

Do Your Research in Canada: It Pays Off!

Canada supports innovation and entrepreneurship through one of the most favourable and efficient tax treatments for scientific research and experimental development (SR&ED) expenditures in the world. This is especially true when combined with the provincial R&D tax incentives.

Canada's SR&ED tax incentive program and its provincial counterparts rely on the principles of stability, simplicity of tax credit design, and reliable administrative support. Adhering to these principles allows for reducing the investor's risk.

Canada's SR&ED administration system is also superior in terms of promotional initiatives and programs actively designed for claimants to minimize the cost of compliance. There are many initiatives ranging from those addressing needs of first-timers to those for repeat filers making the program accessible to all types of claimants. (See Canada Revenue Agency's website: <http://www.cra-arc.gc.ca/txcrdt/sred-rsde/menu-eng.html>)

Reducing R&D costs

Canada's SR&ED tax incentive program is the largest R&D support program aimed at the private sector. All companies based in Canada that invest in R&D can qualify, irrespective of their size, industry sector or technology area they represent – as long as they perform qualified R&D. The total value of federal SR&ED tax credit expenditure is estimated to reach \$4.5 billion by 2010.

Generally, in addition to full tax deduction of current SR&ED expenditures, a tax credit is also available based on qualifying SR&ED expenditures carried out in Canada. Other distinct advantages of the SR&ED program include eligibility of deducting the full cost of R&D machinery and equipment, no limits on subcontracting, and ability to defray part of the R&D expenses incurred abroad on Canadian R&D projects.

For large Canadian corporations and foreign controlled corporations, regardless of size or whether they are public or private, the rate of the tax credit is 20% and is non-refundable. A non-refundable tax credit can be used to offset Canadian federal taxes payable in the current year, in the previous three years, and/or in the next 20 years. There are no ceilings on R&D expenditures, taxable income or taxable capital for companies claiming the 20% tax credit rate. **(See Table 1)**

On the other hand, small Canadian-controlled private corporations (CCPCs), with taxable income of up to \$500,000 and taxable capital of up to \$10 million, can receive a refundable tax credit of 35% of qualifying current and capital SR&ED expenditures, to a maximum of \$3 million of expenditures per year. Over the \$3 million SR&ED expenditure threshold, the credit rate is reduced to 20%, of which 40% may be refundable. A refundable tax credit represents an injection of non-dilutive capital into a company, which in turn can be used for sustaining future R&D activities. The potential exceeds \$1,050,000 of federal tax refund per year.

To top all of this off, various provinces have their own additional tax incentive programs for SR&ED activities carried out in their respective provinces. Although the provincial R&D tax credits must be deducted from a base for federal SR&ED tax credit, the net benefit is essentially one and a half times higher than the benefit of federal SR&ED tax credit alone. In addition, many provinces make the refund of their R&D tax credit available for foreign-owned corporations **(See Table 2)**

Two alternatives are available in calculating qualifying SR&ED expenditures. The traditional method allows specific identification of direct and overhead SR&ED expenditures. The proxy method alleviates the burden of identifying actual SR&ED overhead costs by allowing a proxy amount for overhead expenditures to be calculated based on a maximum of 65% of direct SR&ED salaries and wages.

How can foreign companies qualify for the Canadian SR&ED tax benefits?

(a) Through a Canadian subsidiary of a foreign parent

The Canadian subsidiary can carry out qualifying SR&ED activities in Canada and, through deducting the expenditures and claiming the 20% tax credit, the subsidiary can significantly reduce or even eliminate Canadian taxes payable.

The foreign parent can contract the Canadian subsidiary to carry out the SR&ED activities on their behalf, in which case the foreign parent will own the rights to the SR&ED, and the Canadian subsidiary can still make use of the SR&ED tax incentive program.

(b) Through a Canadian-controlled private corporation

A foreign corporation can set up a CCPC in Canada as long as it owns 50% or less of the company's shares and the shares do not have any special rights attached to them. Traditionally, non-residents set up CCPCs in Canada by having a Canadian investor such as a venture-capital firm or research institution hold the remaining shares.

