Skills training tax credits

Definition, eligibility criteria, eligible expenditure

An officials' issues paper on matters arising
from the Business Tax Review

November 2006

Prepared by the Policy Advice Division of the Inland Revenue Department and by the New Zealand Treasury

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CHAPTER 1

Introduction

1.1 In July 2006 the government released the Business Tax Review discussion document for public comment. It set out a range of possible business tax initiatives that will help transform the New Zealand economy by enhancing our productivity and improving our international competitiveness. Feedback was sought on the relative priority of the initiatives given limited resources.

1.2 The government has made no decisions on what initiatives will be introduced. In the meantime, however, we are seeking further feedback on certain measures put forward in the discussion document, including the design of a skills training tax credit.

1.3 This issues paper has been prepared by officials from the Policy Advice Division of the Inland Revenue Department and from the Treasury, as part of the continuing consultation process. If the government decides to proceed with the tax credit initiative, submissions on the ideas explored in this issues paper will be taken into account in the design of the credit.

1.4 The specific design issues on which we seek feedback are set out in the following chapters. They include a possible definition of "eligible training" and what eligibility criteria and eligible expenditure should be.

1.5 Submissions on the possible approach outlined in this paper are welcomed. Submissions should be made by 1 December 2006 and be addressed to:

Business Tax Review, Skills Training Tax Credits
C/- Deputy Commissioner
Policy Advice Division
Inland Revenue Department
PO Box 2198
Wellington
New Zealand

Or email: policy.webmaster@ird.govt.nz with "Business Tax Review: Skills Training Tax Credits" in the subject line.

1.6 There is a very tight reporting timeframe, and extensions to the deadline are not feasible. Late submissions cannot be considered.

1.7 Submissions should include a brief summary of major points and recommendations. They should also indicate whether it would be acceptable for officials and other government agencies to contact those making submissions to discuss their submission, if required.

1.8 Submissions may be the subject of a request under the Official Information Act 1982, which may result in their publication. The withholding of particular submissions on the grounds of privacy, or for any other reason, will be determined in accordance with that Act. Those making a submission who feel there is any part of it that should be properly withheld under the Act should indicate this clearly.

SUMMARY OF A POSSIBLE APPROACH TO A SKILLS TRAINING TAX CREDIT

Definition

The tax credit should focus on training that leads towards nationally recognised qualifications that demonstrate transferable skills.

The definition of "eligible training" would be: "Training linked to qualifications on the National Qualifications Framework".

Eligibility could also be extended to cover qualifications that are not on the National Qualifications Framework (NQF), but which meet some defined criteria and are recognised international or industry standards.

The tax credit should be targeted to training at or below level 4 on the NQF.

The tax credit would not be restricted to particular types of training providers, particular sizes or types of organisations, particular industries or occupational groups or particular skill/subject areas.

Eligibility criteria

The tax credit would be available to all employers who invest in the training of their employees.

Eligible expenditure

The following expenditure would be eligible:

- tuition and course fees;
- payments for instructors, training advisers and assessment specialists;
- purchase price of training materials, including supplies, textbooks and manuals; and
- rental fee for training facility, equipment or other assets required for training.

The following expenditure would be ineligible:

- travel and accommodation for training purposes; and
- the cost of wages and salaries paid to employees while they participate in training, including the cost of wages and salaries paid to backfill their positions while they are training.

CHAPTER 2

Definition of “eligible training”

Objective of the skills training tax credit

2.1 The government’s objective for the skills training tax credit is to strengthen incentives for employers to invest in the skills and productivity of their employees, through formal training that leads to recognised qualifications. A highly skilled and adaptable workforce is essential to New Zealand’s economic future in an increasingly competitive international economy that has seen rapid growth in the supply of skilled workers across the globe.

2.2 New Zealand has an increasingly mobile workforce where people change jobs frequently during their working lives. New Zealand employers increasingly understand the importance of investing in the skills and productivity of their employees. But without government support and incentives, employers may tend to under-invest in generic and transferable skills because they cannot expect to capture the full future benefits of the resulting increases in productivity. Employers also have inadequate incentives to ensure that their employees’ training levels lead toward substantial, recognised qualifications that are relevant to their longer-term career interest and that will be recognised and valued by other employers.

2.3 The government already supports the development of a skilled workforce through its funding of both pre-employment and employment-related education and training. The National Qualifications Framework (NQF) and quality assurance and accreditation systems provide an infrastructure that ensures the quality of training toward consistent, recognised qualifications that both employers and employees can have confidence in.

2.4 A skills training tax credit would work alongside the government’s other funding and regulatory activity by providing direct financial benefits to employers who invest in developing the skills of their employees.

2.5 The tax credit should focus on training that leads towards nationally recognised qualifications that demonstrate transferable skills (rather than firm-specific skills).

