Business Tax Reform – R&D fact sheet

15 per cent tax credit to promote investment in R&D

New Zealand businesses conducting research and development – R&D – will be eligible for a tax credit of 15 per cent of allowable expenditure.

To qualify, R&D activities must be systematic, investigative and experimental. They must either seek to resolve scientific or technological uncertainty or involve an appreciable element of novelty and be directed at acquiring new knowledge or creating new or improved products or processes. Certain activities are excluded, as they are in other jurisdictions, generally to delineate more clearly the boundary between innovative and routine activity. Activities that support core R&D activities can be eligible.

Encouraging businesses to invest more in R&D will have wider benefits to New Zealand. The tax credit is designed to help improve productivity and international competitiveness, especially with Australia.

How will it work?

- ✓ New Zealand businesses conducting R&D in New Zealand will be eligible for a credit of 15 per cent of allowable expenditure.
- ✓ To qualify for the credit, a business must control the R&D project, bear the financial and technical risk of it and own the project results.
- ✓ The R&D must be carried out predominantly in New Zealand.
- ✓ Eligible expenditure includes the cost of employee remuneration, depreciation of tangible assets used primarily in conducting R&D, overhead costs, consumables and payments to entities conducting R&D on behalf of the business.
- ✓ Ineligible expenditure includes interest, loss on sale or write-off of depreciable property, the cost of acquiring core technology (technology used as a basis for further R&D), expenditure funded from a government grant or the required co-funding, expenditure on intangible assets and professional fees in determining eligibility.
- ✓ R&D credits will reduce tax payments, and imputation credits will arise for the amount of the reduction. R&D credits will be paid out in cash to loss making businesses such as start-ups. The person to whom it is outsourced will not get the credit.
- ✓ Businesses will be able to claim the tax credit as part of their normal tax return process.
- ✓ Businesses that commission R&D from Crown Research Institutes, tertiary institutions and District Health Boards may be eligible for the credit, but those institutions will not receive a credit for R&D undertaken on their own account.
- ✓ The credit will be available for software R&D but software developed for in-house use will normally be subject to a $2 million cap.

Example of how the tax credit will work

COM Ltd is a New Zealand business that manufactures shirts. In 2010 it has a gross income of $1 million. It spends $200,000 of eligible expenditure on an R&D activity to improve its stain- proof fabric. The expenditure includes salaries paid to R&D staff, chemicals used on test fabrics, payments to a third party to test the fabrics and overheads.

COM Ltd files its tax return as follows:

Gross income	$1,000,000
Less	
Eligible expenditure	$200,000
Net income	$800,000
Tax liability	$240,000
Less	
R&D tax credit	**$30,000** (credit to imputation credit account)
Tax still to pay	$210,000

If COM Ltd had a tax loss for the 2010 year and has no outstanding tax liabilities, it will receive the **$30,000** in cash.

Where to from here?

The changes are part of the taxation bill to be introduced following the Budget. Once enacted, the credit will be available from the 2008/09 income year.