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Business Entity Eligibility

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Eligible Entities

Most types of New Zealand-based businesses are eligible to claim the RDTI (R&D Tax Incentive), regardless of their legal structure. For example, an eligible entity may be structured as a company, partnership, joint venture (JV), trust or as a sole trader.

The RDTI takes the place of the Callaghan Innovation Growth Grant as the Government's major form of R&D funding support for businesses. The Growth Grant will cease to exist after 31 March 2021. Different eligibility criteria apply for the RDTI. The RDTI is aimed at a broader base of businesses than the Growth Grant. The rationale behind the RDTI's broader "business entity" definition is to ensure that tax rules do not have any influence on business structuring decisions.

KEY ELIGIBILITY REQUIREMENTS

In order to be eligible to claim the RDTI, a business must meet all the below requirements:

- Have a core R&D activity in New Zealand,
- Have a New Zealand fixed establishment,
- Carry on business in New Zealand,
- Own the results of its R&D (or be able to use the results for no further cost).

WHAT DOES IT MEAN TO HAVE "A CORE R&D ACTIVITY IN NZ"?

A core R&D activity needs to meet all the following requirements. It must:

- | | | | |
|---------------------------------------------------|--------------------------------------------------------|---------------------------|-------------------------------------------------------|
| 1 | 2 | 3 | 4 |
| Aim to create new or improved knowledge or things | Aim to resolve scientific or technological uncertainty | Use a systematic approach | Be performed by you or by a contractor on your behalf |

For more information about core activities, refer to the Eligible Activities information on the RDTI Hub.

CARRYING ON BUSINESS IN NEW ZEALAND

For a business to be eligible to claim the RDTI, it must **carry on business through a fixed establishment in New Zealand**. That means the business must be engaging in a trade, profession, or undertaking with the intention of making a profit.

A **fixed establishment** in New Zealand is a fixed place of business in which substantial business is carried on. It is not enough for the business just to have facilities for storage, information gathering and advertising. Most businesses doing core R&D activities in-house should have a fixed establishment.

"FIXED ESTABLISHMENT" EXAMPLE 1 – US Co

US Co, a foreign pharmaceuticals company, wants to run clinical trials of a new drug in New Zealand through a clinical trials company (not an associate). US Co does not do any other business in New Zealand.

NZ Co performs core and supporting activities in NZ on behalf of US Co. It does not own the results of the R&D performed for US Co.

Is US Co eligible to claim the RDTI?

No. While US Co does have a core activity in New Zealand (through NZ Co doing R&D on its behalf), it does not carry on business in New Zealand through a fixed establishment.

"FIXED ESTABLISHMENT" EXAMPLE 2 – French Rocket Co (FRC)

French Rocket Co (FRC) wants to test its rockets in an area with little sky traffic. So FRC builds a facility in Tauranga to conduct its launch testing in-house.

Is FRC eligible to claim the RDTI?

Yes, because FRC carries on business through a fixed establishment in New Zealand (through its launch testing facility).

OWNERSHIP OF R&D RESULTS

To be eligible to claim the RDTI a business must satisfy the RDTI ownership requirement. There are two main ways the ownership requirement can be satisfied. The first relates to **actual ownership**, the second relates to an RDTI claimant's **right to use the results** of the R&D.

To satisfy the requirement through **actual ownership**, an RDTI claimant must:

- Own the results of the R&D, or
- Be part of a joint venture (JV), look-through company (LTC), or partnership that owns the results, or
- Be in the same group of companies with a company that owns the results of the R&D (provided that company is tax resident of a country or territory New Zealand has a double tax agreement with).

*New Zealand has DTAs with forty jurisdictions including Australia, China, Japan, and the USA. For a full list of New Zealand's DTA countries and territories, refer to the DTA information on **Inland Revenue's website**.

Alternatively, the ownership requirement can be satisfied if an RDTI claimant has a right to use the results of the R&D for no further consideration, either:

- Themselves, or
- Through a partnership, LTC, or JV of which they are a member.

