

Taxation (Research & Development Tax Credits) Bill

Chartered Accountants ANZ 14 December 2018



Chartered Accountants Australia and New Zealand

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Members are known for their professional integrity, principled judgment, financial discipline and a forward-looking approach to business which contributes to the prosperity of our nations.

General Position

In formulating its submissions, Chartered Accountants Australia and New Zealand takes a best practice, public policy perspective. That is, we endeavour to provide comment on a “what is best for New Zealand” basis.

We recognise Government’s legitimate right to set tax policy direction. We comment on those policies, and also make comment on their practical implementation. Our public policy perspective means we endeavour to provide comment free from self-interest or sectorial bias.

Research confirms that in practice the best tax system is one with a broad tax base and low tax rates. Such an approach restricts the conditions that make tax avoidance attractive.

Our guiding principles in formulating this submission are that New Zealand’s tax system must not impede New Zealand’s international competitiveness; growth of the New Zealand economy; and innovation and entrepreneurship.

Recognising there are judgments and trade-offs, taxes should, as far as possible:

- be simple in their application;
- provide certainty in their application;
- be perceived as broadly fair;
- minimise the costs of compliance and administration;
- minimise distortions to the economic behaviour of individuals and businesses;
- utilise businesses’ own accounting systems as the data source for calculation;
- align the obligations with the businesses’ own cash flows; and
- be imposed at an overall rate which allows adequate retention of investment funds within businesses.

We believe one of the pillars of an effective and efficient tax system is taxpayer certainty. This will increase voluntary compliance, decrease administration costs, and deliver positive economic benefits. Tax legislation must be as clear in its policy intent and application. Further, any identified errors post-enactment should be corrected without delay.

In Chartered Accountants Australia and New Zealand’s view tax legislation should not be retrospective unless it corrects an anomaly to ensure taxpayers pay no more tax than Parliament intended. Retrospective application dates undermine the principle of taxpayer certainty and the Generic Tax Policy Process.

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14 December 2018

The Chair
Finance and Expenditure Committee
Parliament
Wellington

Taxation (Research and Development Tax Credits) Bill

Thank you for the opportunity to submit on the Taxation (Research and Development Tax Credits) Bill. We would like to appear before the Finance and Expenditure Committee to discuss our submission.

CA ANZ understands and supports the Government's motivation to encourage investment in R&D in New Zealand to stimulate innovation and business growth which will benefit the economy now and into the future. As a matter of principle however, we do not believe that an R&D tax credit regime is superior to a grant system. CA ANZ respects the Government's decision to cancel the Callaghan growth funds and introduce an R&D tax credit. Given that decision, we believe it is critical to ensure the regime is fiscally sustainable and that the appropriate balance is struck in terms of administrative compliance.

Our principle comments in respect of the key proposals in the Bill are set out below. We have focused on key issues and have not undertaken a full review of every clause of the Bill.

Compliance costs

The Government's desire to support a larger number of firms that previously have had no R&D support by significantly reducing the threshold to \$50,000 is commendable. However, we are concerned that the proposed administrative requirements and associated compliance costs may erode the value of the scheme to the "smaller" entities who perform R&D. We believe if a simplified, lower administrative/compliance cost option is designed and developed for the smaller R&D participants, the scheme will have wider reach and increase the net R&D benefit.

It is also important that administrative requirements take into account the practicalities of identifying new R&D initiatives in the context of existing operations.

Contracted expenditure

In our view the policy decision to limit contracted R&D expenditure to 80% of the contract amount to prevent the principal from receiving an R&D tax credit on the contractor's profit margin is flawed. The Commentary implies that R&D expenditure incurred by a person carrying on an R&D activity in their own right comprises solely of employment remuneration. This is simply not correct. R&D expenditure may include materials or services from persons who are not contractors and those payments will include a profit element. We recommend 'eligible expenditure' include the total contract amount less 'ineligible expenditure'.

We also recommend that an R&D contractor be required to provide a declaration describing the work undertaken and the amount of the 'ineligible expenditure'. A principal should be able to rely on a declaration and not be subject to the proposed anti-avoidance rule in proposed section GB 56.

Foreign expenditure

The Government's desire to support R&D activities carried out in New Zealand must be balanced with the need to obtain overseas expertise due to the lack of local experts. In our view the proposed cap on overseas expenditure should be increased to 20%. A 20% cap should ensure New Zealand businesses obtain overseas expertise where necessary to enable a successful completion of an R&D project, the wider benefits of which will ultimately be received in New Zealand.

