

**GUIDELINES FOR 150 PER CENT TAX
DEDUCTIONS FOR PRIMARY PRODUCTION
RESEARCH AND DEVELOPMENT
EXPENDITURE**

GUIDELINES FOR 150 PER CENT TAX DEDUCTIONS FOR PRIMARY PRODUCTION RESEARCH AND DEVELOPMENT EXPENDITURE

A tax deduction equivalent to 150 per cent of eligible expenditure exists for expenditure by a taxpayer in relation to primary production research and development activities carried out under an 'Approved Primary Production R&D Plan'. This deduction is the 'Concessional Primary Production R&D Tax Deduction'.

In order to be eligible for a tax concession:

- a) An application for an Approved Primary Production R&D Plan must relate to a coming financial year (Special arrangements will apply for the 2004 year).
- b) A minimum R&D expenditure threshold of K50,000 will apply:
- c) The results of the R&D activities must be exploitable on normal commercial terms and for the benefit of the Papua New Guinea community.

Rules will govern what is qualifying expenditure (in particular, interest costs will not be eligible expenditure). Certain activities will be 'excluded activities' (eg: market research; quality control; management studies) even if carried out in association with eligible R&D activities.

Expenditure must occur under an 'Approved Primary Production R&D Plan'. The purpose of this requirement is to reinforce the need for companies to think strategically about their R&D, and provides the Government with the ability to police the extent of claims being made and limit the deduction to genuine R&D.

The Plan will comprise of two parts:

- Part A: A summary of the overall plan, including how each R&D project supports the strategic business objective of the company; and
- Part B: Detailed plans for each project, including description of the technical outcomes; how the R&D will be commercialized; financial information; and the proportion of work to be carried out in Papua New Guinea.

There will be a Primary Production R&D Committee (PPRDC) within the IRC charged with considering Plans.

In order to minimize administration, an R&D Plan may be approved for a period of up to three financial years. Variations to the plan must be notified to the PPRDC, and an annual report provided on how the taxpayer gave effect to the Approved Plan during the year.

The Government shall review the operation of the Concessional Primary Production R&D Tax Deduction by 31 December 2006.

Concessional Primary Production R&D Tax Deduction Available

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Eligible R&D

The Concessional Primary Production R&D Tax Deduction relates to expenditure on Primary Production 'Research and Development activities'.

Primary Production is defined in Income Tax Act to mean production resulting directly from:

- a) the cultivation of land;
- b) the maintenance of animals or poultry for the purpose of selling them or their bodily produce, including natural increase; or
- c) fishing operations,
- d) and includes the manufacture of dairy produce by the person who produced the raw material for use in that manufacture.

'Research and development activities' are:

- a) Systematic, investigative and experimental activities that involve innovation or high levels of technical risk and are carried on for the purpose of:
- b) Acquiring new knowledge (whether or not that knowledge will have a specific practical purpose) or
- c) Creating new improved materials, products, devices, processes or services; or
- d) Other activities that are carried on for a purpose directly related to the carrying on of activities of the kind referred to in 1.

An activity is not taken to involve 'innovation' unless it involves an appreciable element of novelty.

Activities are not taken to involve high levels of technical risk unless:

- a) the probability of obtaining the technical or scientific outcome of the activities cannot be known or determined in advance on the basis of current knowledge or experience; and
- b) the uncertainty of obtaining the outcome can be removed only through a program of systematic, investigative and experimental activities in which scientific method has been applied, in a systematic progression of work (on the basis of physical, biological, chemical, medical, engineering or computer sciences from hypothesis to experiment, observation and evaluation, followed by logical conclusions.

