



Research and Development Tax Incentive Eligible Activity Brief



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1 CORE R&D ACTIVITY

Core research and development activity means an activity that:

- "(i) is conducted using a systematic approach; and
- (ii) has a material purpose of creating new knowledge, or new or improved processes, services, or goods; and
- (iii) has a material purpose of resolving scientific or technological uncertainty;

But does not include an activity, if knowledge required to resolve the uncertainty, is

- (i) publicly available:
- (ii) deducible by a competent professional in the relevant scientific or technological field.

A systematic approach is a methodical (organised and planned) approach to formulate and test possible solution(s) to the uncertainty. How this looks will be different in different sectors. Also, to claim the tax credit your activity cannot be on the list of excluded core research and development (R&D) activities. The flowchart on the next page will help you determine if your activity is a core R&D activity".





1 SUPPORT R&D ACTIVITY

Support R&D Activity

To qualify for the tax credit, a supporting R&D activity must both:

- support the core R&D activity as its only or main purpose
- be required for and integral to the core R&D activity.

In addition, the supporting R&D activity cannot be on the schedule of excluded supporting research and development (R&D) activities (refer page 47 of the Guidance Document).

A core R&D activity may have a number of supporting R&D activities.

Supporting activities can take place before, during or after the relevant core R&D activities.



1 SUPPORT R&D ACTIVITY

Qualifying Support R&D Activities

Activities which could qualify as supporting activities include:

- Literature searches to determine if there is an existing solution.
- Work undertaken to formulate your idea, proposition or hypothesis, so that it can be tested.
- Planning a series of tests, prototypes, or the necessary analysis.
- Writing specialised software to monitor R&D results.
- Designing and producing equipment to be used in testing or analysis.
- Routine crop management of plants required for core R&D activity.
- Documenting the R&D results to meet an internal stage gate or approval process.
- Disassembling testing equipment or prototype and/or disposing of waste material.

Only or Main Purpose Test

- Supporting activities must only be performed for the relevant core activity or must have supporting the core activity as its main purpose.
- If your activity supports a core R&D activity but also supports another purpose, you must assess what the main purpose of the activity is.



Notes



2 EXCLUDED R&D ACTIVITIES

Activities Excluded from Being a Research and Development (R&D) Activity

Refer to the section of the IRD's Guide entitled "Activities excluded from being a research and development (R&D) activity".

The following activities are excluded R&D activities and are described in further detail in the IRD's guide.

- Pre-production activities and reverse engineering
- Minor adaptions, cosmetic or stylistic changes or improvements, including to software
- Software testing, debugging, maintenance and conversion related exclusions
- Ineligible internal software development
- Prospecting for, exploring for, or drilling for, minerals, petroleum, natural gas, or geothermal energy
- Market research, market testing, market development, or sales promotion, including consumer surveys
- Patenting and complying with statutory requirements and standards
- Social sciences, arts, humanities, organisational design and management studies
- Quality control, routine testing, routine collection of information and routine operations on data.



Notes



3 RECORD KEEPING

IRD's Record Keeping Requirements

The records required to support a claim for a research and development (R&D) tax credit will go beyond the financial records normally required to be kept for tax purposes. Records need to be available to support that:

- your business is eligible to claim the R&D tax credit
- the R&D activity is eligible, and
- your R&D expenditure or depreciation loss is eligible.

You are not required to send us your R&D records with your application for the tax credit. Your records will help you complete your R&D supplementary return (and from the 2021 income year your application for in-year approval) and they must be available if we ask to see them. Records for your R&D do not need to be kept on paper but as for all other tax records you are required to retain records, in an accessible state, for 7 years. The general record keeping requirements for business records apply for the R&D tax credit. For example, every person undertaking business in New Zealand must:

- record income, expenses, assets and liabilities
- keep records for seven years after the end of the tax year they relate to
- · keep records in English, unless we approve you using another language, and
- keep electronic records in a format that allows us to readily work out the amount of tax payable.



3 RECORD KEEPING

IRD's Record Keeping Requirements

The administrative records of your R&D will need to be produced in the event that your claim for a tax credit is selected for audit. Therefore, the records must contain clear and explicit information about the costs incurred and expenditure claimed for R&D tax credit.

