The Treasury

Budget 2018 Information Release

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In preparing this Information Release, the Treasury has considered the public interest considerations in section 9(1) and section 18 of the Official Information Act.

Reference: T2017/2925 CM-3-3-1

Date: 18 December 2017

To: Minister of Finance (Hon Grant Robertson)

Deadline: 19th December 2017

Aide Memoire: Ministerial Meeting: Research and Development Tax Credit

You are meeting the Ministers of Research, Science and Innovation and Revenue at 9:30am on 19 December to discuss the introduction of a Research and Development (R&D) Tax Credit.

You have received a Joint Report (T2017/2920 refers) from the Treasury, the Ministry of Business, Innovation and Employment, Inland Revenue and Callaghan Innovation. That report was prepared on the assumption that a tax credit will be introduced as part of Labour's Manifesto commitment and sets out the process for doing so.

The objectives of the meeting are to confirm whether a tax credit will be implemented, and if so the timing and process of the credit. This note highlights the fiscal considerations of introducing a tax credit and the relative risks of implementing a tax credit in 2019 or 2020.

Decisions on the role and objectives of the tax credit are not required at this time. Clear objectives of a tax credit are important to inform design choices and the role of the tax credit, alongside other policy levers, to increase economy wide R&D expenditure to 2% of GDP. If implementation occurs in 2019 these will need to be determined in early January, to inform the discussion document (first draft is expected 25th January).

Rationale

As mentioned in your speech on 1 December 2017, increasing R&D can help increase productivity and wages, leading to higher living standards. Economy wide R&D can be increased by incentivising businesses to perform more R&D. International evidence suggests that R&D policies are most effective if they are stable and predictable.

New Zealand currently incentivises businesses through a range of grants. The Growth Grants scheme is the largest of these and provides non-discretionary grants for businesses that meet certain criteria. In 2016, businesses spent a total of $1.6 billion on R&D, up $356 million (29 percent) from 2014. Ministers should consider if introducing a tax credit results in better outcomes than the current system.

We recommend considering an R&D tax credit in the context of the current R&D and tax settings. This could create a package of support measures that incorporate the best of each measure. Tax credits and grants have different strengths and weaknesses. The non-discretionary element of Growth Grants gives businesses certainty, while their design features allow for some fiscal control (i.e. capped and forward looking). Growth Grants can also be altered through Ministerial direction rather than legislation.

Tax credits have lower compliance costs for firms and are market led, however, they are vulnerable to fiscal risks and incentivising business to re-characterise expenditure to take advantage of the tax credits.

Fiscal Implications

Labour's Fiscal Plan includes $850 million for a tax credit over the forecast period. The final cost of the tax credit will vary significantly depending on design choices, other innovation settings and external parties. As noted in paragraph 14 of the Joint Report, other jurisdictions struggle and often fail to contain the fiscal cost of R&D tax credits. How the tax credit is designed will impact and help mitigate these fiscal risks. Further details on key design choices are set out in the report and, assuming a 2019 implementation, advice on these will provided ahead of the draft discussion document in January.

Process and Timing

Creating a tax credit involves a number of steps, including policy creation, consultation, legislation and implementation. Ministers will be required to make decisions on a wide range of complex design choices (Joint Report refers at paragraph 19).

The earliest possible implementation date of a R&D tax credit is 1 April 2019. This timeline is based on the minimum time for each step. Significant and complex decisions will be required in January 2018, this creates greater risk of unintended consequences, which may increase fiscal risks.

Alternatively, the Joint Report notes an option for the credit to be implemented on 1 April 2020. Treasury's preference is for a 2020 implementation. This timeline allows more opportunity to limit and mitigate the fiscal risks noted above by allowing more time for design, implementation, consultation and preparing the private sector for a tax credit.

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