From: s 9(2)(a)
To: RD Incentive
Cc: s 9(2)(a)
Subject: Feedback: R&D Tax Credit
Date: Thursday, 31 May 2018 12:44:33 p.m.

I have been asked to submit our feedback around the proposed R&D Tax Credit. Below are our concerns:

1. Our main concern is we will be worse off (financially) under the tax credit scheme. We are assuming it will be administered in a similar way to the Callaghan programme. If there is more consideration around *development* and we can ring fence these costs and claim 100% of those expenses then we have a chance of making a few gains.
2. We are concerned that the proposed tax credit will favour smaller businesses and ensuring the benefits are there for them.
3. Tax credits compared to grants are going to definitely affect cash flow.
4. There is a lack of boldness with the scheme which shows a lack of real understanding how the benefits will come back to the economy. R+D is the core of innovation and will encourage growth. Other countries identify this and Australia offer 40% so we should be at least the same or better. Its a very conservative effort to flatten out the opportunities for businesses and we suggest it could be graded to give the bigger spenders a greater benefit.
5. The administration of the claims at present is very intensive and costly so this needs to be considered. If audits are required they need to deductible and timely with other Financial audit processes.

s 9(2)(a) | **W** www.vynco.co.nz | Facebook

Vynco Industries (N.Z.) Limited | 388-396 Tuam Street, Phillipstown, Christchurch, 8011

From: s 9(2)(a)
To: RD Incentive
Subject: Incentives and Grants for R&D Spending
Date: Thursday, 31 May 2018 12:43:38 p.m.

Dear Madam/Sir,

s 9(2)(a) Inugo Systems Ltd, an Auckland based startup that exports car parking technology primarily to the USA. s 9(2)(b)(ii)

I believe strongly that businesses like Inugo are the future for New Zealand. We have a small but strong technology industry being built around 'hardware software interfaces' - that is technology solutions that involve both a hardware and a software component. These kinds of solutions are hard work, and many technology companies around the world do not embark on these kinds of projects because they are so difficult. Here at Inugo, we combine an 'Intelligent Gate Controller' with our 'Inugo App' to provide ticketless parking. Other NZ parking technology companies include Frog Parking (sensors), ITS/Global (parking meters), NIS (camera based license plate recognition) and SmartParking (sensors).

However, the one thing that ALL these companies have in common is that they lose money in their first 5 years. The business plan of all technology startups is the same - we are going to invest a large sum of money in R&D over a 3 year period, and commercialize to make a profit after that time. An R&D credit regime is pointless for these companies - more than pointless, its an insult. It shows that the people structuring the incentives have no understanding of technology startups and the investment/commercialization cycle of research and development. Simply put, an R&D Tax Credit is a subsidy to big businesses (Fonterra subsidiary LIC Automation, Gallagher, Fisher & Paykel) and the expense of supporting technology startups - which by definition do not have a profit to pay taxes against. The big success stories of recent New Zealand technology companies - Xero, PowerbyProxi, Grinding Gears Games, Pushpay and many other smaller success stories may simply not happen.

Secondly, we need to ensure that any system allows for investment in software and hardware technology. These are not strictly 'science'. R&D should be broad enough to include the development of any technology with the intent of commercialization. This excludes purely internal IT spend but allows for a broad brush over investments in technology made with the intention of selling a product and adding to the overall wealth of New Zealand.

The Callaghan process was not perfect. The criteria for approving growth grants meant that many of the large established companies (Fonterra and Gallagher for instance) received maximum grants of $5m, while smaller tech concerns had difficult qualifying. However, a direct or contestable grants system will provide early-stage companies with needed cash to keep developers employed early in a company's lifecycle when the cash is needed most.

Please do not implement this R&D Tax Credit policy, unless it is twinned with policies that directly support startups. Do not give all the benefits to the large and already rich and

profitable corps like Fonterra.

My suggestion is direct wage subsidy for technology roles. s 9(2)(b)(ii) - a direct grant that covers up to 40% of those salaries would achieve the mission of increasing R&D investment simply because I can hire more people to do more work, which will get us to our goal of profitability faster.

Kind regards,
s 9(2)(a)

--

s 9(2)(a)

a: Level 2, 6 Viaduct Harbour Ave, Auckland, NZ
s 9(2)(a)
w: www.inugo.com s 9(2)(a)

From:	s 9(2)(a)
To:	RD Incentive
Cc:	s 9(2)(a)
Subject:	RDincentive Input from Buckley Systems Ltd.
Date:	Thursday, 31 May 2018 12:38:25 p.m.

Dear R&D Tax Incentive Team:

We at Buckley Systems are encouraged by the proposed new RD Tax Credit incentive, and we welcome the opportunity to provide our input. Please see our key points below:

Q2 How well does this definition apply to business R&D carried out in New Zealand?
The definition is quite good. However, clarification is required in two areas: (i) it should be made clear whether the resolution of scientific or technological uncertainty is to be attained relative to what humankind has already achieved or knows on a global level, or relative to what the organization has achieved or knows. We recommend that the scientific or technological uncertainty be judged relative to the level of technical and scientific know-how the organization (which is submitting a claim for an R&D tax credit) has prior to undertaking the R&D. For example, a university in Russia may have developed an ion source technology with certain advanced specifications, however, if an NZ firm wishes to develop such an ion source but does not have the know-how to do so in-house, then it will have to resolve scientific and technological uncertainty as it undertakes the R&D to create the new device, and may fail. Therefore the NZ firm in this example should be eligible to submit a claim for the R&D tax credit even though the technology exists somewhere else in the world.

Q10 What are the advantages and/or disadvantages of limiting eligible expenditure to R&D labour cost?
This would be a big disadvantage to firms undertaking R&D to develop products with large materials/hardware costs. In the development of a new product there could be, for example, a half-dozen expensive proto-types that will be ultimately discarded after testing/failure. It will discourage the incentive for firms of this nature to undertake R&D if these costs are not counted as eligible R&D expenditures.

Q11 What are the advantages and/or disadvantages of setting overhead costs as a percentage of R&D labour costs?
We prefer an either/or approach in that firms can choose whether they use the overhead cost as a percentage of R&D labour, or (for firms with capital intensive R&D with heavy proto-typing materials and hardware costs) they can provide a details submission describing all costs. We agree that for firms where the majority of R&D expense is labour based, then it will be efficient and convenient for them to utilize the overhead as percentage of R&D costs. However, we strongly recommend that firms also be permitted to submit a detailed R&D claim where all R&D labour, and overheads including eligible capital expenditures, proto-type expenses, and R&D scrapping expenses can be claimed.

For existing firms with a strong track record for undertaking and appropriately tracking/claiming R&D (eg with Callaghan), we suggest special classification to continue existing internal programmes and processes to make claims on this basis. We understand an audit may be appropriate in this case to confirm validity. This would remove the need to develop new internal systems to adapt to the new RDincentive programme.

Please kindly confirm receipt of our input.

Thank you for your kind consideration.

Sincerely, s 9(2) .

s 9(2)(a)

[redacted] | [redacted] | **T** +64 9 573 2200 | **F** +64 9 573 0000 | buckleysystems.com

From:	Dave Moskovitz
To:	RD Incentive
Subject:	Submission: Research and development Tax Incentive
Date:	Thursday, 31 May 2018 11:34:46 a.m.

Dear Colleagues,

I'm disappointed by the Research and development Tax Incentive under consideration. My main issue is that **it does nothing for startups**. Having worked with a large number of pre-revenue startups, I can tell you that this scheme would not affect their investment in R&D, nor would it encourage anyone to start up a ground-breaking business.

If you would like more information, please do not hesitate to contact me.

Thanks and best regards
Dave

--
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Email: dave@mosk.nz / Skype: dave_moskovitz
Tel NZ +64 27 220 2202 / Tel USA +1 213 537 2202
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Landcorp Farming Limited
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pamunewzealand.com

Submission on Research and Development Tax Incentive May 2018

1. Pāmu background

1.1 Pāmu Farms of New Zealand (Pāmu) is the brand name for Landcorp Farming Limited.

1.2 Pāmu stands for best practice in sustainable and safe farming, and for the unique provenance of New Zealand foods, nutrition products and fibre on global markets. We strive to be a leader in New Zealand agriculture, carefully creating natural products of high quality and helping transform pastoral-based industries.

1.3 Pāmu is highly experienced in large scale farming operations and we will continue to utilise our skills and brand to target premium, niche markets around the world. We are a diversified national agri-business operating primarily in the dairy, dry-stock and forestry sectors.

2. Executive Summary

2.1 This submission addresses some of the questions put forward in the discussion paper issued in April 2018.

2.2 Pāmu believes that adopting a broad and inclusive approach to the Research and Development (R&D) incentive is the best way to ensure that the widest possible range of businesses are encouraged to invest in R&D.

2.3 Pāmu recommends that State Owned Enterprises (and other Crown entities as appropriate) be included within the R&D incentive scheme and that eligible expenditure includes a variety of types relevant to R&D.

1.1 Pāmu would welcome to opportunity to engage with the R&D Working Group on any of the matters addressed in this document.

3. Research and Development at Pāmu

3.1 Over the past ten years Pāmu has spent an average of s 9(2)(b)(ii)

3.4 Creating an R&D incentive for Pāmu and its associated entities would increase the commercial incentive to identify and develop innovative and forward thinking projects. A refundable incentive would help to ensure that more internal Pāmu R&D proposals satisfy the company's investment criteria.

4. Exclusion of State Owned Enterprises (SOEs) - Question 1

4.1 Pāmu believe that SOEs (and related entities including subsidiaries) should not be excluded from the R&D Tax Incentive scheme.

4.2 The State Owned Enterprises Act 1986 sets out the principles governing the operation of such enterprises. The Act states that the principal objective of every SOE shall be to operate as a successful business and be as profitable and efficient as comparable businesses that are not owned by the Crown.

[1] Earnings before interest tax depreciation, amortisation and revaluations

4.3 Excluding SOEs from the scheme would clearly put them at a disadvantage when compared with other tax paying entities. This appears to be inconsistent with the stated intent of the SOE Act. In addition, excluding the subsidiaries (and potentially SOE joint ventures with third parties) is likely to make them less attractive commercial partners in the future should other entities be denied participation in the scheme through their association with an SOE. This may lead to R&D opportunities being lost entirely or transacted with offshore entities in preference to an SOE.

5. R&D Definition – Questions 2 and 3

5.1 Pāmu supports the definition of core activities as those conducted using a "systematic approach" (rather than "scientific methods"). The scientific method is very formulaic and narrow and may exclude activities which have not followed these strict guidelines.

5.2 Sufficient guidance around other key terms in the definition are required including what "improvements" can be considered R&D. If the level of improvement is a question of materiality, guidance around how that would be measured would be needed.

6. Limited Eligible Expenditure to R&D Labour Cost – Question 10

6.1 Pāmu believe that eligible expenditure should not be limited to labour costs.

6.2 This limitation would exclude a significant portion of current R&D expenditure (including payments to external firms, travel and investment in prototype plant and equipment).

For more information please contact:

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Technical Enquiries

s 9(2)(a)

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Web site: www.metals.org.nz

23 May 2018.

Metals New Zealand Submission: FUELLING INNOVATION TO TRANSFORM OUR ECONOMY. A discussion paper on a Research and Development Tax Incentive for New Zealand

Dear Minister Woods and Nash

Metals New Zealand congratulates you and your government's vision to build a better New Zealand, transforming New Zealand to an inclusive economy, a productive economy and a sustainable economy.

