Inland Revenue
Te Tari Taake

INTERPRETATION STATEMENT | PUTANGA WHAKAMĀORI

Research and development loss tax credits

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This interpretation statement provides guidance on who is eligible for research and development (R&D) loss tax credits. This statement is intended to be read alongside existing information:

- Inland Revenue web guidance Research and development loss tax credit
- Article on the introduction of the R&D loss tax credit regime in *Tax Information Bulletin* Vol 28, No 3 (April 2016):19.

All legislative references are to the Income Tax Act 2007 unless otherwise stated.

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Introduction

1. The research and development (R&D) loss tax credit is in subpart MX of the Act. The R&D loss tax credit is a refundable credit available to eligible companies that have a tax loss arising from their eligible research or development expenditure.

2. General information about the R&D loss tax credit is on the Inland Revenue website (research and development loss tax credit) and in an article on the introduction of the regime (*Tax Information Bulletin* Vol 28, No 3 (April 2016):19).

3. This interpretation statement is intended to be read alongside the general information and addresses areas of uncertainty.

Background

4. The R&D loss tax credit was introduced from the 2016 income year to encourage business innovation. Companies engaged in intensive R&D tend to have high up-front costs and losses in their early years.

5. The aim of the R&D loss tax credit is to assist the cashflow of companies involved in intensive R&D by allowing an eligible company to cash-out its tax losses in a relevant year. This means the company can receive a payment instead of carrying forward the tax loss to use against income derived in a later year.

6. Only companies are eligible to claim the R&D loss tax credit. This is because losses incurred by partnerships, limited partnerships, look-through companies and sole traders pass through to the underlying owners, which can often be offset against their other income.

7. The R&D loss tax credit operates on an annual basis. A company chooses whether to apply for the particular year if requirements are met. This means a company can apply in some years and not others. Strict filing timeframes apply.

8. Once a company has claimed an R&D loss tax credit it has additional obligations. The R&D loss tax credit was designed to operate like an interest-free loan, which means the amount of the tax credit will usually be required to be repaid. It is generally treated as repaid by the company paying tax on income it derives in later years once the company is in profit. However, the company may be required to repay the tax credit earlier if an early repayment event occurs. There are also implications for the company's loss balances and imputation credit accounts.

Relationship with the research and development tax incentive

9. The R&D loss tax credit is different from the research and development tax incentive (RDTI) that was introduced from the 2020 tax year.

10. The loss tax credit and the tax incentive are two different regimes with different criteria that must be satisfied. Companies may be eligible for one regime or both.

11. This interpretation statement does not consider the application of the RDTI. However, information about the RDTI can be found on the Inland Revenue website (Research and development tax incentive) and on the Callahan Innovation RDTI hub.

About this statement

12. Part One of this statement considers when a company will be eligible to claim an R&D loss tax credit (the eligibility criteria). This includes considering the type of company that is eligible, the expenses that are relevant for particular calculations, and the qualifying types of R&D activity.

13. Areas of uncertainty that have arisen with applying the eligibility criteria include:

    - what "research" and "development" means for the R&D loss tax credit (from [22])
    - how the eligibility criteria apply to R&D groups (from [42])
    - what is included in the wage intensity calculation (from [56]) and
    - what qualifies as R&D expenditure (from [85]).

14. Part Two of this statement considers a company's obligations once it is eligible to receive the R&D loss tax credit, including:

    - extinguishing losses and carrying forward excess losses (from [131])
    - when an early repayment of the credit is required (from [138])
    - imputation credits (from [160]); and
    - record keeping requirements (from [165]).

Part One: Eligibility for the R&D loss tax credit

15. This part first summarises the eligibility criteria that must be met in each income year that the R&D loss tax credit is claimed. It then discusses particular areas of uncertainty.

Summary of eligibility criteria

16. A company chooses whether to apply for an R&D loss tax credit in an income year. The company must:

- be New Zealand resident (s MX 2(a) and (b));
- not be a:
  - company established under or subject to the Education and Training Act 2020, Pae Ora (Healthy Futures) Act 2022 or Crown Entities Act 2004 (s MX 2(c));
  - company where 50% or more of its shares are owned by a public authority, a local authority, a Crown Research Institute or a State enterprise (s MX 2(d)); or
  - listed company or listed on a recognised exchange (s MX 2(e));
- have a net loss in the relevant tax year (s MX 1(1)(c));[1]
- satisfy the wage intensity calculation (ss MX 1(1)(f) and MX 3);
- incur R&D expenditure in the income year (s MX 1(1)(e)); and
- own, solely or jointly, the intellectual property and know-how resulting from the R&D (s MX 1(1)(g)).

17. Where the company is part of an R&D group, additional rules need to be met. The combined R&D group must have a net loss for the tax year and satisfy the wage intensity calculation.

18. Some of the above eligibility criteria have given rise to uncertainty. The areas of uncertainty are:

- whether requirements must be satisfied for a full income year;
- the meaning of research and development for the R&D loss tax credit;
- when an R&D group exists and the consequences of grouping;
- what is included in the wage intensity calculation (including where there is an R&D group);

[1] That is, its annual total deductions are greater than its annual total income.

- requirements for R&D expenditure; and
- whether the results of the R&D (that is, the intellectual property and know-how) vest in the company.

19. These issues are addressed in the following paragraphs.

Criteria must be satisfied for the full income year

20. A company must meet the eligibility criteria for an income year (s MX 1). This requirement means:
    - If a company is incorporated during an income year, it must meet the criteria for the part of the year that it exists (s MX 2).
    - If a company that exists for a full income year is eligible for part of that income year only, it has not met the criteria for the income year and cannot claim the R&D loss tax credit for that income year.
    - If a company has a non-standard balance date it must meet the criteria for its income year (for example, from 1 July to 30 June). [2]

21. Example | Tauira 1 demonstrates a company that is not eligible to claim an R&D loss tax credit because it does not meet the requirements for the full income year.

Example | Tauira 1: Not eligible for full income year

A company with a standard balance date meets the eligibility requirements under ss MX 1 and MX 2 on 1 April 2022 (the beginning of its 2023 income year). However, it lists on the NZX during that year. This means the company no longer satisfies the requirements of s MX 2(e). As the company does not meet the eligibility requirements for the full income year, it cannot claim an R&D loss tax credit for the 2023 income year.

Meaning of "research" and "development"

22. Central to the R&D loss tax credit are the concepts of "research" and "development". For instance, the R&D loss tax credit is available to eligible companies who:
    - incur expenditure on certain research or development activities (R&D expenditure); and

[2] A non-standard balance date is a balance date other than 31 March.

- satisfy the wage intensity calculation, which is based on an employee's involvement in research or development (R&D material).

23. The R&D loss tax credit rules adopt the definitions of "research" and "development" in **New Zealand equivalent to international accounting standard 38 intangible assets** (NZ IAS 38). Although the R&D loss tax credit rules adopt these definitions, a company does not need to report under the **New Zealand equivalent to international financial reporting standard** (NZ IFRS) or have adopted NZ IAS 38 to be eligible to claim an R&D loss tax credit. However, whether a company applies NZ IAS 38 for financial reporting purposes may impact its ability to deduct expenditure on research and development and therefore the amount of any net loss and ability to include the expenditure as R&D expenditure (the meaning of R&D expenditure is discussed from [86]).

24. These definitions of research and development are not the same as the meaning of "research and development activity" used for the RDTI. The relevant definitions for the RDTI are in s LY 2 and are relevant to that regime only.

Research

25. "Research" is defined in NZ IAS 38 at [8] as:

> original and planned investigation undertaken with the prospect of gaining new scientific or technical knowledge and understanding.

26. While only the definition is relevant for these purposes, NZ IAS 38 lists examples of research activities at [56] as: [3]

- activities aimed at obtaining new knowledge;
- the search for, evaluation of and final selection of, applications of research findings or other knowledge;
- the search for alternatives for materials, devices, products, processes, systems or services; and
- the formulation, design, evaluation and final selection of possible alternatives for new or improved materials, devices, products, processes, systems or services.

