

Quality control or routing testing can be eligible as supporting activities. For example, an eligible supporting activity might include checking that products in a trial run meet a certain level of quality, where a person's core activity is the development of a new manufacturing process.

Routine collection of information (part A, clause 14)

The routine collection of information in and of itself is not expected to satisfy the core activity definition but it is included in schedule 21 for clarity. Examples of excluded activities include the routine collection of data and information:

- to monitor change from the application of routine engineering or routine technical procedures;
- to provide a baseline against which to monitor naturally occurring change;
- for the purpose of quality control or inventory control; and
- to establish whether a product's characteristics are within usual boundaries.

Minor adaption of, or improvements to, existing processes, services, or goods (part A, clause 15)

Minor changes or improvements to existing processes, services or goods are unlikely to satisfy the core activity definition so are included in schedule 21 for clarity.

Testing (part A, clauses 16 to 19)

Schedule 21 proposes to exclude various testing activities from the core activity definition:

- bug, beta, system requirements, user acceptance, and data integrity testing;
- data mapping and data migration testing;
- testing or comparing the efficiency of algorithms that are already known to work; and
- testing security protocols or arrangements.

Testing itself is unlikely to satisfy the core activity definition. It does not seek to resolve scientific or technological uncertainty but identifies problems that need to be resolved. Testing is included in proposed new schedule 21 for clarity. Testing that is required to assess whether the scientific or technological uncertainty has been resolved may qualify as a supporting activity.

Converting existing systems to new software platforms (part A, clause 20)

Converting existing systems to new software platforms is included in proposed new schedule 21 for clarity. This activity is unlikely to satisfy the core activity definition and its spill-over benefits are likely to be minimal.

Making cosmetic or stylistic changes to processes, services, or goods (part A, clause 21)

This clause excludes changes which affect the appearance of something without changing its substance. Changes that are purely cosmetic or stylistic, such as changes to colour or pattern, are excluded from the core activity definition as they do not involve the resolution of scientific or technological uncertainty. Cosmetic changes

that resolve scientific or technological uncertainty may be eligible, for example, changing the colour of a piece of fruit.

Reproduction of a commercial product or process by a physical examination of an existing system or from plans, blueprints, detailed specifications, or publicly available information (part A, clause 22)

Reproducing or reverse engineering an existing product or process is not R&D. It is not creating any new knowledge, product or process.

Carrying out routine operations on data, including presentation of data (part A, clause 23)

Routine operations on data are unlikely to meet the core activity definition as they are able to be readily performed by a competent professional. This activity is included in proposed new schedule 21 for clarity. The presentation of data relates to human behaviour which is a social science and therefore excluded.

Activities that have not been approved by the Commissioner (part A, clause 24)

From 2020–21, the general approval and significant performer in-year approval regimes will come into force. The effect of these regimes is that a person's activities will not be eligible as core activities unless:

- the Commissioner has approved the person's core activities under the general approval process (see proposed new section 68CB); or
- the person has opted out of the general approval process and into the significant performer process, and complies with the requirements in proposed new section 68CC.

See the section on *Approval: general approval process (year two)* (page 95) for more information.

INTERNAL SOFTWARE DEVELOPMENT

Clauses 21(10) and 22 (proposed new schedules 21 and 21B)

Summary of proposed amendment

The Bill proposes that expenditure on internal software development is subject to a \$3 million cap. It also proposes that such expenditure is excluded altogether where it relates to the ordinary internal administrative functions of a business.

Application date

From the 2019–20 income year.

Key features

It is proposed that:

- Expenditure incurred on internal software development is not eligible for the R&D tax credit regime where it is undertaken for the purpose of using the resultant software to perform common internal business functions (such as payroll, HR or accounting).
- Other internal software development expenditure (that is, software developed for in-house use) is only eligible up to a maximum of \$3 million.

Background

The rationale for excluding or limiting claims for internal software development is the limited spill-over benefits and fiscal risk associated with internal software development activities.

Limited spill-over benefits

There is likely to be limited public benefit from internal software development related to the ordinary administrative functions of a business, such as a firm upgrading its internal HR system. This kind of upgrade is specific to the firm and is unlikely to reflect the circumstances that the policy recognises. It is recognised however that there may be some spill-over benefits from internal software development for non-standard business administration. As a result, it is an eligible activity, although is subject to a \$3 million cap.

Fiscal risk

Projects to upgrade internal business processes can be very expensive in some industries. The Government is cautious about the fiscal consequences of including these activities within the scope of the R&D tax credit regime. This is a further reason

for the outright exclusion of standard administrative functions and the \$3 million cap for non-standard administrative functions.

Detailed analysis

Ordinary administrative functions (schedule 21, part A, clause 11)

Internal software development undertaken by a person for the purpose of the producing software for use in their business, or an associate's, is ineligible if it relates to any of the following systems:

- payroll;
- accounting;
- executive or management information;
- human resources;
- enterprise resource planning;
- invoicing; or
- inventory.

\$3 million cap (schedule 21B, part B, clause 17)

A person is only able to claim up to \$3 million of internal software development expenditure for the R&D tax credit regime. The cap groups the person's expenditure with internal software development already claimed by the person's associates. The rationale behind applying the cap to associated persons is to prevent the cap from being circumvented by the person splitting their expenditure across associates to effectively exceed the cap.

For partnerships and look-through companies, the cap is applied at the partnership or look-through company level (rather than the partner or individual owner level).

Example 2: Associated persons with internal software development expenditure

SL Ltd incurs \$2 million of internal software development expenditure and XW Ltd incurs \$1.5 million. SL Ltd and XW Ltd are wholly owned by Nayana Ltd. As XW Ltd and SL Ltd are associated persons for tax purposes, their combined claim may not exceed \$3 million.

Definition of internal software development expenditure (YA 1)

Internal software development expenditure is defined as expenditure incurred on developing software for the purpose of:

- the internal administration of a person's, or the person's associate's, business; or
- providing services to customers, unless the main reason the customers use the services is to use the software or technology developed by the person.

Example 3: Internal software development expenditure subject to cap

Mohammed runs a courier business and develops software that enables his customers to pinpoint the exact location and condition of their packages. This satisfies the definition of internal software development expenditure, because Mohammed's customers are using his services to receive the goods he delivers, not to use the software Mohammed has developed. The expenditure Mohammed's business incurred to develop the software is subject to the \$3 million cap.

Internal software development expenditure does not include expenditure incurred for the purpose of developing software if:

- the person's main purpose is to sell the software, or a right to use the software, to third parties; or
- the software is an integral part of goods that the person sells.

Example 4: Software development expenditure not subject to cap

Jane runs a software business and develops software that she sells to Mohammed's firm and other courier companies. The expenditure is not internal software development expenditure, so is not subject to the \$3 million cap.

ELIGIBLE EXPENDITURE

Clauses 10 (proposed new section LY 5), 21(7) and 22

Summary of proposed amendment

The Bill proposes that certain expenditure on R&D be eligible for R&D tax credits.

Application date

From the 2019–20 income year.

Key features

Eligible expenditure

Proposed new section LY 5(1) defines eligible expenditure for the R&D tax credit regime.

Eligible expenditure includes expenditure or loss described in proposed new schedule 21B, part A, to the extent to which the expenditure or loss is incurred on an R&D activity in the relevant income year. Schedule 21B, part A lists the categories of expenditure and loss that are eligible for R&D tax credits. See *Eligible and ineligible expenditure: schedule 21B* (page 39) for more information.

Categories of expenditure or loss listed in schedule 21B, part B, are **not** eligible expenditure for the R&D tax credit regime.

There are rules for expenditure incurred on R&D activities performed in the course of commercial production. In this case, expenditure on the activities is only eligible if it would not have been incurred in the absence of a person's R&D activities. With respect to employees, the eligible amount is based on the employees' contribution to the R&D activities.

Contracted and foreign R&D

Proposed new section LY 5(2) provides that the following amounts are only eligible to the extent provided by proposed new sections LY 6 and 7:

- amounts paid by to R&D contractors; and
- amounts incurred on foreign R&D, including amounts paid to non-residents for work or services performed in New Zealand.

Background

Eligible expenditure

Similar to the 2008 regime, proposed new schedule 21B lists categories of expenditure and loss and their eligibility for the R&D tax credit regime. Instead of providing nexus and apportionment rules in the schedules, a “to the extent” test is provided in section LY 5(1)(a), which applies to expenditure on all R&D activities except those performed in a commercial production environment.

An alternate apportionment rule applies to expenditure incurred on R&D activities performed in the course of commercial production. This rule is necessary to prevent business as usual expenditure being recharacterised as R&D expenditure. The rule does not apply to employee expenditure incurred on R&D activities performed in the course of commercial production. A person can apportion expenditure on employees who perform both business as usual and R&D functions.

Example 5: R&D performed by jelly manufacturer

Jellatine Ltd has a factory in East Tamaki, where it produces a variety of food products that contain gelatine. It has been working on a new type of jelly injected with protein, vitamins, and minerals. The aim is to make this new jelly temperature resistant, so that it is able to stay gelatinous despite extreme heat or cold. Jellatine Ltd hopes that its new range of temperature impervious jellies will be attractive to participants in extreme endurance sports and long distance runners.

After completing initial R&D on the new jelly, Jellatine Ltd decides to start trial-runs in its factory to determine whether the new range of jellies can be mass produced on its usual production line. Every Saturday for two months, its entire factory (which is normally closed on weekends) is used to produce the newly developed jelly.

For the two months in which R&D takes place in Jellatine Ltd’s factory, the overheads and consumable costs of the factory increase by twenty percent. The test jelly is disposed of at the end of each day, because it hasn’t undergone sufficient testing to be sold for human consumption. Jellatine Ltd pays its staff extra to come in on the weekend.

Jellatine Ltd purchases a building nearby, where it installs a heavy duty air-conditioning unit to test the new jelly’s responsiveness to temperature fluctuations (“temperature simulator”). The temperature simulator is used solely for R&D activities. Two employees who would normally be responsible for monitoring the quality of all factory outputs for commercial sale are tasked with also monitoring the new jelly in the temperature simulator.

Jellatine Ltd’s eligible expenditure, after it starts trial runs in its factory and acquires the temperature simulator, is made up of:

- The extra twenty percent of expenditure incurred for consumables and factory overhead costs, because these costs would not have been incurred in the absence of the Jellatine Ltd’s R&D activities.
- Expenditure on the staff who come in each Saturday when R&D is performed in Jellatine Ltd’s factory.
- Expenditure on Jellatine Ltd’s staff who monitor the jelly in the temperature simulator, to the extent to which the staff are monitoring the new jelly rather than carrying out their usual duties in relation to Jellatine Ltd’s business as usual activities.
- Expenditure on services and non-depreciable property incurred in relation to the temperature simulator, and its depreciation loss on the depreciable property that makes up the temperature simulator, because the temperature simulator is used solely for Jellatine Ltd’s R&D activities.

Contracted and foreign R&D

See the sections on *Contracted expenditure* (page 33) and *Foreign expenditure* (page 35) for more information on expenditure and losses incurred for R&D contractors and foreign R&D.

CONTRACTED EXPENDITURE

Clause 10 (proposed new section LY 6) and 21(15)

Summary of proposed amendment

The Bill proposes a formula for calculating eligible expenditure where a person pays an R&D contractor to perform R&D activities on their behalf (“contracted expenditure”).

Application date

From the 2019–20 income year.

Key features

Proposed new section LY 6 sets out the formula for calculating a person’s eligible expenditure where the person (the principal) contracts another person (the R&D contractor) to perform R&D activities on their behalf.

The contracted expenditure formula is:

$$0.8 \times (\text{contract amount} - \text{ineligible expenditure})$$

Background

Profit margin

The 0.8 figure is designed to prevent the principal from getting an R&D tax credit on the contractor’s profit margin. For simplicity, a twenty percent profit margin has been chosen.

A person doing R&D in their own right is not able to claim R&D tax credits for any profit margin. Therefore, it is considered appropriate that principals are not able to claim R&D tax credits for profit derived by R&D contractors that they pay to perform R&D activities on their behalf.

Ineligible expenditure

Ineligible expenditure must be removed from the contract amount. It is expected that some contracts may be for activities that are not exclusively R&D activities, and that R&D contractors may incur expenditure that is ineligible expenditure. See the section on *Eligible and ineligible expenditure: schedule 21B* (page 39) for more information.

Detailed analysis

Contracted R&D

Proposed new section LY 6 defines a person's contracted expenditure (referred to in the legislation as contracted research and development expenditure) as an amount for an R&D contractor to perform R&D activities for them.

An R&D contractor is defined in section YA 1 as a person who performs an R&D activity on behalf of another person. The definition excludes industry organisations which receive levies from their members to fund their R&D activities. These bodies are eligible for the tax incentive in their own right.

Contracted expenditure forms part of a person's eligible expenditure. It is calculated using the formula:

$$0.8 \times (\text{contract amount} - \text{ineligible expenditure})$$

Contract amount means the amount that a principal pays an R&D contractor to perform R&D activities on the principal's behalf.

Ineligible expenditure is the amount of the R&D contractor's expenditure or loss that would be ineligible under proposed new section LY 5, treating the R&D contract as the person under section LY 5. See the section on *Eligible expenditure* (page 30) for more information.

Example 6: Rice producer pays R&D contractor to develop chocolate rice

Richard's Rice Ltd is the largest producer of rice in New Zealand. Richard's Rice Ltd is thinking of branching into desserts, and contracts Steph to produce rice that tastes like chocolate.

