

Research and Development Tax Incentive **Review of Implementation**

*Ministry of Business, Innovation and
Employment*

November 2020



Private and confidential

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5 November 2020

Research and Development Tax Incentive Review of Implementation

Dear Kirsty

Please find attached our final report reviewing the implementation of the Research and Development Tax Incentive. This incorporates feedback, as appropriate, received from the Ministry of Business, Innovation and Employment, Inland Revenue and Callaghan Innovation in relation to our earlier draft reports dated 9 and 15 September 2020.

Our report is provided in accordance with our CSO and the terms of business contained therein, dated 14 July 2020. Please note the restrictions regarding our report which are set out in Appendix A.

We have enjoyed working with yourself and Mary on this assignment. If there is anything else we can assist with, please do not hesitate to make contact.

Yours sincerely

Chris Gould
Director, Wellington

Colin Lynch
Partner, Wellington

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1. Executive summary

Introduction

- 1 The Government is ambitious about raising New Zealand's research and development (R&D) expenditure to two per cent of GDP by 2027. To help with achieving this goal, a research and development tax incentive (RDTI) was introduced in 2019. We have reviewed the implementation of the RDTI (also referred to as "the scheme") to assess whether it is on track to meet the underlying policy objectives. Within the scope of our review is:
 - a review of roles, responsibilities and relationships relating to the core team that has been established to administer the scheme and which comprises personnel from Inland Revenue and Callaghan Innovation
 - an assessment of the main activities of the core team being delivery of information, education and engagement initiatives aimed at raising awareness and understanding of the scheme as well as the application of a range of legislated eligibility tests that are deployed in order to determine whether a claim for RDTI is granted
 - initial observations regarding uptake of the RDTI (bearing in mind it is early days for the scheme).

Findings

- 2 Overall, reasonably good progress has been made with implementing the scheme. The core team to administer the scheme has been established and, in the view of the team, it is in the process of embedding effective ways of working. The roles and responsibilities of the core team and its members are for the most part clear. Information and education communication plans have been developed as well as a stakeholder engagement plan. RDTI guidelines have been published. A RDTI website has been established. The core team has participated in over 60 business gatherings involving almost 7,000 attendees.

- 3 Notwithstanding the progress to date, there are some issues. As the Government's key initiative to raise R&D expenditure, these issues need to be addressed urgently.

Roles and responsibilities

- 4 The intent of the core team is that it operate as a partnership between Inland Revenue and Callaghan Innovation. However, the current relationship is one of buyer of services (Inland Revenue) and provider of those services (Callaghan Innovation). In our view, this creates an unhelpful dynamic. Importantly, this arrangement appears to be one of several factors that is contributing to a situation where administration of the RDTI is placing more weight on protecting the tax base than it is increasing the level of R&D expenditure. The concept of partnership between Inland Revenue and Callaghan Innovation is reflected in a draft tripartite Memorandum of Understanding (MoU) that also includes the Ministry of Business, Innovation and Employment (the Ministry or MBIE). However, the buyer-provider relationship pervades in an existing and agreed MoU between Inland Revenue and Callaghan Innovation. The inconsistency needs to be addressed.
- 5 As part of the operating model for administering the RDTI, there was an expectation among officials and Ministers that customer-facing Callaghan Innovation personnel would play a key role in working with, and supporting, R&D performing businesses to consider the tax incentive. Free and frank opinions [REDACTED]
[REDACTED] We note that the Tax Administration Act's information security restrictions adds an additional level of complexity. Nevertheless, our reading of the relevant legislation is that there are no particular constraints on the involvement of the customer-facing personnel other than they should not cross the line into giving tax advice. This issue is no different to the challenge faced by many

regulators who must both inform and educate as well as enforce/authorise. The scope of information and education can be pushed quite a long way before coming close to crossing the line into advice.

Information, education and engagement (IEE)

6 There is a mixed picture as to how much progress has been made in achieving the aims of the IEE programme. As alluded to above, a lot of work has been done to develop and implement the IEE programme. Notwithstanding this, however, there are multiple signs that the IEE programme is yet to be fully effective. Issues in this regard appear to be limiting the level of interest in the RDTI. In particular, we note the following.

- We conducted a small number of interviews with businesses and business advisers. Without exception, they indicated that they are finding many aspects of the RDTI hard to understand. Because of this, there is real risk that businesses are being dissuaded from engaging with the regime.
- We also issued survey questionnaires to various groups (RDTI enrolees, existing Growth Grant recipients, business advisers and a few others). Although knowledge of the RDTI seems to be reasonably good among business advisers, the same is not true of the other groups; their understanding is moderate at best.
- A key test of the effectiveness of the IEE programme is the quality of RDTI claims. The core team has indicated to us that there are many problems in this respect. Part of the issue seems to be that claimants (and their advisers) are referring to other schemes in the expectation this will help them to understand the RDTI. That is a flawed approach and the IEE programme needs to address this. More direct engagement with businesses might be the best way of addressing the problems.
- Guidelines prepared by Inland Revenue are very comprehensive but, reflecting this, extend to 138 pages. “How to” guides have been developed but these are very high level and do not provide sufficient depth to facilitate claims. There is an opportunity to develop further guidance material that sits somewhere in between and that would support the Inland Revenue guidelines by providing further

information regarding specific aspects of the scheme (eg further explanation of key concepts such as what scientific and technological uncertainty means).

Eligibility tests

- 7 There is a balance between promoting R&D on one hand and protecting the tax base on the other. A range of legislated eligibility tests (relating to entities, activities and expenditure) that are applied to claims are intended to achieve an appropriate balance between these objectives.
- 8 The scope of the eligibility tests aligns well with what is provided for in legislation. However, the way in which the activity eligibility test is being applied appears to weight protection of the tax base ahead of increasing R&D expenditure. Our reading of the policy intent is that, if anything, the balance of weight should be the other way around.
- 9 Based on comments made by external stakeholders, the activity eligibility test appear to be being applied in a way that is very narrow, and is adding considerable compliance costs. This includes the following.
 - When applying the test, assessors are breaking down projects into very narrowly defined activities the effect of which is to make it very difficult to pass the test of resolving scientific or technological uncertainty.
 - The competent professional test is being applied by individuals who are highly competent experts in their fields. Free and frank opinions
 - Perhaps reflecting the previous point, when assessing whether the R&D that is the subject of a claim generates something new or improved, the assessors seem to be looking for R&D that leads to step change rather than something that is more incremental in nature and more characteristic of the R&D that is business-led (as opposed to more academic and pure in nature).
 - The approach to the “systematic approach” test also appears to be being applied in a demanding way a consequence of which is it is likely to count against smaller firms that do not have sophisticated approaches to planning and document recording.

10 The narrow approach, if being applied in the way the stakeholders perceive it, runs the risk of making it too hard to meet the requirements of the RDTI which, in turn, will work against the objective of increasing R&D expenditure. We note that there are several features of the scheme design that help to protect against unwanted erosion of the tax base, including the 15 per cent rate of credit, the caps on the amount that can be claimed and rules around expenditure eligibility. That being the case, it is not unreasonable to expect that a relatively broad approach to the legislated eligible activity test would be counterbalanced by the other checks and balances to give, overall, a good balance between the R&D and tax objectives. We note that taking a broad stance is not to be confused with flexibility (which can open the door to inconsistency). There is nothing to stop a broad interpretation of the rules being applied consistently. Examples of less restrictive applications of the tests, but which do not result in inconsistency, are provided in the eligibility section.

11 There are some other issues as well including with applications taking too long to process, a lack of proportionality between the level of compliance costs and the benefits expected to stem from the R&D and insufficient transparency of decision making. In combination with the issues around the narrow stance, these problems appear to be creating a real risk that businesses will be dissuaded from taking-up the RDTI.

Take-up

12 It is too early to have a clear view regarding the level of take-up by business of the RDTI because many businesses have yet to file their tax returns for 2019/2020. Advice received from Inland Revenue on 9 September 2020, indicated that, to date, there are fewer than 400 enrolled RDTI entities. Furthermore, fewer than 30 of these entities have submitted their general approval form, or supplementary return, which then triggers the assessment processes undertaken by Inland Revenue and Callaghan Innovation. We do not have data on the number of completed assessments.

