

# Why the size of the cap really does matter

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*NZBIO chief executive George Slim puts Budget 2014's R&D initiatives under the microscope and finds problems*

THE 2014 Budget announcement of companies being able to cash out research and development (R&D) losses, rather than carry them forward until they do make a profit, may seem good for business at the superficial level. But closer examination shows the move may not help the value creation that New Zealand desperately needs.

The incentive left as it is may see more innovative companies lured offshore into better environments for growth.

Successful R&D is essential to any growing economy in the modern world.

It increases the efficiency of capital, creates new jobs, and increases the competitiveness of exports. This is particularly true when the R&D is done by business.

However, it is high risk. Large amounts of funds may be used to finance a project that leads to a dead end.

A start-up company based on innovation can incur years of losses as it develops its product, finds markets and overcomes regulatory hurdles before the company turns a profit.

Last year an IRD discussion paper suggested the cash out proposal. NZBIO was and remains strongly in support. Except for one thing — the proposed cap on the size of this opportunity for each company is too low for the change to make a meaningful difference to the company and subsequently and consequentially to NZ's aspirations.

You can see this from the Governments Estimates.

The Government expects to pay out some \$58 million over four years. That's just \$15m a year across all New Zealand's R&D intensive businesses.

And remember that the Government would have given up most of that money as tax losses eventually anyway, so it's not even that generous. The size of the cap matters. As it is now, the cash-out will help small companies but not those large enough to make an impact in the high-tech sector. It's a particular problem for our sector where R&D is expensive and takes a long time.

Let's use NZBIO's Company of the Year Pacific Edge as an example. Pacific Edge is targeting a market worth \$1.5 billion in the US alone.

If it was eligible (it is not) for the current scheme announced in the budget and had the scheme started in 2013, then Pacific Edge would have been able to receive a maximum refund of \$140,000.

Unfortunately, Pacific Edge is not eligible as it is listed on the NZX stock exchange - another problem with the scheme.

A refund of \$ 140,000 would be 2 per cent of its current cumulative total tax loss of \$7 million. Even with the proposed refund cap at its maximum it would still get only 8 per cent back

This isn't enough to make a difference. Certainly not to meet the aspirations of the Government to grow our knowledge economy and increase export earnings.

Worse, New Zealand's scheme as announced in the Budget is not internationally competitive. Even with a bite taken out of it in Australia's recent budget, described by our sister organisation AusBiotech in its budget press release as 'bruising', a company in Pacific Edge's position would have been in line for more than \$650,000 and that wouldn't be the maximum.

Australia's R&D taxation is much friendlier to large companies. Companies, like Pacific Edge, with an annual aggregated turnover of less than \$20m qualify for a 43.5 per cent (down from 45 per cent in the last Budget) refundable tax offset for R&D. No matter how large the company, they are assured non-refundable tax offsets of 38.5 percent (down from 40 per cent) for R&D. This is in stark contrast to the New Zealand situation where larger companies essentially get no meaningful benefit with the maximum cash hack capped at \$560,000.

The New Zealand proposal only helps those that are small start-up companies and even then only before they being making a profit.

Already one of New Zealand's leading biotechnology companies, Innate Therapeutics, is conducting some of its research across the Tasman, stating in its annual report that it is due partly to "the very significant R&D tax incentive currently on offer from the Australian Government".