In Confidence

Office of the Minister of Research, Science and Innovation

Office of the Minister of Revenue

Chair, Cabinet Economic Development Committee

Research and Development Tax Incentive for Implementation

Proposal

1. This paper seeks the Cabinet Economic Development Committee's agreement to the final policy design of the Research and Development (R&D) Tax Incentive so that legislation can be drafted for introduction to Parliament in October 2018.

Executive Summary

2. The Government has set a target to increase economy-wide R&D expenditure to 2 per cent of GDP. To reach this target significant growth in business expenditure on R&D (BERD) is required. Internationally, it is common for governments to use R&D tax incentive schemes to stimulate BERD to achieve wider economic benefits.

3. Consultation on the proposed R&D Tax Incentive took place between mid-April and early June this year. This paper seeks agreement to draft legislation for the R&D Tax Incentive whose design is informed by that consultation. The proposed design features include:

   - A user-friendly R&D definition, a credit rate of 15 per cent, a $120 million cap on eligible expenditure, and a minimum R&D expenditure threshold of $50,000 per year[1].
   - A broad set of eligibility criteria and the inclusion of State Owned Enterprises, industry research cooperatives (including levy bodies) and minority-owned subsidiaries of Crown Research Institutes, Tertiary Education Organisations and District Health Boards.
   - Technical design features which ensure the robustness and sustainability of the scheme over the long term, including features that relate to excluded activities, eligible and excluded expenditure and overseas expenditure.
   - Limited refundability of the credit for firms in tax loss for the 2019/20 tax year. The design features for that year will follow that of the R&D tax-loss cash-out scheme. Those features of refundability will likely change in subsequent years once more work is done.
   - A range of features that will help streamline the administrative process relating to the claims process, the use of determinations, binding rules, Order In Council, transparency and evaluation and penalty measures.

4. We propose to give R&D Growth Grant (Growth Grant) recipients with an active Growth Grant on 1 April 2019 the option to remain on the grant until 31 March 2021, one year longer than the transition period proposed in consultation.

5. We also outline additional work being undertaken to ensure the successful implementation and uptake of the scheme over the next two years.

[1] The minimum threshold will not apply to expenditure with an approved research provider.

Background

Raising business expenditure on Research and Development (R&D)

6. The Government has announced a target to increase New Zealand's R&D expenditure to 2 per cent of GDP over ten years. R&D expenditure in New Zealand is currently 1.26 per cent of GDP. To reach the target, significant growth in business expenditure on R&D (BERD) is required.

7. BERD is recognised as a key indicator of business innovation, which affects a business's ability to be successful. Business innovation is critical for New Zealand because it supports economic diversification, raises productivity, creates high value jobs and improves social and environmental well-being. Supporting more firms to undertake R&D may also encourage businesses to help solve some of the 'big issues'[2] currently facing New Zealand.

8. Achieving the 2 per cent target will require a range of policy measures. While BERD will need to lead this growth, the public research and science system is also an important area of long-term investment, particularly for public good research that focuses on environmental sustainability, and well-being.

Benefits and objectives of a R&D Tax Incentive

9. It is common for governments to support BERD. Without government support, businesses tend to invest in less R&D than is optimal for the country as a whole, 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 benefits associated with R&D that they are unable to capture in full.

10. New Zealand currently delivers R&D support primarily through grants (Growth Grants, Project Grants, and Student Grants), but international evidence suggests that a combination of grants and R&D tax incentives are more effective for increasing business expenditure on R&D. The majority of international studies highlight that every one dollar of tax credit generates at least one dollar of R&D spending by business. Some studies show more, additional spending of up to two dollars by business.

11. A R&D tax incentive is a broad-based tool, generally best at incentivising R&D across all types of firms. Increasing the number of businesses performing R&D is one way of increasing the amount of business R&D across the economy. While 302 firms currently receive the Growth Grant, it is expected that up to 2000 additional firms may be eligible for the R&D Tax Incentive.

12. Cabinet has agreed to implement a non-refundable R&D Tax Incentive by 1 April 2019 [CAB-18-Min 0056 refers]. Cabinet has also agreed that by April 2020 there will be some form of support for businesses in tax loss, and noted that the R&D Tax Incentive will replace Growth Grants over time [CAB-18-Min 0051 refers]. Cabinet also agreed to the publication of a R&D Tax Incentive Discussion Document '*Fuelling Innovation to Transform our Economy*', which outlined the main design features of the R&D Tax Incentive. Consultation on this document took place in April and June this year.

[2] The Government has set a series of well-being targets around Future of Work, Just Transitions, Zero Carbon and Child Poverty. R&D expenditure in the Research Science and Innovation portfolio and in other portfolios is expected to help achieve these targets.

Design of the R&D Tax Incentive

13. The R&D Tax Incentive design proposed in the discussion document largely followed the R&D tax credit available for the 2008/09 income year with modifications to reflect changes in international best practice and the current Callaghan Innovation R&D grants programme. The international business environment has changed, however, since 2008. Commercial interactions have become increasingly globalised and technology driven, with commercial inputs being now sourced across multiple jurisdictions. Business structures and practices have changed to reflect this new environment. We have given these factors greater consideration in the selection of design features.

14. In addition to establishing the R&D Tax Incentive, it is important that New Zealand's broader tax policy settings are optimised to support the Government's goal of growing an innovative economy. For example, addressing technical tax issues such as the loss continuity rules and the deductibility of black hole expenditure may help stimulate business innovation. The tax loss continuity rules and black hole expenditure are being considered by the Tax Working Group.

15. The critical R&D Tax Incentive design features recommended for inclusion in legislation are described below. Additional technical design features will also need to be built into the legislation. Please refer to **Annex 1** for information on the technical design features.

Definition of R&D

16. Businesses, industry groups and intermediaries expressed concern throughout the consultation process that the definition proposed in the discussion document was too narrow. There was particular concern about requiring R&D to be conducted using a "scientific method", because it would exclude a lot of business R&D (especially development activity and software R&D) or would require firms to describe their R&D activities creatively to satisfy the definition. The proposed definition is outlined in the box on the next page. It is no longer limited to R&D conducted using a scientific method but instead allows a broad range of systematic approaches to be used in the R&D process for example, engineering, design and software methods.

17. A separate definition for software was explored, but feedback stressed it would be ideal to have one robust definition that captures the majority of R&D performed by businesses in all industries. Having more than one definition could reduce taxpayer certainty, increase compliance costs, and would be unfair if industry-specific definitions were not available for all industry groups.

18. The impact of a materiality test as part the definition was canvassed during consultation. Businesses and intermediaries expressed particular concern around the potential of use of the term "significant" to measure materiality of the R&D, due to the subjective nature of the term.