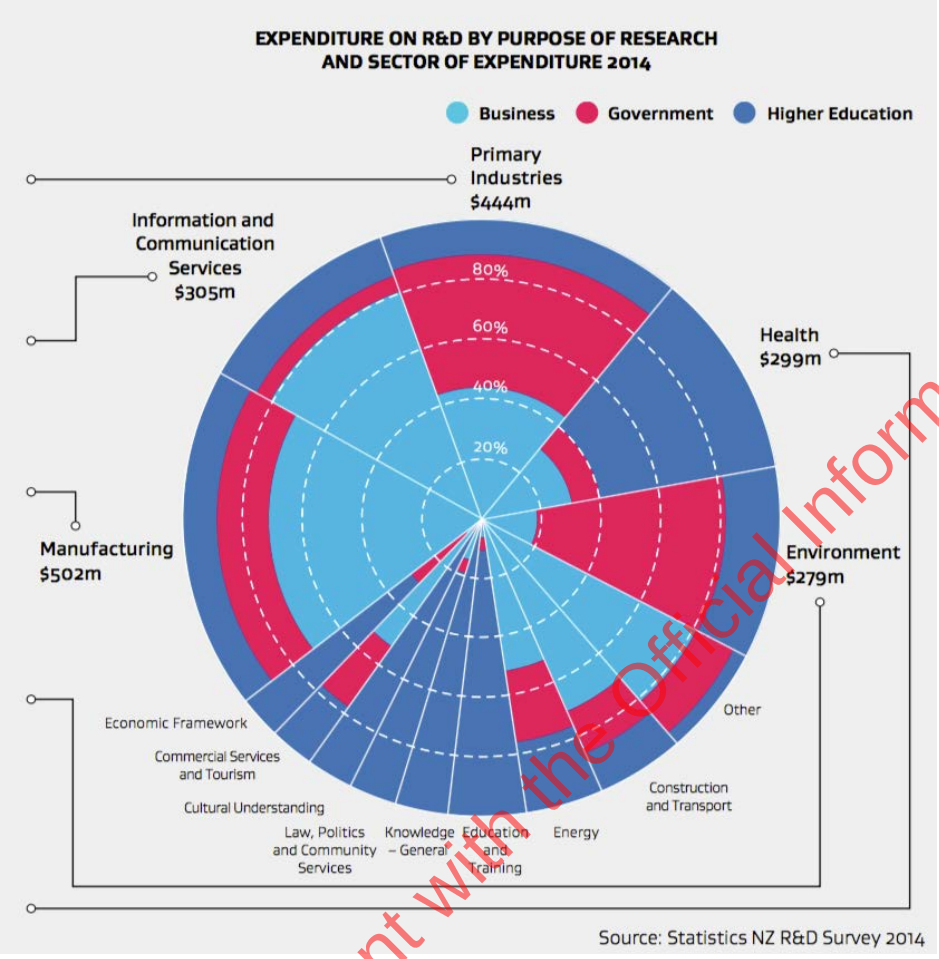
The proposed transformation will not be business as usual. The challenges facing New Zealand, summarised in the document are some of the most significant challenges which our small nation has faced. As you correctly point out the vision can't be achieved with the same old ideas. However much of the proposed incentive is based on the 2008 R&D Tax Credits.

If you as the governing Ministers wish to incentivise New Zealand business to lift its R&D expenditure to 2% over 10 years then we would encourage you to be bolder with the level of tax credit – 20%, to embrace and incentivise small and medium sized businesses on the journey and to focus as much on incentivising the "Development" as the research.

Metals New Zealand encourages the Government to progress beyond the R&D tax incentive to create a more fair and equitable system of incentives and grants in order to incentivise manufacturing and building / construction on a level playing field with the R & D support given to primary industries. Science Investment acknowledges that Government expenditure is responsible for a significant proportion of R&D in the primary sector – as illustrated in the graphic below – (Figure 4) detailing R&D expenditure in 2014. By contrast

the majority of R&D funding for manufacturing and construction /transport sectors is coming from business.

Figure 4: Expenditure on R&D by source of funds



Government funding of R&D in New Zealand is dominated by the primary sector - the very successful Primary Growth Partnerships comprising 19 programmes with a commitment of $727m are estimated to deliver a $6.4 billion to New Zealand's GDP.

In addition to the proposed R&D tax credit, Metals NZ encourages government to adopt a more balanced approach to the funding of R&D, taking successful models from primary sector to build productive capacity in manufacturing and building / construction sectors. A greater focus on development and adoption of current research is needed with the aim of improving productivity and addressing New Zealand's pressing challenges.

Specifically, Metals New Zealand encourages you and the government to be bold, engage and incentivise industry as broadly as possible, rather than focusing on just large business. Specifically, government needs to:

take a more holistic approach to R&D funding

lower the cap to $50k to encourage / reward SME participation.

incentivise the "development" component of R&D

provide significant incentive for development, without which, the real value of the research will not be realised to New Zealand

the challenges are significant and government needs to learn from their own successful research funding models which incentivise / reward sectors for working collaboratively to resolve significant R&D challenges

incentivise investment in the rapidly changing business environment through accelerated depreciation schemes for new plant and equipment.

Thanks for the opportunity to contribute. Answers to your specific questions are provided below.

Yours faithfully

s 9(2)(a)

Metals New Zealand.

Question 1: If SOEs, Crown Research Institutes, District Health Boards, Tertiary Institutions, and their subsidiaries are excluded from the tax incentive, what will the likely impact be on business R&D in New Zealand?

Achieving the Vision and targets will be no easy task. Metals New Zealand would encourage Government to include SOEs, Crown Research Institutes, District Health Boards, Tertiary Institutions, and their subsidiaries in those eligible for the credit.

Question 2: How well does this definition apply to business R&D carried out in New Zealand?

The intention of the scheme is to give incentives for activities which resolve scientic or technological uncertainty. While the definition is adequate to cover the research component of R&D, Metals New Zealand encourages government to look beyond the Frascati definition and take a more holistic perspective to addressing R&D challenges to build industry capacity to working together collaboratively to solve challenging questions, as in the very successful Primary Growth Partnerships.

Question 3: Does this definition exclude R&D that you think should be eligible, please illustrate with examples.

Yes, as previously mentioned the challenges facing New Zealand are significant. Government needs to take a more holistic appraoch to include business development, working together collaboratively across the sector – for example benchmarking across manufacturing and construction sectors. Metals New Zealand suggests that there is much to be learnt from the collaborative initiatives of the Primary Growth Partnerships – successes that could be repeated across manufacturing, building and construction sectors.

Question 4: Does the scientific method requirement exclude valid R&D in some sectors, please illustrate with examples?

Covered above in 3.

Question 5: What would the impact be on business R&D in New Zealand if a materiality test was applied to both the problem the R&D seeks to resolve and the

intended advancement of science or technology?

The language is confusing. Metals New Zealand recommends adopting the more easily understood definition used in Australia for core eligible activities:

> *Core R&D activities are experimental activities:*
>
> *• whose outcome cannot be known or determined in advance on the basis of current knowledge, information or experience, but can only be determined by applying a systematic progression of work that*
>
> *o uses scientific methods, and*
>
> *o proceeds from hypothesis to experiment, observation and evaluation, and leads to logical conclusion*
>
> *• that are conducted for the purpose of generating new knowledge (including about creating new knowledge or improved materials, products, devices, processes or services).*

Question 6: How well does this definition apply to business R&D carried out in New Zealand?

The proposed definition lacks a focus on practical development activities or industrial research solving real world problems. Its use of 'lofty ideals' language implies a very high bar for novelty and advancement, which would probably not be achievable for a range of applied research projects.

Question 7: Are there any reasons why the exclusions should not apply to support as well as core activities? Please describe.

Given the need for government to incentivise both "Research" and "Development", Metals New Zealand suggests that the proposed exclusions are too broad and will significantly limit industries' ability to innovate and develop new products and solutions. The following need to be included as eligible activities:

> *market research, market testing, market development or sales promotion (including consumer surveys)*
>
> *quality control or routine testing of materials, products, devices, processes or services*
>
> *commercial, legal and administrative aspects of patenting, licensing or other activities*
>
> *activities involved in complying with statutory requirements or standards*
>
> *pre-production activities, such as demonstration of commercial viability, tooling-up*

and trial runs

Government needs to to take a more holistic approach to scientific disciplines which are included. For example research into affordable housing solutions need to extend beyond the technical / structural issues to ensure solutions deliver to well being / quality of life. Government needs to include:

Social sciences, arts and humanities

Question 8: Please provide any examples where social science research is/has been a core part of business R&D in New Zealand?

Social science is a critical component of built environment solutions. New Zealand needs holistic solutions to meet immediate affordable housing needs and to deliver future housing and infrastructure to meet challenges of climate change. Over 80% of New Zealand's population live in cities and most of our cities are on the coast and / or on flood plains of rivers. R&D to meet these future challenges and for industry to deliver sustainable housing needs a strong social science component.

Question 9: What is the likely impact on business R&D in New Zealand if dual- purpose activities are ineligible for the R&D Tax Incentive?

Metals New Zealand suggests that where there is a dual purpose activity, the benefits of business as usual are deducted from the total costs before being claimed.

Question 10: What are the advantages and/or disadvantages of limiting eligible expenditure to R&D labour cost?

Limiting eligible expenditure to solely R&-D labour cost will significantly limit the success of the proposed incentive. The discussion document clearly states the enormity of the challenge facing New Zealand to catch up with other OECD countries.

Metals New Zealand encourages Ministers responsible to support investment in innovation and modernising productive capacity of New Zealand's manufacturing industries. An accelerated depreciation regime would recognise the much shorter working life span of modern manufacturing machinery and equipment and allows manufacturers to adopt globally competitive manufacturing methods and practices.

Question 11: What are the advantages and/or disadvantages of setting overhead costs as a percentage of R&D labour costs? What would the appropriate percentage be?

Government's targets are bold, so too must be the incentive to industry. A proportion of direct and indirect costs must be recoverable. Suggest that the proportion of overhead costs is pro rata - research labour as a proportion of total overhead.

Question 15: Is the minimum threshold set at the right level? If 'no', please provide further details.

NO. *New Zealand manufacturing is largely comprised of small or very small firms. Just 3% of firms employ more than 50 workers*[1].

Your discussion document identifies that "*Most BERD is performed by a small number of businesses"* (p24).

Your targets are bold, yet you fail to incentivise the SME sector to invest in R&D.

By focusing on large businesses who already have large R&D spend and seeking to attract large international R&D intensive firms, government, by setting the threshold at $100k, is significantly limiting participation by the SME sector.

Metals New Zealand suggests that government reduces the threshold to $50k and provides larger credits for SMEs to participate.

[1] Beyond Commodities: Manufacturing into the Future. MBIE 2018 p45

From: s 9(2)(a)
To: RD Incentive
Subject: R&D Incentive submission
Date: Thursday, 31 May 2018 8:23:54 a.m.

I wish to submit my view on the upcoming proposals re R&D incentives

Below is a bit of background on our company:

- SLI Systems is an NZX listed company
- We employ ~150 staff, with all Research and Development performed in NZ
- We have turnover >$30m with > 95% coming from customers outside of NZ
- Our core products enables product discovery for customers of on-line retailers, and increased traffic to our customers sites
- s 9(2)(b)(ii) .
- Since we have listed on the NZX we have made losses reflecting our investment in our product and market opportunities

We currently receive a Callaghan Growth Grant, and have for several years. This has enabled us to invest in our Research & Development resource in NZ and allow our business to grow. We believe the proposed R&D tax credits will impact our business unfavourably for the following reasons:

1. **Impact on cashflow -** The current grant system is cash based allowing us to effectively budget our Research & Development investment based on expected quarterly receipts. This has enabled us to make hires on the knowledge of these quarterly cash inflows. Given we have cumulative losses, we will be restricted in our ability to invest in R&D resources due to cash restraints. Further this tax credit is only beneficial provided we maintain shareholder continuity while we are loss making, for which we largely have no control.

2. **Reduction in rate from 20% to 12.5% -** Ignoring the timing (potential permanent) difference talked to above the lower % in funding will impact on the available funds we have to invest in development. Approximately 75% of our eligible R&D is wages based and at our current run rate of grants this funds up to 5 development heads. There has been talk I have seen of the difference in funding being effectively a change from 14.4% to 12.5% - but I don't think this is the case for us given we have tax losses – so we believe this 7.5% reduction is real given the stage of business we are at

3. **Definition** - We have concerns over our current understanding of the definition of eligible R&D under the new plans – particularly the Development side of it. Our understanding is that classic software development processes may be more difficult to include in the proposed definition.

Regards

s 9(2)(a)

s
9(2)
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s 9(2)(a)

SKELLERUP

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30 May 2018

R&D Tax Incentive Team
Ministry of Business, Innovation & Employment
Sent by email: RDincentive@MBIE.govt.nz

Dear Sir/Madam,

Submission on R&D Tax Credit Regime

We describe below the nature of R&D activities undertaken by Skellerup and submit a recommendation in relation to the items or activities that should fall within the definition of eligible expenditure.

The Skellerup Group

Skellerup is a New Zealand based multi-national designer, manufacturer and distributer of polymer and elastomer products and vacuum systems. We are recognised for providing innovative and engineered solutions for customers in dairy rubberware, water and wastewater infrastructure, roofing, plumbing, automotive, mining and a range of other industrial applications.

