Fact sheet – Black hole R&D expenditure

Introduction

Generally, businesses are allowed a deduction for business expenditure against their assessable income. Certain business expenditure, however, does not result in a tax deduction, either immediately or over time. This expenditure is commonly referred to as "black hole" expenditure. The Government is proposing some changes to the income tax treatment of some types of business expenditure.

Main proposed changes

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

- A one-off tax deduction will be allowed for capitalised development expenditure (incurred on or after 7 November 2013) upon the intangible asset to which it relates being written off for accounting purposes, for taxpayers that have developed intangible assets that are not depreciable for tax 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.

Under current tax law, taxpayers are allowed immediate tax deductions for R&D expenditure incurred up until the point that an intangible asset is recognised under the accounting rules. Any further development expenditure incurred must be capitalised and is potentially never able to be deducted for tax purposes. This may discourage businesses from undertaking R&D that they would have undertaken in the absence of taxation.

The proposed changes will reduce distortions against investment in R&D caused by the current tax rules, by allowing capitalised development expenditure to either be deducted over time as depreciation (where the R&D results in a depreciable intangible asset) or deducted upon the intangible asset being written off for accounting purposes (where the R&D does not result in a depreciable intangible asset).

Other proposed changes

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.

A registered design has a legal life of 15 years (assuming all rights of renewal are exercised). Therefore, registered designs are being made depreciable because they are an item of intangible property that has a finite useful life that can be estimated with a reasonable degree of certainty on the date of its acquisition, so meet the criteria for inclusion in schedule 14 of the Income Tax Act 2007.

As the 15 year legal life of a registered design generally commences on the date on which the first application is made (as opposed to the date on which registration is granted), applications for the registration of a design are also being made depreciable, by adding them to schedule 14.

The proposed immediate tax deduction for expenditure incurred for the purpose of applying for registration of a design if registration is not obtained will parallel the tax treatment of expenditure incurred for the purpose of applying for a patent where a patent is not obtained.

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.

Section 75 of the Copyright Act 1994 contains a special exception from copyright protection in the case of an artistic work that has been applied industrially. The effect of this exception is that, once an owner of copyright in an artistic work (or a licensee) has applied the artistic work industrially (as defined in the section), within New Zealand or overseas, their copyright protection will only last for a further 16 years (in the case of product designs and casting moulds) or 25 years (in the case of works of craftsmanship). This time limit makes the copyright in an artistic work that has been applied industrially appropriate for inclusion in schedule 14 of the Income Tax Act 2007.

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.

This proposed amendment will clarify the law to be in line with the policy intent and Inland Revenue's understanding of current taxpayer practice.

Legislation

These proposed changes will be included in the next omnibus taxation bill and will take effect from:

- the statutory time-bar, for the proposed clarification in relation to successful software development; or

- the 2015/16 income year, for all the other proposed changes.