KPMG R&D Update

3 October 2018

Significant announcements for the R&D tax incentive

In a nutshell…

KPMG attended MBIE's announcement of the R&D tax incentive scheme in Auckland this morning and in short, this was the most significant update on the R&D tax incentive from officials since the discussion document was realised in April this year. Prime Minister Jacinda Ardern, Revenue Minister Stuart Nash, and Minister for Revenue Science and Innovation Megan Woods all took part in the announcement.

We understand significant effort has gone into the development of the regime over the incredibly short period of time that Government has sought to implement legislation.

The focus of this morning's session was on the mechanics of the regime, and technical requirements for the taxpayer, without diving into any significant legislative detail.

There were however a number of positive announcements that show officials are making real progress on the implementation of the tax incentive. It's apparent that feedback on the discussion document has been taken seriously, and we believe a number of the changes provide a great outcome for the taxpayer.

The incentive is intended to be effective from the 2019 tax year, onwards.

We outline the key features in some more detail below.

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Key Features explained

Incentive rate of 15%

The proposed incentive in the discussion document was 12.5%. Officials have reacted to feedback and increased the rate of the incentive to 15%. This is the same as the 2008 regime, but also more closely aligns with Growth Grant funding which is still available. Readers should be aware that the tax effected value of the Growth Grant is 14.4%, so in essence, the tax incentive now has a higher net value than the Growth Grant.

Minimum R&D threshold

The initially proposed threshold for minimum R&D spend was $100,000. Officials believe that for smaller business to access the incentive the minimum threshold should be lower – the minimum threshold for eligible R&D spend will be $50,000.

Modernised R&D definition

The definition of R&D will no longer includes reference to a scientific method, but instead a systematic approach. It has been largely recognised that a definition which requires a "scientific method" to be used precludes many businesses that are doing genuine R&D from accessing the incentive. The modernised definition will allow wider access to the incentive, and recognises that R&D has evolved significantly from what was traditionally a scientific process.

Pre-approval mechanism for small claims

Pre-approval will only apply from the second year of the tax incentive. Businesses will be required to pre-approve their R&D activities with Inland Revenue in the year that the R&D activity is being performed.

Despite the additional work required, the approval will be binding on the commissioner, and will provide some certainty to the taxpayer that the activities are eligible for tax incentive support.

If an entity is spending more than $2m on R&D, a separate process will apply. We understand that those entities spending over $2m will not be precluded from pre-approval, though it is possible additional requirements will apply to verify the eligible R&D expenditure.

We expect more detail to be provided on this point as the draft legislation progresses.

Loss making companies

Loss makers will be eligible for a refund under the same terms as the R&D cash-out rules. The R&D cash-out rules allow an amount of R&D loss to be cashed out, provided wage intensity and corporate eligibility tests are met.

A refund will be allowed to the extent that the R&D expenditure is eligible under the new R&D tax incentive rules, but also meets the corporate eligibility and wage intensity tests in the cash-out rules. (Section MX2, MX3).

Loss cash-outs are capped at $1.7m of eligible expenditure (i,e. a cash payment of 0.15x$1.7m = $255k). Any remaining eligible R&D expenditure recognised as a tax credit will be able to be carried forward to future periods.

In brief, in year one, a refund of the tax incentive will be available even if the company is in a loss position, and the taxpayer will be entitled to this in addition to the R&D loss cash-up refund. To achieve the dual impact of the two regimes, the eligibility criteria of the current R&D cash-up must be satisfied.

All businesses eligible

Irrespective of legal structure, all entities will be eligible to claim the tax incentive. This will also include State Owned Enterprises, industry research cooperatives (incl. levy bodies), and some Crown owned entity subsidiaries.

Dual purpose R&D expenditure

Despite the proposal document's consideration of all dual purpose R&D expenditure as ineligible, officials have accepted the genuine R&D is being performed regardless of whether there is a wider commercial outcome.

That being said, if genuine R&D is being performed in the course of commercial production, only those costs specifically related to the R&D activity will be eligible for the incentive.

Cap on eligible expenditure

Eligible R&D expenditure will be capped at $120m. However, businesses who exceed the cap can apply for an extension. An extension of the cap will require a demonstration from the taxpayer that New Zealand will derive substantial benefit from R&D results.

Accounting treatment of expenditure

The accounting treatment of expenditure will not dictate whether it is eligible or not for the tax incentive.

Amending your R&D claim.

An extended timeline will apply for amending your R&D claim, outside of the normal extension of time.

It is anticipated that businesses will complete the R&D claim at the same time as the tax return has been completed, however, there is a recognition that there is an element of complexity in preparing the R&D claim and provision should be made for the taxpayer to amend this at a later date.

The proposed timeframe would allow a business to amend the R&D claim for up to a year after the tax return's due date. For taxpayers with an extension of time, this means up to two years following the end of the financial year.

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.

Tax Incentive, or Growth Grant.

A business will only be able to claim either the tax incentive, or a Callaghan Growth Grant, not both. Regardless of whether separate expenditure is individually eligible for the Grant, or for the Incentive, only one of the two is available for any income year.

What you need to do

Consistent with prior messages, quality record keeping will be crucial to success. It's important that businesses start to record R&D and costing information accurately and contemporaneously.

Businesses should continue to look at their current systems and processes for recording information, and discuss these with your KPMG contact to ensure you are in the best possible position when the R&D incentive is introduced into law.

Businesses should also consider whether the Growth Grant, or the Tax Incentive suits their needs best in the first year, where the incentive only has a limited refund ability.

As this framework will now feed into draft legislation, there is an opportunity to provide feedback through the parliamentary legislative process.

If you have feedback that you would like to be considered in this phase, or have any further queries on the above, please get in touch with your KPMG contact or any of our team below.

For further information

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