27. The definition of research (and listed examples) focuses on original investigation and activities that contribute knowledge and understanding.

[3] For completeness, this is subject to the discussion at [28] and [29] that the research work must be original.

28. The work must be original. This term is relevantly defined in the *Oxford English Dictionary* (online edition) as:

> 1.a. That is the origin or source of something; from which something springs, proceeds, or is derived; primary.
>
> 2.a. Belonging to the beginning or earliest stage of something; existing at or from the first; earliest, first in time.
>
> 5.a. Created, composed, or done by a person directly; produced first-hand; not imitated or copied from another.
>
> 6.a. Having the quality of that which proceeds directly from oneself; such as has not been done or produced before; novel or fresh in character or style.

29. The ordinary meaning of "original" refers to something being created and novel, not imitated or copied. This meaning suggests there must be a level of innovation or creativity.

Development

30. Development is defined in NZ IAS 38 at [8] as:

> the application of research findings or other knowledge to a plan or design for the production of new or substantially improved materials, devices, products, processes, systems or services before the start of commercial production or use.

31. While only the definition is relevant for these purposes, NZ IAS 38 lists examples of development activities at [59] as the:

- design, construction and testing of pre-production or pre-use prototypes and models;
- design of tools, jigs, moulds and dies involving new technology;
- design, construction and operation of a pilot plant that is not of a scale economically feasible for commercial production; and
- design, construction and testing of a chosen alternative for new or improved materials, devices, products, processes, systems or services.

32. The definition refers to the concept of applying research findings or other knowledge to produce new or substantially improved materials, devices, products, processes, systems or services before the start of commercial production or use.

33. The use of the phrase "or other knowledge" widens the scope of development to include activities other than research that produce something new or improved. That is, development includes activities drawing on existing knowledge gained from

research or experience. In addition, development does not consist of ordinary or routine activities based on well-established competence or understanding.

Meaning of "substantially improved"

34. Development activities are those that produce something new or "substantially improved" for the relevant person rather than their business-as-usual activities.

35. The word "substantially" is defined in the *Oxford English Dictionary* (online edition) as:

> **substantially**, adv. Fully, amply; to a great extent or degree; considerably, significantly, much.

36. This definition means the development or improvement must be considerable or significant. Whether the development activities are to create substantially improved materials, devices, products, processes, systems or services always depends on the particular facts.

Before the start of commercial production

37. A question that arises is when a company will have started commercial production (such that an activity is no longer considered to be in development). This question is generally fact dependent and depends on the particular company and its relevant products, processes, systems and so on, that the development work relates to. Examples of when a company has reached the start of commercial production include:

- demonstrations of commercial viability, market research and promotion;
- tooling up for commercial production, planning the production process and commissioning new equipment; and
- developing quality control systems.

38. Guidance on the RTDI refers to R&D performed "in the course of" commercial production, which is a different timing to "before the start of" commercial production.[4] However, that guidance refers to a commercial production environment as including R&D performed on a production line that is producing products for sale, and R&D performed as part of the process of designing, developing or building something where there is a contract in place for the result, or it is for sale. In situations where the company would have started commercial production, the activity will not qualify as being development activity for the purpose of the R&D loss tax credit.

[4] Research and Development Tax Incentive: Guidance (IR 1240, April 2023) at 66.

39. However, it is important to note that some activities that occur before the start of commercial production (so would be included as "development" activities) are ineligible under schedule 22.

Schedule 22 proscribed activities

40. To keep the R&D loss tax credit targeted, certain activities listed in schedule 22 are not eligible as research or development expenditure for the R&D loss tax credit. Schedule 22 is relevant to both "R&D expenditure" and "R&D material" for the wage intensity calculation. The types of activities listed in the schedule are those that take place in a post-development phase, are related to routine work, have an indeterminate relationship with economic growth, or are expected to take place when the company is less likely to be cashflow-constrained.[5] In summary, schedule 22 includes activities that are:

- not performed in New Zealand;
- related to the acquisition or disposal of land, intangible property, intellectual property or core technology;
- related to certain industries (prospecting, exploring or drilling, or research in social sciences, arts and humanities);
- occurring outside core research and development work (for example, activities in the post-development phase or related to routine work) including:
  - market research, testing and promotion;
  - quality control and routine testing;
  - cosmetic alterations;
  - routine collection of information;
  - various legal, commercial, administrative or compliance activities;
  - reproducing a product or process from existing information; and
  - pre-production activities.

41. Example | Tauira 2 demonstrates research and development activity that would not be eligible as either R&D expenditure or R&D material for the wage intensity calculation.

Example | Tauira 2: Overseas activity not eligible for R&D loss tax credit

A Co sends an employee to the United States to supervise the testing of an early prototype in a research facility. The test equipment in the research facility is

[5] *Tax Information Bulletin* Vol 28, No 3 (April 2016): 19 at 20.

state of the art, and far exceeds any equipment available to A Co in New Zealand. Although this activity is related to an R&D project being carried on in New Zealand, the activity (the testing of the early prototype) is being performed outside New Zealand.

A Co determines that the expenditure it incurs on the activity outside of New Zealand comprises:

- the amount paid to the owner of the research facility in the United States
- a portion of the salary and wages paid to A Co's employee (based on the time spent by them supervising the testing of the early prototype in the United States)
- the cost of sending the employee to the United States.

These amounts cannot be included in the amount of R&D expenditure, and the salary components do not qualify as total R&D labour expenditure for the wage intensity calculation, because they relate to activities performed outside New Zealand.

R&D groups

42. If a company is a member of an R&D group, this can affect its eligibility to claim an R&D loss tax credit and the amount of the credit. In particular, if there is an R&D group, the:
    - wage intensity calculation must be satisfied for the R&D group; and
    - R&D group must have a net loss.
43. Accordingly, it is important for a company to determine whether it is a member of an R&D group and who the other members of that group are.

An R&D group is a group of companies

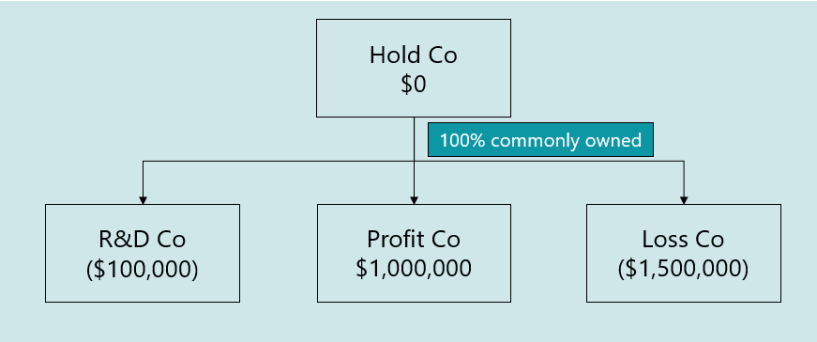
44. An R&D group is a concept that only applies for the purposes of the R&D loss tax credit. The concept is broad and applies where a group of companies exists. A company does not elect to be in or out of the R&D group rules – if a company is in a group of companies, then it is a member of an R&D group. The R&D group also includes other entities such as a look through company and limited partnership that must satisfy the same common voting interest thresholds (treated as if it were a company for that purpose).

45. Section IC 3 defines a group of companies as two or more companies (none of which is a multi-rate portfolio investment entity or a listed portfolio investment entity) in relation to which a group of persons holds:

    - common voting interests that add up to at least 66%; and
    - if a market value circumstance exists for a company that is part of a group of companies, common market value interests that add up to at least 66%.

46. A person's common voting interest in the relevant companies at a particular time is the percentage of their voting interests in each of the companies at the time. For further information about how to measure ownership interests see IS 22/07 **Company losses – ownership continuity, sharing and measurement** from 32.