19. While we acknowledge business's concerns regarding the materiality test, we consider a materiality threshold is necessary to ensure that trivial or incremental R&D is not subsidised. This has been incorporated using a "competent professional" test rather than using the term "significant".

Definition of Research and Development Activity

A core activity is: conducted using a systematic approach; and has a material purpose of creating new knowledge or new or improved processes, services, or goods and of resolving scientific or technological uncertainty.

An activity is not a core activity if knowledge required to resolve the uncertainty is: publicly available; or deducible by a competent professional working in the relevant scientific or technological field.

A support activity: has the only or main purpose of, is required for, and integral to, conducting a core activity.

The credit rate

20. A key theme throughout the consultation process and in submissions was that a 12.5 per cent credit rate is low compared to Growth Grants or other overseas schemes, and would be unlikely to induce additional R&D. It was also noted by businesses that the credit rate in 2008 was 15 per cent and the proposal to reduce it to 12.5 per cent seemed like a backward step to achieve the Government's target.

21. Officials have forecast eligible R&D expenditure over a four-year period based on growth rates of BERD and a range of other behavioural assumptions[3] and used this to calculate the likely cost of the scheme under different credit rates (ranging from 12.5 per cent to 20 per cent). They have compared the forecasts to total funding available, including R&D Tax Incentive budget allocation and baseline funding for Growth Grants.[4]

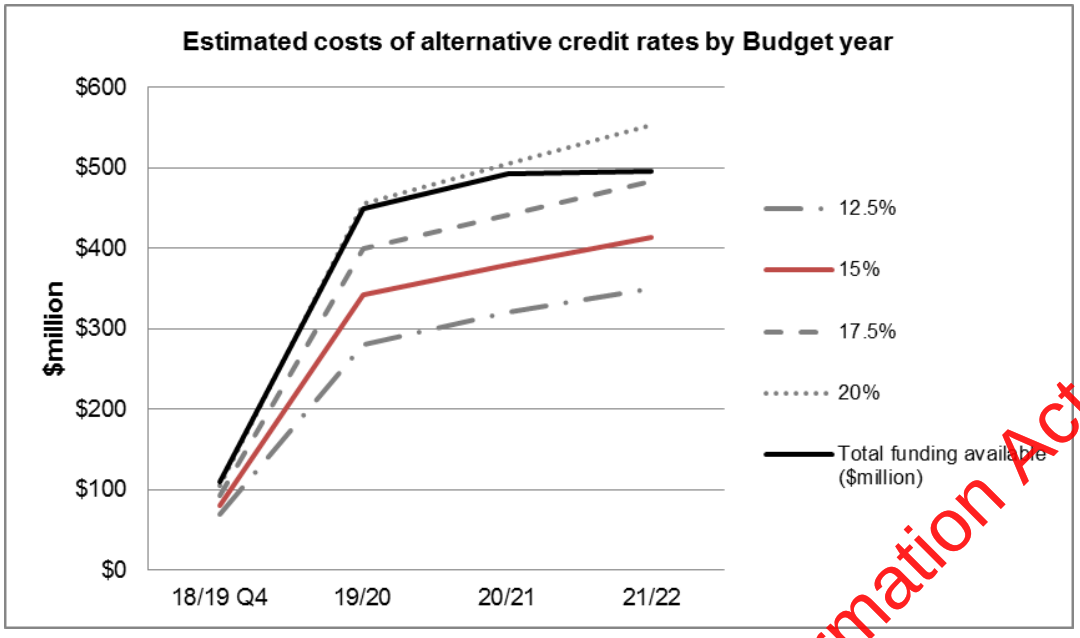
Budget Year	**18/19 Q4****	**19/20**	**20/21**	**21/22**
R&D tax incentive budget allocation ($million)	$70	$280	$320	$350
Growth Grant baseline funding ($million)*	$40	$169	$173	$146
Total funding available ($million)	**$110**	**$449**	**$493**	**$496**
Cost with 12.5% credit rate ($million)	$70	$280	$320	$350
Cost with 15% credit rate ($million)	$80	$342	$379	$414
Cost with 17.5% credit rate ($million)	$93	$399	$442	$484
Cost with 20% credit rate ($million)	$106	$455	$505	$553

*MYA as per Budget 17

** last 3 months of 2018/19 year only

[3] The forecasts are based on R&D expenditure estimates in the 2016 R&D Survey, extrapolated forward in line with GDP growth forecasts. They also incorporate an anticipated response to the R&D Tax Incentive, based on evidence of the response found by studies of overseas schemes.

[4] The model used to generate the forecasts assumes that all Growth Grant recipients switch to the R&D Tax Incentive from 1 April 2019, so the cost of providing an R&D subsidy to these firms through the Growth Grant regime instead of the Tax Incentive is therefore counted in the estimates. However, the costs will be higher if these firms remain on the Growth Grant until a later date and the amount they receive under the Growth Grant is higher than they would have under the R&D Tax Incentive.



22. Based on the information available, we consider that a 15 per cent credit rate starting in April 2019 is feasible. There is enough funding available to meet the forecast cost of the scheme through to the 2021/22 year, if Growth Grants funding is reprioritised once they are phased out. Assuming a similar level of funding is available in 2022/23 as the year prior, there should be enough funding to meet the cost of the scheme in 2022/23. If growth in BERD continues on the trajectory shown new money will likely be required from 2023/24 onwards.

23. We consider starting at a 15 per cent rate as the best option given fiscal constraints because:

- A 15 percent credit rate is likely to induce a greater amount of additional R&D than a lower rate.
- The rate is more favourable than the Growth Grant rate (15 per cent compared to 14.4 percent for businesses in profit), meaning that businesses are more likely to switch to a R&D Tax Incentive earlier than they would otherwise.
- A 15 per cent credit rate is more internationally competitive, particularly in relation to Australia.
- A higher credit rate combined with a mechanism to exceed the eligible R&D expenditure cap is likely to induce more international companies to relocate their R&D activity to New Zealand than would have otherwise.

The minimum threshold

24. The discussion document proposed that taxpayers must spend at least $100,000 on R&D in order to be eligible for the tax credit. Submitters were generally against this as they considered it would disadvantage start-ups.

25. Analysis from the 2016 Statistics NZ R&D Survey shows that around 700 R&D performing businesses per year would not have been eligible for the R&D Tax Incentive if there is a minimum threshold of $100,000.

26. We believe it is important to keep a minimum threshold as part of the scheme because:

- s 6(b)

s 6(b)

27. We propose a minimum threshold for eligible R&D expenditure of $50,000. Businesses that contract out their R&D to Approved Research Providers (which meet the criteria outlined in the box below) will be able to access the R&D Tax Incentive even if they do not satisfy the minimum threshold. Compared with a threshold of $100,000, according to the Department of Statistics 2016 R&D survey, this threshold would have allowed a further 250 R&D performing businesses to access the scheme.

