

Tax Credit Regime – An overview

A proposed 15 per cent tax credit for businesses doing eligible R&D is in a bill before Parliament. Inland Revenue will begin consulting with a range of stakeholders and interested parties on the draft guidelines for the R&D tax credit. This is expected to happen from late December 2007 to mid-February 2008.

The draft guidelines will be made available on the IRD's website consultation page as soon as possible following enactment of the legislation.

Subject to the all of the above the following provides an outline of what can be expected in the new tax credit regime.

Is your business eligible?

There is no restriction on the type of entity that can claim: partnerships, companies and trusts are eligible.

Broadly speaking, to be entitled to claim an R&D tax credits your business must meet the following criteria:

- Carry on business in NZ as a resident or through a fixed establishment or be an industry research cooperative.
- Carry out R&D related to the entity's business or intended business and control the R&D activities.
- Bear the financial and technical risk of the R&D and effectively own the results of the R&D.
- Incur eligible expenditure for the tax year of at least \$20,000 (there is an exception to this rule where the R&D is contracted to a listed research provider).
- Not be a Crown Research Institute, tertiary institution, or a district health board or be controlled by or associated to these entities.

What R&D activities will qualify for the tax credit?

Core activities

These are systematic, investigative and experimental activities that:

- seek to resolve scientific or technological uncertainty, or
- involve an appreciable element of novelty and that are carried out for the purposes of:
 - i. acquiring new knowledge; or
 - ii. creating new or improved materials, products, devices, processes or services.

This means that they need to be planned activities directed towards a particular purpose and that that the R&D must follow a logical progression of work involving:

- Hypothesis
- Experiment
- Observation, and

- Evaluation.

In addition other activities that support core R&D activities can be eligible. These are termed supporting activities. Supporting activities are not eligible *per se*.

What activities will be excluded?

The following activities are excluded from being core R&D activities, but can be supporting activities:

- Exploring for minerals, petroleum, natural gas or geothermal energy.
- Research in social sciences, art or humanities.
- Market research or market development.
- Quality control or routine testing of products, processes or services.
- Cosmetic or stylistic changes to products, processes or services.
- Routine collection of information.
- Commercial, legal and administrative aspects of patenting, licensing etc.
- Activities involved in complying with statutory requirements or standards.
- Management studies or efficiency studies.
- The reproduction of a product or process (from existing systems/blueprints/publicly available information etc).
- Pre-production activities such as demonstration of commercial viability, tooling up and trial runs.

What costs can I claim?

Costs relating to R&D activities including:

- Salary & wage related costs. This includes allowances, bonuses and fringe benefits
- Depreciation of assets used or available for conducting R&D.
- Training, recruitment, relocation and travel for costs incurred directly for R&D activities.
- The cost of consumables.
- The net cost of items processed or transformed in the R&D process.
- Expenditure on materials incorporated into a trial model or preliminary version of a product or plant.
- Overhead costs that are incurred directly for the R&D e.g. administration, personnel, repairs & maintenance, cleaning & security, rates, utilities, insurance & leasing of buildings, plant & equipment.
- Payments to people and organizations conducting R&D on your behalf.

What types of expenditure can't be claimed?

Some expenditure is excluded from being claimed, this includes:

- Interest.
- Depreciation on property created by R&D.
- Expenditure or depreciation incurred in purchasing, leasing or obtaining a right to use core technology.
- Internal software development costs exceeding \$2,000,000.

- Expenditure or depreciation incurred in R&D activities conducted outside NZ where these costs exceed 10% of the eligible amount (calculated on an annual basis).
- Expenditure funded from a government grant or any required co-funding for a grant.
- The costs of acquiring intangible assets.
- Professional fees incurred in determining whether activities are R&D activities or whether the person or expenditure is eligible.
- Expenditure under a financial arrangement.

What documentation will be needed to support R&D claims?

R&D activities will need to be described in the manner and format required by IRD and documentation supporting claims will need to be maintained. This will involve:

- Having internal supporting documentation/R&D plans for each project.
- Maintaining an appropriate level of technical and financial documentation to support all technical claims made (e.g. test reports, technical data, expenditure schedules, overhead cost allocation schedules).

Businesses will be able to claim the tax credit in conjunction with their annual income tax return process for the 2008-09 income year. They will need to file a detailed R&D tax credit claim form, which must be done on line, by the business's normal filing date.

If you would like to discuss how this may affect your business or would like assistance in assessing your eligibility and establishing documentation systems for your R&D please contact us at activate@catalystnz.co.nz .

We also recommend that you discuss the implications of R&D tax credits with your accountant or financial advisor.