47. For example, all the companies from Example | Tauira 3 below are part of a group of companies so are an R&D group (for the purposes of the R&D loss tax credit) even though only one company undertakes any R&D activities:

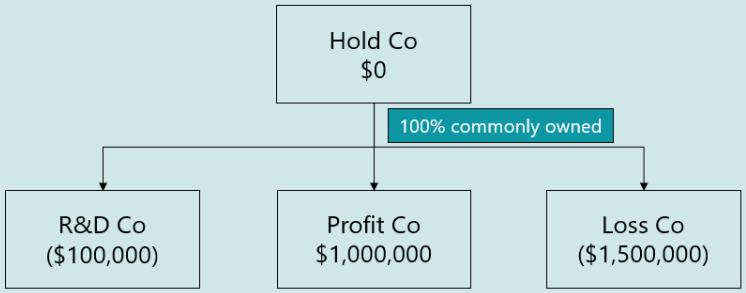


48. Where an entity applying for an R&D loss tax credit is part of an R&D group, its annual application for an R&D loss tax credit must indicate that it is a member of an R&D group.

49. For completeness, where a company is part of a consolidated tax group, the companies in such a group are treated as a single company for tax purposes (s FM 2) and would have a single net loss.

50. A consolidated tax group may be a member of an R&D group. Nothing in the R&D loss tax credit rules suggests a consolidated tax group cannot be eligible for the credit as long as it satisfies the criteria. However, foreign companies cannot be members of a consolidated tax group.

Example | Tauira 3: R&D group has combined net loss



R&D Co carries out R&D and is determining its eligibility for an R&D loss tax credit. R&D Co is a member of an R&D group that includes Profit Co, Loss Co and Hold Co. All entities are New Zealand resident.

Because R&D Co is a member of an R&D group, the net loss requirement needs to be satisfied by both R&D Co and the combined R&D group. R&D Co has a net loss ($100,000). In the relevant income year, the R&D group has a combined net loss of:

($100,000) + ($1,500,000) – $1,000,000 = ($600,000).

This means R&D Co meets the net loss requirement.

Non-resident members of R&D group

51. One issue that arises is whether a non-resident company can be a member of an R&D group, for example, if in Example | Tauira 3 Hold Co was a foreign company.

52. A foreign company can be a member of an R&D group, but only a New Zealand resident company can claim an R&D loss tax credit. This means the foreign company must be included in the calculations for whether the R&D group has a net loss and meets the wage intensity calculation.

53. For the purpose of calculating a foreign company's net income or net loss, that company's New Zealand tax obligations (if any) are what is relevant. Its overseas tax obligations are not included in the calculation of the R&D group's net loss. This is because a net loss is a defined term.

54. A net loss arises where, in a tax year, a person's annual total deduction is more than their annual total income (s BC 4(3)). A person's annual total income reflects their "assessable income" which is the total amount of their income that is not (among other things) non-resident foreign-sourced income. Similarly, a deduction is allowed only where there is a nexus with assessable income. Accordingly, it is only the foreign

company's New Zealand sourced income and deductions that are included as its net income or net loss under the Act. This means only its New Zealand net income or net loss is included in the R&D group's calculation (and not its overseas income or loss amounts).

55. Therefore, if Hold Co in the above example was a foreign company, only its New Zealand net loss or net income would be included in the R&D group calculation.

The wage intensity calculation

56. To claim an R&D loss tax credit, an eligible company must satisfy the wage intensity calculation.

57. This requires 20% of a company's total labour expenditure to be on R&D labour (s MX 3)). This requirement ensures companies have a comparatively high level of expenditure on research or development. For companies that are part of an R&D group, the R&D group combined must also calculate their wage intensity.

58. **The wage intensity calculation is only relevant for determining eligibility to claim the R&D loss tax credit.** The required wage intensity is that at least 20% of the company's total labour expenditure must be on R&D labour expenditure, based on the following formula (s MX 3(2)):

total R&D labour expenditure / total labour expenditure

59. The deductibility (or otherwise) of the labour expenditure is not relevant for the purpose of this calculation. For example, where these amounts are for capital expenditure or are funded by a government grant, that expenditure is still included in this calculation.

60. Uncertainty exists about what is included in or excluded from this calculation and how it affects other calculations (such as R&D expenditure). These uncertainties are addressed in the following paragraphs.

Meaning of total R&D labour expenditure

61. "Total R&D labour expenditure" is defined in s MX 3(3)(a). The focus of the definition is on amounts the company pays to certain persons for providing R&D material.

62. The amounts that must be included in total R&D labour expenditure are:

- salary and wages paid to employees for providing R&D material;
- amounts paid to shareholder employees for providing R&D material (the company cannot use a notional amount representing the market value of services that have been provided); and

- the total amount of contractor R&D consideration multiplied by 0.66.

63. A company can also opt to include as total R&D labour expenditure for each employee who provides R&D material:

    - the employer's superannuation cash contributions for its employee (that are not salary and wages) and the employer's tax on such contributions; and
    - fringe benefits provided by the company and attributed to its employee and the employer's fringe benefit tax liability on those fringe benefits.

64. The amount to be included is the same proportion of the employee's salary and wages that is paid to the employee for providing R&D material.

65. A company might opt to include the amounts described above where a significant portion of the employee's remuneration is made up of fringe benefits or superannuation contributions. Including these optional amounts might enable the company to meet the 20% wage intensity.

66. Importantly, if the optional amounts are included in the amount of total R&D labour expenditure then they must also be included in the amount of total labour expenditure.

67. For a detailed example of this calculation, including the optional amounts, see *Tax Information Bulletin* Vol 28, No 3 (April 2016):19 at 23.

R&D material

68. To be included in total R&D labour expenditure the amount must be paid to the employee, shareholder employee or contractor for providing "R&D material".

69. R&D material refers to goods or services provided to the person to the extent to which:

    - the goods or services are provided as part of a service of research or development;
    - the intellectual property and know-how resulting from the research or development vests in the person, solely or jointly; and
    - the goods and services are not used by the person:
        - for a proscribed activity listed in schedule 22; or
        - to provide a service of research or development or to further another person's research or development activities.

70. If the company uses the goods or services for these qualifying activities as well as other activities, the amount paid to the employee, shareholder employee or contractor must be apportioned.

71. In some cases, an employee, shareholder employee or contractor will provide services other than the provision of R&D material, for example:

- an employee who carries on research or development on eligible activities, as well as other activities that are proscribed by schedule 22; and
- a shareholder employee who spends a portion of their time undertaking research or development on eligible activities and the rest of their time carrying out the day-to-day tasks of running the business.

72. Where this occurs, the company must apportion the amounts paid to the employee, shareholder employee or contractor between amounts paid for providing "R&D material" and amounts paid for providing other goods or services. There are no rules for how an apportionment must be applied, although the apportionment method needs to be fair and reasonable and supported by documentation showing how it was reached. For example, the simplest way to work out an apportionment of a person's time would involve the employee accounting for their time on each activity in some way. However, other methods can be used provided the method is fair and reasonable.

73. Proscribed activity was discussed at [40], and whether the intellectual property and know-how vests in the company is discussed at [114]).

Contractor R&D consideration

74. "Contractor R&D consideration" is the GST-exclusive amount a company pays to a contractor as consideration for providing R&D material to the company. The purpose of including only 66% of the total contractor R&D consideration is to exclude the profit margin and non-wage cost components of the contract price on outsourced research or development.

75. Contractor R&D consideration does not include an amount the company pays to a contractor who is, at the time:

- an employee of the company;
- a member of an R&D group (that the company is a member of); or
- an employee of a member of the R&D group that the company is a member of.

76. Issues can arise where, for part of the year, a contractor had been a member (or an employee of a member) of an R&D group that the company is also a member of. In this situation, an amount paid by a company to the contractor is excluded from being contractor R&D consideration if the company and the contractor were in an R&D group at the time the services to which the payment relates were provided. If the company and contractor were not in the same R&D group at that time, the amount can still qualify as contractor R&D consideration.

Meaning of total labour expenditure

77. "Total labour expenditure" is also defined (s MX 3(3)(b)), and means the total expenditure that the company incurred in the income year for:

- salary and wages paid to all employees;
- contractor R&D consideration (multiplied by 0.66);
- the amount paid to all shareholder employees; and
- the optional amount of expenditure for each employee (that is, for fringe benefits or employer superannuation contributions), if the company has chosen to include these amounts in its total R&D labour expenditure.