28. We recognise that the lower threshold adds to the fiscal risk, not so much through the direct cost of these claims but because the higher volume of claims may reduce the level of scrutiny of claims. However, we consider the greater accessibility from the lower threshold outweighs the risk.

Approved Research Provider –including public and private entities

For a person to become an Approved Research Provider they would have to apply to the Commissioner of Inland Revenue and meet the following requirements:

- capability (including appropriate qualifications and certifications) to perform R&D activities on behalf of other persons
- has in New Zealand the facilities needed to perform the R&D activities
- charges market prices for performing the R&D activities
- available to perform R&D activities on behalf of persons not associated with them.

Cap on R&D expenditure

29. The discussion document proposed that businesses would be able to claim up to $120 million of eligible R&D expenditure each year. This equates to a credit of $18 million based on a 15 per cent credit rate. The discussion document proposed either a Ministerial discretion to exceed the cap on a firm-by-firm basis or a requirement to pre-register larger claims.

30. Submissions generally supported the $120 million cap. Some submitters said the cap would incentivise them to increase their R&D expenditure to reach the cap. The majority of submitters preferred the pre-registration option to Ministerial discretion.

31. We consider the $120 million cap to be at the right level and agree that it is important to have the option to exceed the cap through pre-registration, because larger firms considering whether to conduct their R&D in New Zealand may be marginally more attracted to a discretionary scheme. We propose that the option for exceeding the cap is based on the requirement that applied in 2008, namely that New Zealand will derive a substantial net benefit from the intended completion of the R&D.

Business-eligibility criteria

32. The policy intent is for all businesses to be eligible for the R&D Tax Incentive regardless of legal structure, so that the incentive is accessible, inclusive, and does not distort business structuring decisions. To this end, the discussion document carried forward the 2008 business-eligibility criteria.

33. Businesses expressed concern that the proposed criteria around the control, financial risk, and effective ownership requirements could exclude subsidiaries of international companies undertaking R&D in New Zealand for their parent company.

s 9(2)(b)(ii) [redacted]

34. We consider the business-eligibility criteria carried forward from 2008 could exclude valid R&D activity, so would be contrary to the policy intent. As a result, we propose less restrictive criteria around financial risk and access to the intellectual property generated by the R&D.

35. The focus of these eligibility tests is that the R&D is being conducted in New Zealand as the economic benefits of R&D are localised. There is no requirement that the business is New Zealand owned or that any intellectual property generated by the R&D will be New Zealand owned.

In-house R&D: business-eligibility criteria

36. To satisfy the in-house R&D business-eligibility criteria, we propose that a business undertaking R&D be required to:

- carry on business in New Zealand through a fixed establishment
- perform a core activity in New Zealand
- not contract out the R&D activity to a R&D contractor
- conduct day-to-day management of the core activity in New Zealand
- have R&D controlling rights[5] in relation to the core activity, or ensure these rights are held by a company in the same group of companies as the business
- have results of the R&D activity freely available to use at no extra cost above the business's eligible R&D expenditure for the activity; or
- that the company in the business's corporate group owns the results of the R&D activity, provided the company is tax resident of a jurisdiction with which New Zealand has a double tax agreement

37. Subsidiary companies directly performing R&D in New Zealand for foreign parents would need to satisfy the in-house eligibility criteria to be eligible for the R&D Tax Incentive. The proposed new criteria are more inclusive of subsidiaries, because it does not require subsidiaries to bear the financial risk, and have any control over the R&D activities beyond day-to-day management.

38. Consultation suggested we should assess business partnerships as a whole, rather than at the individual partner level. We consider we should replicate the 2008 approach. This involves testing eligibility at the partnership level and assessing expenditure for the purpose of allocating the tax credit at the partner level.

Contracted R&D: business-eligibility criteria

39. In 2008, there was only one set of eligibility criteria, with various rules intended to ensure that the business contracting out the R&D (the principal) would be eligible for the R&D tax credit. Despite these rules, a number of claims were successfully made by R&D contractors for activities they had been paid to do by other businesses.

40. The separate contracted R&D business-eligibility criteria, in conjunction with other targeted rules, are intended to ensure that R&D tax credits are only paid to the business

[5] We propose that R&D controlling rights be legislatively defined as meaning the rights to start, stop, and change the direction of an activity, and the right to choose whether results are followed up on.

commissioning the R&D, and that credits are not paid out twice in relation to the same R&D activity.

41. To satisfy the contracted R&D business-eligibility criteria, the following criteria should be met

- the principal carries on a business in New Zealand through a fixed establishment
- the contractor performs an R&D activity on the principal's behalf
- the contractor performs the core activity in New Zealand as part of a business carried on by the contractor in New Zealand through a fixed establishment
- the core activity is performed in New Zealand
- the day-to-day management of the core activity is conducted in New Zealand
- R&D controlling rights[6] in relation to the core activity are held by the principal, or a company within the principal's corporate group
- the results of the R&D activity are freely available to use for the principal at no extra cost above the principal's eligible R&D expenditure for the activity or
- a company in the principal's corporate group owns the results of the R&D activity, provided the company is tax resident of a jurisdiction with which New Zealand has a double-tax agreement
- the contractor receives market value consideration for performing the R&D activity from the principal, or from a company within the principal's corporate group

42. We also propose the principal can claim 80 per cent of the amount of consideration paid to the contractor minus any ineligible R&D expenditure. The rationale is to exclude the profit component from the contractor's charge for the R&D, as the Tax Incentive does not cover this for in-house R&D.

Inclusion of industry research cooperatives

43. In line with the proposal in the discussion document, we consider that industry research cooperatives, including levy bodies [7] should be eligible for the R&D tax incentive regardless of not meeting the business test.[8] R&D funded through industry research cooperatives is fundamentally business R&D and may result in benefits that are not fully captured by the industry.

State –owned enterprises will be eligible for the R&D Tax Incentive

44. State-owned enterprises (SOEs) were eligible for the 2008 R&D tax credit. We consulted on whether they should be eligible or ineligible under the R&D Tax Incentive scheme. There was strong concern voiced throughout consultation that excluding SOEs from the scheme would be anti-competitive. Under the State-Owned Enterprises Act 1986, SOEs are required to be 'as profitable and efficient as comparable businesses that are not owned by the Crown'. This objective cannot be achieved if SOEs are not entitled to incentives that are available to comparable private sector businesses.