The following activities are excluded activities' and are not eligible for the Concessional Primary Production R&D Tax Deduction, even if carried out in association with eligible R&D activities:

- a) market research, market testing or market development, or sales promotion (including consumer surveys);
- b) quality control;
- c) prospecting, exploring or drilling for minerals, petroleum or natural gas for the purpose of discovering deposits, determining more precisely the location of deposits or determining the size or quality of deposits;
- d) the making of cosmetic modifications or stylistic changes to products, processes or production methods;
- e) management studies or efficiency surveys;
- f) research in social sciences, arts or humanities,
- g) the making of donations;
- h) pre-production activities, such as demonstration of commercial viability, tooling-up and trial runs;
- i) routine collection of information, except as part of the R&D process;
- j) preparation for teaching;
- k) commercial, legal and administrative aspects of patenting, licensing or other activities;
- l) activities associated with complying with statutory requirements or standards, such as the maintenance of national standards, the calibration of secondary standards and routine testing and analysis

- of materials, compounds, products, processes, soils, atmospheres and other things;
- m) specialized routine medical care; and
- n) any activity related to the production of a commercial product or process by a physical examination of an existing system or from plans, blueprints, detailed specification or publicly available information.

Computer software activities are eligible R&D activities provided they are carried out for the purpose, or for purposes that include the purpose, of sale, rent license, hire or least to at least two non-associates of the company (ie: the product is available for multiple sale). Hence, computer software developed to solve an 'in-house' problem and not available for commercial exploitation is not an eligible R&D activity.

Other Eligibility Requirements

An application for an Approved Primary Production R&D Plan must relate to a coming financial year (ie: the application cannot relate to the current or a past financial year). For the 2004 Financial Year only the application can relate to the current tax year provided it is received by the PPRDC by 30 June 2004)

A minimum R&D expenditure threshold of K50,000 applies to companies claiming the Concessional Primary Production R&D Tax Deduction.

The R&D activities must be carried out by or on behalf of the company making the claim, and not on behalf of any other person, or as nominee or trustee of another entity. (This does not mean the claimant must actually undertake the R&D itself, but it must bear the financial risk associated with undertaking the R&D activities, must control the activities, and be the beneficial owner of the results).

The results of the R&D activities must be exploitable on normal commercial terms and for the benefit of the Papua New Guinea community.

Qualifying Expenditure

Qualifying expenditure includes:

- a) wages and salaries expenditure directly associated with the R&D activities;

- b) other expenditure incurred directly in respect of R&D activities carried on by or on behalf of the company eg: overheads and administrative cost (or appropriate apportionment) such as rent, light and power, property rates and taxes, insurance and leasing costs;
- c) contracted expenditure to other companies or Research Agencies' which have the expertise and facilities to do specified types of R&D activities on behalf of others; and
- d) expenditure on plant if it is acquired for use exclusively for carrying on R&D activities for an initial period, and actually used exclusively for that period through the year.

Where plan which has been the subject of the Concessional Primary Production R&D Deduction is sold, any income derived from that plan is taxable in the ordinary manner.

A deduction for 'feedstock expenditure' is limited to the net cost of the feedstock (ie: where products derived from an R&D process is sold, the value or sales proceeds of the product are deducted from the cost of the feedstock used in the process).

Interest expenditure, or an amount in the nature of interest, incurred in financing R&D activities is not eligible for the Concessional Primary Production R&D Tax Deduction.

Expenditure which is funded through a grant or similar recoupment received from the Government, an aid organisation or other source is not eligible for the Concessional Primary Production R&D Tax Deduction.

Companies registered for VAT/GST are entitled to claim an input credit for the VAT/GST included in its R&D expenditure. Hence, such companies stated expenditure costs for these companies should be net of VAT/GST. Companies not registered for VAT/GST are not entitled to claim an input credit for the VAT/GST included in its R&D expenditure. Hence, such companies stated expenditure costs for these companies may be inclusive of VAT/GST.

R&D Plan

To be eligible for the Concessional Primary Production R&D Tax Deduction the expenditure must occur under an 'Approved Primary Production R&D Plan'.

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R&D Plan

To be eligible for the Concessional Primary Production R&D Tax Deduction the expenditure must occur under an 'Approved Primary Production R&D Plan'.

The purpose of this requirement is to reinforce the need for companies to think strategically about their R&D as a critical and ongoing part of their business. The plan also provides the Government with the ability to police the extent of claims being made and ensure that only genuine R&D activities receive the Concessional R&D Tax Deduction.

Approval is given by the Primary Production R&D Committee (PPRDC). The Plan must be approved prior to any expenditure occurring.