2.6 We have considered a range of options for a workable definition of eligible training that meets the government’s objectives for the tax credit. The definition of “eligible training” would need to:

- be inclusive in its coverage of training that is both industry-recognised and transferable and of the greatest public benefit; and
- ensure the tax credit is simple for employers to understand and administer;

- minimise tax planning opportunities; and
- manage the potential fiscal risks.

A definition of "eligible training"

2.7 Our preferred approach is to use the NQF as the core for the definition of eligible training.

Under that definition, "eligible training" means: "Training linked to qualifications on the National Qualifications Framework".

2.8 The main advantages of limiting the scheme to qualifications on the NQF include:

- It provides certainty for employers as it offers a clear and objective test for eligibility using an existing information source.
- It focuses on training activities that are based on industry standards and lead to transferable skills.
- It allows a smaller unit of training to be recognised – unit standards rather than whole qualifications.

2.9 There are some disadvantages in limiting the tax credit to training linked to qualifications on the NQF. The main disadvantage is that the NQF is not complete in its coverage. Some sectors of the economy have limited coverage by Industry Training Organisations and by NQF qualifications. Many quality-assured and government-funded courses are not included on the NQF (including all university courses and local qualifications developed by polytechnics, private training establishments and Wananga). Much in-house training that is currently undertaken by employers is also not linked into the NQF, although it is often possible to do so).

2.10 Eligibility could therefore be extended to cover qualifications that are not on the NQF, but that are recognised international or industry standards that meet some defined criteria (such as a requirement that the training involves structured assessment and supervision by qualified trainers). This would require a trade-off between the breath of coverage and administrative complexity. We consider this trade-off worthwhile because of the broader coverage of the tax credit and it is our preferred approach.

2.11 If eligibility were extended beyond the NQF, examples of eligible training should include training towards certification by international standard-setting bodies or certification in proprietary technologies that have widespread application (such as licensed software).

2.12 Training towards non-NQF qualifications would need to be approved, as eligible for the tax credit by a nominated authority, so that taxpayers would have the required level of certainty. Both employers and training organisations would be able to apply for the non-NQF training to be approved and it would only need to be approved once.

Targeting the tax credit to particular levels of qualifications

2.13 The NQF has 10 levels – 1 being the least complex and 10 the most. Levels depend on the complexity of learning. Levels 1 to 3 are of approximately the same standard as senior secondary education and basic trades training. Levels 4 to 6 approximate advanced trades, technical and business qualifications. Levels 7 and above approximate advanced qualifications of graduate and postgraduate standard.

2.14 Eligibility for the tax credit could be limited to particular levels on the NQF, enabling the tax credit to offer stronger incentives for training less-skilled workers. The options are to offer the tax credit for training at any level of the NQF, to target training at NQF levels 1 to 4 (encompassing most national certificates) or target training at NQF levels 1 and 2.

2.15 Training in advanced skills and for higher-level qualifications is also essential for the economic development of New Zealand. This training includes building management capability in firms and ensuring that New Zealand workers have the high level skills required in advanced technology industry. Evidence suggests that employers' current investment in training tends to be focused on their more skilled employees and management staff. Targeting the tax credit by qualifications levels is less likely to result in inequities between taxpayers. A tax credit targeted toward recognised transferable qualification and lower-level skills is more likely to encourage investment in areas where firms are currently under-investing.

2.16 Therefore targeting training at or below level 4 on the NQF is our preferred approach because it would allow a more substantial credit to be offered to the employers who invest more in the training of their less skilled employees.

Submission points

Submissions are sought on the following matters in particular:

- Do you agree with the proposed definition of eligible training as "training linked to qualifications on the National Qualifications Framework"?
- Would the benefits of a wider definition of eligible training outweigh the disadvantages of the added complexity and likely compliance and administrative costs?
- Do you agree with the idea of targeting the tax credit at or below level 4 on the NQF (encompassing most national certificate qualifications)?

CHAPTER 3

Who should qualify for the tax credit?

3.1 The eligibility criteria should, in our view, be as inclusive as possible, taking into account the variety of businesses and sectors that invest in the training of their employees. The criteria should be easily understood, and when applied, they should not impose unnecessary compliance and administration costs.

3.2 Training tax credits exist in Ontario, Quebec, several US states, Austria, Italy, Luxembourg, Brazil, Chile and Japan. They are generally targeted more narrowly than the tax credit outlined in this paper – focussing to some degree on certain types of employees (such as youth, retraining displaced workers, low-skilled workers and the unemployed), on or certain sectors (such as manufacturing or construction).

Employer

3.3 The tax credit should apply to all employers[1] who invest in the training of their employees so that it is equitable across all regions, sectors, occupations and entities. This means that employers who are not in business – such as government departments, universities, schools and charities – would also qualify for the tax credit.

