

Budget 2014 – A Calculating Budget?

In an election year, clearly there is a temptation of the incumbent Government to use the Budget as a tool to buy them votes. Announcements in the Budget that lean towards social policy and spending are sometimes then seen as having ulterior motives.

Leading up to Budget 2014, the Government has continually stated the 2014 Budget would not be designed to buy them votes. Was that in fact the case, or did they end up slipping in a few sweeteners to help get them across the line at voting time?

Budget 2014 continues the Government's focus on further strengthening the tax system and improving public services to help provide an environment that supports business.

The Government's four priorities this term are:

- responsibly managing its finances;
- building a more productive and competitive economy;
- delivering better public services; and
- supporting the rebuilding of Christchurch.

For the detail on how the Government will focus on these priorities, please refer to the following links:

Budget speech <http://www.treasury.govt.nz/budget/2014/speech>

Minister's executive summary <http://www.treasury.govt.nz/budget/2014/execsumm>

Budget Highlights for Businesses

Below are key proposals outlined in the 2014 Budget.

Loss-making start-up companies

Following on from the announcement in Budget 2013, loss-making start-up companies will be able to cash out all or part of their tax losses from R&D expenditure.

Black hole expenditure

All businesses will be allowed tax deductibility for R&D "black hole" expenditure that is currently neither deductible nor able to be depreciated. This measure was also announced in Budget 2013.

Tax Compliance

The Budget also provides Inland Revenue with an additional \$132 million over five years to bolster tax compliance and for chasing up unfiled returns. This funding is expected to generate a gross increase in Crown revenue of almost \$300 million over five years.

Cheque Duty

Cheque duty will be abolished from 1 July 2014.

ACC

Budget 2014 indicates ACC is on track to provide further levy reductions of around \$480 million in 2015/16. Final decisions on the levies will be made after public consultation by ACC. Depending on the outcome of this consultation, the average levy for a private motor vehicle could fall by around \$130 a year from 1 July 2015.

Duties and Tariffs on Imported Building Materials

A Productivity Commission inquiry into housing affordability found building materials for a typical modest family home in New Zealand are 30 per cent higher than in Australia. Duties and tariffs currently apply to most of the materials used to build a standard house. Budget 2014 temporarily removes these duties and tariffs to increase competition and improve housing affordability. This is expected to save around \$3,500 on the construction of a standard New Zealand home.

New Zealand Trade and Enterprise

The Budget includes funding of \$69 million over four years, including \$14 million of reprioritised funding, to expand New Zealand Trade and Enterprise's presence in China, South America and the Middle East, and to help 200 more New Zealand firms break into overseas markets.

Centres of Research Excellence

The Budget provides an additional \$53 million over four years to establish another three Centres of Research Excellence, bringing the total number to 10. This includes a Centre focusing on Māori research.

The Budget also provides an additional \$57 million over four years for contestable research in science and innovation.

Tax Highlights

Below are the key tax proposals outlined in the 2014 Budget.

Loss-making start-up companies

Following on from the announcement in Budget 2013, loss-making start-up companies will be able to cash out all or part of their tax losses from R&D expenditure.

Innovative start-ups will be able to "cash-out" an amount of their tax losses arising from qualifying R&D expenditure. This means that instead of carrying the tax loss forward to apply against future assessable income, the company will receive a cash payment.

Innovative start-ups will be able to cash-out up to \$500,000 of eligible tax losses in the first year of the initiative (under a company tax rate of 28% this is equivalent to a cash of \$140,000). This cap will rise by \$300,000 each year up to an eventual maximum of \$2 million (a cash of \$560,000 per year).

Companies that eventually earn assessable income will return the value of the cashed-out loss through taxes paid on that income.

Companies that make a successful return on their investment through a non-taxable capital gain will have their cashed-out losses reinstated as losses to carry forward by repaying the value of the cashed-out loss out of the gain made.

The two main eligibility criteria are:

- 20% of a company's wage and salary expenditure must be on R&D (the wage intensity threshold). This includes expenditure on shareholder salaries, contracted labour and 66% of contracted R&D but does not include sweat equity.
- A company must be carrying out eligible research and development, the definition for which will be consistent with that used by the relevant accounting standard (NZIAS 38 Intangible Assets).

Excluded activities and expenditure will be confirmed shortly as will exactly how these initiatives will be administered.

