



COVERSHEET

Minister	Hon Dr Megan Woods	Portfolio	Research, Science and Innovation
Title of Cabinet paper	Extending Refundability for the Research and Development Tax Incentive	Date to be published	12 July 2019

List of documents that have been proactively released

Date	Title	Author
14 May 2019	Extending Refundability for the Research and Development Tax Incentive	Office of the Minister of Research, Science and Innovation, Office of the Minister of Revenue
22 May 2019	Cabinet Economic Development Committee minute: DEV-19-MIN-0119	Cabinet Office
10 May 2019	Regulatory Impact Statement: R&D Tax Incentive – Refundability	MBIE, IR
13 November 2018	R&D Tax Incentive: Phase 2	MBIE, IR
13 February 2019	R&D Tax Credit: Phase 2 Policy Proposals	MBIE, IR
11 April 2019	Draft Cabinet paper: R&D Tax Incentive – Refundability	MBIE, IR, Callaghan Innovation
2 May 2019	R&D Tax Incentive: Ministerial meeting to discuss refundability	MBIE, IR
17 May 2019	Talking points for the DEV Cabinet paper: Extending Refundability for the R&D Tax Incentive	MBIE
27 June 2019	R&D Tax Incentive – refundability and small innovative firms	MBIE, IR

Information redacted

YES / NO (please select)

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BRIEFING

R&D Tax Incentive: Ministerial meeting to discuss refundability

Date:	2 May 2019	Priority:	High
Security classification:	In Confidence	Tracking number:	3372 18-19 IR2019/233

Action sought		
	Action sought	Deadline
Hon Dr Megan Woods Minister of Research, Science and Innovation	Provide feedback to officials the draft Cabinet paper, <i>Extending Refundability for the Research and Development Tax Incentive</i>	6 May 2019
Hon Stuart Nash Minister of Revenue	Provide feedback to officials on the draft Cabinet paper, <i>Extending Refundability for the Research and Development Tax Incentive</i>	6 May 2019

Contact for telephone discussion (if required)				
Name	Position	Telephone		1st contact
Kirsty Hutchison	Manager, Innovation Policy	04 901 4131	Privacy of natural persons	✓
Keith Taylor	Policy Manager, Inland Revenue	04 890 2808	Privacy of natural persons	

The following departments/agencies have been consulted
Callaghan Innovation

Minister's office to complete:

- | | |
|---|--|
| <input type="checkbox"/> Approved | <input type="checkbox"/> Declined |
| <input type="checkbox"/> Noted | <input type="checkbox"/> Needs change |
| <input type="checkbox"/> Seen | <input type="checkbox"/> Overtaken by Events |
| <input type="checkbox"/> See Minister's Notes | <input type="checkbox"/> Withdrawn |

Comment

BRIEFING

R&D Tax Incentive: Ministerial meeting to discuss refundability

Date:	2 May 2019	Priority:	High
Security classification:	In Confidence	Tracking number:	3372 18-19 IR2019/233

Purpose

To provide you with additional information to support your discussions on the refundability proposal in the draft Cabinet paper: *Extending Refundability for the Research and Development Tax Incentive* (3068 18-19, IR2019/159 refers).

Recommended action

The Ministry of Business, Innovation and Employment (MBIE) and Inland Revenue recommend that you:

	Min. RS&I	Min. Revenue
a Note that Ministers (Minister of Research, Science and Innovation and the Minister of Revenue) are meeting on Monday 6 May at 5.30pm to discuss the refundability proposal in the draft Cabinet paper, <i>Extending Refundability for the Research and Development Tax Incentive</i>	<i>Noted</i>	<i>Noted</i>
b Note that subject to your agreement to a final draft of the cabinet paper, the paper will need to be lodged on 16 May 2019 for consideration at the Cabinet Economic Development Committee on 22 May	<i>Noted</i>	<i>Noted</i>