Richard's Rice Ltd pays Steph \$1 million to develop chocolate rice. Steph incurs \$120,000 of expenditure that is ineligible under proposed new section LY 5.

Richard's Rice Ltd has the following eligible expenditure:

$$0.8 \times (\$1,000,000 - \$120,000) = \$704,000$$

Contracted R&D performed overseas (proposed new sections LY 6(4) and LY 7)

If an R&D contractor performs R&D activities overseas, then a person must calculate their eligible expenditure in accordance with proposed new section LY 7. This is instead of applying the contracted expenditure formula in proposed new section LY 6. See the section on *Foreign expenditure* (page 35) for more information.

FOREIGN EXPENDITURE

Clause 10 (proposed new section LY 7)

Summary of proposed amendment

The Bill proposes that foreign expenditure that would otherwise be eligible expenditure only be eligible to the extent it comprises no more than ten percent of a person's overall R&D tax credit claim.

Application date

From the 2019–20 income year.

Key features

Proposed new section LY 7 provides that foreign expenditure is eligible expenditure, capped at ten percent of a person's overall R&D tax credit claim, to the extent it is:

- expenditure incurred on an R&D activity performed outside New Zealand, if the R&D activity is only or mainly for, required for, and integral to, conducting a core activity (note that activities performed overseas cannot be core activities);
- a payment of salary or wages to a non-resident person performing an R&D activity in New Zealand; or
- a payment for services performed by a non-resident person, where the services are performed in New Zealand.

Only eighty percent of amounts paid for contracted services (under the first and third bullet points above) are eligible, less any amounts that are ineligible under schedule 21B, part B.

While the proposed rule affects payments to non-resident persons and for R&D activities performed overseas, expenditure on imported materials is considered domestic expenditure (so is not restricted by sections LY 5(2)(b) and LY 7).

Background

The R&D tax credit regime aims to primarily incentivise R&D activities performed in New Zealand because the wider benefits are more likely to be gained by New Zealand companies. The Government recognises, however, that in some circumstances R&D activities cannot be fully performed in New Zealand.

Experts in certain scientific or technological fields may only be available overseas, suitable populations for testing or trials may be located outside New Zealand, or the type of R&D activity a claimant needs to undertake may be cost prohibitive if performed in New Zealand.

The 2008 regime was broadly similar but also required foreign expenditure to account for less than half the expenditure on a relevant R&D project to be eligible. This secondary requirement has been relaxed.

Detailed analysis

Foreign expenditure (section LY 7(1))

Foreign expenditure (referred to as “foreign research and development expenditure” in the legislation) is defined as expenditure or loss:

- incurred on R&D activities performed outside New Zealand with the only or main purpose of, that is required for, and integral to, conducting a core activity;
- that is a payment of salary or wages to a non-resident person for activities performed in New Zealand; or
- that is a payment for services performed by a non-resident person in New Zealand.

Eligible expenditure (section LY 7(2))

Eligible expenditure, for proposed new section LY 5(2)(b), includes foreign expenditure equal to the **lesser** of the person’s actual overseas expenditure and their capped overseas expenditure.

Actual overseas expenditure

Actual overseas expenditure is made up of expenditure a person incurs themselves on an R&D activity carried out overseas, and amounts contractors incur on an R&D activity carried out overseas on the person’s behalf.

Proposed new section LY 7(3) sets out the formula for calculating actual overseas expenditure:

$$(0.8 \times (\text{contract amount}) - \text{ineligible expenditure}) + \text{foreign in-house amount}$$

Proposed new section LY 7(4)) defines the components of the formula.

Contract amount means the amounts paid to a foreign contractor to perform R&D activities on a person’s behalf (essentially an R&D contractor as defined in YA 1, but for activities performed outside New Zealand).

Ineligible expenditure means the expenditure or loss incurred by a foreign contractor that would be ineligible under schedule 21B, treating the foreign contractor as though they were the person claiming R&D tax credits.

Foreign in-house amount means expenditure or loss incurred by a person on activities performed overseas, to the extent these activities are performed by the person themselves (rather than by a foreign contractor).

For the rationale behind only allowing eighty percent of amounts paid to foreign contractors see the section on *Contracted expenditure* (page 33).

Capped overseas expenditure

Proposed new section LY 7(5) sets out the formula for calculating capped overseas expenditure:

$$0.1 \times \text{total New Zealand R\&D expenditure} \div 0.9$$

Proposed new section LY 7(6)) defines total New Zealand R&D expenditure as a person's total eligible expenditure, less any amounts that are foreign expenditure as defined in section LY 7(1).

This formula means the capped amount of overseas expenditure is equal to ten percent of the total eligible expenditure.

Example 7: Speakers in emergency radio systems

Tamaki Ltd is in the business of producing high quality audio devices for use in portable electronic equipment. It has a team of 200 staff working on R&D in its purpose-built R&D facility in the Wairarapa.

Once it has a workable concept, it then sends a delegation of its R&D staff to Thailand, where Tamaki Ltd has a factory dedicated to producing audio devices. In Thailand, Tamaki Ltd reconfigures its manufacturing facilities temporarily, so that they can be used to produce its new prototype, and then sends those prototypes back to New Zealand for further testing and analysis.

In November 2018, Tamaki Ltd begins R&D on a new type of speaker, which it would like to use to replace the speakers in its existing emergency radio systems. Tamaki Ltd has developed a concept, but it needs to test whether it will work in the emergency radio systems produced in its Thailand manufacturing facility.

Tamaki Ltd has incurred \$1 million of eligible expenditure on R&D performed in New Zealand to date, which includes a mixture of eligible core and supporting activities. In January 2019, Tamaki Ltd sends a team of engineers to Thailand to configure its plant and oversee the production of a prototype of the emergency radio system incorporating the new speaker design. Tamaki Ltd spends \$300,000 on its R&D in Thailand.

Actual overseas expenditure

The formula is: $(0.8 \times (\text{contract amount} - \text{ineligible expenditure}) + \text{foreign in-house amount})$, where:

- the contract amount and ineligible expenditure = nil, as Tamaki Ltd performed all of its foreign R&D in-house; and
- the foreign in-house amount = \$300,000.

Applying the formula: $(0.8 \times (0) - 0) + \$300,000 = \$300,000$.

Capped overseas expenditure

The formula is: $0.1 \times \text{total New Zealand R\&D expenditure} \div 0.9$, where the total New Zealand R&D expenditure = \$1,000,000.

Applying the formula: $0.1 \times \$1,000,000 \div 0.9 = \$111,111$.

Eligible expenditure (for proposed new section LY 5)

Tamaki Ltd's eligible foreign expenditure is \$111,111, which is the lesser of its actual overseas expenditure (\$300,000) and its capped overseas expenditure (\$111,111).

ELIGIBLE AND INELIGIBLE EXPENDITURE: SCHEDULE 21B

Clauses 6, 21 and 22 (proposed new schedule 21B)

Summary of proposed amendment

The Bill proposes that certain types of expenditure are eligible for the tax credit, and that some types are ineligible.

Application date

From the 2019–20 income year.

Key features

Proposed new schedule 21B, part A provides that only the following expenditure, to the extent the expenditure is incurred on R&D, is eligible for the R&D tax credit regime:

- depreciation loss for items used in performing R&D;
- expenditure or loss on acquiring goods and services used in performing R&D; and
- amounts paid to employees.

Proposed new schedule 21B, part B provides that the following expenditure is ineligible for the R&D tax credit regime:

- amounts incurred by a person and their associates on R&D to the extent the amounts exceed \$120 million;
- expenditure incurred in acquiring depreciable property;
- expenditure that contributes to the cost of depreciable tangible property;
- depreciation loss for depreciable property, to the extent to which the cost of the property is eligible R&D expenditure;
- depreciation loss on items in a pool of depreciable property where an item in the pool is not used solely in performing R&D;
- certain amounts of depreciation loss on assets acquired from associates;
- profits on R&D services and property provided by associates;
- amounts in excess of market value for leasing property from associates;
- expenditure on employee recruitment, relocation, bonuses, and employee share schemes;
- interest and other financing costs;

- professional fees in determining whether a person qualifies for the R&D tax credit regime;
- expenditure on acquiring an interest in intangible property other than software;
- expenditure on bespoke software;
- internal software development expenditure incurred by a person and their associates, to the extent it exceeds \$3 million (see the section on *Internal software development* (page 27) for more information);
- expenditure on goods or services to the extent it exceeds the market value of the goods or services;
- gifts;
- the cost of acquiring technology that is used as a basis for further R&D activities;
- expenditure to commercialise the results of an R&D activity;
- expenditure that relates to a government or local authority grant;
- expenditure on inputs used, or subject to a process or transformation, to the extent the expenditure does not exceed the value of the output from that expenditure (feedstock rule);
- expenditure for which a person has received an R&D tax credit from another country; and
- if a person's eligible expenditure is less than \$50,000, expenditure or loss under \$50,000 that is not for an approved research provider to perform an R&D activity on behalf of the person.

Background

Expenditure that is eligible for the R&D tax credit regime must have a direct link to a person's R&D activities. Expenditure is excluded via schedule 21B to:

- clarify when expenditure will have insufficient connection with an R&D activity;
- reduce compliance and administrative costs;
- prevent double dipping;
- prevent abuse of the R&D tax credit regime; and
- limit fiscal risk.

Detailed analysis

Eligible expenditure

Depreciation (schedule 21B, part A, clause 1 and proposed amendment to section EE 6(1)(b))

Depreciation loss for an item of depreciable property is eligible expenditure to the extent to which the depreciable property is used in performing an R&D activity. An R&D tax credit is therefore not available on an asset which is available for use in R&D but not actually used in the relevant income year.

The capital cost of assets used in R&D is not eligible expenditure, because the capital cost is unlikely to reflect the actual expenditure incurred on R&D. An asset that is initially purchased for use in R&D activities may subsequently be sold or used for non-R&D activities. Depreciation loss calculated for each year an asset is used in R&D is a better measure of cost, and reflects the fact that an asset has value over its useful life, not just the year it was purchased.

The proposed amendment to section EE 6 ensures that tax exempt entities, such as charities, are able to claim R&D tax credits for depreciation loss on assets used in their R&D activities.

Expenditure or loss to acquire goods and services used in performing R&D (schedule 21B part A, clause 2)

Expenditure on non-depreciable goods and services is eligible expenditure to the extent the goods and services relate to performing an R&D activity.

This inclusion is broad and intended to cover expenditure such as:

- the cost of goods consumed in R&D activities;
- overheads, to the extent they relate to R&D activities. For example, rates, utilities, insurance, and lease payments; and
- the cost of materials incorporated into prototypes.

Amounts paid to employees (schedule 21B, part A, clause 3)

Salaries and wages paid to employees are eligible expenditure to the extent an employee's employment relates to performing an R&D activity. Some other employment related costs are ineligible.

Ineligible expenditure

Amounts exceeding \$120 million (schedule 21B, part B, clause 1)

Expenditure on R&D that would otherwise be eligible is ineligible to the extent it is greater than \$120 million for the income year. The \$120 million cap takes into account the eligible expenditure claimed by associated persons, to prevent the cap being circumvented by a person splitting their expenditure amongst associates. See

the section on *Expenditure cap (including approved R&D caps)* (page 51) for more information.

Expenditure incurred in acquiring depreciable property (schedule 21B, part B, clause 2)

Expenditure or loss on acquiring depreciable property is ineligible. Depreciation loss is the better measure of cost to a person, and is eligible to the extent to which depreciable property is used in R&D activities.

Expenditure or loss that contributes to the cost of depreciable tangible property (schedule 21B, part B, clause 3)

Expenditure or loss that contributes to the cost of depreciable tangible property is ineligible, unless the depreciable tangible property is used solely in performing an R&D activity. An example of eligible expenditure is expenditure on producing a prototype that is solely used in a person's R&D activities.

Note that expenditure incurred in the research phase of creating depreciable tangible property, which would be deductible for tax purposes, is eligible expenditure. Such expenditure is not considered part of the cost of creating the depreciable tangible property.

The depreciable tangible property exclusion is to prevent expenditure with a different purpose being characterised as R&D. There are also concerns about the potential fiscal cost of allowing such expenditure. This is the same approach as was adopted in 2008. It is similar to Australia's R&D rules, which also explicitly exclude expenditure on producing depreciable tangible property.

Depreciation loss where cost of depreciable property was eligible expenditure (schedule 21B, part B, clause 4)

Depreciation loss for an item of depreciable property is ineligible for the credit to the extent the cost of producing the property was eligible expenditure. This exclusion aims to prevent a person from getting R&D tax credits more than once for the same expenditure.

Pooled property (schedule 21B, part B, clause 5)

Depreciation loss on depreciable assets in a tax depreciation pool is ineligible, unless the pool consists solely of assets used wholly in conducting R&D activities. This exclusion aims to prevent a person from receiving R&D tax credits for depreciation loss on assets used in non-R&D activities.

Certain depreciation deductions on assets acquired from an associate (schedule 21B, part B, clause 6)

A person's depreciation loss on an item of depreciable property acquired from an associate is ineligible, to the extent:

- the person purchased the property for more than the property's adjusted tax value ("ATV") (in the hands of the associate); and

- the property was used in the associate's R&D activities.

