

DO YOUR RESEARCH AND DEVELOPMENT IN CANADA: IT PAYS OFF!

The Government of Canada supports innovation and entrepreneurship through the Scientific Research and Experimental Development (SR&ED) Tax Incentive Program. In fiscal year 2015-16, the program provided more than \$3 billion in SR&ED investment tax credits to businesses performing R&D in Canada and this amount was increased through the R&D tax incentives offered by the Canadian provinces and territories¹. SR&ED program also features a business-friendly administration to provide access to the tax incentive.

REDUCING R&D COSTS

Companies in Canada that invest in R&D can apply for the SR&ED tax incentives, irrespective of size, industry sector, or field of technology. The SR&ED tax credit and provincial tax credits for R&D are a distinct benefit in addition to corporate tax provisions allowing for full deduction of current R&D expenditures from business income.

The SR&ED tax incentive program provides tax incentives for the direct in-house costs of performing eligible R&D work in Canada. Eligible work

includes experimental development, applied research, basic research, and certain types of work in support of experimental development, applied research and basic research. This support work includes: engineering, design, operations research, mathematical analysis, computer programming, data collection, testing, and psychological research.

Activities not eligible for the tax incentives include: market research or sales promotion; quality control or routine testing of materials, devices, products, or processes; research in the social sciences or humanities; commercial production of a new or improved material, device or product or the commercial use of a new or improved process; style changes; routine data collection; and prospecting, exploring or drilling for, or producing minerals, petroleum or natural gas.

Eligible expenses include: wages and salaries of employees directly engaged in the eligible R&D work, overhead expenditures, and materials. Capital expenditures including machinery, equipment and buildings, are not eligible for the SR&ED tax incentive, however, capital may be deducted from business income as a depreciation (capital cost allowance) expense.

The SR&ED program also allows for the inclusion of the following expenses:

- » contract expenditures for SR&ED performed on behalf of the claimant²;
- » salaries and wages incurred by the firm on SR&ED activities conducted abroad³; and
- » overhead costs, which may be calculated by a simple proxy method⁴.

These features make Canada's SR&ED program truly one of the most generous and accessible R&D tax incentives in the industrialized world.

SR&ED TAX INCENTIVES

The SR&ED program provides two tax incentives: (1) a deduction to reduce the income for tax purposes; and (2) an investment tax credit. More specifically,

1. A business can deduct the SR&ED expenditures to reduce their tax liability in the current year or carry these expenditures forward indefinitely to reduce their tax liability in future years.
2. A business can receive an SR&ED investment tax credit that may be refundable and/or used to reduce taxes payable.

HOW CAN FOREIGN COMPANIES QUALIFY FOR THE CANADIAN SR&ED TAX BENEFITS?

a. Through a Canadian subsidiary of a foreign parent – a Canadian subsidiary, performing eligible R&D work in Canada for itself or on a contractual basis for the foreign-owned parent, can deduct eligible expenditures and claim the 15% tax credit on these to reduce taxes payable, and is non-refundable. A non-refundable tax credit can be used to reduce federal taxes

payable in the current year, in the previous three years, and/or in the next 20 years. There are no ceilings on SR&ED expenditures for companies claiming the tax credit.

b. Through a Canadian-controlled private corporation (CCPC) – a foreign corporation can establish a corporation in Canada that may qualify as a CCPC. For more information on the definition of a CCPC, and other types of corporation, see the following link: <http://www.cra-arc.gc.ca/tx/bsnss/tpcs/crprtns/typs-eng.html>

Canadian-controlled private corporations (CCPCs) may be eligible to receive a refundable tax credit of 35% of qualifying SR&ED expenditures, to a maximum of \$3 million of expenditures per year⁵ (i.e., up to \$1,050,000 of refundable tax credit). Over the \$3 million SR&ED expenditure threshold the credit rate is reduced to 15%, of which 40% may be refundable. (See Table 1)

TABLE 1

Illustration of the federal SR&ED program on \$5 million of qualified SR&ED expenditures (CAD\$)