13 Based on information obtained from the surveys and interviews, there is a mixed picture regarding likely take-up rates. Around two-thirds of respondents who took part in a survey distributed to existing Growth Grant recipients and enrolled entities indicated that would be very likely to consider applying for the RDTI. In contrast, however, external

stakeholders we interviewed were uniformly of the view that the way in which the scheme is being administered – particularly the activity eligibility test – is creating significant compliance costs. There are signs that businesses are deferring claims until they can observe and learn from the experience of other claimants. The risk with this is that few firms will be willing to be “first movers” and the scheme will struggle to incentivise the lift in R&D expenditure to the extent that is desired.

14 The level of take-up is the ultimate criteria by which the Government’s key initiative to increase R&D expenditure will be measured. While the data may not show a clear picture of take-up just yet, the opportunities to improve the RDTI should be taken now to ensure that the scheme contributes to the goal of lifting R&D expenditure.

Opportunities to improve scheme administration

15 To address the various issues summarised above, our main recommendations are set out below (with more detail provided in section 6). We recommend that:

- the relationship within the core team be repositioned as a partnership (consistent with initial expectations) and the existing MoU between Inland Revenue and Callaghan Innovation be reviewed with the intention of aligning it with the draft tripartite MoU that also includes MBIE
- the core team should seek to co-locate
- further information and education material be developed to support the umbrella Inland Revenue guide (recognising that any new scheme warrants heavy investment in information and education) with a view to the additional material sitting between the existing Inland Revenue guide and the “How to guides” that are available on the RDTI website
- case studies of successful and unsuccessful claims be published (subject to preserving taxpayer confidentiality)
- the role of Callaghan Innovation customer facing personnel be strengthened to provide more effective support for promoting interest in, and take-up of, the RDTI
- the stance taken with respect to application of the legislated activity eligibility test should be rebalanced so that, compared to the

existing situation, the bar for having a claim approved is lowered consistent with legislative purpose and, by implication, consistent with placing a bit more weight on promoting R&D and a bit less on preserving the tax base.

2. Introduction

- 16 In 2018, the Government announced a target to increase New Zealand's research and development (R&D) expenditure to two per cent of GDP by 2027, up from 1.25 per cent of GDP in 2017.
- 17 To reach the target, significant growth in business expenditure on R&D (BERD) is required. Without government support for BERD, businesses tend to invest less R&D than is optimal for the country because they are unable to capture all of the benefits from their R&D (ie R&D expenditure gives rise to significant externality benefits). The Research and Development Tax Incentive (RDTI or the scheme) is the Government's primary mechanism for addressing the externalities issue and achieving the uplift in R&D expenditure.
- 18 Although it has not been within the scope of this review to assess the merits of the scheme or its design, it is worth noting that external stakeholders interviewed as part of our work have all commented very positively about the consultation process that was undertaken as part of developing the RDTI.
- 19 For entities, activities and expenditures that meet the eligibility requirements, the RDTI subsidises 15 per cent of the cost of undertaking R&D.
- 20 The first phase of the implementation of the RDTI is for the 2019/2020 tax year, with a more comprehensive system in place for 2020/2021.

Review purpose and scope

- 21 The primary purpose of this review is to assess whether the implementation of the RDTI is on-track to meet the policy objective noted above and to deliver a world-class, user friendly and sustainable scheme. Any opportunities for improving the administration scheme should be identified.

- 22 The policy objectives of the scheme are out of scope for this review and legislative settings, that define the scheme, are also out of scope.

Approach

- 23 We reviewed various documents that describe the policy background to the scheme as well as information and education material that helps to explain the RDTI and how it is intended to work.
- 24 We interviewed:
- Ministry of Business, Innovation and Employment (MBIE)
 - Callaghan Innovation
 - Inland Revenue
 - four professional services firms ("Big Four" and mid-tier)
 - three businesses that engage in R&D (a start-up business, one medium-sized company and one major company)
 - one peak body.
- 25 We also surveyed a range of entities engaged or potentially engaged with the RDTI:
- Growth Grant recipients
 - entities enrolled in the RDTI
 - members of the Research and Development Advisory Group (RDAG)
 - members of the Regional Business Partner Network
 - members of the Corporate Taxpayers Group.
- 26 The surveys are not intended to provide statistically robust data because of the relatively few number of organisations to whom the survey was sent (and the relatively small number of responses). The surveys have been used as a cost effective way of gathering information in addition to the information obtained through the interviews.

Report structure

27 Beyond this introduction, there are four main sections as follows:

- Section 3 provides an overview of the roles and responsibilities of the core team that has been established to administer the scheme. The core team comprises personnel from Inland Revenue and Callaghan Innovation and we comment on the nature of the relationship between these two agencies.
- Section 4 reviews the information, education and engagement programme that has been developed and implemented to build interest in, and understanding of, the RDTI.
- Section 5 contains an assessment of the way in which eligibility tests are being applied by the core team. These tests are the primary mechanism for determining whether RDTI claims are approved. We also comment briefly on rates of take-up of the scheme.
- Section 6 concludes this report with some suggestions for improving the operation of the scheme.

3. Roles, responsibilities and relationships

Introduction

28 By way of background a R&D tax-loss scheme was introduced in 2015 (but was subsequently terminated and replaced by a grants-based regime). Inland Revenue and Callaghan Innovation developed a shared approach to the delivery of the tax-loss scheme. The agencies entered into a Memorandum of Understanding (MoU) that formally acknowledged the collaborative approach between the agencies.

29 Building on that experience, the service model intended for delivery of the RDTI is a continuation of the collaborative, joint agency approach. This approach is intended to ensure that the strengths of each organisation can be shared:

- Inland Revenue with extensive experience in managing tax-based initiatives
- Callaghan Innovation with expansive connections across the innovation and R&D ecosystem, strong experience in delivering R&D support initiatives, programmes and services (eg Growth Grants) and extensive R&D and commercialisation capability.

Expectations

30 Against the background summarised above, a core and dedicated team comprising Inland Revenue and Callaghan Innovation personnel has been established to administer the RDTI. As documented in various updates to Ministers on implementation of the scheme, the expectation is that the personnel will engage and collaborate as one team rather than as distinct teams from each of the agencies. In addition to specialist skills, all roles within the core team require competencies in customer engagement, relationship management, strong social intelligence and teamwork capabilities as well as general business acumen. Moreover, it is expected that the core team will successfully

blend the different cultures of both organisations building on the shared approach to delivery of the R&D tax loss scheme¹.

31 Further expectations were articulated in respect of Callaghan Innovation's roles. In particular, it is expected that Callaghan Innovation customer facing staff will provide guidance and support to customers as to how to apply for RDTI with the goal of the customer being fully informed when they decide to apply for a credit².

32 Reflecting the expectations above, we have looked for evidence of:

- a logical assignment of responsibilities (ie aligned with the comparative advantage of each agency)
- shared understanding between the parties of their respective roles and how these mesh together
- shared understanding of the objectives and principles that help define how the relationship is intended to work, and the outcomes the parties are jointly trying to achieve as well as shared understanding of respective roles and responsibilities
- roles and responsibilities being clearly documented in a MoU (or similar) with the MoU observed in spirit (and letter)
- the agencies presenting as a unified team from the perspective of external parties thereby enabling a “no wrong door” approach to service delivery and engagement with business
- arrangements that avoid duplication and promote effective collaboration and handover points.

¹ Update on Implementation of the R&D Tax Incentive 12 December 2018 (Inland Revenue 2018/747) p3

² Uptake of R&D tax incentive and core team support for businesses, 5 March 2020 (Inland Revenue 2020/069, Callaghan Innovation B-20-002 and MBIE BR 2491 19-20 refer) p2

Findings

Roles and responsibilities are, for the most part, clear but there are issues.

33 Broadly speaking, the assignment of roles and responsibilities is sound. Inland Revenue takes the lead on assessing the eligibility of entities for the RDTI, assessing eligible expenditure and taking overall responsibility for approving (or declining) RDTI claims.

34 Callaghan Innovation is the business engagement lead. It is responsible for information, education and engagement and uptake of the RDTI by eligible businesses reflecting its linkages with the R&D ecosystem. It takes the lead in assessing the eligibility of activities for RDTI claims given that this aspect of eligibility assessment rests heavily on R&D technical expertise.

35 The agencies themselves consider there is a clear division of responsibilities between them. There are no signs of duplicated roles, confusion as to who does what or gaps in roles and responsibilities (though which things fall). None of the interviews conducted as part of the review have raised issues regarding the handovers between Callaghan Innovation and Inland Revenue that occur as claims progress through the assessment process.