Knowledge management is an essential feature of commercially driven R&D. Good R&D record keeping has other associated benefits, including to:

- record new knowledge and lessons
- track risks and successes
- review objectives and milestones
- track progress and stages
- record the specific costs of the R&D programme
- meet compliance and reporting requirements
- accurately record and calculate eligible expenditure
- support a claim for a tax credit.



3 RECORD KEEPING

IRD's Record Keeping Requirements

If your research and development (R&D) supplementary return is selected for audit or review, it is essential that you have retained sufficient documentation to support the expenditure claimed as eligible for the tax credit. The level of documentation should be appropriate to the scale of the project.

For more detail about general record keeping requirements at www.ird.govt.nz (search keywords: record keeping).



Records to Demonstrate you have R&D Activity that meets the Definition

IRD advise "To claim the tax credit, you must have records which demonstrate that your activities meet the definition of eligible R&D activities. The following information must be recorded and kept.

- The purpose of the R&D it must be for new knowledge or a new or improved process, product or service.
- The scientific or technological uncertainty (the question) that the systematic approach is intended to resolve.
- How you know the uncertainty could not be resolved based on publicly available information or deduced by a competent professional.
- The systematic approach that was undertaken in an attempt to resolve the uncertainty (these are the core R&D activities). The activities must be described in enough detail to show that they are not on the list of excluded activities.
- The nature of any supporting activities that are only, or mainly, for the purpose of supporting the core R&D activity.

Once you have identified that you are dealing with a scientific or technological uncertainty our recommendation is that your standard project documentation should be used as much as possible to capture the required information."



Purpose

You must record the purpose of the R&D. What new knowledge, or new or improved product, process or service are the core R&D activities directed towards?

Evidence that supports the requirement that the knowledge, product, process or service is new or improved should also be documented. The test is not that it is new or improved for your business or in New Zealand, but on a worldwide basis. This information might be recorded in work done to assess the state of the market or in patent or web searches or from discussions with industry colleagues. This information should be documented and retained.



Scientific or Technological Uncertainty

One of the material purposes of your core research and development activity must be to resolve scientific or technological uncertainty otherwise your expenditure may not qualify for the tax credit.

You must document the scientific or technological uncertainty that your core R&D activity is seeking to resolve. This is the question(s) that the systematic approach is undertaken to answer.

Project commissioning and initiation reports often focus more on the commercial uncertainties than the technological and we recognise that commissioning documents are often written stressing the prospects of success rather than the scale of scientific or technological challenge. However, if there is scientific or technological uncertainty in the project you should include a section somewhere in your core project documentation identifying it.

To document the uncertainty, you should identify the issue(s) that you do not know whether you can resolve (the uncertainty or uncertainties) focussing on the scientific or technological dimensions and what it is that makes the issues difficult. If this information is included in your project documentation you will have simplified the subsequent process of completing your research and development (R&D) supplementary return (and from the 2021 income year your application for general approval.



Scientific or Technological Uncertainty

Experience with the 2008 R&D tax credit and from overseas jurisdictions suggests that the key to effectively describing scientific and technological uncertainties is early involvement of the research or technical staff. Identification of the uncertainty should allow you to track the activity to resolve it, and the related expenditure, through an additional layer in your existing project management system(s). This will reduce your compliance costs.

If the scientific or technological uncertainty was not recognised when the project began but emerged subsequently you should document the uncertainty as soon as you recognise it. This might be in a standalone document. However, you will simplify and improve the process of tracking the eligible activity, and the related expenditure, if you add it to your normal project management system and track it from there.



State of Knowledge

You should record the state of knowledge which existed when the R&D was undertaken. This information is required to demonstrate that the knowledge to resolve the uncertainty wasn't publicly available or deducible by a competent professional when you began your core R&D activity. This is particularly important in fast moving fields where others may be working on the same problems.

Many businesses undertake this work in scoping the situation and looking for solutions before undertaking R&D activity. The state of knowledge might be recorded in the results of literature reviews or in patent or other searches, in articles in trade or professional journals or in advice from competent professionals who know the state of knowledge in the relevant field. You should document and retain this information, or a summary of it.