Privacy of natural persons

Kirsty Hutchison
Manager, Innovation Policy
Labour, Science and Enterprise, MBIE

02 / 05 / 19

Hon Dr Megan Woods
**Minister of Research, Science and
Innovation**

..... / /

Privacy of natural persons

Keith Taylor
Policy Manager
Inland Revenue

02 / 05 / 19

Hon Stuart Nash
Minister of Revenue

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PROACTIVELY RELEASED

Background

1. Ministry of Business, Innovation and Employment (MBIE) officials met with Minister Woods on Monday 29 April to discuss the draft Cabinet paper on the refundability proposal. Minister Woods suggested that she and her colleague Minister Nash meet to discuss the draft Cabinet paper, *Extending Refundability for the Research and Development Tax Incentive* (3068 18-19/IR2019/159 refers).
2. This brief provides you with additional information to support your discussions on the refundability proposal included in the draft Cabinet paper.

The Cabinet paper proposes broad-based refundability

3. The draft Cabinet paper, *Extending Refundability for the Research and Development Tax Incentive*, outlined a proposal for the design of the longer term refundability policy to replace the limited refundability that applies for year one of the R&D Tax Incentive (Tax Incentive) scheme.
4. The Tax Incentive has been designed to be a broad based scheme, providing easily accessible R&D support for eligible businesses regardless of their size, revenue or profit or loss position. The refundability proposal as recommended by officials is consistent with this overarching policy objective.
5. Officials have proposed that refundability is broadly available to all firms in loss whose R&D activities qualify for the Tax Incentive. We propose that Levy bodies are eligible for the Tax Incentive but that charities, local authorities and other tax-exempt organisations are ineligible.
6. We are also proposing a cap based on payroll taxes to constrain how much of the R&D tax credit can be refunded in any one year. This is to manage the risks that refundability poses to the integrity of the scheme. A cap based on payroll taxes ensures the amount a firm receives from refundability is not more than the amount the firm puts into the tax system. It is also simple to understand and easy to administer.

An alternative is to target refundability to SMEs, or to apply a cap

Targeting refundability to small-medium-enterprises (SMEs)

7. Our analysis shows that two-thirds of Growth Grant recipients are in loss. It also shows that 73 per cent of Growth Grant recipients are not SMEs (i.e. they have more than 20 full-time-equivalents (FTEs)). This analysis indicates that there would be a significant number of Growth Grant recipients who would not receive the benefit of refundability if it were targeted to SMEs only.

Limiting refundability by introducing a cap on the amount that can be refunded

8. If there was a less restrictive form of targeting, for example a cap on the amount of R&D tax credits that can be refunded then fewer firms would be impacted. Analysis shows there are between four to six New Zealand based R&D performers who are likely to be negatively impacted by a \$5 million cap (i.e. they are in loss and also undertake more than \$30 million worth of R&D activity per year).
9. If Ministers choose to limit refundability to a specific capped amount then officials consider that it would be necessary to provide further advice on threshold options or ways to treat atypical businesses such as cooperatives to ensure such firms are not disadvantaged. Additional policy options are likely to add further complexity to the scheme.

Examples of firms that would be impacted by targeted refundability

10. During our consultation on the Tax Incentive, and as part of stakeholder engagement on refundability, we have built up a picture of the type of R&D being conducted by large R&D performers in New Zealand. This information is commercially sensitive but has been given to us to help develop robust policy options. Examples of businesses that would be negatively impacted by targeting refundability to SMEs, or by limiting refundability with a cap (for example a \$5 million cap):

■ Commercial Information

[Redacted]

- **Exporters.** New Zealand has a number of R&D performing firms that are exporters. These include large firms that can undertake significant amounts of R&D activity in any year. These firms may be profit making so not affected by refundability, but some could be in temporary loss-making positions because of international factors including transfer pricing rules applied in other jurisdictions as well as market and exchange rate fluctuations. Being eligible for refundability would support exporters to continue their R&D investment independent of external factors.

• Commercial Information

[Redacted]

- **Multi-national-corporations (MNCs).** A cap on refundability could also weaken the attraction of the Tax Incentive for MNCs who might be considering relocating their R&D activities to New Zealand. If these firms did move their R&D operations to New Zealand, the payroll cap would incentivise economic activity such as investment and employment, even if other linkages or tax contributions to the New Zealand economy are not large.