Part-year continuity rules

CA ANZ notes that the proposed continuity rule does not include part-year rules that allow a company to receive an R&D tax credit in the year that a breach of continuity occurs when eligible R&D expenditure is incurred post the shareholding change.

Similarly, the proposed rule does not allow a company to utilise a carried forward R&D tax credit to offset any tax liability arising from the profit derived in the period before the shareholding change.

We recommend part year continuity rules be included that are consistent with the part year loss carry forward rules. This will ensure that substantially the same people who incurred the R&D

expenditure are able to benefit from the R&D tax credit when it is applied in satisfaction of a tax liability.

Terminology

The proposed legislation uses a number of phrases, such as “business as usual”, “commercial production”, “employers’ contribution” where the intended meaning is not obvious nor are the terms defined. We recommend these phrases be defined or replaced with tax terms. Alternatively, the intended meaning should be explained in published commentary.

Yours sincerely



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Overview

To help increase business R&D undertaken in New Zealand to 2% of gross domestic product by 2028 the Government proposes to introduce an R&D tax credit.

The key proposals include:

- A 15% tax credit rate on eligible expenditure from the 2019/20 income year;
- R&D expenditure from \$50,000 up to \$120 million per year (subject to some exceptions) will qualify;
- Foreign R&D is capped at 10%;
- An R&D activity requires a systematic approach, creates something new and resolves scientific or technological uncertainty;
- R&D tax credits refundable for companies up to a maximum of \$255,000 per year if they qualify for the existing R&D loss cash out regime;
- State Owned Enterprises, industry research cooperatives, levy bodies, and minority-owned subsidiaries of select Crown entities qualify.

Eligibility

We support the following proposals unless stated otherwise:

Clause	Section	Description	Comment
R&D tax credits			
Clause 10	proposed new section LY 1	Defines contracted research and development expenditure for the purposes of section LY 5.	See submission 1 below.
Eligible persons			
Clause 10	proposed new section LY 3	Sets out the basic tests that must be satisfied before a person can receive a R&D tax credit	See submission 5
R&D activities			
Clause 10	proposed new section LY2	Defines ‘core research and development activity’, ‘research and development activity’, and ‘supporting research and development activity’.	See submission 2 ; submission 3 and submission 4 .
Clause 21(6)	Amends section YA 1	Inserts a new definition of core research and development activity, consequential to the definition of core research and development activity in section LY 2.	
Clause 21(14)	Amends section YA 1	Inserts a new definition of research and development activity, consequential to the definition of research and development activity in section LY 2.	
Clause 21(16)	Amends section YA 1	Inserts a new definition of research and development tax credit.	
Excluded activities			
Clause 22	proposed new schedule 21, part A and part B	Inserts new schedules 21 and 21B, namely schedules of eligible and ineligible expenditure and of ineligible activities, as criteria for a person’s entitlement to research and development tax credits.	

Clause	Section	Description	Comment
Internal software development			
Clause 21(10)	Amends section YA 1	Inserts a new definition of internal software development expenditure to ensure that inappropriate expenditure on internal software development is not counted, under schedule 21B, part B	
Clause 22	proposed new schedules 21 and 21B	Inserts new schedules 21 and 21B, namely schedules of eligible and ineligible expenditure and of ineligible activities, as criteria for a person's entitlement to research and development tax credits.	

Eligible expenditure			
Clause 10	proposed new section LY 5	Defines eligible research and development expenditure.	See submission 6 .
Clause 22	proposed new schedules 21 and 21B	Inserts new schedules 21 and 21B, namely schedules of eligible and ineligible expenditure and of ineligible activities, as criteria for a person's entitlement to research and development tax credits.	

Contracted expenditure			
Clause 10	proposed new section LY 6	Defines contracted research and development expenditure for the purposes of section LY 5.	See submission 7 , submission 8 and submission 9 .
Clause 21(15)	Amends section YA 1	Defines research and development contractor.	

Foreign expenditure			
Clause 10	proposed new section LY 7	Defines foreign research and development expenditure for the purposes of section LY 5.	See submission 10 and submission 11 .

Eligible and ineligible expenditure: schedule 21B			
Clause 6	Amends section EE 6	Ensures that 'depreciable property' includes property that is used or is available for use in deriving exempt income and is used in performing research and development activities.	See submission 12 .
Clause 21(7)	Amends section YA 1	Inserts a new definition of 'eligible research and development expenditure'	

Clause	Section	Description	Comment
Clause 22	proposed new schedule 21B	Inserts new schedules 21 and 21B, namely schedules of eligible and ineligible expenditure and of ineligible activities, as criteria for a person's entitlement to research and development tax credits.	See submission 13 .