78. Example | Tauira 4 and Example | Tauira 5 explain how to apply the calculations.

Example | Tauira 4: Simple wage intensity calculation

B Co pays $200,000 in salary and wages to two full-time staff who are providing R&D material in an income year. B Co's total labour expenditure (salary and wages and shareholder salaries) for all staff (including the two full-time staff providing R&D material) is $1,000,000 in that year.

Wage intensity = total R&D labour expenditure / total labour expenditure

$200,000 / $1,000,000 = 0.2

20% of B Co's total labour expenditure is R&D labour expenditure, so B Co meets the wage intensity requirement.

Example | Tauira 5: Wage intensity calculation including certain expenditure

In the 2023 income year C Co pays:

- $200,000 in salary and wages to two full-time staff for providing R&D material in relation to Project X ($100,000 of this is funded by a government grant);
- $100,000 salary to Tim, a shareholder-employee; and
- total labour expenditure (salary and wages and shareholder salary) for all staff of $1,100,000

Tim carries out development work on Project Y as well as general business duties. Tim separately records his development work on Project Y in a special time sheet code for that project. C Co determines that:

- 50% of Tim's time relates to his provision of R&D material for Project Y, and 50% to other duties; and
- all the expenditure it incurs on Project Y in the 2023 income year is non-deductible for tax purposes.

When calculating the wage intensity, it is not relevant that part of Tim's salary (relating to the work on Project Y) is non-deductible, or that some of the R&D labour salary is funded by a government grant. However, it is relevant that only half Tim's time (and salary) is spent on R&D work.

C Co's wage intensity is:

total R&D labour expenditure / total labour expenditure

($200,000 + ($100,000 * 0.5)) / $1,100,000 = 0.227

As 22.7% of C Co's total labour expenditure is R&D labour expenditure, it meets the requirement.

As is explained in Example | Tauira 10 and Example | Tauira 11, the non-deductibility of part of the salary costs and the government grant funding has consequences for other calculations.

Calculating wage intensity for an R&D group

79. If the company is part of an R&D group, the R&D group must meet the wage intensity calculation in aggregate. This means the total R&D labour expenditure and total labour expenditure are the combined amounts of all the members of the group.

80. The R&D group's total R&D labour expenditure includes payments of salary and wages to each group member's employees or shareholder employees for the provision of R&D material to that relevant group member. Contractor R&D consideration is only for payments made to contractors outside the R&D group.

81. The relevant amounts must be for providing R&D material, which, as previously explained, is only for goods and services provided to the particular company and does not include amounts paid to further another person's R&D activities. There is no allowance in the definition of R&D material for furthering the R&D activities of another group member. This is illustrated in Example | Tauira 6.

Example | Tauira 6: Wage intensity for an R&D group

Op Co and Management Co are owned by the same shareholder, John. Therefore, they are members of an R&D group.

John is the sole employee of Management Co and receives a salary of $200,000. John manages the day-to-day operations of Op Co and Management Co and provides R&D material to Op Co in relation to Project Z.

Op Co carries on eligible R&D activities in relation to Project Z. Op Co incurs salary and wage expenditure of $400,000 in relation to R&D material provided by its employees working on Project Z, and other salary and wage expenditure of $900,000.

Management Co charges Op Co a service fee of $160,000 for John's provision of R&D material in relation to Project Z.

Op Co wage intensity calculation

Op Co's total R&D labour expenditure includes only the salary and wages paid to its employees for providing R&D material ($400,000). Op Co cannot include the amount paid to Management Co for John's services because the payment is not:

- salary or wages of an employee or shareholder employee of Op Co; or
- contractor R&D consideration as this excludes amounts paid to a member of an R&D group that the company (Op Co) is a member of.

Op Co's wage intensity calculation is:

total R&D labour expenditure / total labour expenditure

$400,000 / ($400,000 + $900,000) = 0.307

This means 30.7% of Op Co's total labour expenditure is R&D labour expenditure, and Op Co has sufficient wage intensity.

R&D Group wage intensity calculation

For the group, the total R&D labour expenditure includes the salary and wages paid to employees and shareholder employees of both Op Co and Management Co for providing R&D material. R&D material does not include an employee's services provided to another entity, even within a group. This means the service fee paid for John's R&D contribution is not included in the group aggregate amount, because John did not provide R&D material to Management Co.

The R&D Group's calculation is:

total R&D labour expenditure / total labour expenditure

$400,000 / ($400,000 + $900,000 + $200,000) = 0.266

This means 26.6% of the R&D group's total labour is R&D labour expenditure. The R&D group also has sufficient wage intensity (despite John's service fee not being included).

82. If a member of an R&D group is a foreign company, any salary and wages paid to that company's employees are included in the wage intensity calculation.

83. Where a foreign company's employees are performing R&D activities outside New Zealand, then salary and wages paid to those employees are not included in the total R&D labour expenditure of the group. This is because R&D material does not include activities subject to schedule 2, which includes activities performed outside New Zealand.

84. However, there is no similar exclusion in total labour expenditure. Therefore, all salary and wages paid to all employees (including foreign employees) must be included as total labour expenditure. This is illustrated in Example | Tauira 7.

Example | Tauira 7: Wage intensity calculation with non-resident group member

NZ Co is a wholly owned subsidiary of US Co.

US Co employs three R&D employees who are paid the equivalent of NZ$100,000 each and 10 other employees who are paid the equivalent of NZ$1,500,000 combined.

NZ Co employs two R&D employees who are each paid $100,000 for full time R&D work, and another two employees who are each paid $80,000 for administrative work. NZ Co is working on an R&D project based in New Zealand.

NZ Co's wage intensity calculation

Wage intensity = total R&D labour expenditure / total labour expenditure

$200,000 (2 x $100,000) / $360,000 ((2 x $100,000) + (2 x $80,000)) = 0.55

At 55%, NZ Co has sufficient wage intensity.

R&D group's wage intensity calculation

Only R&D work undertaken in New Zealand qualifies as total R&D labour expenditure. Therefore, the salary paid to US Co's R&D employees does not qualify. However, the amounts paid to all of US Co's employees must be included in the R&D group's total labour expenditure:

= $200,000 + 0 / $360,000 + ((3 x $100,000) + 1,500,000))

= $200,000/ $2,160,000 = 0.09

At 9%, the R&D group does not have sufficient wage intensity. Therefore, NZ Co is not eligible for an R&D loss tax credit.

R&D expenditure

85. The above analysis dealt with issues that arise when determining whether a company is eligible to claim an R&D loss tax credit. The next issue is whether it is incurring eligible R&D expenditure. For eligibility purposes no particular amount of R&D expenditure is required, although the amount is relevant for determining the amount of credit that is available.

86. R&D expenditure is expenditure the company incurs on goods and services to the extent it relates to research or development. Also, the intellectual property and know-how resulting from the research or development must vest in the company (solely or jointly). R&D expenditure excludes expenditure that:

- relates to an activity described in schedule 22 (proscribed activities);
- is on goods and services used to provide a service of research or development to another person, or that furthers another person's R&D activities;
- is not deductible in the income year;
- is for or under a financial arrangement (such as interest); or
- is for the acquisition or transfer of intangible property, core technology, intellectual property or know-how.

87. The meaning of R&D, and the schedule 22 proscribed activities, were considered earlier from [22] to [40]. It is also relevant that the R&D work must be undertaken for the company. Expenditure is not eligible where a company undertakes R&D for another person (including another person within an R&D group).

Expenditure that "relates to" research or development

88. A question that arises concerns what goods or services acquired by a business could be said to "relate to" eligible research or development.

89. The words "relate to" mean the expenditure must be "connected to" the research or development activities, and the connection must be more than tenuous.

90. In some cases, a company may incur expenditure for goods and services that relate in part to eligible activities and in part to other activities. For example, salary (and other) costs for R&D staff who also work on ineligible activities, costs of materials or depreciable property used in both R&D work and other work, and some overheads.