We have two divisions – Agri and Industrial – and employ a diverse and highly skilled workforce of over 750 people across the globe including 350 in NZ. Over 75% of our revenue is generated from sales into international markets and over 50% of our profit or earnings are captured in NZ. Our ethos is to develop strong and deep relationships with key partners, in particular original equipment manufacturers (OEMs) and major distributors.

R&D at Skellerup

Our OEM customers see us as a key part of their R&D team and our branded products carry a strong and reliable reputation. We are focused on growing revenue and earnings by continuing to expand into new growth markets through leveraging our innovative and world leading polymer expertise with the development of leading OEM and branded products.

The majority of our R&D activities are undertaken in NZ via three subsidiary entities – Skellerup Industries Limited (SIL), Skellerup Rubber Services Limited (SRS) and Ultralon Foam International Limited (UFI).

R&D Activities for Direct Customers

The R&D activities undertaken by SIL are and UFI are on their own behalf. SIL and UFI incur R&D costs and retain ownership of the product design and tooling created and earning a return from the sale of any successful products to their customer base. Based on the information provided in relation to the proposed Regime it appears the R&D costs incurred will fall within the definition of eligible expenditure.

R&D Activities for Related Companies

A significant portion of the R&D activities undertaken by SRS are undertaken for related overseas group companies (all wholly owned by Skellerup holdings Limited, the parent company) operating in international markets. Our technical sales people in these markets identify opportunities with OEM

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customers. The R&D team in NZ develop technologies and capability that enables them to design products and associated tooling and deliver to the related company in commercial production ready state. These services are delivered to the related companies on a cost-plus basis to generate a return for SRS (under arms' length principles as required by New Zealand's transfer pricing rules). The manufacturing of the products designed is then either undertaken by SRS and priced on an arm's length basis or undertaken by a contract manufacturing partner under the direction of the related company.

It is not clear to us whether the R&D costs incurred will be eligible under the proposed Regime, in particular under the following issues:

- Whether SRS will be eligible owing to whether it bears the financial risk (Discussion Document page 14)
- Whether the commercial nature of this R&D would fail the proposed new "dual purpose activities" excluded activities (Discussion Document, question 7)
- Whether SRS would be excluded by having a reasonable expectation of receiving consideration (Discussion Document, question 12)

We submit that the R&D activities for related companies that are reimbursed on a cost-plus basis should be included in the definition of eligible expenditure within the proposed R&D Tax Credit Regime. We note that all R&D undertaken by the Skellerup Group is done so for a dual purpose of commercial gain and is always customer focused. This R&D is undertaken both in Skellerup's R&D laboratory and pilot plants, and also in the factory itself (in terms of R&D relating to process or product innovations and improvements). This R&D necessitates experimental trials, often on the manufacturing lines themselves to determine whether the R&D has been successful and the technical uncertainty has been resolved. Skellerup accordingly does not agree to the proposal in question 7 to extend the excluded activities to supporting activities as well as the core activities (and in particular in relation to dual purpose activities, and pre-production activities such as demonstration of commercial viability, tooling up and trial runs).

Finally, Skellerup does not support the transparency proposal to publish the R&D tax credit recipients including their quantum of claim. Skellerup is in a highly competitive industry sector against large foreign multi-national competitors and considers that this information should be commercially confidential as it could potentially be used by competitors to Skellerup's disadvantage in customer bids and negotiations.

The activity described results in the following positive and profitable outcomes for NZ:

1. Employment and development of highly skilled design staff in NZ.
2. Investment in associated research and production equipment and employment of associated operators in NZ.
3. Profitable revenue in NZ from the provision of services priced on a cost-plus basis.
4. Profitable revenue in NZ from the manufacture and sale of products priced on an arm's length basis.

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Inclusion within the definition of eligible expenditure will provide an incentive for Skellerup to expand the nature of these activities in NZ.

Yours sincerely

s 9(2)(a)

AMS
Simplifying Complexity

R&D Tax incentive team
Ministry of Business Innovation and Employment
PO Box 1473
Wellington 6140

30 May 2018

Research and Development Tax Incentives

Advanced Management Systems Ltd (AMS) is a privately owned, New Zealand software solutions and services company that has been in business for more than 30 years. We are committed to developing new software in New Zealand and have invested heavily in this area for a number of years with the support of Callaghan Innovation. We have summarised our view below and in the Appendix addressed the specific questions from the paper where we have a view.

Preamble

Over the last 50 years New Zealand has fallen behind the rest of the world in terms of its GDP Per capita and there have been numerous studies that show that we are a lower waged and lower skilled economy and have moved backwards compared to other developed countries that have invested more heavily in R&D. As a nation, our R&D expenditure in relation to its GDP is significantly lower than the OECD average; and as an economy we have a heavy reliance on primary industry. Denmark is a good comparator as it has been an agricultural economy based on pork but has consistently spent over twice as much as New Zealand on R&D which has allowed it to diversify into many sectors and its GDP per capita is 30% higher than New Zealand's today. Our nearest neighbour Australia enjoys a similar surplus over New Zealand. Your chart on P7 reveals Israel is well ahead of other countries in its R&D ratio – as a fellow D5 member, what can be learned from its achievements? We believe we should aspire to invest more than the OECD average on R&D and be in the upper quartile if we are to have a sustainable economy for the twenty-first century.

In short, we support incentives that will increase the R&D expenditure in New Zealand as we believe that in the longer-term this will benefit the New Zealand economy. We believe the software industry is the standout exemplar in terms of R&D investment resulting in an optimal sustainable business model that also helps NZ become a higher waged and higher skilled economy with weightless exports.

However, we believe that the level of the incentive needs to be higher if there is going to be a significant change in the behaviour of companies in New Zealand. At best, the 20% Growth Grant (GG) can provide an after-tax benefit of up to 20% (when profit is less than the value of the GG payments); at worst, it provides a similar economic outcome to the proposed tax credit of 12.5% when taking into account the costs of the recipient-funded Callaghan review/audit. There is however a very significant cash flow difference between a GG that is received quarterly and a tax credit which will not be enjoyed for at least a year: not only that, but loss-making companies won't enjoy a cash flow benefit for longer, although we note that some more work needs to be done in this area.

The proposal

We support a scheme that is easy to administer and easily understood.

Our reading of the proposal is that the definition of R&D is similar to the current IR position and we look forward to the software-specific definitions you have proposed, as IR provided for their R&D tax refunds. We would also appreciate some clarity of what qualifies from a software perspective [Q2]: there is some language used such as "scientific method" [Q4] which if narrowly interpreted might preclude software R&D being eligible for a tax credit.

As a software business we believe that non-labour costs should be included in the incentive [Q10]. The definitions of what overheads can and what can't be included are straightforward in the current Callaghan GG environment and we would support the continuation of those rules.

Commercial consideration should not affect eligibility for the tax incentive for software R&D, unless it is an unconditional payment regardless of the success of the project, and in that case the unconditional payment should be netted off the amount eligible for R&D, rather than disqualifying the whole project. We believe that if the commercial consideration is contingent on successful completion of the R&D project then this should not reduce the credit as we continue to bear the risks around failure of the project.

We look forward with interest to the work on defining software R&D [Q13]. We believe that clarity with examples of what is eligible and what is not eligible is important, and that the definition should be sufficiently broad to incentivise people to continue R&D projects.

Conclusion

From our perspective the risks that need to be managed [Q19] are:

- There needs to be a clear R&D definition for the software sector; otherwise there is a risk that software businesses will conduct less R&D. Compared to the rest of the economy the level of R&D investment in software is much higher than most sectors and continued investment needs to be encouraged. Certainty is paramount; businesses should not be expected to undertake more R&D if there's any risk their claim will be rejected "after the money has been spent"; perhaps a pre-registration arrangement could be available for businesses seeking that certainty.
- There will be a significant negative impact on business cashflows when Callaghan is replaced. Cashflow is a major consideration for most SMEs. Using a pre-registration process if necessary, could businesses be permitted to deduct 1/3rd of their anticipated eligible R&D expenditure from each Provisional tax payment?
- The encouragement of foreign rather than local firms could increase the GDP gap between those countries and New Zealand; with a result that our economy remains excessively reliant on primary industries and tourism. Care also needs to be taken that foreign firms encouraged here complement and don't compete with/destroy local firms.
- The quantum (12.5% credit) and timing of the cash flows as currently drafted does not, in our view, act as an incentive for more R&D compared to the current Callaghan grant system. Most commentators agree. In fact, the deferred cash flows could act as a disincentive for early stage.

But we do welcome a more easily understood scheme with an appropriate level of incentive to promote R&D expenditure in software and other industries.

Yours sincerely

Noel Reid
Founding Director

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Appendix

Question 1: If SOEs, Crown Research Institutes, District Health Boards, Tertiary Institutions, and their subsidiaries are excluded from the tax incentive, what the likely impact be on business R&D in New Zealand?

We believe this would have a positive impact if this means more funding is available for business R&D as we believe business R&D to be more effective than public sector R&D and a greater proportion of funds should be allocated accordingly.

Question 2: How well does this definition apply to business R&D carried out in New Zealand?

We believe more clarity is required from the perspective of software companies with examples.

Question 3: Does this definition exclude R&D that you think should be eligible, please illustrate with examples.

We believe more clarity is required from the perspective of software companies with examples.

Question 4: Does the scientific method requirement exclude valid R&D in some sectors, please illustrate with an example

We believe it will create serious uncertainty in the software sector, so again more clarity is required from the perspective of software companies with examples.

Question 5: What would the impact be on business R&D in New Zealand if a materiality tests was applied to both the problem the R&D seeks to resolve and the intended advancement of science or technology?

We believe that this would be hard to assess.

Question 6: How well does this definition apply to business R&D carried out in New Zealand?

We agree with both the uncertainty aspects and the inclusion of support activities.

Question 7: Are there any reasons why the exclusions should not apply to support as well as core activities? Please describe

No comment.

Question 8: Please provide any examples where social science research is / has been a core part of business R&D in New Zealand?

No comment.

Question 9: What is the likely impact on business R&D in New Zealand if dual purpose activities are ineligible for the R&D Tax incentive?

Negative. Callaghan has demonstrated that with proper time recording, it's a simple matter to separate business as usual from R&D, and we believe if people had to be 100% dedicated to R&D for those projects to be eligible that it would significantly curtail R&D projects in the software sector.

Question 10: What are the advantages and / or disadvantages of limiting eligible expenditure to R&D labour cost?

Non-labour costs should definitely be included in the incentive, as they're an unavoidable and essential part of employing people in the software sector. The definitions of what overheads can and what can't be included are straightforward in the current Callaghan and IR R&D Tax refund schemes.

Question 11: What are the advantages and / or disadvantages of setting overhead costs as a percentage of R&D labour costs? What would an appropriate percentage be?

See 10 above.

Question 12: Are there any reasons why expenditure related to R&D activities for which commercial consideration is received should be eligible for a tax incentive? Please describe

Yes; commercial consideration should not affect eligibility for the tax incentive for software R&D unless it is an unconditional payment regardless of the success of the project.

Note that the costs of successful software R&D are almost invariably recouped in the longer-term via licence fees from a large number of customers. Where a software business is able to get some commitment(s) to pay licence fees only on completion of a successful R&D project we believe that the commercial consideration should continue to qualify: we don't believe the timing of the license fees (i.e. before or after the project is successfully concluded) should impact the eligibility for the tax incentive, rather it should be whether the payment is contingent on a successful outcome. This is because such a commitment hasn't de-risked the software R&D at all, and trying to obtain revenue as quickly as possible is a sign of a healthy business; not a problematic one.

Question 13: What variations or extensions to the definition of core activities are required to ensure it adequately captures R&D software activities?

We look forward with interest to the work on defining software R&D. We believe that clarity with examples of what is eligible and what is not eligible is important, and that the definition should be sufficiently broad to incentivise people to continue R&D projects.

Question 14: Are there reasons why continuity rules should not apply to tax credits?

Continuity rules should not be imposed for the reasons you mention; that could possibly help retain the ownership of innovative IT businesses within NZ, along with the IP they have created.

Question 15: Is the minimum threshold set at the right level? If 'no', please provide further details.

Yes, we are happy with this

Question 16: How important is a cap or a mechanism to go beyond the cap? Please provide further details

Yes, we support a mechanism to go beyond the cap, provided the scheme can be administered to protect against exploitation of loopholes

Question 17: What features of a Ministerial discretion or pre-registration would make them most effective

No comment

Question 18: What are your views on the proposed mechanisms to promote transparency and enhance evaluation?

