MINISTRY OF BUSINESS, INNOVATION & EMPLOYMENT
HĪKINA WHAKATUTUKI

COVERSHEET

Minister	Hon Dr Ayesha Verrall	**Portfolio**	Research, Science and Innovation
Title of Cabinet paper	Research and Development Tax Incentive In-year Payments	**Date to be published**	31 January 2023

List of documents that have been proactively released		
Date	**Title**	**Author**
30 March 2022	*Research and Development Tax Incentive In-year Payments (1B)*	Minister of Research, Science and Innovation
30 March 2022	*DEV-22-MIN-0062 Minute (1C)*	Cabinet Office
21 June 2022	*2122-4602 Next steps for in-year payments of the R&D tax incentive (1D)*	MBIE
15 July 2022	*T2022-1322 Loan request for in-year payments of the Research and Development Tax Incentive (1E)*	The Treasury
29 September 2022	*T2022/1953 Delegation of loan approval for the Research and Development Tax Incentive in-year payments (1F)*	The Treasury
15 November 2022	*2223-1557 In-year payments of the RDTI - final design and scheme commencement (1G)*	MBIE

Information redacted **YES**

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Some information has been withheld for the reason of privacy of natural persons.

In Confidence

Office of the Minister of Research, Science and Innovation

Chair, Cabinet Economic Development Committee

Research and Development Tax Incentive In-year Payments

Proposal

1. This paper seeks Cabinet's in principle agreement to establish a fiscally neutral temporary scheme to provide in-year payments of the Research and Development Tax Incentive (RDTI). This mechanism will provide in-year payments on a temporary basis for the 2022/23, 2023/24 and 2024/25 business income tax years, and will be superseded by Inland Revenue implementing in-year payments through the tax system.

Relation to government priorities

2. The Government recognises the importance of investing in innovation to accelerate New Zealand's recovery from the impact of COVID-19 and future economic prosperity. The RDTI is the Government's flagship policy to support business research and development (R&D). In-year payments will improve the operation of the RDTI, attract more businesses to use the RDTI and increase its impact on growing R&D in New Zealand.

Executive Summary

3. The RDTI has been operating since 1 April 2019. At present, the RDTI credit or refund is paid in one lump sum to businesses after they have filed their income tax return (generally about 15 months after the end of their income tax year).

4. In-year payment of the RDTI, where the RDTI entitlement is paid in the same year the R&D expenditure is incurred, would increase the value of the RDTI to recipients. In addition to the time value of money (money today is worth more than the same amount in future), in-year payments would help businesses manage cash flow and may be of particular interest to loss-making businesses and pre-revenue start-ups who face cash flow challenges. In-year payments has been requested by R&D-performing stakeholders, including former R&D Growth Grant recipients, who were accustomed to quarterly payments.

5. Independent economic analysis showed in-year payments through the tax system or with government-supported loans would result in economic benefits to both the firms that undertake R&D and net benefits to New Zealand. Quarterly payments through the tax system had the highest return to the firm and the highest net benefit to the nation. The tax system option would also cost the least to administer. Inland Revenue has previously indicated in-year payments through the tax system could be implemented in time for the 2023/24 year if sufficiently prioritised, but this would require deprioritising other work. Inland Revenue has suggested a better target would be implementation for the 2024/25 year.

6. I consider the anticipated benefits warrant the government providing in-year payments as soon as possible through a temporary mechanism until Inland Revenue can provide in-year payments through the tax system. The Minister of Revenue and I have agreed to a two-phase approach wherein the government works with the private sector, if possible, to implement in-year payments on a temporary basis. This temporary mechanism will be superseded by Inland Revenue implementing in-year payments through the tax system.

7. I am seeking Cabinet agreement to appropriate the necessary funds for this short-term scheme so we are able to proceed quickly with implementation. I propose funding the capital expenditure and operating costs associated with in-year payments using funding already

appropriated for the RDTI, so the scheme will be fiscally neutral. Assuming that the scheme will operate on the same basis as a loan, the cash impact of the scheme is anticipated at around $67.2 million, comprising administrative costs of $8.85 million and loan default amounts of $58.35 million. This will enable $583.5 million of loans that effectively act as an advance on a business's anticipated RDTI credit, making the funds available to claimants sooner.

Business R&D strengthens New Zealand's economy

8. Business R&D is a key driver of innovation, enabling businesses to produce new and improved products and services. Innovative firms have contributed to New Zealand's success in weathering and recovering from COVID-19. Investment in business R&D will be critical to our ability to build a more resilient, productive, and sustainable New Zealand economy.

9. The vast majority of advanced economies have mechanisms to support business R&D via the tax system. Without government support, businesses tend to invest in less R&D than is optimal for the nation, as they are unable to capture the full benefits of their investment. The wider societal gains that come from knowledge creation tend to be distributed in various ways, including worker mobility, reverse engineering, and product imitation. Government support for business R&D is primarily to compensate businesses for the economy-wide benefits associated with R&D that they are unable to capture in full.

The RDTI is the Government's main mechanism to support business R&D

10. New Zealand's RDTI was implemented in April 2019 to support a wide range of R&D-performing businesses to increase their investment in R&D, replacing R&D Growth Grants as the government's main mechanism to support business R&D. Tax incentives are a common mechanism to support business R&D around the world, and 34 of the 38 OECD countries offer government tax relief for R&D expenditure.[1] New Zealand's RDTI helps more businesses innovate and contribute to a stronger and more productive economy that benefits all New Zealanders.

In-year payments would return funds to R&D-performing businesses faster, improving the operation of the RDTI

11. Currently the RDTI credit or refund is paid in one lump sum to businesses after they have filed their income tax return (about 15 months after the end of their income tax year). If a business has an income tax liability, the credit covers the liability first, and any remaining credit can be refunded through a cash payment. This means that businesses can face a considerable wait between incurring R&D expenditure and receiving the RDTI associated with that expenditure.

12. In-year payment of the RDTI (paying a business its RDTI entitlement sooner, in the same year in which it incurred the R&D expenditure) would increase the value of the RDTI to the business. This is due to the time value of money - an amount of money today is worth more than the same amount in future. In-year payments would also help businesses manage cash flow and may be of particular interest to loss-making businesses and pre-revenue start-ups who face greater cash flow challenges, as well as former Growth Grant recipients, who were accustomed to quarterly payments. While in-year payments would have clear benefits, its complexity meant it was not implemented when the RDTI was first introduced. We instead planned to introduce it as soon as practicable following the introduction of the mains scheme.

13. Currently, firms that are in tax loss or low profit positions must wait until they have filed their income tax return before they can benefit from their R&D tax credit. However, businesses in

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[1] *OECD R&D tax incentives database, 2021 edition.* As of 2021, Costa Rica, Estonia, Latvia and Luxembourg were the only OECD countries without an R&D tax incentive.

profit can get cash flow benefits from the RDTI by reducing their provisional tax payments, either by using the default method to benefit from the prior year's RDTI or the estimation method to benefit from their anticipated R&D tax credit for the current year. Businesses that pay provisional tax can also use tax pooling services to manage the timing of their payments at a relatively low cost giving them some further ability to manage their cashflows. Offering in-year payments to firms in tax loss or low profit positions would enable them to also derive cash flow benefits from their RDTI.

In-year payments would benefit both R&D performing firms and the nation

14. Officials commissioned an independent economic analysis of the benefits of in-year payments of the RDTI, which economics consultancy Infometrics provided in November 2021. The analysis quantified the benefits of the following scenarios and variations thereof:

- Payments after filing income tax return (status quo)
- Quarterly payments from government through the tax system
- Government loan with payments during the year, with a low rate of interest of 4%
- Private sector loans at an interest rate of 15%

15. The analysis found making funds available to businesses earlier through in-year payments – either via the tax system or via government loans - would result in economic benefits to both the firms that undertake R&D and net benefits for New Zealand. Quarterly payments through the tax system had the highest return to the firm and the highest net benefit to the nation. A private sector loan with a 15% interest rate produced a poorer return to firms and to the economy than the status quo. The differences in the benefit-cost ratios for the different options were modest:

Option	Benefit-Cost Ratio to firm	Benefit-Cost Ratio to nation
RDTI credit after filing income tax return (status quo)	2.07	1.62
In-year payments quarterly through the tax system	2.37	1.73-1.76
Government loan at concessional rate of 4% interest[2]	2.23	1.69
Private sector loan at commercial rate of 15% interest	1.93	1.56

16. In engagement with Callaghan Innovation over February-March 2022, RDTI claimants highlighted cashflow as their most desired improvement to the RDTI. I anticipate in-year payments will help make the RDTI more appealing to businesses, driving uptake and increasing R&D activity.

Several different mechanisms could be used to provide in-year payments

17. Government officials have investigated three high level options to deliver in-year payments:

Through the tax system

18. In-year payments would be delivered under a sub-regime within the RDTI. Taxpayers eligible for the RDTI would apply for and receive in-year payments from Inland Revenue, rather than waiting until they file their income tax return after the end of their accounting year.

[2] Lowering the interest rate below 4%, as in the mechanism proposed in this paper, gives slight increases to the Benefit-Cost Ratio to the firm and nation.

19. This option had the lowest expected implementation cost, with Inland Revenue estimating between $1.8 million and $3 million to establish and $0.53 million per year in ongoing costs thereafter.

Through a government loan scheme

20. In-year payments would be delivered through a government loan scheme as an advance on the anticipated RDTI credit/refund, delivered by an existing agency (Callaghan Innovation or MBIE).

21. This option had the highest expected implementation costs. Callaghan Innovation estimated $1.344 million to establish the scheme and $7.065 million per year for ongoing costs, while MBIE estimated around $5-6 million to establish and administer the first year of the scheme and around $3.5 million per year thereafter in ongoing administration costs.

Through a government-private sector hybrid approach

22. In-year payments would be delivered through a loan as an advance on the anticipated RDTI credit/refund. The loans would be government loans but a large part of the operations and administration would be contracted to a private sector provider. This would have the advantages of being quicker to set up and making efficient use of existing systems and expertise (such as for making payments and managing loan books).

23. MBIE has estimated the costs of this option at around $9 million to deliver in-year payments over three business tax years, placing the cost above the tax system option but below the government loans option.

Stakeholders have a clear preference for in-year payments through the tax system

24. Over August-September 2021 officials consulted on the three high level options for delivering in-year payments for the RDTI. The consultation revealed strong stakeholder desire for in-year payments to be available and to be delivered soon, with a priority on ease of access and certainty about the amount and timing of the payments.

25. Of the available options, there was a clear preference for in-year payments through the tax system. Reasons for preferring the tax system included: fewer parties to deal with, it would fit with current ways of working, could be administratively aligned with other tax types like provisional tax, Goods and Services Tax (GST), or Pay As You Earn (PAYE). Another key reason is that it would not be a loan, which poses challenges for some business due to possible requirements to seek approval from their shareholders and potential breach of bank covenants. There was however concern about how long it would take to implement in-year payments through the tax system, and suggestions that an interim approach would be helpful until a tax system option could be available, if it was easy to use.

26. A number of stakeholders preferred a government loan approach because they perceived it would have low or no interest and be faster to implement than the tax system. There was also interest in government-private sector provider hybrid approach, which would in turn lower the cost of the loans for business.

Inland Revenue could deliver in-year payments through the tax system, but speedy implementation would require deprioritising other work

27. In-year payments through the tax system would have the highest benefits and least cost to implement of the options examined.

28. Inland Revenue officials previously indicated that the tax system option for in-year payments could be implemented in time for the 2023/24 year if sufficiently prioritised by the Minister of

Finance and the Minister of Revenue as part of the delivery of the Tax Policy Work Programme. However, this would add to Inland Revenue's systems design work programme and require deprioritising other Inland Revenue work.

29. Inland Revenue officials suggested a better target would be implementation for the 2024/25 year, with the first in-year payments disbursed in approximately July 2024 for the April-June 2024 quarter. This timeframe would both allow Inland Revenue to progress its existing work and carry less delivery risk.

Ministers agreed to a temporary solution to provide in-year payments through loans until Inland Revenue can implement in-year payments through the tax system

30. I consider the anticipated benefits warrant the government providing in-year payments as soon as possible through a temporary mechanism until Inland Revenue can provide in-year payments through the tax system.

31. In November 2021, considering Inland Revenue's implementation timeframe, the Minister of Revenue and I agreed to proceed with in-year payments through a government – private sector hybrid in the short term and through the tax system for the long-term. We agreed for officials to gather information on interest in, capacity of, and costs for, a government-private sector hybrid approach as a temporary mechanism for up to three tax years. This temporary mechanism would be superseded by Inland Revenue implementing in-year payments through the tax system. Providing the temporary mechanism for three years, not two years, would make it easier to contract services from a private sector supplier, make the temporary mechanism more attractive to businesses, and allow Inland Revenue more time to implement in-year payments through the tax system.

I am seeking Cabinet's agreement to appropriate funding to implement in-year payments through a temporary scheme

32. I propose implementing in-year payments of the RDTI through a temporary scheme until such a time as Inland Revenue can implement a permanent scheme. Advancing such a scheme will require further investigation and design work, and further formal processes with private sector suppliers, if we choose to use them. To begin this design work, it is necessary to obtain surety of funding so officials are able to engage with potential private sector suppliers. I am therefore seeking Cabinet's agreement to appropriate this funding through this paper.

33. For the purposes of planning a temporary scheme, I assume it will take the form of a loan, which will effectively act as an advance on a business's anticipated RDTI credit, which is repaid once the business receives its RDTI credit. Such a loan would function to mobilise RDTI funds sooner, allowing businesses to better manage their cash flow and reinvest funds in R&D.

34. I propose that in-year payments are available to RDTI applicants who do not expect to be in profit, or do not expect to be in profit at a level sufficient to use their entire RDTI on provisional tax offset. Assisting these cashflow-constrained businesses in a tax loss or low profit position is the main objective of this policy. Businesses in profit who can already use their entire RDTI to offset their provisional tax will not be eligible for in-year payments loans as they are already able to derive cash flow benefits from their RDTI credit.

I propose that officials work with potential suppliers on the operational policy and delivery of such a scheme, and report back to Ministers when this work is finalised

35. Over December 2021-January 2022 officials used a Request for Information on the Government Electronic Tender Service to seek more information about interest from potential private sector supplier and prospective costs to provide these services.