[6] We propose that R&D controlling rights be legislatively defined as meaning the rights to start, stop, and change the direction of an activity, and the right to choose whether results lead to further work.
[7] This includes businesses controlled by one or more of these entities.
[8] The "in business" test is based on case law, requiring a person to intend to make a profit, and to carry on a profession, trade, manufacturing or undertaking.

45. Furthermore, many SOEs are established R&D performers and anticipate the R&D Tax Incentive would incentivise them to undertake additional R&D. We therefore consider they should be eligible under the tax incentive.

Exclusions to business-eligibility tests

46. Crown Research Institutes (CRIs), District Health Boards (DHBs) and Tertiary Education Organisations (TEOs) were ineligible for the 2008 R&D tax credit. The tax credit was intended to stimulate business investment, rather than Crown investment in R&D, and it was considered there were more appropriate and efficient mechanisms to increase R&D in these entities than through the tax system. It is recommended that CRIs, DHBs and TEOs remain excluded from the 2019 R&D Tax Incentive.

47. To avoid artificial structuring, we propose subsidiaries of CRIs, DHBs and TEOs will not be eligible for the R&D Tax Incentive where a CRI, DHB or TEO, or a combination of them, has a shareholding in the subsidiary of 50 per cent or more.

48. We recommend a rule that prevents businesses from claiming R&D tax credits if they are receiving a Growth Grant. Businesses receiving other Government assistance for the R&D, eg a Project Grant, would be eligible for the tax incentive but not for activities for which they are receiving the Government support.

Support for pre-profit and loss-making firms – Refundability

49. The design of the R&D tax incentive ensures that a broader range of firms are incentivised to do R&D, including early stage R&D intensive companies. We recognise these firms spend their early years in a tax-loss position, and have a lower probability of becoming profitable than other types of businesses. These firms are considered important participants within the innovation system both as a source of value-add employment and with the development of a more productive and diversified economy.

50. We intend to provide a mechanism for pre-profit and loss-making firms to cash out – or refund their tax credits. Officials have previously advised that it would not be possible to implement a mechanism for refunding R&D tax credits through the tax system in time for the introduction of the R&D Tax Incentive on 1 April 2019. Support for firms in loss could be implemented from 1 April 2020.

51. Feedback received during consultation highlighted that it would be important to provide some level of refundability sooner. Officials now consider it feasible to provide a limited form of refundability from the first year of the tax credit. Because of the time constraints associated with introducing legislation, we propose eligibility for the first year of refundability should reflect the parameters of the R&D tax-loss cash-out[9] scheme.

52. These parameters are already defined in legislation. The eligibility constraints are unlikely to be ideal for the long-term policy on refundability, but it is the best solution under the short timeframes. Because it is already in operation, there is a benefit by being able to predict the impact on the R&D Tax Incentive in the first year. The design of eligibility constraints for refundability is likely to change in subsequent years, once policy work is done.

53. If refundability is available for the 2019/20 tax year, eligible firms would start to receive pay-outs once their 2019/20 tax return is processed, which is an end-of-year process. Business could expect to receive the credit from July 2020 onwards.

[9] In 2019/20, these limitations will be that at least 20 per cent of the firm's labour cost is R&D related and the maximum eligible R&D expenditure is $1.7m. For firms that meet the R&D intensity test, and at a tax credit rate of 15 per cent, this would mean a maximum payout of $255,000. Currently, around 350 firms are in the tax-loss cash-out scheme.

Atypical businesses

54. As part of the future policy work on refundability to apply from the second year of the tax incentive, consideration will also be given to the treatment of atypical businesses. Currently, the R&D Tax Incentive is available to a range of entity structures including charitable businesses, levy bodies, other industry research co-operatives, co-operatives and some Maori businesses[10]. Often these businesses will be structured to never incur tax liability, so while eligible for the R&D Tax Incentive they may not benefit from it in the first year. Officials will be providing us with advice on how these firms may be supported under the R&D Tax Incentive as part of the future work on refundability in late 2018 with final policy decisions expected to be made in 2019. Consultation with key stakeholders will take place during this time. We will report to Cabinet on the long-term policy on refundability in mid-2019.

Transition from Growth Grants

55. The Growth Grant transition proposal outlined in the discussion document was to allow all businesses with an active Growth Grant on 31 March 2019 to continue receiving Growth Grant funding for R&D performed through to 31 March 2020. Most submitters indicated that they would like a longer time to transition to adjust to the new scheme.

56. We propose to provide an automatic two-year extension to Growth Grants recipients that have an active Growth Grant on 1 April 2019 to allow them to remain on their Growth Grant for up to two years (ie, until 31 March 2021). We also considered placing restrictions on the conditions of the Growth Grant in the second year of the transition period, either changing the eligibility criteria or reducing the rate, but these measures risk disrupting their R&D programmes.

57. The existing arrangements for Growth Grant will continue until 31 March 2019. This means that recipients with expiring contracts must apply and satisfy the criteria for renewal, which is to maintain or increase their eligible R&D expenditure and R&D intensity, relative to the two years prior to the grant period. There are 75 recipients whose Growth Grants are due to expire between now and 31 March 2019, and Callaghan Innovation understands that at least ten of these (among them some of New Zealand's biggest R&D spenders) will not satisfy the criteria under the current rules to requalify for the Growth Grant on 30 September 2018. Moreover, additional recipients may fail to requalify when their contracts expire between 31 December 2018 and 31 March 2019.

58. We propose to continue the existing contract renewal process until 31 March 2019 and, for those companies who do not meet the criteria for a renewal, to allow a contract extension to 31 March 2019. The justification for extending the contracts of the firms that do not satisfy the criteria is that without it they would face a six-month gap in any form of Government support until they are eligible for the R&D Tax Incentive. The reduction in support may cause them to reduce their R&D expenditure.

Additional work

Successful uptake of the R&D Tax Incentive

59. To ensure the successful implementation of the R&D Tax Incentive there needs to be strong uptake of it by R&D performing businesses. However, consultation has shown that there is a lack of awareness of the benefits of the scheme and some of its design features. Specifically, there was confusion about the credit in comparison with the Growth Grants, concern about the lack of support for start-ups and businesses in tax loss, and concern that software businesses may be excluded from the scheme.

[10] Māori businesses, in particular, are more likely to have varying entity structure. These structures can be created under legislation, collective land titles and treaty settlements and can involve a large number of owners and complex governance arrangements. This can make it difficult to transfer business operations into a company structure.

60. To address these issues officials from MBIE, Inland Revenue and Callaghan Innovation are developing an implementation strategy to ensure widespread awareness and understanding of the R&D Tax Incentive before its implementation date in April 2019. As part of this process departments will ensure businesses, as well as atypical businesses understand the next phase of the refundability work and what it may mean for them.