We advocate for maximum transparency and support regular evaluation

Question 19: Are there any other risks that need to be managed? Please describe

From our perspective the risks that need to be managed are:

- *There needs to be a clear R&D definition for the software sector, otherwise there is a risk that they will conduct less R&D. Compared to the rest of the economy the level of R&D investment in software is much higher than most sectors and continued investment needs to be encouraged. Certainty is paramount; businesses should not be expected to undertake more R&D if there's any risk their claim will be rejected "after the money has been spent"; perhaps a pre-registration arrangement could be available for businesses seeking that certainty.*
- *There will be a significant negative impact on business cashflows when Callaghan is replaced. Cashflow is a major consideration for most businesses. Using a pre-registration process if necessary, could businesses be permitted to deduct 1/3rd of their anticipated eligible R&D expenditure from each Provisional tax payment?*
- *The encouragement of foreign rather than local firms could increase the GDP gap between those countries and New Zealand; with a result that our economy remains excessive reliant on primary industries and tourism. Care also needs to be taken that foreign firms encouraged here complement and don't compete with/destroy local firms.*
- *The quantum (12.5% credit) and timing of the cash flows as currently drafted does not, in our view, act as an incentive for more R&D compared to the current Callaghan grant system. Most commentators agree. In fact, the deferred cash flows could act as a disincentive for early stage businesses*

But we welcome a more easily understood scheme with an appropriate level of incentive to promote R&D expenditure in software and other industries.

Question 20: What are the risks with making external advisors liable in this way?

We think the focus should be on eliminating the need for external advisors; it should be the responsibility of those administrating the R&D Tax Credit scheme to ensure it is simple enough for all businesses to deal with internally, along with their accounting advisors.

Question 21: What is the right level of information required to support a claim?

Enough to ensure the integrity of the system without unnecessary administration; for the software sector, we think that the level of information required for Callaghan GGs today remains appropriate

Question 22: What opportunities are there for customer to submit R&D Tax Incentive claims via third party software?

We don't know whether third party software would have the capability to record what Callaghan currently require, but we do support simplification of filing, along with systems that improve the integrity.

Question 23: What integrity measures do you think Inland Revenue should use?

Similar to those used with the R&D Tax Refunds, supported by random review/audits using independent accounting firms, as Callaghan do. These could be random or based on concerns about integrity; where the business was found to be completely satisfactory, IR should pay the fee; in other cases (except where the mistakes were clearly innocent and not intentional) the business should be obliged to pay the fee, and there should be a penalty (at the very least denial of the tax credit) in clear instances of "gaming the system" or submitting fallacious claims.

#26

COMPLETE

Collector:	Web Link 1 (Web Link)
Started:	Thursday, May 31, 2018 7:58:38 PM
Last Modified:	Thursday, May 31, 2018 8:18:38 PM
Time Spent:	00:20:00
IP Address:	s 9(2)(a)

Page 2

Q1 (i) For individuals — **Respondent skipped this question**

Q2 (ii) For organisations

Name of organisation	**Advanced Management Systems Ltd**
Contact person name	**Noel Reid**
Position	**director**

Q3 (iii) How long has your business been operating in New Zealand? — **10 years or more**

Q4 (iv) How many employees (FTEs) are employed by your business in New Zealand? Please include full-time and part-time employees but do not include contractors or the business owners. — **20 – 49**

Q5 (v) What industry sector does your business operate in? — **Other services**

Q6 (vi) Has your organisation ever received a R&D project or R&D growth grant?

R&D Growth Grant	**2015**

Q7 (vii) Has your organisation ever received any other R&D government support? — **Yes,**
If yes, please specify names of grant(s)/support.:
R&D tax refund

Q8 How likely is it that your organisation will be in a position to use the full amount of an R&D tax credit in the 2019/20 tax year? (Note, to use the full amount of a R&D tax credit in a given year, your business' tax liability needs to be at least as large of the R&D tax credit you are entitled to claim.) — **Very likely**

Q9 How much R&D does your organisation expect to carry out in the coming year? **$1M-$5M**

Page 3: Responses to questions in the consultation document

Q10 Q1 What impact will the proposed transition arrangements have on your business? For example, your cash-flow or internal reporting mechanisms? Please describe.

Adverse impact:
1. Without a R&D definition for software we face uncertainty of eligibility for current and planned R&D.
2. Some projects run for several years; how can we start one of those at the moment when we don't know what the position will be in 10 month's time?
3. Cashflow will be negatively impacted. From getting 90% of 20% (after the retention), we will now need to wait about a year to gain a benefit in the form of a lower tax payment.
4. The value will be less, even after allowing for the cost of the Callaghan review/audit. The after-tax value of the GG payments range from 20% down to 14.4%, depending on how much of the taxable profit is attributable to GG payments.

Q11 Q2 What do you believe to be a necessary transitional period? Please explain the reasons why this is necessary for your business?

3-5 years would provide the necessary level of business certainty, given there's currently no definition for SW and the length/timeline of some projects.

Q12 Q3 What impact will the proposed transition arrangements have on your R&D programme over the next few years?

The degree of uncertainty will force us to consider not undertaking longer timeline R&D projects.

Q13 Q4 Please provide any other comments about the proposed transition arrangements.

1. We don't understand why the Discussion Document was released without even a draft definition for SW R&D; why did you consider it necessary to create this level of uncertainty?
2. It's really disappointing that, upfront when collecting info about our business, you don't have a business category for SW - not even IT! That's even after your Discussion Doc recognises the growth and significance of the SW sector...

Q14 Q5 For businesses in tax loss, what impact will the proposed temporary grant have on your business during the transition process? Please describe. **Respondent skipped this question**

O202 FACEWEAR

31 May 2018

R&D Tax Incentive Team

Ministry of Business, Innovation & Employment

PO Box 1473

Wellington 6140

Dear Sir/Madam,

Re: R&D Tax Incentive Submission

Thank you for the opportunity to provide a response to the discussion paper "Fueling Innovation to Transform Our Economy". We believe the issues that the discussion paper seeks to address are vital for an innovation, inclusive, sustainable, and productive economy. As the reader will be aware, for the more innovative, high growth companies such as O2O2 typically feature high weighted average costs of capital and as such any changes to tax incentives and/or grants have a disproportionate impact on growth when compared to larger established companies.

This submission is largely in relation to the proposed R&D Tax Incentive being non-refundable, and the proposal to end the Growth Grant Scheme.

Background

The sector which O2O2 operates in is the $13bn respiratory protection market which is growing at double digit rates annually driven by a multitude of factors from air pollution in China, to airborne diseases and improving workplace health and safety standards. Over 7 million die from environmental air pollution every year alone; while the current solution is fraught with fundamental problems. O2O2 have a stated ambition to enable the millions who are dependent on masks and respirators daily the ability to live and work without fear of air pollution. Through a deep R&D program from Auckland, New Zealand O2O2 has developed a solution which is up to 50x better than current solutions on the market and in international testing 87% of consumers confirmed their purchase intention.

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While O2O2 remains a startup and pre-revenue we have developed a strong list of globally partners to join us on this R&D journey. These parties include:

1. **BMW:** Who have invested into O2O2 and have provided design input.
2. **US Military:** Have provided engineering resource through PACFLT.
3. **Auckland University:** Have provided ongoing support and we are expected to be an ongoing partner with multiple R&D programs being developed.
4. **AUT:** Have provided technical validation of the product while O2O2 have funded one of their graduate student's academic activities.
5. **SOSV:** The worlds most active venture capital investor, who invested into O2O2.
6. **A Global Consumer Brand:** Who we are unable to name, but who are undertaking consumer testing across China in conjunction with O2O2.
7. **Revolution Fibres:** The award-winning NZ nanofiber development company.
8. **KHVatec:** While probably unknown to the reader, KHVatec are a $1bn+ Korean engineering company who are a key collaborator with Samsung. KHVatec have invested directly into O2O2 and provide engineering and prototyping resource.

At present, over 80% of our activities could be considered R&D. The outcomes of this R&D to date should be measured against the age of the company (1.5yrs old) and are therefore modest when considered against established companies but has included employment growth, educational support, global investment into a New Zealand company and set the foundation for a company which has a billion-dollar potential. Importantly however these benefits are also accruing to the wider ecosystem within which we operate.

As a company with global ambitions there is already strong pressure to relocate closer to our revenue markets, closer to suppliers, R&D partners and to a market with lower costs of capital. As such, we look upon the proposal through the lens of a) how will these proposals impact our cost of capital and b) how does this proposal engender an R&D ecosystem so strong that working from New Zealand with other New Zealand companies is the only logical choice.

Refundability of R&D Tax Credits

The R&D Tax Incentive which is to be introduced from 1 April 2019 is proposed to be "non-refundable" and therefore the support it will provide to start-up and early stage businesses which are usually in a tax loss position is negligible. These businesses will only be able to carry forward their tax credit to a future tax year. This proposal is inconsistent which many global R&D tax credits (for example, the policies in place in. Australia, UK and

Canada) which are refundable to early stage companies in a tax loss position. Furthermore for a high growth company, these accrued benefits are most likely to be realized and revisited when the company is under it's greatest pressure to sell out to overseas interests and as such will be considered an cash injection into the transaction process ie further facilitating the exit of NZ high potential companies.

As the Government undertakes further assessment of this issue we strongly urge it to consider a "refundability" mechanism and that these refunds are paid on a quarterly basis. Start-up companies need cash in order to fund their ongoing research and development activities and to accelerate the growth of the business. While there is uncertainty around the refundability of the R&D Tax Incentive it will be more difficult for early stage businesses to raise capital from investors.

We understand the current research and development loss tax credit cash-out policy will not be affected by this proposed R&D Tax Incentive scheme. As such, if the proposed scheme does not incorporate a refundability element, we strongly support the retention of the current treatment of tax losses.

Growth Grant Scheme

Early stage companies working in the de technology space typically take years before they generate revenue or make a profit due to their focus on difficult problems and highly R&D intensive activities. While these investment activities are often poorly (expensively) priced by private investors the world over, this particularly acute in New Zealand with it's shallower pools of capital. As a result their growth in the early stages is of often self-funded, from costly private investment and Callaghan Innovation's R&D Grants. These companies rely on the Growth Grant in order to bridge the gap between being small enough to benefit from Getting Started Grants or Project Grants and being in a position where they are generating revenue to fund further research and development themselves.

By ending the Growth Grant Scheme, funding for R&D and IP heavy companies to get to the next stage in their development is severely limited. This is particularly crucial because their time to profit is significantly longer than that of software or other digital tech companies. We strongly urge Government to reconsider the removal of the Growth Grant Scheme.

Eligible Expenditure

Two possible approaches are proposed for determining eligible expenditure. It is the belief of O2O2 that eligible expenditure should not be limited to

solely the direct R&D labour costs. For deep technology companies, the materials incorporated into prototype products or pilot plants, as well as the items consumed in the R&D process, are a significant expenditure and should be considered "eligible expenditure" under this R&D Tax Incentive scheme.

Minimum Expenditure

The minimum eligible expenditure threshold is proposed to be set at $100,000 in order for a company to qualify for the R&D Tax Incentive. While this minimum threshold does not apply to R&D activities outsourced to an Approved Research Provider, O2O2 believes this threshold is too high for start-up companies. Many start-up businesses run very light for the first year or so, and often they don't pay the founders. As such, the true "cost" to the business and shareholders to reach $100,000 of overheads and other direct costs would be much higher.

We recommend the minimum expenditure threshold is reduced to $50,000 in order to allow early stage companies to access the R&D Tax Incentive at a time when it is material to their ongoing activities.

Yours sincerely,

[redacted]

R&D Tax Incentive Team
Ministry of Business, Innovation & Employment
PO Box 1473
Wellington 6140

25 May 2018

Re: Submission on Proposed Research & Development Tax Incentive Scheme

Thank you for the opportunity to provide input on the Government's proposed Research & Development tax incentive scheme. Hutt City Council and the Hutt Valley Chamber of Commerce asked science, technology, engineering, and high-tech manufacturing (STEMM) businesses in Lower Hutt to provide their opinions on the scheme, and we summarise the 28 responses received here.

Just under half (44%) of the STEMM businesses that responded to our survey supported the new tax incentive scheme. An additional 37% said "it depends" on factors such as knowing more details of the scheme, how it is administered, and how difficult it is to apply for the incentive.