36. Responses were received from three of New Zealand's registered tax pooling intermediaries, and one from an international R&D financing company. This process helped test assumptions about services the private sector could provide, the proposed mechanism, and the structure of the loans.

37. Subject to Cabinet's agreement to the proposed approach, officials will engage with stakeholders to explore options for the temporary in-year payment scheme, design the operational policy, and continue the procurement process to select an appropriate private sector supplier to assist in administering the scheme.

38. I seek Cabinet's agreement to delegate the final decisions on such a scheme to me, the Minister of Finance and the Minister of Revenue.

Estimated uptake and loan values

39. In preparation for the possibility that the scheme will operate as a loan, officials have estimated the value of the loans, the fair value write-down and administration costs. Officials estimate issuing a total of 3,650 loans at an average of $150,000 per loan. Officials have also included an extra $12 million in each year to cover a few larger claims.

40. The number of businesses that would seek in-year payment loans is estimated to be 1,000 in the first year, 1,250 in the second year and 1,400 in the third year. This assumes that most businesses in tax loss or low profit and that have enrolled in the RDTI are expected to apply, and that the number of businesses will grow over the next three years as interest in the RDTI grows. However, it is possible that some of these businesses with smaller RDTI claims may not go to the effort of obtaining loans.

41. The average anticipated loan value is 85% of the average RDTI entitlement provided to businesses in tax loss during the 2019/20 year, plus a correction for the weighting of the 2019/20 data towards smaller claims. The data for the 2019/20 period is not complete, as claims are still being processed, but provides the current best estimate of average RDTI entitlement value for businesses in tax loss. Claims that are lower value (and therefore lower financial risk to the government) tend to be processed faster. A correction of 15% has been added to the average to account for the incomplete data set and for loans to low profit businesses (in addition to businesses in tax loss).

42. The estimated loan uptake and loan values are shown below:

R&D expenditure period	**April 2022 – March 23**	**April 2023 – March 24**	**April 2024 – March 25**	**Total**
Estimated number of claims for in-year payments	1,000	1,250	1,400	3,650 fn.3
Estimated average loan value	$150,000 + $12 million	$150,000 + 12 million	$150,000 +12 million	
Estimated capital expenditure required for loans	$162 million	$199.5 million	$222 million	**$583.5 million**

[3] The same businesses are expected to make repeat claims; the number of unique businesses making claims for in-year payments is expected to be around 1,400.

43. The estimated loan repayments are shown below:

Government financial year	2023/24	2024/25	2025/26	2026/27	Total
Assumed repayments (accounting for risk of default), $m	102.060	169.425	193.725	59.940	**525.150**

44. Assumptions used to form these estimates are detailed in Appendix One.

Administration costs

45. Officials estimate administration costs to be around $8.850 million to provide in-year payments for three years of RDTI claims and receive loan repayments for two years beyond this. These costs comprise the government administration costs associated with loan administration (internal administration costs) and costs of engaging the private sector supplier (external administration costs). Costs are estimated as follows:

Government financial year	2022/23	2023/24	2024/25	2025/26	2026/27	2027/28
Estimated cost of government administration ($m)	0.85	1.0	1.0	0.3	0.3	0.2
Estimated cost for private sector administration ($m)	0.6	1.2	1.2	1.2	0.6	0.4

46. The private sector administration cost estimates were informed by responses to the Request for Information from potential private sector suppliers and the uptake estimates above. There will however remain some uncertainty around administration costs given the next stage is to issue a Request for Proposal to contract a private sector supplier, which will not commence until Cabinet has provided its agreement to the present proposal.

Financial Implications

47. The original expenditure forecasts for the RDTI were based on the best estimates of R&D expenditure available at the time (from the R&D Survey), projected forward in line with the macroeconomic modelling of GDP growth provided by the Treasury. They were designed to reflect the aggregate potential demand for the RDTI, and were a necessarily conservative estimate that erred on the side of overprovisioning to avoid an unplanned overspend.

48. Uptake of the RDTI to date has been significantly below the original forecast. Firm demographic data for the RDTI shows that uptake from businesses not in tax loss has been broadly in line with expectations, however uptake has been lower amongst businesses in tax loss positions. The business advisory sector has confirmed that providing in-year payments will increase the RDTI's appeal to businesses in tax loss and I therefore expect it will increase the uptake of the RDTI over the medium term to bring it in line with the original forecasts.

49. Nevertheless, I anticipate that demand will continue to track below expectations over the next two to three years until businesses – especially those in tax loss – are able to take full advantage of the RDTI, aided by the availability of in-year payments. Therefore, I propose that we use the shortfall between the amount that we previously appropriated, which was based on the original expectations of demand, and the expected expenditure over the next two to three years to cover the cost of providing a temporary in-year payments mechanism.

50. I believe that this is the best way to achieve the original policy intent of the RDTI while staying within the original cost envelope of the scheme. Reallocating funds from the RDTI appropriation to this temporary in-year payments facility will also be consistent with the scope of the RDTI appropriation, which is limited to “providing an R&D tax credit to eligible R&D performing businesses”.

51. Implementing the temporary in-year payments mechanism will require new appropriations for the capital expenditure of the loans, the fair value write-down, and the administrative costs of the scheme associated with government administration and engaging the private sector supplier. A large proportion of the loans are expected to be repaid; the cash impact of the scheme comprises the anticipated loan default amount and administrative costs and is much lower than the total appropriations.

52. Capital expenditure for the loans is estimated to be $583.5 million for in-year payments over three business tax years. The fair value write-down comes to around 32% of the capital expenditure, comprising a 10% expected default rate on the loans, 12% concessionary expense, and 10% subsequent impairment, giving a fair value write-down of $187.236 million. In addition, administrative costs are estimated at $8.850 million. Total appropriations are therefore estimated at $779.586 million. The Treasury has advised the capital expenditure of the loans can be treated as fiscally neutral if it is repaid within 10 years.

53. The cash impact is less than the appropriation as a large proportion of the loans are expected to be repaid and the concessionary expense and subsequent impairment estimates do not have a cash impact. Officials estimate $525.15 million to be repaid, with a default amount of $58.35 million. The cash impact is estimated at $67.2 million, comprising administrative costs of $8.850 million and the default amount of $58.35 million.

54. The impact of the combined capital and operational appropriations for in-year payments over the 5 year uses 27% of the RDTI forecast for this period. If repayments are taken into account, then these appropriations use 12%.

Risks

55. The complexity of this proposal carries three areas of risk for the Crown: financial risk due to business default or fraud, the operational delivery of in year payments within a reasonable timeframe, and the fiscal risks associated with higher-than-anticipated uptake of the RDTI affecting the total cost of the scheme.

56. Although the Crown will need to adopt a reasonable tolerance level for financial risk, officials advise me that there are several operational mechanisms available to reduce financial risks associated with business default and fraud:

- It would be possible to reduce the risk of default by legislative change to enable Inland Revenue to take a business’s RDTI entitlement and use it to repay the government loan, rather than paying it to the business to use at their discretion as is currently required. This change would be consistent with general taxation principles wherein a credit is used to offset a liability, rather than the credit being paid out to the business to use at their discretion.

- The financial risk of businesses not repaying the loans as a result of business closure or cashflow difficulties has been accounted for with a 10% default rate incorporated into the fair value write-down expense. To encourage repayment on time, a 7% interest rate is proposed that would apply after repayment is due and should encourage repayment by those that are able to.

- Fraud risk will be mitigated by the existing checks in place for RDTI claimants. Applicants for in-year payments must have enrolled in the RDTI and filed an application for a General Approval or a Criteria and Methodology approval before they can apply for the loan. The private sector supplier will perform due diligence checks on applicants as part of the application process.

- There is a risk that the private sector supplier has limited motivation to adequately manage risks associated with the loans, as the loans come from the government not their own funds. This risk will be managed by placing contractual requirements on the supplier with consequences for inadequate risk management. However, some defaults are still expected, and the Crown will need to adopt an approach that has a reasonable risk-tolerance level.

- There is a risk that a business is provided with in-year payment of an anticipated RDTI claim that is ultimately not accepted or covers significantly different activities than the business indicated in its application (either deliberately or by mistake). In this case, the standard loan repayment conditions will apply with no additional penalties, provided the business made their application in good faith with a reasonable expectation it would be accepted. This risk will be mitigated by designing a check on in-year payment applications for large increases in R&D expenditure compared to the previous year. For example, if there is an increase in R&D expenditure of three times or more compared to the previous year, then the applicant will need to give evidence for this increase or wait for the General Approval to be approved. Officials will work on the details of the approach as the design of the scheme is finalised.

- To avoid reoccurring poor behaviour, businesses will not be able to receive further in-year payments if they have not repaid a loan advancing an earlier year's R&D tax credits.

57. These operational parameters can only be confirmed once officials have engaged with the private sector providers so that Ministers can make a decision on the appropriate balance between financial risk and operational cost.

58. Finally, there are fiscal risks associated with faster-than-expected uptake of the RDTI due to the provision of in-year payments. Although the overall cash impact is projected to be 12% of the RDTI appropriation over five years, the fiscal neutrality of an interim in-year payments solution is covered by our expectations around the length of time required for businesses in tax loss to take up the scheme. Faster uptake increases the possibility that the RDTI would result in more tax revenue foregone than anticipated. However, this would also mean that New Zealand's businesses are investing more in innovative R&D and the Government would achieve its manifesto commitment to raise total R&D investment to 2% of GDP over a shorter timeframe.

Legislative Implications

59. No legislative changes are required for the short-term solution of in-year payments through a government loan. However, it may be desirable to reduce the risk of the loan default through legislative change that enables Inland Revenue to use a business's RDTI entitlement to repay the government loan, rather than being required to pay it to the business.

60. The long-term solution of in-year payments through the tax system will require legislative changes to the *Income Tax Act 2007* and/or the *Tax Administration Act 1994*.

Consultation

61. Inland Revenue and the Treasury were consulted in the preparation of this paper.

62. The Treasury's feedback included the following:

   - Requested clarification about the relative costs and benefits of introducing in-year payments through a loans scheme ahead of Inland Revenue implementing it;
   - Concerned the private sector supplier, who does not bear the risk of lending, had little incentive to adequately manage the risks associated with the loans;
   - Requested clarification on the rationale for any change to the RDTI appropriation forecast and the measures MBIE has in place to ensure that the RDTI appropriation does not go unappropriated in future.

63. The Treasury would have preferred RDTI in-year payments to be considered through the Budget 2022 process so benefits and costs could be considered against other spending proposals.

Publicity

64. No announcements on in-year payments would be made until the Minister of Finance has agreed that the loans are necessary or expedient in the public interest under the Public Finance Act, the private sector supplier has been selected, and the system is operating or close to operating.

Proactive Release

65. I propose that this paper is proactively released within 30 days of Cabinet decisions having been made and the Minister of Finance having agreed that the loans are necessary or expedient in the public interest under the Public Finance Act, with any redactions in line with the provisions of the Official Information Act 1982.

Recommendations

66. I recommend that Cabinet:

1.1 **note** the R&D tax incentive (RDTI) has been operating since 1 April 2019;

1.2 **note** at present, the RDTI credit or refund is paid in one lump sum to businesses after they have filed their income tax return, generally about 15 months after the end of their income tax year;

1.3 **note** in-year payment of the RDTI, wherein an RDTI entitlement is paid in the same year the R&D expenditure is incurred, would increase the value of the RDTI to recipients. Stakeholders strongly support in-year payments and want them to be delivered soon;

1.4 **note** officials have investigated and consulted on three options for delivering in-year payments for the RDTI: through the tax system, through government loans, or through a government-private sector hybrid approach;

1.5 **note** stakeholders have a clear preference for in-year payments through the tax system, which would be simplest for businesses to use. There was also interest in a government loan or government-private sector hybrid approach;

1.6 **note** independent economic analysis showed in-year payments through the tax system or with government loans would result in economic benefits to both the firms that undertake R&D and net benefits to New Zealand;

1.7 **note** in-year payments through the tax system has the most benefits, but Inland Revenue has competing work priorities and recommends targeting implementation for the 2024/25 income tax year;

1.8 **note** considering Inland Revenue's implementation timeframe for the tax system solution, the Minister of Research, Science and Innovation and the Minister of Revenue agreed to proceed with a temporary mechanism to provide in-year payments with administrative support from a private sector supplier;

1.9 **note** this temporary mechanism would operate in the 2022/23, 2023/24 and 2024/25 tax years and be superseded by Inland Revenue implementing in-year payments through the tax system;

1.10 **note** that to provide surety of funding so that officials can engage with potential private sector providers on a certain basis, I seek to appropriate funding sufficient to operate the temporary mechanism as a loan scheme;

1.11 **note** such a temporary mechanism is estimated to require appropriation of $779.586 million, comprising capital expenditure of $583.5 million for the loans, fair value write-down of $187.236 million, and administration costs of $8.850 million;

1.12 **note** this funding would provide 3,650 in-year payments loans to over three tax years (2022/23, 2023/24 and 2024/25) to approximately 1,400 businesses, with capital expenditure of $583.5 million. Approximately $525.15 million of loaned funds are expected to be repaid;

1.13 **note** there are significant operational risks to this temporary mechanism that officials will need to investigate and seek legal advice on. I will seek agreement from Cabinet once risks have been more fully assessed;

1.14 **note** uptake of the RDTI has been lower than expected to date. The availability of in-year payments and other improvements will support increased uptake of the RDTI over time;

1.15 **note** that under section 65L of the Public Finance Act 1989, the Minister of Finance, on behalf of the Crown, may lend money to a person or organisation if it appears to the Minister to be necessary or expedient in the public interest to do so;

1.16 **note** that the Minister of Finance's approval to any in-year payments loans under section 65L of the Public Finance Act will be sought separately following the approval of this project from Cabinet;

1.17 **agree** in principle to establish a mechanism to provide in-year payments of the RDTI, subject to further operational policy work, design, and engagement with potential private sector partners;

1.18 **agree** that final decisions on the operational design of such a scheme be delegated to the Minister of Research, Science and Innovation, the Minister of Finance and the Minister of Revenue;

1.19 **agree** to increase spending to provide for potential costs associated with the policy decision in recommendation 1.17 above, with the following impacts on the operating balance and net core Crown debt:

	$m – increase/(decrease)							
Vote Business, Science and Innovation	**2021/22**	**2022/23**	**2023/24**	**2024/25**	**2025/26**	**2026/27**	**2027/28**	**2028/29 and outyears**
Operating Balance and Net Core Crown Debt Impact	1.459	2.909	13.870	19.705	27.757	0.900	0.600	-
Operating Balance Impact Only	45.396	250.442	229.921	187.627	-	-	-	-
Net Core Crown Debt Impact Only	-	-	-	-	-	-	-	-
No Impact	-	-	-	-	-	-	-	-
Total	46.855	253.350	243.791	206.332	27.756	0.900	0.600	-

1.20 **agree** to establish the following new multi-year appropriations, to run from 1 April 2022 to 30 June 2026:

Vote	**Appropriation Minister**	**Title**	**Type**	**Scope**
Vote Business, Science and Innovation	Minister of Research, Science and Innovation	In-year payments loans	Non-departmental Capital Expenditure	This appropriation is limited to providing a loan to eligible businesses to provide an in-year payment of their anticipated research and development tax credit.
Vote Business, Science and Innovation	Minister of Research, Science and Innovation	In-year payments fair value write-down and impairment	Non-departmental other expense	This appropriation is limited to the fair value write-down of providing an in-year payment loan of a firm's anticipated research and development tax credit, as well as any subsequent impairment.

