



LEGISLATION DESIGN AND ADVISORY COMMITTEE

13 December 2018

Michael Wood MP
Parliament Buildings
Wellington

Dear Mr Wood

Taxation (Research and Development Tax Credit) Bill

1. The Legislation Design and Advisory Committee (LDAC) was established by the Attorney-General in June 2015 to improve the quality and effectiveness of legislation. LDAC provides advice on design, framework, constitutional, and public law issues arising out of legislative proposals. It is responsible for the *Legislation Guidelines* (2018 edition), which have been adopted by Cabinet.
2. In particular, LDAC's terms of reference include these dual roles:
 - a. providing advice to departments in the initial stages of developing legislation when legislative proposals are being prepared; and
 - b. scrutinising and making representations to the appropriate body or person on aspects of bills that raise matters of particular public law concern.
3. The Taxation (Research and Development Tax Credit) Bill was not considered by LDAC prior to introduction. LDAC has therefore reviewed and wishes to make the attached submission on the Bill as introduced.
4. Thank you for taking the time to consider the LDAC's submission.

Yours sincerely

Paul Rishworth QC
Chairperson
Legislation Design and Advisory Committee



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Michael Wood MP
Finance and Expenditure Committee
Parliament Buildings
Wellington

Dear Mr Wood

Taxation (Research and Development Tax Credit) Bill

1. The Legislation Design and Advisory Committee has been given a mandate by Cabinet to review introduced Bills against the *Legislation Guidelines* (2018 edition) (**Guidelines**). The Guidelines have been adopted by Cabinet as the government's key point of reference for assessing whether draft legislation is well designed and accords with fundamental legal and constitutional principles. Our focus is not on policy, but rather on legislative design and the consistency of a Bill with the principles contained in the Guidelines.
2. Our submission is directed at new section LY 9, which would confer power for an Order in Council to be made on the joint recommendation of the Minister of Revenue and the Minister of Research, Science, and Innovation to amend Schedules 21 and 21B. We are concerned that this power covers a matter of policy that could be better dealt with by primary, rather than secondary, legislation. If this matter is dealt with by secondary legislation, we submit that there should be controls on the exercise of the power.
3. We do not submit on the policy underlying the Bill.

Background

4. Under new section LY 9 of the Bill, Schedules 21 and 21B may be amended by Order in Council. Schedule 21 lists the activities that are excluded from the definitions of "core research and development activity" and "supporting research and development activity." Activities which are excluded from these definitions will not be eligible for a research and development tax credit. Schedule 21B lists eligible and ineligible expenditure or loss for research and development tax credits.
5. New section LY 9 is an empowering provision that delegates law-making power to Ministers. It therefore raises issues traversed in chapter 14 of the Guidelines, including these: Important policy content should be a matter determined by Parliament through an open democratic process;

Law is generally designed to be durable, and delegation can be appropriate to allow refinement of a regulatory system.¹

6. The empowerment of secondary legislation that will amend an Act requires justification. The matter is dealt with in chapter 15 of the Guidelines.² The question is why the power must be delegated, as opposed to being exercised by Parliament.

Is the matter appropriate for secondary legislation?

7. One indicator that a matter is significant policy is that the policy answers the key questions in the problem addressed by the legislation. Another indicator is that the policy has the potential to give rise to controversy. A third indicator is that without the policy decision being made it would be otherwise unclear what the overall implications of the Bill are.³
8. Subpart LY of the Bill relates to research and development tax credits. New section LY 1 states that:
The purpose of this subpart is to-
 - (a) provide a tax credit (a research and development tax credit) to a person for performing, or contracting for the performance of, activities to create new knowledge, or new or improved processes, services, or goods; and
 - (b) ensure that business-as-usual activities do not qualify for research and development tax credits.
9. The Bill seeks to encourage research and development by providing for tax credits for those who undertake research and development. The answer to the question of what qualifies for the tax credit goes to the core of the Bill. It is not a minor matter or one of implementation.
10. The policy decisions regarding what qualifies for tax credits could also give rise to controversy. Those who are excluded from the tax credits may object to this exclusion. Conversely, the inclusion of industries will lead to a reduction in potential tax revenue.
11. The authorisation of the levying of a tax, or the spending of public money, should be authorised by primary legislation. Those who carry out activities excluded by the Bill from the definition of research and development will be paying more tax than those who are within the definition. Although the Bill will not involve the spending of public money, it will reduce the sum of money (in the form of taxes), that would otherwise be collected from businesses.
12. Legislation should empower secondary legislation to amend or override an Act only if there is a strong need or benefit to do so, the empowering provision is as limited as possible to achieve the objective, and the safeguards reflect the significance of the power.
13. It is submitted that the Committee ought to satisfy itself that there is a sufficiently strong need in this case for the Bill to be amended by secondary legislation. There are other mechanisms by which Schedules 21 and 21B could be amended in a timely way. For instance, the schedules could be amended in annual revenue legislation. Before recommending the

¹ *Legislation Guidelines* (2018 edition) chapter 14.