Example 8: Depreciable property acquired from associate at above ATV

Webb Ltd sells an asset that was used in R&D, which cost \$200 and has an ATV of \$100, to its associate, Wood Ltd, for \$130. Wood Ltd's depreciation loss on the \$30 above the asset's ATV is ineligible.

The rationale for this rule is to prevent associated entities from claiming R&D tax credits twice for what is essentially the same amount of depreciation loss. In the above example, absent this rule, Webb Ltd and Wood Ltd would both have claimed depreciation loss on the asset's decline in value from \$130 to \$100.

Profits on R&D services and property provided by associates (schedule 21B, part B, clause 7)

An amount of expenditure or loss for goods or services acquired from an associate is ineligible to the extent the consideration paid to the associate is more than the lowest cost of the goods or services to an associate. This rule is designed to prevent expenditure from being eligible to the extent it is on goods or services that are overpriced.

Property leased from an associate (schedule 21B, part B, clause 8)

Expenditure on leasing property from an associate is ineligible to the extent a person is paying in excess of market value. This exclusion aims to prevent a person from claiming R&D tax credits on excess cost.

Expenditure on employee recruitment, relocation, bonuses, and employee share schemes (schedule 21B, part B, clauses 9 to 11)

Expenditure on employee share schemes, recruitment, relocation and bonuses is ineligible because the extent to which these payments actually relate to R&D may be unclear.

Example 9: Expenditure on employee relocation and bonuses

Zoomboom Ltd employs Nicola to assist them in the R&D of the world's fastest rocket, the Zoom 2. Zoomboom Ltd pays Nicola a sign on bonus and reimburses her for relocation costs. These costs are not eligible expenditure.

Interest and other financing costs (schedule 21B, part B, clauses 12 and 13)

Amounts of expenditure under financial arrangements and deductions under sections DB 5 to DB 15, which relate to financing and financial arrangement adjustments, are ineligible. This is to ensure R&D tax credits are not provided for interest, or amounts in the nature of interest, related to financing the R&D activities.

Professional fees (schedule 21B, part B, clause 14)

Professional fees are not eligible for the credit. This exclusion covers fees paid to determine the eligibility of a person, activity, or amount of expenditure, and amounts paid to a tax agent to prepare a person's R&D claim. Professional fees are excluded because they do not relate to resolving the scientific or technological uncertainty.

Expenditure on acquiring an interest in intangible property (schedule 21B, part B, clause 15)

Expenditure for acquiring an interest in intangible property, other than software, is ineligible. This expenditure is excluded to reduce fiscal risk. Costs associated with creating intangible assets from R&D activities, however, may be eligible.

Expenditure on bespoke software (schedule 21B, part B, clause 16)

Expenditure incurred on acquiring bespoke software, or software that is not widely commercially available, is ineligible. Expenditure on software that is widely available, such as Microsoft Excel, may be eligible expenditure.

Internal software development expenditure exceeding \$3 million (schedule 21B, part B, clause 17)

Internal software development expenditure incurred by a person or their associates is ineligible to the extent it exceeds \$3 million. See the section on *Internal software development* (page 27) for more information.

Above market value goods or services (schedule 21B, part B, clause 18)

Expenditure on goods or services is ineligible to the extent it exceeds market value. This provision is intended to apply broadly, so applies to transactions with associates and third parties. This exclusion targets arrangements where a person deliberately attempts to increase their eligible expenditure by paying above market value for a good or service.

Gifts (schedule 21B, part B, clause 19)

Expenditure or loss on gifts is ineligible. Only amounts incurred directly on R&D activities are eligible expenditure. Gifts are ineligible because they are discretionary.

Ineligible technology expenditure (schedule 21B, part B, clause 20)

Expenditure or loss on technology expenditure that is defined in section YA 1 as "ineligible technology expenditure" is ineligible. The exclusion targets the cost of acquiring technology that is used as a basis for further R&D. The Government does not want to give R&D tax credits to a person for the results of R&D that the person has not created. Otherwise, there is a risk the Government may give the credit twice for the same R&D.

Expenditure to commercialise the results of an R&D activity (schedule 21B, part B, clause 21)

Expenditure or loss for plant, machinery, or materials to commercialise the results of an R&D activity is ineligible. Commercialisation of R&D generally happens after scientific or technological uncertainty has been resolved. Expenditure incurred to resolve scientific or technological uncertainty that arises during the commercialisation stage of R&D may, however, be eligible for the credit.

Expenditure that relates to a government or local authority grant (schedule 21B, part B, clause 22)

Expenditure or loss that relates to a government or local authority grant is ineligible. A local authority or government grant amount received by a person that is then spent by the person on eligible R&D activities is ineligible expenditure. Expenditure is also ineligible when it is from funds required as a condition of a grant (known as required co-funding). Such expenditure is ineligible because the expenditure has either already been subsidised by the Government or relates to an activity that the Government has already subsidised.

Example 10: Expenditure funded by and required by government grant

Watts Ltd receives an R&D grant of \$500,000 from the Government to subsidise its R&D salary costs. As a condition of the grant, Watts Ltd is required to contribute \$500,000 of its own funds towards the project.

Watts Ltd uses the \$1 million to fund its R&D activities. This includes paying for R&D salaries and constructing prototypes used solely in R&D activities. While this expenditure would normally be eligible, it is ineligible expenditure because the grant exclusion in proposed new schedule 21B, part B, clause 22.

Feedstock rule (schedule 21B, part B, clause 23)

The feedstock rule applies to inputs that are used in, processed, or transformed as part of a person's R&D activities, where the activities result in goods acquired or produced by the person. The rule provides that expenditure on inputs is ineligible to the extent the person's inputs are less than the market value of the person's outputs from their R&D activities. Inputs includes expenditure on energy, such as electricity and gas.

Only the net cost of inputs used in R&D activities are eligible. That is, the excess of the cost of a person's inputs over the market value of their outputs.

Example 11: Feedstock rule

Mike's Mountain Bikes Ltd is developing a new coating for bike frames which will be more durable than paint. The company has painted some frames to test the coating, and incurs the following costs:

Expenditure on inputs	Amount
Cost of inputs (value of steel frames and coating)	\$2,000
Electricity used in the process	\$500
Total cost of inputs	\$2,500

The total cost of Mike's Mountain Bikes Ltd's inputs is \$2,500, which is made up of the cost of the steel frames and the electricity used in the R&D process. The company incurred \$1,000 on other production costs, like labour and overhead costs, but these costs are not considered inputs for the feedstock rule.

Once Mike's Mountain Bikes Ltd completes its R&D activities, the market value of the coated frames is \$2,500. The cost of the company's inputs and the value of its outputs net out at zero, so none of Mike's Mountain Bikes Ltd's input costs are eligible. The \$1,000 incurred on other production costs is, however, eligible expenditure despite the application of the feedstock rule.

The feedstock rule ensures a business only gets a tax credit for the extra costs associated with their R&D. Costs of inputs which are recouped are therefore ineligible. Energy was not included in the feedstock rule under the 2008 tax credit, but is now included.

Expenditure for which a person has received an R&D tax credit from another country (schedule 21B, part B, clause 24)

Expenditure is ineligible to the extent a person has received a credit of a similar nature to the R&D tax credit for the expenditure from another country. It is not appropriate to have two credits for the same expenditure.

Expenditure or loss under \$50,000 (schedule 21B, part B, clause 25)

See the section on the *Minimum threshold* (page 49) for more information on this exclusion.

Calculating the tax credit

MINIMUM THRESHOLD

Clauses 10 (proposed new section LY 4) and 22 (proposed new schedule 21B, part B)

Summary of proposed amendment

The Bill proposes that claimants must have at least \$50,000 of eligible expenditure, or have approved research provider expenditure, to be eligible for the R&D tax credit regime.

Application date

From the 2019–20 income year.

Key features

Proposed new section LY 4 provides that a person is only eligible for the R&D tax credit regime if the person has at least \$50,000 of eligible expenditure or has approved research provider expenditure. See the section on *Approved research providers* (page 65) for more information.

A person who only satisfies the minimum threshold because they have approved research provider expenditure is restricted to only claiming their eligible approved research provider expenditure (see clause 25 of proposed new schedule 21B, part B).

For partners in partnership and owners of look-through companies (LTCs), the minimum threshold can be satisfied by assessing the total eligible expenditure of the partnership or LTC as a whole.

Background

A minimum threshold ensures that the combination of compliance and administration costs do not outweigh the value of the credit.

Example 12: Partners with less than \$50,000 of eligible expenditure

Emma and Luke are in partnership together. Emma has \$20,000 of eligible expenditure, and Luke has \$35,000 of eligible expenditure. Individually, Emma and Luke are unable to satisfy the minimum threshold. Since they are in partnership, their expenditure can be grouped (proposed new section LY 4(1)). As a result, Emma and Luke are able to satisfy the \$50,000 minimum threshold.

Example 13: Person with approved research provider expenditure

Dockery Ltd is a business that sells electronic deck shadings. In the 2020–21 income year it has performed activities that satisfy the core and supporting activity definitions, and has done some of its R&D itself and contracted the rest out to an approved research provider.

Dockery Ltd: 2020–21 income year

Eligible expenditure	Amount
In-house	\$10,000
Approved research provider	\$35,000
Total R&D expenditure	\$45,000

Dockery Ltd is unable to satisfy the \$50,000 minimum threshold, as it has only incurred \$45,000 of eligible expenditure. It is nevertheless eligible for the R&D tax credit regime because it has approved research provider expenditure. Its eligible expenditure, however, is limited to the approved research provider amount.

Dockery Ltd: 2020–21 income year

Expenditure type	Amount
Total R&D expenditure	\$45,000
Ineligible expenditure	(\$10,000)
Eligible expenditure	\$35,000

EXPENDITURE CAP (INCLUDING APPROVED R&D CAPS)

Clauses 10 (proposed new section LY 4), 21(2), 24(2) and 30

Summary of proposed amendment

The Bill proposes that an expenditure cap of \$120 million apply to restrict the maximum R&D tax credit that can be claimed by any one person (including any associates of the person). It is also proposed that the Commissioner have discretion to allow businesses to exceed the cap in some circumstances.

Application date

From the 2019–20 income year.

Key features

Proposed new section LY 4(3) provides that the maximum amount of eligible expenditure that a person can claim in any income year is \$120 million. If a person's expenditure exceeds \$120 million, then their eligible expenditure for the R&D tax credit regime equals \$120 million. The cap includes expenditure claimed by the person's associates, so that the combined claim of a person and their associates is limited to \$120 million.

Applying to exceed the cap

Proposed new section 68CD enables people who expect to have more than \$120 million of eligible expenditure in an income year to apply to the Commissioner to exceed the expenditure cap. If approved, a person's total R&D expenditure (for calculating their R&D tax credit under proposed new section LY 4) equals their cap as approved by the Commissioner (approved R&D cap).

Applications to exceed the cap must be made by the seventh day of the second month after the end of the relevant income year (for a person with a standard balance date in the year ended 31 March 2021, their application to exceed the cap would need to be filed by 7 May 2021).

The Commissioner can only approve applications to exceed the cap if satisfied that an applicant's R&D activities will give rise to a substantial net benefit for New Zealand. The Commissioner is also required to consult with the Chief Executive of MBIE.

Background

The expenditure cap of \$120 million for each income year equates to a maximum credit of \$18 million, based on a 15% R&D tax credit rate. The cap contains the fiscal risk associated with the R&D tax credit regime.

The Government believes it is important, however, for businesses to be able to apply to exceed the \$120 million cap if their R&D is expected to result in a substantial net benefit for New Zealand.

The information that is likely to be required to demonstrate a substantial net benefit for New Zealand includes:

- impacts on New Zealand based economic activity;
- impacts on job opportunities and skills of New Zealanders;
- enhancements to market competition, efficiency, productivity, and service levels in New Zealand;
- wider benefits to New Zealand; and
- the durability and sustainability of the benefits to New Zealand.

Example 14: Associated persons with expenditure in excess of the cap

Muff Ltd and Mungnip Ltd are associated. Their combined R&D expenditure for the year ended 31 March 2022 totals \$150 million. They were not able to apply to exceed the \$120 million cap, because their R&D will not result in a substantial net benefit for New Zealand.

**Muff Ltd and Mungnip Ltd
31 March 2022**

Claimant	R&D expenditure
Muff Ltd	\$80 million
Mungnip Ltd	\$70 million
Total	\$150 million

Muff Ltd filed its income tax and R&D supplementary returns on 1 October 2022. Mungnip Ltd intends to file its returns by 31 March 2023. The returns of both Muff Ltd and Mungnip Ltd are prepared by tax agents, so they both have an extension of time for their returns.

Applying the aggregation rules in clause 1, schedule 21B, part B:

**Muff Ltd and Mungnip Ltd
31 March 2022**

Description	Amount
Muff Ltd's claimed expenditure (as returned)	\$80 million
Mungnip Ltd's gross eligible expenditure	\$70 million
Total	\$150 million
Mungnip Ltd's gross eligible expenditure	\$70 million
Mungnip Ltd's ineligible expenditure (\$150,000,000 less \$120,000,000)	(\$30 million)
Mungnip Ltd's net eligible expenditure	\$40 million

Mungnip Ltd's eligible expenditure that it can claim in its income tax and R&D supplementary returns is \$40 million. This is because \$80 million (Muff Ltd's claimed expenditure) plus \$40 million (Mungnip Ltd's eligible expenditure) equals \$120 million.