61. Departments will also focus on the development of guidelines which will complement the tax legislation to inform businesses of the detailed parameters of scheme.

In year-approval

62. During consultation, stakeholders expressed a desire for greater certainty within the process of applying for and receiving the R&D tax incentive.

63. We propose to include an in-year approval mechanism in the legislation which would require firms to seek and receive approval of their R&D activity in the year in which they are conducting it[11]. This approval would be binding on Inland Revenue and would mean that firms could have confidence that their activity meets the test of being R&D. The process will be tailored to different types of R&D performers. For instance, approval will last for more than one year for firms engaged in longer term projects, and different approaches will apply for large firms undertaking many R&D projects.

64. We consider this approach will support other features of the tax incentive that we would like to introduce, such as extending refundability to a wider pool of firms and providing in-year refundability of the tax incentive for firms in loss. Further work is required to determine if it is possible to introduce this feature from year one. If not, it will commence in year two and the legislation will also include a separate mechanism to activate the requirement.

Consultation

65. Public consultation on the design of the R&D Tax Incentive took place for six weeks from 19 April to 1 June. In total, 214 submissions were received. The table below contains the breakdown of the submitters by segment. A number of submissions received shortly after the consultation period closed were also taken into account.

66. In parallel with the written submissions, officials organised six technical workshops with select key stakeholder groups, including R&D performing businesses, startups and SOEs. There were also twelve in-depth interviews with individual organisations, including the four large accounting firms (EY, PWC, KPMG, Deloitte).

Segment	Count	Description
Business	141	Businesses, R&D performing or otherwise
Industry groups	34	Levy bodies, advocacy groups and unions
SOE CRI DHB TEO	17	State-Owned Enterprises (SOEs), Crown Research Institutes (CRIs), District Health Boards (DHBs) and Tertiary Education Organisations (TEOs)
Individuals	13	Individuals responding on their own behalf, not that of their business
Territorial local authorities/Economic development agencies	5	Regional councils and development agencies
Intermediaries	4	Large accounting firms
Total	**214**	

[11] This is a key feature of the Norwegian R&D tax credit which has been operating since 2002.

67. Submissions were analysed and the main themes have been incorporated in the revisions to the R&D Tax Incentive outlined in this paper.

Treasury comment

68. The Treasury has been consulted on this Cabinet paper and does not support the increase in the rate of the R&D Tax Incentive from 12.5 per cent to 15 per cent. This is because:

- The Treasury does not consider that an adequate value-for-money case has been presented for the additional funding required to increase the rate and this has not been assessed against Government priorities.
- The proposal to increase the rate suggests this can be funded with money currently set aside for Growth Grants. The Government has not made a decision regarding how any Growth Grant funding which may become available should be used.
- Starting the rate at 12.5 per cent and retaining the Growth Grants appropriation allows the Government more flexibility in their future business R&D policy.
- Additionally, this feature would increase the fiscal uncertainty of the R&D Tax incentive and the higher rate may increase risks to the integrity of the tax system.

69. If Ministers are interested in raising the credit rate, Treasury recommends that this be considered at the first evaluation in 2024.

Financial Implications

70. Budget 2018 allocated $1,020 million towards the R&D Tax Incentive, with $70 million allocated for the last quarter of the 2018/19 fiscal year, rising to $350 million in 2021/22. This budget allocation was based on an R&D Tax Incentive at a 12.5 per cent credit rate. A credit rate of 15 per cent will mean that additional funding of approximately $195 million over four years will be needed to meet the cost of the R&D Tax Incentive. However, we expect the cost of a R&D Tax Incentive at the higher rate can largely be met with the funds appropriated for the R&D Tax Incentive in Budget 2018. This is because the majority of existing Growth Grant recipients is likely to remain on their grant until 31 March 2021 and these businesses cannot claim a R&D tax credit if they are still receiving a Growth Grant.

71. Moreover, $528 million has been appropriated for the Growth Grant Multi-Year appropriation for the fourth quarter of 2018/19 (ie, from 1 April 2019) to the end of the 2021/22 year. As Growth Grant recipients switch over to the R&D Tax Incentive, the funding from the Growth Grant appropriation will become available. We propose that this funding be reprioritised to meet the additional cost of the R&D Tax Incentive at a rate of 15 per cent rather than other priorities. We forecast that the combination of the remaining funds from the Growth Grant Multi-Year appropriation and the funding allocated to the R&D Tax Incentive in Budget 2018 is sufficient to meet the additional costs of a 15 per cent tax credit rate. The appropriations for the Growth Grant and the R&D Tax Incentive will be updated in Budget 2019, following receipt of more up-to-date estimates of R&D expenditure.

Administration costs

72. Budget 2018 allocated $4.3 million over four financial years for the administration of the R&D Tax Incentive through Vote Revenue.

73. This was primarily to cover one-off implementation costs of introducing the policy, based on what was known at the time. It does not necessarily include additional implementation costs for improvements such as in-year refundability. It contained a small amount for ongoing administration. Experience from overseas has shown that it is important for tax authorities to be appropriately resourced to ensure integrity and sustainability of the schemes.

74. Inland Revenue has now identified that additional FTEs are required to administer the R&D Tax Incentive. It has estimated up to 20 FTEs are required, which covers advisory, compliance, on-going operational support, technical escalations and management. The full cost of the annual ongoing administration is estimated to be up to $6 million per year. The exact cost will depend on policy settings and the level of uptake of the incentive. Inland Revenue will continue to refine its cost estimates and reconcile these against the current allocation.

75. We consider that this annual administration cost can be met from the baseline funding under the R&D Tax Incentive appropriation combined with the reprioritised funding from the Growth Grant appropriation. We therefore propose these appropriations be used to meet the administration cost.

Risks

76. There is a possibility that the cost of the R&D Tax Incentive is greater than what is forecasted as a result of higher business uptake and/or larger genuine claims. This is because the R&D Tax Incentive is a demand-based policy tool (ie, the uptake of the incentive and the quantity of R&D undertaken comes down to decisions made by individual businesses). This makes the short and long-term cost of the intervention difficult to predict accurately.

77. There is also a risk of bad claims or abuse of the scheme (eg, recharacterising of general expenditure as R&D expenditure) by a minority of businesses. To mitigate this risk we have applied international best practice and domestic lessons to the design of the R&D Tax Incentive. For example, we have focussed on the development of clear and unambiguous rules, so firms understand what is and is not eligible under the R&D Tax Incentive and can be held to account, and to limit the amount of recharacterisation that can happen. We have also proposed transparency and penalty measures to deter firms or their advisors from making dishonest claims.