1.21 **agree** to establish the following new appropriations:

Vote	Appropriation Minister	Title	Type	Scope
Vote Business, Science and Innovation	Minister of Research, Science and Innovation	In-year payments administrative costs (internal)	Departmental output expense	This appropriation is limited to the departmental administrative costs of providing an in-year payment loan of a firm's anticipated research and development tax credit.
Vote Business, Science and Innovation	Minister of Research, Science and Innovation	In-year payments administrative costs (external)	Non-departmental output expense	This appropriation is limited to the non-departmental administrative costs of providing an in-year payment loan of a firm's anticipated research and development tax credit.

1.22 **approve** the following forecast change to give effect to the policy decision in recommendation 1.17 above:

	$m – increase/(decrease)					
	2021/22	**2022/23**	**2023/24**	**2024/25**	**2025/26**	**2026/27 and outyears**
Vote Revenue **Minister of Revenue** Non-departmental Other Expenses: Research, Science and Innovation: R&D Tax Incentive	(6.355)	(81.975)	(38.666)	(39.832)	(27.758)	-

1.23 **approve** the following changes to further give effect to the policy decision in recommendation 1.17 above:

	$m – increase/(decrease)					
	2021/22	**2022/23**	**2023/24**	**2024/25**	**2025/26**	**2026/27 and outyears**
Vote Business, Science and Innovation **Minister of Research, Science and Innovation** Non-departmental Capital Expenditure: Research, Science and Innovation: In-year payments loans	583.500					-
Departmental Output Expenses: Research, Science and Innovation: In-year payments administrative costs (internal)	-	0.850	1.000	1.000	0.300	
Non-departmental Output Expenses: Research, Science and Innovation: In-year payments administrative costs (external)	-	0.600	1.200	1.200	1.200	
Non - departmental Other Expenses: Research, Science and Innovation: In-year payments fair value write-down and impairment	187.236					-

1.24 **note** that the capital expense can be treated as fiscally neutral, as the loans are expected to be repaid within ten years;

1.25 **note** that the indicative spending profile for the new multi-year appropriations described in recommendation 1.20 above is as follows:

	$m – increase/(decrease)					
Vote Business, Science and Innovation Minister of Research, Science and Innovation	**2021/22**	**2022/23**	**2023/24**	**2024/25**	**2025/26**	**2026/27 and outyears**
Non-departmental Capital Expenditure: Research, Science and Innovation: In-year payments loans	40.500	171.375	205.125	166.500	-	-
Non-departmental Other Expenses: Research, Science and Innovation: In-year payments fair-value write down	6.355	80.525	36.466	37.632	26.258	-

1.26 **approve** the following changes to appropriations to give effect to the policy decision in recommendation 1.17 above:

	$m – increase/(decrease)				
Vote Business, Science and Innovation Minister of Research, Science and Innovation	**2024/25**	**2025/26**	**2026/27**	**2027/28**	**2028/29 and outyears**
Departmental Output Expenses: Research, Science and Innovation: In-year payments administrative costs (internal)	-	-	0.300	0.200	-
Non-departmental Output Expenses: Research, Science and Innovation: In-year payments administrative costs (external)	-	-	0.600	0.400	-

1.27 **agree** that the proposed change to appropriations in the recommendations above be included in the 2021/22 Supplementary Estimates and that, in the interim, the increase be met from Imprest Supply;

1.28 **agree** that that the expenses incurred under the recommendations above be charged against the between-Budget contingency established as part of Budget 2021;

1.29 **note** that overall operating impact of the proposal is fiscally neutral, as the reduction in forecast spending in Vote Revenue is equal to the additional spending in Vote BSI;

1.30 **agree** to delegate to the Minister of Finance and the Minister of Research, Science and Innovation the ability to adjust the appropriations for fair value write-down and impairment if needed.

Authorised for lodgement

Hon Dr Megan Woods

Minister of Research, Science and Innovation

Appendix One – assumptions used to form loan estimates

1. Eligibility: in-year payment loans will be available to businesses in loss or that do not expect to pay provisional tax.
2. Uptake: assumes all RDTI claimants in tax loss would take up in-year payments, plus some businesses in a low profit position. We assume the RDTI and also in-year payments uptake will grow over the next three years, with estimated numbers of loan applications of 1,000 in 2022/23, 1,250 in 2023/24 and 1,400 in 2024/25.
3. Loan value: assumes eligible businesses apply for a loan equivalent to 80% of their expected RDTI if expenses incurred are based on an application for a General Approval or 90% of their expected RDTI if based on an approved General Approval. The estimated average loan value used to calculate the capital requirements is based on approved RDTI claims in the 2019/20 tax year who were in tax loss. These data were used because they were more complete than the 2020/21 tax year. We have assumed that most businesses will have a RDTI entitlement under $4 million and have used an average RDTI entitlement of those claims. We have adjusted this upwards to take into account low profit businesses and that even the 2019/20 tax year data is still not a complete year, to settle on an estimated average in-year payment loan of $150,000. We have also adjusted the annual appropriation to take into account up to $12 million of larger claims each year. These are the best estimates we have at present, but we may need to review after the first year of in-year payments.
4. Interest and repayments: no interest charges on the loans between drawdown and the RDTI being available to customers – to make it appealing and helpful to business that need cash flow to cover their costs or to increase R&D spend. Repayment is required in full a short time after the RDTI becomes available to the business (or its RDTI claim is rejected). Additional interest charges will apply after this point to incentivise repayment. The Inland Revenue Use of Money Interest rate will be used each year. This is currently 7%. We have assumed that most business will repay on time, but there may be 5% that do not. The interest will apply until they repay. After a time, other contractual remedies will be used to recover the funds. The repayments are calculated using the capital value less the default rate. We assumed that 70% of the loans will be repaid during the government financial year after the loans have been drawn down (about two years after the first drawdown), and 30% in the year following. This allows time for some businesses that have different balance dates or file their tax returns late, and for some RDTI claims that may take longer to be assessed.
5. Fair value write-down: the fair value write-down includes a concessionary expense, default rate and subsequent impairment in case the default rate is underestimated. The total fair value write down is $187.236 million and is around 32% of the capital value. More details about each component of the fair value write down are described below.
6. Default rate: businesses may default on their loans if they go out of business or if they do not have cash to repay the loans. These businesses may be in tax loss and may be pre-profit which poses some risk of default and or closure. However, many R&D performing businesses that seek the RDTI are established businesses with a track record of R&D. Also, if they spend money on eligible R&D activities then they are entitled to the RDTI, so they will have funds to repay their loans, making repayment likely. Furthermore, of the 800 or so businesses that are currently participating in the RDTI, only 3 of these have a bankruptcy, liquidation or receivership indicator.[4] The expected credit losses/default rate has therefore been estimated at $58.3 million, 10% of the capital value. We note that a 30% rate was used for the R&D cashflow loan scheme. This scheme was designed to support businesses with R&D expenditure through COVID, that may have suffered impacts to their funding. This could be

[4] Inland Revenue receives external advice about companies that are in bankruptcy, liquidation or receivership and it notes these on their files. In some cases, these businesses are either sold (and continue to operate) or they trade out of this situation.

considered an upper limit for in-year payments. The R&D loss tax credit scheme was set up in 2016. The Treasury predicted that 10-15% of this group would fail, but while the analysis of this scheme is still in progress, we understand the actual number of businesses that failed to be much lower. Therefore, a lower default rate than that used for these two schemes makes sense for in-year payments.

7. Subsequent impairment: a subsequent impairment of a further 10% in case the estimate for the default rate is too low.

8. Administration costs: are based on rough estimates of MBIE costs, and information provided by potential private sector providers to the Request for Information (notably not to an RFP). These are being further refined in discussion with RFI respondents and MBIE colleagues. We anticipate requiring 2 – 2.5 full time employees over 6 years to manage the scheme within MBIE. This covers programme lead and loan administration support. We also anticipate some legal and documentation fees. These other costs mean administration costs arise over 7 years.

9. Transition to the tax system: as this is an interim approach, we anticipate making the loans available over three income tax years. Loans would therefore no longer be available to cover RDTI entitlement arising from expenditure after 1 April 2025. However, there will be a tail of activities as RDTI entitlement comes through, repayments are made, final under and over payments are reconciled, and any non-repayments are identified.

MINISTRY OF BUSINESS, INNOVATION & EMPLOYMENT
HĪKINA WHAKATUTUKI

BRIEFING

Next steps for in-year payments of the R&D tax incentive

Date:	21 June 2022	**Priority:**	Medium
Security classification:	In Confidence	**Tracking number:**	2122-4602

Action sought

	Action sought	Deadline
Hon Dr Ayesha Verrall **Minister of Research, Science and Innovation** Hon Grant Robertson **Minister of Finance** Hon David Parker **Minister of Revenue**	**Note** in April Cabinet agreed in principle to provide in-year payments of the RDTI and to delegate final decisions on the operational design to the Minister of Research, Science and Innovation, the Minister of Finance, and the Minister of Revenue. **Agree** to the proposed operational design and terms and conditions as noted in this paper which have been updated after further policy design and conversations with experts and potential providers. **Note** that the Minister of Finance's approval to lend money for in-year payment loans under the Public Finance Act will be sought separately following the approval of this paper. **Note** MBIE will procure a provider to administer in-year payment loans.	28 June 2022

Contact for telephone discussion (if required)				
Name	**Position**	**Telephone**		**1st contact**
Dr Jess Robertson	Manager, Innovation Policy, MBIE	04 896 5276	Privacy of natural persons	✓
Leah Murphy	Principal Policy Advisor, Innovation Policy, MBIE			

The following departments/agencies have been consulted
The Treasury and Inland Revenue

Minister's office to complete:

☐ Approved

☐ Declined

☐ Noted

☐ Needs change

☐ Seen

☐ Overtaken by Events

☐ See Minister's Notes

☐ Withdrawn

Comments

MINISTRY OF BUSINESS, INNOVATION & EMPLOYMENT
HĪKINA WHAKATUTUKI

BRIEFING

Next steps for in-year payments of the R&D tax incentive

Date:	21 June 2022	**Priority:**	Medium
Security classification:	In Confidence	**Tracking number:**	2122-4602

Purpose

To seek your agreement to the proposed operational design for the temporary in-year payments scheme for the Research and Development Tax Incentive (RDTI) which has been updated following Cabinet decisions in April; to outline the next steps for procuring a private sector provider and implementing the scheme.

Executive summary

In April Cabinet agreed in principle to establish a temporary mechanism to provide in-year payments of the RDTI subject to further policy development and engagement with potential providers [CAB-22-MIN-0105 and DEV-22-MIN-0062 refer]. Cabinet also agreed that final decisions on the operational design for in-year payments be delegated to the Minister of Research, Science and Innovation, the Minister of Finance, and the Minister of Revenue.

An updated operational design for in-year payments of the RDTI is presented in this paper. The operational design has been developed since the Cabinet paper decisions and after further policy development as well as conversations with potential private sector in-year payments providers, legal and tax experts.

The proposal is for in-year payment loans of 90 per cent of an applicant's expected RDTI, based on eligible expenditure during the year and paid in arrears, for most businesses in tax loss[1] or businesses that can only partially offset their RDTI against provisional tax payments. The key changes are:

- a simplified description of eligibility
- a single total loan value (90 per cent of expected RDTI)
- a reduction in drawdown frequency to fit in with provisional tax payments
- the requirement that RDTI applications are approved before loan payments are made (although loan applications can be processed based on a lodged RDTI application)
- ability to vary loan agreements if more eligible R&D takes place than what was anticipated in the RDTI application or if provisional tax reductions change during the year
- the removal of a requirement for tax agents to make declarations about businesses
- the right to audit the information provided by the business
- a standardised repayment plan, and
- allow for the possibility of procuring multiple providers.

[1] We are investigating whether in-year payments will be made available to business that get non-refundable credits, which could take a few years before the business would receive it as a credit against other taxes or as cash.

These changes are geared towards simplifying the scheme, ensuring it provides equity to businesses that are eligible for the RDTI, and lowering risks.

After the approval of this updated operational policy for in-year payments, the following next steps will take place, some in parallel:

- issue a Request for Proposal for a private sector provider to administer the loans
- seek the Minister of Finance’s approval that the loans are necessary or expedient in the public interest under the Public Finance Act and agreement to delegate to the Secretary to the Treasury, and
- seek ability to delegate the approval of the loans to the appropriate level in MBIE.

Subject to a successful procurement process, we anticipate loan applications to be open before the end of December 2022 and would cover eligible R&D expenditure from 1 April 2022.

Recommended action

The Ministry of Business, Innovation and Employment (MBIE) recommends that you:

a **Note** in April 2022 Cabinet agreed in principle to establish a temporary mechanism to provide in-year payments of the RDTI subject to further policy development and engagement with potential providers.

Noted *Noted* *Noted*

b **Note** Cabinet also agreed to delegate final decisions on the operational design for in-year payments to the Minister of Research, Science and Innovation, the Minister of Finance, and the Minister of Revenue.

Noted *Noted* *Noted*

c **Note** the proposed operational design has been updated after further policy design, conversations with experts and potential providers.