TAX CREDIT RATE AND CALCULATION

Clauses 10 (proposed new section LY 4), 21(7) and 21(15)

Summary of proposed amendment

The Bill proposes that a person's R&D tax credit equals 15% of their eligible expenditure, subject to a minimum threshold and expenditure cap. Special rules apply for contracted and foreign expenditure.

Application date

From the 2019–20 income year.

Key features

Proposed new section LY 4 provides the formula for calculating a person's R&D tax credits for an income year. The formula is 15% multiplied by a person's total eligible R&D expenditure (restricted by a \$120 million expenditure cap, for more information see the section on *Expenditure cap (including approved R&D caps)* (page 51)).

Total eligible R&D expenditure is defined to mean:

- \$120 million if a person has exceeded the expenditure cap in proposed new section LY 4(3)(a) but has not received approval to exceed the cap;
- a person's approved R&D cap, if the person has received approval from the Commissioner to exceed the expenditure cap (see sections LY 3 and 68CD); or
- if a person's expenditure is less than \$120 million, the person's actual eligible expenditure, as defined in proposed new section LY 5 (see the section on *Eligible expenditure* (page 30) for more information).

STRIPPING OUT GST INPUTS

Clause 10 (proposed new sections LY 1(5) to (7))

Summary of proposed amendment

The Bill proposes that a person cannot receive R&D tax credits for expenditure to the extent the person is able to claim GST input tax credits in relation to the expenditure.

Application date

From the 2019–20 income year.

Key features

Proposed new sections LY 1(5) to (7) provide that a person's eligible expenditure is:

- reduced by the amount of input tax the person may claim for the expenditure;
- reduced by the amount of an adjustment made under section 20(3)(e) of the Goods and Services Tax Act 1985; and
- increased by adding a relevant amount of deductible output tax the person has for the income year.

Background

R&D expenditure need not be tax deductible to be eligible expenditure (see the section on *Eligible expenditure* (page 30) for more information). As a result, section DB 2, which denies a person a deduction for the GST input tax portion of expenditure, does not apply to R&D tax credit claims.

Proposed new sections LY 1(5) to (7) are intended to achieve the same effect as section DB 2 in the context of the R&D tax credit regime. The rationale is to ensure a person does not receive an R&D tax credit for expenditure which is then refunded to them through claiming a GST input tax credit.

Detailed analysis

GST inputs (section LY 1(5))

Proposed new section LY 1(5) reduces a person's eligible expenditure by the amount of input tax credit applying to the relevant goods or services purchased by the person.

Example 15: GST input amount excluded from eligible expenditure

Alison purchases \$10,000 of oil for use in her R&D activities. Alison is GST registered, so she can claim an input tax credit of \$1,304.34, which is refunded to her by Inland Revenue. The true cost of the oil to Alison is \$8,695.66, and she may only include this amount in her eligible expenditure for the R&D tax credit regime.

Deductions from output tax (section LY 1(6))

A person's eligible expenditure is reduced by the amount of any adjustment made under section 20(3)(e) of the Goods and Services Act 1985.

Example 16: Deductions from output tax

James purchases \$20,000 worth of oil. He originally intended to use 2/3 of the oil in his R&D process and take 1/3 home for his Ferrari. James ends up using all \$20,000 of the oil in his R&D process.

As James thought he would be using 1/3 of the oil for private use when he purchased it, he only claimed an input tax credit of \$1,739. Because James used all of the oil for taxable purposes, he could have claimed an input tax credit of \$2,609. James may deduct from his output tax \$870, being the additional input tax credit he could have claimed.

When James files his tax return and claims his R&D tax credit, this \$870 must be deducted off his eligible expenditure to reflect the fact that the true cost of the oil to James was \$17,391.

Adjustments for output tax (section LY 1(7))

A person's expenditure or loss is increased by adding the relevant amount of deductible output tax the person has.

REFUNDABILITY

Clause 9

Summary of proposed amendment

The Bill proposes that R&D tax credits be refundable for companies in loss or with insufficient income tax liability to use all of their R&D tax credits in an income year, provided certain criteria are met. A company may receive a maximum of \$255,000 refundable R&D tax credits. Any credits that are not refunded may be carried forward by the company to the next income year, provided shareholder continuity requirements are met.

Application date

From the 2019–20 income year.

Key features

Proposed new section LA 5(4B) provides that a company's R&D tax credits are refundable if the company:

- is in a tax loss position, or has insufficient income tax liability to utilise all of its R&D tax credits in the relevant income year;
- satisfies the R&D tax loss cash-out corporate eligibility and wage intensity criteria in sections MX 2 and 3;
- does not derive exempt income and is not associated with a person who derives exempt income;
- is not a listed company and is not associated with a listed company; and
- does not have an outstanding tax liability.

Only the first \$255,000 of the company's R&D tax credits is refundable, which is the equivalent of \$1.7 million of eligible expenditure. Any remaining R&D tax credits may be carried forward to the next income year provided the shareholder continuity requirements in proposed new section LY 8 are met.

Background

Many R&D intensive firms operate at a loss, especially in their early years. For the R&D tax credit regime to encourage more businesses to undertake a greater amount of R&D, proposed new section LA 5(4B) ensures that eligible companies are able to receive the benefit of up to \$255,000 of their R&D tax credits each income year.

The corporate eligibility and wage intensity criteria (LA 5(4B)(a)(i) and (ii)) are intended to target the refundability of R&D tax credits to start-up firms heavily

engaged in R&D. New section LA 5(4B) uses the R&D tax loss cash-out corporate eligibility and wage intensity criteria.

R&D tax credits cannot be refunded under LA 5(4B) for non-corporate entities and companies that do not satisfy the requirements of LA 5(4B)(a)(i) to (vi).

The Government intends to undertake further policy work on refunding R&D tax credits, and the policy may change for year two.

Detailed analysis

Criteria for refundable R&D tax credits

A person who has received R&D tax credits may only have their credits refunded under new section LA 5(4B), up to a maximum of \$255,000, if they meet certain criteria. These criteria are in addition to the general eligibility criteria in proposed new section LY 3, which require, among other things, that a person carries on business through a fixed establishment in New Zealand.

Corporate eligibility criteria must be met ((a)(i))

The corporate eligibility criteria are met if a person:

- is a company (this includes companies incorporated part way through an income year);
- is tax resident in New Zealand;
- is not treated as tax resident in another country under a double tax agreement;
- does not have fifty percent or more of its shares held by a public or local authority, a CRI, or a State enterprise;
- is not an entity established by, or subject to, the Education Act 1989, the New Zealand Public Health and Disability Act 2000, or the Crown Entities Act 2004; and
- is not a listed company or otherwise listed on a recognised exchange.

Example 17: Joint venture partially owned by Crown ineligible

A tertiary education organisation and a State enterprise each have a twenty five percent share of a joint venture company set up to do R&D on a new method of generating electricity through wind turbines. The other fifty percent is owned by Brya, who is a private investor. The joint venture company is unable to receive a refund of its R&D tax credits under new section LA 5(4B) because it is fifty percent owned by the Crown.

Example 18: Residence of shareholders

James is a pumpkin grower who has an idea to develop purple pumpkins that can glow in the dark. James thinks that “glow in the dark” purple pumpkins will appeal greatly to the US market, especially over Halloween. Stephanie, who is an Australian resident, agrees to provide funding for initial research and development on the idea.

James and Stephanie incorporate Purple Pumpkin Ltd (PPL) in New Zealand. James holds thirty percent of the shares in PPL, and Stephanie holds the remaining seventy percent of shares. PPL commences R&D on the idea.

PPL is eligible for refundable R&D tax credits under new section LA 5(4B) because:

- the residence of its shareholders does not affect PPL’s New Zealand tax resident status;
- PPL is in a tax loss position; and
- PPL satisfies the other requirements of LA 5(4B)(a).

Wage intensity criteria must be met ((a)(ii))

The wage intensity criteria are set out in section MX 3. To be eligible, twenty percent or more of a firm’s labour costs must be R&D related. If the company is part of a group of companies, the amount calculated for the R&D group (in the aggregate) should be 0.2 or more. Wage intensity for the R&D tax credit regime is calculated in the same way as for the R&D tax loss cash-out regime.

Company must not derive exempt income

Companies that derive exempt income, or are associated with an entity that derives exempt income, are not eligible for refundable R&D tax credits. These entities will, however, be able to carry their R&D tax credits forward in accordance with section LY 8.

Company must not be a listed company

Listed companies and entities associated with listed companies will not be eligible to refund their R&D tax credits.

R&D tax loss cash-out regime

The R&D tax loss cash-out and the R&D tax credit regimes have different criteria and definitions for eligible R&D activity. A company which cashes out its losses under the R&D tax loss cash-out regime is also able to claim R&D tax credits in the same income year.

The provisions relating to the R&D tax loss cash-out regime in subpart MX are only relevant to the R&D tax credit regime to the extent they are brought into LA 5(4B) for determining a company’s eligibility for refundable R&D tax credits. Other aspects of eligibility for the R&D tax credit regime are determined solely by reference to the requirements in subpart LY.

CARRYING FORWARD SURPLUS R&D TAX CREDITS

Clause 10 (proposed new section LY 8) and 21

Summary of proposed amendment

It is proposed that a taxpayer may carry forward any surplus R&D tax credits to the next tax year. Companies must meet certain shareholder continuity requirements in order for R&D tax credits to be carried forward.

Application date

From the 2019–20 income year.

Key features

Under proposed new section LY 8, a taxpayer may carry forward any remaining R&D tax credits to the next tax year. A company may carry forward those credits if it meets the continuity requirements.

Background

The test proposed above for whether a company can carry forward its remaining R&D tax credits is the same as the test that currently determines whether a company can carry forward its losses.

The rationale behind the continuity requirement is to ensure that substantially the same people who incurred the expenditure giving rise to the R&D tax credit are able to benefit from it when the credit is ultimately applied in satisfaction of a tax liability, or refunded.

Detailed analysis

Under proposed new section LY 8, a person's remaining R&D tax credits for a tax year may be carried forward to the next tax year.

If the taxpayer is a company, the remaining tax credits are extinguished and must not be carried forward unless a group of persons has, for the continuity period:

- minimum voting interests in the company of forty nine percent or more; and
- if a market value circumstance exists for the company in the continuity period, minimum market value interests in the company of forty nine percent or more.

Continuity period

The continuity period starts from the beginning of the income year in which the R&D tax credits arises, and ends on the last day of the income year to which the R&D tax credit has been carried forward to.

Minimum voting interest

A minimum voting interest is the lowest voting interest that a person has in the company. A person's voting interest in a company is determined by the percentage of the total shareholder decision making rights, ascertained from shares or options over shares, the person holds for the company.

Market value circumstance

A market value circumstance exists where a person's voting interest in the company does not accurately reflect their economic interest in the company. The market value interest takes into account debentures, shares, options or other arrangements which could affect the balance of interests within the company so that a simple examination of voting power would be misleading.

Example 19: Company with market value circumstance

R&D Ltd has an R&D tax credit of \$100,000 for the 2019–20 income year. R&D Ltd is a standard balance date taxpayer, and wishes to carry forward its R&D tax credit to the 2020–21 income year. R&D Ltd's shareholding for the relevant period is as follows:

Shareholders	Shares held as at		Minimum voting interests as at 31 March 2021
	1 April 2019	31 March 2021	
James	45	20	20
Steph	30	20	20
Richard	15	35	15
Alison	10	25	10
Total:			65

The continuity period runs from 1 April 2019 the beginning of the income year in which the R&D tax credit arises) to 31 March 2021 (the end of the income year to which the credit is being carried forward to).

The minimum voting interests in the company for the period total sixty five percent. This is greater than the required forty nine percent, therefore R&D Ltd may carry forward its \$100,000 R&D tax credit to the 2020–21 income year.

Example 20: Company with minimum voting interests below forty nine percent

Using the same example as before, but the shareholding is now as follows:

R&D Ltd

Shareholders	Shares held as at		Minimum voting interests as at 31 March 2021
	1 April 2019	31 March 2021	
James	45	0	0
Will	0	45	0
Steph	30	20	20
Richard	15	35	15
Alison	10	25	10
Total:			45

The minimum voting interests in R&D Ltd for the continuity period total forty five percent, so R&D Ltd cannot carry forward its R&D tax credit to the 2020–21 income year.

Other matters

APPROVED RESEARCH PROVIDERS

Clauses 21(3), 24(3), 25 and 36

Summary of proposed amendment

The Bill proposes that a person can apply for the Commissioner's approval to be an approved research provider for the R&D tax credit regime.

Application date

From the 2019–20 income year.

Key features

Proposed new section 15ZB provides that a person is an approved research provider if they apply, the Commissioner approves their application, and the person keeps appropriate records.

The Commissioner will only approve a person if the person is:

- capable of performing R&D activities on behalf of other people;
- has facilities in New Zealand to perform R&D activities;
- is available to perform R&D activities on behalf of third parties; and
- performs, or will perform, R&D activities for other people for market value consideration.

If a person receives approval, the Commissioner has to notify the person and publish their name in a publication chosen by the Commissioner. The Commissioner is able to revoke approval at her discretion, although if she does revoke an approval she must provide the person with the reason for the revocation and specify the date from which the revocation takes effect. A decision made by the Commissioner under the proposed new section cannot be challenged, except through judicial review.