Almost half (46%) of the respondents also said that the scheme would help their businesses, while 11% said they thought it would hurt their businesses. The two major objections to the scheme were:

1) **The $100,000 threshold is too high.** Many respondents emphasised that the many SMEs in New Zealand will not benefit from the scheme. (According to the latest data from Statistics NZ, small enterprises of up to 20 employees account for 97% of all NZ enterprises.) The following quote exemplifies this view:

   Given that 90% of New Zealand companies employ less than 20 people and 98% employ less than 100, maybe the $100,000 threshold is a bit high. Why can't the tax break be based on a proposal, for example, so that the potential benefits can be judged on their merits rather than some random amount?

2) **Start-ups and businesses that are not profitable will not benefit from the scheme**. Comments such as the one below suggested that there needs to be mechanisms to support start-up R&D that might lead to further product development and market validation:

   Many businesses undertaking development work are still not profitable. A tax credit is only of benefit to a profitable business. Their need at early development stage is for cash, which this proposal will not generate for them. I support it only if the present programs of cash grants for approved R&D are continued, or better still, increased.

Several participants also expressed uncertainty at how the scheme would be applied to offshore entities. One respondent felt the scheme should only benefit foreign-owned entities if the R&D "benefits NZ", while in contrast another commented:

We have had no ability to claim back credits or R&D incentives as we are 100% offshore owned, despite all portfolio being NZ registered companies and being 100% tax residents. The current regime clearly does not provide R&D incentives for even NZ-loyal FDI as anyone on our parent company Board will attest. This needs to change under the proposed legislation.

One additional comment is that while the tax incentive scheme addresses research, it does not appear to provide appropriate recognition of development.

Overall, we think STEMM businesses in Lower Hutt would support the scheme if a lower threshold for spending was adopted and as long as alternative funding is available to start-up companies. You can view the full results of our survey here: https://docs.google.com/forms/d/1ca9JppoQ1mclHgS5FayuY8V3Vy8LkVTCezEigryPN6E/edit?usp=sharing.

Thank you again for the opportunity to give feedback on this proposal, and please do not hesitate to contact us if we can provide further assistance.

Kind Regards,

s 9(2)(a)

Hutt City Council

s 9(2)(a)

Hutt Valley Chamber of Commerce and Industry Inc.

From:	s 9(2)(a)
To:	RD Incentive
Subject:	Growth Grants changes
Date:	Wednesday, 30 May 2018 4:08:06 p.m.
Attachments:	A645C11C-CEE4-4451-ADAA-805799493213[77].png 01875FF9-4E35-4513-B793-5D4908A3F426[77].png

To whom it may concern,

The growth grants are an effective mechanism to support the Research and development investment and therefore the innovation capability of businesses in New Zealand.

For us at Forsite the funding means we can hire more skilled employees, invest more into research and development to drive our innovation faster, which in term accelerates our export earnings.
More skilled well paid employment and export earnings are good outcomes for New Zealand, if this is a typical result from the growth grants mechanism.

For us changing this funding to a tax credit will reduce our capacity to add skilled well paid employees and will reduce both our research and development investment and our innovation capability.
My concern is that this will reduce our ability to drive export earnings.

Both of these changes for businesses like ours will have a negative impact for New Zealand economically.

Other countries such as Singapore, the United Kingdom and Australia understand the economic benefit of assisting their businesses to accelerate their research and development investment and innovation through primarily cash funding mechanisms, such as Australia's 45% tax cash rebate.

The New Zealand governments plan to remove the cash funding and replace this with a non cash tax rebate would seem to be contrary to most other countries approaches. This makes me question whether this is the right mechanism to support the understood need for greater research and development investment.

My concern is this will reduce New Zealand's investment to research and development when we all recognise the need to increase this.

If the mechanism should be changed, change it with a mechanism that provides cash to facilitate greater research and development investment, do not change it to a non cash mechanism that will reduce research and development investment.

Your faithfully,

s 9(2)(a)

FORS!TE

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my LinkedIn profile

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28 May 2018

R&D Tax Incentive Team
Ministry of Business, Innovation & Employment
PO Box 1473
WELLINGTON 6140

RDincentive@MBIE.govt.nz

Dear Sir / Madam

RE: FUELLING INNOVATION TO TRANSFORM OUR ECONOMY: A DISCUSSION PAPER ON A RESEARCH & DEVELOPMENT TAX INCENTIVE FOR NEW ZEALAND

Aderant Legal Holdings (NZ) ULC ("Aderant NZ") is writing to provide comment on the discussion paper *Fuelling Innovation to Transform our Economy: A discussion paper on a Research & Development Tax Incentive for New Zealand* ("the discussion paper").

Aderant NZ welcomes the opportunity to submit on the proposed R&D tax incentive, in particular commenting on the areas of the proposals relevant to our business. We set out some background to our company below, before providing more detailed submission points on the proposals.

About Aderant Legal Holdings

Aderant NZ are a software development company providing specialist software suites for the legal industry. We undertake development activities in our Auckland premises for our global group on a contract basis and have been doing so for over 15 years, recently taking over as the top provider of professional services software to the top 200 law firms in the United States.

We have a strong focus on User Experience optimisation, enterprise system architecture and a wide range of server and client development techniques and technologies. Overall, Aderant has a great track record of working with leading edge technologies and being first to market with new product concepts.

Our position as a leading R&D software developer

Aderant globally is one of the largest dedicated legal solutions providers, and looks to ultimately become the premier supplier of complete software solutions for legal firms.

Aderant NZ employs over 120 R&D staff in New Zealand who work on developing software, with a strong mix of new and experienced personnel. We have a heavy graduate focus, with over 60% of our staff having Aderant as their first employer in the field. The remainder of our staff typically have 15-25 years' experience and lead the positive learning and training environment for graduates starting at Aderant.

Our submission

As a starting point, Aderant NZ would have preferred that the Callaghan Innovation Growth Grants are retained, in contrast to the introduction of an R&D tax credit regime. However, to the extent that Growth Grants are replaced with a tax incentive, then it is important that the

regime is one that motivates as much R&D activity as possible, doing its best to maximise the positives of R&D for the benefit of New Zealand.

To this end, we set out below detailed comments on the proposals, including our views on how the R&D tax regime could evolve in the future, beyond what is iterated in the discussion paper.

1. Grants and Tax incentives

An incentive encourages additional endeavour

1.1 Growth Grants have been pivotal to growing Aderant's R&D activity in New Zealand as this money was received with the understanding that it would be used for R&D expenditure. This, confirmed through the regular nature of the grant, incentivised and encouraged R&D activity, as there was a promissory link between receiving the cash and investing this in R&D.

1.2 Our concern is that, in comparison, the R&D tax credit as currently outlined, is being marketed as an 'incentive', but is in reality a reward for undertaking R&D expenditure. While there is some level of incentivising continuing R&D behaviour, the benefit from the tax credit can be directed towards any purpose – there is no corresponding connection that will incentivise companies to reinvest the benefit from the tax credit in further R&D activity.

1.3 As an example of how Growth Grants have incentivised behaviour, we note that they have enabled and encouraged Aderant to increase our capabilities and the size of the New Zealand R&D contribution by our organisation. Since we started receiving Growth Grants we have:

- Added nearly 40 new engineering staff in Auckland (close to a 50% increase in staff).
- Had our Executive decide that New Zealand should undertake more of the R&D activity Aderant undertakes globally, with the relocation of several major projects to New Zealand.
- Seen a shift in our Executive for the company to include a New Zealand Executive.
- Seen almost all new major products for the company initiated from New Zealand.

We can confidently say that without Growth Grants, this growth and development would not have been as likely, nor incentivised to occur in New Zealand.

1.4 As the recipient of "tax credits" in other R&D locations, we can without question confirm that the New Zealand Grant was the only benefit approach that has had a direct positive influence on our company's R&D planning in recent years. Furthermore, it generated significant interest in the various U.S. investment companies that we have contact with; especially in regard to the encouragement for R&D and associated direct financial benefit possible with establishing N.Z. operations.

Transition from Growth Grants to a tax credit regime

1.5 To the extent there is a transition away from Growth Grants, Aderant NZ would strongly support these continuing through to (at a minimum) 31 March 2020 for any grant recipients in the regime as at 1 April 2019.

1.6 If there is any scope for this period to be extended further than 31 March 2020, Aderant NZ would also be supportive of this. Aderant NZ also submits that any Growth Grant recipients in the regime at 1 April 2019 should have their grants automatically rolled over to the end of the transition period (unless they specifically elect out), so that they are afforded the ability to benefit from the regime while any outstanding issues are considered and dealt with.

1.7 It is vital that the transition process provides users of the regime with some certainty and predictability of funding. Organisations will go from a system where they know how much they are getting and when, to a system where any benefits will only be derived following the end of the year, with the filing and assessment of a tax return. This will inevitably force most into a conservative position which will counteract any R&D benefit targeted by the scheme and potentially result in an actual reduction in R&D (and potential associated loss of the highly paid, highly skilled jobs New Zealand wants to be known for).

1.8 While Aderant has a preference for a grants system, we acknowledge that this may, at this stage, be off the table. With this being the position, the remainder of our submission sets out our views on the tax settings of the proposed R&D tax credit regime.

2. Eligibility Criteria

Control and ownership of R&D

2.1 The proposal requiring that the organisation carrying out the R&D activity own the results of the R&D, have control over the R&D activities and bear the financial risk, immediately excludes a significant percentage of valuable R&D activity currently occurring to the benefit of New Zealand and enhancing New Zealand's recognition and value on the world stage.

2.2 The reality is that parents of multinational organisations are the ones who hold the ultimate control and ownership of R&D expenditure and any resulting intellectual property. This is the standard multinational structure, where New Zealand will contract and charge for the R&D work done on a 'cost plus' basis, with the parent bearing the ultimate financial risk. We refer to this in our submission as "contract R&D".

2.3 Aderant's main concern is that by removing eligibility to the extent that organisations carry out this contract R&D, a large proportion of R&D undertaken in New Zealand will be excluded from the regime. The R&D tax 'incentive' will in fact act as an active disincentive to organisations (including large multinationals) from coming to, or expanding, New Zealand operations to undertake R&D.

2.4 The greatest benefits from R&D activity comes from R&D being physically undertaken in New Zealand, and the implicit gains in personal IP and reputation, not just from the ownership of the R&D (we consider these benefits further below). If New Zealand wants to attract the R&D activities of multinational organisations, then we must ensure that our system is flexible enough to allow for this.

Financial Risk of R&D

2.5 The discussion paper indicates that a taxpayer needs to bear financial risk and there cannot be "commercial consideration" in relation to R&D. Aderant NZ submits that when taxpayers are involved in contract R&D, it should not be necessary to satisfy these criteria. By its nature, contract R&D is undertaken for commercial consideration. In many instances it cannot be said that the R&D business has financial risk if they are in effect reimbursed for all costs with a margin.

2.6 This concern could extend to any employment, especially the very common scenario of contract employment in IT. We believe this aspect needs to be reviewed or clarified in terms of the concern and objective it is trying to meet to confirm it is not excluding recipients inappropriately.

3. The benefits of all R&D activity based in New Zealand are greater than just those where we have ownership or control

3.1 R&D activity that is based in New Zealand has benefits far greater than the ownership of the intellectual property. At the end of the day when R&D activity is undertaken in New Zealand, it is New Zealanders who are gaining skills and knowledge and it is New Zealanders managing the projects. At Aderant we credit the majority of our success to our people – our staff are world leaders in the industry and will take the experience they have gained from working at Aderant with them to other opportunities that may await.

3.2 To take the growth of Aderant's New Zealand R&D centre as an example, our New Zealand development centre has become the undisputed primary location for new product development, driving the bulk of the technology initiatives and innovations Aderant provides. Aderant's know-how and capability is now based in New Zealand, evidenced by New Zealand repeatedly being selected to take over the lead R&D functions from overseas Aderant locations, even lower cost locations such as India and Ukraine. This has resulted in significant growth in the New Zealand operation to cater for the increased number and diversity of projects that ensued.

3.3 This has all ultimately led to more employment opportunities in New Zealand, particularly for young New Zealand graduates hired to meet the demand. We have a close relationship with Massey University, including an annual intern / student project programme which has allowed a number of students to participate in, and contribute to, our projects.

3.4 Over the years we have developed capital inside our company and built IP in our people, which has also resulted in the formation of New Zealand companies spinning off Aderant, providing further employment and learning opportunities.