78. As with any schemes like this one, there will be residual risk and uncertainty of cost due to both genuine claims by the majority and dishonest claims by the minority. However, we consider that the benefits of the scheme outweigh these risks. Furthermore, we will be proactively monitoring the scheme's fiscal costs, and adjusting the scheme as necessary, as risks arise, to ensure its integrity, robustness and sustainability remain strong.

Legislative Implications

79. Implementing the R&D Tax Incentive will require changes to the *Income Tax Act 2007* and the *Tax Administration Act 1994*. Consequential amendments to other enactments may also be required. A number, but not all, of the Inland Revenue Acts currently bind the Crown. The R&D Tax Incentive legislation will not alter the status quo in this respect.

80. If approved, we propose including the legislative changes arising from these recommendations in the Taxation (Research and Development Tax Credits) Bill ('the 'Bill') scheduled for introduction in late October 2018.

81. The bill has a category five priority on the 2018 Legislation Programme (to be referred to a select committee in 2018).

Impact Analysis

82. A regulatory impact assessment (RIA) has been prepared and is attached to the Cabinet Paper. A cross-agency quality assurance panel with independent representatives from the Treasury, the Ministry for Business, Innovation and Employment (MBIE) and Inland Revenue has reviewed the Regulatory Impact Statement: R&D Tax Incentive prepared by MBIE and Inland Revenue and considers that it meets the quality assurance criteria.

83. The RIA meets the quality assurance criteria of being clear, concise, convincing, complete and consulted and provides a good basis for informed decision-making by Ministers

Human Rights

84. There are no human rights implications arising from the proposals in this paper.

Gender Implications

85. There are no gender implications arising from the proposals in this paper.

Disability Perspective

86. There are no specific disability considerations arising from the proposals in this paper.

Publicity

87. Once Cabinet decisions on the R&D Tax Incentive design features are finalised, a schedule of in-depth interviews with key publications (Fairfax, NZ Herald, RNZ, Newsroom, NewsDesk and NBR) will be arranged to publicise the design features of the incentive.

Proactive Release

88. The submissions received during public consultation will be proactively released by the Ministry of Business, Innovation and Employment once Cabinet decisions on the R&D Tax Incentive design are finalised.

Recommendations

89. We recommend that the Cabinet Economic Development Committee:

1.1 **Note** that Cabinet has agreed to introduce a R&D Tax Incentive to come into effect from 1 April 2019 and that the following recommendations relate to its design:

1.1.1 **Agree** to a core activity definition described for eligible R&D activities, namely: conducted using a systematic approach; and a material purpose of creating new knowledge or new and improved processes, services, or goods; and of resolving scientific or technological uncertainty;

1.1.2 **Agree** to a materiality threshold, namely: an activity is not core R&D if knowledge required to resolve the scientific or technological uncertainty is publicly available; or deducible by a competent professional working in a relevant scientific or technological field;

1.1.3 **Agree** to a R&D tax credit rate of 15 per cent;

1.1.4 **Agree** to a minimum R&D expenditure threshold of $50,000 per year;

1.1.5 **Agree** to a $120 million cap on R&D expenditure per year with approval to exceed the cap through a pre-registration mechanism; and subject to New Zealand deriving a substantial net benefit from the intended completion of the R&D;

1.1.6 **Agree** to business-eligibility criteria for both businesses and contractors covering having a fixed establishment in New Zealand, performing R&D in New Zealand, day-to-day management of the R&D activity, freely using the results of the R&D, and the controlling rights to the R&D;

1.1.7 **Agree** that industry research cooperatives will be included in the R&D Tax Incentive scheme but will not be required to meet the requirement to be a business.

1.1.8 **Agree** that specific exclusions to the scheme are, CRIs, DHBs and TEOs, subsidiaries of CRIs, DHBs and TEOs where one or more CRI, DHB or TEO has a shareholding (or a combined shareholding) equal to or more than 50 per cent, and recipients of Callaghan Innovation Growth Grants.

1.1.9 **Agree** that end of year refundability be available for the 2019/20 tax year, with eligibility based on parameters of the R&D tax-loss cash-out scheme.

1.1.10 **Note** the design features for refundability will likely change in subsequent years.

1.1.11 **Agree** to include an in-year approval mechanism in the legislation which would require firms to seek and receive approval of their R&D activity in the year in which they are conducting it.

1.1.12 **Agree** to the technical design features described in Annex 1.

1.2 **Agree** to delegate joint authority to the Ministers of Research, Science and Innovation and Revenue to make final decisions on:

1.2.1 Apportionment rule for dual purpose expenditure

1.2.2 Excluded activities

1.2.3 Eligible and ineligible expenditure

1.3 **Agree** that Callaghan Innovation Growth Grants will be closed to new applicants from 31 March 2019.

1.4 **Agree** to provide an automatic extension until 31 March 2021 for all existing Growth Grant recipients whose contracts expire on or after 1 April 2019 without any limitations or changes in terms.

1.5 **Agree** that the contracts of all Growth Grant recipients whose contracts expire after 1 April 2021 will be changed to terminate on that date.

1.6 **Agree** to continue the existing contract renewal process until 31 March 2019 and, for those companies who do not meet the criteria for a renewal, allow a contract extension to 31 March 2019 or the commencement of the company's 2019/20 financial year (whichever is later).

1.7 **Agree** to delegate authority to the Minister of Research, Science and Innovation to amend the Ministerial Direction to Callaghan Innovation to allow the phasing out of the Growth Grants by 31 March 2021.

1.8 **Note** the combination of the remaining funds from the Growth Grant Multi-Year appropriation and the funding allocated to the R&D Tax Incentive in Budget 2018 are forecast to be sufficient to meet the fiscal costs of the R&D Tax Incentive at 15 per cent.

1.9 **Agree** to reprioritise funding from the Growth Grant appropriation to fund the additional cost of a 15 per cent R&D Tax Incentive (rather than other priorities).

1.10 **Note** the appropriations for the Growth Grant and the R&D Tax Incentive will be updated in Budget 2019, following receipt of more up-to-date estimates of R&D expenditure.

1.11 **Note** that Inland Revenue has estimated the full cost of annual administration of the R&D tax incentive is up to $6 million.

1.12 **Note** that Inland Revenue will continue to refine its cost estimates for administration of the R&D tax incentive.

1.13 **Agree** to reprioritise funding from the Growth Grant appropriation and/or the R&D Tax Incentive appropriation to fund Inland Revenue for the additional administration costs of the R&D Tax Incentive.

1.14 **Agree** to delegate authority to the Ministers of Research, Science and Innovation and Revenue to make any adjustments of a minor and technical nature to the design features of the R&D Tax Incentive as necessary, to achieve its policy intent.

1.15 **Invite** the Ministers of Research, Science and Innovation and Revenue to instruct Inland Revenue to draft legislation to give effect to the policy proposals and its intent contained in this paper.