Systematic Activity

You must record the start and end date of the core R&D activity and the systematic approach undertaken to resolve the uncertainty. This will require a description of the investigations, tests, analysis or experiments undertaken and whether the results resolved the uncertainty.

A single business project may be made up of both eligible activities and activities that are not directed towards resolving scientific or technological uncertainty. In addition, there may be activities which are on the schedule of excluded research and development (R&D) activities.

To support a claim for the tax credit your record keeping should be sufficiently detailed to differentiate between eligible activities and those which are ineligible because they serve another purpose or because they are excluded activities. As noted above you should if possible capture this information by establishing the core R&D activity as a deliverable (or other appropriate artefact) in your project management system.

Different industries and sectors will have different approaches to documenting their R&D activities. Record keeping for the tax credit should largely derive from standard project documentation such as project plans, test results, sprint documentation or stage gate reports. Further discussion of appropriate record keeping in different environments appears in the section on Records to demonstrate you have R&D activity that meets the definition.



Eligible Support Activities

If you have a core R&D activity that meets the definition, there may also be eligible supporting R&D activity.

If you claim for supporting activity, you must be able to show that the supporting activity or activities, were required for and integral to the core R&D activity and had the only or main purpose of supporting the core R&D activity. In addition, there must be enough detail so that the claimed activity can be seen to not be on the list of activities excluded as supporting activities.



3 RECORD KEEPING - Importance of Project Management and Record Keeping Systems

Importance of Project Management and Record Keeping Systems

You will need to plan for how you are going to record your R&D activities and expenditure. If you haven't already, you will need to implement a suitable project management or record keeping system to keep track of your R&D project and supporting information.

Having a system will assist you to complete the research and development (R&D) supplementary return and calculate the expenditure claim. It will also help you have the relevant project and expenditure information to hand in case your claim is selected for review.

The key requirement is to make sure that where a scientific or technological uncertainty is known to exist, or emerges, the activities required to resolve it are captured as a deliverable or deliverables in their own right and that expenditure is appropriately recorded or apportioned against those deliverables. This will often require the use of additional project costing codes to capture the expenditure or provide a basis for apportionment.

A description of the scientific or technological uncertainty should be included in the description of the deliverable and routine reporting on progress with deliverables should include information that demonstrates that systematic activities were undertaken to resolve the uncertainty.



3 RECORD KEEPING -Record Keeping When you use a Contractor

Record Keeping When you use a Contractor

Where you use a contractor (including an approved research provider) to undertake R&D on your behalf you remain responsible for the content of your supplementary return/request for general approval, and for the tax position you take in your income tax return. To enable you to make and support your claim you should make sure the contractor keeps appropriate records and that you can access them. What this will look like will vary depending on the work you have contracted but if your contractor has been involved in your R&D from the beginning it will include being able to access records that document the investigation of the state of knowledge and which identify the scientific and technological uncertainty.

The information you should require your contractor to keep will include both the information you need to file your supplementary return (from year two the information you need to apply for general approval) and additional information to support the claim should we have questions.

If your contract includes work that does not meet the definition of an R&D activity, you will need to make sure the records are sufficiently detailed to separate the payments made for the core and supporting R&D activity, from the other work.



Record Keeping When you use a Contractor

You might do this by making sure the eligible and ineligible activities are separately categorised in the schedule of work and agreeing that you will be invoiced on the basis of these categories with enough description of the eligible activities to allow you to complete the supplementary return. Alternatively, you might agree to an itemisation of the activities that you will be charged for, sufficient to enable you to classify them as eligible R&D activities or as ineligible.

In addition to ensuring that you only claim for contractor expenditure on eligible R&D activity you will be required to confirm that the expenditure for which you claim the tax credit:

- was of a type included in the schedule as eligible expenditure, and
- was not on the schedule of ineligible expenditure.



3 RECORD KEEPING -Record Keeping When you use a Contractor

Record Keeping When you use a Contractor

You might satisfy this requirement by requiring your contractor to advise you of the subtotal spent or incurred on ineligible expenditure types, or alternatively to confirm in writing that all of the expenditure on eligible R&D activity was eligible expenditure.

It is possible that we may follow up with you to seek further information about the claimed activity or expenditure and you should have an arrangement in place whereby you can access this information from you contractor if it is required to support your claim.