36 Notwithstanding these points, there is a confused picture in terms of who has overall responsibility for the administration of the RDTI. As discussed further below, there are indications that Inland Revenue has this responsibility. However, we are not convinced that this is consistent with the two agencies acting as a partnership and it is not consistent with a draft tripartite MoU between MBIE, Inland Revenue and Callaghan Innovation. We discuss this further later in this section.

The relationship within the core team appears to be working fairly well, but there have been some issues.

37 The members of the core team from both agencies consider that the working relationship has improved considerably and is now much more collaborative and effective than it was at the beginning of 2020 (ie when the team within Callaghan Innovation was gaining critical mass and the core team was first coming together).

38 We note that tensions are to be expected, especially in the early days of the scheme in part reflecting different organisational cultures, the different size of organisations, and their different roles. The agencies need some time to learn how to work effectively together.

39 Notwithstanding these overall positive findings, there are some issues.

40 Perhaps reflecting the previous point regarding earlier tensions, interviews conducted as part of the review have clearly signalled a perception among external stakeholders that Callaghan Innovation and Inland Revenue are not presenting as being particularly collaborative.

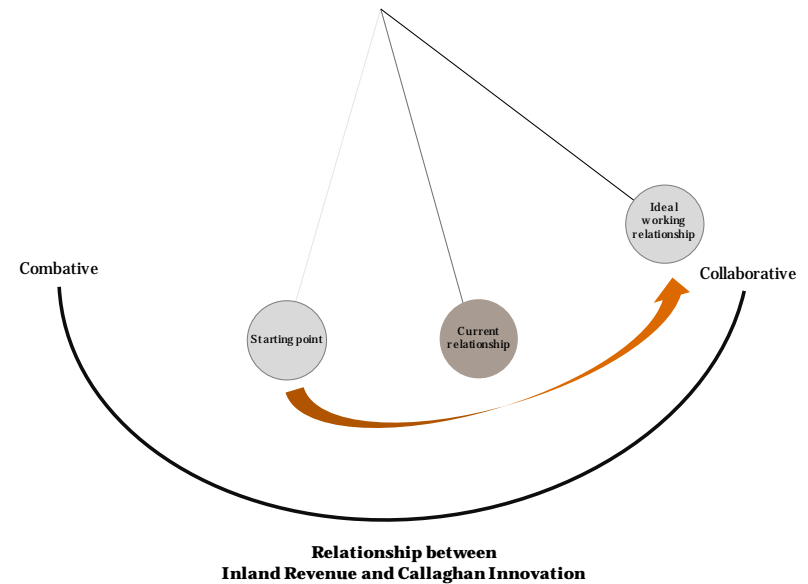
41 One specific concern that stems from this is a view among external stakeholders that they are not sure who to turn to get clarity around aspects of the scheme. One interviewee commented that when faced with an issue and seeking help to resolve it, MBIE advised that this was outside its brief because the matter was operational; Callaghan Innovation advised that because Inland Revenue is the ultimate decision maker, the business should approach Inland Revenue; and Inland Revenue said the nature of the issue raised was a Callaghan Innovation matter to deal with. This example, which we doubt is isolated, does not convey a sense that institutional arrangements are well-coordinated and joined-up.

42 We are not entirely convinced that the “one-team” expectation has been fully achieved. The relationship appears to have started as two separate teams (and refer to our comments below regarding the MoU) but in the view of Callaghan Innovation and Inland Revenue, they are coming together as one team.

43 The personnel from Inland Revenue and Callaghan Innovation, who comprise the core team, are physically separate (the expectation at the outset of the scheme was that they would co-locate). Both agencies refer to having very regular joint meetings and they work jointly on claim applications (an interactive process involving both agencies). These initiatives are designed to compensate for the lack of physical co-location.

- 44 While the efforts being made to ensure a joined-up way of working are positive, working remotely can have limitations and pose challenges particularly in terms of fostering team culture and leadership. Remoteness can also give rise to inefficiency; it takes longer to get things done when having to conduct work via video conferencing and the episodic nature of engagement via video (or phone) makes the building of team relationships and dynamics harder to achieve.
- 45 We are also not convinced that the MoU that exists between Callaghan Innovation and Inland Revenue truly reflects the expectation of the relationship being one of partnership.
- 46 The MoU is structured primarily as a service agreement between Callaghan Innovation (as provider) and Inland Revenue (as buyer). It has been suggested to us that this arrangement reflects the fact that funding sits with Inland Revenue and that ultimate responsibility for administration of the scheme rests with Inland Revenue (a point we take issue with).
- 47 The MoU sets out the services that Callaghan Innovation is to provide to Inland Revenue. The main body of the MoU clearly envisages a buyer-provider relationship; not a partnership. It sets out Inland Revenue's expectations of Callaghan Innovation but not vice versa. Schedule 1 of the MoU explicitly refers to the core team and the need for collaboration. However, it lacks any discussion of the objectives that the core team is working to and it doesn't really talk to how the core team is supposed to operate. The MoU refers to the parties working collaboratively but it stops a long way short of articulating the concept of partnership.
- 48 In summary, notwithstanding indications that the quality of the relationship has improved, we consider that the relationship is on the right track, but it is not yet at the point that was envisaged and conveyed in various briefings to Ministers. This is illustrated in Figure 1 below.

Figure 1: Relationship between Inland Revenue and Callaghan Innovation



More use could be made of the customer-facing personnel within Callaghan Innovation.

- 49 Callaghan Innovation customer-facing personnel are not engaged as much as they could be despite the clear expectation that they would be a central part of support to businesses. The issue of whether, or under what circumstances, they can be involved has been raised with some voicing the opinion that for tax secrecy reasons, there are constraints on their involvement (eg a view that Callaghan Innovation customer facing personnel are not allowed to know about the tax situation of an entity unless the entity has volunteered this information). Our reading of the relevant sections of the Income Tax Act that relate to the RDTI, is that this view is incorrect.
- 50 The confusion (mixed messages) in this area is unhelpful. Callaghan Innovation (rightly) wants early engagement with potential claimants because of the benefits this brings in terms of better quality claims, with greater chance of success. Callaghan Innovation also, and appropriately, takes direction from Inland Revenue on matters of tax secrecy. The consequence of this is that it seems to be getting in the way of early involvement and engagement more generally.

Work on a tripartite MoU is ongoing.

- 51 There is an intention to enter into a tripartite MoU involving Callaghan Innovation, Inland Revenue and MBIE with a primary focus on describing the governance arrangements for the scheme. This MoU has yet to be completed but we have been provided with an undated draft version.
- 52 Overall, we like the tenor and contents of the draft tripartite MoU more than we do the MoU between Callaghan Innovation and Inland Revenue.
- 53 The tripartite MoU includes some important and beneficial differences including:
- much more explicit recognition that the parties are *collectively* [emphasis added] responsible for achieving the objectives
 - the objectives of the scheme are laid out (they are absent in the other MoU)
 - providing a clear and succinct commentary of the policy context within which the MoU sits (again this is missing from the other MoU).
- 54 One manifestation of the absence of an overarching MoU is that responsibility for leadership of the scheme is unclear. There are conflicting messages in this regard as evidenced by the following.
- Briefing papers to Ministers asserted that responsibility for administration of the RDTI sits with Inland Revenue (with support coming from Callaghan Innovation)³. However, the draft tripartite MoU confers joint responsibility on Callaghan Innovation and Inland Revenue for the administration of the RDTI⁴.
 - In similar vein, the October 2019 MoU between Inland Revenue and Callaghan Innovation states that the latter is responsible for supporting Inland Revenue in the administration of the RDTI⁵ which is different to the message being conveyed in the draft tripartite MoU.
- 55 This seems to point to a weakness in the design of the operating model for the scheme. There is an uneasy tension between each of the agencies having lead responsibilities for parts of the scheme but lack of clarity as to where overall leadership sits. Effective leadership matters but it is not clear where leadership responsibilities sit.
- 56 We note that Callaghan Innovation is of the view that the overall responsibility for the RDTI rests with Inland Revenue for the following reasons, among others:
- The RDTI is contained in the Income Tax Act, which is administered by Inland Revenue.
 - Inland Revenue delegates authority to the Callaghan Innovation core team manager.
 - Inland Revenue funds Callaghan Innovation's core team.
 - Applicants for the RDTI are administered through the tax system.
- 57 Notwithstanding these valid points, if the operationalisation of the scheme is truly one of partnership, then leadership sits with the partnership; not with one or other of the members of the partnership. In this regard, the governance arrangements described in the draft tripartite MoU are important. In our view, the governance provisions in the draft tripartite MoU align well with the concept of partnership.