91. The cost of the goods and services must have some relationship with the R&D activity to be said to "relate to" that activity (and must not relate to proscribed activities such as routine work under schedule 22). Where expenditure has the relevant relationship, the company must apportion the expenditure between the eligible and ineligible activities. Only the portion that relates to eligible activity counts as R&D expenditure.

92. No specific rules relate to apportionment, but it must be fair and reasonable and able to be quantified in some way. Examples of apportioning overhead costs include:

- Salary or wages paid to staff who provide services to R&D staff as well as other staff could be apportioned based on time sheet codes, or on a percentage of R&D staff compared with non R&D staff (if that is fair and reasonable).
- Electricity, insurance and maintenance costs for a building that is used in part for eligible R&D activity and in part for other activity could be apportioned based on the percentage of the area used for R&D compared with other activity.

93. Overheads that do not relate to the R&D work cannot be included in an apportionment. For example, a company's general accounting costs (whether in-house or external accounting costs) would not relate to R&D work undertaken (even if they include expenses incurred in claiming an R&D loss tax credit, those expenses do not relate to the R&D work itself). However, a company can have accounting or finance costs that "relate to" eligible research or development. For example, costs to create budgets for R&D activities/projects.

94. Apportioning an employee's time and overheads are illustrated in Example | Tauira 8 and Example | Tauira 9.

Example | Tauira 8: R&D expenditure – apportionment of an employee's time

ABC Co is a manufacturing company that launched its first product (Product A) in the 2021 income year and is starting to see a steady increase in customers. The company is developing an innovative new product (Product B) as an R&D project.

Jo is employed by the company in the information technology team, and works part-time on the development of Product B. Jo uses a timesheet to record her hours worked and uses a special code for time spent on the R&D project. Over the course of the income year, Jo's time on the R&D project has averaged 35% of her recorded time.

ABC Co includes 35% of Jo's salary as R&D labour expenditure when calculating wage intensity. ABC Co concludes the expenditure on Jo's salary relating to the R&D project satisfies the requirements to be R&D expenditure. Therefore, ABC Co also includes that amount as part of its eligible R&D expenditure.

Example | Tauira 9: R&D expenditure – expenditure related to R&D

X Co employs two full time R&D employees (who undertake eligible R&D work) and 18 other employees.

Bob carries out administrative services on a part time basis. Bob is paid $45,000 for the relevant income year. He undertakes specific administrative services for the R&D employees, as well as general administrative services for other employees. He does not record his time.

Aroha carries out various management and accounting services. Aroha is paid $70,000 for the relevant income year. She is involved in filing tax returns and making the relevant R&D loss tax credit claims.

X Co apportions Bob's time spent on services to R&D staff based on the number of R&D employees in X Co (two) as a proportion of the total number of employees (20). X Co calculates that $4,500 (2/20 x $45,000) can be included as R&D expenditure (and decides the expenditure meets all the other requirements of the R&D expenditure definition). However, as Bob is not providing R&D material, this amount is not included in the total R&D labour expenditure calculation for wage intensity.

Aroha's time (including filing R&D loss tax credit claims) is not sufficiently related to R&D work. Accordingly, no part of her salary can be included as R&D expenditure or total R&D labour expenditure.

X Co incurs other costs including electricity, insurance and ongoing maintenance of its premises that are used partly for its R&D work. X Co has a separate area for the R&D activities undertaken by the two R&D employees and calculates that to be 15% of the total floor spaces of the premises. Therefore, 15% of these overheads can be included as R&D expenditure.

Expenditure must be tax deductible in the year it is incurred

95. Importantly, expenditure only qualifies as R&D expenditure if a deduction is available for the expenditure in the income year. The company must incur the relevant expenditure in the income year in which it claims a credit (s MX 4(1)(h)). Under the

definition of R&D expenditure the deduction must also be available in that income year.

96. Sometimes the deduction for expenditure on R&D is allocated to a different income year under s EJ 23. Expenditure for which a deduction is available (but allocated to a different income year) can qualify as R&D expenditure in the income year it is incurred (subject to satisfying the other requirements of R&D expenditure discussed at [86]). However, such expenditure does not qualify as R&D expenditure in the income year it is deducted as only expenditure incurred in the income year qualifies as R&D expenditure.

97. A deduction could be available for research or development expenditure under:

- a specific provision such as s DB 33 or s DB 34 (research or development) or
- the general deductibility provision in s DA 1.

98. Uncertainty arose because s DB 34 uses the definitions of "research" and "development" in NZ IAS 38 that are also relevant to the R&D loss tax credit. However, the deduction does not have to be available under that provision.

Deductibility under ss DB 33 and DB 34

99. Section DB 33 provides that a person is allowed a deduction for expenditure incurred in connection with scientific research that they carry on for the purpose of deriving their assessable income. However, it does not apply to expenditure incurred on an asset that is not created from the scientific research and where they are allowed a deduction for depreciation loss. "Scientific research" is not defined for these purposes.

100. Section DB 34 applies to a person who applies NZ IAS 38 for financial reporting purposes. Broadly, under s DB 34, a deduction is allowed for research or development expenditure if the person has recognised the expenditure as an expense under NZ IAS 38. The definitions of research and development for these purposes are the same as those discussed earlier.

101. Section DB 34 effectively applies accounting concepts to determine whether a deduction is available in the income year. If an expense is recognised for accounting purposes (and otherwise satisfies the section) then a deduction is allowed. This differs to general deductibility treatment where accounting treatment is not determinative of deductibility. For further information on the application of s DB 34 see IG 23/01: **Deductibility of software as a service (SaaS) configuration and customisation costs.**

102. Expenditure that is deductible under these provisions must still meet the other requirements previously discussed to be R&D expenditure.

Deductibility under s DA 1 – general permission

103. The other way in which a deduction is available is under general principles. Under s DA 1 a person is allowed a deduction for an amount of expenditure or loss to the extent they incur it in deriving their income, or in the course of carrying on a business for the purpose of deriving income. This is known as the general permission.

104. The expenditure or loss must be incurred in the course of carrying on a business. A sufficient relationship must exist between the expenditure and the business that is being carried on (*CIR v Banks* (1978) 3 NZTC 61,236 (CA) and *Buckley & Young Ltd v CIR* (1978) 3 NZTC 61,271 (CA)). The type of expenditure and its relevance to the income-earning process are relevant for deciding whether that relationship exists. This includes looking at how the company earns its income and the factual situation at the time the expenditure is incurred.

105. Even where a deduction is allowed under s DA 1, it may be disallowed under the limitations to deductibility. The most likely limitation that can apply to research or development expenditure is for capital expenditure in s DA 2(1). Whether expenditure is of a capital nature is a factual question that needs to be considered in each case.

106. When considering deductibility under general principles, the accounting treatment is of limited relevance. This differs to the position under s DB 34 where companies that apply NZ IAS 38 can generally follow their accounting treatment. Non-deductibility of expenses is illustrated in Example | Tauira 10.

Example | Tauira 10: R&D expenditure – non-deductible expenses

C Co from Example | Tauira 5 is now calculating the amount of R&D expenditure it incurred in the 2023 income year.

C Co paid $200,000 in salary and wages to two staff and 50% (that is, $50,000) of Tim's salary for providing R&D material. C Co does not apply NZ IAS 38. C Co had determined that the amount paid to Tim for his work on Project Y was non-deductible expenditure because it related to a capital project.

Tim's R&D portion of salary ($50,000) was included in C Co's total R&D labour expenditure for the purpose of determining whether it satisfied the wage intensity calculation. However, R&D expenditure excludes expenditure for which no deduction is available in the income year. As the $50,000 shareholder-salary paid to Tim for providing R&D material is not deductible, it cannot be included in C Co's R&D expenditure.

C Co determined that the $200,000 salary and wages paid to the two full-time staff for providing R&D material was deductible. However, see Example | Tauira 11 about the treatment of amounts funded by a government grant.

Government grant funding

107. If a company receives certain types of government grant funding for research or development, and the government grant provisions in ss CX 47 and DF 1 apply, the amount of the grant is not taxable income, but the expense funded by the grant is non-deductible. This means R&D expenditure cannot include any expenditure to the extent it is funded by such a grant.

