New Zealand R&D Tax Incentive:
Policy changes from the Discussion Document

Design features	Discussion paper on a Research & Development Tax Incentive for New Zealand (April 2018)	Responses from consultation	Government decisions on the design of the R&D Tax Incentive
Eligibility	All businesses, regardless of legal structure, will be eligible to claim the Tax Incentive. Consideration as to whether State Owned Enterprises (SOEs), Crown Research Institutes (CRIs), district health boards (DHBs), and tertiary institutions - and subsidiaries - should be excluded. Industry research cooperatives (including levy bodies) would be eligible.	Two thirds of responses indicated that exclusions for SOEs, CRIs, TEOs, DHBs and subsidiaries would be counterproductive. In the case of SOEs it was seen as potentially anti-competitive.	All businesses, regardless of legal structure, will be eligible to claim the Tax Incentive. Industry research cooperatives (including levy bodies) will be eligible for the scheme. State Owned Enterprises and Mixed Ownership Model companies will be eligible. CRIs, DHBs, and tertiary education organisations, and majority owned subsidiaries will be ineligible. Recipients of Callaghan Innovation Growth Grants (for the same income year) will be ineligible.

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Control and ownership of IP	A business must have control over the R&D activities; bear the financial risk and effectively own the results of the R&D.	Responses indicated the requirements to have effective ownership of IP did not reflect business reality in 2018, where NZ-based subsidiaries would undertake R&D for a parent without bearing the risk or having ownership of the IP.	***Control over activity*** The business or a company in the same corporate group must have control over the R&D activity. ***Bear the financial risk*** There is no requirement that the person bear the financial risk of the activity. ***Ownership of results*** Eligibility applies where the business undertaking the R&D owns the results of the R&D; or The business undertaking the R&D can use the results for no consideration; or Another company in the same group owns the results of the R&D and is resident in a country with which New Zealand has a double tax agreement.

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Rate	A 12.5 per cent tax credit on eligible expenditure will be available to business doing R&D in New Zealand.	Responses generally indicated that the proposed rate was low compared to Growth Grants or other international schemes and may not induce additional R&D. Also noted that the credit rate under the 2008 scheme was 15 per cent.	The rate for the Tax Incentive will be set at 15 per cent.
Minimum threshold	A business will need to spend a minimum of $100,000 on eligible expenditure, within one year, to qualify for the Tax Incentive. The minimum threshold will not apply to R&D activities outsourced to an Approved Research Provider.	Respondents to the consultation generally indicated that a threshold set at $100,000 would be too high, and instead should be lowered. The main concern was that such a threshold could impact detrimentally in particular on small businesses, as well as start-ups.	A minimum threshold for the scheme will be set at $50,000 a year. Businesses that contract their R&D to Approved Research Providers will be able to access the R&D Tax Incentive even if they do not satisfy the minimum threshold.

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Cap on R&D expenditure	A business will be able to claim a tax credit for up to $120 million of R&D expenditure each year. This equates to a tax credit of $15 million each year based on a 12.5 per cent rate. In order to incentivise spending on R&D above the level of the cap the options are to: ○ Have a Ministerial discretion to waive the cap for genuine claims; or ○ To require pre-registration for large claims.	Submissions received during consultation generally support the proposal for a $120 million cap. The majority of respondents additionally preferred the option of pre-registration as opposed to Ministerial discretion in incentivising R&D expenditure beyond the cap.	A cap for the tax incentive will be set at $120 million. Businesses that may exceed the level of the cap can apply for an extension above this figure. They will be required first to demonstrate that New Zealand will derive a substantial net benefit from the intended completion of the R&D.

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Definition of R&D	The incentive is intended to support R&D that address a material problem and anticipates a material advance in science or technology. R&D would be defined as: ○ Activities conducted using scientific methods that are performed for the purposes of acquiring new knowledge or creating new or improved materials, products, devices, processes or services; and ○ Intended to advance science or technology through the resolution of scientific of technological uncertainty.	General concern for the proposed definition, particularly with the proposal to limit R&D projects to those conducted using a scientific method. Viewed as overly restrictive and not reflective of R&D conducted in New Zealand.	The requirement to use scientific methods has been replaced with a requirement to use a systematic approach. Core R&D activities must be performed for the purpose of acquiring new knowledge or creating new or improved processes, services or goods and must seek to resolve scientific or technological uncertainty. The test for 'scientific or technological uncertainty' will be the competent professional test. If the information to resolve the scientific or technological uncertainty is publically available or could be deduced by a competent professional in that field, then the activities do not meet the definition of R&D. If a competent professional is unable to tell a business whether it is possible to achieve the desired result without a series of tests or analysis or building a prototype, to resolve the uncertainty, then there may be R&D that meets the definition.