These ownership requirements help Inland Revenue to determine whether someone is a principal commissioning some R&D (a person who is eligible to claim the RDTI), or a contractor (someone who is not generally eligible to claim the RDTI). They also help prevent double dipping.

"OWNERSHIP OF R&D" EXAMPLE 1 – US Co

US Co, a foreign pharmaceuticals company, wants to run clinical trials of a new drug in New Zealand through a third party clinical trials company. US Co does not do any other business in New Zealand and is not eligible for the credit.

NZ Co performs core and supporting activities in New Zealand on behalf of US Co. NZ Co does not own the results of the R&D performed for US Co.

Does NZ Co satisfy the ownership requirements?

No. while NZ Co does carry out business in NZ and have a fixed establishment here, it does not own the results of the R&D it does on behalf of US Co.

"OWNERSHIP OF R&D" EXAMPLE 2 – AU Co and NZ Co – who can claim?

AU Co owns NZ Co. It funds NZ Co to do some R&D in New Zealand. AU Co owns the results of NZ Co's R&D. AU Co is a tax resident of Australia and has no fixed establishment in New Zealand.

NZ Co carries out business through a New Zealand fixed establishment. The company does eligible core and supporting R&D activities in New Zealand for AU Co. NZ Co doesn't own the R&D results, but AU Co does.

Which entity is eligible for the RDTI?

AU Co is **ineligible** because it does not carry on business through a New Zealand fixed establishment.

NZ Co may be **eligible** because:

- it carries on business through a fixed establishment in New Zealand,
- it has a core activity, and
- the results of its R&D activities are owned by its parent, AU Co, which is located in a DTA territory.

Ineligible Entities

Key facts:

Some business entities are ineligible to claim the RDTI. These include:

- Callaghan Innovation Growth Grant recipients (note that the Growth Grant has been retired in the 2020/2021 income year).
- Some Crown-owned entities
- Foreign tertiary education organisations
- R&D contractors.

Some business entities which receive certain types of exempt income will be ineligible from year 2 of the RDTI scheme (i.e. from the 2020/2021 income year).

GROWTH GRANT RECIPIENTS

Businesses cannot receive both the Callaghan Innovation Growth Grant and the RDTI for the same income year. This exclusion extends to associates and entities controlled by a Growth Grant recipient.

CROWN-OWNED ENTITIES

Some Crown-owned entities cannot claim the RDTI. These entities include:

- Crown Research Institutes,
- District health boards,
- Tertiary education organisations, and
- Callaghan Innovation.

The exclusion also extends to associates and entities controlled by these organisations. The use of the word "control" is not defined in tax law but could include ownership of 50% or more of shares or voting interests in another entity. It could also include controlling appointments to an entity's controlling board. Control transfers through entities – for example, if **A Co** controls **B Co**, and **B Co** controls **C Co**, then **A Co** is also considered to control **C Co**.

Entities are considered to be "associates" when they have a close relationship and common interest. Examples of associated entities include:

- A partner and their partnership
- A person and a company, when the person owns or controls 25% or more of the company's interests
- A person and their family
- Where there are two separate companies, an individual or group that has a controlling stake in both companies.

FOREIGN TERTIARY EDUCATION ORGANISATIONS

Foreign tertiary education organisations are not eligible for the RDTI. This includes associates and entities controlled by such organisations.

ENTITIES WHICH DERIVE (SOME KINDS OF) EXEMPT INCOME

From year 2 of the RDTI scheme (i.e. from the 2020/2021 income year), entities which derive certain kinds of tax-exempt income will be ineligible for the RDTI. Excluded entities include local authorities, public authorities, charities, and local and regional promotion bodies.

Unlike the exclusion for Crown-owned entities, this exclusion does not extend to associates. That means just having an excluded entity (e.g. a charity) in your business structure won't make you ineligible.

Find out more about ineligible entities on pages 24-28 of Inland Revenue's detailed guidance.