Research and development tax credits

Clause 10 (proposed new section LY 1)

Proposal

Proposed section LY 1 sets out the purpose of subpart LY.

Submission 1: clarify meaning of 'business-as-usual'

The meaning of *'business-as-usual'* should be clarified.

Comment

Proposed section LY 1(1)(b) refers to *'business-as-usual'*. To ensure there is no ambiguity this term should be defined in the legislation or dealt with in commentary.

R&D Activities

Clauses 10 (proposed new section LY 2), 21(6), 21(14) and 21(16)

Proposal

Proposed section LY 2 sets out the meaning of key terms.

Submission 2: clarify meaning of ‘material’

The term ‘*material*’ used in proposed section LY 2(1)(ii) and (iii) should be clarified.

Comment

Proposed section LY 2(1)(ii) and (iii) requires an activity to have a ‘*material purpose*’. To ensure there is no ambiguity ‘material’ should be defined in the legislation or dealt with in commentary.

Submission 3: delete ‘day-to-day management’ requirements

Proposed section LY 2(1)(iv) should be deleted.

Comment

It is not clear why an R&D activity’s day-to-day management must be conducted in New Zealand, particularly as proposed section LY 3 requires a person to perform a core research and development activity in New Zealand. The requirement that day-to-day management be conducted in New Zealand adds nothing. Apart from measuring a person’s ability to self-manage ‘day-to-day management’ is hard to define and is purely subjective.

Submission 4: amend “the only or main purpose”

The words “*only or main purpose*” used in proposed section LY 2(3)(a) should be amended.

Comment

Proposed section LY 2(3)(a) defines a supporting R&D activity as “*an activity that has the only or main purpose of...*” The words “*the only or main purpose*” may exclude overhead expenditure that supports the R&D activity from being eligible.

Eligible persons

Clause 10 (proposed new section LY 3)

Proposal

Proposed section LY 3 sets out the basic criteria that a person must satisfy to receive an R&D tax credit.

Submission 5: delete “sole”

The word ‘sole’ which is used in proposed section LY 3(1)(c) should be deleted.

Comment

The ‘*sole right*’ test is too restrictive and will prevent persons who undertake R&D collaboratively where there are joint decision making rights, e.g. joint ventures, from receiving an R&D tax credit.

Eligible expenditure

Clauses 10 (proposed new section LY 5), 21(7) and 22

Proposal

Proposed section LY 5(1) sets out the meaning of “*eligible research and development expenditure*”, that is expenditure that will qualify for an R&D tax credit.

Submission 6: clarify definitions of ‘commercial production’; ‘employee’s contribution’

The meaning of ‘*commercial production*’ and ‘*employee’s contribution to a research and development activity*’ should be clarified.

Comment

Proposed section LY 5 refers to ‘*commercial production*’ and ‘*employee’s contribution to a research and development activity*’. To ensure there is no ambiguity these terms should be defined in the legislation or dealt with in the commentary.

Contracted expenditure

Clauses 10 (proposed new section LY 6) and 21(15)

Proposal

Proposed section LY 6(2) limits a person's eligible expenditure to 80% of the contract amount where a person pays an R&D contractor to perform R&D activities on their behalf.

Submission 7: delete 80% contracted expenditure

Proposed section LY 6(2) should be amended to remove "0.8 x".

Comment

In our view, there should not be an arbitrary distinction to exclude a profit margin where R&D is contracted out. In addition, there is no evidence to support the assertion that "*contract amount*" includes a twenty per cent profit margin. The Commentary implies that R&D expenditure incurred by a person doing R&D in their own right will comprise solely of salaries and wages. However, it fails to consider that R&D expenditure is not limited to employee salaries and wages. It may also include materials or services from persons that are not contractors, and those payments will include a profit element.

Proposal

Proposed section LY 6(3)(a) defines "contract amount" as "*the amount of consideration **paid** by the person to a contractor to perform research and development activities*" (emphasis added)

Submission 8: "contract amount" defined

The word "paid" should be replaced with "incurred".

Comment

The meaning of “contract amount” focuses on “*the amount of consideration **paid** by the person*”. This implies taxpayers must use a cash basis method of accounting for “contracted expenditure”. A cash approach does not align with the meaning of “eligible expenditure” in proposed Schedule 21B, Part A(2) which refers to “*Expenditure or loss that is not paid to employees and is **incurred** in acquiring...*” (emphasis added).