Background

Some businesses may not have sufficient expenditure to satisfy the minimum threshold of \$50,000. These businesses are nevertheless able to be eligible for the R&D tax credit regime if they have approved research provider expenditure. This is to ensure the R&D tax credit regime is accessible to businesses of all sizes.

It is expected that approved research providers will have robust processes in place and will have experience performing R&D activities for other people. For more information on approved research providers and how they interact with the minimum threshold, see the section on *Minimum threshold* (page 49).

PROVISIONAL TAX

Clause 21(17)

Summary of proposed amendment

It is proposed that the R&D tax credit will reduce a person's future provisional tax payments.

Application date

From the 2019–20 income year.

Key features

The definition of residual income tax has been amended so that R&D tax credits are taken into account in determining a person's residual income tax.

Background

A person's residual income tax is their tax to pay after all available tax credits have been subtracted.

Payment of provisional tax is generally based on the taxpayer's residual income tax for the previous year. For example, under the standard method for paying provisional tax the amount payable is 105% of the person's residual income tax for the preceding tax year. By ensuring that R&D tax credits are taken into account in calculating a person's residual income tax, taxpayers using this method will have reduced provisional tax payments in the following year.

Taxpayers who wish to benefit from R&D tax credits via reduced tax payments in the current year may use the estimation method for paying their provisional tax.

ORDERING RULES

Clause 8

Summary of proposed amendment

It is proposed that R&D tax credits are used fourth, in the order of utilising tax credits to satisfy a taxpayer's income tax liability, after credits for imputation credits and before refundable tax credits.

Application date

From the 2019–20 income year.

Key features

It is proposed that section LA 4 is amended so that a person's R&D tax credit is applied to satisfy a person's income tax liability after imputation credits, and before refundable tax credits.

Background

Where a person's tax credit for a tax year is greater than their income tax liability for the tax year, excess tax credits are currently used according to the following order:

1. First, a non-refundable tax credit.
2. Second, a tax credit for a supplementary dividend.
3. Third, a tax credit for an imputation credit.
4. Fourth, a refundable tax credit.

Detailed analysis

The proposed amendment to section LA 4 puts R&D tax credits into fourth place. The rationale behind this is that imputation credits are more likely to be lost than R&D tax credits due to the fact that sixty six percent continuity of shareholding is required to carry imputation credits forward (compared with forty nine percent for R&D tax credits), and therefore should be used before R&D tax credits.

Example 21: Person with imputation credits and tax credits

Keith has an income tax liability for the 2020 tax year of \$50,000. He has \$10,000 of imputation credits and \$50,000 of R&D tax credits. His imputation credits would be first applied to his tax liability, followed by his R&D tax credits. Keith's remaining \$10,000 R&D tax credits would either be carried forward to a future tax year, or refunded (if Keith met the requirements – see the section on *Refundability* (page 56) for more information).

IMPUTATION AND MĀORI AUTHORITY CREDITS

Clauses 11–20

Summary of proposed amendment

The Bill proposes that companies and Māori authorities performing R&D have an imputation credit or Māori authority credit respectively, equal to their R&D tax credit.

Application date

From the 2019–20 income year.

Key features

It is proposed that:

- new section OB 9C grants a company an imputation credit for the amount of R&D tax credits the company is entitled to;
- new section OK 6C grants a Māori authority a Māori authority credit for the amount of R&D tax credits the Māori authority is entitled to;
- new section OP 11C grants a consolidated imputation group an imputation credit for the amount of R&D tax credits the group company is entitled to; and
- the imputation credit or Māori authority credit, as applicable, is credited on the day the relevant entity files its R&D supplementary return for the income year.

Background

Unless an imputation or Māori authority credit (as applicable) is given for an R&D tax credit, the R&D tax credit will be “clawed back” when a company or Māori authority makes a distribution.

Example 22: Company with ICAs but no R&D special credits

Company income:	\$200
R&D expenditure:	<u>\$100</u>
Taxable income:	\$100

Tax at 28%:	\$28
R&D tax credit	<u>(\$15)</u>
Tax to pay:	\$13

ICA result:	
Tax paid:	\$13
R&D special credit:	<u>\$0</u>
	\$13

Retained earnings	
Pre-tax income:	\$100
Less tax expense:	<u>\$13</u>
	\$87

Dividend to 28% shareholder

Cash dividend:	\$87
Imputation credits	<u>\$13</u>
	\$100

Tax at 28%:	\$28
Less ICs:	<u>\$13</u>
Shareholder tax to pay:	\$15.5

By issuing the company with an imputation credit equal to the R&D tax credit, the value of the tax credit is substantially preserved following a distribution.

Example 23: Company with ICAs and R&D special credits

Company income:	\$200
R&D expenditure:	<u>\$100</u>
Taxable income:	\$100
Tax at 28%:	\$28
Tax credit	<u>(\$15)</u>
Tax to pay:	\$13
ICA result:	
Tax paid	\$13
R&D special credit:	<u>\$15</u>
	\$28
Retained earnings	
Pre-tax income:	\$100
Net tax expense:	<u>\$13</u>
	\$87
Dividend to 28% shareholder	
Cash dividend:	\$87
Imputation credits	<u>\$28</u>
	\$115
Tax at 28%:	\$32.2
Less ICs:	<u>\$28.0</u>
Shareholder tax to pay:	\$4.2

Detailed analysis

Companies

Proposed new section OB 9C grants a company an imputation credit equal to the R&D tax credit it is entitled to. This is credited on the date the company files its R&D supplementary return. Proposed new section OP 11C achieves the same effect but for consolidated imputation groups.

An amendment to section OB 4 ensures that a company does not receive an imputation credit for tax paid by crediting an R&D tax credit. This ensures a company does not receive double the amount of imputation credits that was intended – that is, the first amount when the company filed its R&D supplementary return, and the second amount when the company used the R&D tax credit to satisfy a tax liability. A similar amendment has been made to OP 7 to ensure consolidated imputation groups do not receive the imputation credits twice.

Māori authorities

Proposed new section OK 6C grants a Māori authority a Māori authority credit equal to the R&D tax credit it is entitled to. This is credited on the date the Māori authority files its R&D supplementary return.

An amendment to section OK 2 ensures that a Māori authority does not receive a Māori authority credit for tax paid by crediting an R&D tax credit. The rationale is the same as that explained above in relation to companies.

Administrative requirements

RECORD KEEPING

Clause 26

Summary of proposed amendment

It is proposed that taxpayers must keep sufficient records to support their claim for an R&D tax credit.

Application date

From the 2019–20 income year.

Key features

It is proposed that:

- persons who receive an R&D tax credit be required to keep sufficient records to support their R&D claim;
- approved research providers be required to keep sufficient records to show:
 - they meet the requirements to be an approved research provider; and
 - the amounts derived and incurred by them in performing R&D activities on behalf of other persons.

The records must be kept for seven years after the end of the income year to which the records relate.

Inland Revenue will provide further guidance on the records firms are required to keep.

Background

The rationale for requiring taxpayers to keep records is so that they are able to substantiate their claim.

Detailed analysis

Section 22 of the Tax Administration Act 1994, which sets out the keeping of business and other records, is being amended to require persons receiving an R&D tax credit and approved research providers to keep, for seven years, sufficient records so that the Commissioner may readily ascertain:

- the amount of the person's credit; or

- in the case of approved research providers, their compliance with the requirements to be an approved research provider, and the amounts incurred by them in performing R&D activities on behalf of others.

For Inland Revenue to calculate and approve the R&D tax credit, the claim must be based on records which identify the creator and the date of creation, not records which are backdated or created at year end.

These record keeping requirements go beyond the general financial records that businesses must keep under section 22.

Claiming an R&D tax credit

A person claiming an R&D tax credit will need to keep records for seven years to substantiate the following:

- eligibility;
- R&D activity; and
- R&D expenditure.

The type of evidence required to substantiate the above will include project documentation (such as log sheets, project plans and test results), as well as minutes of meetings, internal reports, receipts and contracts.

The onus is on the person claiming the credit to have sufficient records. This means that where the person has engaged a contractor to perform the R&D activities, the person will need to ensure that the contractor provides them with the required evidence, of the activities undertaken and the expenditure incurred.

Business eligibility

Records will need to be kept to evidence the following:

- an R&D activity is performed in New Zealand;
- the person carries on business in New Zealand;
- the person, or a company in the same corporate group has the R&D controlling rights over the R&D activity; and
- that:
 - the person, or a company that is in the same group of companies as the person and is resident in a country with which New Zealand has a double tax agreement, owns the results of the R&D activity; or
 - the person has the ability to use the results for no further consideration.

R&D activity

It is proposed that a person must keep records to demonstrate that the activities they undertook met the definition of R&D activity. The type of records that must be kept include records which show:

- the purpose of the R&D;
- the scientific or technological uncertainty the R&D intends to resolve;
- why that uncertainty could not be resolved by information that is publicly available or deductible by a competent professional;
- the systematic approach that was undertaken to try resolve the uncertainty; and
- the nature of any supporting activities, and evidence to show they were integral to the core R&D activity.

R&D expenditure

Records kept in relation to expenditure will need to be sufficiently detailed to show:

- the connection between the expenditure and the eligible R&D activities;
- that the expenditure is on the list of eligible expenditure, and not on the list of ineligible expenditure;
- evidence of reasonable apportionment methods where the expenditure is incurred on R&D and non-R&D activities. For example, a time recording system or weekly project report to show the extent to which staff costs relate to eligible R&D activities;
- where R&D expenditure is incurred in a commercial production environment (see the section on *Eligible expenditure* (page 30) for more information), evidence that the expenditure is additional expenditure. That is, the expenditure would not have been incurred in the absence of the R&D activity);
- the proportion of expenditure incurred on R&D activities conducted outside New Zealand; and
- the amount of expenditure incurred on internal software development.

Approved research providers

An approved research provider will need to keep records to show that they meet the requirements of proposed new section 15ZB(4):

- are capable of performing R&D activities on behalf of others and are available to do so;
- have, in New Zealand, the necessary facilities to perform those activities; and
- perform, or will perform, those R&D activities on behalf of others for market value consideration.

In addition, an approved research provider will need to keep records of the R&D activities they perform for others and the associated expenditure, to the same detail as described above.

R&D SUPPLEMENTARY RETURNS

Clauses 27–29

Summary of proposed amendment

It is proposed that a person who wishes to claim an R&D tax credit must file an R&D supplementary return within 30 days of filing their tax return for the relevant income year.

Application date

From the 2019–20 income year.

Key features

It is proposed that:

- a person claiming an R&D tax credit must file an R&D supplementary return in an electronic format prescribed by the Commissioner within 30 days of filing their income tax return for the relevant income year;
- the Commissioner must prescribe one or more electronic formats in which a person’s R&D supplementary return must be filed; and
- the Commissioner may also set specifications for software for use in populating the R&D supplementary return.

Background

The rationale behind requiring a person to file an R&D supplementary return is to provide information to substantiate their claim for an R&D tax credit. It is important for the fiscal sustainability of the scheme that the credit is only provided for legitimate R&D. Data will also be used for statistical and analytical purposes, for instance evaluating the R&D tax credit regime policies’ effectiveness.

In the future software will be able to be used to extract relevant information and assist in completing a person’s supplementary return. This is why it is proposed that the Commissioner has the ability to set specifications for such software.

Detailed analysis

R&D supplementary return (clause 27)

Clause 27 proposes that a person must file an R&D supplementary return in an electronic format prescribed by the Commissioner by the date they are required to file their tax return for the year.

The tax credit will be claimed through the person's tax return, with the supplementary return attached as evidence of the claim.

Electronic formats (clause 28)

Clause 28 requires the Commissioner to prescribe one or more electronic formats in which the return must be filed. Prescribing the electronic format includes the way the information must be delivered, as well as the content.

Clause 28 also allows the Commissioner to set specifications for software for use in prepopulating R&D supplementary returns.

Content of supplementary return

In the first year of the tax credit, taxpayers will be asked for a description of their R&D activity and expenditure incurred.

The required information will include:

- Activities:
 - What systematic approach was used to conduct the activity?
 - What new knowledge, process, service or good did the eligible R&D aim to produce?
 - What scientific or technological uncertainty did the activity seek to resolve?
 - Why could the scientific or technological uncertainty not be resolved using publicly available knowledge or knowledge deducible by a competent professional working in the relevant scientific or technological field?
 - For supporting activities, why were they integral to the core activity?
- Expenditure – broken down indicatively into categories such as:
 - Employee remuneration;
 - Depreciation;
 - Consumables;
 - Overheads;
 - Net cost of items used in, or subject to, a process or transformation;
 - Expenditure on internal software development; and
 - Expenditure incurred on R&D activities conducted outside New Zealand.

Taxpayers who are subject to the general in-year approval process (see the section on *Approval: general approval process (year two)* (page 95) for more information) will mainly provide expenditure information with their tax return, as information on their activities will have been provided during the year. However, they will be required to provide a declaration that their activities haven't materially changed from how they

were described in their in-year approval application, and allocate their claimed expenditure to the relevant approved activity.

The onus is on the person claiming the credit to provide the required detail. This means that where the person has engaged a contractor to perform the R&D activities, the person will need to ensure that the contractor provides them with enough information regarding the activities undertaken and the associated expenditure.

Integrity measures

AMENDMENTS TO SECRECY PROVISIONS

Clause 31

Summary of proposed amendment

The Bill proposes amendments to existing secrecy provisions to ensure Inland Revenue is able to communicate information to other state sector entities for evaluating, administering, reporting statistics on, and forming the policy for the R&D tax credit regime.