A R&D Plan contains two parts:

Part A: Comprising:

- a) A description of the strategic business objective of the company;
- b) A list of all of the R&D projects proposed to be undertaken for which the Concessional R&D Tax Deduction will be sought;
- c) A description of how each R&D project supports the strategic business objective of the company;
- d) A signed statement of approval for the Plan by the Board of Directors or an 'authorized officer' of the Company.

Part B: An 'R&D Project Plan' for each project, containing as a minimum the following information:

- a) The title of the project;
- b) The name of the project manager;
- c) The date when the Plan is prepared or last updated;
- d) Background information, including the reasons for undertaking the project and a description of how the project will enhance the commercial success of the company;
- e) A brief description of any preliminary work undertaken before the commencement of the project;
- f) A statement of the technical objective or specific technical aim of the project;
- g) A description of the steps involved in commercializing or implementing the result of the project activity;
- h) A statement of the scope of the project, including the starting and finishing dates, relevant time lines or

Gantt charts covering major activities and milestones forming part of the project; and

- i) A statement of the resources allocated to the project, including budget or forecast funding for the personal, plant and facilities necessary for the project;
- j) A statement of what aspects of the project will be taken overseas (if applicable), including cost, and an explanation as to why the R&D cannot be undertaken in Papua New Guinea

It would be anticipated that each R&D Project Plan would be 2-3 pages.

An R&D Plan may be approved by the PPRDC for a period of up to three financial years.

Annual Report

Within 90 days of the end of each financial year the taxpayer must provide a report on how it gave effect to the Approved R&D Plan during the year (the 'Annual Report') to the PPRDC. The Annual Report shall include financial costs, key milestones reached and outcomes achieved.

Failure to provide an Annual Report will render a tax-payer ineligible for the Concessional Primary Production R&D Tax Deduction.

Variations to R&D Plans

It is an inevitable part of R&D process that projects will not proceed according to plan and therefore changes to an R&D Project will be required from time to time.

A company may amend an R&D Project Plan after approval has been given for the R&D Plan of which the R&D Project Plan is a part. The amendment must be approved by either the Board of Directors, an authorized officer or the project manager.

An updated R&D Plan should be resubmitted to the PPRDC if significant variations occur in relation to budget, technical objectives or outcomes. The PPRDC is not required to expressly authorize the variation to the R&D Plan, but may (within 60 days) decide to withdraw its approval.

The Commission General may refuse a deduction where the claimed R&D activity varies significantly from the Approved R&D Plan, or the taxpayer has failed to substantially give effect to the Plan, and there has not been notification of the variations to the PPRDC.

Primary Production Research & Development Committee (PPRDC)

PPRDC shall comprise of five members:

1. The Commissioner-General of the Internal Revenue Commission or his delegate, as Chair;
2. Two ordinary members involved in, or having expertise in, research and development, appointed by the Minister responsible for taxation; and
3. Two ordinary members involved in, or who have expertise in, financial or business administration, appointed by the Minister responsible for taxation.

Secretarial and support services to PPRDC will be provided by the Internal Revenue Commission.

The quorum for any meeting of the PPRDC shall be the Chair and two ordinary members (one from Division 2 and one from Division 3).

The PPRDC may approve an R&D Plan or not-approve an R&D Plan.

The PPRDC will endeavor to make a decision in relation to an R&D Plan within 60 days of it being received by the Commissioner General.

The PPRDC shall ensure its decision in relation to an R&D Plan is notified to the applicant within 14 days of its decision.

Record Keeping Rules

Companies which have an Approved R&D Plan are required to maintain complete records of R&D activity undertaken in order to determine whether the claimed deduction is valid. Companies claiming the Concessional R&D Deduction are required to maintain:

- a) written approval by management of the company for the project;
- b) records of a literature search conducted to establish the current technology and whether it is commercially viable;

- c) personnel log-sheets, diaries and time-sheets; and
- d) a document to wind up the project, such as final report, including a summary of the objectives achieved.

Review

The Government shall review the operation of the Concessional Primary Production R&D Tax Deduction by 31 December 2006.