Proposal

Proposed section LY 6(3)(b) sets out the meaning of “*ineligible expenditure*”.

Submission 9: declaration of “ineligible expenditure”

The legislation should require the research and development contractor to provide a declaration setting out a description and the amount of the ineligible expenditure.

Comment

If a person has an amount of “*contracted research and development expenditure*” the research and development contractor should be required to provide a declaration setting out a description and the amount of the “*ineligible expenditure*”. The recipient should be able to rely on the declaration and should not be subject to the anti-avoidance rule in proposed section GB 56 (refer [submission 24](#) below).

Foreign expenditure

Clause 10 (proposed new section LY 7)

Proposal

Foreign expenditure will be eligible for the R&D tax credit only if it comprises no more than 10% of a person's overall R&D tax credit claim.

Submission 10: clarify 'core activities'

Proposed section LY 7 should clarify that activities performed overseas cannot be 'core activities'.

Comment

The Commentary on page 35 makes it clear that activities performed overseas cannot be core activities. Proposed section LY 7(1)(a) should make it clear that the research and development expenditure must relate to supporting activities. However, we note, it is not apparent why core activities should be excluded where the R&D core activity is primarily conducted in New Zealand.

Submission 11: increase 10% cap on foreign expenditure to 20%

Proposed section LY 7(5) should be amended. The 10% cap for foreign expenditure should be increased to 20%.

Comment

In our view the proposed 10% cap for foreign expenditure is too low and should be increased to 20%. As acknowledged in the Commentary, New Zealand businesses may need to go overseas to obtain the required expertise. Persons carrying on business in New Zealand and engaging in R&D that ultimately benefits New Zealand should not be unfairly disadvantaged because they cannot obtain the required expertise in New Zealand.

We recommend guidance is published making it clear that the cap is applied on an annual basis. That is, a claim can include eligible expenditure incurred overseas in a year up to x% of the total eligible expenditure claimed that year.

Eligible and ineligible expenditure: schedule 21B

Clauses 6, 21 and 22 (proposed new schedule 21B)

Proposal

Proposed amendment to section EE 6(1)(b) ensures that a depreciation loss for an item of depreciable property is eligible expenditure to the extent to which it is used in performing R&D activities.

Submission 12: correct defined term

Clause 6(2) erroneously refers to ‘research and development tax credit’. This should be replaced with ‘research and development activity’.

Proposal

Schedule 21B part B, clause 23, referred to in the Commentary as the ‘feedstock’ rule, includes as ‘ineligible expenditure’ expenditure that is incurred in acquiring or producing goods (including expenditure on energy) to the extent the expenditure does not exceed the market value of the goods.

Submission 13: feedstock guidance

Detailed guidance on the ‘feedstock’ rule should be published.

Comment

Specific detailed guidance setting out the application of the ‘feedstock’ rule should be published including how expenditure for energy should be identified and linked to the ‘good’ that is produced. This will help provide certainty to claimants in respect of ineligible expenditure.

Calculating the tax credit

We support the following proposals unless stated otherwise:

Clause	Section	Description	Comment
Minimum threshold			
Clause 10	proposed new section LY 4	Provides the calculation of the tax credit at the rate of 15 cents for every dollar of total eligible research and development expenditure.	
Clause 22	proposed new schedule 21B, part B	Inserts new schedules 21 Excluded Activities and 21B Eligible and ineligible expenditure being the criteria for a person's entitlement to research and development tax credits.	

Expenditure cap (including approved R&D caps)			
Clause 10	proposed new section LY 4	Provides the calculation of the tax credit at the rate of 15 cents for every dollar of total eligible research and development expenditure up to \$120 million.	
Clause 21(2)	Amends section YA 1	Inserts a new definition of approved research and development cap, to allow a variable maximum entitlement for the research and development tax credit if the procedure in the Tax Administration Act 1994 is followed.	
Clause 24(2)	Amends section 3	Inserts a new definition of approved research and development cap, to allow a variable maximum entitlement for the research and development tax credit	
Clause 30	Proposed new section 68CD	Provides a process for approving a maximum cap for a person's eligible research and development expenditure.	

Tax credit rate and calculation			
Clause 10	proposed new section LY 4	Provides the formula for calculating the tax credit at the rate of 15 cents for every dollar of total eligible research and development expenditure.	

