R&D Tax Incentive Team
Ministry of Business, Innovation & Employment
Wellington
By email: RDincentive@mbie.govt.nz

Friday 1 June, 2018

LETTER OF SUPPORT: RESEARCH AND DEVELOPMENT TAX INCENTIVE DISCUSSION DOCUMENT

The Wellington Chamber of Commerce (The Chamber) writes to express our support for ExportNZ, ManufacturingNZ and BusinessNZ's submissions on the Research and Development Tax Incentive consultation. The Chamber welcomes the opportunity to submit on the R&D Tax Incentive Discussion Document.

The Chamber has been the voice of business in the Wellington region for 161 years since 1856 and advocates policies that reflect the interests of the business community in both the city and region, and the development of the region's economy as a whole. The Chamber advocates the views of its members and obtains that view through regularly surveying members.

We are a business membership association, representing 3,400 members and their interests throughout the Wellington region, as well as being one of the four regional organisations comprising New Zealand's peak business advocacy group, BusinessNZ. In Wellington, our organisation operates the Wellington Chamber of Commerce, accredited to the New Zealand Chamber of Commerce network. Our organisation also delivers ExportNZ to Wellington, the Hawke's Bay and the Central region.

The Chamber supports ExportNZ, ManufacturingNZ, and BusinessNZ's submission to the Ministry of Business, Innovation and Employment and wholly endorses these organisation's comments.

This letter of support doesn't seek to necessarily comment specifically on each question asked in the discussion document. However we do wish to raise issues we know businesses are particularly concerned with.

PROPOSAL

The Government is proposing a system of 12.5% tax refunds on company investment in R&D for expenditure over $100,000 a year. The system would work in tandem with the R&D grants administered by Callaghan Innovation, and would replace the current Callaghan Growth Grants. There are pros and cons from moving away from Growth Grants to an R & D tax credit.

It is of the real importance that we look at how this can best benefit industry and move towards a higher-innovation economy. There's no question that New Zealand has got to improve our share of R&D - currently it's 1.28 percent of GDP, compared to an OECD average of 2.38 per cent.

But of course it's always a question of what we do and how we do it. We need to make sure whether a tax incentive system would be easier or harder to navigate than the current system of Growth Grants, especially for small to medium sized businesses.

Feedback that ExportNZ and ManufacturingNZ have received from their Chief Technology Officers Group (CTO) is that many were happy with the current scheme and it was contributing significantly to their ability to increase investment in R & D. It is worth noting the things that the CTO collectively liked about the scheme in case some of the elements can be replicated in the R & D tax credit scheme.

- Low transaction cost to participate in the Growth Grant scheme. Once you met the criteria there was little administrative complexity to contend with.
- Essentially pre-approval of what you would be reimbursed for – along with regular payments which is good for cash-flow. So, good predictability and good cash-flow.

It could also be argued that the larger companies that were eligible for growth grants had the greater commercialisation potential. That said, MBIE statistics indicate that we have less R & D occurring in some of our larger firms than is the case internationally and that our small to medium size firms are quite R & D intensive as a proportion of their turn-over. As the ExportNZ and ManufacturingNZ points out, if this is the case – how do we get these larger firms to intensify their R & D – and if they were not going for Growth Grants, will the tax credit be the incentive they need? It could be, in that some of them were not eligible for Growth Grants – due to the 1.5% of revenue they needed to invest in R & D.

On the con side of Growth Grants, there were a lot of firms doing good R & D or with good R & D potential that were not eligible for support. A tax credit scheme moves away from "picking winners" and spreads the incentive more widely.

We believe the question needs to be asked, whether at 12.5% this tax incentive will be enough to shift the dial and be transformational for the New Zealand economy. Australian tax credits are significantly higher for the SME's – but we also appreciate that if we want simplicity then having a two track approach to large and small firms would increase complexity.

On balance – we would agree with the ExportNZ and ManufacturingNZ submission, that this new approach (R & D tax credits, plus the retention of Project Grants) should be pursued, but aim for a higher rate than 12.5%.

Other issues raised by ExportNZ, ManufacturingNZ and BusinessNZ we wish to draw to your attention to include:

- We do not feel that **excluding 'activities involved in complying with statutory requirements or standards'** would support development, as development regarding standards was necessary to ensure quality control but can be substantive in the R&D sense. Additionally, a substantial amount of development goes into 'pre-production activities, such as demonstration of commercial viability, tooling-up and trial runs' – exclusion would cut out qualification for an area that companies can invest a lot into developing.

- While we appreciate the stance taken regarding **dual purpose activities** – namely an R&D tax credit would be better targeted if it applies to an activity conducted solely for an R&D purpose – we endorse BusinessNZ's point and strongly urge caution here. In almost all situations, a business will undertake R&D for the purpose of making income as businesses are generally not narrowly defined within just the research space. They have to continuously be nimble enough to look for opportunities in the market whereby R&D is undertaken with the end purpose of commercializing their work. Therefore, to solely apply it to pure R&D purposes only without the other purpose of commercialisation would greatly inhibit almost all businesses from applying.

- As with BusinessNZ, in principle, we agree that **R&D costs incurred overseas** should be eligible for the concession for up to a certain percentage of the total cost of the project if the overseas work is part of an R&D project based in New Zealand and at least half the R&D expenditure within a project is for activities carried out in New Zealand. Overall, we view this as a pragmatic outcome, and we supported a similar stance taken in 2007 given it would be idealistic to think New Zealand can undertake everything. As noted in the paper, New Zealand may not have complete capability to do the work locally, so foreign R&D jurisdiction requirements and customisation of a product for a particular market may need to take place in that market.

- However, a key question is whether the percentage value of 10% as outlined in the Discussion Document is realistic enough in today's global environment? While we appreciate the fact that we do not want a situation where almost all the R&D is done offshore, at the same time we also do not want to see missed opportunities because of the restrictive nature of the 10% limit, thus creating some form of silo mentality when it comes to R&D activity in New Zealand. Therefore, if there are sufficient practical reasons outlined by other submitters that this should be more than 10%, we do not have any significant concerns about this being increased.

- The discussion document, while providing some guidance on the overall intention of the tax incentive scheme, does leave some **vast grey areas in which businesses are concerned around what is to be eligible and what isn't**. We believe it would be useful for the government agencies working on this project to provide some guidance on self-assessment in order to ensure those applying for the scheme will be compliant with regulation.

- Given the current grants are drip fed throughout the year, many of the companies currently receiving grants will be reliant on them to **ensure cash-flow for their current R&D projects**. We believe this needs to be considered in terms of assisting businesses with the transition to the tax credit system.

- In principle, we agree with the intent of the overall move to tax incentives, in that it will reach more companies and encourage investment in more R&D. However, the risk is in the implementation of the system, the **compliance costs and time** put into applications would be unconducive to the intent of the change. We see it as essential that pre-approvals are in place as soon as possible.

Yours sincerely,

John Milford, Chief Executive, Wellington Chamber of Commerce