108. The government grant provisions only apply in certain situations. The grant must be provided by certain types of government agencies, and it must be provided for (otherwise) deductible expenditure. For further information on when the government grant provisions apply see IS 23/06: **Income tax – Government payments to businesses (grants and subsidies).**

109. Where the grant funding is less than the relevant expenses, the part of the expense not funded by the grant may still be deductible. This is illustrated in Example | Tauira 11.

Example | Tauira 11: R&D expenditure – government grant funding

C Co (from Example | Tauira 5 and Example | Tauira 10) received a government grant of $100,000 for Project X. The grant was aimed at attracting more R&D staff so required the funds be used for R&D salaries. C Co funded half of its $200,000 R&D salary costs with this grant.

Government grant funding does not affect the wage intensity calculation. C Co's total R&D labour expenditure still includes the $100,000 of staff salaries funded by the grant.

However, when calculating its R&D expenditure, C Co cannot include expenditure that is not deductible. While C Co had determined the salaries were ordinarily deductible, this particular grant satisfied s DF 1. That means the expenses funded by the grant become non-deductible. C Co can only treat the $100,000 salary not funded by the grant as "R&D expenditure".

C Co cannot assume the total R&D labour expenditure is eligible R&D expenditure.

110. Where an R&D project is co-funded, the costs of the project not funded by the government grant may still be deductible. This is illustrated in Example | Tauira 12.

Example | Tauira 12: R&D expenditure – co-funding arrangement

B Co receives a government grant of $100,000 towards a $200,000 R&D project on the basis that B Co's investors will provide the other $100,000 funding.

B Co determines that the government grant provisions in ss CX 47 and DF 1 apply to the $100,000 government grant.

When calculating its R&D expenditure, B Co cannot include expenditure that is not deductible. The R&D project expenses funded by the government grant are non-deductible.

B Co determines that the R&D project expenses co-funded by investors are deductible. Accordingly, these expenses can be included as R&D expenditure provided the other requirements for expenditure to be R&D expenditure are met.

Interaction between wage intensity calculation and "R&D expenditure"

111. An area of uncertainty has been the relationship between the wage intensity calculation and the company's R&D expenditure. In short, there is no relationship between these amounts.

112. Where expenses are excluded from the wage intensity, they may be included in R&D expenditure (and vice versa). Also, neither amount affects the calculation of the company's net loss for tax purposes. These amounts are only relevant as separate indicators of eligibility for the R&D loss tax credit.

113. The maximum amount of credit that can be claimed is discussed in part two of this statement. This includes amounts relating to:

- the total R&D labour expenditure (part of the wage intensity calculation); and
- the amount of R&D expenditure incurred.

The company must own the results of the R&D

114. A company can only claim an R&D loss tax credit for R&D activities if the results of those activities (the intellectual property and know-how) vest in the company solely or jointly with another person. The word "vests" in this context means the company owns or has a present legal right to that property.

115. This requirement is included both in relation to the company's eligibility to claim a credit and in the definition of R&D expenditure.

116. The requirement is designed to ensure the person making a claim to cash-out the R&D tax losses is the person who invested in the research or development. However, in recognition that parties may jointly undertake R&D activities, the requirement is satisfied if the intellectual property and know-how vests in the company jointly. For example, two or more companies may agree to carry out R&D activities together and to share ownership of the results.

117. Whether the intellectual property and know-how vests in a person depends on the facts. Usually, the intellectual property and know-how from R&D activities vest in the person carrying out the activity, the creator of the invention or knowledge. However, this might not be the case if, for example, the person is carrying out the activity:

- in the course of their employment (the intellectual property will usually vest in the employer); or
- for another person.

118. A company must have sufficient rights in the results of the R&D activities to meet the requirement that the intellectual property and know-how vests in the person. A company will usually satisfy that requirement if it:

- carries out research or development activities for itself;
- owns the results of research or development carried out by a contractor on the company's behalf; or
- has a contractual arrangement with another party to share the results of the research or development.

119. Some R&D groups may structure their operations so that the intellectual property is owned by a separate group company from the company undertaking the research or development. In that case, each company needs to be considered on its own to determine if it meets this requirement. The company undertaking R&D will not qualify for the credit if it is undertaking that work for another person (that is, the person who owns the results of the R&D). Similarly, the company that owns the intellectual property will need to be undertaking enough of its own R&D work to qualify.

120. This requirement differs from the RDTI which applies where the person can use the results from the R&D activity (such as the intellectual property created) for no consideration, or where the results are owned by another company within the same group of companies, or a member of a joint venture that the person is a member of (s LY 3(1)(c)).

121. The ownership of the intellectual property and know-how vesting with a different company to the company undertaking the R&D is illustrated in Example | Tauira 13.

Example | Tauira 13: Intellectual property owned within an R&D group

R&D Co and Op Co are each wholly owned by Hold Co.

R&D Co is a research and development company carrying out eligible R&D activities on behalf of Op Co in the 2022 income year. Op Co owns the intellectual property and know-how generated from the R&D carried out by R&D Co. R&D Co invoices Op Co for R&D work it is undertaking.

R&D Co cannot claim an R&D loss tax credit for the 2022 income year as it is undertaking its R&D work for another company, and also because it does not own the results of its R&D activities. This is the case even though R&D Co and Op Co are members of the same R&D group.

Summary

122. The above analysis considered common issues that have arisen in determining a company's eligibility for the R&D loss tax credit. In brief, an eligible company is one that:

- chooses in an income year to apply for an R&D loss tax credit;
- is New Zealand resident and not an ineligible type of company;
- has a net loss in the tax year;
- satisfies the wage intensity calculation;
- incurs eligible R&D expenditure;
- owns the results of the R&D; and
- notifies Inland Revenue when it is in an R&D group and in that event the R&D group must:
  - have a combined net loss in the tax year; and
  - satisfy the wage intensity calculation.

123. Having considered it meets all the criteria as explained in this part of this statement, an eligible company is entitled to claim an R&D loss tax credit. Part two of this statement discusses the ongoing obligations of such a company.

Part Two: Obligations and repayments

124. Having determined that a company is eligible for the R&D loss tax credit, this part sets out obligations the company must meet.

Applications

125. The Inland Revenue website provides guidelines on the information needed to support an application for an R&D loss tax credit (Apply for the R&D loss tax credit).

126. The time for filing an R&D statement is provided for in s 70C(2) of the Tax Administration Act 1994 (TAA). For the 2023 and later tax years, the R&D statement must be filed no later than 30 days after the last day for filing the company's income tax return for the relevant income year.[6] The last day for filing a company's income tax return is the date provided for in s 37 of the TAA. If a company does not file the R&D statement by the due date it is not entitled to claim an R&D loss tax credit for that year. The due date for filing the R&D statement is illustrated in Example | Tauira 14.

Example | Tauira 14: Due date for R&D statement

Newco is undertaking R&D in the 2023 income year and has registered for the R&D loss tax credit.

Newco does not have a tax agent and has a standard balance date of 31 March. Newco's income tax return for the 2023 income year is due on 7 July 2023.

If Newco wants to claim an R&D loss tax credit for the 2023 income year it must file its R&D statement no later than 6 August 2023. If it files the R&D statement on 7 August 2023, it will not be eligible to claim a credit.

If Newco has a tax agent, then it will get an extension of time for filing its income tax return. The last day for filing Newco's income tax return for the 2023 income year will be 31 March 2024, and Newco will need to file an R&D statement no later than 30 April 2024.

Calculation of credit

127. The amount of the R&D loss tax credit is calculated under s MX 4. The amount of the available tax credit is the lowest of:

- for the 2021 and subsequent income years, $560,000;
- the company's net loss for the tax year x the basic tax rate for a company (28%);
- the company's total R&D expenditure for the income year x 28%; and
- 1.5 x the company's total R&D labour expenditure in the income year x 28%.

[6] Note different timeframes applied for earlier years.