Clause	Section	Description	Comment
Clause 21(7)	Amends section YA 1	Inserts a new definition of eligible research and development expenditure, consequential to the definition of eligible research and development expenditure in section LY 5.	

Stripping out GST inputs			
Clause 10	proposed new sections LY 1(5) to (7)	Provides that a person cannot receive research and development tax credits to the extent the person is able to claim GST input tax credits in relation to the expenditure.	

Refundability			
Clause 9	Amends section LA 5	Provides for research and development tax credits to be refundable for companies in loss or with insufficient income tax liability to use all of their credits. If the relevant criteria are met, up to \$255,000 of the remaining tax credits may be refunded, or otherwise carried forward if not able to be refunded.	See submission 14 .

Carrying forward surplus R&D tax credits			
Clause 10	proposed new section LY 8	Allows a person to carry forward their remaining research and development tax credits.	See submission 15 and submission 16 .
Clause 21(4)-(5)	Amends section YA 1	Amends the definitions of continuity period and continuity provisions, consequential to the carry forward rule for unused and unrefunded tax credits.	
Clause 21(11)-(12)	Amends section YA 1	Amends the definitions of minimum market value interest and minimum voting interests.	

Refundability

Clause 9 (Proposed new section LA 5(4B))

Proposal

R&D tax credits be refundable up to a maximum of \$255,000 for companies that:

- are in loss or with insufficient income tax liabilities to use all of the R&D tax credits;
- do not derive exempt income and is not associated with a person who derives exempt income;
- are not a listed company and are not associated with a listed company; and
- do not have an outstanding tax liability.

Submission 14: remove exclusion of companies that derive exempt income

Proposed section LA 5(4B)(a)(iii) and (iv) should be deleted.

Comment

It is difficult to understand why companies that derive exempt income or are associated with a person that derives exempt income are excluded. The requirement is overly restrictive, e.g. companies that derive \$1 of exempt income will be excluded.

We note that the Government intends to undertake further policy work on refunding R&D tax credits. In our view the work should be undertaken as quickly as possible so that persons who carry out R&D activities and do not operate through a company are not disadvantaged.

Carrying forward surplus R&D tax credits

Clauses 10 (proposed new section LY 8) and 21

Proposal

It is proposed a company must satisfy the loss continuity rules to carry forward any surplus R&D tax credits to the next year. It is proposed that the continuity period starts from the beginning of the income year in which the R&D tax credit arises and ends on the last day of the income year in which the R&D tax credit has been carried forward.

Submission 15: part year R&D tax credit incurred after continuity breach

Part year continuity rules should be included to allow an R&D tax credit that is attributable to the part period of the year after the shareholding change. To the extent the R&D tax credit is not utilised it should be available for carry forward where:

- the 49% continuity requirement is satisfied from the date of the ownership change until the end of the income year to which the R&D tax credit has been carried forward; and
- adequate accounts are provided given to the Commissioner setting out the amount of the R&D tax credit attributable to that part year.

Submission 16: part year R&D tax credit incurred before continuity breach

Part year continuity rules should be included to allow surplus R&D tax credits carried forward to be utilised from any current part-year net income that is attributable to the period before the shareholding change. Adequate accounts are provided to the Commissioner setting out the amount of the net income attributable to that part year.

Comment

The omission of part year rules for the R&D tax credit are inconsistent with the loss carry-forward rules and is unfair. The proposed R&D tax credit continuity rules could impede the goal of a strong uptake of the incentive by R&D performing firms. Part year rules will ensure that substantially the

same people who incurred the R&D expenditure are able to benefit from the R&D tax credit when it is applied in satisfaction of a tax liability or refunded.

For example, a shareholder continuity breach occurs in April 20X1. NZ Co commences an R&D activity in June 20X1 and incurs eligible R&D expenditure between June 20X1 and March 20X2. The proposed legislation does not allow NZ Co to receive an R&D tax credit for the 20X1 /X2 income year.