R&D Contractors

R&D contractors perform R&D activities on behalf of someone else. Contractors generally are not eligible for the RDTI, as principals (the business commissioning the R&D) are expected to claim. This rule prevents two entities from claiming the RDTI for the same expenditure, which stops double-dipping.

It may not always be clear whether someone is a contractor. Here are some key factors to consider:

- Has the person or entity been contracted to conduct R&D or contracted to produce an outcome?
- Who has control over the R&D activity?
- Who owns the results of the R&D?
- Who is bearing the financial risk?

For further information, refer to page 27 of Inland Revenue's detailed guidance.

R&D CONTRACTORS EXAMPLE

A Co is developing a zero-emissions car engine. It has completed a prototype, but does not have the capacity to produce a car chassis to test it in. A Co contracts B Co to make a test chassis to house the engine. A Co satisfies the eligibility criteria and owns the results of B Co's R&D work on the test chassis.

Who can claim?

B Co **cannot claim** as it is an R&D contractor and does not own the results.

A Co **may be able to claim** the RDTI as it is the principal and owns the results.

Special rules for partnerships and joint ventures (JVs), and look-through companies (LTCs)

It is a requirement that each individual partner in a partnership, owner of an LTC, or JV member ("member") must file their own RDTI claim. Each member must also be a tax resident of New Zealand for their whole income year, in order to be eligible.

However, certain eligibility criteria can be satisfied by a partnership, LTC, or JV as a whole and attributed to each member wishing to claim. This includes:

- Eligible entity criteria,
- Eligible activity requirements, and
- The \$50,000 minimum expenditure threshold.

You can find further information about this on page 29 of Inland Revenue's detailed guidance.

JOINT VENTURE EXAMPLE – A Beer Cheese Joint Venture

***Yummy Cheese Co** is a larger company that wants to incorporate beer flavour into a cheese it is developing. It doesn't have enough expertise in beer to develop its own beer-flavoured cheese but is interested in partnering with a beer company.*

***Cool Craft Beer Co** is a loss-making, R&D intensive start-up in the craft beer scene. It has some new and exciting IP it wants to use as a basis for conducting further R&D – it wants to develop a food seasoning that tastes like beer. Cool Craft Beer Co doesn't have enough cash flow to invest in a new project.*

The two companies form a joint venture (JV) in which Cool Craft Beer Co provides the IP and labour to work on producing the beer seasoning, and Yummy Cheese Co provides the facilities and funding for the R&D work on the new beer seasoning.

Who owns the R&D results?

Cool Craft Beer Co:

- Owns the results of the R&D itself
- Is a New Zealand resident for the income year
- Satisfies the "in business" and fixed establishment requirements

Yummy Cheese Co:

- Has the right to use the results of the R&D to develop and commercialise beer-flavoured cheese
- Is a New Zealand resident for the income year
- Satisfies the "in business" and fixed establishment requirements