Noted *Noted* *Noted*

d **Note** the risks around default, fraud, and timely operational delivery, and the mechanisms to mitigate these.

Noted *Noted* *Noted*

e **Agree** to the proposed operational policy design for in-year payment loans of 90 per cent of expected RDTI, paid in arrears based on actual eligible expenditure during the year, for businesses in tax loss or that can only partially offset their RDTI against provisional tax payments and other updated terms and conditions as noted in this paper.

Agree / Disagree *Agree / Disagree* *Agree / Disagree*

f **Note** that under section 65L of the Public Finance Act 1989, the Minister of Finance, on behalf of the Crown, may lend money if it appears to the Minister to be necessary or expedient in the public interest to do so.

Noted *Noted* *Noted*

g **Note** that Minister of Finance's approval to the in-year payment loans under section 65L of the Public Finance Act will be sought separately following the approval of this paper.

Noted *Noted* *Noted*

h **Note** MBIE will proceed with a Request for Proposal to procure a private sector provider to administer the loans based on the updated operational policy design included in this paper.

Noted *Noted* *Noted*

i **Note** that any changes recommended by Ministers can be reflected in the procurement process prior to the conclusion of the Request for Proposal period.

Noted *Noted* *Noted*

j **Note** we are aiming to open for loan applications before the end of December 2022.

Noted *Noted* *Noted*

Dr Jess Robertson
Manager, Innovation Policy
Labour, Science and Enterprise, MBIE

21 / 06 / 2022

Hon Dr Ayesha Verrall
Minister of Research, Science and Innovation

..... / ...... / ......

Hon Grant Robertson
Minister of Finance

..... / ...... / ......

Hon David Parker
Minister of Revenue

..... / ...... / ......

Background

1. In-year payments of the Research and Development Tax Incentive (RDTI) provides the RDTI as an advance payment to businesses in the same year the R&D expenditure is incurred. In-year payments would increase the value of the RDTI to businesses and help them manage cash flow challenges.

2. The Research and Development Tax Incentive (RDTI) was introduced in 2019 to support a wide range of R&D-performing businesses to increase their investment in R&D. Currently the RDTI credit or refund is paid in one lump sum to businesses after they have filed their income tax return (generally about 15 months after the end of their income tax year). This means they do not receive the credit until 15-27 months after the eligible R&D expenditure is incurred.

3. The delay between the business incurring R&D expenditure and eventually receiving the RDTI makes the incentive less effective, blunting its policy intent. If a business receives its RDTI credit quickly it is more likely to increase its R&D expenditure, whereas a business that has a significant delay is less likely to modify its behaviour. Furthermore, the delay in receiving the RDTI reduces its value to the business due to the time value of money (money today is worth more than the same amount in future). Some businesses have expressed that this delay means the RDTI does not justify the administrative effort for them to apply. This issue of payment timing is a major inhibitor to the overall success of the RDTI scheme.

4. While businesses in profit have the option to utilise their RDTI credit earlier by reducing their provisional tax payments, this is not available to businesses that do not pay provisional tax, which tend to be smaller and earlier stage, and are an important target of the RDTI. In-year payments of the RDTI, where the RDTI entitlement is paid in the same year the R&D expenditure is incurred, would increase the effectiveness of the incentive, increase its value to businesses, and help them manage cash flow challenges. In-year payments was intended in the original RDTI design, however its complexity meant the RDTI was launched without in-year payments to avoid delay.

5. In 2021, MBIE consulted on three options for delivering in-year payments: through the tax system, with Government loans or through a private sector-run loan scheme. In late 2021 the Minister of Revenue and the Minister of Research, Science and Innovation agreed that the longer-term intention was for Inland Revenue to deliver in-year payments of the RDTI through the tax system but noted competing work priorities meant Inland Revenue would not be able to do so for at least another 2 or 3 years – during which time the RDTI would be less effective at incentivising R&D activity. Facing this delay, Ministers agreed for MBIE to investigate quickly establishing a temporary mechanism to provide in-year payments of the RDTI in the form of a Crown loan.

6. A Request for Information was issued in December 2021 to find out if there are private sector providers interested in administering in-year payments. We presented an option where the Crown would be the lender and a private sector provider would administer the loans and undertake liaison with businesses. We received three responses from registered New Zealand tax pooling intermediaries and one response from a multinational R&D finance company.

7. In April Cabinet agreed in principle to establish a temporary mechanism to provide in-year payments of the RDTI[2], subject to further operational policy work, design, and engagement with potential private sector partners [CAB-22-MIN-0105 and DEV-22-MIN-0062 refer]. Cabinet agreed to delegate final decisions on the operational design of the scheme to the

[2] The mechanism will provide in-year payments on a temporary basis for the 2022/23, 2023/24 and 2024/25 business income tax years, and will be superseded by Inland Revenue implementing in-year payments through the tax system.

Minister of Research, Science and Innovation, the Minister of Finance and the Minister of Revenue.

8. This paper provides an update to the proposed operational design following further policy development, conversations with private sector providers that responded to the Request for Information, a legal expert and tax advisors.

Summary of key changes to the operational design

A loan instrument is the most appropriate mechanism

9. We confirm that a loan instrument is the most appropriate mechanism. If a repayable grant is used it would likely legally still be a loan and/or it would undermine and replace the RDTI itself which is not intended.

Devolving activities to the private sector provider will minimise operational delivery risk and cost

10. Procuring loan administration services from one or more private sector providers and devolving some authority to them will avoid the need for MBIE to establish a more substantial internal team to manage in-year payment loans.

11. We received responses to the Request for Information from two types of entities - finance companies and tax pool intermediaries.[3] The finance company respondent expected to receive a loan of funds from MBIE, which they would in turn loan to customers. Tax pool intermediaries, on the other hand, manage funds and payments on behalf of clients but do not loan funds and were not interested in doing so. They would however be able to sign individual loan agreements on the Crown's behalf and make individual drawdown payments.

12. While there is a legal difference between who is the lender, these two approaches would operate quite similarly in practice and are both viable. The loan approval and payments (drawdowns) would be arranged in bulk whether the lender is the provider (in the case of a finance company) or MBIE (in the case of a tax pool intermediary). The risks under both approaches are similar, as the Crown either provides the funding and underwrites the loans issued by the finance company or directly takes on the risk of the loans.

13. In either case, MBIE can have a relatively minor administrative team to support in-year payments and will arrange for delegated approval of bulk loan applications by the General Manager (Science, Innovation and International), and loan payments by a senior person with the appropriate financial delegations (most likely a Deputy Secretary or the Chief Financial Officer. Please see Annex One for a list of roles and responsibilities (activities) associated with in-year payments. The approach will be highly standardised with objective eligibility criteria so that the authorisation of loans to businesses and drawdown against them can be delegated down to an operationally efficient level.

A direct payment of the RDTI from Inland Revenue is not necessary but could be helpful

14. We have explored whether it is possible to lower the risk of loan default through a direct payment of the RDTI from Inland Revenue to the provider, if the business nominates the providers bank account themselves. We think this is unnecessary and may be more complicated than simply having a contractual obligation on the business to repay the loan once it gets its RDTI credit or refund.

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[3] Tax pooling allows New Zealand taxpayers to pool their provisional tax payments together in an account held by a registered tax pooling intermediary at Inland Revenue (IRD) so that underpayments by some can be offset by overpayments by\of others. Taxpayers receive/pay an interest rate that is higher/lower than IRD's rates if they overpay/underpay provisional tax. Intermediaries operate under legislation set out in the Income Tax Act 2007 and Tax Administration Act 1994.

15. It is more complicated because the payment from the Inland Revenue may not represent the full RDTI, it may be less, or it may be more. It may be less than the RDTI because the Inland Revenue will use the RDTI to pay for other taxes. The payment could also include an income tax refund.

Updated proposed loan terms and conditions

16. We have updated the loan terms and conditions compared to the Cabinet paper. In particular:

- The eligibility criterion has been clarified so that it captures businesses that do not get a reduction in their provisional tax payments for the full extent of their RDTI. The previous eligibility criteria did not provide for those that had a partial offset – which could arise if a business is in low profit and does a lot of R&D. It means that all businesses will be on an equal footing, in that they will either get a reduction in their provisional tax or they can get an in-year payment loan or a combination of both.

- The total loan value has been changed to be up to 90 per cent of expected RDTI rather than having a two-stage approach for either 80 per cent or 90 per cent depending on the stage of the RDTI application. This makes the loan simpler to administer and easier for businesses to understand. The two-stage approach was to help manage higher uncertainty associated with the activities included in an unapproved application compared to an approved application. However, we have also changed the drawdown requirements so that they must be based on activities in an approved application.

- The drawdown request includes a declaration from an officer of the business that the expenditure is true and correct. We have also included a right to audit the information provided by the businesses for an application or a drawdown. The drawdown frequency has been changed to three times a year, from four times a year, to fit in with provisional tax payments. This aligns with the eligibility criterion and makes it easier for businesses that have partial offset through provisional tax to calculate their in-year payment loan drawdown requests.

- The requirement for tax agents to make declarations about businesses when they apply for the loan or seek a drawdown has been removed. Instead, a declaration from an officer of the business is required. This reduces overall compliance costs.

- An explicit ability to vary the loan agreements if more eligible R&D takes place than what was anticipated in the RDTI application or if provisional tax reductions change during the year so that the cumulative drawdown payments exceed the estimated loan entitlement.

- We have added a standardised repayment plan for early-stage arrears management if a business does not repay their loan in full when the RDTI refund or credit is received. This helps to streamline and standardise the loans.

17. In developing these terms and conditions we considered how to keep the overall design simple and objective and how to lower operational risk by outsourcing administration activities to providers for whom such activities are their core business. We undertook further operational policy design and tested the proposed loan terms and conditions with potential providers and tax advisors. These loan terms and conditions create standardised eligibility and terms for all loans that simplify implementation. Please see Annex Two for the full updated proposed loan terms and conditions.

18. While these changes could have an impact on the appropriations, we do not have sufficient detailed information on which to base an amended request. However, once we have launched the loans and have an understanding of the uptake in the first year then we can

adjust the appropriation ahead of the second and third drawdowns, based on more certain data.

Options for service delivery

19. A finance company and tax pool intermediaries responded to our Request for Information, and we believe either is capable of helping us deliver in-year payments. If we choose tax pool intermediaries, we would like to allow for the possibility of more than one supplier to deliver in-year payments. This would avoid skewing the market or creating awkward situations where a business uses a tax advisor that uses a particular tax pool intermediary that does not offer in-year payments (causing the business to have to switch tax advisors to get in-year payments). However, it is possible that the scheme will cost more because of the need to fund multiple providers for setup costs and the fixed element of ongoing costs. The relative costs and benefits of using multiple providers compared with one provider will be considered as part of the procurement process.

Risks

20. Although the Crown will need to adopt a reasonable tolerance level for financial risk, we note below operational mechanisms that are designed to reduce financial risks associated with business default and fraud.

21. The possibility of cashflow difficulties or business failure is the most significant risk to in-year payment loans. To encourage repayment on time, the Crown will apply a 7 per cent interest rate after repayment is due. We have also proposed a standardised repayment instalment plan to facilitate repayment by those that cannot pay on the due date but may be able to repay over the next 6 months.

22. If businesses either are not able to sign up to a repayment plan or do not repay after the repayment plan, then the loan would be considered in default. Management of the loan would return to MBIE. In the case of a business in liquidation, MBIE would lodge a claim.

23. The nature of R&D intensive businesses is that some default is likely to occur, and some risk tolerance is needed. We have provided for a possible default rate of 10 per cent in the cost of the scheme. We note this risk is no different to a grant scheme when the Crown provides money to a business that is ultimately not successful. We believe that the benefit of this scheme to help grow R&D in New Zealand justifies this risk.

24. To avoid reoccurring poor behaviour, businesses will not be able to receive further in-year payments if they have not repaid a loan advancing an earlier year's R&D tax credits.

25. There is a low risk of fraud. We do not anticipate fraud will be a large issue, and do not wish to include onerous requirements in the scheme, but we do need some simple mechanisms to manage the possibility. Fraud risk will be mitigated by the existing checks in place for RDTI claimants. Applicants for in-year payments must have enrolled in the RDTI and filed an application before they can apply for the loan, and the application must be approved before they can receive their first drawdown. In addition, the loan agreement will require a declaration from the business that they are a going concern and are not being prosecuted for fraud.

26. There are operational delivery risks that the loan scheme is not delivered quickly or to a high service standard. The timing risk relies on the procurement process and on MBIE and the private sector provider working well together. It also relies on the private sector provider(s) keeping to the agreed timelines. To mitigate these risks, we will ensure the procurement follows good process and communication and all contract documentation is to a high standard.

Next steps

27. The table below lists next step and opportunities for public announcements:

Document(s)	Description/purpose	When	Possible announcement
Briefing note to Ministers (RSI, Revenue and Finance)	Approval operational parameters of the scheme and next step to proceed to RFP	June-July	
Public interest test	Seek approval from the Minister of Finance that in-year payment loans are in the public interest, and an approach to delegation for each loan	Late June/early July	Ministers (RSI, Revenue and Finance) have approved an approach to in-year payments and the MoF has agreed the approach is in the public interest. We are now going to issue an RFP process to find a supplier.
Issue a Request for Proposal	For a private sector provider	Late June/early July	
Contract to administer in-year payment loans	Select provider(s)	September	MBIE has contracted with a supplier and anticipate loan applications will be available from November 2022 to cover eligible R&D expenditure from 1 April 2022.
Loan applications open	Businesses can apply for in-year payment loans	November TBC	Loan applications are now open. Link available on RDTI website. First drawdowns available in December 2022/January 2023 which is 15-16 months ahead of when businesses would otherwise get their RDTI credit or refund.
First drawdowns available	These drawdowns could capture the first four months of R&D expenditure from 1 April – 30 July 2022.	December/ January TBC	

Consultation

28. The Treasury and Inland Revenue have been consulted on the content of this briefing note. Callaghan Innovation has been informed of the content of this briefing note.