Commercial Information

[Redacted]

Additional analysis of the proposed payroll cap

11. Our recommended refundability policy option limits the amount of the R&D tax credit that is refundable to the amount of payroll taxes² paid in the same tax year. In our previous briefing we undertook to investigate the impact a payroll cap has on firms and report back on this (3068 18-19, IR2019/159 refers).
12. We investigated the impact a payroll cap will have on smaller firms, by assessing how it would affect current Callaghan Innovation Project Grant recipients. Project Grants are designed for businesses new to or trying to expand their R&D. Officials selected Project Grants recipients for our analysis because we are able to identify Project Grant recipients in the Inland Revenue system and they are a proxy for early stage R&D intensive firms. However, no adjustment has been made for Project Grant recipients who have an estimated level of eligible R&D below the \$50,000 per year threshold.
13. There are 326 firms in the Project Grant sample, of these:
 - 20 per cent are in profit, so would receive the benefit of an R&D tax credit
 - The remaining 80 per cent did not report income or are in loss. Of this 80 per cent:
 - 43 per cent did not report income or are in loss, but pay sufficient payroll taxes to get all or most of their R&D tax credits refunded
 - 18 per cent did not report income or are in loss and only pay a small amount of payroll taxes so would need to carry forward a relatively large proportion of their R&D tax credits
 - 39 per cent did not report income or are in loss and do not pay any payroll taxes so would be unable to receive any refund of their R&D tax credit, and would carry forward all their R&D tax credits
14. However, there are significant caveats³ around this analysis which means it should only be considered as indicative for early stage R&D intensive firms. Nonetheless, it indicates that a notable proportion of early stage R&D intensive firms may not receive a full refund of their R&D tax credits. This is consistent with feedback received from the stakeholder workshops.
15. The introduction of the Tax Incentive does not change firms' access to Project Grants. And some firms receiving Project Grants will also have additional R&D expenditure that qualifies for the Tax Incentive.
16. As noted previously the Tax Incentive is not the only tool to support start-ups. Officials are in the process of reviewing Project Grants and the R&D Tax Loss Cash Out policy to identify improvements to these instruments. Changes to the R&D Tax Loss Cash Out policy will unlikely to be in place when the revised refundability policy will commence in April 2020, but changes to Project Grants could be.

² Payroll taxes would include PAYE, fringe benefit tax, employer superannuation contribution tax and withholding tax on schedular payments. It is also proposed that eligible payments to Approved Research Providers would not be subject to the cap.

³ The assessment of R&D expenditure could be an under estimate of the firm's eligible expenditure under the R&D Tax Incentive. We have not taken into account any behavioural changes, for instance firms and contractors entering into voluntary schedular arrangements to deduct withholding tax or firms being able to adjust the level of net income they report so that the tax credit offsets any tax liability. Some firms will be part of a corporate group so the amounts of payroll taxes paid may be greater than what we have assessed.

Feedback from agency consultation on local authorities' eligibility for the Tax Incentive

17. The draft Cabinet paper recommends that all local authorities, as well as entities controlled by or associated with local authorities, are not eligible for the Tax Incentive. In its feedback on the draft Cabinet paper, the Department of Internal Affairs suggested that the underlying rationale for excluding local authorities was sound, but pointed out that companies minority owned by councils operated in the commercial sphere and therefore could be considered for eligibility.
18. We think this is a sensible adjustment, as it would bring these minority-owned entities of councils onto the same footing as minority owned entities of Crown Research Institutes, District Health Boards and tertiary organisations.

Next Steps

19. We will incorporate your feedback and provide you with a revised draft Cabinet paper which you can use for consultation with other Ministers and their offices.
20. In order to meet the legislative timetable, we recommend the Cabinet paper is lodged on 16 May 2019, for consideration at Cabinet Economic Development Committee on 22 May 2019.
21. The regulatory impact statement is being assessed by the review panel. We expect to be able to provide this to your office next week.
22. The timetable for Cabinet and LEG approval on 24 June 2019 is dictated by other items that will be in the Tax Omnibus Bill.