Other Matters

We support the following proposals unless stated otherwise:

Clause	Section	Description	Comment
Approved research providers			
Clause 21(3)	Amends section YA 1	Inserts a new definition of approved research provider, to allow a variable threshold in relation to certain persons and activities if the procedure in the Tax Administration Act 1994 is followed.	
Clause 24(3)	Amends Section 3	Inserts a new definition of approved research provider, to allow a variable threshold in relation to certain persons and activities.	
Clause 25	Inserts section 15ZB	To provide the substantive rules for approved research providers, for the purpose of allowing a variable threshold in relation to certain persons and activities for the research and development tax credit.	See submission 17 .
Clause 36	Amends section 138E	As a consequential cross-reference matter.	
Provisional tax			
Clause 21(17)	Amends section YA 1	To amend the definition of residual income tax, consequential to the use of research and development tax credits to pay tax.	
Ordering rules			
Clause 8	Amends LA 4	To insert an ordering rule for the use of research and development tax credits against income tax liability.	See submission 18 .
Imputation and Māori authority credits			
Clauses 11 – 20	New sections OB 9C, OK 6C, OP 11C	To amend the memorandum account regimes, to ensure that imputation credit accounts and Maori authority credit accounts correctly reflect research and development tax credit entitlements.	

Approved research providers

Clauses 21(3), 24(3), 25 and 36

Proposal

Proposed section 15ZB sets out the substantive rules for approved research providers.

Submission 17: insert “to the extent required” before has in New Zealand the facilities

Proposed section 15ZB(4)(b) should be amended. The words “*to the extent required*” should be inserted before “*has in New Zealand the facilities need...*”.

Comment

Proposed section 15ZB(4)(b) may preclude a person from becoming an “approved research provider” if facilities are not required and the services are performed on the client’s premises. We suggest the words “*to the extent required*” should be added.

Ordering rules

Clause 8 (Section LA 4)

Proposal

It is proposed to amend section LA 4 so that an R&D tax credit is used to satisfy a person's tax liability after imputation credits and before refundable credits.

Submission 18: include prior year R&D tax credit in the ordering rules

Section LA 4 should be amended to include a prior year R&D tax credit.

Comment

R&D tax credits should be utilised on a first-in-first-out basis. A carried forward R&D tax credit should be used to satisfy a person's tax liability after imputation credits and before a current year R&D tax credit.

Administrative requirements

We support the following proposals unless stated otherwise:

Clause	Section	Description	Comment
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Record Keeping			
Clause 26	Amends section 22	To provide appropriate record keeping requirements for the research and development tax credit regime.	

R&D supplementary returns			
Clause 27	Inserts new section 33E	To provide a special supplementary research and development tax credit return.	See submission 19 .
Clause 28	Inserts new section 36BE	To provide an electronic format for the supplementary research and development tax credit return, and to provide flexibility in specifying software in relation to the return.	See submission 20 .
Clause 29	Amends section 36C	A consequential cross-reference matter.	

R&D supplementary returns

Clauses 27 – 29

Proposal

It is proposed that a person who wishes to claim an R&D tax credit must file an R&D supplementary return within 30 days of filing their tax return for the relevant income year.

Submission 19: amend to cover persons who are not required to file a tax return

Proposed section 33E should be amended to cover persons who are not required to file a tax return.

Comment

It is proposed that a person must file an R&D supplementary return 30 days after they file their tax return. This provision assumes all persons claiming an R&D tax credit are filing a tax return. However, R&D may be carried out by a tax charity who is not obliged to file a tax return. The section should be amended to cover R&D participants in this situation.

We appreciate presently the R&D tax credit advantages only tax charities that operate through a corporate structure.

Submission 20: simplified compliance option for smaller firms

The compliance functions be simplified and streamlined for smaller firms.

Comment

The Impact Statement¹ states that “By significantly lowering the threshold for non-discretionary support of R&D, from \$300,000 to \$50,000, the R&D Tax Incentive will be available to a large number of firms that previously had no support”.

¹ Research and Development Tax Incentive Impact Statement page 3

We commend the Government for lowering the threshold and making the incentive available to smaller firms. However, we are concerned that the compliance costs associated with making an R&D tax credit claim will far outweigh the benefits received and make the scheme unattractive for the majority of smaller firms that the Government wishes to attract. Identifying the R&D activity, obtaining approval, identifying eligible and ineligible expenditure and making a claim will be a technical, complex, guidance and advice-heavy process. Indications from Australia suggest compliance costs associated with making an R&D claim are generally around \$A35,000 to \$A40,000. To make the scheme more attractive for smaller firms we recommend the development and introduction of a simpler more streamlined compliance option.

