Inland Revenue
Te Tari Taake

POLICY ADVICE DIVISION

THE TREASURY
Kaitohutohu Kaupapa Rawa

Tax policy report: Market development tax credit issues paper

Date:	27 October 2006	**Priority:**	High
Security Level:		**Report No:**	T2006/1995 PAD2006/226

Action sought

	Action Sought	**Deadline**
Minister of Finance	Agree to recommendations	30 October 2006
Minister of Revenue	Agree to recommendations	30 October 2006

Contact for telephone discussion (if required)

Name	**Position**	**Telephone**
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[information deleted in order to protect the privacy of natural persons, including deceased people]		

Minister of Finance
Minister of Revenue

Market development tax credit issues paper

Executive summary

Officials agreed to report to Ministers on the specific issues relating to the detail of tax credits for research and development, export market development and the improvement of workforce skills, which are under consideration. This report outlines the detailed design issues of an export market development tax credit and seeks your agreement to include these issues in the issues paper and to release the attached draft issues paper for public consultation.

Comment

The issues paper has been drafted on the basis of Ministers' guidance provided at the meetings with officials on 18 and 19 October. The issues paper may need to be amended to reflect Ministers' decisions on the detailed design. If Ministers elect to use an incremental approach (the subject of a separate report), the issues paper will need to be further amended.

This report seeks Ministers' agreement that the following design features of the market development tax credit be included in the issues paper for public release.

- The objective of the market development tax credit would be to support all forms of market development in relation to exports to countries other than Australia, subject to limits on eligibility and maximum and minimum expenditure.

- "Market development" is defined as activities undertaken by a firm to create or expand a presence in a market outside Australia and New Zealand in order to sell goods and services. It is not the cost of selling those goods and services.

- The issues paper provides a clear administrable definition of "export", namely "the exporting of goods and services to overseas countries when those goods and services are consumed overseas". Inbound tourism and educational services provided to foreign students

would be excluded as these services are consumed in New Zealand. This definition is consistent with rules used to zero-rate goods and services for GST purposes.

- All New Zealand tax resident businesses would be eligible for the credit, regardless of whether their business is undertaken in a corporate or other business structure. The definition of "business" would be the tax definition. Entities that are exempt from income tax would still be able to qualify for the tax credit provided they met the business test and the other qualifying criteria.

- Businesses would not qualify for the credit if they have turnover of over $50 million per annum or spend less than $20,000 of qualifying expenditure on market development.

- The tax credit would be available for developing a market for goods and services of New Zealand origin. The definition of "place of origin" used in the guide to interpreting the Fair Trading Act could be used to determine whether goods are of New Zealand origin.

- The market development tax credit would be limited to the following categories of expenditure, which are consistent with the MDAS grant expenditure categories:

Standard costs	• In-market visits; • attendance at trade shows and events; • bringing overseas buyers to New Zealand;
Actual costs	• advertising and promotional expenditure (excluding sponsorship); • marketing material; • trade shows and events; • time-based overseas representation; and • market research, where the market research is related to refining an approach to a market, rather than establishing an overall strategic direction.

- Standard costs would be set for in-market visits, attendance at trade shows, and bringing overseas buyers to New Zealand. This is consistent with the way the MDAS grant is administered.

- Expenditure that does not fall within the preceding qualifying expenditure categories would not qualify for the tax credit. There are some categories of expenditure which are specifically excluded, even though they may otherwise fall within the definition of "qualifying expenditure", namely:
    - salaries of employees in preparing marketing information or while visiting overseas markets;
    - costs of producing samples;
    - expenditure on developing a generic website;
    - expenditure covered by another government grant;
    - costs of setting up an overseas office or plant; and
    - fees relating to professional advice or testing/certifying products and services.

- Expenditure of a spouse travelling on business would be eligible for the credit to the extent that it met the test of ordinarily deductible for tax purposes.

- The tax credit would be limited to market development expenditure up to $1 million. Expenditure over that amount would not be eligible for the credit. That is, firms with market development expenditure greater than $1 million would be eligible to claim credit only on the first $1 million of expenditure.

Fiscal implications

Officials have not been able to estimate the revenue impacts of this proposal as official data on market development expenditure by exporting firms is not available. In the absence of such data, officials have been able to identify only one component of market developments - business overseas travel expenditure. NZTE has advised us that it has data on current MDAS recipients, which we may be able to analyse to produce revenue impacts. However, this data is in a manual form and would require additional time to extract it.

Officials will report back on the fiscal costs, although we are not confident that the revenue impact can be measured with any degree of precision.

Ministry of Foreign Affairs and Trade comment

"The Ministry understands that it has been decided to exclude services consumed in New Zealand from the ambit of the scheme. The Ministry wishes to note that education and tourism, in particular, are two of New Zealand's biggest export earners, and require substantial overseas market development in trade fairs, promotional visits and in-market research.

"The Ministry also wishes to note that the definition of goods and services that qualify for the tax credit will limit the scheme to goods actually manufactured in New Zealand. It would exclude New Zealand companies producing identifiably New Zealand products that would not necessarily meet this test, but may benefit from assistance with market development activities.

"In our view it would be sufficient to simply state that for market development activities to be within the scope of the scheme, they must relate to developing export markets for "goods and services of New Zealand origin" and leave this term to be interpreted on a common sense, case by case basis, taking into account a range of contextual factors."

Publication of the issues paper

If Ministers decide that the issues paper is to be released for consultation, it may be subject to minor editorial work to bring it up to publication standard.

Recommended action

We recommend you **agree** that the market development tax credit issues paper provides that:

(a) Market development is to be defined as the activities undertaken by a firm to develop a presence in a market outside Australia and New Zealand.

Agreed/not agreed Agreed/not agreed

(b) The definition of “export” includes goods and services to overseas countries when those goods and services are consumed overseas.

Agreed/not agreed Agreed/not agreed

(c) All New Zealand tax-resident businesses would potentially be eligible to the tax credit.

Agreed/not agreed Agreed/not agreed

(d) Businesses would not qualify for the credit if they have turnover of over $50 million per annum or spend less than $20,000 of qualifying expenditure on market development.

Agreed/not agreed Agreed/not agreed

(e) The tax credit would be available for developing a market for goods and services of New Zealand origin.

Agreed/not agreed Agreed/not agreed

(f) Qualifying expenditure would be limited to expenditure relating to market visits, overseas representation, bringing overseas buyers to New Zealand, advertising and promotional expenditure, marketing material, trade shows and events and certain types of market research.

Agreed/not agreed Agreed/not agreed

(g) all expenditure that does not fall within qualifying expenditure would not qualify for the tax credit, including:

- salaries of employees in preparing marketing information or while visiting overseas markets;
- costs of producing samples;
- expenditure on developing a generic website;
- expenditure covered by another government grant;
- costs of setting up an overseas office or plant; and
- fees relating to professional advice or testing/certifying products and services.

Agreed/not agreed Agreed/not agreed

(h) A minimum of $20,000 per year of qualifying expenditure would be required for any entity to be eligible for the tax credit.

Agreed/not agreed Agreed/not agreed

(i) The tax credit would be limited to market development expenditure up to $1 million.

Agreed/not agreed Agreed/not agreed

(j) Expenditure of a spouse travelling on business would be eligible for the credit to the extent that the expenditure meets the test of ordinarily deductible for tax purposes.

Agreed/not agreed

Agreed/not agreed

Benedikte Jensen
for Secretary to the Treasury

Emma Grigg
Policy Manager
Inland Revenue

Hon Dr Michael Cullen
Minister of Finance

Hon Peter Dunne
Minister of Revenue