

KPMG R&D Update

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Australia, Callaghan Innovation, and the R&D Tax Incentive

In a nutshell...

In this update we share the insights and lessons learned from our attendance at KPMG Australia's recent National R&D Conference. As the New Zealand R&D model can draw on the Australian experience it is important businesses are familiar with the practical consequences and lessons of an R&D tax incentive regime.

This update also looks at the part Callaghan Innovation can play in the changing landscape of R&D funding. We look at the potential opportunity for Callaghan Innovation to strengthen their role as an innovation activist in New Zealand and the ways in which it can utilise its expertise to provide the best possible support for business.

We also look at the way in which Callaghan Innovation and IRD can work together to ensure administrative responsibilities are maintained and balanced to avoid IRD dominating the R&D Tax Incentive, a fear some businesses have already expressed. For this, Australia is a valuable resource.

Lessons from Australia:

- Contemporaneous record keeping
- Regular dialogue
- Benefit of site visits
- The dual agency approach

Analyse the potential roles of Callaghan Innovation and IRD to provide the best possible support for business

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Lessons from Australia

Our R&D team recently attended KPMG Australia's National R&D Conference. As the NZ experience is likely to exhibit traits similar to Australia over time, the insights we gained from our visit will prove extremely valuable going forward, and in this update we share these with you.

This is particularly important as the level of Australian audit activity has increased significantly over the last two years. It is possible that this is a consequence of the increased fiscal cost of the Australian regime. Regardless of the reason, it is important that NZ businesses are familiar with the relevant lessons.

Contemporaneous record-keeping

It is difficult to overstate the importance of this. Companies who attempt to prepare activity and costing information at the end of the year rather than at the time of doing their R&D have a very difficult time establishing credibility with reviewers.

Format of documentation

The Australian legislation does not prescribe the specific form that documentation should take. However, where companies have relied solely on internal business documentation to support their R&D claim, they have often found it difficult to demonstrate to reviewers how this ties to the activity and expenditure rules specified in the legislation.

The benefit of site visits

It is often difficult for a reviewer to understand an R&D project when they lack the context of the business. Experience shows site visits often help with clarification and lead to more streamlined reviews of claims. However, companies cannot rely on this as a 'silver bullet' since reviewers have limited resources.

For this reason, it is critical that a company's documentation, as best as possible, conveys to a future reviewer as much context as would be garnered from undertaking a site visit. To assist with this, project files can also include diagrams, photographs, 3D models, or even short videos.

Regular dialogue

It is important that Officials share their concerns with the business community on a regular basis regarding any issues with the regime. Conversely, it is also important that the business community share its concerns with Officials in a timely and constructive manner.

The dual agency approach

In Australia, the Australian Taxation Office (ATO) is responsible for reviewing the eligibility of expenditure, and AusIndustry the eligibility of activities. Each agency is independent and equal to the other, and both have the power to commence reviews following their own processes.

Callaghan Innovation: A Brave New Future

Liberate the Innovation Activist

Callaghan Innovation has identified a role for itself – to stimulate demand for innovation and as an activist for New Zealand innovation.

Since Callaghan Innovation's establishment, it is arguable that R&D Grants have assumed a larger than ideal profile for the organisation, causing internal distraction and external confusion of Callaghan Innovation's role to its customers.

While Project and Student Grants will remain, the lower eligibility thresholds being proposed for the R&D Tax Incentive (compared to the Growth Grant) are anticipated

to free up Account Managers and position them to more closely work with businesses on their R&D and Innovation activities - a positive outcome.

The introduction of an R&D Tax Incentive is an opportunity for Callaghan Innovation to consolidate its activist role in New Zealand's R&D and innovation ecosystem.

Creating Ubiquitous Access

Callaghan Innovation generates significant knowledge on innovation, however this is not accessible to all businesses. Accordingly, further thought should be given to how to spread its reach.

An example of this would be Callaghan Innovation reviewing its service delivery – and creating a digital self-serve platform for elements of its services – both existing and those to be developed. Such an approach could readily include web-casting of specialist seminars – assisting in addressing the issues of time constraints and distance.