Integrity measures

We support the following proposals unless stated otherwise:

Clause	Section	Description	Comment
Amendments to secrecy provisions			
Clause 31	Amends section 81	To allow information flows that appropriately support the administration of the research and development tax credit, and related incentives and advice.	
Publication of claim details			
Clause 30	proposed new section 68CE	Provides for the publication of limited details of all people who receive a research and development tax credit.	See submission 21 .
Evaluation			
Clauses 10	Proposed new section LY 10	Provides for a 5-yearly independent evaluation of the effectiveness of the research and development tax credit regime.	See submission 22 .
Clause 31	Amends section 81	To allow information flows that appropriately support the administration of the research and development tax credit, and related incentives and advice.	
Flexibility: Orders in Council			
Clauses 10	proposed new section LY 9	Provides for Orders in Council to vary new schedules 21 and 21B, namely schedules of eligible and ineligible expenditure and of ineligible activities.	See submission 23 .
Clause 22	proposed new schedules 21 and 21B	Provides schedules of eligible and ineligible expenditure and of ineligible activities: criteria for a person's entitlement to research and development tax credits.	
Binding rulings			
Clause 24	Amends section 3(4)	Amends the definition of proscribed question, to prevent the Commissioner from making binding rulings on questions related to the tax credit.	

Clause	Section	Description	Comment
Anti-avoidance rule			
Clause 7	proposed new section GB 56	An anti-avoidance measure, to prevent abuse of the research and development tax credit.	See submission 24 .
Clause 10	proposed new section LY 1(4)	Provides a cross reference to the anti-avoidance rule.	

Penalties			
Clauses 36	Amends section 138E	A consequential cross-reference matter.	
Clause 37	Amends section 141EC	To strengthen the promoter penalties regime appropriately for the research and development tax credit regime.	See submission 25 .

Deadlines for filing and amending assessments			
Clause 10	proposed new section LY 3(2)(a)	Prevents a taxpayer from claiming an R&D tax credit if they have not filed their tax return for the relevant year within one year after the due date for filing.	
Clause 32	Amends section 89 DA	To prevent disputes where a taxpayer has failed to file a research and development supplementary return.	
Clause 33	Amends section 108	To shorten the time-bar for the tax credits, and therefore shorten the period in which back years may be opened up for re-assessment.	
Clause 34	Repeals section 113D	A consequential matter.	
Clause 35	Inserts section 113E	Provides a single opportunity to open back years for reassessment.	See submission 26 .

Publication of claim details

Clause 30 (proposed new section 68CE)

Proposal

The name of each person and their eligible R&D expenditure in dollar bands will be published two years after the end of the tax year to which an R&D tax credit claim relates.

Submission 21: reporting threshold increase from two years to five years

The two year time threshold in proposed section 68CE(2) should be increased to five years.

Comment

R&D projects may span a number of years and a two year time period is insufficient. R&D projects may be jeopardized where the claim information is published before the R&D project has been finalised and intellectual property protected, for example patent applications filed. We recommend the proposed legislation be amended to allow the reporting period to be extended if the R&D project is still going.

Evaluation

Clauses 10 (Proposed new section LY 10) and 31

Proposal

An objective and independent evaluation of the R&D regime will be carried out every 5 years.

Submission 22: five yearly evaluation

Amend proposed section LY 10 to require the Minister to also objectively and independently evaluate the R&D tax credit regime on:

- the inclusion of additional core and support activities;
- the appropriateness of the internal software development expenditure cap of \$3 million.

Comment

CA ANZ supports and commends the Government for the inclusion of a 5 yearly evaluation of the R&D regime which should ensure the rules are fit for purpose.

The five yearly evaluation should consider the inclusion of additional activities whether the software cap is set at an appropriate level.

Flexibility: Orders in Council

Clauses 10 (proposed new section LY 9) and 22 (proposed new schedules 21 and 21B)

Proposal

To allow the Governor-General to make changes to Schedules 21 and 21B on the joint recommendation of the Minister of Revenue and Minister of Research, Science and Innovation.

Submission 23: consultation required

Proposed section LY 9 should be amended to require that consultation be undertaken before a joint recommendation is made by the Minister of Revenue and Minister of Research Science and Innovation to make changes to Schedules 21 and/or 21B.

Comment

The proposed empowering provision could compromise the integrity of the tax system. We recommend amendments should only be made after consultation.

Anti-avoidance rule

Clauses 7 (proposed new section GB 56) and 10 (proposed new section LY 1(4))

Proposal

Introduce an anti-avoidance rule for arrangements involving R&D tax credits.

Submission 24: reliance on declaration issued by R&D contractor

Proposed section GB 56 should be amended to exclude a person who relies on a declaration from a research and development contractor to calculate their contracted expenditure.

Comment

The proposed anti-avoidance rule should not apply to a person who relies on a declaration provided by a research and development contractor to calculate their “contracted research and development expenditure”.

