



Inland Revenue
Te Tari Taake

POLICY AND STRATEGY

Tax policy report: **Speaking Notes for Research and Development Cabinet paper at DEV**

Date:	5 April 2018	Priority:	Medium
Security level:	In Confidence	Report no:	IR2018/211

Action sought

	Action sought	Deadline
Minister of Revenue	Note the contents of this report	11 April 2018

Contact for telephone discussion (if required)

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5 April 2018

Minister of Revenue

Speaking Notes for Research and Development Cabinet paper at DEV

Executive summary

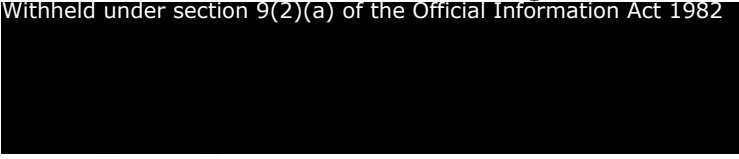
1. Jointly with Min Woods, you are taking the Cabinet paper Research and Development Tax Incentive Discussion Document to the DEV Cabinet Committee on 11 April.
2. You are seeking approval to publish the Discussion Document *Fuelling Innovation to Transform our Economy* that will underpin consultation on the proposed R&D tax credit. The Discussion Document does not commit the Government to any policy, but it signals the parameters of Government's intended support for the research, science and innovation sector.
3. This report provides you with suggested answers to possible tax-related questions from your Cabinet colleagues.

Recommended action

4. It is recommended you:

Note the contents of this briefing

Withheld under section 9(2)(a) of the Official Information Act 1982



Richard Braae
Senior Policy Advisor
Policy and Strategy

Hon Stuart Nash
Minister of Revenue
/ /2018

Background

5. Jointly with Min Woods, you are taking the Cabinet paper Research and Development Tax Incentive Discussion Document to the DEV Cabinet Committee on 11 April. (Briefing 2757 17-18, IR2018/205 refers.)
6. You are seeking approval to publish the Discussion Document *Fuelling Innovation to Transform our Economy* that will underpin consultation on the proposed R&D tax credit.
7. The Discussion Document does not commit the Government to any policy, but it signals the parameters of Government's intended support for the research, science and innovation sector.
8. We anticipate that Minister Woods will take the lead in introducing the item and responding to questions about how this policy fits into the wider picture of Government support business innovation. This briefing therefore addresses tax-related issues.

Tax-Related Questions that may be raised

9. **Q:** What's the difference between a tax incentive and a tax credit?
10. Minister Woods has requested the policy be referred to as a tax incentive because this provides a better description of the outcome sought. The instrument is a tax credit – that's the technical way it will be described in the tax legislation.
11. **Q:** How does the proposed rate of 12.5% compare with Australia's tax credit scheme?
12. The Australian scheme is more complex than what's proposed for New Zealand so it's not possible to make a simple comparison of the schemes' generosity. For small businesses, the Australian scheme is at a higher effective rate (16%) and is refundable, so is more generous. For large firms, the Australian scheme is at a lower effective rate (8.5%) and is not refundable, so is less generous.
13. **Q:** Is there a risk that the proposed definition will exclude firms undertaking valuable innovation that we want to be eligible for the subsidy?
14. With the definition, we are trying to balance two competing objectives:
 - Including worthy R&D, while
 - Excluding business as usual being recharacterised as R&D.

15. The purpose of consultation is to get feedback on whether we've got that balance right.

16. In addition, it won't be the case that all worthwhile innovative activity will be eligible for the tax credit. The credit is focused on subsidising the acquisition and application of new knowledge because this is where market incentives are likely to be weakest for firms. For other innovative activities, the market provides good incentives so there is less justification for a government subsidy.

17. **Q:** Many small R&D performing firms will be in loss. Why is the tax credit not refundable right from the start?

18. Officials agree that ideally there should be support for R&D firms in loss. However, the risks associated with refundability are greater than with non-refundability. That is why we are proceeding carefully before introducing this feature. The issues that need to be worked through are set out at paragraph 32 of the Cabinet paper. These are substantial issues and there is not the time to work through them and get legislation enacted to meet the April 2019 start date for the credit.

19. **Q:** How can we make sure that this scheme is not rorted?

20. There are several ways we are ensuring the R&D tax incentive will support genuine R&D.

- The definition of R&D, including the excluded activities and expenditure, will set out eligible expenditure and is designed to exclude business as usual expenditure. This definition incorporates lessons from the experience of the 2008 credit – for instance some of the additional exclusions that are being proposed are designed to defeat the types of claims that did not seem to be genuine R&D.
- Because the tax credit will be part of the tax system, we will make sure the standard shortfall penalties within the tax system will apply to claims made for the tax credit.
- Officials are investigating whether there are additional measures that need to apply to deter aggressive behaviour by tax advisors.

21. All these provide some measure of safeguard. However, they will not be an absolute protection. Therefore there will also be, in the legislation, a capacity to adjust the definition of R&D so that we can quickly remedy issues that suggest the scheme's integrity is being compromised.