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New Zealand R&D tax incentive - Accounting treatment

Overview

New Zealand has introduced a research and development (R&D) tax incentive to encourage business innovation by reducing the cost of doing R&D. The incentive provides a **15% tax credit** on eligible activities and expenses starting from a business's 2019/20 income year. The main features of the programme include:

- A broad definition of R&D
- Available to most business operating in New Zealand
- R&D expenditure of $50,000 to $120 million p.a. typically qualifies
- Unused R&D credits can be carried forward, or in some circumstances be cashed out

Businesses will need to enrol with Inland Revenue before they can submit a claim

R&D activities

To qualify for the tax credit, a business must undertake core R&D activities and/or supporting R&D activities. A core R&D activity must satisfy all of the following requirements:

- Be conducted using a systematic approach
- Has a material purpose of creating new knowledge, or new or improved processes, goods or services
- Has a material purpose of re solving scientific or technological uncertainty that a competent professional would not be able to resolve using publicly available information
- Be performed in New Zealand

Supporting R&D activities include activities which are undertaken solely or mainly in support of and are integral to a core R&D activity. Supporting activities may occur outside of New Zealand, however, only 10% of the business's qualifying R&D expenditure can relate to overseas activities.

Refundability

A limited group of businesses can cash-out their unused R&D tax credits in the 2019/20 income year. Other unused R&D credits can be carried forward for use in a future year. However, a Bill is currently before the New Zealand Parliament to extend the cash-out of unused current and carry-forward tax credits from the 2020/21 income year.

Accounting for the R&D tax incentive

Investment tax credits are not defined in either New Zealand equivalent to International Accounting Standard 12 Income Taxes (NZ IAS 12) or New Zealand equivalent to International Accounting Standard 20 *Accounting for Government Grants and Disclosure of Government Assistance* (NZ IAS 20), but they are commonly taken to comprise government assistance and incentives for specific kinds of business activity and investment delivered through the tax system.

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Investment tax credits can take different forms and be subject to different conditions including a deductible expense in computing the entity's tax liability or a deduction from the entity's tax liability. At times they could involve entitlements to cash payments from government.

Under the updated R&D tax incentive scheme, entities in New Zealand may receive tax incentives relating to research and development or other specific activities. A portion of these credits may be settled directly in cash, though the 'default' mechanism is through a reduction in current or future income taxes payable. There are a number of conditions associated with receiving R&D incentive for both the company and the activity and the result thereof.

As noted above, NZ IAS 12 states that it does not deal with the methods of accounting for government grants or investment tax credits although any temporary differences that arise from them are in the scope of the Standard. At the same time, government assistance that is either provided by way of a reduction in taxable income, or determined or limited according to an entity's income tax liability, is excluded from the scope of NZ IAS 20. Accordingly, if government assistance is an investment tax credit, and is determined or limited by reference to an entity's liability to income taxes, there is no specific standard to deal with this.

The fact that both NZ IAS 20 and NZ IAS 12 use the term 'investment tax credits' to describe items excluded from their scope requires entities to carefully consider the nature of such incentives and the conditions attached to them in order to determine which standard the particular tax credit is excluded from and, therefore, whether they fall in the scope of NZ IAS 12 or NZ IAS 20. An accounting policy choice is required as outlined in New Zealand equivalents to International Accounting Standard 8 *Accounting Policies, Changes in Accounting Estimates and Errors* (NZ IAS 8).

The judgment as to which standard applies is made by reference to the nature of each type of investment tax credit and the conditions attached to it. This may mean that the predominant treatment in a particular jurisdiction for a specific type of investment tax credit has evolved differently from consensus in another jurisdiction for what could appear to be a substantially similar credit.

The following factors may be important in determining whether the arrangement is of a type that falls within the scope of NZ IAS 12 or NZ IAS 20:

- The predominant local determination as to whether a specific credit in the relevant tax jurisdiction falls within the scope of NZ IAS 12 or NZ IAS 20
- If there is no predominant local consensus, the group-wide approach to determining the standard that applies to such a credit should be applied, and
- In the absence of a predominant local treatment or a group-wide approach to making the determination, the indicators listed in the table below should provide guidance.

While an entity operating in a number of territories adopts different accounting treatments for apparently similar arrangements in different countries, one would expect a measure of comparability between different entities operating in the same tax jurisdiction.

Judgement is normally made depending on the specific criteria of the incentive.

The following table considers the R&D Incentive Scheme in New Zealand against the factors outlined above:

Feature of credit	Indicator of NZ IAS 12 treatment	Indicator of NZ IAS 20 treatment	R&D Incentive
Method of realisation	Only available as a reduction in income taxes payable (i.e. benefit is forfeit if there are insufficient income taxes payable). However, the longer the period allowed for carrying forward unused credits, the less relevant this indicator becomes.	Directly settled in cash where there are insufficient taxable profits to allow credit to be fully offset, or available for set off against payroll taxes, sales taxes or amounts owed to government other than income taxes payable.	For loss making entities there is an ability to receive cash up to a limit of $225k (conditions exist), noting that the total possible benefit is from R&D expenses of up to $1.7 million in tax year 2019/20, which could be reviewed for years 2020/21 and beyond. For tax paying entities the incentive is applied as a deduction in taxes payable. The deduction can be carried forward indefinitely (subject to shareholder continuity). **Conclusion – inconclusive depends on facts and circumstances of the entity**
Number of conditions not related to tax position (e.g. minimum employment, manner of ongoing use of purchased assets)	None or few	Many	Some conditions exist in order receive the incentive such as the type of entity eligible and amount of spend required. **Conclusion – possibly NZ IAS 20**
Restrictions as to nature of expenditure required to receive the grant	Broad criteria encompassing many different types of qualifying expenditure	Highly specific	Highly specific, the type of research being completed must meet specific criteria, the type of costs incurred must meet specific requirements. **Conclusion – NZ IAS 20**
Tax status of grant income	Not taxable	Taxable	The incentive is not taxable **Conclusion – NZ IAS 12**

Conclusion

We expect that entities in New Zealand consider their specific facts and circumstances, which may determine the relative weight of the factors described above to each entity. While we typically note an emerging local practice with prevailing view in each jurisdiction, the design of New Zealand R&D tax incentive may result in different entities arriving at different views especially in cases when method of realisation of the award is different.