Achievement of this would generate two positive outcomes: The tyranny of distance would be resolved for regional and rural based businesses, and Callaghan Innovation Account Managers could be freed up to provide targeted specialist advice and guidance to further accelerate leading innovative businesses.

Recruitment Support

A significant issue facing growing innovation companies is finding the right people. Creating the functionality where businesses can use Callaghan Innovation to facilitate this would be a powerful tool. An example of how Callaghan Innovation could assist this would be to enable customers to post open roles to a common job board. Similarly, Callaghan Innovation could partner with a group of recruitment agencies to support smaller businesses looking to fill highly skilled positions.

Training

Echoing the comments from the January 2018 Independent Progress Review of Callaghan Innovation, an investment in training can have a significant impact on Callaghan Innovation's effectiveness. Strength of understanding Callaghan Innovation's products, including identification of capability/knowledge gaps, and familiarity with adjacent products, e.g. in New Zealand Trade and Enterprise and Ministry of Business, Innovation and Employment, can have a powerful effect in Callaghan Innovation's role as a connector in the innovation ecosystem.

Furthermore, as there is likely to be some overlap with the R&D Tax Incentive, having a grasp of the key tax technical issues will be critical. Therefore, providing the necessary training to Callaghan Innovation's business facing team will be essential.

Support and Assistance to IRD: Avoidance of Gamekeeper Turn Poacher Allegations

The joint Ministerial view in the April 2018 discussion paper notes;

"Tax incentives allow firms to decide what R&D they should do. They do offer a greater element of certainty to businesses. It (the R&D Tax Incentive) will be a simpler process, opening access to those that have either struggled to access support or have been shut out of the process in the past. We want to establish a system of support that will stand the test of time and give businesses the consistency and confidence they need to succeed."

Some businesses have expressed concern over IRD controlling oversight of the R&D Tax Incentive, raising the question of other jurisdictions' experiences. As noted above, we see value in the Australian approach where the ATO and AusIndustry have joint administrative responsibility for the Australian R&D Tax Incentive programme.

IRD's role in improving the economic and social wellbeing of New Zealanders can be readily dovetailed with Callaghan Innovation's experience and expertise in supporting



hi-tech businesses, to provide certainty about, and confidence in, the R&D Tax Incentive regime. We believe visible independence in the R&D Tax Incentive assessment process will provide the required consistency and certainty for businesses to have confidence in the scheme.

Callaghan Innovation already supports IRD with the (smaller) R&D Loss Tax credit scheme, showing a proven inter-agency cooperation model that can be expanded to provide demonstrable separation of duties as achieved in the Australian model. This would avoid IRD being viewed as 'gamekeeper' and 'poacher'.

Callaghan Innovation has the relevant R&D Grant assessment capability that, when combined with its in-house technical expertise, well positions the organisation in terms of understanding R&D in the business context. In doing so, Callaghan Innovation can support business confidence in the R&D Tax Incentive –and champion R&D and Innovation – thereby maximising the benefits of the incentive for the NZ economy.

Key Issues

We believe the following will be critical:

- Consolidate Callaghan Innovation as the national agency for business R&D and Innovation in the commercial context.
- Provide businesses with confidence and certainty in the R&D Tax Incentive scheme through active Callaghan Innovation involvement in determining the eligibility of R&D activities.
- Like the ATO, IRD can be charged with determining eligible costs (within the deemed eligible R&D activities) of R&D Tax Incentive claims. However, as noted in the learnings from Australia, IRD and Callaghan Innovation's workflow must be harmonised to avoid the claimant interacting with two entities in parallel.

What you need to do

As noted in the 'lessons from Australia', quality record keeping is crucial, and it is important that businesses are in a place to start recording their R&D activity and costing information accurately, and contemporaneously.

Businesses should look to the current state of their systems and processes for recording information, and discuss these with their KPMG contact to ensure they are in the best possible position when the R&D Tax Incentive regime comes into force. Alternatively, contact our team below for assistance with this.

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