Eligibility

Eligible activities include experimental development, applied research, basic research, and support work. Activities not eligible for benefits under the SR&ED program include research in the social sciences or humanities; commercial production of a new or improved material, device or product; the commercial use of a new or improved process; style changes; market research or sales promotion; quality control or routine testing of materials, devices, products or processes; routine data collection; and prospecting, exploring, or drilling for or producing minerals, petroleum or natural gas.

Up to 10% of R&D wages and salaries of Canadian-resident employees incurred abroad by a Canadian-based company are also eligible. The activities outside Canada must be in support of SR&ED carried on in Canada directly by the company.

For more information on eligible activities, please contact the Canada Revenue Agency (CRA) to ensure that you can qualify for the program. The CRA offers up-front review and preliminary (pre-claim) opinion on the eligibility of projects for the SR&ED program.



Table 1: Illustration of the federal SR&ED program on \$5 million of qualified SR&ED expenditures (all figures in C\$) (Note that performing R&D in a province with its own R&D tax incentive program will considerably increase the amounts shown here).

	SR & ED Expenditures	Credit Rate	% Refund	Refundable Tax Credit (Cash Back)	Non-Refundable Tax Credit (Reduce Taxes)
Small Canadian-controlled Private Corporations	First \$3 million	35%	100%	\$1,050,000	-
	Remaining \$2 million	20%	40%	\$160,000	\$240,000
Total				\$1,210,000	\$240,000
Large Public or Foreign-controlled Corporations	First \$3 million	20%	-	-	\$400,000
	Remaining \$2 million	20%	-	-	\$600,000
Total				-	\$1,000,000

Table 2: Combined Federal and Provincial/Territorial SR&ED tax incentives.

Small Canadian-controlled Private Corporations						Large Public or Foreign-controlled Corporations					
Provinces	Provincial Credit		Federal Credit		Combined Credit Rate ¹	Provinces	Provincial Credit		Federal Credit		Combined Credit Rate ¹
	Rate	Refund?	Rate	Refund?			Rate	Refund?	Rate	Refund?	
Alberta	10%	Yes	35%	Yes	41.50%	Alberta	10%	Yes	20%	No	28%
British Columbia	10%	Yes	35%	Yes	41.50%	British Columbia	10%	No	20%	No	28%
Manitoba ²	20%	No	35%	Yes	48.00%	Manitoba ²	20%	No	20%	No	36%
New Brunswick	15%	Yes	35%	Yes	44.75%	New Brunswick	15%	Yes	20%	No	32%
Newfoundland and Labrador	15%	Yes	35%	Yes	44.75%	Newfoundland and Labrador	15%	Yes	20%	No	32%
Nova Scotia	15%	Yes	35%	Yes	44.75%	Nova Scotia	15%	Yes	20%	No	32%
Ontario ³	10%+4.5%	Yes/No	35%	Yes	44.43%	Ontario ³	4.50%	No	20%	No	23.60%
Prince Edward Island	-	-	35%	Yes	35.00%	Prince Edward Island	-	-	20%	No	20%
Quebec ⁴	37.50%	Yes	35%	Yes	60.94%	Quebec ⁴	17.50%	Yes	20%	No	34%
Saskatchewan	15%	Yes	35%	Yes	44.75%	Saskatchewan	15%	Yes	20%	No	32%
Nunavut	-	-	35%	Yes	35.00%	Nunavut	-	-	20%	No	20%
NWT	-	-	35%	Yes	35.00%	NWT	-	-	20%	No	20%
Yukon ⁵	15%	Yes	35%	Yes	44.75%	Yukon ⁵	15%	Yes	20%	No	32%

1. In calculating the combined credit, the federal tax credit is reduced by the provincial tax credit receivable.
2. From 2010, Manitoba will allow refund on R&D into new technologies and biotechnologies under contract with research institutes
3. Ontario non-refundable R&D Tax Credit of 4.5% is available as of January 1, 2009. Ontario Innovation tax credit of 10% is refundable and applicable to small public or foreign controlled corporations.
4. In Quebec, only R&D wages are eligible for R&D tax credits, not materials, equipment or overhead.
5. Yukon allows a 20% tax credit on R&D performed in collaboration with Yukon College.

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