1.16 **Note** the Taxation (Research and Development Tax Credits) Bill holds a category five priority on the 2018 Legislation Programme (to be referred to a select committee in 2018);

1.17 **Note** that the Bill makes substantive, remedial, and technical amendments to the following legislation:

- Income Tax Act 2007
- Tax Administration Act 1994.

Authorised for lodgement

Hon Dr Megan Woods

Minister for Research, Science and Innovation

Hon Stuart Nash

Minister of Revenue

Annex 1: Technical Design Features Required in Legislation

General expenditure rule

Discussion document position and feedback

The discussion document proposed that expenditure must be deductible or amortisable for it to be eligible for the R&D tax incentive.

Feedback from consultation emphasised that the tax incentive should reward all business R&D, whether it is successful or not, and that the accounting treatment of R&D expenditure should not influence its eligibility for the R&D tax incentive. In particular, submitters wanted expenditure on unsuccessful R&D, which is often black hole expenditure, to be included.

Proposed design

We propose that expenditure should be eligible for the tax incentive if it is incurred on an eligible R&D activity in the relevant income year, subject to the exceptions outlined below.

- Only the tax depreciation loss calculated on depreciable property acquired for use in R&D is eligible for the R&D tax incentive in the relevant income year. Without this exception, the entire cost of the depreciable property used in R&D would be eligible in the year the property is acquired.
- Prepayments and other tax adjustments follow their usual tax treatment.
- Where a business has decided to defer its deductions of R&D expenditure, the deferred expenditure is nevertheless eligible in the year it is actually incurred rather than in the year to which the deduction is deferred.

The proposed treatment is in line with the treatment of eligible expenditure in the 2008 tax incentive.

List of eligible and ineligible expenditure

Discussion document position and feedback

The discussion document proposed two possibilities for eligible expenditure. The first was to limit it solely to direct labour costs and the second was to include a more comprehensive list of eligible expenditure.

Limiting eligibility to labour costs only was the less popular of the two options, with over half of respondents arguing that the test did not accurately capture R&D expenditure and favoured labour intensive industries. Respondents acknowledged that the more comprehensive approach would require additional administration to record and report.

Proposed design

We propose that eligible expenditure be based on a broad range of actual R&D costs, for example:

- Salary and wages of employees doing R&D
- Depreciation on assets used in the R&D
- The cost of consumables used in the R&D
- Overheads.

Officials will investigate the option of allowing a simpler alternative from year two, such as allowing businesses to calculate their overheads as percentage of R&D labour.

The legislation will also include a list of excluded expenditure (a draft list is provided in **Annex 3)**. The principles that will determine any further items being added to the excluded expenditure list include:

- Insufficient connection of the expenditure to the R&D activity
- To reduce compliance and administrative costs
- To prevent the credit applying to the same expenditure twice (i.e. prevent double dipping)
- To prevent the abuse of the tax incentive and limit fiscal cost where risk of recharacterisation of expenditure is high or apportionment is difficult.

We seek Cabinet approval to make decisions on the final eligible and ineligible expenditure lists.

Overseas R&D expenditure

Discussion document position and feedback

The aim of R&D tax incentive is to primarily incentivise R&D activity taking place in New Zealand. Therefore the discussion document proposed a two prong test to achieve this requiring that no more than 10 percent of a business's R&D claim can be for overseas expenditure, provided less than half of the R&D expenditure for a project occurs overseas.

A small proportion of respondents submitted that the 10 percent threshold would limit what they would otherwise consider eligible expenditure.

Proposed design

We consider that the 10 per cent overseas expenditure threshold appropriately balances the policy intent with commercial reality of businesses operating across borders. It is more advantageous than the Growth Grant which denies all overseas expenditure. Internationally, there is no clear consensus on the ideal threshold to apply to the eligibility of overseas R&D expenditure and we see this as an expenditure risk area.

The rule as proposed in the discussion document may be overly complex to apply. We propose retaining the requirement that no more than 10 per cent of a R&D claim can be for overseas expenditure but removing the requirement for 50 per cent of the total cost of the project to be tied to New Zealand. Overseas expenditure will need to be defined in the legislation. Imported materials would be considered domestic expenditure but salaries of non-residents working in New Zealand would be considered overseas expenditure.

Apportionment rule for dual purpose expenditure

Discussion document position and feedback

The discussion document proposed a dual purpose activity exclusion, where an activity carried out for both a R&D purpose and a non-R&D purpose should not qualify as R&D.

Most submissions said the dual purpose exclusion could prevent any of their R&D activities from qualifying for the R&D tax incentive.

Proposed design

We consider it helpful to distinguish between R&D that occurs as a discrete activity and R&D that is integral to a commercial process, such as R&D performed while a factory is producing its standard output. In the first instance, we consider a firm should be able to use apportionment rules to allocate a reasonable portion of its overhead and shared costs to its eligible cost of R&D. In the latter instance, we consider a stricter additionality principle is more appropriate. This would mean the firm could only claim as R&D expenditure the additional costs associated with undertaking the R&D.

The practicality of the proposed apportionment and additionality tests are still being tested with stakeholders. We seek Cabinet's approval to delegate finalise decisions on the dual purpose expenditure apportionment rule to Ministers.

Activity exclusions

Discussion document position and feedback

The discussion document proposed certain activity exclusions. Internationally, most R&D tax incentives routinely exclude certain activities, for example activities where the boundary between experimental development and pre-and post-development activity are blurred.

Businesses were in favour of clear distinctions being made between activities included as support activities and those excluded from core activities.

Proposed design

We recommend having two lists of activity exclusions:

- one which excludes specific activities from core R&D; and
- one which excludes specific activities from both core and supporting R&D.

The list of proposed activity exclusions is similar to that of the 2008 R&D tax credit with some additional exclusions. The exclusion lists are necessary to ensure that only R&D activities critical to the R&D process qualify for the R&D Tax Incentive and are based on the following principles:

- To remove uncertainty over whether the activity could be considered R&D.
- To clarify the boundary between R&D and no-R&D, such as development and post-development activity, or innovative and routine work.
- Prevent the R&D tax incentive scheme incentivising particular activities, such as where there are insufficient economic spillovers.

Annex two provides indicative activity exclusion lists and we seek Cabinet approval to make decisions on the final lists.

Shareholder continuity rules

Discussion document position and feedback

The discussion document suggested that shareholder continuity rules could be imposed on the R&D tax credits.

Proposed design

We consider the same rules as apply to loss continuity should apply to the R&D tax credit. We note that loss continuity may be reviewed by the Tax Working Group. Also, to the extent refundability of credits occurs for firms in loss, the issue of shareholder continuity ceases to be a problem.