It is intended that the policy will apply from income years beginning on or after 1 April 2015.

For more information, view the Inland Revenue's Fact Sheet

<http://taxpolicy.ird.govt.nz/sites/default/files/2014-budget-factsheet-business-losses.pdf>

Black hole expenditure

All businesses will be allowed tax deductibility for R&D "black hole" expenditure that is currently neither deductible nor able to be depreciated. This measure was also announced in Budget 2013.

The main proposed changes are:

- **R&D that results in a depreciable intangible asset**

Capitalised development expenditure (incurred on or after 7 November 2013) that relates to a patent, patent application or plant variety rights will be allowed to be included as part of the depreciable costs of the relevant depreciable intangible asset, for taxpayers that have carried out research and development (R&D) that has led to them acquiring one of these depreciable intangible assets.

- **R&D that does not result in a depreciable intangible asset**

For taxpayers that have developed intangible assets that are not depreciable for tax purposes, a one-off tax deduction will be allowed for capitalised development expenditure (incurred on or after 7 November 2013). This will occur upon the intangible asset to which it relates being written off for accounting purposes,. This will apply irrespective of whether the asset was useful for a period or the R&D was unsuccessful.

- **Integrity measures**

In the event that an intangible asset that has been written off for accounting purposes becomes useful, any capitalised development expenditure previously allowed as a tax deduction will be clawed back as income, with the clawed-back amount able to be depreciated over the estimated useful life of the asset if the asset is depreciable.

In the event that an intangible asset that has been written off for accounting purposes is sold, any capitalised development expenditure previously allowed as a tax deduction (or the sale proceeds, if this amount is lower) will be clawed back as income.

- **Registered designs**

Registered designs (and applications for the registration of a design) will be made depreciable (over 15 years), by adding them to schedule 14 of the Income Tax Act 2007.

Capitalised expenditure (incurred on or after 7 November 2013) in creating the design will be able to be included as part of the depreciable costs of a registered design (and associated application), for taxpayers that have created a design that they have applied to have registered, as well as legal and administrative fees incurred in the design registration process.

An immediate tax deduction will be allowed for expenditure incurred for the purpose of applying for registration of a design if registration is not obtained because the application is not lodged or is withdrawn, or because registration is refused. A taxpayer will receive the deduction in the income year in which they decide not to lodge the application, withdraw the application, or are refused registration.

- **Copyright that has been applied industrially**

Copyright in an artistic work that has been applied industrially (as defined in section 75(4) of the Copyright Act 1994) will be made depreciable, by adding it to schedule 14 of the Income Tax Act 2007.

Depreciation will be over:

- 16 years, in the case of product designs and casting moulds; or
- 25 years, in the case of works of craftsmanship.

Capitalised expenditure (incurred on or after 7 November 2013) in creating the artistic work will comprise the depreciable costs of the copyright, for taxpayers who have created an original artistic work that they (or their licensee) have applied industrially.

- **Successful software development**

The Income Tax Act 2007 will be amended to clarify that capitalised expenditure incurred by a person in the successful development of software for use in their own business is depreciable.

These proposed changes will be included in the next taxation bill and most changes will take effect from the 2015/16 income year.

For more information, view the Inland Revenue's Fact Sheet

<http://taxpolicy.ird.govt.nz/sites/default/files/2014-budget-factsheet-support-business.pdf>

Parental Tax Credit Changes

The Government will significantly boost the parental tax credit. From 1 April 2015, the Government will increase the parental tax credit from \$150 a week to \$220 a week, and the payment period will be extended from eight weeks to 10 weeks. This increases the total credit from \$1,200 to \$2,200.

In addition, the abatement rules will be changed to better target the parental tax credit towards low-to middle income families. A couple having their second child, for example, will not receive any payments if they together earn more than \$99,847.

Tax Compliance

The Budget also provides Inland Revenue with an additional \$132 million over five years to bolster tax compliance and for chasing up unfiled returns. This funding is expected to generate a gross increase in Crown revenue of almost \$300 million over five years.