³ Update in implementation of the R&D Tax Incentive 12 December 2018 (IR2018/474 paragraph 9 refers).

⁴ Section 5.2(d) refers.

⁵ Draft MoU dated October 2019 p2.

4. Information, education and engagement (IEE)

Introduction

- 58 The RDTI is a new scheme and it replaces the Growth Grants scheme (which is now closed to new applications). Although the RDTI draws on features within similar schemes overseas, it is unique to NZ. It follows, therefore, that there is a need to raise awareness and understanding of the RDTI among business.
- 59 A budget of up to \$930,000 was approved in May 2019 to deliver an information, education and engagement (IEE) programme. The funding comprised a transfer of \$830,000 from the FY20 Growth Grants appropriation plus a further \$100,000 from existing Inland Revenue baseline. The funding was intended to enable Callaghan Innovation to develop and deliver an education and engagement campaign. In parallel, Callaghan Innovation and Inland Revenue were jointly charged with developing a stakeholder engagement plan to ensure that key influencers and business networks inform their members about the RDTI. Together, these initiatives have formed the core of the IEE programme.
- 60 The aims of the IEE programme are to⁶:
- **inform** businesses about RDTI
 - **educate** them about the benefits of R&D
 - **engage** with businesses directly to support behaviour change that increases their investment in R&D (or begin investing in R&D).

Expectations

- 61 Ministers indicated several expectations regarding IEE. In their minds, a key indicator of the success of the IEE programme is the submission of good quality claims by businesses.
- 62 At the time of the funding approval, it was expected that the education and engagement campaign would involve delivering key messages and information through a multi-channel approach including tradeshows, conferences, events, stakeholder workshops and meetings, websites, media statements, media articles, brochures and so on⁷. In short, a mix of mass marketing as well as tailored outreach.
- 63 Callaghan Innovation was expected to provide overall leadership for the IEE programme because it has strong business networks and access to R&D specialists and business advisors who are best placed to communicate with businesses.
- 64 Ministers also indicated that they expected Callaghan Innovation's network of business advisors to play an active role in supporting the IEE programme. To this end, Ministers were advised in September 2019 that Callaghan Innovation's internal staff training plan, under development at the time, aimed to ensure its customer-facing staff had detailed knowledge of the tax incentive and provide them with the knowledge they need to speak confidently to businesses and support their customers⁸.

⁶ R&D Tax Incentive: Bridging Communications and Marketing Plan v1.0 September 2019

⁷ RDTI: Further advice on Information, Education and Engagement Programme 20 May 2019 (B-19-014 refers)

⁸ Update on Implementing the RDTI 26 September 2019: (IR 2019/535 and CI B-19-028 refers paragraph 43)

65 Free and frank opinions
More generally, Ministers appear to have set quite a high bar in terms of the level of understanding to be achieved by business regarding the RDTI; they envisaged that the IEE programme would enable the scheme to be largely a self-serve regime that avoided heavy reliance on business advisers and associated costs.

Findings

- 66 Quite a lot has been delivered. Callaghan Innovation has led, with support from Inland Revenue and MBIE, the development of:
- an interim communications and marketing plan covering the period to September 2019
 - an updated and expanded communications and marketing plan covering late-September 2019 to June 2020
 - a stakeholder engagement plan.
- 67 These are comprehensive documents.
- 68 The interim communications and marketing plan was aimed at supporting three main milestones: the availability of RDTI guidance and an eligibility tool (being developed by Inland Revenue), the opening of enrolment and the passage of legislation on refundability. The interim plan was completed later than expected owing to delays in getting funding approved (granted in May 2019) and the timing of market research used to inform the plan.
- 69 The communications and marketing plan was updated to cover the period from late-September 2019 to June 2020. The plan is comprehensive and orthodox. It includes objectives, risks, assignment of responsibilities, key messages (and FAQs), a stock take of key audiences, their information needs and preferred communications channels, an overarching strategy, a phased approach to roll-out of the plan and budget (within the funding envelope of \$930,000).

70 The stakeholder engagement plan sets out, among other things, the principles underpinning engagement, the engagement objectives (which align well with the IEE aims noted above), and roles and responsibilities of personnel within Callaghan Innovation, Inland Revenue and MBIE. It also documents a comprehensive list of relevant stakeholders and prioritises these across four criteria (importance, influence, level of interest and impact). Based on this information, the plan contains a reasonably detailed plan of action for engaging with the stakeholders. Overall, it is a comprehensive plan.

71 During the second half of 2019 and first quarter of 2020 (prior to lock-down), there has been a large number of events in the form of meetings, seminars, webinars, conferences and workshops attended by Callaghan Innovation and/or Inland Revenue; by 30 June 2020 these summed to 61 events involving almost 7,000 attendees. We note that many of these events were organised and driven by the policy team at Inland Revenue and also, in many cases, by professional services firms. Callaghan Innovation led 29 of the 51 events (57 per cent) of the events pre-March lockdown. The engagements were not led by Callaghan Innovation to the extent expected, given that the Inland Revenue policy team and professional services firms have taken some leadership on this point. We acknowledge that Callaghan Innovation had planned to lead the majority of events in April to June, but these were cancelled due to COVID-19.

Notwithstanding activity to date, there appear to be some issues in terms of content and the channels through which information and education is delivered.

72 Published guidance material is a key source of information for businesses (and their advisers) that are considering the RDTI. The main guide published to date is Inland Revenue's RDTI Guidance document dated April 2020 (IR1240). All external stakeholders interviewed during our work referred to the IR RDTI Guidance.

73 These guidelines are comprehensive. They cover all aspects of the RDTI and span 138 pages. Callaghan Innovation has commented to us that the organisation looks to the IR RDTI Guidance as "the bible".

- 74 In addition to the IR RDTI Guidance, a series of “How to” guides have been developed recently and are available on the RDTI website. The “How to” guides are pitched at a high level; they are written in plain English and are very accessible.
- 75 As far as we are aware the “How to” guides and the IR RDTI Guidance are the main documents that seek to explain the RDTI and how it works. There are some issues with this.
- 76 Our understanding of the intent behind the IR RDTI Guidance is that it would act as an umbrella document under which supporting documents would sit. The supporting documents would:
- provide further guidance regarding specific aspects of the RDTI including, for example further explanation of some of the key concepts (eg scientific or technological uncertainty) and examples of what the concepts mean in practice
 - be more tailored in terms of types of R&D and/or particular aspects of the process for assessing RDTI claims and/or particular categories of audience (eg businesses versus the advisor community).
- 77 The “How-to” guides do not help to fill this gap. They are not detailed enough, nor are they intended to be, to give businesses the guidance they need over the interpretation of key concepts such as scientific or technological uncertainty and systematic approach. Businesses need something that sits between the IR RDTI Guidance and the plainer English “How-to” Guides, consistent with the idea of having a range of guidance material that sits under the umbrella IR RDTI Guidance.
- 78 We note that the IEE plan is to be delivered over two years and that the IR RDTI Guidance and the “How to” guides are to be delivered in Year 1, with supporting documents to be delivered in Year 2. We would expect supporting documents with practical and sector-specific examples to be delivered in Year 2. We acknowledge Callaghan Innovation’ view that the deliverables for Year 2 depend on the interim steps:
- a signed tripartite MoU
 - sufficient history of claims to draw precedents
- the increase of capacity of the core team to deliver these supporting documents.
- In any event, prospective applicants and advisors can only use what they have access to in the moment.
- 79 Feedback from internal stakeholders indicates that they view the IR RDTI Guidance as defining a “gold standard”. It is appropriate to have guidance material that illustrates what best practice looks like. Equally however, and in the early days of a new scheme when practices are evolving, it is not realistic to expect claimants to achieve the “gold standard” from the outset. By implication, guidance needs to be more nuanced to convey a sense of the minimum requirements that must be met and the additional features that are highly desirable but which may take some time to be fully realised (a crude analogy might be guidance aimed at vehicle drivers generally versus guidance that is aimed at advanced driving skills – the former is sufficient for the purposes of getting licensed but the latter is helpful to build proficiency). Examples of where a lower, but still appropriate, standard may be sufficient can be found in the relevant eligibility test sections below.
- 80 External stakeholders also point to particular aspects of the scheme that businesses are finding most challenging. These aspects revolve mainly around the activity eligibility requirements and in particular the three legislated tests of resolving scientific or technological uncertainty, the need to create something new or improved and the requirement to adopt a systematic approach to the R&D. The feedback from the external stakeholders is that existing guidance material is not sufficient to help them navigate the complexities of meeting the requirements in these areas.
- 81 External stakeholders also raised with us instances where the quality of engagement was not as helpful as they would have liked. External stakeholders commented to us that the quality of engagement was much better at the time the RDTI scheme was being developed than it is now. They noted that Callaghan Innovation is not being specific enough about what is required to improve applications for fear of providing tax advice (an issue we comment on further below). Most of the external stakeholders interviewed also commented that Callaghan

Innovation had sent a strong signal that software-related R&D is out of scope of the regime (contrary to legislative settings).