² *Legislation Guidelines* (2018 edition) chapter 15.1. See also RI Carter, J McHerron and R Malone *Subordinate Legislation in New Zealand* (LexisNexis, 2014) at page 31. "Delegated legislation should not amend or repeal Acts of Parliament."

³ *Legislation Guidelines* (2018 edition) chapter 14.1 at page 66.

passage of LY 9, it is submitted that the Committee ought to satisfy itself that amendment through annual revenue legislation is inadequate.

Is the secondary legislation subject to appropriate safeguards?

14. Another question to be considered is whether the proposed secondary legislation is subject to appropriate safeguards. For example, all secondary legislation should be subject to an appropriate level of scrutiny and a good law-making process.⁴ A good law-making process in certain cases may involve consultation with those who will be affected by the secondary legislation.⁵ A legislative requirement to consult may be necessary to acknowledge the views of, and provide certainty to, those affected by the Ministers' decision to change tax credit eligibility.
15. The empowering Act should clearly and precisely define the permitted subject matter of secondary legislation and the purposes for which it may be made.⁶ It is usual for the named delegate to be empowered to make the secondary legislation for defined purposes. There are no specified criteria for the exercise of this discretion. This leaves it open to Ministers to decide what will be added or removed from tax credit eligibility without the guidance or restriction of any factors specified in primary legislation, and without opportunity for the choice of industries, sectors or activities to be scrutinised and debated democratically.
16. If new section LY 9 is retained, we recommend that the delegated power be subject to a requirement to consult and that specified criteria be included to ensure there are appropriate safeguards around its exercise. The criteria should clearly specify that the power may only be exercised for the purpose of keeping the schedules current as the types of research and development change and not for the purpose of changing the policy behind the Act or significantly changing the scope of the tax credits provided by the Act.

Is the secondary legislation subject to appropriate safeguards?

17. Another question to be considered is whether the proposed secondary legislation is subject to appropriate safeguards. For example, all secondary legislation should be subject to an appropriate level of scrutiny and a good law-making process.⁷ A good law-making process in certain cases may involve consultation with those who will be affected by the secondary legislation.⁸ A legislative requirement to consult may be necessary to acknowledge the views of, and provide certainty to, those affected by the Ministers' decision to change tax credit eligibility.
18. The empowering Act should clearly and precisely define the permitted subject matter of secondary legislation and the purposes for which it may be made.⁹ It is usual for the named delegate to be empowered to make the secondary legislation for defined purposes. There are no specified criteria for the exercise of this discretion. This leaves it open to Ministers to decide what will be added or removed from tax credit eligibility without the guidance or

⁴ *Legislation Guidelines* (2018 edition) chapter 14.4.

⁵ See *Legislation Guidelines* (2018 edition) chapter 19.

⁶ *Legislation Guidelines* (2018 edition) chapter 14.2.

⁷ *Legislation Guidelines* (2018 edition) chapter 14.4.

⁸ See *Legislation Guidelines* (2018 edition) chapter 19.

⁹ *Legislation Guidelines* (2018 edition) chapter 14.2.

restriction of any factors specified in primary legislation, and without opportunity for the choice of industries, sectors or activities to be scrutinised and debated democratically.

19. If new section LY 9 is retained, we recommend that the delegated power be subject to a requirement to consult and that specified criteria be included to ensure there are appropriate safeguards around its exercise.

Recommendation to amend new section LY 9

20. It is submitted that the Committee ought to satisfy itself that there is a sufficiently strong need in this case for the power in new section LY 9.
21. If new section LY 9 is retained, we believe section LY 9 should be amended to:
 - include criteria to limit the scope of the power; and
 - include a requirement to consult before the power is exercised.
22. Thank you for considering our submission. We do not wish to be heard in person.

Yours sincerely



Paul Rishworth QC
Chairperson
Legislation Design and Advisory Committee