Annexes

Annex One: In-year payments roles and responsibilities

Annex Two: Detailed updated design features and their rationale

Annex One: In-year payments roles and responsibilities

No.	Requirement		MBIE	Private provider	Callaghan Innovation	Inland Revenue
1.	Design and build of RDTI in-year payment loans	Set eligibility criteria for the provision of Funding				
		Create draft standard transaction document templates				
		Determine drawdown schedule, standardised across all customers and requirements for drawdown requests				
		Make suggestions for improvements to the way the scheme is implemented,				
		Build the website/webpage/customer portal through which an Applicant can apply for in-year payment loans through the Provider				
		Promote in-year payment loans, using existing explanatory collateral created by the Government and including links to RDTI website				
		Promote availability of in-year payment loans to existing and potential future customer networks				
		Promote availability of in-year payment loans to existing RDTI and potential new RDTI customers, create links for in-year payment applications to RDTI website				
2.	Receive and assess applications against MBIE's eligibility criteria.	Receive applications from Businesses for the loans				
		Collect, review, and verify information from Applicants				
		Complete necessary customer due diligence				
		Perform eligibility assessment based on criteria set by MBIE				
		Give recommendations to MBIE to approve applications in bulk				
		Review exceptions (applications that are above a threshold or that do not clearly meet or not meet the criteria) and decline applications				
		Approve applications in bulk				

		Communicate acceptance/non-acceptance with Applicants				
3.	Co-ordinate document execution, and collate and provide executed documents	Set pre-contract conditions				
		Prepare loan template documents				
		Obtain information about specified terms (including estimated loan amount and other variable terms) from approved applications				
		Execution of loan agreement for approved applications with the Business (to be confirmed after provider selection)				
		Arrange for business to execute agreement				
		Confirm execution of documents by Business, then send loan agreement to MBIE for records				
4.	Manage and monitor payment of the Funding to Businesses at each Drawdown	Receive Drawdown request from Business				
		Review Drawdown requests and confirm they meet requirements				
		Arrange to vary any loans where sum of drawdowns exceeds original loan estimate				
		Send bulk funding instruction to MBIE, including list of businesses and summary information about Drawdown requests (anticipate 3 times a year)				
		Review exceptions (payment requests above a threshold or that do not clearly meet or not meet the criteria)				
		Approve bulk funding request				
		Make bulk funding payment to providers account (MBIE finance)				
		Provide payment to each Business				
		Provide a follow-up confirmation of payment to the Business				
		Provide report to MBIE on payments made at each Drawdown and expected future payments for future Drawdowns within the current income tax year				

		Report to Ministers after each Drawdown				
5.	Reporting	Prepare reporting templates and requirements including timing content and format				
		Internal financial reporting requirements against appropriation				
		Maintain relevant information and reports in a format approved by MBIE to enable periodic audits of payments and the in-year payment loan scheme				
		Provide regular reports about the in-year payment loans to MBIE to allow for financial monitoring of the in-year payment loan scheme, verification or audit of eligibility or repayment obligations, assessing the performance of the policy, etc				
6.	Monitor existing loans	Review compliance by each Business of obligations under existing loans				
		Communicate any non-compliance with each relevant Business				
		Communicate any non-compliance with MBIE, and plans to manage non-compliance				
		Communicate the total amounts owing and date for payment to each Business to avoid potential non-compliance				
		Report on non-compliance and how being managed to Governance of scheme				
7.	Repayment	Confirm date RDTI available, and amount of each Business' RDTI refund or credit with the Business				
		Arrange for each Business to repay their loans one month after they have received RDTI refund or credit				
		Track repayments				
		Report to MBIE whether repayment obligation has been satisfied in full.				
8.	Arrears management	Communicate to any defaulting business the amount of any arrears and the relevant payment obligations that need to be satisfied				

		Set date interest applies and rate of interest each year				
		Commence charging interest one month after RDTI is available to business (or as otherwise determined by MBIE)				
		Inform Business of interest charges				
		Set repayment regime for Businesses that do not repay in full on the due date for short-term repayment over 6 months after the due date				
		Undertake standard recovery activities, including a repayment plan if relevant				
		Identify if business is in default due to bankruptcy				
		Handover loan management to MBIE for loans with businesses in default or that have not repaid after repayment plan.				
		Lodge claim for repayment into any legal proceedings for liquidation				
		Take further loan recovery action, including approve any write-off or forgiveness where appropriate				
9.	Transition	Design the transition to delivering in-year payments through the tax system				
		Support policy design process to ensure it meets overall objectives of the RDTI				
		Work with MBIE and Inland Revenue as necessary around the end of the RDTI scheme to assist in the transition to delivering in-year payments through the tax system				
		Communicate with any Business affected by the transition.				

Annex Two: Updated in-year payment loan terms and conditions and their rationale

Eligibility	Rationale
A business can get an in-year payment loan if is in tax loss or if it can only partially offset their RDTI against provisional tax payments. A business that has received an in-year payment loan in the past, but that has not repaid it, is not eligible to receive another.	This criterion means all businesses will have access to a cashflow benefit from the RDTI during the income year – either through reduced provisional tax payments or through in-year payments. This will particularly benefit early stage startups and lower profit R&D-intensive businesses.
Application Process	**Rationale**
Must have applied for the RDTI to apply for a loan. The business would also declare that it is a going concern and that it is not being prosecuted for fraud.	We propose to accept an application based on the activities and estimated R&D expenditure included in a business's RDTI application. The RDTI application must then be approved before any payments are made. This declaration by the business about being a going concern and not being prosecuted for fraud will help minimise the risk of default because a business is about to fold or is acting fraudulently. We considered having a tax advisor undertake the declaration about being a going concern and not being prosecuted for fraud, but this would also add compliance effort and costs for businesses.
Entitlement	**Rationale**
The loan application would include an estimated loan amount which is 90 per cent of the expected eligible RDTI entitlement, as included in the RDTI application, less any anticipated reductions to provisional tax payments as a result of the RDTI. This estimate would be a cap for the loan, however, the sum of three drawdowns during the year will become the actual value of the loan. If the sum of the three drawdowns exceeds the initial estimate at any stage, then the loan agreement can be varied.	The loan entitlement is 90 per cent of the anticipated RDTI and while this is estimated at the time of arranging the loan, three drawdowns make up the actual value of the loan. The entitlement must be reduced by any anticipated reductions in provisional tax payments as a result of the RDTI. This can be based on any approach to calculating provisional tax and should take into account information held by the business at the time of seeking an in-year payment loan. As noted below, we propose that the drawdowns are based on actual expenditure on eligible activities, and this lowers the risk that the loan value exceeds the future RDTI. It does involve compliance effort for businesses as compared to striking the loan and payments based on the upfront estimate of R&D expenditure included in the application.

	The drawdown information is the same as what is required for the Supplementary Return and is useful record keeping. During consultation, businesses advised they were comfortable with getting in year payments in arrears based on actual expenditure.
Drawdown	**Rationale**
Drawdowns are available three times a year, every four months to align with provisional tax dates for standard balance dates and are 28 August (D1), 15 January (D2) and 7 May (D3). • D1: covers R&D expenditure between 1 April – 31 July. Drawdown request 15 August, with payment made on 28 August. • D2: covers R&D expenditure between 1 August – 30 November. Drawdown request by 20 December, with payment made on 15 January. • D3: covers R&D expenditure between 1 December – 30 March. Drawdown request by 30 April, with payment made on 7 May. • No other options for different provisional tax approaches or dates are proposed, as this would make it too complex to administer or for businesses to understand. • The drawdown request would be 90 per cent of 15 per cent of actual expenditure on eligible R&D during the period, less any reduction in the upcoming provisional tax payment for RDTI (irrespective of how provisional tax or any RDTI reduction is calculated). The drawdown request should include a summary of the expenditure and how the drawdown request has been calculated. • The drawdown request must be based on expenditure associated with activities included in an approved RDTI application. If the activities and associated estimate of expenditure is different to the in-year payment loan agreement then a variation to the loan can be arranged. • If the cumulative drawdown payments exceed the estimate in the in-year	Drawdowns make up the actual value of the loan, the initial calculation is based on eligible expenditure during the period and is then reduced by reductions in provisional tax for RDTI. This approach means businesses are not likely to overclaim their in-year payment loan and will not 'double dip' by getting reductions in provisional tax as well as in-year payments. Three payments aligned with provisional tax dates enables businesses with partial offset of their RDTI against provisional tax payments to take into account the partial offset when they calculate their drawdown request. RDTI applications must be approved before drawdown payments are made. However, in-year payment loans can be approved based on an RDTI application that is lodged but not approved. This helps avoid loan payments being made for activities that are not eligible for the RDTI. The declaration will help ensure information provided by the business is true and correct. We considered requiring this declaration to be made by the businesses tax advisor, but as most businesses will act in good faith, and we wish to lower compliance costs associated with in-year payments a tax advisor is not required. The ability to easily vary the loan agreement to recognise increase eligible R&D than planned or different reductions to provisional tax than anticipated (if the calculation method or information changes) should make the loans flexible and match the eventual RDTI entitlement. No additional information would be needed other than what is required for the drawdown itself.

payment loan agreement, then a variation can be arranged, if the additional expenditure is on eligible R&D activity or if the anticipated reduction in provisional tax payments changes. Reasons for the additional expenditure should be provided. • A declaration from an officer of the business, such as a director or the Chief Financial Officer, will be required at each drawdown that the information provided in the drawdown request is a true and correct record of expenditure and that the circumstances of the business relating it being a going concern, and that it is not being prosecuted for fraud, have not changed. If the officer knowingly makes a false declaration, then they can be personally be fined or prosecuted.	
Ability to audit	**Rationale**
The contract will contain the right to audit information provided in the loan application and drawdown requests.	This ability would not get used often, but it is essential in case there is a need to review information provided. RDTI applications and supplementary returns are separately managed through a comprehensive legislative regime to maintain the integrity of R&D tax credits. This provides a backstop to any mischief in the loan scheme. It is unlikely we would set up routine audits.
Declined Application	**Rationale**
If an RDTI application is declined, then no further drawdowns will be available. Repayment of drawdowns given so far will be sought 1 month after the application is declined. No interest will be charged until the third drawdown date, 7 May. If the loan is not repaid by the third drawdown date, then a repayment plan will be arranged (see below).	While repayment of a loan that should not have been paid is important, we do not wish to be overly punitive.
Repayments	**Rationale**
Contractual obligation to repay the loan in full one month after RDTI is paid into the businesses bank account or credited to the businesses tax account. After this date, interest charges commence.	This is essentially a bridging loan that becomes due when the RDTI is available to the business.
Interest Charges to Commence	**Rationale**
Zero interest on the loan from its commencement, including after each drawdown and through the following income	A 7 per cent interest rate is intended to encourage businesses to repay the loan as

tax year. Interest charges commence one month after the RDTI is paid into the businesses bank account or credited to the businesses tax account. The rate of interest is tied to the Inland Revenue's Use of Money Interest Rate, currently 7 per cent per annum. For standard balance dates we estimate this date to be 30 June.	quickly as possible without being overly punitive.
Arrears Management	**Rationale**
The loan contract will clearly state that once the RDTI credit is received, the corresponding loan matures and is repayable in full within one month. If a business does not repay the in-year payment loan in full when it is due, then in addition to interest, a standardised, short-term repayment plan will be arranged. This plan will anticipate four payments in equal instalments and will include interest. It will start one month after the loan is due. For standard balance dates this would be on 31 July, 30 August, 30 September, and 31 November. If the loan is still not repaid by 31 November, then management of the loan will return to MBIE.	This arrears management approach is intended to standardise the approach to loans and to make it easy for businesses to understand what is expected of them. While most businesses are likely to pay the in-year payment loans in full by the due date, there will be some that due to poor business management or bad luck do not have the cash available at the time to repay the loans but are able to find it within a relatively short period of time. We wish to support these businesses through a short-term cash shortage.
Security	**Rationale**
Unsecured (but with a contractual obligation to pay back within one month after the RDTI is available).	To make the loans easy for businesses to access. It may be difficult for some businesses to get debt finance given other bank covenants or shareholder agreements.
Ranking	**Rationale**
Unsubordinated	To make the loans easy for businesses to access.
Restrictions	**Rationale**
Minimal restrictions on what they can spend it on but intend not to allow them to use it to pay shareholders, such as through a dividend block.	The security, ranking and restrictions are intended to make the loan easy to obtain. And given these are short-term loans where businesses are expected to receive a credit (that lowers another tax obligation) or cash to match the value of the loan, then they are relatively low risk. However, these terms mean that if a business goes into liquidation the Crown will not be high on the list of debtors to repay. This risk is relatively low and is preferable to creating a loan product that is difficult to get. A restriction on using the funding to pay shareholders is proposed to avoid an unlikely situation where a business uses the funding to

	pay shareholders before closing the business (and then not being able to repay the loan).

TE TAI ŌHANGA
THE TREASURY

Treasury Report: Loan request for in-year payments of the Research and Development Tax Incentive

Date:	15 July 2022	**Report No:**	T2022/1322
		File Number:	SH-9-0

Action sought

	Action sought	**Deadline**
Hon Grant Robertson **Minister of Finance**	**Agree** to grant loans either directly to R&D-performing businesses or to a private provider, for the purpose of delivering in-year payments of the RDTI. **Refer** this report to the Minister of Research, Science and Innovation and the Minister of Revenue.	None

Contact for telephone discussion (if required)

Name	**Position**	**Telephone**		**1st Contact**
Taylor Farr	Analyst, Regions, Enterprise and Economic Development	Privacy of natural persons	N/A (mob)	✓
John Marney	Manager, Regions, Enterprise and Economic Development		N/A (mob)	

Minister's Office actions (if required)

Return the signed report to Treasury.

Refer the report to the Minister of Research, Science and Innovation and the Minister of Revenue.

Note any feedback on the quality of the report	

Enclosure: Yes (attached)

Treasury Report: Loan request for in-year payments of the Research and Development Tax Incentive

Executive Summary

This report seeks your agreement to the Ministry of Business, Innovation and Employment (MBIE) providing loans to research and development (R&D)-performing businesses or a private provider for the purpose of providing in-year payments of the Research and Development Tax Incentive (RDTI).

Some RDTI recipients currently receive their credit in a lump sum after the end of the tax year. This limits the value of the scheme for businesses, because payment of the tax credit is significantly delayed from the time of the actual qualifying R&D investment. In-year payments of the scheme will ultimately be delivered through the tax system by Inland Revenue, but likely only by 2024/25.

