

8 February 2008

Robin Oliver
Deputy Commissioner - Policy
Inland Revenue Department
PO Box 2198
WELLINGTON

Email: robin.oliver@ird.govt.nz

Dear Robin

Re: Draft Research and Development Tax Credit Guide

I am writing to you in regard to the recent draft guide released by the Inland Revenue Department (IRD) entitled *Draft Research and Development Tax Credit Guide*. While the draft guide is a significant body of work at over 200 pages long, Business New Zealand would like to provide some overarching comments to ensure it provides both the pre-eminent information for applicants, as well as the best opportunity to lift the level of R&D expenditure by businesses in New Zealand.

As a background, although Business New Zealand did not support the introduction of R&D tax credits into New Zealand, we fully support the proper and correct use of the credits to improve the level of R&D that takes place in this country. The challenge for both applicants and IRD will not be at the end of the spectrums for defining R&D where there is a clear distinction between standard operational expenditure and R&D expenditure. The difficulty will lie in the middle where boundaries are not clearly defined and open to interpretation.

Overall, IRD have provided a useful and lengthy guide. However, there are aspects of it that we believe could be enhanced or added to so that it becomes a valuable resource for applicants, as well as ensuring the allocation of funds are fully utilised by the business community.

First, as the title suggests, it should remain a guide rather than any 'locked-in' definitive publication that would not require modification or additions over the short-medium term. While we would want the first publicly released guide to be as accurate as possible, there will most likely be further additions as issues relating to R&D tax credits that are perhaps unique to New Zealand evolves. As the guide would almost always be downloaded from the IRD website, IRD need to ensure that

the webpage providing the guide outlines any significant amendments etc which may require a modified copy to be downloaded or printed by applicants. Also, given the length of over 200 pages, we would not object to some intermediate guide that pulled out the fundamentals of the credit system, which could involve a series of downloadable pages off the IRD website. Furthermore, we would want IRD to remain transparent in terms of how the credit system unfolds in terms of decisions as to whether applications are accepted or declined. We would obviously not expect names of companies and exact details to be published, but the general outcomes of decisions could be used as examples in the guide, or kept as an electronic logbook that could be referred to by prospective applicants.

Second, as with the scheme itself, we would not want the guide to be overly prescriptive in its interpretations. As you are well aware, IRD have generally taken a self-assessment taxation approach, whereby taxpayers are responsible for calculating their own tax obligations, paying the tax to the IRD and filing their tax returns. Although the self-assessment regime is buttressed by audit activity, generally the regulatory approach favoured by IRD facilitates good outcomes rather than prescribes a set way of doing things.

Unfortunately, this prescriptive approach is evident via the considerable planning and record keeping requirements businesses need to provide IRD with regarding the actual R&D expenditure incurred. While the guide discusses the roll of self-assessment in the guide when discussing record-keeping responsibilities, the assessment requirements are high. One could argue that it borders on being of a particularly prescriptive nature. We would certainly not want businesses allocating expenses that are simply not R&D, but the considerable record keeping provisions creates a significant compliance cost issue that businesses need to be aware of upfront. We would hope that businesses do not find the prescriptive requirements so high that the actual decision to apply is put in doubt. Therefore, we would want the full implications of the record keeping requirements etc to be extended at the beginning of the guide so that businesses are aware of their obligations.

Third, while the guide has examples throughout that attempt to explain the practical outcomes of the guidelines associated with the credit, we believe there is scope for a 'next level' of examples, that go beyond the often simple ones provided in the draft. While all examples have the disclaimer that the examples are simple and applicants should check the details within the guide or consult with a professional, there would be chapters in the draft where further examples would help explain procedures. Given the regulatory of blank space throughout the draft, there should be ample room for further examples included. Also, a summary of potential compliance costs would be useful to outline for certain types of businesses. Obviously, given the broad nature of the guide, any specifics could be difficult to outline, but some form of checklist might be useful to help determine what would potentially lie ahead.

At a broader issue in relation to R&D tax credits, we would expect IRD to position themselves on the side of acceptance rather than denial regarding applications that are on the margin for being classified as R&D expenditure. As mentioned above,

Business New Zealand would want to ensure that tax credits provided for R&D are for legitimate purposes. However, there is a point at which the threshold becomes so difficult that no one applies, and therefore the credits are underutilised for R&D purposes (i.e. there is disuse of the credit because of fears of misuse). While IRD may be taking an initial conservative stance so that the allocated funds are not soaked up by doubtful R&D expenditure, consistent declines of applications may inhibit future use of the credits by businesses, as they might perceive their chances are low, and it most probably would be a waste of business resources given the time and effort required during the application process. Therefore, we would expect that both the guide and general position taken by IRD concerning those applying for the R&D tax credits would not come from such a conservative stance that applications largely considered to be proper expenditure by the business community are declined.

Overall, Business New Zealand will be taking a keen interest in how successful the R&D tax credits system is in improving the level of R&D taking place in the country, and we hope that it will lead to businesses taking a more proactive and strategic consideration of the role R&D plays for their further expansion. We believe it would be advisable for some form of review to take place after say a year that invited public comment so as to define improvements and points of difficulty, especially any compliance and operational issues that may appear.

Regards,

A handwritten signature in black ink, appearing to read 'P. O'Reilly', with a stylized flourish extending to the right.

Phil O'Reilly
Chief Executive
Business New Zealand