82 In addition to concerns about the scope of information, education and engagement, concerns have also been raised by interviewees regarding the channels through which support is provided. Some have suggested that too much emphasis has been given to social marketing and not enough to direct engagement (outreach). In our view, there is mixed evidence on this point. As noted earlier, Callaghan Innovation and Inland Revenue have been in front of many businesses and the stakeholder plan is comprehensive.

83 There is, however, an issue regarding the role played by Callaghan Innovation’s customer-facing teams. As noted earlier, there was a clear expectation that the customer-facing personnel would play a key role in supporting business. There are signs, however, that this expectation has not been fully realised and there are two aspects to this.

- First, and as discussed in the roles, responsibilities and relationships section, there appears to have been a view (stemming from legal advisers within Inland Revenue) questioning whether the customer-facing teams within Callaghan Innovation can proactively assist and support businesses. Our reading of the legislation is that they can.
- Second, there is an issue regarding the scope of support that the customer-facing advisers can provide without crossing the line into providing tax advice. Clearly, the teams must avoid creating a conflict of interest and compromising objectivity. It is not tenable to have a situation where one part of Callaghan Innovation is advising a claimant and another part then assesses their claim. This issue is, however, no different to the challenge faced by many regulators who must both inform and educate as well as enforce/authorise. The scope of information and education can be pushed quite a long way before coming close to crossing the line into advice. As it stands, the nature and scope of the engagement falls well short of that line.

Reflecting the issues noted above, there is a mixed picture as to how much progress has been made in achieving the aims of the IEE programme.

84 There are signs that the IEE programme to date is not being as effective as it needs to be. There are several factors pointing to this conclusion.

85 The first of these is the feedback from external stakeholders which points to issues with understanding key aspects of the scheme – particularly around activity eligibility.

86 Second, feedback provided from surveys tends to confirm the point above. Taken together, the graphs below suggest there is a reasonable understanding of the RDTI but there are too many businesses that do not have a well-developed understanding.

Figure 2: How would you describe your overall knowledge of the RDTI?

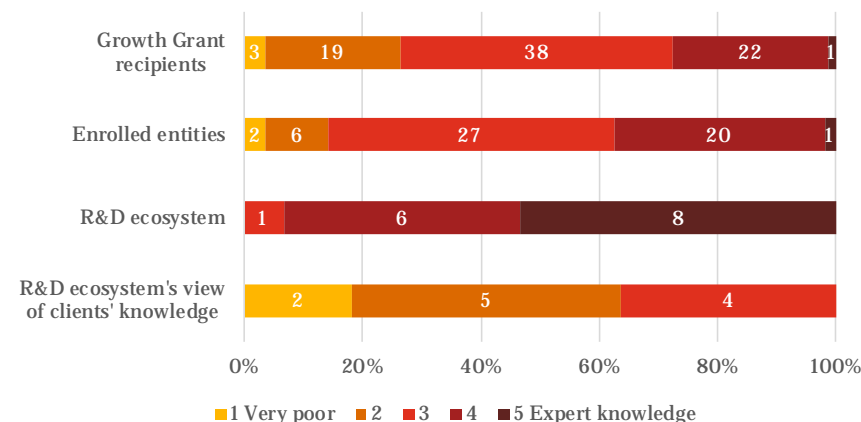
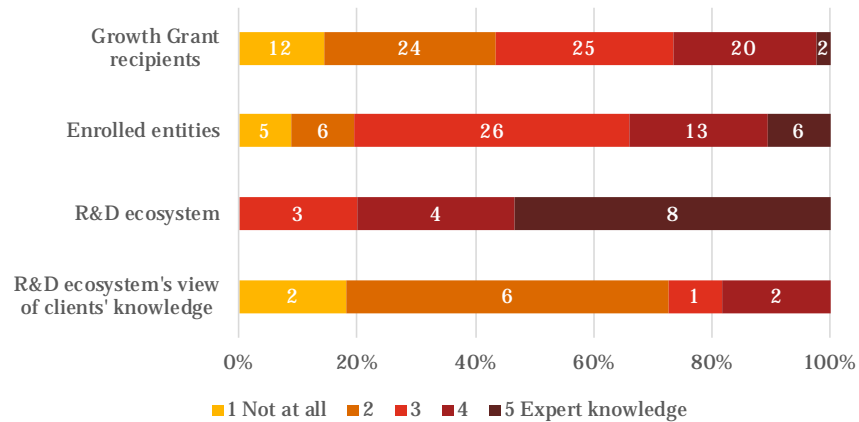


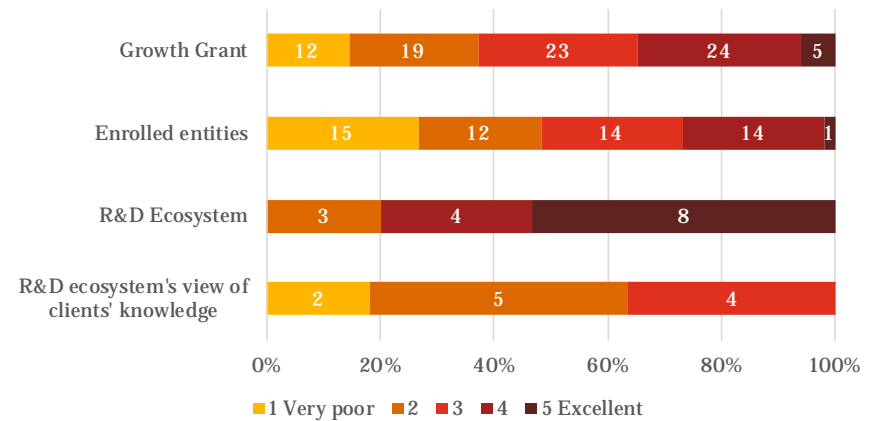
Figure 3: How well do you understand the process for applying for the RDTI?



87 The third factor is comments from the core team that many (if not the majority) of claims are falling short of the standard of information that is needed in order for them to be successful (and many are falling well short of the mark). Free and frank opinions

We suspect this observation has some validity; several external stakeholder interviewees have experience of the former tax credit regime and/or the Growth Grants scheme and/or tax credit schemes operating in other jurisdictions and/or definitions of R&D in other contexts (eg IAS38). We suspect that some businesses and their advisers are trying to interpret the RDTI with reference to these other schemes which is a flawed approach given that the RDTI is not a mirror image of any other scheme. There is some evidence of this point from the following survey results.

Figure 4: How well do you understand the differences in the definition of R&D between the Growth Grant and the RDTI regimes?



88 The implication is that if this is the approach businesses are taking, more effort is needed to drive home the message that NZ's RDTI is different.

89 A key test of the effectiveness of the IEE programme is the quality of claims and on this measure, the conclusion is that more needs to be done. To this end, and for the reasons discussed above, we consider there is more guidance needed. Implementing the original intention of supporting the IR RDTI Guidance with a suite of supporting guides might be a way of achieving this. Furthermore, there is an opportunity to make more use of Callaghan Innovation's customer-facing teams to provide more direct engagement.

5. Eligibility

Introduction

90 In this section of the report, we assess the other of the main functions performed by the core team; the application of a range of legislated eligibility tests to determine whether or not an RDTI claim should be approved.

91 There is a balance between promoting R&D on one hand and protecting the tax base on the other. The RDTI scheme seeks to balance these competing objectives by providing a tax credit only if three eligibility tests are met:

- eligible entity
- eligible activity
- eligible expenditure.

92 Within the eligible activity test (which is the test that, drawing on stakeholder interviews, appears to be raising the most issues and is discussed further below), the R&D must:

- resolve a scientific or technological uncertainty (ie the knowledge required to resolve it is not publicly available or deducible by a competent professional)
- create new knowledge, or new or improved process, services or goods
- be conducted using a systematic approach.