Company category	SR&ED expenditures	Credit Rate	% Refund	Refundable tax credit (cash back)	Non-refundable tax credit (reduce taxes)
Foreign-controlled corporations and all corporations not eligible for CCPC status	First \$3 million	15%	N/A	N/A	\$450,000
	Remaining \$2 million	15%	N/A	N/A	\$300,000
Total	N/A	N/A	N/A	N/A	\$750,000
Canadian-controlled private corporations (CCPCs)	First \$3 million	35%	100%	\$1,050,000	N/A
	Remaining \$2 million	15%	40%	\$120,000	\$180,000
Total	N/A	N/A	N/A	\$1,170,000	\$180,000

Performing R&D in a province or territory with its own R&D tax incentive program will increase the total amount of R&D assistance provided to the business. With the exceptions of Prince Edward Island, Nunavut and the North West Territories, all provinces and territories have additional tax incentive programs for R&D activities carried

out in their respective jurisdictions. (See Table 2 for provincial/territorial tax credit rates.)

Although the provincial R&D tax credits must be deducted from the base of the federal SR&ED tax credit, the combined benefit is up to 2 times higher than the benefit of the federal SR&ED tax credit

alone. In addition to reducing provincial taxes payable, many provinces have R&D tax credits that may be refundable.

TABLE 2**Combined Federal and Provincial/Territorial SR&ED tax credits**

Foreign-controlled corporations and other corporations not eligible for CCPC status					
Provinces	Provincial credit rate	Provincial credit refund?	Federal credit rate	Federal credit refund?	Combined credit rate ⁶
Alberta	10%	Yes	15%	No	23.5%
British Columbia	10%	No	15%	No	23.5%
Manitoba	20%	Yes ⁷	15%	No	32%
New Brunswick	15%	Yes	15%	No	27.75%
Newfoundland and Labrador	15%	Yes	15%	No	27.75%
Nova Scotia	15%	Yes	15%	No	27.75%
Ontario ^{8,9}	8.0% + 3.5%	Yes/No	15%	No	24.80%
Ontario ⁸	3.5%	No	15%	No	18.0%
Prince Edward Island	N/A	N/A	15%	No	15%
Quebec ¹⁰	14%	Yes	15%	No	26.9%
Saskatchewan	10%	No	15%	No	23.5%
Nunavut	N/A	N/A	15%	No	15%
NWT	N/A	N/A	15%	No	15%
Yukon ¹¹	15%	Yes	15%	No	27.75%

Canadian-controlled private corporations (CCPCs)					
Provinces	Provincial credit rate	Provincial credit refund?	Federal credit rate	Federal credit refund?	Combined credit rate ⁶
Alberta	10%	Yes	35%	Yes	41.5%
British Columbia	10%	Yes	35%	Yes	41.5%
Manitoba	20%	Yes ⁷	35%	Yes	48%
New Brunswick	15%	Yes	35%	Yes	44.75%
Newfoundland and Labrador	15%	Yes	35%	Yes	44.75%
Nova Scotia	15%	Yes	35%	Yes	44.75%
Ontario ^{8,9}	8.0% + 3.5%	Yes/No	35%	Yes	42.50%
Ontario ⁸	3.50%	No	35%	Yes	37.30%
Prince Edward Island	N/A	N/A	35%	Yes	35%
Quebec ¹⁰	30%	Yes	35%	Yes	54.5%
Saskatchewan	10%	No	35%	Yes	41.5%
Nunavut	N/A	N/A	35%	Yes	35%
NWT	N/A	N/A	35%	Yes	35%
Yukon ¹¹	15%	Yes	35%	Yes	44.75%

ADMINISTRATION OF THE SR&ED PROGRAM: THE CANADA REVENUE AGENCY

The Canada Revenue Agency (CRA) administers the SR&ED program on behalf of the Government of Canada. The CRA offers a number of services

and tools to help claimants access the SR&ED tax incentives, including:

Videos — Four informational videos about the SR&ED program are available on the CRA website and YouTube channel. The videos focus on four themes: an overview of the SR&ED program, the type of work and

expenditures that qualify for the SR&ED tax incentives, how to calculate the SR&ED investment tax credit, and how to file a claim. (See: <https://www.canada.ca/en/revenue-agency/services/scientific-research-experimental-development-tax-incentive-program/claiming-tax-incentives.html>)



Webinars — These free webinars provide a general overview of the program, explaining the program's eligibility requirements, what expenditures are eligible, and how to file an SR&ED claim. These webinars are offered throughout the year. (See: <http://www.cra-arc.gc.ca/txcrdt/sred-rsde/smnrs/wbnrs-eng.html>)