Cabinet agreed 'in-principle' to establish a temporary mechanism to provide in-year payments of the RDTI and appropriated $583.5 million capital, $187.236 million for write-down and impairment of the loans and $8.85 million for administration costs. Ministers with delegated responsibility for the scheme recently agreed to a proposed design where the Crown would loan money to R&D-performing businesses as an advance on their expected RDTI payment. MBIE would procure a private supplier (or suppliers) of loan administration services to help deliver the loans. Depending on the type of provider engaged by MBIE to deliver the scheme, the loans would be provided either directly to individual R&D-performing businesses (with administrative and operational support from the provider) or to the private provider so that they can on-lend to businesses.

The Public Finance Act 1989 allows the Minister of Finance to lend money to a person or organisation if it appears to the Minister to be necessary or expedient in the public interest to do so. This report seeks your decision as to whether you consider it to be necessary or expedient in the public interest to loan money to a private provider of in-year payment loans or directly to R&D-performing businesses.

MBIE has already issued a Request for Proposals to identify one or more suppliers to administer the delivery of in-year payment loans. We seek your decision at this stage to allow MBIE to engage in good faith with potential providers. Because MBIE has not identified the provider of the scheme, we do not seek delegation of your powers in this report. Once MBIE has identified the provider that will deliver the scheme, we will provide further advice seeking delegation of your powers in order to implement the loan scheme.

Recommended Action

We recommend that you:

a **note** that there is currently a significant delay for some recipients of the Research and Development Tax Incentive (RDTI) between incurring R&D expenditure and receiving their tax credit;

b **note** that in-year payments of the RDTI will ultimately be delivered through the tax system by Inland Revenue, but that this is likely only achievable by 2024/25 due to competing demands in Inland Revenue's work programme**;**

c **note** that Cabinet agreed 'in-principle' to establish a temporary mechanism to provide in-year payments of the RDTI [CAB-22-MIN-0105] and delegated further operational decisions to the Minister of Revenue, the Minister of Research, Science and Innovation and the Minister of Finance;

d **note** that Ministers with delegated responsibility for the scheme have agreed to a proposed operational policy design where loans of 90 per cent of a business's expected RDTI payment would be provided to R&D-performing businesses as an advance on their RDTI entitlement;

e **note** that the Ministry of Business, Innovation and Employment requires the ability to lend money in order to deliver the proposed temporary in-year payments loan scheme and considers that there are no viable alternatives to a loan to deliver a temporary RDTI in-year payments scheme;

f **note** that under section 65L of the Public Finance Act 1989, the Minister of Finance may, on behalf of the Crown, give a loan if it appears to the Minister to be necessary or expedient in the public interest to do so;

g **note** that, in the circumstances, Treasury considers giving a loan to either a private provider of in-year payment loans or directly to R&D-performing businesses to be necessary or expedient in the public interest;

h **agree** that it appears to you to be necessary or expedient in the public interest to provide loans to a private provider of in-year payment loans or to R&D-performing businesses, on the key loan terms summarised in this report;

Agree/disagree.

i **agree** to provide loans to a private provider or to R&D-performing businesses under section 65L of the Public Finance Act 1989;

Agree/disagree.

j **note** that, once MBIE has identified a private provider of in-year payment loans, your agreement will be sought to delegate your powers in sections 65L and 65O of the Public Finance Act 1989 to the Secretary to the Treasury, and subsequently for these powers to be sub-delegated to the Chief Executive of the Ministry of Business, Innovation and Employment who will delegate within MBIE;

k **refer** a copy of this report to the Minister of Revenue and the Minister of Research, Science and Innovation.

Refer/not referred.

John Marney
Manager, Regions, Enterprise and Economic Development

Hon Grant Robertson
Minister of Finance 17/7/22

Treasury Report: Loan request for in-year payments of the Research and Development Tax Incentive

Purpose of Report

1. This report seeks your agreement to the Ministry of Business, Innovation and Employment (MBIE) providing loans to research and development (R&D)-performing businesses or a private provider, for the purpose of providing in-year payments of the Research and Development Tax Incentive (RDTI).

Background

2. The RDTI was introduced in April 2019 and provides businesses with a tax credit on eligible R&D expenditure. The scheme replaced Growth Grants as the Government's primary way of supporting R&D.

3. Businesses in profit have the option to utilise their RDTI credit by reducing their provisional tax payments. However, some RDTI recipients currently receive their credit in a lump sum which is paid, on average, about 15 months after the end of the tax year. The delay between incurring expenditure and receiving the credit is a source of frustration for R&D-performing businesses, who have requested that the credit be delivered as an in-year payment to help them manage cash flow and to recognise the time value of money.

4. Inland Revenue will implement in-year payments through the tax system, but only by 2024/25 because of competing priorities in their work programme. In April 2022, Cabinet agreed 'in-principle' to establish a temporary mechanism to provide in-year payments of the RDTI in the meantime, with further operational decisions to be taken by the Minister of Research, Science and Innovation, the Minister of Finance and the Minister of Revenue. Cabinet also appropriated $583.5 million for capital, $187.236 million for write-down and impairment of the loans and $8.85 million for administration costs [CAB-22-MIN-0105].

5. The responsible Ministers recently agreed to the design of a temporary scheme, in which the Crown would loan money to R&D-performing businesses as an advance on their expected RDTI payment. MBIE would procure a private supplier, or suppliers, of loan administration services to help deliver the loans. The temporary scheme would be in place for three business tax years (2023/24 to 2025/26) and would ultimately be replaced by in-year payments through the tax system.

6. MBIE received four responses to a Request for Information in December 2021 – three from tax pooling intermediaries and one from an R&D finance company. Because these respondents operate differently, there are two options for loaning funds:
   - the Crown lends sufficient funding for the provider to provide loans to individual businesses, with the Crown underwriting those loans; or
   - the Crown lends to the individual businesses, with administrative and operational support from a supplier.

The Proposed Loan

7. The loans will be provided by MBIE, on behalf of the Crown, either:

- directly to R&D-performing businesses; or
- to a private provider, or providers, who will subsequently loan the money to R&D-performing businesses.

8. Eligible businesses must:
   - be enrolled in the RDTI with Inland Revenue; and
   - have filed an RDTI application with Inland Revenue; and
   - be either in tax loss or only able to partially offset their RDTI against provisional tax payments.

9. The private provider will be either a finance company or a tax pool intermediary and will be contracted to:
   - co-design and build the delivery model/platform;
   - receive and assess applications against MBIE's eligibility criteria;
   - coordinate document execution, collate and provide executed documents;
   - manage and monitor payment of the loans at each drawdown;
   - provide regular reporting to MBIE to allow for monitoring of the programme;
   - monitor existing loans and compliance with obligations;
   - arrange and monitor repayments;
   - provide arrears management;
   - assist in the transition to in-year payments through the tax system.

10. The maximum loan value, as set out in an individual business's loan contract, will be capped at 90 per cent of a claimant's expected eligible RDTI entitlement (as included in their RDTI application). This is intended to mitigate the financial risk of the scheme for the Crown.

11. The loan will be delivered in three instalments (or drawdowns) per business tax year. The actual total loan value will be the sum of the three drawdowns. Each drawdown payment will be calculated from actual eligible expenditure during the preceding period, reduced by any reduction in provisional tax.

12. Drawdowns will only be paid once the RDTI application has been approved by Inland Revenue. If an RDTI application is declined by Inland Revenue, no drawdowns will be paid. If the sum of the three drawdowns would exceed the maximum loan value - for example, due to actual R&D expenditure exceeding the estimated spend in the approved RDTI application - then the maximum loan value may be varied.

13. There will be a contractual obligation to repay the loan in full one month after the RDTI payment is paid into the business's bank account or credited to the business's tax account. After this date, interest charges will commence. The rate of interest will be set at Inland Revenue's use of money interest rate, currently 7.28 per cent per annum.

14. In-year payments loans will be available for the 2022/23, 2023/24 and 2024/25 business tax years. The approval to lend under 65L of the Public Finance Act 1989 will be terminated 6 months after repayment of the final loan is due.

15. Each loan contract will contain the right to audit information provided in the loan application and drawdown requests. The provider will produce regular reports, including at each drawdown, to allow for financial monitoring of the in-year payment loan scheme, verification or audit of eligibility or repayment obligations and to assess the performance of the policy. MBIE will report to the responsible Ministers after each drawdown.

16. The maximum total cost of the loans is $583.5 million capital and $196.086 million operating expenditure.

17. $583.5 million is the limit of the capital expenditure appropriation that Cabinet has authorised. This is based on MBIE's estimate of a total of 3,650 loans at an average of $150,000 per loan (a total $547.5 million), plus $12 million per year as a buffer. This estimate is based on approved RDTI claims in the 2019/20 tax year.

18. In addition, Cabinet has agreed $187.236 million for write-down and impairment of the loans and $8.85 million for administration costs.

Table 1. Estimates of in-year payment loan uptake (Ministry of Business, Innovation and Employment).

R&D expenditure period	April 2022 – March 23	April 2023 – March 24	April 2024 – March 25	Total
Estimated number of claims	1,000	1,250	1,400	3,650
Estimated average loan value	$150,000	$150,000	$150,000	-
Estimated total value of loans (plus $12 million buffer)	$162 million	$199.5 million	$222 million	$583.5 million

Your power under section 65L of the Public Finance Act 1989 to lend money

19. Section 65L of the Public Finance Act 1989 (the Act) empowers you, as the Minister responsible for the administration of the Act, to lend money to a person, organisation or government if it appears to you to be 'necessary or expedient in the public interest' to do so, and to give such a loan on any terms and conditions that you think fit.

20. Section 65P of the Act provides that any lending under section 65L must be made from a capital expenditure appropriation, or other authority, approved by Parliament for the purpose. A non-departmental capital expenditure appropriation is in place for the purpose of providing loans to eligible businesses in anticipation of their research and development tax credit.

Officials' assessment that providing loans to R&D-performing businesses or a private provider in the terms outlined in this report is 'necessary or expedient in the public interest'

21. It is a matter for you to decide whether you are satisfied that it is necessary or expedient in the public interest to lend money to a private provider or R&D-performing business in the terms outlined in this report.

22. The following paragraphs set out factors that officials consider are relevant to that assessment. You may decide to ignore these factors, or take into account other factors you consider relevant, and you may give such weight to the factors referred to below as you deem fit. You should make an independent decision and are not bound to accept the assessment below.

Public interest

23. The Act does not define 'the public interest'. However, it is generally accepted that the public interest is broadly equivalent to the concept of the public good and can cover a wide range of values and principles relating to the public good, or what is in the best interests of society. In the context of the Public Finance Act 1989, the public interest should be viewed in a New Zealand context, that is, in the interest of the New Zealand public.

24. Cabinet has already made the 'in-principle' decision to bring forward in-year payments of the RDTI and establish a temporary mechanism to do this [CAB-22-MIN-0105]. At the time the Treasury advised that, while we saw benefits to providing the RDTI in-year, it was not clear whether the benefits of implementing a short-term loan scheme to bring forward implementation outweighed the risks and costs. We note that the scheme has since been further developed to address some of our concerns.

25. In making an 'in-principle' decision to implement a temporary in-year payments scheme, Cabinet has taken the view that the benefits of bringing forward in-year payments outweigh the costs. We have taken this judgement into account in preparing this advice and assumed that, having considered our earlier advice, you have concluded that the policy decision to implement a temporary mechanism to bring forward in-year payments of the RDTI is in the public interest. Our advice therefore focuses specifically on whether *issuing loans* is necessary or expedient in the public interest to implement a temporary in-year payments scheme.

26. In brief, we consider that, in the circumstances, giving the requested loans on the terms set out in this report satisfies the "public interest test" in section 65L of the PFA. The following sections outline the benefits of providing in-year payments of the RDTI and why we consider that providing loans is necessary or expedient.

Benefits

27. The main public benefit of the RDTI policy *in general* is to incentivise businesses to perform R&D activities. R&D enables businesses to improve products and services, lift productivity and build a more diverse and prosperous economy. The Government has set a target to increase economy-wide R&D expenditure to 2 per cent of GDP.

28. The RDTI was expected to increase business R&D over the medium to long term, but the current operation of the scheme reduces its effectiveness. The delay between a business incurring R&D expenditure and eventually receiving its RDTI makes the incentive less effective and claimants have highlighted payment timing as their most desired improvement to the scheme. Delivering in-year payments is therefore expected to increase the effectiveness of the incentive and its benefit to businesses by reducing the delay between incurring R&D expenditure and receiving the RDTI. In consultations

in 2021, MBIE received survey responses from 64 R&D-performing businesses - over half said they could do more R&D, 20% said they could do ‘the same amount but faster’ and just over 10% said it would make no difference.

29. Inland Revenue will deliver in-year payments through the tax system in the future. The benefit of the loan scheme proposed in this report is to allow MBIE to rapidly implement a temporary in-year payments scheme and deliver in-year payments to businesses 2-3 years earlier than otherwise. This brings forward the benefits that arise from improved operation of the RDTI.

Necessary or expedient

30. MBIE has not identified any viable alternatives which would allow them to deliver a temporary in-year payments scheme in the next 2 to 3 years. It therefore appears that the proposed scheme is the most appropriate mechanism to deliver temporary in-year payments and that giving the requested loans may be regarded as necessary or expedient in the public interest.

31. MBIE considered whether a grant scheme could be used to provide in-year payments, but this option risks undermining the intent of the RDTI policy. The RDTI was a deliberate policy shift in how New Zealand incentivises R&D expenditure. When it was first introduced, the RDTI and existing Growth Grant scheme were considered to be mutually exclusive because they both subsidise the same R&D activity through different mechanisms. Offering a grant for the same R&D expenditure that the RDTI incentivises would therefore risk undermining the RDTI scheme as a whole.

32. A repayable grant, which the business is obliged to repay, is treated as a loan from legal and accounting perspectives and recorded as a liability. It is therefore no different to a loan and does not provide a viable alternative.

33. MBIE considered a grant that is subsequently deducted from the RDTI credit a business receives. This is not suitable because Inland Revenue is legally obliged to pay the RDTI to a business after they submit their supplementary return. To implement this option, legislative change would be required.

34. Should you decide that the proposed loan scheme is not necessary or expedient in the public interest, this decision will not affect the eventual implementation of in-year payments through the tax system. However, this decision would affect the delivery of a temporary in-year payments scheme, because MBIE have not identified any alternatives to the scheme proposed in this report.