Application date

From the 2019–20 income year.

Key features

The proposed amendments to section 81(4)(w) and (x) will enable Inland Revenue to share information with other state sector entities. These provisions, as currently enacted, amend Inland Revenue's secrecy requirements for the R&D tax loss cash-out regime.

The proposed amendment to section 81(4)(w) empowers Inland Revenue to share any information reasonably necessary for a representative of the Treasury, Callaghan Innovation, the Ministry of Business, Innovation and Employment (MBIE), or a state sector entity charged with any functions relating to R&D advice or incentives to undertake the following:

- evaluate the R&D tax credit regime in accordance with proposed new section LY 10;
- administer the R&D tax credit and R&D tax loss cash-out regimes;
- report statistics on the R&D tax credit and R&D tax loss cash-out regimes; and
- form policy for the R&D tax credit and R&D tax loss cash-out regimes.

The proposed amendments to section 81(4)(x) allow Inland Revenue to share any information reasonably necessary for a representative of MBIE or Callaghan Innovation to perform their work relating to offering R&D advice and incentives.

Background

The R&D tax credit regime is an MBIE-led cross-agency initiative aimed at encouraging greater levels of business R&D.

New section LY 10 proposes that the Minister of Research, Science and Innovation evaluate the tax credit and report to Parliament every five years. Inland Revenue

needs to be able to communicate to MBIE the information required for the Minister to prepare the report.

It is expected that Inland Revenue, with the assistance of Callaghan Innovation (or another state sector entity), will be primarily responsible for administering the R&D tax credit and R&D tax loss cash-out regimes from the 2019–20 income year.

Inland Revenue intends to share statistical information on the R&D tax credit and R&D tax loss cash-out regimes with Statistics New Zealand, to gain insights about business R&D in New Zealand. Claim information will be integrated into the Statistics New Zealand Longitudinal Business Database and the National Research Information System. Information held by Statistics New Zealand will be anonymised.

Policy formation of the R&D tax credit regime to date has primarily involved Inland Revenue, MBIE, Callaghan Innovation and the Treasury. Any future policy development of the R&D tax credit or R&D tax loss cash-out regimes will continue to be undertaken across multiple state sector agencies. Therefore, Inland Revenue needs to have the ability to share information with other agencies for this purpose.

PUBLICATION OF CLAIM DETAILS

Clause 30 (proposed new section 68CE)

Summary of proposed amendment

The Bill proposes that the Commissioner be required to publish the name of each person, and their eligible R&D expenditure amount in dollar bands, two years after the end of the tax year to which an R&D tax credit claim relates.

Application date

From the 2019–20 income years.

Key features

Proposed new section 68CE requires the Commissioner to publish the names of people who have received R&D tax credits, and the amount of eligible R&D expenditure claimed, in appropriate dollar bands. The Commissioner must not publish a person's name and band until at least two years have passed since the end of the tax year to which the person's R&D tax credit relates.

Background

Publishing the names of R&D tax credits recipients and the bands within which their eligible R&D expenditure claims fall provides transparency about how the R&D tax credit regime is operating.

Similar information is currently published by Callaghan Innovation for Growth Grants. The Commissioner will delay publishing claim information until two years have passed to avoid publishing commercially sensitive information.

Example 24: Claim details publication (illustrative only – actual publication format may vary)

In the 2019–20 tax year:

- Kawhia Ltd claims \$79,00 of eligible R&D expenditure;
- Marsden Ltd claims \$695,000 of eligible R&D expenditure; and
- Northland Ltd claims \$50,000,000 of eligible R&D expenditure.

After 1 April 2022, the Commissioner publishes the following details in an online publication:

Tax year	Claimant	Expenditure band
2019–20	Kawhia Ltd	Less than \$100,000
2019–20	Marsden Ltd	\$500,000 to \$1,000,000
2019–20	Northland Ltd	\$50,00,000 to \$120,000,000

EVALUATION

Clauses 10 (proposed new section LY 10) and 31

Summary of proposed amendment

The Bill proposes that an objective and independent evaluation will be carried out on the R&D tax credit regime every five years.

Application date

From the 2019–20 income year.

Key features

Proposed new section LY 10 of the Income Tax 2007 requires the Minister of Research, Science and Innovation to report to Parliament on the R&D tax credit regime every five years. The first report will be due as soon as practicable after the end of the 2023/24 tax year.

The Minister's report must objectively and independently evaluate the R&D tax credit regime on:

- delivery of the policy intent of the regime;
- to what extent the regime is stimulating expenditure on R&D activities;
- compliance costs of the regime for taxpayers;
- administration costs of the regime for government; and
- the extent to which claimants are complying with the legal requirements of the regime.

The proposed amendment to section 81(w) of the Tax Administration Act 1994 provides Inland Revenue with the ability to communicate the information necessary for an evaluation of the R&D tax credit regime to take place in accordance with proposed new section LY 10.

Background

Other jurisdictions' experience with R&D tax credit regimes indicates that regular, independent evaluations are important to ensure an R&D tax credit regime continues to function as intended. Regular evaluations will ensure any deficiencies with the regime are identified and addressed through legislative or operational change.

FLEXIBILITY: ORDERS IN COUNCIL

Clauses 10 (proposed new section LY 9) and 22 (proposed new schedules 21 and 21B)

Summary of proposed amendment

The Bill proposes that the Governor-General have the ability to make changes to schedules 21 and 21B on the joint recommendation of the Minister of Revenue and the Minister of Research, Science and Innovation.

Application date

From the 2019–20 income year.

Key features

Proposed new section LY 9 empowers the Governor-General to amend proposed new schedules 21 (excluded activities) and 21B (eligible and ineligible expenditure).

Background

The flexibility offered by the ability to amend schedules 21 and 21B by Order in Council is necessary for three key reasons:

- Given the constant and sometimes unpredictable advances of science and technology, it is impossible to fully anticipate all possible R&D activities and determine whether these activities should be incentivised by the R&D tax credit or some other support mechanism. Therefore, having the ability to amend the lists of excluded activities is necessary so that they do not remain static while science and technology continues to progress.
- It enables the Government to make changes to the lists where the Government's policy intent has changed.
- The Government needs to be able to add or remove activities and expenditure from the lists to close off problem areas that could impact on the fiscal sustainability of the R&D tax credit regime.

BINDING RULINGS

Clause 24

Summary of proposed amendment

It is proposed that taxpayers will not be able to obtain binding rulings as to whether they are eligible for an R&D tax credit.

Application date

From the 2019–20 income year.

Key features

The definition of proscribed question has been amended to include a question that relates to R&D tax credits under subpart LY of the Income Tax Act 2007. This prevents taxpayers from obtaining binding rulings, as the Commissioner may not make a private ruling if it would require the Commissioner to determine a proscribed question (section 91E(4) of the Tax Administration Act 1994).

Background

It is proposed that binding rulings are not available in the first year of the R&D tax credit regime as Inland Revenue will not have sufficient resources to consider them. From the 2020–21 income year, most claimants will be required to get in-year approval of their activity to qualify for R&D tax credits (see the section on *Approval: general approval process (year two)* (page 95) for more information).

ANTI-AVOIDANCE RULE

Clauses 7 (proposed new section GB 56) and 10 (proposed new section LY 1(4))

Summary of proposed amendment

Proposed new section GB 56 introduces an anti-avoidance rule for arrangements involving R&D tax credits.

Application date

From the 2019–20 income year.

Key features

Proposed new section GB 56, which introduces an anti-avoidance rule in the context of R&D tax credits, applies where:

- an arrangement has a purpose or effect of defeating the intent and application of the R&D tax credit legislation in subpart LY; and/or
- eligible R&D expenditure for relevant goods and services is more than the market value.

Under the rule the Commissioner may reduce the person's entitlement to the R&D tax credit to the amount the Commissioner considers would have arisen if the arrangement or inflated transaction had not occurred. The rule applies regardless of whether the relevant person is a party to the arrangement or inflated transaction.

Background

The proposed anti-avoidance rule has been drafted broadly to catch expenditure misallocation and contrived R&D activities, even where the person that benefits from the arrangement is not a party to it.

The reconstruction provision refers to reducing the person's entitlement. This means that where there is an offending arrangement, the Commissioner may still give a credit for any legitimate expenditure that is part of the arrangement.

An anti-avoidance rule is necessary to uphold the integrity of the regime and to ensure government money is not misappropriated.

PENALTIES

Clauses 36 and 37

Summary of proposed amendment

It is proposed that the promoter penalty regime is extended to include people offering schemes involving R&D tax credits.

Application date

From the 2019–20 income year.

Key features

Proposed amendments to section 141EC extend the promoter penalties regime to include a person providing services on a contingency fee basis in relation to R&D tax credit claims. This means that promoters of R&D tax credit schemes will be liable for a penalty where the requirements of section 141EB are met.

The Bill proposes amendments to the definition of promoter, so that a promoter includes a person party to, or significantly involved in, formulating software from which an arrangement is offered.

Background

The Bill extends the promoter penalty regime to include promoters of R&D tax credit schemes to disincentivise the promotion of such schemes.

DEADLINES FOR FILING AND AMENDING ASSESSMENTS

Clauses 10 (proposed new section LY 3(2)(a)) and 32–34

Summary of proposed amendment

The Bill proposes to limit taxpayers' ability to retrospectively claim an R&D tax credit.

Application date

From the 2019–20 income year.

Key features

It is proposed that:

- a taxpayer must file their income tax return within one year after the due date for filing if they wish to claim an R&D tax credit;
- the Commissioner may not increase the amount of a person's R&D tax credit after two years from the due date of the person's tax income tax return; and
- an R&D tax credit claim, once filed, can only be amended once. A request to amend a claim must be made within two years of the date on which a person's income tax return is due for the relevant income year.

Background

The rationale behind the above amendments is to limit a person's ability to retrospectively reclassify their expenditure. This includes where R&D activities or expenditure is identified after the end of an income year. If a person receives R&D tax credits for R&D they were unaware of at the time the R&D activities took place, the R&D tax credit regime has not provided any incentive to the person to undertake additional R&D.

The proposed time limits are intended to give people enough time to prepare the required information and make any necessary adjustments to their claims, while discouraging the retrospective reclassification of expenditure.

Detailed analysis

Filing deadline

Proposed new section LY 3(2)(a) prevents a taxpayer from claiming an R&D tax credit if they have not filed their tax return for the relevant year within one year after the due date for filing.

For example, a person with an extension of time arrangement for the year ended 31 March 2019 has to file their income tax return for that year by 31 March 2020. The effect of section LY 3(2)(a) is that if the person has not filed by 31 March 2021 (which is one year after the person's due date for filing), the person cannot make an R&D tax credit claim.

Time bar

The Bill proposes amendments to the time bar in section 108 of the Tax Administration Act 1994, so that the Commissioner cannot increase the amount of a person's R&D tax credit if two years have passed from the due date of the person's tax return for the relevant tax year.

Notice of proposed adjustments (NOPA) and section 113 adjustments

A person is only able to adjust their R&D tax credit claim upwards once, and must do so within two years of the due date of their income tax return for the relevant income year. This restriction applies whether a person issues a NOPA or requests an amendment under section 113.

In-year approval

APPROVAL: GENERAL APPROVAL PROCESS (YEAR TWO)

Clauses 38, 39, 43 and 44

Summary of proposed amendment

The Bill proposes that persons intending to apply for R&D tax credits must, in most circumstances, obtain approval of their core activities for each income year.

Application date

From the 2020–21 income year.

Key features

From the 2020–21 income year, all persons (including LTCs and partnerships) will be required to obtain approval under proposed new section 68CB or section 68CC. The default rule is in proposed new section 68CB, which requires anyone intending to apply for an R&D tax credit for an income year to obtain approval of their core activities (general approval). General approval can last for up to three income years.

Applications for approval must be made by the seventh day of the second month after the end of the relevant income year. For a person with a standard balance date with eligible R&D expenditure in the year ended 31 March 2021, the person would need to apply for general approval by 7 May 2021. Without general approval, a person is not able to obtain R&D tax credits for an income year, unless they satisfy the requirements of, and choose to apply, proposed new section 68CC.

Under proposed new section 68CC, a person may opt-out of the general approval regime if they satisfy certain requirements, including a requirement that the person (or their partnership or corporate group) has, or reasonably estimates that they will have, more than \$2 million of eligible R&D expenditure for the relevant income year. See the section on *Approval: significant performer regime (year two)* (page 99) for more information.

A decision made by the Commissioner under the proposed new sections cannot be challenged, except through judicial review.

Background

General approval is designed to:

- provide certainty;
- act as an integrity measure; and
- shift the timing, and burden, of compliance and administrative costs so that it is easier on both government and people making R&D tax credit claims.

Certainty

General approval is intended to provide people making R&D tax credit claims with greater certainty, because they will be able to obtain approval of their core activities while they are undertaking them. Operational constraints mean that general approval will only be available from the 2020–21 income year.

Integrity measure

Requiring people to obtain general approval acts as an integrity measure, because it ensures they apply for approval of their core activities when (or slightly before or after) they are actually performing their R&D activities. As a result, general approval:

- increases the likelihood that R&D tax credits are only paid out to those persons who were aware that they were performing R&D activities in the relevant income year; and
- makes it easier to identify that there is scientific or technological uncertainty than would be the case if the examination occurred one or two years after the R&D activity has been completed.