Expectations

93 We have assessed the way in which the eligibility tests have been applied against five main criteria:

- **alignment with the legislation** – that is, the scope of the eligibility tests matches the criteria set out in legislation

- **policy intent** – the extent to which application of the legislated tests helps achieve the policy intent of the RDTI
- **timeliness** – the Minister has indicated an expectation that claims will be processed within six weeks of receipt excluding the time spent awaiting any further information sought from the claimant
- **compliance costs** – there should be signs that compliance costs are being minimised wherever possible and that the level of compliance costs imposed on a claimant is proportional to the benefits that are expected from the claim
- **transparency** – of both process and, at least as importantly, of decision making.

94 It is important to note that it has not been within the scope or purpose of this review to assess whether the right decisions have been made in respect of those RDTI claims for which decisions have already been taken.

Findings

Legislative alignment

95 With respect to the first of the criteria, we have not identified any issues.

96 The legislation is prescriptive in terms of the eligibility tests that need to be applied. These tests are reflected, and explained further, in the IR RDTI Guidance and other information and education collateral. Although the scope of this review has not required us to undertake a review of the actual processes and conduct of eligibility assessments, and we haven't spoken directly to core team assessors, there has been nothing arising from discussions with stakeholders to suggest that there is misalignment between the scope of the eligibility tests and what is provided for in the legislation. That said, there is an issue in relation to software that we touch on later.

Support for policy objectives

97 The way in which the legislated eligibility tests are applied is pivotal in terms of the achievement of policy objectives which is why we have given them particular focus in our findings below.

98 At a macro level, the expectation is that the way the RDTI is administered will help to achieve the objective of increasing R&D expenditure. Callaghan Innovation takes the lead on the eligible activity test because this test relies heavily on R&D expertise. As Callaghan Innovation has strong interest in R&D, it is not unreasonable to expect that it would err toward a broad application of the legislated eligible activity test. For reasons set out below, however, we consider that the reverse is true; the approach seems to be quite narrow.

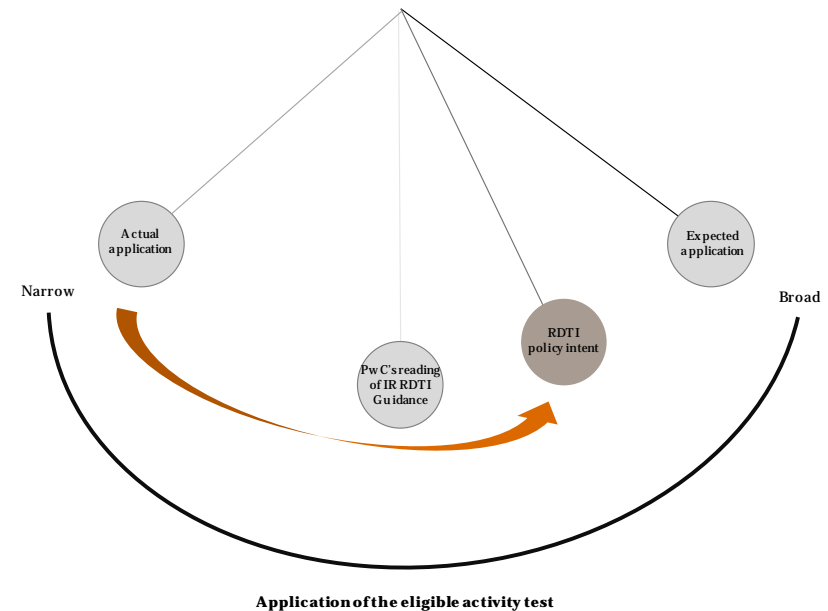
99 Our reading of the IR RDTI Guidance is that it is neutral in terms of taking a broad (promoting R&D) versus narrow (protecting the tax base) approach. We note that there are several features of the scheme design that help to protect against unwanted erosion of the tax base, including the 15 per cent rate of credit, the caps on the amount that can be claimed and rules around expenditure eligibility. That being the case, it is not unreasonable to expect that a relatively broad approach to the legislated eligible activity test would be counterbalanced by the other checks and balances to give, overall, a good balance between the R&D and tax objectives.

100 However, for the reasons explained below, our assessment of the approach to the legislated eligibility tests (particularly the activity eligibility test) is that they appear to be being applied in a way that is too narrow and that is increasing compliance costs significantly. As a consequence, there is a risk of unintentionally frustrating the ability to achieve the goal of increasing R&D expenditure. Our interpretation of the current situation is illustrated in Figure 5 below.

101 Feedback from external stakeholders points to a narrow stance being taken in respect of:

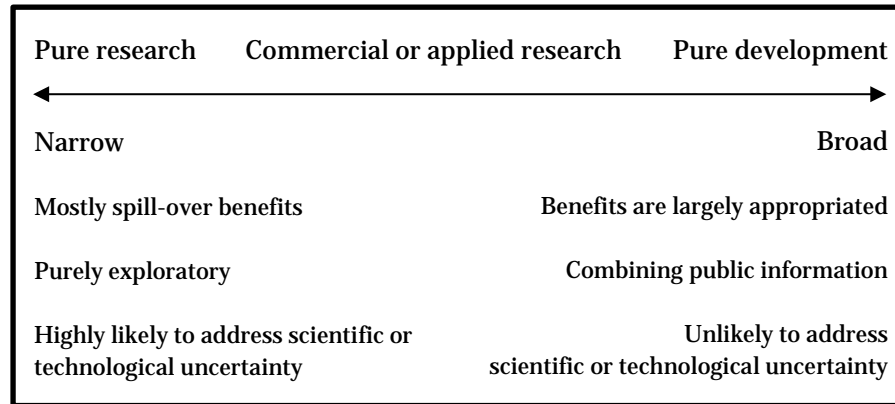
- the need to demonstrate that the R&D will resolve scientific or technological uncertainty
- the requirement for new knowledge, or new or improved process, services or goods
- the need for a systematic approach.

Figure 5: Pendulum of application of the legislated eligible activity test



102 To put the comments into some context, we have found it useful to characterise R&D as spanning a spectrum that, at one end, is pure research (sometimes referred to a blue-sky research) and at the other end, is pure development.

Figure 6: R&D spectrum



103 In economic terms, externality effects (spill-overs) are pervasive with pure research and are largely, or completely, non-existent with respect to pure development. Our understanding is that the RDTI is aimed around the middle of the spectrum. The feedback from external stakeholders suggests, however, that the way in which the legislated activity eligibility test is being applied is erring too far toward the pure research end of the spectrum.

Resolving scientific or technological uncertainty

104 Three issues have been drawn to our attention.

105 The first of the issues stems from the need to break down a project into activities, some of which can be expected to address scientific or technological uncertainty and others which do not. Considering a RDTI claim at the project level runs the risk of allowing ineligible spending to be included – hence the need to break down a project into its activities. The concern that external stakeholders have raised with us is that in applying the activity eligibility test, the assessors are

seeking to break down activities into small and smaller parts. The problems with this approach are twofold. First, the more an activity is decomposed, the less likely it is the activity will resolve scientific or technological uncertainty (ie on its own, a very narrowly defined activity doesn't really solve anything) or, in terms of Figure 6 above, involve externalities. As a result, no aspect of the project meets the test. The second problem is that the requirement to decompose activities into smaller and smaller parts is adding significantly to compliance costs.

106 The second issue relates to the requirement that the uncertainty is not capable of being addressed by a competent professional using publicly available information. External stakeholders generally consider the core team is applying a very high bar on this point. Free and frank opinions

with the result that too many claims are failing this particular aspect of the test. Currently, the competent professional is judged at an international level. Recalibrating the reference group, for example, to being a competent professional in New Zealand or within a business, would broaden the test and could be applied consistently. In this respect, there is also a suggestion from external stakeholders that the competent professional test is being misused in the sense of assessing whether the business claiming the RDTI has competent people to perform the R&D. Callaghan Innovation have commented that they do not apply this test in this way, and that it is applied as legislated in section LY2 of the Income Tax Act.

107 The last of the issues relates to software. The extent to which software R&D might be eligible matters because a significant proportion of overall R&D activity is software related. There has been a concern within the business sector that the scheme would not encompass software development. This issue was acknowledged as part of the consultation on the Bill and the legislation was broadened accordingly by removing the requirement for a “scientific approach” and replacing this with a requirement for a “systematic approach”. As a consequence, the scheme clearly allows for the possibility that software R&D could qualify.

108 Notwithstanding the change made to the legislation, there appears to be insufficient clarity around the test of scientific and technological

uncertainty when it comes to software. We understand that Inland Revenue is taking another look at this including re-engaging with relevant overseas jurisdictions who operate with similar tests and definitions.