Risks and mitigations

35. The main risk is that businesses do not repay their loans. This is mitigated by:

    a basing the maximum value of the loan on 90% of a claimant’s anticipated RDTI entitlement;

    b calculating a claimant’s actual loan payments based on their actual eligible expenditure in a preceding period;

    c paying drawdowns only after a claimant’s RDTI application has been approved;

    d applying Inland Revenue’s use of money interest rate (currently 7.28 per cent) after repayment is due;

    e disqualifying a business that has received an in-year payment loan in the past and not repaid it from receiving more loans;

f incorporating a default rate of 10 per cent into the fair-value write down appropriation;

g reserving the right to audit.

36. Should the Crown loan funds to a private provider, who subsequently provides loans to claimants, there is additional risk of the provider becoming insolvent. This could be mitigated by:

a MBIE performing thorough due diligence of the provider prior to engaging them as a supplier through the procurement process;

b appropriate contractual arrangements, including security and ranking.

37. There is a risk of fraud. This is mitigated by:

a requiring applicants to have enrolled in the RDTI and filed an application;

b paying drawdowns only after a claimant's RDTI application has been approved;

c the private sector supplier performing due diligence checks on applicants as part of the application process;

d requiring a declaration from an officer of the business, such as a director or the Chief Financial Officer, that the business is a going concern and is not being prosecuted for fraud;

e requiring the officer of the business to declare that the information provided in the drawdown request is a true and correct record of expenditure and the circumstances of the business relating it being a going concern and not being prosecuted for fraud have not changed.

38. There is a risk that uptake of the scheme is greater than expected and the total value of loans provided approaches the limit of the capital appropriation. This is mitigated by:

a calculating cost estimates by assuming that most businesses in tax loss or low profit and enrolled in the RDTI would apply, and that the number of businesses would grow over the next three years as interest in the RDTI grows;

b the multi-year capital appropriation established by Cabinet - as the loans will be issued over three business tax years, with three drawdowns per year, the risk of accidentally exceeding the appropriation is very low;

c MBIE approaching the responsible Ministers, should the value of loans approach the balance of the appropriation, to determine whether to ask Cabinet to appropriate more funds.

Assessment of risks and benefits against the public interest threshold

39. In light of the above, officials consider that:

a there is a public interest in giving a loan to a private provider or R&D-performing businesses on the terms set out in this report;

b based on the limited time available to assess the risks to the Crown associated with the loan, the benefits of the proposed loan appear to outweigh those risks when mitigations are taken into account; and

c there are no viable alternatives to a loan when it comes to delivering a temporary in-year payments scheme.

Other Relevant Information

40. This request has been prepared in consultation with MBIE and has been reviewed by Te Puna Rōia (Treasury Legal).

41. In order to deliver the loan scheme, your agreement will be sought to delegate your powers in sections 65L and 65O of the Public Finance Act 1989 to the Secretary to the Treasury, and subsequently for these powers to be sub-delegated to the Chief Executive of MBIE who will delegate within the organisation. MBIE have indicated that they wish to seek this delegation only once they have engaged a private provider to deliver the loans. This is because the type of provider will affect the appropriate level of delegation within MBIE.

42. Once MBIE has identified the provider that will deliver the scheme, officials will provide further advice seeking agreement to delegate your powers in sections 65L and 65O of the Public Finance Act 1989.

TE TAI ŌHANGA
THE TREASURY

Treasury Report: Delegation of power to grant loans for Research and Development Tax Incentive in-year payments

Date:	29 September 2022	**Report No:**	T2022/1953
		File Number:	MG-1-1

Action sought

	Action sought	Deadline
Hon Grant Robertson **Minister of Finance**	**Agree to delegate** to the Secretary to the Treasury the power to enter into and perform loan arrangements under sections 65L and 65O of the Public Finance Act 1989, for the purpose of making in-year payments of the Research and Development Tax Incentive to R&D-performing businesses. **Authorise** the Secretary to the Treasury to sub-delegate to the Chief Executive of the Ministry of Business, Innovation and Employment and consent to further sub-delegation to senior MBIE staff with appropriate expertise. **Sign, date and have witnessed** the attached delegation to the Secretary to the Treasury. **Refer** this report to the Minister of Research, Science and Innovation and the Minister of Revenue.	5 October 2022

Contact for telephone discussion (if required)

Name	Position	Telephone		1st Contact
Marko Garlick	Graduate Analyst, Regions. Enterprise and Economic Development	Privacy of natural persons	n/a (mob)	✓
John Marney	Manager, Regions. Enterprise and Economic Development		N/A (mob)	

Minister's Office actions (if required)

Once signed, dated and witnessed, return the delegation instrument to the Treasury.

Note any feedback on the quality of the report	

Enclosure: Delegation Letter to the Secretary to the Treasury

Treasury Report: Delegation of power to lend money for Research and Development Tax Incentive in-year payments

Executive Summary

This report seeks your agreement to delegate to the Secretary to the Treasury the power to enter into and perform loan arrangements under sections 65L and 65O of the Public Finance Act 1989, for the purpose of making in-year payments of the Research and Development Tax Incentive to R&D-performing businesses.

You are also asked to authorise the Secretary to the Treasury to sub-delegate to the Chief Executive of the Ministry of Business, Innovation and Employment and consent to further sub-delegation to senior MBIE staff with appropriate expertise.

Your delegation and sub-delegations are made under clauses 5 and 2 of Schedule 6 of the Public Service Act 2020, respectively.

Recommended Action

We recommend that you:

a **note** that there is currently a significant delay for some recipients of the Research and Development Tax Incentive (RDTI) between incurring R&D expenditure and receiving their tax credit;

b **note** that in-year payments of the RDTI will ultimately be delivered through the tax system by Inland Revenue, but that this is likely only achievable by 2024/25 due to competing demands in Inland Revenue's work programme;

c **note** that Cabinet agreed 'in-principle' to establish a temporary mechanism to provide in-year payments of the RDTI [CAB-22-MIN-0105] and delegated further operational decisions to the Minister of Revenue, the Minister of Research, Science and Innovation and the Minister of Finance;

d **note** that Ministers with delegated responsibility for the scheme have agreed to a proposed operational policy design where loans of 90 per cent of a business's expected RDTI payment would be provided to R&D-performing businesses as an advance on their RDTI entitlement;

e **note** that you agreed that it is necessary or expedient in the public interest to provide loans to a private provider or to R&D-performing businesses under section 65L of the Public Finance Act 1989 [T2022/1322];

f **note** that the Ministry of Business, Innovation and Employment (MBIE) has chosen a preferred private service provider to administer the in-year payment loans and that MBIE will issue the loans directly to R&D-performing businesses;

g **agree** to delegate to the Secretary to the Treasury (under clause 5 of Schedule 6 of the Public Service Act 2020) your powers under sections 65L and 65O of the Public Finance Act 1989, for the purpose of providing in-year payments of the RDTI to R&D-performing businesses.

Agree/disagree.

h **authorise** the Secretary to the Treasury to sub-delegate to the Chief Executive of the Ministry of Business, Innovation and Employment and consent to further sub-delegation to senior MBIE staff with appropriate expertise (under clause 2 of Schedule 6 of the Public Service Act 2020) the powers under sections 65L and 65O of the Public Finance Act 1989, for the purpose of providing in-year payments of the RDTI to R&D-performing businesses.

Authorise/Not Authorise

i **sign, date and have witnessed** the attached Delegation Instrument to the Secretary to the Treasury;

j **return** to the Treasury the signed Delegation Instrument to the Secretary to the Treasury; and

k **refer** a copy of this report to the Minister of Revenue and the Minister of Research, Science and Innovation.

Refer/not referred.

John Marney
Manager
Regions, Enterprise, Economic Development

Hon Grant Robertson
Minister of Finance

_____/_____/_______

Treasury Report: Delegation of loan approval for the Research and Development Tax Incentive in-year payments

Purpose of Report

1. This report seeks your agreement to delegate to the Secretary to the Treasury your powers under section 65L and 65O of the Public Finance Act 1989, for the purpose of providing in-year payments of the Research and Development Tax Incentive (RDTI) to R&D-performing businesses.

Background

2. The RDTI was introduced in April 2019 and provides businesses with a tax credit on eligible R&D expenditure. The scheme replaced Growth Grants as the Government's primary way of supporting R&D.

3. There is currently a significant delay for some RDTI recipients between incurring R&D expenditure and receiving their tax credit. On average, that wait is about 15 months after the end of the tax year. This is a source of frustration and cashflow issues for recipients.

4. Inland Revenue will implement in-year payments through the tax system, but only by 2024/25 because of competing priorities in their work programme. In April 2022, Cabinet agreed 'in-principle' to establish a temporary mechanism to provide in-year payments of the RDTI, with further operational decisions to be taken by the Minister of Research, Science and Innovation, the Minister of Finance and the Minister of Revenue [CAB-22-MIN-0105]. $583.5 million capital and $196.086 million operating expenditure was appropriated by Cabinet for the in-year payments.

5. The responsible Ministers agreed to the design of a temporary scheme, in which the Crown would loan money to R&D-performing businesses as an advance on their expected RDTI payment [MBIE Briefing 2122-4602]. The temporary scheme will be in place for three business tax years (2023/24 to 2025/26).

6. You agreed that it is necessary or expedient in the public interest to provide in-year payment loans to a private provider or directly to R&D-performing businesses under sections 65L and 65O of the Public Finance Act 1989 [T2022/1322]. You also agreed to the key terms of the in-year payment loans.

7. Section 65P requires that any lending under section 65L must be made from a capital expenditure appropriation. Lending will draw down from the appropriation *Research, Science and Innovation: In-year payments loans MYA* in Vote Business, Science and Innovation.

8. Delegation of the power to lend money was not sought at the time of that briefing as the Ministry of Business, Innovation and Employment (MBIE) had not yet chosen a preferred provider to either directly provide the loans or administer the loans that MBIE provide.

9. MBIE has now chosen a preferred private service provider to administer the loans and expect to have a contract signed shortly. MBIE will issue the loans directly to R&D-performing businesses.

Delegation of power

10. Delegation of your power to lend money is now required from:

    a The Minister of Finance (you) to the Secretary to the Treasury,

    b The Secretary to the Treasury to the Chief Executive of MBIE, and

    c The Chief Executive of MBIE to senior MBIE staff with appropriate expertise.

Consent to delegation and sub-delegation of power

11. If you agree with the recommendations in this report, you should sign the enclosed Delegation Instrument.

12. The Delegation Instrument provides your consent to delegate your power to lend money, determine the terms and conditions to apply, and accept money payable for the in-year payment loans to the Secretary to the Treasury (under clause 5 of Schedule 6 of the Public Service Act 2020).

13. The Delegation Instrument also provides your consent for the Secretary to the Treasury to sub-delegate that power to the Chief Executive of MBIE, and your consent for the Chief Executive of MBIE to further sub-delegate to senior MBIE staff with appropriate expertise (under clauses 2 of Schedule 6 of the Public Service Act 2020).

Conditions of delegation

14. You previously agreed to the key terms of the in-year payment loans [T2022/1322]. The conditions of the delegation are:

    a To be eligible for the RDTI in-year payments loan (**Loan**), a business must:

        i be enrolled in the RDTI with Inland Revenue;

        ii have filed an RDTI application with Inland Revenue; and

        iii be either in tax loss or only able to partially offset their RDTI against provisional tax payments

    b The maximum Loan value will for each eligible business be capped at 90 per cent of that business's expected RDTI entitlement (as estimated in their RDTI application).

    c Notwithstanding the Loan eligibility criteria set out above, drawdowns will only be paid to a Loan applicant once its RDTI application has been approved by Inland Revenue. If the RDTI application is declined by Inland Revenue, no drawdowns will be paid.

    d There will be a contractual obligation to repay the Loan in full one month after the RDTI is paid into the business's bank account or credited to the business's tax account. After this date, interest charges will commence if the Loan (or any part of it) remains unpaid. The rate of interest will be set at Inland Revenue's use of money interest rate.

15. Three key terms that you previously agreed to [T2022/1322] have not been included as conditions of the delegation. The omitted conditions are:

    a Three drawdowns per business tax year calculated from actual eligible expenditure during the preceding period, reduced by any reduction in provisional tax;

b Maximum loan value able to be varied if three drawdowns would exceed maximum value; and

c Right to audit information.

16. MBIE considers that the inclusion of those conditions would present an operational risk and that omitting them from the Delegation Instrument would not change the overall nature or scope of the loans.

Term of delegation

17. The delegation will come into effect on the date of its execution and continue in force until it is revoked.

Other relevant information

18. This request has been prepared in consultation with MBIE and has been reviewed by Te Puna Rōia (Treasury Legal).

DELEGATION BY THE MINISTER OF FINANCE TO THE SECRETARY TO THE TREASURY TO LEND MONEY FOR IN-YEAR PAYMENT LOANS FOR THE RESEARCH AND DEVELOPMENT TAX INCENTIVE

From: **Minister of Finance**

To: **The Secretary to the Treasury**

1. Delegation

Pursuant to clause 5 of Schedule 6 of the Public Service Act 2020, I the Honourable Grant Robertson, **Minister of Finance** delegate to the **Secretary to the Treasury** (and any person acting in such role from time to time), the power to enter into and perform loan arrangements under sections 65L and 65O of the Public Finance Act 1989, for the purpose of making in-year payments for the Research and Development Tax Incentive to R&D-performing businesses.

2. Consent to sub-delegation

I, the Honourable Grant Robertson, **Minister of Finance**, consent to the sub-delegation by the **Secretary to the Treasury** to the **Chief Executive of the Ministry of Business, Innovation and Employment** pursuant to clause 2 of Schedule 6 of the Public Service Act 2020 of all or any of the authority and powers delegated by us in this instrument.

3. Consent to further sub-delegation

I, the Honourable Grant Robertson, **Minister of Finance**, consent to the further sub-delegation by the **Chief Executive of the Ministry of Business, Innovation and Employment** to **senior MBIE staff with appropriate expertise** pursuant to clause 2 of Schedule 6 of the Public Service Act 2020 of all or any of the authority and powers delegated by us in this instrument.