Other benefits

In other jurisdictions, government approval of core activities and the certainty this provides has enabled people with approval to obtain R&D funding more easily. In these jurisdictions, lenders take government approval into account when providing funding for R&D activities.

Detailed analysis

General approval not available in year one

General approval will only be available from the 2020–21 income year onwards (see clause 38).

Modification to general eligibility criteria in year two (section LY 3(1)(b))

A proposed amendment to section LY 3, through the insertion of new paragraph (b), ensures that obtaining general approval or opting into the significant performer regime is a prerequisite for any persons seeking to obtain R&D tax credits.

Proposed new section 68CB sets out the general approval process. Section 68CC provides an alternate approval process for persons who have \$2 million or more of eligible R&D in an income year and choose to opt out of the general approval process.

Application deadline

Applications for general approval must be made by the seventh day of the second month after the end of the relevant income year.

Example 25: Application deadline for standard balance date taxpayer

Taylor Ltd has a 31 March balance date. It wants to obtain general approval for the year ended 31 March 2021. Taylor Ltd will need to ensure it applies for general approval by 7 May 2021.

Example 26: Application deadline for non-standard balance date taxpayer

Pym Ltd has a 31 December balance date. It wants to obtain general approval for the year ended 31 December 2020. Pym Ltd will need to ensure it applies for general approval by 7 February 2021.

Application requirements

Applications for general approval must set out the activities a person wants approved as core activities, the income years the person wants the general approval to apply for, and any other information required by the Commissioner.

Once general approval is granted, the Commissioner must notify the person which activities are approved as core activities, the income years for which the general approval applies, and any conditions of the general approval.

The Commissioner's decision to approve or reject a general approval application cannot be challenged.

Impact on core and supporting activities

General approval can only be obtained for core activities. Expenditure on supporting activities is only eligible to the extent the supporting activities relate to approved core activities.

General approval is binding if certain requirements are met

General approval is valid and binding on the Commissioner if:

- a person's application is accurate;
- the person satisfies any conditions of the general approval that have been set by the Commissioner; and
- there is no change to subpart LY (and any associated provisions) that materially alters the basis on which the general approval was provided.

If the Commissioner has provided general approval for more than one income year under section 68 CB(3), then the person must provide the Commissioner with confirmation that they have continued to satisfy the conditions of their general approval.

Varying an existing general approval

A person can apply to vary an existing general approval if their circumstances change. An application to do this must be submitted by the seventh day of the second month after the end of the relevant income year (which is the same application deadline for new general approval applications).

Opting out of the general approval regime

A person can opt out of the general approval regime if they satisfy the requirements of proposed new section 68CC(1), which says that section 68CC applies if a person:

- chooses to opt out of the general approval regime; and
- has more than \$2 million of eligible R&D expenditure for the relevant income year, or reasonably estimates that they will have more than \$2 million of eligible R&D expenditure for the relevant income year.

A person can also satisfy the \$2 million threshold by grouping their expenditure with other members of their corporate group. A person in partnership with others is not assessed individually. The person satisfies the \$2 million threshold if their partnership has more than \$2 million of eligible R&D expenditure in an income year.

APPROVAL: SIGNIFICANT PERFORMER REGIME (YEAR TWO)

Clauses 38, 39, 42, 43 and 44

Summary of proposed amendment

The Bill proposes that persons with more than \$2 million of eligible expenditure in an income year have the ability to opt out of the general approval process and into the significant performer regime.

Application date

From the 2020–21 income year.

Key features

From the 2020–21 income year, all persons will be required to obtain approval under either proposed new section 68CB or section 68CC. The default rule is general approval, which is in proposed new section 68CB. See the section on *Approval: general approval process (year two)* (page 95) for more information.

An alternative to the general approval process, the significant performer regime, is available to persons who have (or reasonably estimate that they will have) more than \$2 million of eligible expenditure in an income year. A person must notify the Commissioner if they wish to opt out of the general approval process and into the significant performer regime.

A decision made by the Commissioner under the proposed new sections cannot be challenged, except through judicial review.

Significant performer regime requirements

People who opt into the significant performer regime are not able to obtain general approval of their core activities. Instead, they need to notify the Commissioner of their intention to opt into the significant performer regime, and provide an estimate of the amount of eligible expenditure they expect to incur for the income year. All people in the significant performer regime must provide R&D certificates alongside their R&D supplementary returns.

Optional criteria approval

People in the significant performer regime can apply for approval from the Commissioner of their criteria and methodologies for determining the eligibility of their R&D activities and expenditure (“criteria approval”). Criteria approval is optional, and can be granted for up to three income years.

The Commissioner can revoke a criteria approval from the beginning of an income year if she considers that a person has classified their activities or expenditure in a

way that defeats the intent and purpose of the R&D tax credit regime. The Commissioner's decision to grant, decline, or revoke a criteria approval cannot be challenged.

Background

Significant performers are exempt from the general approval process, if they wish to be, because:

- the size of their R&D spend indicates they are mature R&D performers who are likely to have robust systems in place; and
- they are less likely to desire the certainty provided by in-year approval, as the maturity makes them more likely to know whether their activities are eligible core or supporting activities.

Significant R&D performers must notify the Commissioner by the seventh day of the second month after the end of the relevant income year if they want to opt-out of the general approval regime. This deadline is the same for general approval applications, for ease of compliance and administration.

Requiring significant R&D performers to obtain R&D certificates will provide the Commissioner with the assurance that these claimants have the processes expected of mature R&D performers.

Detailed analysis

Modification to general eligibility criteria in year two (section LY 3(1)(b))

A proposed amendment to section LY 3, through the insertion of new paragraph (b), ensures that obtaining general approval or opting into the significant performer regime is a prerequisite for any persons seeking to obtain R&D tax credits.

More than \$2 million of eligible R&D expenditure

For a person to be eligible for the significant performer regime, they must have (or reasonably expect that they will have) more than \$2 million of eligible R&D expenditure for the relevant income year. The expenditure of partners in partnership, as well as companies in the same group of companies, can be grouped when determining this.

Example 27: Partners in partnership

Mike and Jay are in partnership together. In the 2020–21 income year, both partners reasonably expect to incur less than \$2 million of eligible R&D expenditure individually, but as a whole the partnership will satisfy the \$2 million threshold.

**Estimate of eligible R&D expenditure
for the year ended 31 March 2021**

Partner	Expenditure
Mike	\$1.5m
Jay	\$1.2m
Total	\$2.7m

The partnership is able to opt in to the significant performer regime because it reasonably expects to incur \$2.7 million of eligible R&D expenditure in the 2020–21 income year.

Example 28: Members of the same corporate group

Papaya Ltd reasonably estimates that it will have \$1.5 million of eligible R&D expenditure for the 2020–21 income year. It is wholly owned by Tropical Fruit Ltd, which also owns Mango Ltd.

Mango Ltd reasonably estimates that it will have \$800,000 of eligible R&D expenditure for the 2020–21 income year.

Papaya Ltd and Mango Ltd are able to group their expenditure to determine their eligibility for the significant performer regime. Since their combined expenditure estimate is \$2.3 million, they satisfy the \$2 million threshold.

Notification deadline

People who wish to opt in to the significant performer regime must notify the Commissioner by the seventh day of the second month after the end of the relevant income year. They must also notify the Commissioner of their expenditure estimate by this date.

Example 29: Notification deadline for standard balance date taxpayer

Rainbow Ltd has a 31 March balance date. It has \$2.5m of eligible R&D expenditure for the year ended 31 March 2021.

If Rainbow Ltd wants to opt in to the significant performer regime, it will need to notify the Commissioner and provide an expenditure estimate by 7 May 2021.

Example 30: Application deadline for non-standard balance date taxpayer

Pot of Gold Ltd has a 31 December balance date, which is an early balance date. It reasonably expects to incur \$3 million in the year ended 31 December 2020, and wants to opt into the significant performer regime.

Pot of Gold Ltd notifies the Commissioner of its intention to opt into the significant performer regime on 1 February 2021. It provides the Commissioner with a summary of the expenditure it estimates it has incurred in the year ended 31 December 2020.

Pot of Gold Ltd has complied with the requirement that notification must be provided to the Commissioner by the seventh day of the second month following the end of the relevant income year.

R&D certificates

If a person opts into the significant performer regime, they are required to supply the Commissioner with an R&D certificate alongside their R&D supplementary return (see the section on *R&D supplementary returns* (page 78) for more information).

The information R&D certificates must contain is not prescribed by legislation, but it is expected that R&D certificates will confirm that:

- an R&D certifier (typically a law or accounting firm) has reviewed a sample of a person’s eligible R&D expenditure;
- the expenditure sample reviewed by the R&D certifier was calculated in accordance with the R&D tax credit rules; and
- the person actually incurred, or was reasonable in estimating that they would incur, more than \$2 million of eligible R&D expenditure in the relevant income year.

R&D certifiers

Proposed new section 15ZC sets out the requirements for R&D certificates and R&D certifiers (referred to as “accepted research and development certifiers” in the Bill).

A person is an R&D certifier if they:

- have requested approval from the Commissioner in the prescribed form;
- have not had their R&D certifier approval revoked in the last two years;
- have made a statutory declaration that they are competent in applying appropriate accounting and legal standards in relation to R&D tax credits;
- have declared any other matters the Commissioner requires them to declare for assuring the Commissioner that they have the legal, accounting, and scientific expertise to complete R&D certificates; and
- the Commissioner approves their application.

Once the Commissioner approves a person's application to be an R&D certifier, the Commissioner must notify the person and publish the approval in a publication chosen by the Commissioner.

The Commissioner is able to revoke approval of an R&D certifier at her discretion. If approval is revoked, this must be published in a publication chosen by the Commissioner.

If an R&D certifier provides an R&D certificate to a person in relation to an income year, and the person subsequently receives a shortfall penalty in relation to R&D tax credits for the income year, the Commissioner must revoke the R&D certifier's approval. The Commissioner will not revoke an approval, however, where a person has wilfully misled the R&D certifier. Once approval is revoked, the R&D certifier may not be reinstated as an R&D certifier for two years.

The Commissioner's decision to approve, decline to approve, or revoke the approval of an R&D certifier cannot be challenged.

Optional criteria approval

People who opt into the significant performer regime are able to apply for optional criteria approval.

Application requirements

Applications for criteria approval must detail:

- the criteria and methodologies the person wants the Commissioner to approve;
- the income years the criteria approval will apply for; and
- any other information required by the Commissioner.

Commissioner's approval

The Commissioner is able to approve appropriate criteria methodologies that the person can use to determine whether their R&D activities and expenditure are eligible. Once criteria approval is granted, the Commissioner must notify the person what criteria and methodologies the Commissioner approves of, the period for which the criteria approval applies, and any conditions of the criteria approval.

Approval is binding on the Commissioner if certain requirements met

Criteria approval is valid and binding on the Commissioner if:

- a person's application is accurate;
- the person satisfies any conditions of the criteria approval that have been imposed by the Commissioner;
- there is no change to subpart LY (and any associated provisions) that materially alters the basis on which the criteria approval was provided; and

- the person satisfies the other requirements of the significant performer regime (that is, the person satisfies the \$2 million threshold and supplies an R&D certificate alongside their R&D supplementary return).

Commissioner can revoke criteria approval

The Commissioner can revoke a criteria approval from the beginning of an income year if she considers that a person has classified their activities or expenditure in a way that defeats the intent and purpose of the R&D tax credit regime. The Commissioner's decision to approve, decline to approve, or revoke a criteria approval cannot be challenged.

Appendices

APPENDIX 1: ADMINISTRATION

The Bill contains requirements about a person's compliance obligations so that they can receive the tax credit, such as:

- record keeping (see the section on *Record keeping*, page 75);
- electronic filing and deadlines for filing (see the section on *R&D supplementary returns*, page 78); and
- in-year activity approval (see the section on *Approval: general approval process (year two)*, page 95).

This appendix covers how the R&D tax credit will be administered.

The tax credit will be administered by Inland Revenue with support from Callaghan Innovation. Callaghan Innovation will bring technical research and scientific knowledge to support the on-going administration of the tax credit.

Businesses will not be able to receive the tax credit in the same year as a Callaghan Innovation Growth Grant. Businesses who currently receive a Growth Grant will be supported through their transition by Callaghan Innovation.

There will be a dedicated R&D tax incentive delivery team to manage the approval processes and general support to businesses considering and applying for a R&D tax credit.

Businesses will apply for the tax credit through a calculation on the corresponding income tax return and by submitting an electronic supplementary return which details the associated R&D activity and expenditure. This will also include any relevant eligibility tests and calculations about the refundability of the tax credit for businesses in loss.

Businesses will be able to apply for both the tax credit and the existing R&D tax loss cash-out (as provided for by subpart MX) in the same financial year. Businesses will need to submit full application information to satisfy the eligibility criteria for both of these, however there will be support available to assist them through the process.

The first year of the tax credit will be administered as a complete end-of-year process at the same time as the filing and processing of a business's income tax return. From year two of the tax credit businesses will be required to seek in-year activity approval, and submit end-of-year expenditure information.