New knowledge, or new or improved process, services or goods

109 External stakeholder feedback suggests that this test is being applied too narrowly. It appears that the assessors are looking for a ‘step-change’, rather than just an incremental improvement (which otherwise meets the new knowledge, or new or improved process test). The IR RDTI Guidance also imports a requirement that the new knowledge, or new or improved process, services or goods be “new to the world”. This goes beyond what was provided in the legislation and could be relaxed in favour of a broader approach to applying this test. In terms of Figure 6 above, application of this part of the activity eligibility test is pointing toward the pure research end of the spectrum; that is, research that fundamentally shifts the state of knowledge about something.

110 In contrast, we would characterise most business-led R&D as seeking to address a particular business or customer issue the outcome of which is more in the nature of incremental change. Our understanding is that this type of R&D is within the scope of what is intended under the RDTI scheme.

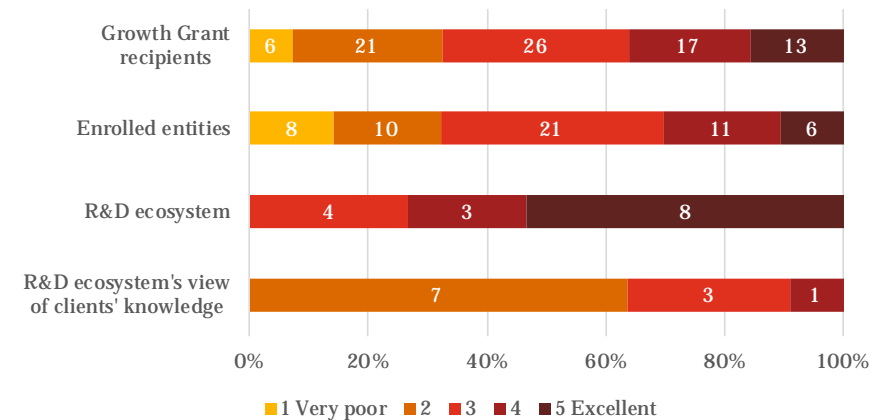
Systematic approach

111 Similarly, external stakeholders consider that the requirements of this test are too demanding and this is also adding to compliance costs. In their view, the requirements set out in the IR RDTI Guidance portray ‘world-class’ or ‘gold standard’ requirements and, moreover, that these requirements are being used by the assessors as they minimum that must be achieved. In terms of Figure 6 above, the same theme emerges; the test being applied seems to be equivalent to the requirements (for a systematic approach) that would be expected in the context of pure research rather than research that is more applied in nature. In contrast, our understanding is that the need for a systematic approach was intended to promote some degree of

rigour in planning and record keeping and to avoid a situation where “accidental” R&D ended up being eligible for the RDTI.

112 The contemporaneous documentation requirements appear to be a particularly challenging part of the systematic approach test. As shown in Figure 7 below, the majority of businesses do not appear to have a well-developed understanding of requirements in this area.

Figure 7: How well do you understand the compliance and contemporaneous documentation requirements (ie good record keeping in real time) of the RDTI?



113 As we have discussed earlier in the IEE section, in the early days of a new scheme it is reasonable to take a broader stance in terms of the interpretation and application of the rules as understanding of, and experience with, the requirements develops. For instance, the current requirement for a comprehensive description of the approach taken could be loosened to a box-ticking exercise confirming that the approach taken was planned, documented and repeatable. Other requirements can be added over time as required (but still be applied consistently).

114 In short, interviews with external stakeholders have left us with a clear impression that the legislated activity eligibility test is being applied too narrowly and gives rise to unreasonable compliance costs.

115 A driver for this, assuming the concerns have some validity, appears to be a tendency to weight preservation of the tax base more highly

than the primary objective of increasing the level of R&D expenditure. Our reading of the policy intent is that this should be the other way around.

116 If our interpretation is correct, possible reasons as to why preserving the tax base has greater prominence might be because:

- Callaghan Innovation sees itself as being a service provider to, rather than a partner with, Inland Revenue and the RDTI being “Inland Revenue’s scheme” (which as discussed in the relationships section, is not how we would see arrangements)
- decisions taken by the Commissioner being binding decisions (so wanting to avoid setting unhelpful precedents).

117 Before concluding on this point, we heard from the core team that there is a danger with applying a flexible approach to the requirements. We agree. However, there is a distinction between being flexible, where the requirements change, and taking a broad stance to the application of the legislated eligibility tests, where the requirements are consistently applied. Flexibility could be interpreted as opening the door to inconsistency which is to be avoided. Conversely, there is nothing to stop a broad interpretation of the rules which are applied consistently. Examples where a sufficient but lower standard could be applied have been identified throughout this section.

Timeliness

118 We heard from some external stakeholders that have submitted a claim for the RDTI that they experienced long periods (eg 10 weeks) before hearing back from the core team. They said there was limited visibility from their perspective of when they can expect to hear back, where they are in the application process and what they can expect to happen next.

Compliance costs

119 Ministers have expressed a preference that the RDTI should, as much as possible, be a self-serve scheme with limited need for businesses to engage advisors to assist with claims. In other words, reducing the

reliance on the need to engage advisers is seen as a way of reducing compliance costs.

120 We question how far this expectation can be met. Any incentive scheme that is operationalised using the tax system is likely to be inherently complex. The RDTI has within it some concepts (as part of the eligibility tests) that are hard to define and apply.

121 As part of the surveys undertaken as part of this review, we asked businesses and their advisers to indicate whether the need to pay for advisers to assist with RDTI claims is anticipated.

122 The general picture that emerges is that such a need is very likely for many potential claimants as shown in Figure 8 and Figure 9 below.

Figure 8: How likely is it that you need to pay for compliance expertise to participate in the RDTI?

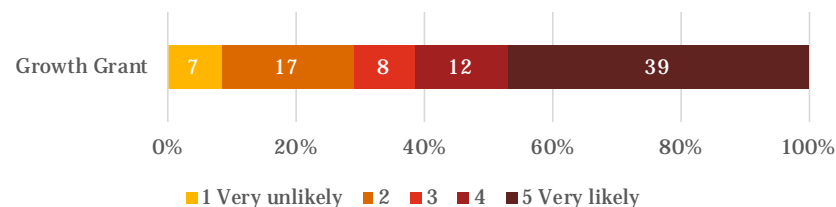
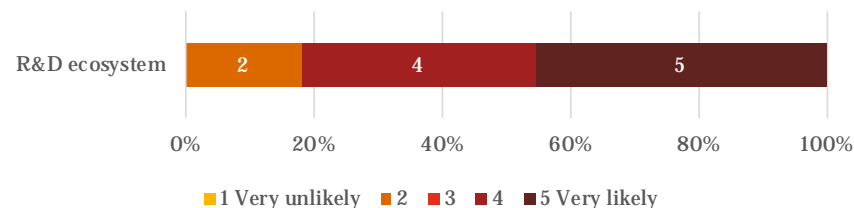


Figure 9: How likely are the organisations you have helped to need to pay for compliance expertise to participate in the RDTI?



123 We have heard that due to the design and application of the legislated eligibility tests, and especially the eligible activity test and its sub-tests, potential claimants felt like they needed to retain advisors to help with understanding the rules. Anecdotally, the costs of engaging

advisors to help submit a claim could be at least \$10,000 and, in many cases, significantly more. This is not trivial and has a disproportionate impact on smaller businesses who are part of the target market for the RDTI.

- 124 Moreover, and as noted above, the businesses and business advisers we interviewed were consistently of the view that the way in which the legislated activity eligibility test, in particular, is being applied is adding considerably to compliance costs.
- 125 While the tests need to be in line with the legislation and policy intent, there is need for proportionality in the application of the eligibility tests, especially for activity eligibility. The level of risk of approving a claim that may not meet a high standard should be balanced against to the potential unwanted erosion of the tax base. This is especially important for start-ups and small R&D entities, where the claimed amount is likely to be lower.
- 126 We have also heard a particular issue with the RDTI, as it relates to a simultaneous claim for a R&D tax loss credit. Specifically, one claimant was told that they had to withdraw their RDTI claim to be able to be paid out for their simultaneous R&D tax loss credit, and then resubmit their RDTI claim even though the two claims are independent.

