

**R&D tax credit expenditure limit for internal software
development**

Guidance for applying to increase the expenditure limit

March 2009

INTRODUCTION

1. This guide outlines the process for seeking the approval of the Minister of Finance to increase the expenditure limit on internal software development.¹
2. Overseas experience highlights a risk that routine in-house software development may be reclassified as R&D expenditure. The annual \$3 million expenditure limit is intended to mitigate that risk, while the discretion allows for some flexibility in the application of the limit.
3. It is important to note that ministerial approval of an increased expenditure limit does not constitute confirmation of the eligibility of the applicant, their R&D activity or their expenditure for the R&D tax credit. Applicants are responsible for ensuring that they meet the eligibility requirements for the R&D tax credit.

MINISTER'S CONSIDERATION

4. In applying this discretion, the Minister of Finance must be satisfied that an application meets all three of the following legislative criteria:
 - the internal software development will be used mainly for the benefit of the New Zealand economy;
 - New Zealand will derive a substantial net benefit from the intended completion of the internal software development; and
 - claimants have a commitment to retain the value of their business in New Zealand.

¹ Section LH 13 of the Income Tax Act 2007 gives the Minister a discretion to raise the expenditure limit.

5. In evaluating applications against these criteria and making a decision, the Minister of Finance will take into account the following indicative factors:

- whether the results of the R&D activity will be used in New Zealand;
- the likely take-up of the innovation by other businesses in New Zealand;
- the linkages between the requesting taxpayer and other businesses in New Zealand;
- whether the R&D will result in a technological advance significant enough to give confidence that New Zealand will derive a substantial net benefit from the R&D;
- whether ownership of the asset resulting from the R&D activity, including the intellectual property, is likely to remain in New Zealand; and
- whether the team that is doing the R&D is likely to remain in New Zealand.

6. These factors are illustrative and not an exhaustive list. In considering applications, the Minister of Finance may also take into account other factors.

MAKING AN APPLICATION

When applications can be made

7. Applications may be made before the R&D activity begins and at any time during the R&D activity. The Minister of Finance will not, however, consider retrospective applications – that is, once the taxpayer has submitted their claim to Inland Revenue in relation to that activity. This means that if you estimate that the level of expenditure you will incur on eligible R&D in internal software development may exceed the \$3 million limit and you consider that you meet the legislated criteria you should apply to the Minister well in advance of preparing your R&D claim.

Necessary information

8. The following information must be provided as part of an application to increase the expenditure limit:

- a) the increase in the expenditure limit that is being sought;
- b) factual information about the applicant and the R&D activity – specifically:
 - the parties involved in the R&D activity (including the entity that will be lodging the R&D tax credit claim);
 - the nature and purpose of the R&D activity;
 - estimated start and finish dates for the R&D activity;
 - the estimated cost of the R&D activity; and

- the location where the R&D activity will be undertaken, if it is not all to be done in New Zealand.
- c) a self-assessment of how the legislated criteria will be met.

9. You also may wish to specifically address the factors detailed in paragraph 5. Further, as these factors are illustrative rather than exhaustive, you should provide any information you consider relevant. The Minister of Finance may request additional information or evidence from you to properly evaluate the application.

10. The Minister of Finance may also take into account other information beyond that provided in your application. For example, the Minister may also refer to information that is in the public arena, seek advice from other sources of information and consult as appropriate.

11. Finally, the Minister of Finance may also have regard to other factors beyond those listed in paragraph 5 or those raised in your application.

General requirements

12. There are a number of general conditions that must also be met. First, the applicant must be a party to the R&D in internal software development.

13. Secondly, the responsibility for full disclosure rests with the applicant throughout this process and any material omission or misrepresentation, whether intentional or not, will be grounds for the ministerial approval to be void. Should there be any change, during the course of the R&D activity, in the facts and outcomes underlying the information provided to the Minister of Finance, successful applicants will be required to confirm the status of the ministerial determination.

EVALUATION OF APPLICATIONS

14. Information in the application will be treated in confidence but may be viewed by advisors to the Minister of Finance, including officials from the Treasury and Inland Revenue.

15. As directed by the Minister of Finance, advisors will undertake an assessment of the extent to which an application meets the legislative criteria and report on this assessment to the Minister. As part of this preliminary assessment, officials may:

- confer with the applicant where clarification is necessary; and
- communicate their preliminary written assessment to the application;
- amend their assessment as a consequence of discussion with the applicant; and
- provide the applicant with an opportunity to make written comment to the Minister of Finance on officials' final assessment.

Approval of an application

16. The Minister of Finance's decision to approve an application does not necessarily mean that applications that might be considered to be similar will also be successful.

17. All applicants, whether successful or unsuccessful, will be advised in writing of the Minister of Finance's decision. The details of the Minister's decision will be confidential to the applicant. However, in the interests of transparency, the Minister will publish the name of a successful applicant and the increase in the expenditure limit in the *Gazette* unless an applicant can demonstrate good reasons for not doing so.

18. If the Minister of Finance approves an application and agrees to an increase in the expenditure limit, the specific terms and conditions of the ministerial determination will be provided to the applicant for review in draft before it is finalised to ensure that the conditions are clear and that the applicant understands their obligations. Officials will assist in this process.

19. Should an applicant fail to meet any of the terms and conditions included in the Minister of Finance's determination, the approved increase in the expenditure limit for internal software development is void.

20. Monitoring an applicant's compliance with the terms and conditions of a ministerial determination may be subject to audit by Inland Revenue.

TIME TO EVALUATE THE APPLICATION

21. The timeframe for the Minister of Finance to make a decision will depend on a number of factors, including the completeness and quality of the information provided by the applicant and the availability of the Minister. Applicants will be contacted if further information is required.

22. Applications are likely to take a minimum of eight weeks to be considered and applicants should take this into account in their planning.

APPENDIX ONE: FORM OF APPLICATION

All applications should be in the form of a letter and be addressed to either:

Office of the Minister of Finance
Parliament Buildings
Wellington 6160.

or

Ministerial.Discretion@ird.govt.nz.

The application should not be provided to officials from Inland Revenue or the Treasury. The Minister will refer the application to Inland Revenue or Treasury if the Minister considers it appropriate.

Please structure your application in the following way:

Application under section LH 13 of the Income Tax Act 2007

A. Your request

The level of increase in the expenditure limit being sought.

B. Contextual information

Name of the applicant	<i>Specify who will claim the R&D tax credit.</i>
IRD number	
Contact details	<i>Provide a point of contact in case further information is required.</i>
Parties involved in the R&D activity and their role in the R&D activity	<i>For example, if you are the controller of an internal software development group, please list the members of the group.</i>
Nature and purpose of the R&D activity	
Estimated cost of the R&D activity	
Estimated start and finish dates for the R&D activity	
Location of the R&D activity	<i>If it is not all to be done in New Zealand.</i>

C. Self-assessment against the three legislative criteria.

Applicants may also wish to make reference to the indicative factors that the Minister will take into account in making a determination.

- Criterion 1: The internal software development will be used mainly for the benefit of the New Zealand economy.
- Criterion 2: New Zealand will derive a substantial net benefit from the intended completion of the internal software development.
- Criterion 3: The claimant has a commitment to retain the value of their business in New Zealand.

D. Any other relevant information