Pre-Claim Consultation (PCC) service — The PCC service lets a business know whether their R&D work is SR&ED work, and therefore eligible for the SR&ED tax incentives, before they submit their claim. Through this service, the CRA will: identify the R&D work that qualifies as SR&ED; provide a decision in a written report that confirms whether the work qualifies for SR&ED tax incentives; provide advice on what supporting documents to keep; and answer client questions and offer advice and recommendations. <http://www.cra-arc.gc.ca/txcrdt/sred-rsde/pccwbp-eng.html>

First-Time Claimant Advisory Service (FTCAS) — This free service connects new claimants with SR&ED program staff who will work with them to answer their questions and provide them with information on how to better complete a future SR&ED claim. SR&ED program staff will meet with first-time claimants at their place of business to help them get a better understanding of the SR&ED program and to provide them with an information session specifically tailored to their business. The staff will also advise them on how to identify eligible work and allowable expenditures and how to identify documentation and other evidence to support their claim. (See: <http://www.cra-arc.gc.ca/txcrdt/sred-rsde/ftcs-eng.html>)

Self-Assessment Learning Tool (SALT) — SALT is an online tool, which through specific questions, answers, and examples, helps businesses to understand the SR&ED

program requirements. SALT also helps businesses determine whether a company project might include SR&ED work, to assess the extent to which the company's work may be eligible under the program, and to estimate the resulting value of the Investment Tax Credits (ITC). (See: <http://www.cra-arc.gc.ca/txcrdt/sred-rsde/slt-eng.html>)

All SR&ED program policy information, including the Eligibility of Work for SR&ED Investment Tax Credits Policy — a document that clarifies what work constitutes "SR&ED", is posted on the CRA website. (See: <http://www.cra-arc.gc.ca/txcrdt/sred-rsde/clmng/clmngsr-eng.html>)

For more information, including specific SR&ED program details for eligible activities and how to file a claim, go to the CRA's website at <http://www.cra-arc.gc.ca/txcrdt/sred-rsde/menu-eng.html>.

Endnotes

- ¹ Canada Revenue Agency-Departmental Performance Report 2015-16, http://www.cra-arc.gc.ca/gncy/prfrmnc_rpts/2015-2016/dpr-2015-16-eng.pdf
- ² The amount payable under the contract would be an eligible SR&ED expenditure, and 80% of the expenditure would qualify for investment tax credit purposes. Expenditures incurred for non-arm's length SR&ED contracts are not considered to be qualified SR&ED expenditures for investment tax credit purposes. However, the claimant and the non-arm's length performer can file a specific form (e.g. Form T1146) so that all or part of the performer's qualified expenditures for SR&ED can be transferred to the claimant (payer) for investment tax credit purposes.
- ³ The limit is 10% of the total salary and wages directly attributable to SR&ED carried on in Canada by the corporation during the year.
- ⁴ An alternative to the traditional method of specifically identifying the actual SR&ED overhead and other expenditures, the proxy method allows a proxy amount to be calculated based on a maximum of 55% of direct SR&ED salaries and wages.
- ⁵ The expenditure limit (\$3 million maximum) is reduced when the previous year's taxable income is greater than \$500,000 or the previous year's capital is greater than \$10 million.
- ⁶ In calculating the combined credit, the federal tax credit base is reduced by the provincial tax credit receivable.
- ⁷ Fully refundable for corporations that work with eligible institutes in Manitoba and 50% refundable for in-house R&D.
- ⁸ The Ontario Innovation Tax Credit (OITC) of 8.0% (effective June 1, 2016) is refundable and is available to all corporations, irrespective of ownership. The maximum tax credit under OITC is \$300,000; this tax credit is gradually reduced when a firm's federal taxable income of the prior tax year exceeds \$500,000, and is completely eliminated at \$800,000.
- ⁹ The Ontario Research and Development Tax Credit (ORDTC) of 3.5% (effective June 1, 2016) is non-refundable; in calculating the ORDTC, eligible expenditures will be reduced in respect to government assistance, including the OITC, received. The ORDTC is pro-rata and without eligibility limitations; the combined SR&ED-ORDTC % may be considered as the 'basic' combined rate.
- ¹⁰ Only R&D wages are eligible for Quebec's R&D tax credit.
- ¹¹ Yukon allows a 20% tax credit on R&D performed in collaboration with Yukon College.