3.4 Given the policy objective of the tax credit to strengthen incentives for employers to invest in the training of their employees, we do not consider it desirable to limit the tax credit to employers of a certain size or particular industry. Even so, tax planning opportunities might arise as a result of a wide definition of "employer" – for example, as in the case of family members employed by a closely held company. On this basis, specific rules could be introduced to ensure that the credit was not abused in this situation and others involving partnerships, trusts, associated persons, shareholder/employees and independent contractors. A consequence of these rules is that the self-employed would also be excluded from the tax credit.

Employee

3.5 The options are to limit the definition of an "eligible employee"[2] by hours of work, length of employment, residence and citizenship or not impose any limits. The preferred option is for the tax credit to apply to all employees. While this means that specific groups with greater training needs are not targeted (with what could be a higher rate of tax credit), targeting problems can be addressed through the government's funding of tertiary education and training, enabling a more inclusive approach to the tax credit that reduces compliance costs.

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[1] An employer is defined in the Income Tax Act as a person who pays or is liable to pay a source deduction payment. A source deduction payment in defined in section OB 2(1) and includes a payment by way of salary or wages, an extra pay or a withholding payment.

[2] An employee is defined in the Income Tax Act as a person who receives or is entitled to receive a source deduction payment.

Submission points

Submissions are sought on the following matters in particular:

- Do you support a definition of “eligible employer” that covers all employers or should it be limited to only those employers in business?
- Do you support the definition of “employee” outlined here, including the exclusion of the self-employed?
- Do you think that the credit should apply to eligible training undertaken by government departments, universities, schools and charities?

CHAPTER 4

Eligible expenditure

4.1 This chapter specifies the expenditure that, in our view, would attract the tax credit.

General principles

4.2 The tax credit should apply only to direct training expenditure that is deductible under the Income Tax Act or would be deductible if the employer was in business. This requirement would exclude expenditure of a private and domestic nature.

Timing

4.3 The tax credit should be available only in the year in which the deduction for direct training expenditure is allowed. In other words, the timing rules in the Act should apply to the credit.

Definition of "eligible expenditure"

4.4 Only the direct training expenditure incurred by an employer would be eligible for the credit. Direct training expenditure would be limited to:

- tuition and course fees;
- payments for external instructors, industry training organisations, assessment specialists and in-house trainers;
- purchase price of training materials, including supplies, textbooks and manuals; and
- attributable costs of training facilities, equipment or other assets required for training.

Exclusions from "eligible expenditure"

4.5 There are a lot of risks associated with having a wide definition of eligible expenditure. They include subsidising expenditure that may have a private and domestic component and fiscal cost. To reduce these risks, we propose the following exclusions:

- travel and accommodation for training purposes; and
- the cost of wages and salaries paid to employees while they participate in training, including the cost of wages and salaries paid to backfill their positions while they are training.

4.6 We recognise that by excluding the cost of wages and salaries paid to employees while they participate in training, including the cost of wages/salaries paid to backfill their positions while they are training, we are excluding the major cost faced by smaller employers who try to invest in the training of their employees. For these employers it is often hard or impossible to find temporary people who are able to cover their employees' positions while they are being trained.

Standard costs

4.7 A wider definition of eligible training costs could be used when standard costs are used for travel, accommodation and wages and salaries paid to employees while they participate in training and those paid to backfill their positions while training.

Capping the amount of tax credit that could be claimed

4.8 A wider definition of eligible training costs could also be used, including travel, accommodation and wages and salaries paid to employees while they participate in training and those paid to backfill their position while training, when the tax credit is capped at the employee level. Caps are a common feature of training tax credits in other jurisdictions, to limit fiscal risk.

Apportionment of expenditure

4.9 Employers could be required to apportion expenditure when the total amount of eligible expenditure could not be determined from an invoice – for example, where an invoice for eligible training includes tuition, accommodation and travel and these costs are not separated out. To reduce the risk of abuse, when an invoice was separated out, there would be an obligation on the training provider to ensure that the invoice was reasonable. For example, at the extreme end, it would not be considered reasonable for an invoice for a $1,000 that includes tuition, out of town accommodation and travel to have $995 allocated to tuition and $5 allocated to accommodation and travel.

4.10 Employers could not claim a tax credit for any eligible training expenditure that employees are required to reimburse or pay for, either directly or indirectly or through use of forfeiture of salary, annual leave or other compensable time. This would prevent situations where an employer may have claimed a tax credit but, in reality, the employee has actually incurred the cost of the eligible training for a private purpose and to prevent salary sacrifice.

Submission points

Submissions are sought on the following matters in particular:

- Do you agree with the definition of "eligible expenditure" outlined here and the exclusions?
- Would you prefer a tax credit that is not subject to a per-employee cap, but has a narrow definition of "eligible expenditure", or would you prefer a capped tax credit that covers a broader range of training-related expenditure?
- Would you prefer a wider definition of "eligible training" that includes standard costs used for travel, accommodation and wages?