Note.

We will not follow up directly with your R&D contractor without your knowledge but if you cannot source or arrange for us to access the required information for your claim, or request for in year approval, we may not be able to progress your application.



3 RECORD KEEPING - Contemporaneous Record Keeping

Contemporaneous Record Keeping

IRD advise "The legislation requires anyone who claims the tax credit to keep sufficient records to allow us to readily ascertain the amount of the tax credit.

For us to be able to readily ascertain the amount of the tax credit, the claim should be based on records kept at the time the R&D was done (contemporaneous records). The credibility of your records will be improved if they identify the author/creator and date of creation.

There is no absolute standard for how frequently a record must be kept for it to be seen as contemporaneous, but the records must be timely and not backdated or created at the end of the year."



- R&D project plans
- R&D resources and their allocation
- R&D work papers
- · Progress and status reports
- R&D project financial reports, including asset registers and R&D depreciation calculations
- · Testing protocols, analysis, conclusions
- · Testing and trial records, the results, and follow-up actions
- Separate project or activity details that show how many hours each employee has worked on the project
- · which part of the project the employee worked on and their hourly cost
- A worksheet that shows how you calculated the claim expenditure for each line item this
 must reconcile
- · against the amount you have claimed
- Activity initiation or commencement documents
- Details on the technological challenges to be overcome
- Records showing the date when commercialisation of the R&D results has begun
- · Activity proposal agreed to by internal stakeholders
- Documents identifying the new knowledge sought by the R&D project
- Documents recording the scientific or technological uncertainties
- · Documents relating to the state of knowledge and technology at the start of the project
- · Details on research into publicly available information
- Advice or research documents that show how it was determined that the knowledge being sought was not
- readily deducible be a competent professional, and why this conclusion was reached
- · Research commissioning documents
- Contractual agreements with approved research providers or other R&D contractors
- Worksheet showing the calculation of any feedstock inputs and how the net cost was calculated



Notes







Drafting Tools for Responding to this Brief

We have drafting documents to assist your team to provide their contributions and inputs to this briefing.

These include:

- Microsoft Word Templates
- Microsoft Excel Templates
- Adobe pdf documents

To obtain your copies of our document drafting templates for this briefing contact us.



021 1323 955

Email <u>info@appliedsupportservices.co.nz</u>



Contact Us: Research and Development Tax Incentive Services

Applied Support Services Limited

Unit 2, 48 Lemnos Place, Auckland 0604, New Zealand.

Phone 09 817 7460 Mobile 0211 323 955

Emailinfo@appliedsupportservices.co.nzWebwww.appliedsupportservices.co.nz

Contact Michael Venter, MA (Hons), Director

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Air Conditioning Engineering

Aquaculture

Architecture
Bath & Shower Manufacturing

Biotechnology Building

Chemicals

Computing Construction

Crown Research Institutes

Cut Flowers

Distribution Education

Electronics Energy

Engineering

Entertainment
Environment
Fertiliser Manufacturer
Food & Beverage
Food Processing

Government Central

Freight

Government Local Horticulture

Housing Incubators

Industry Associations

Insurance

Information Technology

Manufacturing

Media Medical Minerals

Marine

Non Government Organisations

Nutrition Packaging Oil & Gas

Pharmaceuticals

Plastics

Price-Escalation

Property Recycling

Refrigeration Engineering

Retail Seafood Shipping Software Technology

Telecommunications

Tourism Training Transport



REFERENCES & SOURCES

Inland Revenue; Research and Development Tax Incentive Guidance IR1240 Dec 2021

Ministry of Business, Innovation and Employment

Inland Revenue

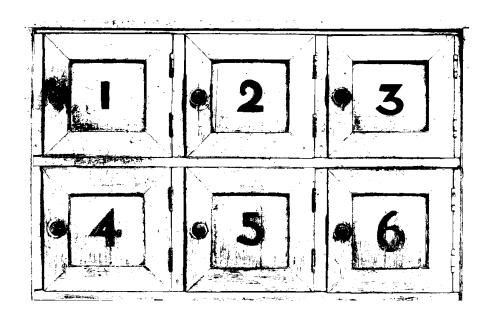
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