3.5 New Zealand needs to encourage organisations like Aderant who are helping to create a bigger pool of talent in New Zealand, the likes of which will attract more and more sizeable R&D projects to New Zealand. This will allow more innovative R&D, in, around and beyond those companies enhancing both human and physical capital in New Zealand.

4. What variations or extensions to the definition of core activities are required to ensure it adequately captures R&D software activities? [Question 13 of discussion paper]

4.1 Aderant NZ submits that as much *software* R&D as possible should be included in the tax incentive regime from the outset. There has never been a more crucial time for New Zealand to take a proactive IT stance. With the explosion of computing technology (including AI and other automation enablers), being left behind could side-line a small country extremely rapidly into spectator or irrelevant status. Software development is the biggest area of potential growth for R&D innovation in New Zealand (and also potentially the easiest, given it is not necessarily capital, or natural resource intensive and it is relatively easy for organisations to move countries to undertake software development). New Zealand can be an attractive resource provider, with a stable and still cost effective economy, excellent education and communication reputation and a reasonable time-zone. Not to mention, being a safe and attractive destination for investors.

4.2 Aderant NZ is of the firm belief that software R&D must specifically be included in the R&D tax credit regime. Aderant NZ is concerned that in the previous R&D tax credit regime, a high threshold was applied for software R&D expenditure and that such an approach will be taken again in the new regime. The Frascati Manual defines R&D as being about systematic work undertaken to increase the stock of knowledge and to devise new applications of available knowledge[1], this would seemingly incorporate software R&D. We submit:

- The specific wording from the Frascati Manual definition of R&D could be used to draw in software R&D.
- Alternatively, expenditure on software R&D could be brought into regime using the concept of "novelty" as part of the definition.
- To the extent an appropriate definition cannot be determined within the standard definition of R&D, a separate limb should be included in the definition specifically for software R&D.
- Certain activities in relation to software R&D, such as testing and internal software development, should be specifically included as eligible R&D activity.
- It will be important that guidance is produced and published in relation to the R&D tax incentive regime. In particular this guidance should include illustrative examples of eligible software R&D activity given the uncertainty surrounding this area. These examples should be varied and cover a number of different scenarios in order to provide clarity and predictability.

5. Financial incentive and Non-refundable tax credit

The benefits of a tax credit may not be recognised in New Zealand

5.1 Aderant's performance, like many companies, is measured on Earnings Before Interest, Taxes, Depreciation and Amortisation (EBITDA), with our investment pool calculated as a subset of operating expenditure. This means Aderant's R&D ability is limited to revenue / cash in hand, without tax forming a part of this consideration, and as such, a tax credit is less likely to implicitly encourage higher levels of R&D. It is for this reason that Aderant NZ favours an above the line incentive model that encourages increased investment.

[1] OECD Frascati Manual 2015.

5.2 Aderant NZ currently contributes to the government's goal of increasing R&D expenditure to 2% of GDP through significant staffing and wages that would not exist without the backing of the multi-national owning the IP. Any return from a tax credit (noting our comments below on the expected return), will occur below the line, increasing potential return for the overseas shareholders rather than being available, and encouraged, to spend directly on additional New Zealand R&D and wage earners.

A non-refundable tax credit means that there could be limited actual incentive returns

5.3 Aderant NZ submits that the proposed 12.5% tax credit should be refundable. If it is not, Aderant NZ, and others like us, will not see the benefits of the tax credit, reducing Aderant's ability to undertake R&D in New Zealand.

5.4 The consequence of the tax credit being non-refundable is that the actual cash benefit of the R&D tax credit, in a particular year, will be limited to the tax payable that year. To utilise a tax credit, organisations must have income against which to offset the tax credit. R&D intensive entities, which have little other business activity in New Zealand, will often have little other income and so will never realise the benefits of a tax credit. This position is to the detriment of New Zealand as it will reduce the effectiveness and incentivising nature of a tax credit.

5.5 s 9(2)(b)(ii)

5.6 Based on this example, the effective cash benefit of the tax credit would only be 2.2% of the eligible R&D expenditure, with the remaining R&D tax credits carried forward, just sitting there, unused. The inability to use these tax credits will materially reduce the benefit of the regime to companies like Aderant and consequently reduce the attractiveness of undertaking R&D in New Zealand. There is also a risk that shareholder continuity changes will result in these credits being lost, meaning there is a high chance the benefits of the carried forward tax credits are never actually realised.

5.7 This, plus the nature of an incentive being to encourage rather than just reward R&D, highlights the importance of the credit being refundable. Even if this does not occur during the first year of the credit, it needs to be in place by 1 April 2020 to support organisations at the end of their Growth Grant transition period.

6. The future of an R&D tax incentive

6.1 Aderant NZ would like to see the R&D tax incentive system deliver, or evolve into, a model that encourages many of the key benefits that the grant system achieved. To the extent this is not possible, a grant-like system could also be implemented to cover any key gaps, with the goal being to provide the following benefits:

- *Certainty* – Provide a predictable quantity of funding at defined times (such as quarterly), allowing organisations to plan and commit to their R&D activities based on the amount of money that, given compliance to the criterion, they know they will receive. Aderant, like most companies, plan their R&D investment based on importance and available funds – this becomes difficult if the benefit is only visible long after completion.

- *Incentivise* – Provide an incentive to do the work, as opposed to being rewarded later for having done the work. The regime should ensure that the receipt of the benefit is based on pursuing progressive objectives, encouraging the use of the incentive for true R&D activity rather than just as a cost offset.

- *Point of difference* – Much of the world has a tax credit/incentive system, while our grant system has been unique and attracted investment to New Zealand. Consider how any new system can continue to provide a differentiator that positions New Zealand as supportive, progressive and unique.

- *Competitive credit rate* – The 12.5% credit rate should be reconsidered and raised, if we are to be competitive with other jurisdictions.

- *Above the line measurement* – The incentive should recognise different company performance measurement models and ensure the incentive comes in 'above the line', to encourage investment in R&D activity instead of going to profits.

- *IP / ownership* – Organisations should not be excluded based purely on location of IP rights. This would limit the growth of IP in New Zealanders and creation of highly-skilled, highly-paid jobs. Enticing organisations who own IP would have a benefit, but this is speculative and ignores the immediate and tangible benefit of growing the IP in our people, here in New Zealand.

Concluding statement

Aderant is of the firm belief that New Zealand is a country of innovation and a world leader in the development of new technologies and novel ideas. As a company we have demonstrated the effectiveness of focused government encouragement in R&D. While we might have appreciated the grants regime, a well modelled R&D tax regime could go a long way to supporting and developing R&D and investment in New Zealand.

Thank you again for the opportunity to comment on these proposals and for taking the time to consider our submission.

Yours sincerely

s 9(2)(a)

s 9(2)(a)

Contact

If you have any queries about this submission or for more information, please contact s 9(2)(a)

30/5/2018

'R&D tax incentive team'
Ministry of Business, Innovation & Employment
PO Box 1473
Wellington 6140
New Zealand

Dear Team RE. Harraway & Sons LTD input. 'Discussion Paper' on R&D Tax Incentive for NZ

Please find below the company's specific points of view - as to the questions posed via the paper. If any question answers have been left blank the company has no specific input to make on that particular question.

Question 1: If SOEs, Crown Research Institutes, District Health Boards, Tertiary Institutions, and their subsidiaries are excluded from the tax incentive, what will the likely impact be on business R&D in New Zealand?

Despite these organisations receiving limited, specific funding for R&D projects - excluding these organisations (+ subsidiaries) from the incentive will be a major impediment to the overall 'R&D uptake' objective. These organisations (not just private organisations) are major partners to private enterprise in assisting R&D endeavour. If there is no incentive for them to get involved and as such play an even larger role in R&D facilitation - this will certainly impede the scheme's progress in our view

Question 2: How well does this definition apply to business R&D carried out in NZ? Definition seems fair in our view

Question 3: Does this definition exclude R&D that you think should be eligible, please illustrate with examples? Company feels definition is comprehensively covered

Question 4: Does the scientific method requirement exclude valid R&D in some sectors, please illustrate with examples? Not to our knowledge in our industry

Question 5: What would the impact be on business R&D in NZ if a materiality test was applied to both the problem the R&D seeks to resolve and the intended advancement of science or technology? The company feels that inserting this aspect into the scheme is not a good idea. It adds complication and difficulty into the process that will simply impede progress. The process MUST be simple to attract enterprise interest, activity and investment

Question 6: How well does this definition apply to business R&D carried out in NZ? The company feels that this is fine as it is

Question 7: Are there any reasons why the exclusions should not apply to support as well as core activities? Please describe. The areas the company feels should be included in the scheme (in either core or support activities) and that are currently excluded are listed below (including the company's reasoning):

- Prospecting, exploring or drilling for minerals, petroleum, natural gas or geothermal reserves. → These sectors of industry are sources of major employment and GDP growth. Excluding all aspects of these definitions is not supported. There could be some element of

'discretion' with this aspect (i.e. based on pre-determined guidelines/'practical' scenarios that 'discretion' decisions are decided upon to reduce subjectivity) versus a complete exclusion. Some aspects of these activities can indeed be both sustainable and economically valuable to NZ into the future

- Market research, market testing, market development or sales promotion (including surveys) → the company believes these costs should be included as they are a key part of the R&D process, in that these activities can commercially validate R&D endeavour and as such the 'value add' from customer perspectives. The investment into these areas is significant and should be within scope
- Commercial, legal and administrative aspects of patenting, licensing or other activities → the company believes these costs are a very real part of R&D investment in that they protect/safeguard the R&D endeavour for the future, for the enterprise taking the chance on R&D. These costs are a very real part of the enterprise 'doing its' best' to ensure longer term returns to both the enterprise and NZ's GDP materialise. As such the company believes these costs should be included
- Pre-production activities, such as demonstration of commercial viability, tooling-up and trial runs → again the company sees these as key costs that should be included as they are valid 'check points' within an R&D project

Question 8: Please provide any examples where social science research is/has been a core part of business R&D in NZ?

Question 9: What is the likely impact on business R&D in NZ if dual purpose activities are ineligible for the R&D Tax Incentive? Again the company believes if this is implemented it will make the incentive scheme less attractive for enterprise and uptake will be affected

Question 10: What are the advantages and/or disadvantages of limiting eligible expenditure to R&D labour cost? Advantage: Simpler calculation Disadvantage: Excludes 'real' costs that do impact business decisions on future R&D 'appetite'

Question 11: What are the advantages and/or disadvantages of setting overhead costs as a % of R&D labour costs? What would the appropriate percentage be? Advantage: Simple. Disadvantage/Recommendation: Overheads can be viewed as a true (yet non exhaustive) measure of R&D, however the company believes taking this approach is too simplistic and could be subjective. For example in market, or consumer testing, etc. are other 'true' testing aspects to R&D endeavour. There needs to be a more rigorous 'cost formula' adopted that takes a broader, commercial view of realistic costs incurred that impact an enterprise's R&D decision making 'appetite'. Thoughts on a %? A one size fits all approach is unrealistic as some industries require higher ongoing R&D labour %'s than others. So if the labour definition was adopted the %'s would realistically need to differ by industry segment

Question 12: Are there any reasons why expenditure related to R&D activities for which commercial consideration is received should be eligible for a tax incentive? Please describe. The company does not understand this question. ANY R&D decision in our view should be based on **commercial consideration...**period!

Question 13: What variations or extensions to the definition of core activities are required to ensure it adequately captures R&D software activities?

Question 14: Are there reasons why continuity rules should not apply to tax credits? Please describe.

Question 15: Is the minimum threshold set at the right level? If 'no', please provide further details. No. The company feels this aspect of the incentive needs to be 'open ended' and based on a 'return basis to GDP, or the business'

Question 16: How important is a cap or mechanism to go beyond the cap? Please provide further details. Refer to our recommendation above (Q15). Company size and scale should not be a consideration in getting involved in the scheme. The % of larger companies currently investing in R&D versus SMES in NZ (versus rest of world) indicates NZ has a problem to fix! Capping is not the way to fix this. Being 'open ended' is our position. The company feels that it comes back to an overall return to GDP and how that is made up is of no consequence (i.e. it could

be that lots more SMEs take this up and drive up the %, or it is a bigger mix of larger enterprises that begin to get involved to drive up the % - but to us there is no right or wrong in terms of size preference)

Question 17: *What features of a Ministerial discretion or pre-registration would make them most effective?* The company believes that simply ensuring a predetermined/pre-registered set of guidelines should be adhered to by applicants. 'Discretion' is totally subjective and we believe is a 'flawed' approach. 'Discretion' should be eliminated ideally, and where possible

Question 18: *What are your views on the proposed mechanisms to promote transparency and enhance evaluation?* The company disagrees on this. The scheme and applicants dealings should be surrounded by confidentiality given new, competitively sensitive activities are being explored/developed. Maintain status quo is our position.