Transparency

- 127 External stakeholders have indicated that when a claim has been declined, the reasons have not been explained in a sufficiently transparent way. While the core team provides the grounds for why a claim has been declined, claimants consider that they have not gone far enough. Some external stakeholders have characterised the assessment team as being akin to an exam marker (who provides the grade but nothing more), when they should be a teacher who provides feedback and support to enable the student to pass the exam.
- 128 Under administrative law, there is a general duty on public agencies to be transparent both as to the process behind, and reasons for decisions taken. This duty applies to the RDTI.

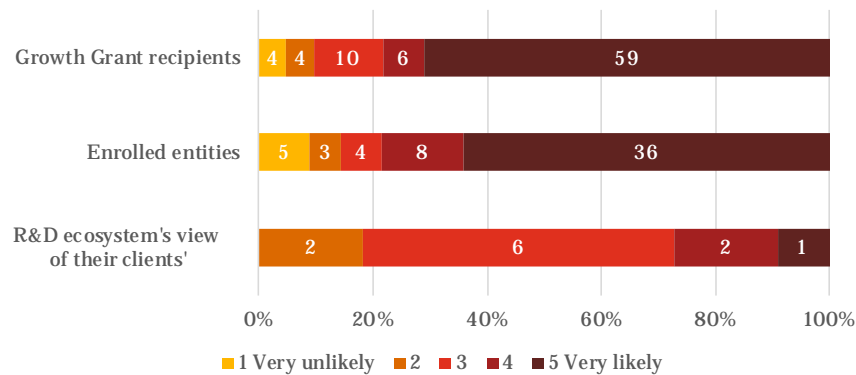
Take-up Expectations

- 129 The overall policy intent of the RDTI is to increase R&D expenditure. The switch from Growth Grants to the RDTI is intended to broaden the range of businesses, and the range of R&D activities, that are eligible for financial support.
- 130 Given that the RDTI is replacing the Growth Grant as the Government's primary mechanism for incentivising R&D, the expectation at the time the new scheme was being developed was that many Growth Grant recipients would migrate to the RDTI.

Findings

- 131 It is still relatively early days for the RDTI. Many businesses have yet to file their tax returns for the 2019/20 tax year and, accordingly, it is likely that most RDTI claims have yet to be submitted.
- 132 Inland Revenue advise that, to date, there are fewer than 400 enrolled RDTI entities. Furthermore, fewer than 30 of these entities have submitted their general approval form, or supplementary return, which then triggers the assessment processes undertaken by Inland Revenue and Callaghan Innovation. We do not have data on the number of completed assessments. Accordingly, the comments that follow are based solely on survey results and comments made to us by interviewees.
- 133 In short, there is a mixed picture regarding take-up of the RDTI. The survey responses paint a relatively positive picture. As shown in Figure 10, around two-thirds of Growth Grant recipients and entities that have already enrolled in the RDTI are very likely to make a claim. We note, however, that around 20 per cent of those who are enrolled in the RDTI were either neutral or were unlikely to lodge a claim.

Figure 10: How likely are you to consider applying for the RDTI?



134 The feedback from interviewees is not as positive. As discussed earlier, among the external stakeholders interviewed, there are strongly held views that the legislated eligibility tests are being applied too narrowly. Anecdotally, there is a perception that a significant proportion of claims are being rejected and this appears to be consistent with views expressed by the core team that many claim applications are of poor quality.

135 In the view of external stakeholder interviewees, the challenge and costs involved in making a RDTI are too great relative to the financial benefit if a claim is approved.

136 We heard that potential claimants are holding back from developing and submitting claims with the aim of waiting to see how other businesses fare when making claims. If this becomes a widespread phenomenon, then there is a risk of creating an undesirable cycle in which few are willing to be “first movers” which then further dissuades others from pursuing a claim. If this were to eventuate, there is a real risk that the primary objective of increasing R&D expenditure may not be fulfilled.

137 Leaving aside this behavioural dynamic, there are other reasons why claim numbers might be slow to escalate.

- Growth Grant recipients cannot apply for RDTI in the same tax year that they receive the Growth Grant (although provisions have been implemented to allow recipients to effectively cancel and repay Growth Grants if they want to move earlier onto the RDTI).
- Compliance costs are not trivial.
- The adverse economic consequences of COVID-19 means many businesses are focused on survival and the RDTI is low on their list of priorities.
- Businesses are in the process of understanding Inland Revenue’s new systems and processes (resulting from the transformation programme) which, in the short term, is also serving to divert attention away from RDTI.

138 In summary, there are signs that take-up of the RDTI is off to a slow start. Whether this will change is hard to gauge but if the issues outlined in this report persist, then up-take may not be as great as desired.

6. Changes to improve the operation of the scheme

139 In this section, we summarise a range of initiatives that, if implemented, will serve to improve the administration of the scheme and make it more user-friendly. Given that the RDTI is the Government's key initiative to raise R&D expenditure, these issues need to be addressed urgently.

Core team relationships

140 The existing relationship within the core team is one of buyer of services (Inland Revenue) and provider of those services (Callaghan Innovation). This conflicts with the expectation that the relationship would be that of partnership.

141 We consider that the nature of the relationship matters. Current arrangements position the RDTI as Inland Revenue's scheme which, in our view, means the balance is tilted toward preserving the tax based rather than increasing R&D expenditure.

142 The draft MoU that is intended to exist between MBIE, Inland Revenue and Callaghan Innovation reflects the original intention that the core team would operate as a partnership. We recommend that the 2019 MoU between Inland Revenue and Callaghan Innovation be reviewed with the intention of replacing it with the tripartite MoU (or modifying it to align with the tripartite MoU), and, therefore, better reflecting a relationship that is grounded in partnership.

143 To further strengthen the culture of partnership, we recommend that the core team seek to co-locate as far as practicable.

Information, education and engagement

144 As discussed in section 4, there are signs that the IEE programme is not as effective as it needs to be. To address this, we recommend that:

- more in-depth analysis be undertaken to better understand why businesses appear to be taking limited notice of the information and education that exists and, in light of the further analysis, consider reorienting the messages within the IEE programme
- further information and education collateral be developed to support the IR RDTI Guidance and bridge the gap that exists between the IR RDTI Guidance and the "How-to" guides that sit on the RDTI website
- the role of the Callaghan Innovation customer facing personnel be encouraged and strengthened (including early engagement with claimants)
- a case manager approach to engagement be adopted (which could be achieved if Callaghan Innovation customer facing personnel become much more involved)
- case studies of successful and unsuccessful claims be published (subject to preserving taxpayer confidentiality).

Eligibility

145 In section 5 we expressed the view that the current approach to application of the legislated activity eligibility test is too narrow. External stakeholders interviewed during the review consider that the approach is increasing, rather than reducing, compliance costs. This is dissuading businesses from applying for a grant which, if this is a widespread consequence, means a risk that the objective of increasing R&D expenditure will be harder to achieve.

146 For any scheme of this type, business needs time to fully understand how it works. The further investment in the IEE programme will assist in this regard. In addition, however, in the early days of the scheme we consider there is scope to adopt a broader approach to application of the legislated activity eligibility test. By this we mean that the bar for having a claim granted be lowered consistent with placing a bit more weight on promoting an increase in R&D expenditure and a bit less weight on preserving the tax base recognising that the overall scheme includes several features that are designed to mitigate the risk of unwanted erosion of the tax base.

147 Accordingly, we consider there is a need:

- for the three main agencies to collectively determine where the pendulum should sit on the broad – narrow spectrum
- for the core team to recalibrate the approach to assessments in light of the previous point particular in respect of the activity eligibility test.

148 In addition, there is also a need to address the software issue although we note that Inland Revenue already has work underway in this regard.

Appendix A: Restrictions

This report has been prepared for the Ministry of Business, Innovation and Employment (the Ministry). This report has been prepared solely for this purpose and should not be relied upon for any other purpose. We accept no liability to any party should it be used for any purpose other than that for which it was prepared.

This report has been prepared solely for use by the Ministry and may not be copied or distributed to third parties without our prior written consent.

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We have not independently verified the accuracy of information provided to us, and have not conducted any form of audit in respect of the Ministry. Accordingly, we express no opinion on the reliability, accuracy, or completeness of the information provided to us and upon which we have relied.

The statements and opinions expressed herein have been made in good faith, and on the basis that all information relied upon is true and accurate in all material respects, and not misleading by reason of omission or otherwise.

The statements and opinions expressed in this report are based on information available as at the date of the report.

We reserve the right, but will be under no obligation, to review or amend our report, if any additional information, which was in existence on the

date of this report, was not brought to our attention, or subsequently comes to light.

This report is issued pursuant to the terms and conditions set out in our letter of engagement dated 14 July 2020.