4. Conditions of delegation

This delegation is subject to the following conditions:

a To be eligible for the RDTI in-year payments loan (**Loan**), a business must:

  i be enrolled in the RDTI with Inland Revenue;

  ii have filed an RDTI application with Inland Revenue; and

  iii be either in tax loss or only able to partially offset their RDTI against provisional tax payments

b The maximum Loan value will for each eligible business be capped at 90 per cent of that business's expected RDTI entitlement (as estimated in their RDTI application).

c Notwithstanding the Loan eligibility criteria set out above, drawdowns will only be paid to a Loan applicant once its RDTI application has been approved by Inland Revenue. If the RDTI application is declined by Inland Revenue, no drawdowns will be paid.

d There will be a contractual obligation to repay the Loan in full one month after the RDTI is paid into the business's bank account or credited to the business's tax account. After this date, interest charges will commence if the Loan (or any part of it) remains unpaid. The rate of interest will be set at Inland Revenue's use of money interest rate.

5. Term of delegation

The delegation will come into effect on the date of its execution and continue in force until it is revoked.

SIGNED by the **MINISTER OF FINANCE,**
the Honourable Grant Robertson

____
Signature

____
Date

In the presence of:

Signature of witness

Name of witness: ______________________________

Occupation: ______________________________

Address: ______________________________

SUB-DELEGATION BY THE SECRETARY TO THE TREASURY TO THE CHIEF EXECUTIVE OF THE MINISTRY OF BUSINESS, INNOVATION AND EMPLOYMENT

From: **Secretary to the Treasury**

To: **Chief Executive of the Ministry of Business, Innovation and Employment**

1. Background

By instrument dated **_________**, pursuant to clause 5 of Schedule 6 of the Public Service Act 2020, the **Minister of Finance** delegated to the **Secretary to the Treasury** the power to enter into and perform loan arrangements under sections 65L and 65O of the Public Finance Act 1989, for the purpose of making in-year payments for the Research and Development Tax Incentive (RDTI) to R&D-performing businesses (the **Delegation**).

The Delegation also included consent to the sub-delegation by the **Secretary to the Treasury** to the **Chief Executive of the Ministry of Business, Innovation and Employment**, and consented to further sub-delegation to **senior MBIE staff with appropriate expertise.**

2. Sub-delegation

I, **Secretary to the Treasury** pursuant to the Delegation and clause 2 of Schedule 6 of the Public Service Act 2020, delegate to the **Chief Executive of the Ministry of Business, Innovation and Employment** the authority to lend money under section 65L of the Public Finance Act 1989, for the purpose of providing in-year payments of the RDTI.

3. Consent to sub-delegation

I consent to the further sub-delegation of all or any of the authority delegated under this instrument **senior MBIE staff with appropriate expertise.**

4. Conditions of delegation

This delegation is subject to the following conditions:

e To be eligible for the RDTI in-year payments loan (**Loan**), a business must:

  i be enrolled in the RDTI with Inland Revenue;

  ii have filed an RDTI application with Inland Revenue; and

  iii be either in tax loss or only able to partially offset their RDTI against provisional tax payments

f The maximum Loan value will for each eligible business be capped at 90 per cent of that business's expected RDTI entitlement (as estimated in their RDTI application).

g Notwithstanding the Loan eligibility criteria set out above, drawdowns will only be paid to a Loan applicant once its RDTI application has been approved by Inland Revenue. If the RDTI application is declined by Inland Revenue, no drawdowns will be paid.

h There will be a contractual obligation to repay the Loan in full one month after the RDTI is paid into the business's bank account or credited to the business's tax account. After this date, interest charges will commence if the Loan (or any part of it) remains unpaid. The rate of interest will be set at Inland Revenue's use of money interest rate.

5. Term of delegation

The delegation will come into effect on the date of its execution and continue in force until it is revoked.

SIGNED by the **SECRETARY TO THE TREASURY**
Caralee McLiesh

____
Signature

____
Date

In the presence of:

Signature of witness

Name of witness: ________________________________

Occupation: ________________________________

Address: ________________________________

Made under the authority of the Public Service Act 2020 and the Delegation dated __________.

MINISTRY OF BUSINESS, INNOVATION & EMPLOYMENT
HĪKINA WHAKATUTUKI

BRIEFING

In-year payments of the RDTI: final design and scheme commencement

Date:	15 November 2022	**Priority:**	Medium
Security classification:	In Confidence	**Tracking number:**	2223-1557

Action sought		
	Action sought	**Deadline**
Hon Dr Ayesha Verrall **Minister of Research, Science and Innovation**	**Note** the final design of in-year payments set out in this briefing **Note** we expect to open the scheme to applications in Q1 of 2023 **Agree** to forward a copy of this briefing to the Minister of Finance and the Minister of Revenue	25 November 2022

Contact for telephone discussion (if required)			
Name	**Position**	**Telephone**	**1st contact**
Dr Jess Robertson	Manager, Innovation Policy	Privacy of natural persons	✓
David Bennett	Senior Policy Advisor, Innovation Policy	04 901 4173	

The following departments/agencies have been consulted

Minister's office to complete:

- ☐ Approved
- ☐ Declined
- ☐ Noted
- ☐ Needs change
- ☐ Seen
- ☐ Overtaken by Events
- ☐ See Minister's Notes
- ☐ Withdrawn

Comments

MINISTRY OF BUSINESS, INNOVATION & EMPLOYMENT
HĪKINA WHAKATUTUKI

BRIEFING

In-year payments of the RDTI: final design and scheme commencement

Date:	15 November 2022	**Priority:**	Medium
Security classification:	In Confidence	**Tracking number:**	2223-1557

Purpose

To update you on the final design of in-year payments of the R&D tax incentive and the anticipated timing for scheme commencement.

Executive summary

MBIE is establishing a temporary scheme to deliver in-year payments of the Research and Development Tax Incentive (RDTI) through short-term Crown loans. We have now finalised the detailed terms and conditions of the in-year payments scheme.

All RDTI customers with an approved RDTI application will be eligible to receive an in-year payments loan. One loan covers a given income year, with three regular drawdown intervals during the year. The loan amount will be up to 80 per cent of the business's expected RDTI entitlement for the preceding period minus any offset of the RDTI against provisional tax by the business. The loan becomes due for repayment 30 days after the business receives its corresponding RDTI entitlement from Inland Revenue. No interest is charged on loans that are repaid on time, after that interest will be applied and the business will enter a repayment plan.

MBIE has engaged Tax Management New Zealand (TMNZ) to administer the loans. This will offer better value for money than establishing and managing these functions within MBIE. TMNZ will receive in-year payments applications and loan drawdown requests and make recommendations to MBIE for final decision.

Recommended action

The Ministry of Business, Innovation and Employment recommends that you:

a **Note** the final design of in-year payments set out in this briefing

Noted

b **Note** once you have noted the final design of in-year payments set out in this briefing we will communicate details of the scheme and how it will work to customers

Noted

c **Note** we expect to open the scheme to applications in Q1 of 2023

Noted

d **Agree** to forward a copy of this briefing to the Minister of Finance and the Minister of Revenue for their information

Agree / Disagree

Dr Jess Robertson
Manager, Innovation Policy
Labour, Science and Enterprise, MBIE

15 / 11 / 2022

Hon Dr Ayesha Verrall
Minister of Research, Science & Innovation

..... / ...... / ......

Background

1. MBIE is establishing a scheme to deliver in-year payments of the RDTI. In-year payments will get funds to R&D-performing businesses earlier – in the same year they incur that R&D expenditure – increasing the value of the RDTI to businesses and helping them manage cash flow challenges. In-year payments is stakeholders' main request to improve the RDTI.

2. In April 2022 Cabinet agreed in principle to establish a temporary mechanism to provide in-year payments of the RDTI and appropriated necessary funds [CAB-22-MIN-0105 and DEV-22-MIN-0062]. In June 2022, the Minister of Research, Science and Innovation, the Minister of Finance and the Minister of Revenue agreed to MBIE's proposed operational design and terms and conditions [Briefing 2122-4602]. In-year payments will be delivered as an interest-free loan that becomes repayable when the corresponding RDTI becomes available.

3. The temporary in-year payments scheme will operate for three years (2022/23-2024/25) and be superseded by Inland Revenue implementing in-year payments through the tax system.

Final design

We have finalised the detailed terms and conditions of in-year payments

4. Since we last reported to you in June [Briefing 2122-4602], we have finalised the detailed terms and conditions of the in-year payments scheme. We have also tested the final design with Callaghan Innovation, Inland Revenue, tax agents, tax advisors and current RDTI customers.

Eligibility

5. All RDTI customers with an approved RDTI application (General Approval or Criteria and Methodologies) will be eligible to apply for an in-year payments loan.

Loan amount

6. The loan amount will be up to 80 per cent of the business's expected RDTI entitlement against actual eligible R&D expenditure incurred minus any offset of the RDTI against provisional tax by the business.

7. Subtracting the provisional tax offset from the loan amount ensures all businesses derive similar early benefits from the RDTI. Businesses in profit can already offset their RDTI benefit against their provisional tax bill, deriving benefit from the RDTI sooner. However, this option is not available to businesses with no provisional tax to pay, nor can it be fully utilised by profitable businesses if their tax credit exceeds their provisional tax due. The in-year payment loan will address this imbalance.

8. The 80 per cent weighting reduces the risk of the loan exceeding the business's approved RDTI amount. The final amount approved by Inland Revenue is often slightly less than the amount claimed by the business in their Supplementary Return. We had earlier proposed a weighting of up to 90 per cent [Briefing 2122-4602] but have reduced this after assessing aggregated data on historic RDTI claims from Inland Revenue.

Timing

9. One loan covers a given income year. The loan recipient can draw down the loan at three regular intervals during the income year, which will shortly follow provisional tax deadlines. Loan drawdowns will be based on the actual eligible R&D expenditure in the preceding four months. The standard drawdown dates still apply to businesses with a non-standard balance date.

10. A business with an overdue loan will not be eligible for a further loan. It will however be possible for a business to have more than one active loan, as an earlier loan may not have yet become due.

Repayment

11. The loan becomes due for repayment 30 days after the business has had its Supplementary Return approved by Inland Revenue. We have developed a process for Inland Revenue to inform TMNZ when a customer's Supplementary Return has been approved.

12. Repayment will be due 30 days after the Supplementary Return submission deadline for the few businesses who fail to lodge a Supplementary Return to claim the RDTI.

13. No interest is charged on loans that are repaid on time.

14. If a loan has not been repaid in full when it is due, TMNZ will commence applying Inland Revenue's Use of Money Interest Rate (currently 7.96%) on behalf of MBIE to encourage repayment.

15. TMNZ, on behalf of MBIE, will also require the business to enter a standardised short-term repayment plan. If the loan is still not repaid by the end of the plan, management of the loan will return to MBIE.

16. The loans will be unsecured, as previously agreed by Ministers [Briefing 2022-4602].

Risk management

17. MBIE has the right to audit information provided in loan application and drawdown requests if required. A business will only be able to make a payment request after it has passed an Anti-Money Laundering check.

We have engaged Tax Management New Zealand to administer the loans

18. MBIE has engaged Tax Management New Zealand (TMNZ), New Zealand's first and largest registered tax pool intermediary, to provide loan administration services. The Crown will enter into loan agreements with individual businesses, with TMNZ providing administrative and operational support for the loans. This will offer better value for money than establishing and managing these functions within MBIE.

19. MBIE's open RFP received four proposals, with TMNZ selected as the preferred supplier, offering best value for money, a good understanding of the proposed solution, and the capability and capacity to deliver.

TMNZ will receive in-year payments requests and make recommendations to MBIE

20. TNNZ will receive and review loan applications and recommend whether MBIE should approve or decline, with MBIE making all final decisions. TMNZ will perform due diligence and an Anti-Money Laundering check on the applicant and apply MBIE's standardised loan eligibility criteria and terms and conditions in making its recommendation. Because loan eligibility is linked to eligibility for the RDTI, little discretion is required to administer the loans.

TMNZ will receive loan drawdown requests and pass funding instructions to MBIE

21. TMNZ will receive loan drawdown requests and supply MBIE with a bulk funding request for MBIE to execute. MBIE will review payment requests, approve loans, and transfer corresponding funds to a trustee account administered by Guardian Trust. When the business has supplied TMNZ with a signed, executed loan document, TMNZ will instruct Guardian Trust to make payment to the business.

TMNZ will notify MBIE when the loan becomes due

22. As a condition of the loan, the business will assign TMNZ Authority to Act for the business's Inland Revenue RDTI account. This will allow TMNZ to verify the RDTI application information used in the loan application and payment request, and be notified once a business's Supplementary Return has been completed, triggering the loan to become due.

Loan-making authority has been delegated to MBIE

23. On 17 July 2022 the Minister of Finance agreed the loans appeared necessary or expedient in the public interest and agreed to provide the loans [Treasury Report T2022/1322].

24. On 24 October 2022 the Minister of Finance delegated the power to enter into and perform loan arrangements to the Secretary to the Treasury [Treasury Report T2022/1953], who has sub-delegated to the Chief Executive of MBIE.

25. These acts enable MBIE to operationalise the in-year payments scheme.

We have publicly announced that in-year payments is coming

26. On 7 October 2022 the MBIE and RDTI websites announced in-year payments would be introduced in early 2023. In-year payments would be paid to businesses as an interest-free loan, repayable when the corresponding RDTI credit is available. Further details and the start date will be announced later this year.

We will proactively release documents relating to in-year payments once the details of the scheme have been announced

27. We will be ready to communicate details of the scheme and how it will work to customers soon, in line with the design described in this briefing. We will seek your agreement to proactively release the Cabinet paper and other documents relating to in-year payments shortly after that.

28. We have not yet proactively released these documents as the scheme had not yet been announced, a procurement process was underway, and the details of the scheme had not been determined.

We anticipate the scheme opening to applications in Q1 of 2023

29. We expect to open the scheme to applications in Q1 of 2023. The first loan payments will cover eligible expenditure for the period from 1 April 2022.

30. These timeframes depend upon TMNZ's delivery of the system to receive loan applications and facilitate payments from MBIE, and upon MBIE establishing necessary internal processes to approve loan applications and payments.

Next steps

31. Once you have noted the final design of in-year payments set out in this briefing we will communicate details of the scheme and how it will work to customers.

32. Although Cabinet delegated joint responsibility for final design of the scheme to you, the Minister of Finance and the Minister of Revenue, we do not consider these final changes to be substantially different to what you have already jointly agreed [Briefing 2122-4602]. If you agree, we will forward a copy of this briefing to the Minister of Finance and the Minister of Revenue for their information.