Question 19: *Are there any other risks that need to be managed? Please describe.* The company believes the major risk is making the scheme's process and 'guideline' changes: (i) too difficult to understand (ii) too complex to work to in the real/practical world (ii) too confusing - which will just 'turn off' interest from enterprise in getting involved in the scheme and in the end this will affect the key objective of increasing the R&D investment % in NZ

Question 20: *What are the risks with making external advisors liable in this way?* Company position as per Q19. This scheme cannot and must not be too 'heavy handed' as uptake will be impeded if this is so. I.e. Enterprise will be too scared to get involved for risk they will be penalised

Question 21: *What is the right level of information required to support a claim?* The company believes that this is 'reasonable bookkeeping records', as per current tax department rules

Question 22: *What opportunities are there for customers to submit R&D Tax Incentive claims via third party software?*

Question 23: *What integrity measures do you think Inland Revenue should use?* Use measures as per current tax law. No need to reinvent the wheel'!

s 9(2)(a)

s 9(2)(a)

161 Main South Road, Green Island, Dunedin 9018

PO Box 13040, Green Island, Dunedin 9052

From:	s 9(2)(a)
To:	RD Incentive
Subject:	Submission: A discussion paper on a Research and Development Tax Incentive for New Zealand
Date:	Wednesday, 30 May 2018 12:20:41 p.m.

Thank you for the opportunity to make submissions on the Ministry's discussion paper on a Research and Development Tax Incentive for
New Zealand. We wanted to take this opportunity to discuss one aspect of the paper - the application of the concept of research and development to software companies.

The discussion paper acknowledges that there are challenges with applying traditional definitions and categorisations of research and development to software development.

If we consider the sorts of hi-tech business we have most successfully produced in New Zealand in recent years (companies like Xero, Vend, Timely, Serko, PushPay, Orion, etc) they are companies that comprise teams of software engineers, product managers, and designers, working on computers and at whiteboards in very normal looking offices, rather than the more traditional idea of scientists in research laboratories.

We believe that at least some aspects of the work these companies do should be considered eligible research and development for the purposes of government incentives.

There are two types of activities that are listed in the discussion paper as being excluded from the proposed definition of research and development that, in our experience, are critical to successful outcomes for these companies:

1/ "market research, market testing, market development or sales promotion (including consumer surveys)"

Modern growth companies typically follow the "lean startup" methodology that encourages short iterations, where product development is informed by real feedback from real customers. Market research and testing is a critical part of building this kind of company successfully.

2/ "the making of cosmetic or stylistic changes to materials, products, devices, processes or services"

Design-led thinking (as characterised in the NZTE "Better By Design" programme) works from the premise that design is integral to the ongoing development of successful products and services. The most successful examples of this are companies like Apple.

These categories are excluded from the traditional definitions because they are perceived to be "business as usual" activities. Our experience is that software teams often have difficulty accounting for research and development separately from business as usual activities when applying for grants or tax credits, because the work is nearly always undertaken concurrently.

For example, "business as usual" activities such as customer support often results in teams paying attention to how existing customers are using the software, and lets them identify and prioritise future development work - meaning new features, products and services developed by the company.

We acknowledge that the discussion paper contemplates a differing treatment may need to be implemented for software companies and hope that the eventual definitions and

exclusions for research and development recognise the different environment in which these businesses grow and succeed.

Nga mihi

s 9(2)(a)

Hoku Group

SKOPE Industries - Submission feedback on proposed R&D Tax Credit scheme.

General Feedback

SKOPE 100% supports a Government incentive for research and development. We are competing in a global market so any assistance to close the research and development gap against our global competition is critical. As a recipient of the Callaghan Growth Grant we have benefited from 3 critical factors with regard to the current R&D scheme:

1. the Callaghan Growth Grant is **positive** in that it rewards investment in research and development

2. the R&D definition is aligned with the **nature of R&D in New Zealand** and to the accounting definition as per IAS38. As a direct result of the Callaghan funding we have employed additional engineers and increased our output of R&D.

3. the Callaghan Growth Grant is **immediate**. The funding is paid quarterly, and we do not have to wait 12 to 18 months to receive the funding that you would under the proposed R&D tax credit scheme.

The Callaghan Growth grant provides certainty of cashflow for the contract period. This allows SKOPE to plan and allocate resources knowing that we will have the cash flow to fund additional employees. For the above reasons we therefore do not agree with the change in policy direction on research and development funding and strongly believe that this will reduce spending on research and development. Due to the proposed tax credit structure this will result in SKOPE employing less research and development employees, which will be negative for our customers, underlying profitability and for our prospects.

Further general comments:

- If you are carrying forward losses then the tax credit should be paid out. This is consistent with the objective of incentivising R&D
- Including up to 10% of overseas R&D makes sense. We have a China based subsidiary with engineering staff. NZ design engineers also travel to China. This is critical to remaining competitive globally.
- R&D tax credit should apply to capitalised R&D. We should not be penalised for capitalising R&D.
- 12.5% is lower % than the net 14% available under the Callaghan Growth Grant scheme
- We support no changes to Callaghan student grants. These worked well.
- Accelerated depreciation on plant and equipment should also be considered to increase productivity.

Q1: If SOEs, Crown Research Institutes, District Health Boards, Tertiary Institutions, and their subsidiaries are excluded from the tax incentive, what will the likely impact be on business R&D in New Zealand?

SKOPE response: Potential unknown benefits but low impact.

Q2: How well does this definition apply to business R&D carried out in New Zealand?

SKOPE response: The definition is more relevant to large corporates with large R&D business centres/units. NZ research and development by nature is more aligned to the commercialisation of product and has a broader definition than what is being proposed i.e. the definition needs to include development. Often R&D may include selecting existing technologies and applying them to the commercialisation of product.

R&D is often done on a project basis so splitting out the R&D that meets the scientific definition becomes very difficult. By not following the definition of R&D as per the accounting standards this creates additional administration cost.

Q3: Does this definition exclude R&D that you think should be eligible, please illustrate with examples.

SKOPE response: As per question 2 this excludes the commercial element of R&D. As an example, we are currently undertaking a large project converting our fridges from synthetic refrigerants to natural refrigerants. This has already been completed by overseas manufacturers however we now need to perform the conversion with our own fridges. This will not advance science or technology necessarily however will require innovation on our part to ensure we maximise the following when we apply to our own fridges:

- Energy efficiency
- Health & Safety
- Performance
- Pricing
- Compliance
- Noise

Q4: Does the scientific method requirement exclude valid R&D in some sectors, please illustrate with examples?

SKOPE response: Please refer to our response on Question 3.
R&D in NZ business is typically looking at the commercial application of new technology, as opposed to the creation of new technology that advances scientific knowledge. The advances come from the 'how' of applying new technology in a commercial environment with commercial constraints.

SKOPE use a tool called technology Readiness level to evaluate how close to commercialisation a given technology is.:

9 Actual technology proven through successful use in an operational environment
8 Actual technology completed and qualified through tests and demonstrations
7 System prototype demonstration in an operational environment
6 System/subsystem model or prototype demonstrated in a simulated environment
5 Component validation in a simulated environment
4 Component validation in a laboratory environment
3 Analytical and experimental critical function and/or characteristic Proof-of concept
2 Technology concept and/or application formulated
1 Basic principles observed and reported

Using the Technology Readiness levels as a reference, it would be fair to say that most activity occurs from level 5 and up. Levels 1-4 are what we would expected to be generated from Universities or Research institutes and fall more into the Scientific knowledge realm
We believe that the number of NZ businesses developing IP in the levels 1-4 would be rare.

Q5: What would the impact be on business R&D in New Zealand if a materiality test was applied to both the problem the R&D seeks to resolve and the intended advancement of science or technology?

SKOPE response: We believe the impact would be significant and would skew R&D towards smaller entrepreneurial companies and towards start-ups who by their very nature have fewer employment opportunities and often struggle to be profitable in the initial years. This will significantly reduce the amount of R&D that can be claimed.

Q6: How well does this definition apply to business R&D carried out in New Zealand?

SKOPE response: Definition (a) which requires the resolution of scientific or technological uncertainty narrows significantly what can be claimed under support activities.

Q7: Are there any reasons why the exclusions should not apply to support as well as core activities? Please describe.

SKOPE response: This question is made redundant by the definition of R&D in (a) being too narrow.

Q8: Please provide any examples where social science research is/has been a core part of business R&D in New Zealand?

SKOPE response: We are not aware of specific examples but as technology develops will become more important to understand consumer behaviour.

Q9: What is the likely impact on business R&D in New Zealand if dual purpose activities are ineligible for the R&D Tax Incentive?

SKOPE response: Will reduce R&D activities being undertaken by business and hence less tax credit will be claimed. R&D is hardly ever pure and if dual purpose activities are ineligible this goes against the objective of incentivising R&D.

Q10: What are the advantages and/or disadvantages of limiting eligible expenditure to R&D labour cost?

SKOPE response:

Advantages

- Keeps it simple and removes subjectivity

Disadvantages

- R&D attracts overhead by its nature i.e. design software, travel, admin etc

- Limiting eligible R&D expenditure goes against the policy of encouraging R&D and this coupled with a narrower definition, exclusion of dual purpose activities will not result in the desired effect of lifting R&D as a % of GDP.

Q11: What are the advantages and/or disadvantages of setting overhead costs as a percentage of R&D labour costs? What would the appropriate percentage be?

Advantages

- Keeps it simple

Disadvantages

- Overhead costs can vary and an overhead % is an inaccurate way of completing this.

Our view is that the policy should allow for both. The door should not be closed on other techniques.

Q12: Are there any reasons why expenditure related to R&D activities for which commercial consideration is received should be eligible for a tax incentive? Please describe.

SKOPE response: Yes, this should be eligible. If commercial consideration received removes the eligibility of claiming the R&D tax credit then this would also remove the motivation to negotiate commercial consideration. Companies should be incentivised to negotiate commercial consideration as this benefits the NZ economy. We believe this also goes against the objective of the policy which is to lift R&D as a % of GDP.

Q13: What variations or extensions to the definition of core activities are required to ensure it adequately captures R&D software activities?

SKOPE response: n/a.

Q14: Are there reasons why continuity rules should not apply to tax credits? Please describe.

SKOPE response: Yes, for the reasons described in the discussion paper. Would penalise initial investors and is inconsistent with the growth cycle of R&D start-ups. Will reduce R&D.

Q15: Is the minimum threshold set at the right level? If 'no', please provide further details.

SKOPE response: Should be reduced to $50,000.

Q16: How important is a cap or a mechanism to go beyond the cap? Please provide further details.

SKOPE response: Important. Ministerial discretion and pre-registration for large claims is a good idea.

Q17: What features of a Ministerial discretion or pre-registration would make them most effective?

SKOPE response: Not sure.

Q18: What are your views on the proposed mechanisms to promote transparency and enhance evaluation?

SKOPE response: We don't agree due to commercial sensitivity i.e. competitors and customers having access. We are a private company.

Q19: Are there any other risks that need to be managed? Please describe.

SKOPE response: As above.

Q20: What are the risks with making external advisors liable in this way?

SKOPE response: We don't agree. Will increase tax consultancy fees making the new onerous process even more onerous.

Q21: What is the right level of information required to support a claim?

SKOPE response: Keeping it simple and not duplicating compliance costs is critical. This is one of the big negatives of moving away from the accounting definition of R&D (one of the benefits of the Callaghan Growth Grant was the alignment with accounting standards so that financial statements could be relied upon). This also increased compliance costs when R&D tax credits were introduced previously. Developing a simple generic template that is used across different business would be helpful that way tax advisors are working towards a consistent template and should keep their costs down and not fill the pockets of tax consultants

Q22: What opportunities are there for customers to submit R&D Tax Incentive claims via third party software?

SKOPE response: Any automation we would support.

Q23: What integrity measures do you think Inland Revenue should use?

SKOPE response: Reliance on independent audit if completed.