128. Many of these terms were explained in Part One:

- A net loss arises where the company's total amount of deductions for the tax year exceeds its total income for the tax year. This amount includes all deductions and all income and is not restricted to R&D (see [54]).
- A company's total R&D expenditure is the cost of all goods and services that relate to eligible R&D activities in the income year and for which a deduction is available in that year (see [86]).
- The total R&D labour expenditure is the same amount as determined under the wage intensity calculation (see [61]).

129. A company needs to do all these calculations to determine which amount applies. See the example in the article in *Tax Information Bulletin* Vol 28, No 3 (April 2016):19 at 24. If the company tax rate changes, further calculations may be required under s MX 6. This is also explained at page 24 of the above article.

130. When calculating these amounts, some expenses excluded from some calculations are included in others. The differences between the calculations are summarised in Table | Tūtohi 1 and Example | Tauira 15.

Table | Tūtohi 1: Expenses included in the different calculations

Expense type	Total R&D labour expenditure	Deductible expenditure (R&D expenditure & net loss)
External contractor payments for eligible R&D	Only 66% included	Full amount included (unless capital)
Employees/contractors work on capital R&D projects	Included	Not included (unless s DB 33 or s DB 34 allows)
Payments to member of group or employee of member of group for R&D	Not included	Included (unless capital)
R&D salary/wages funded by government grant (s DF 1)	Included	Not included to the extent funded by grant

Example | Tauira 15: R&D expenditure compared with total R&D labour expenditure

Op Co and Management Co from Example | Tauira 6 are members of an R&D group.

Op Co is carrying on eligible R&D activities (Project Z). It incurs salary and wage expenditure of $400,000 for the team working on Project Z. Op Co had also incurred expenditure of $160,000 for R&D services provided by Management Co (through shareholder employee John).

Op Co excluded the amount paid for the services John provided from its R&D labour expenditure for calculating wage intensity.

However, for calculating its R&D expenditure, Op Co determined that the payment to Management Co is deductible, and it meets all the requirements to be R&D expenditure. Unlike the wage intensity calculation, the R&D expenditure calculation does not limit the contractor payment to 66%. The full amount is included.

Treatment of losses

131. Once the available amount of credit is calculated, the company will have some or all of its net loss extinguished (s MX 5). The loss is extinguished because it has been cashed out by the company claiming the credit.

132. The amount of loss extinguished is:

    the amount of the R&D loss tax credit / the basic tax rate for a company (28%)

133. If the amount of loss extinguished is less than the company's available net tax loss, the remaining losses for that year may be carried forward to the next tax year. For further details about the requirements for carrying forward company losses see IS 22/07.

134. If losses are carried forward the company cannot then cash-out those losses in a later year, but it can offset them against income or they can be carried forward to future years.

135. The extinguishment of losses is illustrated in Example | Tauira 16.

Example | Tauira 16: Calculation of R&D loss tax credit and losses extinguished

Research Co is carrying on an R&D project in the 2022 income year and has:

- a net loss of $700,000;
- total R&D expenditure of $525,000; and
- total R&D labour expenditure of $450,000.

The amount of R&D loss tax credit available is the lowest of:

- $560,000;
- net loss ($700,000) x 28% = $196,000;
- total R&D expenditure ($525,000) x 28% = $147,000; and
- 1.5 x R&D labour expenditure ($675,000) x 28% = $189,000.

The amount available as the R&D loss tax credit is $147,000.

The amount of tax loss extinguished under s MX 5 is:

$147,000 / 28% = $525,000.

Research Co meets the requirements to carry forward its remaining losses and carries forward those tax losses to the next tax year. This is calculated as:

net loss for the year - losses extinguished = losses carried forward

$700,000 - $525,000 = $175,000

Research Co cannot claim the tax losses carried forward ($175,000) as R&D loss tax credits in any subsequent tax year.

Repayment obligations

136. A company that has an R&D loss tax credit has obligations regarding the repayment of the tax credit. This is important for companies to realise, as subsequent events can trigger a requirement to repay the credits that were previously cashed out. Imposing repayment tax is not intended to deter a company from claiming an R&D loss tax credit but reflects that in some circumstances it is appropriate for the R&D loss tax credit to be repaid.

137. The general repayment obligation is that as the company pays tax on income, this is treated as a repayment of the R&D loss tax credit. This is illustrated in Example | Tauira 17.

Example | Tauira 17: Repay R&D loss tax credit by payments of income tax

R&D Co claims an R&D loss tax credit for the 2020 income year of $79,800. This results in the extinguishment of all its 2020 net loss of $285,000. R&D Co has no losses carried forward from prior years.

In the 2021 income year R&D Co has taxable income of $100,000. R&D Co has no losses available to offset against its income as its previous losses were cashed

out and extinguished. Accordingly, R&D Co has tax to pay of $28,000 ($100,000 x 28%).

In the following income year R&D Co has taxable income of $200,000. R&D Co has no losses available and has tax to pay of $56,000 ($200,000 x 28%).

At the end of the 2022 income year R&D Co has repaid the R&D loss tax credit claimed ($79,800) through the payment of income tax of an equal amount $79,800 ($28,000 + $51,800). R&D Co has fully repaid the R&D loss tax credits.

Early repayment events – "loss recovery events"

138. In certain situations the company is required to make an early repayment of a previously claimed R&D loss tax credit. These situations are referred to as "loss recovery events". If a loss recovery event occurs the company will have a liability for an amount of R&D repayment tax. The amount of R&D repayment tax depends on the type of event that has occurred.

139. The types of loss recovery events are when:

- the company disposes of or transfers intangible property, core technology, intellectual property or know-how for less than market value, and/or where the amount is not assessable income of the company;
- the company is no longer New Zealand resident;
- a liquidator is appointed; or
- there is a loss of the required shareholder continuity.

140. For detailed discussion of the repayment events see the article in *Tax Information Bulletin* Vol 28, No 3 (April 2016):19 at 25 to 28. Each loss recovery event has a formula for calculating the amount of R&D repayment tax. A component of each calculation is the total amount of R&D loss tax credits that the company has ever claimed (ss MX 7(2)(a), MX 7(4)(a) and s MX 7(6)).

141. Because the R&D repayment tax is calculated from the first year for which the company has claimed an R&D loss tax credit, a company needs to ensure it keeps records to support the calculations that will be required. This means a company needs to keep a record of any repayments it has made (including by paying tax). A company must file an R&D statement in relation to R&D repayment tax that they must pay for a tax year.

142. A company also should keep in mind that, from the first year in which it claims the R&D loss tax credit, the credit may need to be repaid early. As noted below, this means it is best practice to determine the value of any property created by the R&D

and the company's shares, on an ongoing basis, in the event that a repayment event occurs.

Disposal of property, core technology, intellectual property or know-how

143. The first loss recovery event is when a company disposes of or transfers intangible property, core technology, intellectual property or know-how. However, a loss recovery event does not arise if the disposal or transfer is:

- to an amalgamated company as part of an amalgamation; or
- at market value or above and the consideration received is assessable income of the company.

144. The market value of property is a factual question that depends on the circumstances of each case. A company that has claimed an R&D loss tax credit may want to give some thought to how to value the property it is creating. This means that if the relevant property is sold, the company will have the information to be able to establish the market value at that time. The relevant market for determining market value is an open market, and not the value to the particular company. This is illustrated in Example | Tauira 18.

Example | Tauira 18: Intellectual Property disposal at market value not a loss recovery event

Startup Co is incorporated in June 2019 to undertake R&D work for an innovative new manufacturing process, with a plan of selling the intellectual property created. However, its R&D project failed, and Startup Co was in the process of winding up its activity.

Startup Co had routinely considered what the intellectual property generated was worth, and sold the intellectual property for open market value to its founder. The amount received is assessable income.

As the intellectual property was sold at market value and was assessable income, no loss recovery event occurs. However, depending on how the company winds up, other events could arise.

Determining market value can be difficult. It is important to realise that the market value is the value on the open market, and not the value to the company that is winding up.

Migration of company

145. The second loss recovery event is when a company fails to meet a corporate eligibility requirement in s MX 2(a) or (b). A company will fail this requirement if it ceases to be a New Zealand resident company or is treated as a resident of a foreign country or territory under a double tax agreement.