From year two of the tax credit, for in-year approval there will be two regimes available:

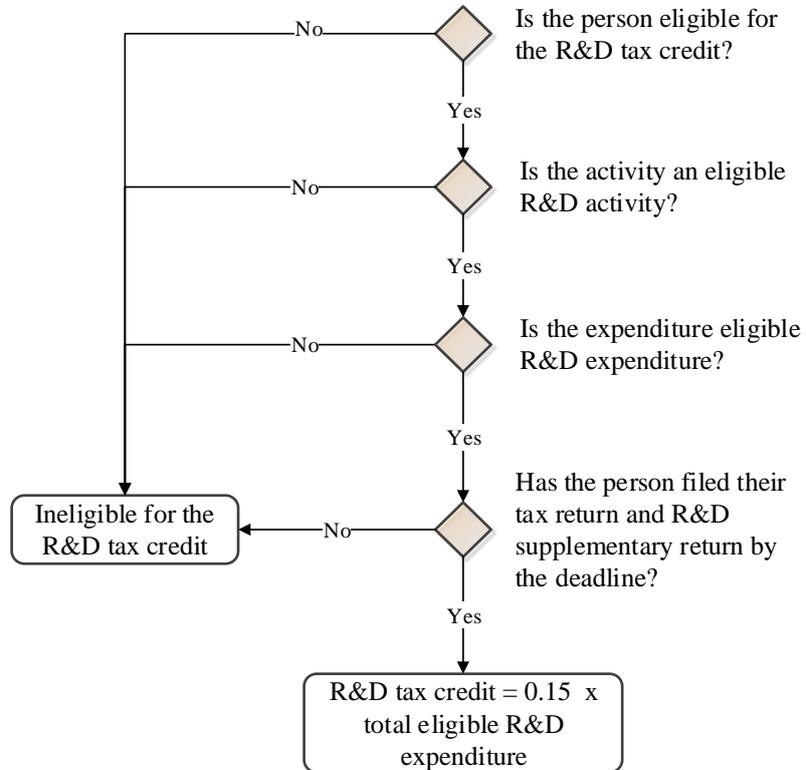
- general approval process – any eligible R&D performing business; and
- significant R&D performer – businesses who expect to spend in excess of \$2 million on eligible R&D expenditure.

Organisations will be able to apply to Inland Revenue to become approved research providers for the tax credit. From year two, organisations will be able to apply to become approved R&D certifiers for the significant R&D performer approval.

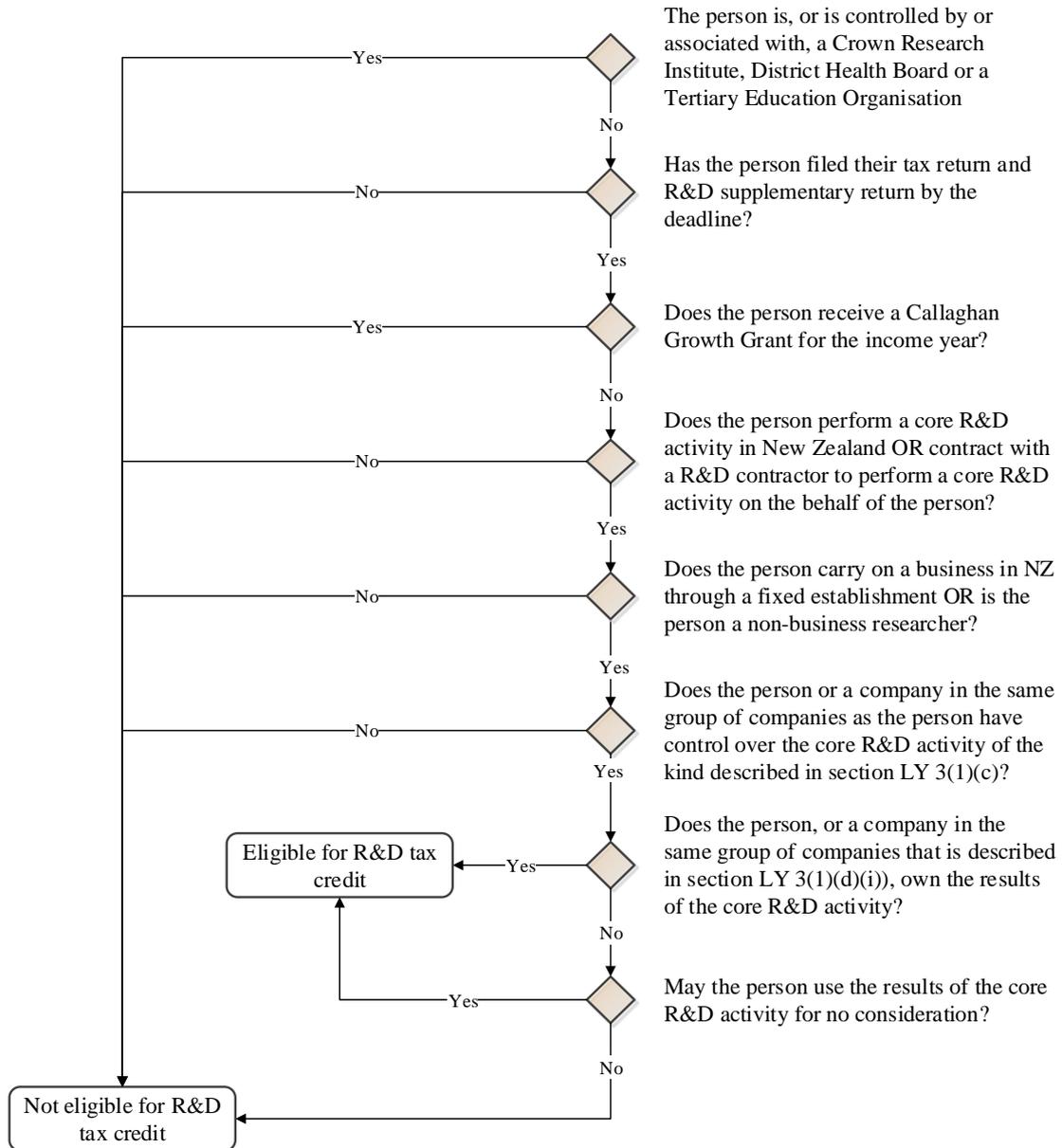
Once the Bill is enacted Inland Revenue will publish more detailed information about the administration of the R&D tax credit, such as detailed record keeping guidance, process for becoming an approved research provider, the tax credit service model, electronic tax credit enrolment process, approval processes, and the electronic application process.

APPENDIX 2: FLOW CHARTS

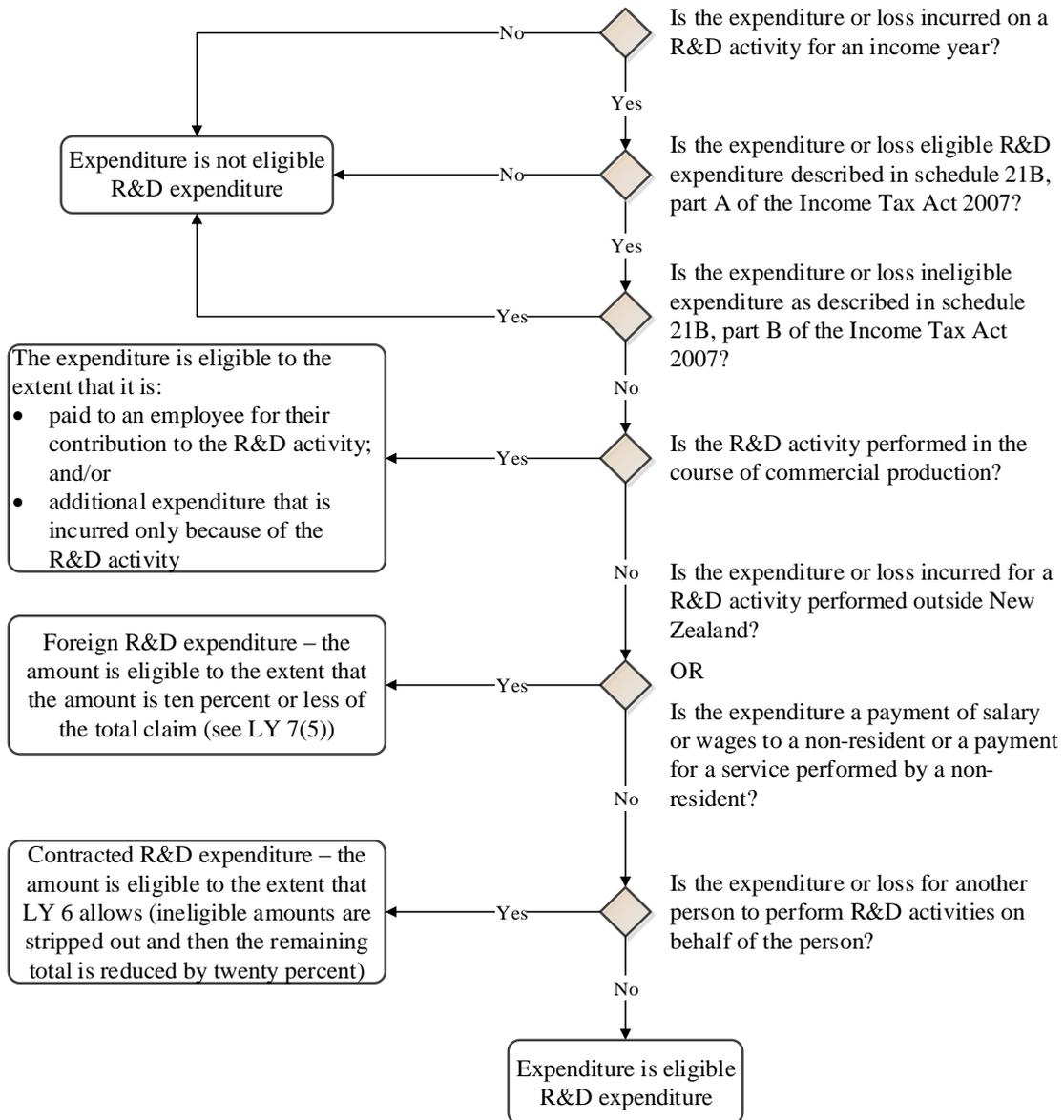
Flow chart 1: Outline of the R&D incentive policy



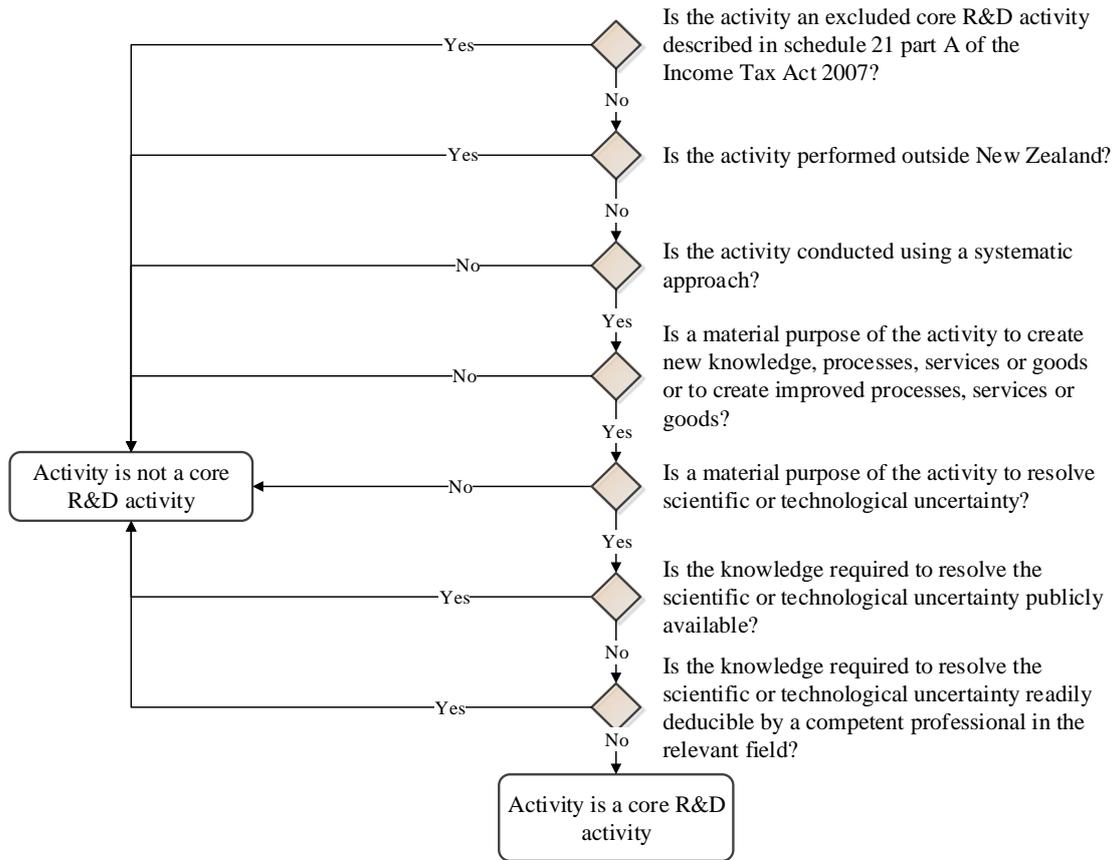
Flow chart 2: Is a person eligible for the R&D tax credit?



Flow chart 3: Is expenditure eligible R&D expenditure?



Flow chart 4: Is an activity a core R&D activity?



From year two, core R&D activities will require approval under either section 68CB or 68CC of the Tax Administration Act 1994

Flow chart 5: Does a person have an amount of R&D tax credit to be refunded or carried forward?

