NZmea
SUPPORTING THE REAL ECONOMY

30 August 2013

R&D Tax Losses Proposal
C/- Deputy Commissioner, Policy and Strategy
Inland Revenue Department
PO Box 2198
Wellington 6140

Email: policy.webmaster@ird.govt.nz

Dear Sirs

Submission on R&D Tax Losses Proposal

Thank you for the opportunity to comment on the above document.

The New Zealand Manufacturers and Exporters Association (NZMEA) represent the interests of manufacturers and exporters throughout New Zealand.

The Association is New Zealand's only focused and independent voice for manufacturers and exporters. Members make over $2.7 billion in sales per year, with an export value of around $1.3 billion. The Association can trace its beginning back to the early history of New Zealand.

The Association also includes in its membership affiliate organisations such as the Wood Processors Association, the Engineering Printing & Manufacturing Union Inc, the Heavy Engineering Research Association (HERA), and Plastics New Zealand.

The NZMEA is an independent association of manufacturers and exporters. We do not seek or receive funding from local or central government; we have affiliate organisations, we do not affiliate to any other organisation.

Submission Points

Is this the right characterisation of the problem?
We agree that cash flow is a key issue for companies undertaking R&D. It is fair to say that this is largely an issue for pre-revenue start-up companies but in difficult times it can affect those companies further along the growth path that might be struggling for profitability. In such circumstances funding options are limited. Compared to start-ups these later stage companies might be better able to monetise R&D outcomes.

Is this a significant problem in practice (given the existence of look-through companies and limited partnerships)?
In practice, cash flow is a significant problem for all R&D intensive companies (i.e. both start-ups and well established companies).

Do the eligibility criteria effectively target R&D-intensive start-up companies? Are there any additional eligility criteria that should be included?
Yes, the criteria does effectively target R&D based start-ups, although we believe later stage companies which satisfy the R&D intensity requirements should receive additional R&D support.

Are there likely to be difficulties arising in using these critiera? Are there possible unintended consequences? Is the 20 percent R&D wage intensity threshold appropriate?
When the R&D work is conducted inhouse the 20 percent R&D wage intensity threshold is appropriate. Any R&D-intensive company, start-up or later stage, should easily meet these critiera.

Do you anticipate any problems with the proposed arrangements for dealing with contracted R&D; either for purchasers or suppliers of R&D?
When dealing with contracted R&D the situation is more difficult. The requirement to identify wage and salary components of the outsourced R&D expenditure might be problematic. Contractors will see information around wage rates, and implicitly margins, as commercially confidential, undermining the firms ability to demonstrate R&D wage intensity which has to be identified in order to meet the 20% threshold.

Does the section on grouping rules accurately describe the risks in relation to grouping? Have any situations been omitted?
We do not see this issue of grouping as a problem in practice.

Recognising that too loose a set of criteria could leave significant scope for abuse and undermine the integrity and durability of the proposal, is the definition of R&D, when combined with the other criteria, sufficiently robust?
In paragraph 5.28, the late stages of software devleopment (for example coding) has been excluded from the R&D definition. Based on our experience, a significant amount of intellectual property is developed as an inherent part of the coding process and should be classified as R&D. Would the exclusion of clinical trials include medical devices? Device trials are a key part of the R&D process.

Are there other definitions of R&D used by companies that could be used for the suggested changes?
It is worth remembering that much of the work done by firms in New Zealand is more development than research, development still has the uncertainty and risk associated with doing new things and the development is done in the anticipation of future commercial activity.

Using R&D definitions that are more expansive suits the reality of the R&D landscape in New Zealand. Firms don’t do R&D for fun, there is a risk in any new activity based on technical development; the definition “new to the firm” as opposed to “new to the world” would support more R&D here and will help support more commercial activity in the future.

We suggest a broad inclusive approach to R&D be used rather than take a narrow exclusive approach, we suggest patent and standard compliance cost be included as these are yet another inherent part of the development process.

Would excluding government grants cause specific distortions? If so, what would be the nature and magnitude of these distortions?
We agree that government grants should not be included, we do not see any major distortion resulting from this exclusion.

What approaches would be helpful to reduce uncertainty about the application process for potential applicants?
To reduce the uncertainty, applicants should be notified at the beginning of the screening process. A clear timeframe should also be provided and delivered.

Are the possible unintended consequences that have not been captured above (Chapter 7)?
No comment.

What other measures may be needed to minimise risk to the tax base?
No comment.

Would the proposed loss recovery rules be significantly less complex if the proposed rules governing the sale of company shares were not included, and the loss stayed within the company? If yes, how else could a neutral tax outcome be achieved, with lower complexity, for situations where some of the shares of the company are sold?
As shareholdings in start-up companies can change often during early stages it would be much more straightforward for the tax loss to remain with the company, rather than be attached to the shareholders. The tax recovery follows when the company moves into a profitable situation.

Finally, the most straightforward approach for the sale of the company, would be for the potential liability on loss recovery income to follow transfer or amalgamation.

Yours sincerely

John Walley

John Walley
Chief Executive