Callaghan Innovation
New Zealand's Innovation Agency

Guidelines

Evidencing R&D for the R&D loan scheme

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Rukuhia te wāhi ngaro,
hei maunga tātai whetū.
Explore the unknown,
pursue excellence.

Contents

1. Introduction

The objective of the "short-term loan scheme to support R&D-performing businesses in response to the COVID-19 crisis" (the R&D loan scheme) is to encourage R&D-performing businesses impacted by the COVID-19 pandemic to maintain R&D activity in the year to 30 June 2021.

To have eligible research and development (R&D) expenditure you must have:

- Incurred or intend to incur expenditure on eligible R&D activity during the year ending 30 June 2021; and
- Expenditure must not be in the list of exclusions.

These guidelines are based on the Ministerial Direction but include additional clarification. They are not intended to be exhaustive, and you are encouraged to **discuss any matters with Callaghan Innovation directly**.

2. Recording and reporting

You must record the R&D expenditure for which you use the R&D Loan. You will be required to report on your expenditure in accordance with the Loan Contract and retain your records for audit purposes.

3. Eligible R&D

The following extract from the Ministerial Direction (June 2020) defines eligible R&D as follows:

The intention is that the loan is used to support R&D activity that the business would have performed during the year ending 30 June 2021 without the existence of the scheme but for the negative impact of COVID-19 on the availability of private sources of funding.

'Research' and 'Development' are defined as follows:

- *Research is original and planned investigation undertaken with the prospect of gaining new scientific or technical knowledge and understanding.*
- *Development is 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.*

R&D activity is distinguished from other activity by the presence or absence of an appreciable element of innovation. If the activity departs from routine and breaks new ground it is normally R&D activity; if it follows an established pattern it is normally not R&D activity.

Clarifying Principle

If necessary, when seeking to distinguish R&D activity from other activity, the further advice provided by the OECD Frascati Manual definition should be applied. R&D activity is distinguished from other types of activity by the presence of the following five criteria. The activity needs to:

- *be novel;*
- *be creative;*
- *have uncertainty about the final outcome;*
- *be performed systematically; and*
- *lead to results that will be reproducible and have the potential for transfer (to increase the existing stock of knowledge).*

Exclusions

The following types of activity are not eligible R&D activity for the purposes of the R&D loan scheme. This list is not exhaustive. Activities not specifically excluded are only eligible provided they meet all other features of the definition. Specific activities excluded are:

- *Engineering follow-through in an early phase of commercial production.*
- *Activities related to the construction, relocation, rearrangement or start-up of facilities or equipment other than facilities or equipment solely used for the businesses R&D (which may be included). Pre-production activities that occur before production but after scientific or technological uncertainty has been resolved are excluded. Excluded activities include: demonstrations of commercial viability; tooling-up for commercial production; planning the production process; developing control systems; undertaking start-up procedures; and commissioning new equipment.*
- *Routine, on-going efforts to refine, enrich, or otherwise improve on the qualities of an existing product or process, or to make cosmetic or stylistic changes to it. Where a competent professional knows that it is possible to successfully develop a product or adapt a process or recipe, and testing is only required to confirm or optimise the results, the activities are not eligible.*
- *Routine design of tools, jigs, moulds and dies, or seasonal or other periodic design changes to existing products. However, expensed design activities involved in developing a new product or process are eligible.*
- *Activities involved in ensuring that existing products or processes comply with statutory requirements or standards, and quality control, routine testing or troubleshooting during commercial production. However, testing in search of significant product or process improvements is eligible. Tests to commission equipment, calibrate, fine-tune, or optimise processes or production systems are not eligible.*

- *Adapting an existing product or process to a particular customer's need or site. Activities to adapt an existing product or process to a customer's need or site using standard engineering approaches for problem solving are not eligible.*
- *Supporting, de-bugging or making minor improvements to existing computer software. Activities using known methods to de-bug, support or make minor improvements to existing software using methods that a competent professional familiar with that type of software knows could achieve the minor improvement are not eligible.*
- *Market research or surveys, market testing, market development or sales promotion, management studies, efficiency surveys or the routine collection of information. This exclusion targets activities conducted to investigate consumers' preferences and/or potential interest in a product or service, or activities designed to encourage the consumption of products or services.*
- *Any costs involved in protecting, licensing, selling or defending intellectual property or of acquiring or using external intangible assets (eg, patent licences). This exclusion is concerned with the commercial, legal and administrative activity associated with taking steps to protect your own intellectual property; and granting rights to another party to use or access your intellectual property and covers patents, trademarks, designs and plant breeders' rights. Patent searches that are undertaken to discover the existing state of knowledge may be eligible.*
- *Interest expenses or lease payments of any kind, and any overheads that are not closely linked to R&D activities. Exclusions include interest and other financing costs and any overheads that are not closely linked to R&D activities.*
- *Prospecting or exploring for minerals, petroleum, natural gas or geothermal energy.*
- *Research in the social sciences, arts and humanities.*
- *No more than 10% of the loan funds can be spent on R&D undertaken outside of New Zealand.*

3.1 Eligible activities

Activities that would typically include R&D are described below. If this guidance does not fit your situation, contact Callaghan Innovation to discuss.