Appointment of a liquidator

146. The third loss recovery event occurs if the company has a liquidator appointed.[7] A liquidator can be appointed by special resolution of the company's shareholders, the board of the company, or a court order.

147. The appointment of a liquidator is not the same as the removal of a company from the companies register. A company can be wound up in different ways. This event is only triggered on the appointment of a liquidator.

Loss of shareholder continuity

148. The fourth loss recovery event occurs if the company breaches the shareholder continuity requirements set out in s MX 7(1)(b).

149. Shareholding continuity will not be breached if at least 10% of the voting interests in the company are held by the same group of persons throughout the relevant period. For further information on calculating voting interests see IS 22/07.

150. A company that has claimed an R&D loss tax credit must track shareholding changes in the company from the first credit year (that is, from the first year in respect of which they have claimed an R&D loss tax credit) until the R&D loss tax credits have been repaid in full. This enables the company to determine whether a shareholding continuity breach has occurred.

151. For this event, the value of the company's shares is relevant to the calculation of the amount of R&D repayment tax (refer to Table | Tūtohi 2). As already noted, "market value" is a factual question. A company that has claimed an R&D loss tax credit may want to consider how it will determine the market value of its shares, if there is a breach of the required shareholder continuity.

152. If a holding company is interposed between the original shareholders and the R&D company, that holding company is looked through to the ultimate shareholders

[7] In Taxation (Annual Rates for 2015-16, Research and Development, and Remedial Matters) Bill Officials' report on the Bill (Policy and Regulatory Stewardship, Inland Revenue, 2015) p 18, Officials commented that it was anticipated that a number of companies will be liquidated because they cannot meet their debts and the Commissioner will be an unsecured creditor. The unrecoverable nature of much of this debt was included in the estimated fiscal cost of the policy.

(s YC 4). There will not be a breach of the shareholder continuity requirement in that event. This is illustrated in Example | Tauira 19.

Example | Tauira 19: Shareholding continuity – interposed holding company

R&D Co has been carrying on a business of developing widgets since the 2020 income year. R&D Co claimed an R&D loss tax credit for the 2020 income year (the earliest credit year). Since incorporation, the shares in R&D Co have been owned by Jason (50%) and Devendra (50%).

Jason and Devendra set up a holding company with each holding 50% of the shares in Hold Co. In the 2022 income year Jason and Devendra sell their shares in R&D Co to Hold Co.

Although the shares in R&D Co have been sold to Hold Co, the required shareholding continuity has not been breached. Jason and Devendra each hold 50% of the shares in Hold Co and, under s YC 4, are treated as holding 50% in R&D Co throughout the relevant period.

The sale of the shares to Hold Co does not trigger a loss recovery event.

R&D repayment tax

153. The amount of R&D repayment tax is set out in Table | Tūtohi 2 (including which calculation to apply if there are multiple events).

Table | Tūtohi 2: Amount of R&D repayment tax by loss recovery event

Loss recovery event	How much is repaid?	Which calculation?
1 Disposal of property	Lesser of: • balance of unrepaid R&D loss tax credits; or • market value of property disposed of x 0.28.	This applies only if loss recovery event 2 or 3 does not apply.
2 Breach of corporate eligibility 3 Liquidator appointed	Balance of unrepaid R&D loss tax credits	This calculation applies over others.
4 Loss of shareholder continuity	Lesser of: • balance of unrepaid R&D loss tax credits; or • market value of shares disposed of x 0.28.	This applies only if loss recovery event 2 or 3 does not apply.

R&D repayment tax – filing obligations

154. A company must file an R&D statement in relation to R&D loss tax credits they claim for a tax year and/or R&D repayment tax they must pay for a tax year. The R&D statement must be filed by the date provided in s 70C(2) of the TAA.

155. There is a place on the R&D statement to notify the Commissioner that a loss recovery event has occurred and the amount of R&D repayment tax that is to be paid for a tax year (s 70C of the TAA). The R&D statement must also show any other repayments of the R&D loss tax credit that have been made in the year, for example, a payment of income tax will reduce the balance of the R&D loss tax credits required to be repaid.

R&D repayment tax – due date for payment

156. The due date for paying the R&D repayment tax is the terminal tax date for the relevant tax year (s 70C(3) of the TAA). The terminal tax date for the company will depend on the company's balance date and whether the company's return of income is linked to a tax agent.

Deduction for repayment tax – s DV 26

157. If a company has an obligation for R&D repayment tax, the company is allowed a deduction for that amount in the same income year under s DV 26.

158. Effectively, the amount of loss that was claimed (and that has to be repaid) is reinstated by the amount of the deduction. This operates to put the company back into the same position it was in before claiming the credits (that is, the loss that was extinguished when credits were claimed). The deduction is allocated to the year in which the company incurs the expenditure on the R&D repayment tax. The company incurs this expenditure in the income year in which the event that gives rise to the R&D repayment tax (the loss recovery event) occurs. This is illustrated in Example | Tauira 20.

159. The amount of the deduction is:

amount of R&D repayment tax / basic tax rate for a company (28%).

Example | Tauira 20: reinstatement of tax losses

R&D Co's ultimate shareholders (Jason and Devendra) from Example | Tauira 19, sold all their shares in January 2021. This means R&D Co has breached shareholder continuity in the 2021 income year. The obligation for the R&D repayment tax arises immediately after the breach in shareholder continuity occurs. R&D Co calculates the amount of R&D repayment tax payable for that year as $735,000.

R&D Co is allowed a deduction for the amount of R&D repayment tax, and this deduction arises in the same income year.

The amount of deduction is calculated under s MX 7(7) as follows:

R&D repayment tax /28%

$735,000/0.28 = $2,625,000

R&D Co has a deduction of $2,625,000.

Imputation credit accounts

160. Imputation credits are credits of tax a company pays on its income and that can be attached to a dividend received by a shareholder. Imputation ensures a shareholder is not effectively taxed twice on the same amount (once when the company earns profit, and again when the shareholder receives a distribution of that profit).

161. Most New Zealand resident companies are required to establish and maintain an imputation credit account (ICA). Under s OB 4, the ICA company will have an imputation credit in their account for an amount of income tax paid.

162. Where an ICA company has claimed an R&D loss tax credit and has not had to pay R&D repayment tax, the company will have an imputation debit for the year calculated under s OB 47B. The amount of the imputation debit is the lesser of:

- the imputation credit that the company has for the year (that is, for amounts of tax paid); and
- the company's total R&D loss tax credits less the imputation debits under s OB 47B for previous income years

163. Because the amount of imputation debit is limited to the amount of tax paid during the year, the ICA company will not end up with a closing debit ICA balance due to the R&D loss tax credit.

164. The effect of this calculation means the company will not be able to attach imputation credits to dividends until it has repaid the R&D loss tax credit amounts in full (whether through paying income tax or R&D repayment tax). For an example, see the article in *Tax Information Bulletin* Vol 28, No 3 (April 2016):19 at 28.

Record keeping for the R&D loss tax credit

165. A company's record keeping requirements are set out in s 22 of the TAA. For guidance on record keeping for the R&D loss tax credit, see the Inland Revenue website (Record keeping for the research and development loss tax credit).

166. A company making a claim for R&D loss tax credits has additional matters to consider from the first credit year until the R&D loss tax credits are fully repaid.. If a loss recovery event has occurred, the company will have repayment obligations and will need to be able to calculate the amount of the R&D repayment tax. For this purpose, the company will need to maintain records that will support:

- any shareholding changes (to ensure the required continuity is maintained);
- the market value of the company's shares at the time any shares are disposed of; and
- the market value of the intellectual property and know-how resulting from the research and development (to support the value attributed to it if there is a sale or disposal).

167. If a company has a liquidator appointed, then the liquidator will also have an obligation to file the company's tax return and the R&D statement under s 70C of the TAA.

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Legislative references | Tohutoro whakatureture

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Research and Development Tax Incentive (webpage, Inland Revenue, last updated 25 June 2021) Research and development tax incentive (ird.govt.nz).

Research and Development Tax Incentive Guidance (IR 1240, April 2023)

Oxford English Dictionary (online edition)

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