Feedstock rule

Discussion document position and feedback

The discussion document proposed only allowing the net cost of feedstock.

The feedstock rule as applied in the 2008 scheme meant that only the net cost of an item *subject to a process or transformation* would receive the tax credit. In other words, a person was allowed a credit to the extent the cost of the input exceeded the value of the output. Officials have analysed 2008 claims and consider the feedstock rule was difficult to enforce and allowed rechacterisation of expenditure.

Proposed design

We propose to strengthen the feedstock rule by extending it to inputs that are used or destroyed in the R&D process, in addition to those that are subject to a process or transformation.

Other design features identified in the consultation and design process

Imputation credits

Officials propose that companies are given an imputation credit equal to their R&D tax credit. The purpose of this is to prevent 'claw back' of the R&D tax credit when the benefit of the credit is distributed to shareholders through a dividend.

Ordering rules

We recommend that R&D tax credits should be applied to a taxpayer's tax liability after non-refundable credits and imputation credits, but before refundable credits. The order reflects the fact that non-refundable credits and imputation credits are more likely to be lost tha R&D tax credits so should be used first. This is necessary as any unused non-refundable credits are extinguished, and imputation credits have a harsher carry forward test than the test proposed for R&D tax credits.

Provisional tax

It is proposed that any R&D tax credits received by a business be taken into consideration when calculating the business's residual income tax. This ensures that firms in profit receive the benefit of the R&D tax credit during the year through reduced provisional tax payments.

Orders In Council

It is also proposed that the legislation allow for Orders in Council to be used in the following situations:

- To amend the lists of excluded and included expenditure. The ability to make changes to the schedules outside of primary legislation is necessary so that problem areas can be amended quickly to maintain fiscal sustainability of the R&D Tax Incentive.
- To enable the use of approved third party software by claimants once this software is available.

Claims process: Filing

We propose that a R&D tax incentive claim may only be made up until a year after the taxpayer's return is required to be filed with Inland Revenue. This is to manage fiscal risk and to ensure we incentivise additional R&D. Claims filed several years after the R&D has been a source of higher expenditure in other jurisdictions. Also, if a claim is filed several years after it is due, it is unlikely the claimant was aware they were doing R&D or that they will be incentivised to do more R&D.

Inland Revenue has made the following administrative decisions:

- In year one, businesses will be required to register their interest in applying for the incentive and to file their claims online through Inland Revenue's e-service (myIR) at the end of the tax year.
- As part of the online claim process firms will be required to submit and upload supporting information that details the R&D activity and expenditure.
- By year three the intention is to only allow R&D returns from approved accounting software packages.

Start date

It is proposed that the R&D tax incentive apply from 2019-2020 tax year. This means early balance date taxpayers (balance dates before 1 April 2019) will be eligible for the R&D tax incentive from as early as October 2018. Most claimants are expected to have standard balance dates and will only be eligible for the R&D tax incentive from 1 April 2019.

Transparency, evaluation and penalties

We recommend the following transparency measures:

- that the names and funding bands of successful claimants of R&D tax incentives be published with a two year lag;
- that Inland Revenue have the ability to share taxpayer-specific information regarding R&D tax incentive claims with MBIE, Treasury, and Callaghan Innovation officials; and
- that claim information be considered for integration into Statistics New Zealand Longitudinal Business Database (LBD) and the National Research Information System (NRIS).

We recommend including a legislative requirement that government commission an evaluation on the R&D tax incentive every five years from the commencement of the scheme.

We recommend that standard penalty provisions in the *Tax Administration Act 1994* apply to R&D tax incentive claims, and that the promoter penalty rules be extended to include R&D advisers paid on a contingency fee basis.

Annex 2: draft activity exclusions under core and support activities

Activity exclusion	Core	Supporting
Research in social sciences, arts, or humanities	Excluded	Included
Quality control or routine testing of processes, services, or goods	Excluded	Included
Routine collection of information	Excluded	Included
Preproduction activities, such as a demonstration of commercial viability, tooling up, and trial runs	Excluded	Included
Testing	Excluded	Included
Supporting, de-bugging, or making minor improvements to existing computer software, using known methods	Excluded	
Routine software and computer maintenance	Excluded	
Converting existing systems to new software platforms	Excluded	Included
Creating products using tools designed for that purpose	Excluded	Included
Prospecting for, exploring for, or drilling for, minerals, petroleum, natural gas, or geothermal energy	Excluded	
Market development, or sales promotion, including consumer surveys	Excluded	
Market research, market testing	Excluded	Included
Making cosmetic or stylistic changes to processes, services, or goods	Excluded	
Commercial, legal, or administrative aspects of patenting, licensing, or other activities	Excluded	
Activities involved in complying with statutory requirements or standards[12]	Excluded	
Management studies, efficiency surveys, or organisational design	Excluded	
Reproduction of a commercial product or process by a physical examination of an existing system or from plans, blueprints, detailed specifications, or publicly available information	Excluded	
Software development undertaken for the only or main purpose of internal administration of standard business procedures (eg, payroll or human resources)	Excluded	
Software development undertaken for the only or main purpose of internal administration of non-standard business procedures (eg, logistics tracking for a freight company)	Included up to a cap of $3m. Amounts over $3m excluded.[13]	

[12] The support activity exclusion relates to existing products only. Complying with statutory requirements for new products may qualify as a support activity.
[13] The $3m cap applied to all internal administration in 2018.

Annex 3: draft list of ineligible expenditure

- Payments of salary or wages to a non-resident[14].
- Payments for services performed by a non-resident[15].
- Expenditure on employee share schemes.
- Expenditure on employee recruitment and relocation.
- Payments of bonuses to employees.
- Expenditure under a financial arrangement.
- A deduction under sections DB 5 to DB 15 (which relate to financing and financial arrangement adjustments).
- Professional fees incurred in determining a person's entitlement or lack of entitlement to a research and development tax credit.
- Expenditure or loss in relation to a right to use intangible property other than software.
- Expenditure or loss in relation to software that is bespoke or customised, or is not widely commercially available.
- Gifts.
- Expenditure or loss in relation to buying, leasing or obtaining the right to use core technology[16].
- Expenditure or loss for plant, machinery, or materials to commercialise R and D activities' results, including pre-production expenditure or loss.
- Expenditure or loss that is a pre-condition to, subject to the terms of, required by, or otherwise related to a grant made by the Crown or a local authority.

[14] Payments of salary or wages to a non-resident may be eligible under overseas R&D expenditure.
[15] Payments for services performed by a non-resident may be eligible under overseas R&D expenditure.
[16] This means a firm will not receive the tax incentive for purchasing another firm's R&D.