- Research activities in New Zealand for which the primary purpose is to inform the technical development of the product
- Research aimed at discovery of new knowledge
- Searching for application of new research findings or other knowledge
- Formulation and design of possible new or improved product or process alternatives
- Testing in search of significant product or process improvements or alternatives

- Evaluation of product or process alternatives
- Design, construction and testing of pre-production prototypes and models
- Development of a software system/platform, architecture and new code
- Design of tools, jigs, moulds, and dies involving new technology as distinct from routine design of tools, jigs, moulds, and dies.

4. Expenses and overhead expenses

The R&D loan scheme can be used for overhead and other expenses that are used in R&D activities. Expenses must be recorded and will need to be reported to Callaghan Innovation.

If an expense relates to performing R&D, it should be recorded directly rather than included in an overhead rate.

Examples of expenditure that can be recorded as eligible R&D expenditure are:

- Employee costs – the actual salary or wage paid to employees. Wage records should include timesheets that accurately identify the number of hours an employee spends on R&D. Employee costs that are eligible to the extent they relate to performing R&D include: salary and wages, bonuses, employee share schemes (where this is paid as part of the employee's salary package), employee recruitment and relocation costs, overtime, holiday pay, long-service pay, and superannuation contributions.

  If you or anyone else has contributed unpaid time to your R&D, you cannot attribute a value to those hours and include it as eligible R&D expenditure. Remuneration must have actually been paid to be eligible expenditure.

  Eligible salary or wages paid to shareholders is limited to the lesser of $60 per hour or actual payments made, whichever is the lesser. You must be able to demonstrate an ability to continue these payments after the R&D loan scheme ends.

- Contracted R&D or external labour. The expenditure incurred by the contractor is subject to the same exclusions as expenditure you incur yourself. Where you engage a contractor associated with you (a related party or company), you can only record the lesser of what you paid the contractor and the contractor's costs. All the profit margin is removed.
- The cost of goods or materials consumed in R&D activities or used solely for R&D activities.

  Tangible items created as part of your project that have commercial value beyond the R&D project such as prototypes, manufacturing tools or saleable items are not eligible expenditure (the commercial value must be subtracted from total R&D expenditure).

Goods purchased overseas to be consumed in R&D activity in New Zealand is eligible expenditure.

- Travel and training expenditure that is directly related to the R&D activity. Travel costs paid by loyalty scheme points are not eligible expenditure.
- Depreciation on new capital items directly used in performing R&D. The calculation is based on the time the asset is used for R&D as a proportion of total use. Use the IRD straight line depreciation rates. The acquisition of the item (purchase cost) is not eligible. Proof of purchase needs to be retained in your records.

  Depreciation on existing capital items can be captured in the overhead rate.

  Any expenditure that is an internally generated intangible asset or is capitalised as an intangible asset is not eligible expenditure.

You may also claim for expenses incurred in undertaking eligible R&D activities overseas up to a maximum of 10% of the loan applied for.

Expenses which can be recorded in an overhead calculation are activities that are associated with the R&D activity such as:

- Depreciation on existing capital items
- Insurance
- Rent
- Depreciation of right-of-use (ROU) asset (excluding interest on the lease liability) under IAS 16. (Depreciation of ROU assets was previously described as operating lease)
- Repairs and maintenance
- Utilities
- Telephone expenses
- Printing and stationary
- ACC levies
- Rates
- Accounting fees
- Office cleaning
- Security costs
- Corporate services, such as human resources

An overhead rate of 20% added to internal labour costs is considered to be a standard overhead rate.

If this standard overhead calculation does not suit your business, you can calculate overheads using alternative methods. An apportionment is required where the goods and services are also used in non-R&D activities. The overhead expense calculation can use either an estimation of percentage of use or percentage of employees who are R&D FTE to total FTE. If you calculate overheads differently please discuss your method with Callaghan Innovation.

IMPORTANT – no matter how a loan recipient chooses to calculate the overhead rate and other expenses claimed, you must keep sufficient records to easily demonstrate to an independent party how you have made the calculation and why it is reasonable.

Ineligible overhead expenses include:

- Advertising and marketing expenses
- Bad debts
- Entertainment expenses
- Interest expenses
- Legal expenses
- Salaries or wages not paid in cash (e.g. shares in the business)
- Directors fees
- Freight & delivery expenses not related to performing the R&D activity
- Motor vehicle expenses
- Directors liability insurance
- Recruitment expenses not related to performing the R&D activity
- Travel expenses not related to performing the R&D activity
- Expenses incurred using loyalty schemes (e.g. air-points, FlyBuys).

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