More detail on the Tax Highlights in the Budget can be viewed on the Tax Policy website <http://taxpolicy.ird.govt.nz/news/2014-05-15-budget-2014#budget2014>

Budget Highlights for Families

The Budget contains a \$500 million package of support for children and families. The package is clearly focused on young families and those vulnerable children who most need the Government's care and protection. The package of support contains five elements:

1. **Paid parental leave** - the Government will extend paid parental leave from 14 weeks to 18 weeks. This will happen in two steps – to 16 weeks on 1 April 2015 and to 18 weeks on 1 April 2016.

In addition, eligibility for paid parental leave will be significantly extended. “Home for Life” caregivers and people with similar permanent care arrangements will become eligible for paid parental leave.

Parental leave payments will also be extended to people in less-regular jobs, including seasonal and casual workers, those who have recently changed jobs, and workers with more than one employer.

2. **Parental tax credit** - as mentioned above under Tax Highlights, the Government will boost the parental tax credit by increasing the weekly credit to \$220 and extending the payment period to 10 weeks. The abatement rules will also be changed to better target the parental tax credit towards low-to-middle income families.
3. **Free doctor visits** - the Government will invest \$90 million over four years to make doctors' visits and prescriptions free for children aged under 13. Already, doctors' visits and prescriptions are generally free for children under the age of six. The Government is extending this to children under 13, so primary school-aged children will be able to go to the doctor for free, any time of the day or night, and get their prescriptions free as well. The Government will offer this scheme to GPs from 1 July 2015.
4. **Early childhood education** - the fourth part of this package is an increase in funding for early childhood education. The Government has a target of increasing participation in early childhood education so that 98 per cent of children starting school will have participated in quality ECE. The Budget contains funding of \$156 million over four years to help early childhood centres remain accessible and affordable, meet demand pressures and increase participation towards the 98 per cent target.
5. **Support for vulnerable children** - the Budget contains funding to help the most vulnerable young New Zealanders and protect them from abuse and neglect. This includes funding to roll out eight more children's teams around the country to identify and work with at-risk children and their families. The Budget also provides funding to screen people who work with children, as set out in the Vulnerable Children Bill, to help support children in Child, Youth and Family care, and to provide greater support for caregivers.

Budget Highlights for Health and Medical

The Budget contains an additional \$110 million to fund more elective surgery and reduce waiting times, \$33 million for cancer screening and treatment, and \$20 million to prevent rheumatic fever.

The Government is also providing \$96 million for home-based support services, \$112 million for disability support services, and \$40 million for additional support for elderly people, including those with dementia.

The duty-free tobacco allowance will fall from 200 cigarettes to 50 cigarettes, in line with the allowance that applies in Australia.

Budget Highlights for Education

Education receives an additional \$858 million over the next four years and the remainder of this year, to lift the achievement of New Zealand students, strengthen the teaching profession and meet funding pressures.

Of this, \$359 million is to recognise excellent teachers and principals, keep good teachers in the classroom, and share expertise across schools.

Schools' operational grants will increase by \$85 million and early childhood education services get a \$156 million increase.

The Budget also provides \$111 million of operating funding for school property development and maintenance.

Budget 2014 also increases the Government's investment in tertiary education, research and innovation, which are crucial for sustained economic growth. This investment includes \$83 million of operating funding over four years to raise tuition subsidies in science, agriculture and health sciences.

As announced last week, the Government is providing \$20 million over two years to fund 6,000 extra places for apprentices.

Budget 2014 also contains a proposed change to the Student Loan Scheme to freeze the repayment threshold at its current level of \$19,084.

So how did the Budget stack up?

Clearly there are sweeteners in this Budget, particularly in relation to the measures aimed at families. There are also clearly some similarities with policies Labour have been touting in recent months. The Government has seemingly cherry picked those that have been getting the most traction and made these their own.

Given where NZ is currently at, the Government has a lot it can be happy about. The economy is strong, particularly compared to our Australian neighbours whose Budget announcements yesterday were a far cry from the announcements made in the NZ Budget today. In addition forecasts project rising surpluses in the next 4 years and, on the back of growth in our economy, a reduction in NZ's net debt.

These attributes are encouraging for NZ businesses. We have certainly seen an increase in activity over recent months due in part to this increased business confidence.

Overall this Budget seems to again be a prudent one, with increased spending in areas that will ultimately assist the economy and NZ businesses to grow in the coming years.

If you have any questions, please contact the Knowledge Shop consultants at solutions@knowledgeshop.co.nz or the tax team direct:

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