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Businesses in tax loss	The Government is committed to providing a better policy option to support businesses that are in tax loss or which have insufficient taxable income to use their tax credits. Officials are undertaking further work to consider support for such companies and will consult with stakeholders as policy positions are develop. From April 2020, an appropriate policy incorporating additional features supporting businesses in tax loss will be introduced.	A number of submissions indicated that they wanted the R&D Tax Incentive to be refundable from the start.	Firms will be eligible for a refund of their tax credit for R&D expenditure of up to $1.7million (this equates to a maximum refund of $255,000), if: ○ they meet the corporate eligibility test and the wage intensity test for the R&D tax loss cash out (MX 2 and MX 3 of the Income Tax Act 2007) ○ they are taxpayers ○ their activity and expenditure meets the eligibility tests of the R&D tax incentive. Tax credits not refunded will be carried forward. There will be no change to the R&D tax loss cash out scheme. Firms that are eligible for the R&D tax loss cash out and for the R&D tax incentive, noting the definitions of eligible R&D differ between these schemes, can receive cash under both schemes. The Government remains committed to further policy work for introduction from 1 April 2020.

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Eligibility of R&D carried out overseas	Up to 10 per cent of the eligible expenditure on an R&D project can be for overseas R&D costs if: ○ The overseas work is part of an R&D project based in New Zealand; and ○ At least half the R&D expenditure within a project is for activities carried out in New Zealand.	A small number of responses to the consultation indicated that important R&D can often take place overseas beyond the 10 per cent level.	The Tax Incentive permits that up to 10 per cent of an annual claim can be overseas R&D.
Transition from Growth Grants	The Growth Grant administered by Callaghan Innovation will be phased out with the introduction of the Tax Incentive. All businesses with an active Growth Grant on 31 March 2019 will continue receiving Growth Grant funding for R&D performed through to 31 March 2020.	A number of submissions to the consultation indicated that they would like a longer time to transition to adjust to the new scheme.	Growth Grants recipients that have an active Growth Grant on 1 April 2019 will have an automatic two year extension to allow them to remain on their Growth Grant for up to two years (up until 31 March 2021 at the latest). The existing arrangements for Growth Grant will continue until 31 March 2019. Recipients with expiring contracts must apply and satisfy the criteria for renewal. For those companies who do not meet the criteria for renewal the Government will allow a contract extension until 31 March 2019 or the end of a recipient's 2018/19 income year, whichever is later.

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Administration	Inland Revenue will administer the R&D Tax Incentive, supported by Callaghan Innovation. The design of the administration will have a customer focus to provide certainty for claimants.	Respondents expressed a desire for greater certainty within the process of applying for and receiving the R&D tax incentive	Inland Revenue will administer the R&D Tax Incentive, supported by Callaghan Innovation. Tax incentive claims should be filed alongside firms' income tax returns. Firms will be able to make amendments to their tax incentive claims provided the amendments are lodged with Inland Revenue within one year of the latest date for filing their income tax returns. Starting in the second year of the tax incentive (the 2021 income year): ○ Businesses will be required to receive approval of their R&D activity in the year in which they are conducting it. This approval will be binding on Inland Revenue and will mean that firms have confidence that their activity meets the test of being R&D. ○ For firms spending more than $2,000,000 on research and development, different processes will apply.

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Eligible expenditure on R&D	Two possible approaches for determining eligible expenditure. Either: ○ Solely on direct R&D labour cost; or ○ On a broader range of direct and indirect costs (including options for determining appropriate overhead expenditure).	Respondents generally did not favour limiting eligibility to labour costs, with concerns that such a test would not accurately capture R&D expenditure. In contrast the inclusion of overheads received more support because it would be easier to administer.	The Government proposes to base eligible expenditure on a broad range of actual R&D costs, for example: ○ Salary and wages of employees doing R&D; ○ Depreciation on assets used in the R&D; ○ The costs of consumables used in the R&D; and ○ Overheads. The accounting treatment of expenditure will not determine eligibility. However, R&D expenditure that is capitalised and that will form part of the cost base of a depreciable, tangible asset, will not be eligible.
Apportionment rule for dual purpose expenditure	If an activity was carried out both for a R&D purpose and non-R&D purpose, the entire activity would not qualify as a R&D activity.	Most submissions received said the dual purpose exclusion could prevent many of their R&D activities from qualifying for the incentive.	If research and development activity occurs in the course of commercial production, amounts paid to employees working on the research and development plus additional costs as a result of undertaking the research and development, will be eligible expenditure.