Fact sheet – Cashing-out research and development tax losses

Innovative start-up companies typically experience a sustained period in tax loss while undertaking research and development. As a result, these companies are often unable to use their tax losses in a timely fashion, or even at all, because taxpayers are required to carry their tax losses forward to deduct against future income.

This can compound existing cash-flow and capital constraints, which can be particularly challenging issues for innovative start-ups.

What is happening?

- Innovative start-ups will be able to "cash-out" an amount of their tax losses arising from qualifying R&D expenditure. This means that instead of carrying the tax loss forward to apply against future assessable income, the company will receive a cash payment.
- Innovative start-ups will be able to cash-out up to $500,000 of eligible tax losses in the first year of the initiative (under a company tax rate of 28% this is equivalent to a cash-out of $140,000). This cap will rise by $300,000 each year up to an eventual maximum of $2 million (a cash-out of $560,000 per year).
- Companies that eventually earn assessable income will return the value of the cashed-out loss through taxes paid on that income.
- Companies that make a successful return on their investment through a non-taxable capital gain will have their cashed-out losses reinstated as losses to carry forward by repaying the value of the cashed-out loss out of the gain made.
- The administration of the initiative is still under consideration. Officials are working to create a process that enables these innovative start-ups to easily comply with the requirements of the policy. How the initiative is administered will be determined shortly after the 2014 Budget.

Why?

- The cashed-out loss will provide a timing benefit for these companies on their tax losses arising from R&D expenditure, reducing the bias against R&D investment arising from current tax settings and their cash-flow constraint.
- As the intention is to provide a timing benefit only and not a grant, companies are obliged to eventually return the value of any cashed-out loss taken by either taxes paid or from any gain on sale.

Key facts

- The policy is targeted at innovative New Zealand start-up companies in a tax loss position. The two main eligibility criteria are:
  - 20% of a company's wage and salary expenditure must be on R&D (the wage intensity threshold). This includes expenditure on shareholder salaries, contracted labour and 66% of contracted R&D but does not include sweat equity.
  - A company must be carrying out eligible research and development, the definition for which will be consistent with that used by the relevant accounting standard (NZIAS 38 Intangible Assets).

- If the company is in a group, the group must also meet the tax loss requirement and wage intensity threshold.
- The company cannot be a look-through or qualifying company, special corporate entity or publically listed on a stock exchange.
- Excluded activities and expenditure will be similar to those listed in the R&D tax losses Officials' issues paper, and will be confirmed shortly after the 2014 Budget.
- Companies that make a capital return will trigger a "loss recovery event", where the value of the cashed-out loss is recovered. This would take place when:
  - the company sells intellectual property;
  - 90% of the company's shares are sold;
  - the company becomes non-resident (for tax purposes); or
  - the company is liquidated.
- The value of the cashed out loss would be reinstated as research and development expenditure to be allocated to subsequent years to align with the setting that allows R&D losses to survive a continuity breach.
- The policy will apply from income years beginning on or after 1 April 2015.