SKOPE Industries - Submission on Growth grant transitional requirements

- Our Callaghan Growth grant expires on 30 September 2018

- As a current growth grant recipient we need time to update our systems and processes and to understand the impact of moving to the R&D tax credit scheme. The Callaghan Growth grant is currently paying for the employment of additional R&D engineers so any immediate change to this funding will have a material effect on our funding of these positions. There is also the time gap between our Callaghan contract expiring and the R&D tax credit scheme beginning

- We need the ability to extend the Callaghan Growth grant fund over the transition period. Our strong preference would be to extend the contract to 30 June 2020 which would allow us the time to fully understand the impact of the changes, and to make the structural and process changes required to meet the requirements of the R&D tax credit scheme.

- If we do not have the ability to reapply for the Growth Grant our research and development spend will reduce and we will need to review our research and development resourcing. We are in the middle of some key customer projects and not being able to extend the Growth grant will have a material impact on these projects.

Date: 24 May 2018
To: Ministry of Business and Innovation

Reference: Research and Development Tax Incentive

Dear MBIE,

ABB Limited, New Zealand has reviewed the discussion documents published regarding the proposal to introduce a tax incentive for business R&D.

In New Zealand ABB undertakes research and development at both its manufacturing sites in Auckland and Napier. As a multinational technology sector company ABB is pleased to see the desire to attract large R&D performing organisations to New Zealand (outlined on page 26 of the discussion paper). We have some points where ABB would like to comment as we see them applying to us, relating to the tax credit proposal that could potentially limit how ABB and similar large multinational companies realise their desired R&D activities.

Our feedback on the discussion paper are listed below:

Ownership of Results

Page 14. An entity will be eligible if they *"effectively own the results of the R&D"*.

In the case of ABB the Intellectual Policy generated from the R&D activity in New Zealand s 9(2)(b)(ii) The R&D activities are undertaken in New Zealand, directly employing over 30 people involved solely in R&D activities. This R&D performed in New Zealand does however directly flow into the products being manufactured at the 2 ABB sites in New Zealand. This ownership clause could potentially make ABB, and similar multinational companies, ineligible to the R&D incentive. We would suggest meaning of "effectively owned" should be broadened to allow the entity performing the activity to receive the benefit of the tax credit.

Eligible expenditure

Page 19. ABB would suggest that such a scheme not be limited to only R&D associated labour costs. R&D activities encompass other areas of cost and risk. ABB invests significantly in capital and prototype materials to develop high value specialised electrical products as part of its R&D effort.

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Continuation of R&D funding / growth grants

ABB has in the past benefited from R&D funding via Callahan Innovation by way of project grants. ABB is currently investigating a growth grant application. Growth grants are effective for increasing R&D activity for ABB as the funding directly supports actual R&D costs. We would envisage a form of growth grants to be retained in addition to or alongside the proposed tax credit regime, for the following reasons:

- Allow MBIE better control over specific funding going towards proven activities, including multinational and foreign owned companies, to be sure of the direct benefit to New Zealand.
- The effort required to complete the documentation for application can be overcome by capable organisations who typically have suitable resources and time to prepare such applications.
- This funding model will result in increased R&D activities. This has been our direct experience based on our applications in the recent past.

ABB would like to thank MBIE for the opportunity to subit commments on the proposed tax credit and would welcome further discussion on this submission it would be helpful.

Yours sincerely,

s 9(2)(a)

[redacted]

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29 May 2018

Submission regarding the proposed New Zealand R&D Tax Credit Incentive

Dear Officials,

Introduction

1. This submission is made on behalf of the Australia New Zealand Leadership Forum (ANZLF). The ANZLF brings together Australian and New Zealand leaders from across both communities, on a roughly annual basis, to discuss how the two countries can prosper together in the global economy and leverage the Closer Economic Relationship and Single Economic Market. The ANZLF is underpinned by an annual work program of business-led activities and advocacy to realise opportunities to deepen the relationship.

2. The ANZLF supports in principle the introduction into New Zealand of a Research and Development Tax Incentive. We would like to share some observations on the proposal for an R&D Tax Incentive which was outlined in the recent Discussion Document "Fuelling Innovation to Transform Our Economy".

General Comments

3. We would first like to thank the Government for its initial efforts towards what has the potential to become a component of an effective R&D incentive package of significant benefit to New Zealand businesses, investors and ultimately all New Zealanders. The Forum anticipates that a full incentive package will aid the development of the "trans-Tasman science and innovation ecosystem" which both the Australian and New Zealand Prime Ministers wish to foster. However, there are several elements of the proposal that we believe require further consideration to support not only our most successful R&D active corporates but our innovative SMEs alike.

Make the R&D tax credit refundable in cash to small and medium size businesses.

4. The non-refundable nature of the proposed tax credit, along with the removal of Callaghan Innovation Growth Grants and the uncertainty around whether there will be a tax loss cash-out mechanism, is a serious concern with relation to emerging R&D active SMEs that are yet to reach profit. This issue is compounded by the fact that tax credits may be forfeited where there is a change in ownership or capital structure, leaving the incentive with little or no value to some business owners incurring R&D costs in the business start-up phase.

5. The New Zealand Prime Minister, in her speech to the ANZLF on 2nd March 2018, emphasised the value of SMEs to the growth of the New Zealand economy. The current lack of certainty around cash flow support for

our small SMEs who are in vulnerable R&D intensive phases does not put the Prime Minister's words into effect. We submit that a form of cash flow support for R&D active entities in loss should be introduced at the same time as the tax credit. For example, the proposed tax credit could be refundable in certain circumstances or to a certain level, as will be the case in Australia (with a $4m cash-out cap).

6. The 2018 Australian Budget includes reforms to the country's R&D tax incentive with the aim of dramatically reducing the cost of the regime. Despite this goal, the Australian Government identified the importance of providing "critical cash flow support of start-ups who are often unprofitable in early years" and have chosen to retain a refundable tax credit. The New Zealand Prime Minister also expressed in her 2nd March speech that New Zealand would be following the approach of Australia in lifting our R&D "game". We submit that New Zealand should align itself to Australia with respect to cash flow benefits for tax loss entities, a move that would also help to even the playing field between start-ups in New Zealand and Australia.

Proposed Definition of R&D

7. As is the case in Australia, the New Zealand government desires to ensure that only genuine R&D activity is incentivised, and the ANZLF agrees with this approach. However, we submit that the proposed definition of R&D, in particular its focus on the use of a "scientific method" and for the purpose of "advancing science or technology through the resolution of scientific or technological uncertainty", may exclude valid R&D in the technology arena, such as software or apps[1]. We recommend amendment of the definition before legislative enactment to capture such activity.

8. We believe that a failure to capture R&D in the technology arena in the definition would have a negative effect on the New Zealand R&D landscape, evident from the fact that software R&D amounts to between 40% - 50% of cash grants in the past 3 years (noted by the Discussion Document). The Forum supports the Government seeking public submission on this definition. The Forum also believes that there should be special treatment for activities including testing and internal software development as these are significant stages in production.

9. Although software development may not be utilising a "scientific method" or solving "uncertainty" in the traditional sense, it is valuable innovation that requires Government and investor support if we are to harness it for the benefit of our future economy. We recommend updating the definitions used in the R&D tax incentive proposal if the legislation is going to lend itself to current modern and future innovative areas.

[1] It is worth noting that the ANZLF Health Technology Sector Group has proposed creating a Health Passport app for medications. It is envisaged that certain medical records would be shared in a secure way via an app which can be used by patients in both countries. This type of technology innovation, which has value to the economy and to the health of individuals, is just the type of product that the Government should be supporting.

Submission

10. In summary, the Forum submits that the Government should amend the proposal to create an R&D incentive scheme that allows New Zealand's vulnerable yet valuable SMEs to grow whilst continuing to support New Zealand's largest R&D players. The growth of our SMEs into larger businesses is vital for the sustainability of the New Zealand economy and to pull our weight in the growing trans-Tasman science and innovation ecosystem.

Yours sincerely,

s 9(2)(a)

SUBMISSION OF s 9(2)(b)(ii) ON THE PROPOSED CHANGES TO FUNDING OF RESEARCH & DEVELOPMENT.

1. s 9(2)(a)

   s 9(2)(b)(ii)

   s 9(2)(b)(ii).

2. s 9(2)(b)(ii) have in the past received tax incentives for R&D and at present receive and are participating in a Growth Grant from Callaghan Innovation. The Growth Grant was extended last year and s 9(2)(b)(ii)

3. s 9(2)(b)(ii) agrees with the objective of the government to lift the level of R&D investment in New Zealand.

4. s 9(2)(b)(ii) has some concerns about the change from a grant based fund to tax incentives that it wishes to have considered.

5. At present the Callaghan staff that have been involved in our R&D Grants and reporting have a high science knowledge. They have been able to assist us in our R&D direction, provide meaningful contacts into other research organisations and peer review our research outputs. The building up of this level of contact has also exposed s 9(2)(b)(ii) to other grant options such as PhD and employment grants for science graduates. It would be unhelpful if this level of support was removed. It is stated that Callaghan will be involved in the tax incentive process but s 9(2)(b)(ii) would suggest that this is done on an individual taxpayer basis so that the above benefits can be utilized.

6. We therefore have concerns that the tax incentive proposal will be administered by the Inland Revenue Department. Their staff lack the science backgrounds to properly understand R&D issues and the issues facing researchers in the agricultural sector. Their motivation is, correctly, to return the correct amount of tax from taxpayers to the government.

7. An undirected tax incentive process runs the risk of providing a scatter gun approach to science research in New Zealand. The connection between IRD and Callaghan is noted. Some form of connection between the other science related parts of government (other CRI and MBIE) and the Inland Revenue Department will also be helpful to ensure that New Zealand is investing in R&D that will add to our economic development. It is recognized that too much direction means that opportunities are missed, but too little direction means that R&D simply becomes a method to reduce tax without economic gain.

8. The change to an R&D tax incentive will have significant impact on the cash flows arising from government support. Under a Growth Grant from Callaghan Innovation s 9(2)(b)(ii) makes quarterly claims based on R&D expenditure in the prior quarter. This is paid quickly by Callaghan Innovation after the Claim has been made. Under the tax incentive proposal a full claim cannot be made until the tax return is filed. It is conceded that adjustments can and will be made to provisional tax payments which largely mitigate this issue. However this remains problematic in a business like s 9(2)(b)(ii) which has high seasonality in its business even though the R&D is spent on a consistent basis.

9. If the company is to make a tax loss in any given year or has tax losses to be brought forward then the tax incentive will not be available. During the dairy downturn in 2015/16 many businesses, including s 9(2)(b)(ii) who operated in the dairy sector ran at a loss. During this time s 9(2)(b)(ii) did not lessen its input into R&D. Rather it increased its funding into this area particularly to understand s 9(2)(b)(ii) The payment of the Growth Grant quarterly assisted the company in taking these steps. Without those quarterly payments we would have slowed our R&D expenditure and not achieved the objectives we did.

10. Under the Grant scheme Grant income is treated as taxable income. By removing it from taxable income and moving it to a tax incentive means that a taxable profit might move into taxable loss. This makes it harder to obtain the benefits of a tax incentive or in all likelihood mean that R&D expenditure is reduced so that the business remains in a tax profit positive position. This is counter intuitive to the objectives of the government.

11. The compliance with claiming tax incentives under the R&D tax incentive scheme will be subject to the general penalty regime under Income Tax law. At present s 9(2)(b)(ii) hold detailed discussions with Callaghan Innovation before applying for a Grant. Once provided they assist and review Claims as they occur. There is open dialogue on what is acceptable and what is not. Under the tax incentive system we are unlikely to find out what is acceptable and what is not until after we file our tax return. Any error is then subject to interest and penalty clauses under Income Tax law. These can be uncertain, extensive and costly.

12. Further under the Growth Grant Claim process s 9(2)(b)(ii) is required to have the annual claim reviewed by our auditors. While we will continue to have

audited annual NZ IFRS accounts this independent review process will disappear. This is unlikely to lead to a cost saving and will in our opinion lead to additional cost as we consult with our taxation advisors on the tax incentive claims. Like the Inland Revenue Department staff, our tax advisors staff do not have specialist science knowledge.

13. s 9(2)(b)(ii) is unlikely to decrease its R&D expenditure due to these changes but the cost of meeting the compliance requirements of the tax incentive scheme will increase, particularly with the involvement of our tax advisors who at present provide no input into this area.

Thank you for considering this submission.

s 9(2)(a)

Dated 31st May 2018