Penalties

Clauses 36 and 37

Proposal

Extends the promoter penalty regime to include persons providing services on a contingency fee basis in relation to R&D tax credit claims.

Submission 25: inflation of R&D claim

Proposed section 141EC(1)(c) should be amended to apply only where the person deliberately assists a taxpayer to inflate their R&D claim.

Comment

We question the need to categorise a person as a “promoter” because they offer services on a contingency fee basis. It is not uncommon for advisors to offer services on a contingency fee basis. This is an accepted commercial practice and could occur where it is difficult for an advisor to recover the time involved in quantifying the amount of eligible expenditure in a R&D claim.

Deadlines for filing and amending assessments

Clauses 10 (proposed new section LY 3(2)(a)) and 32 – 35

Proposal

To limit taxpayers' ability to retrospectively claim the R&D tax credit.

Submission 26: rewrite proposed section 113E

Proposed section 113E should be rewritten.

Comment

Proposed section 113E is confusing and should be rewritten to clarify that a person can only:

- adjust their R&D tax credit claim upwards once; and
- the claim must be completed within two years of the due date of their income tax return for the relevant income year.

In-year approval

We support the following proposals unless stated otherwise:

Clause	Section	Description	Comment
Approval: General approval process (year two)			
Clause 38	Part 2	Sets the application date from the 2020-21 income year.	
Clause 39	Amends section LY 3	To introduce, in the second year, pre-approval of people and their research and development activities.	
Clause 43	Proposed new section 68CB	Provides approval processes for the second year and subsequent years of the research and development tax credit for people with less than \$2 million annually eligible research and development expenditure.	See submission 27 . This should also apply for the significant performer regime.
Clause 44	Amends section 138E	To ensure that certification and approval (under new sections 15ZC, 68CB and 68CC) are not amenable to the disputes process, as matters left to the discretion of the Commissioner.	

Approval: Significant performer regime (year two)			
Clause 38	Part 2	Sets the application date from 2020-21 income year.	
Clause 39	Amends section LY 3	Amends section LY 3 of the Income Tax Act 2007, to introduce, in the second year, pre-approval of people and their research and development activities.	
Clause 42	Proposed new section 15ZC	Provides a certification process for some people to verify their research and development tax credits. People with greater than \$2 million annual eligible research and development expenditure will be able to choose to use certificates.	
Clause 43	Proposed new section 68CC	Provides approval processes for the second year and subsequent years of the research and development tax credit for people over \$2 million.	See submission 27 .
Clause 44	Amends section 138E	To ensure that certification and approval (under new sections 15ZC, 68CB and 68CC) are not amenable to the disputes process, as matters left to the discretion of the Commissioner.	See submission 28 .

Approval: General approval process (year two)

Clauses 38, 39, 43 and 44

Proposal

From 2020-21 income year all persons intending to apply for an R&D tax credit will be required to obtain approval of their core activities. Applications must be made by the seventh day of the second month after the end of the relevant income year.

Submission 27: Commissioner must respond to application within 3 months

The legislation should include a provision that requires the Commissioner to respond within a set time frame, say three months, of receipt of an application. The deadline could be subject to a waiver by the taxpayer where the Commissioner requests further information.

Comment

To provide certainty the Commissioner should, say within three months of receiving an application, be required to respond by either approving or declining the application. For example, see section 91AAM of the Tax Administration Act 1994.

Approval: Significant performer regime (year two)

Clauses 38, 39, 42, 43 and 44

Proposal

A person that opts into the significant performer regime is required to supply an R&D certificate that has been issued by an R&D certifier. A person is an R&D certifier if they:

- have requested approval from the Commissioner in the prescribed form;
- have not had their R&D certifier approval revoked in the last two years;
- have made a statutory declaration that they are competent in applying appropriate accounting and legal standards in relation to R&D tax credits;
- have declared any other matters the Commissioner requires them to declare for assuring the Commissioner that they have the legal, accounting and scientific expertise to complete R&D certificates; and
- the Commissioner approves their application.

Submission 28: R&D certifier should be a member of a professional body

Proposed section 15ZC(2)(b) should be amended to also require the person to be a member of an appropriate professional body.

Comment

Company auditors must be a member a recognised professional body and hold a practicing certificate (recognising experience, technical competence and ethical integrity). In our view, a similar requirement should be imposed on an R&D certifier. Being a member of a recognised professional body should help ensure the person is competent to audit the R&D expenditure and calculations and is also bound by professional ethics.