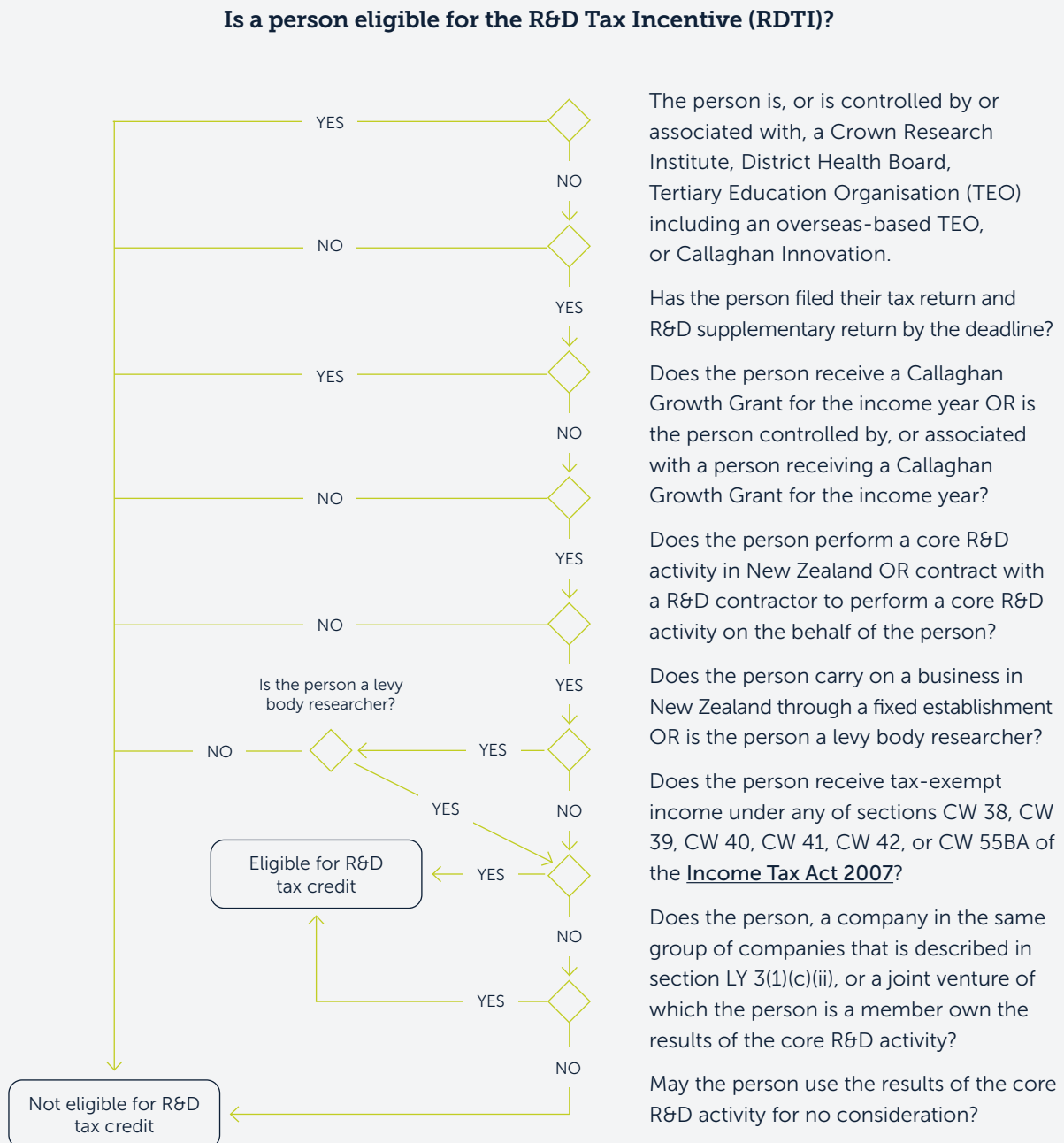
Who is eligible?

Both companies may be eligible because they satisfy the ownership requirement:

- Cool Craft Beer Co owns the results
- Yummy Cheese Co satisfies the requirement because the JV, as a whole, owns the results (because a member of the JV – Cool Craft Beer Co - owns the results).

Summary

A high-level summary of the eligible entity rules can be found in the flowchart below.



Year 2 approvals process (from the 2020/2021 income year)

If you think your business is eligible to make an RDTI claim, it is important to note that from the 2020/21 income year (1 April 2020 for most businesses), “in-year” approval will be mandatory for all businesses. There are two types of approval: general approval and criteria and methodologies approval:

- Most businesses will need to get **general approval**, which must be obtained for core and supporting R&D activities.
- If you expect to spend more than \$2 million on eligible R&D in a given income year, you may be eligible for **criteria and methodologies approval (“CAM”)**. If eligible, you can opt to get CAM instead of general approval.

For further information, refer to page 106 of Inland Revenue’s detailed guidance.

Where do I find more information?

For further guidance information to help you determine whether your business entity is eligible to claim the RDTI, visit Inland Revenue’s detailed guidance.

