

SR&ED in Canada



What is it and How It Works June 2009

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Presentation Objectives

- SR&ED Program Overview
- General and Eligibility Requirements
- Financial Incentives
- Current and Capital Expenditures
- Qualified SR&ED Expenditures
- Investment Tax Credit
- Comparison With U.S. R&D Program

SR&ED Program Overview

- Encourage and foster SR&ED in Canada
- Provide support to Canadian businesses
- Enhance Canada's economic growth
- Increase Canada's competitiveness while advancing Canada's technological base

SR&ED Program Overview (continued)

- Canada's major SR&ED support program
- Used by over 19,000 claimants annually
- Provides – over \$4.3 billion/year in tax credits
- Benefits virtually every industry
- Policy is set by the Department of Finance
- Program is administered by the Canada Revenue Agency (CRA)
 - Research and Technology Advisors
 - National Technology Sector Specialists
 - Financial Reviewers

General and Eligibility Requirements

- SR&ED must take place in Canada (limited support work outside Canada qualifies – federal budget 2008)
- Claimant must carry on a business in Canada
 - Non-residents must have permanent establishment in Canada (e.g. subsidiary or branch)
- SR&ED must be related to the business
- Claimant must incur qualifying expenditures

General and Eligibility Requirements (continued)

- Basic Research:
 - advancing scientific knowledge without a specific application
- Applied Research:
 - advancing scientific knowledge with a specific application
- Experimental Development:
 - Achieving technological advances in order to create or improve materials, devices, products, or processes

General and Eligibility Requirements (continued)

- Technical Support Work:
- Includes work that is commensurate with the needs and in direct support of Basic and Applied Research or Experimental Development
 - Engineering
 - Design
 - Operations Research
 - Mathematical Analysis
 - Computer Programming
 - Data Collection
 - Testing
 - Psychological Research

General and Eligibility Requirements (continued)

- SR&ED project must contain:
- Scientific or technological advancement
- Scientific or technological uncertainty
- Scientific and technical content

The above 3 criteria must be fulfilled in order for a project to be eligible

General and Eligibility Requirements (continued)

Non-SR&ED Activities:

- Market research or sales promotion
- Quality control or routine testing
- Social science or humanities research
- Prospecting, exploring, producing, or drilling
- Commercial production or commercial use
- Style changes
- Routine data collection

Financial Incentives

- Current and capital expenditures can be deducted from income in the year
 - Any remaining SR&ED expenditures can be carried forward indefinitely
- Investment tax credit (ITC) of 20% or 35% may be earned on qualified SR&ED expenditures
 - Can be used to reduce taxes payable or received as a cash refund
 - Any remaining ITC may be carried back 3 years or forward 20 years

Current and Capital Expenditures

- Salary and Wages (employees)
- Materials (consumed or transformed)
- SR&ED Contracts (payments to another party)
- Leases (machinery and equipment)
- Overhead (actual or proxy amount)
- Third Party Payments (universities, approved entities)
- Capital Expenditures (machinery and equipment)

Qualified SR&ED Expenditures

- Begin with
 - Current expenditures
 - Capital expenditures
 - Overhead expenditures or traditional method
 - Shared use equipment (50% of costs over 2 years)
- Subtract
 - Contract revenue (from Canadian sources)
 - Government/Non-government assistance
 - Prescribed expenditures (used equipment)
- Obtain
 - Qualified expenditures

Investment Tax Credit

$$\text{ITC} = \text{Qualified Expenditures} \times \text{ITC Rate}$$

- ITCs are earned at:
 - 35% for Canadian controlled private corporations
 - 20% for other corporations (public or foreign), individuals, partnerships, or trusts
- ITCs may be used to reduce taxes payable
- ITCs earned at 35% rate may be refunded

Summary Comparing United States vs. Canadian R&D Tax Credit Incentives

United States	Canada
<ul style="list-style-type: none"> ▪ 20% federal tax credit for incremental R&E. State R&E tax credits also available in certain states 	<ul style="list-style-type: none"> ▪ 20% federal tax credit for all SR&ED expenditures. Provincial SR&ED tax credits also available in all provinces except Prince Edward Island
<ul style="list-style-type: none"> ▪ No refundable R&E tax credit 	<ul style="list-style-type: none"> ▪ 35% refundable SR&ED tax credit available to certain Canadian Controlled Private Corporations
<ul style="list-style-type: none"> ▪ U.S. definition of R&E is more restrictive than Canadian SR&ED definition 	<ul style="list-style-type: none"> ▪ Canadian SR&ED credit definition is broader than U.S. R&E definition

Summary Comparing United States vs. Canadian R&D Tax Credit Incentives

United States	Canada
<ul style="list-style-type: none"> ▪ Qualifying R&E expenses include salary and wages, supplies and contract expenses 	<ul style="list-style-type: none"> ▪ Qualifying SR&ED expenses include salary and wages, materials, contract payments, leases, overheads, and capital expenditures
<ul style="list-style-type: none"> ▪ Eligible R&E contracts restricted to 65% of contract amount 	<ul style="list-style-type: none"> ▪ No restriction on eligible SR&ED contracts (100% of amount to be claimed)
<ul style="list-style-type: none"> ▪ No accelerated write-off for R&E equipment 	<ul style="list-style-type: none"> ▪ 100% write-off for eligible SR&ED equipment
<ul style="list-style-type: none"> ▪ Unused R&E tax credits can be carried back 1 taxation year and forward 20 taxation years 	<ul style="list-style-type: none"> ▪ Unused SR&ED tax credits can be carried back 3 taxation years and forward 20 taxation years
<ul style="list-style-type: none"> ▪ R&E credit is extended every few years. It is not permanent 	<ul style="list-style-type: none"> ▪ SR&ED tax credit is permanent

Ontario

Illustration of Tax Benefits

		SR&ED with OBRI	SR&ED without OBRI	No SR&ED
Amount of Expenditure	(A)	\$100.00	\$100.00	\$100.00
Federal Tax Credit		(15.28)	(19.10)	-
Ontario Tax Credit		(3.60)	(4.50)	-
OBRI Tax Credit		(20.00)	-	-
Deduction from taxable income		61.12	76.40	100.00

Tax Savings

Deduction from taxable income		19.91	24.89	32.58
Federal Tax Credit		15.28	19.10	-
Ontario Tax Credit		3.60	4.50	-
OBRI Tax Credit		20.00	-	-
Total tax savings	(B)	58.79	48.49	32.58
Net cost of expenditure	[(A)-(B)]	41.21	51.51	67.42

Quebec

Illustration of Tax Benefits

		Public Research Contract	Private Research Contract	SR&ED Salaries	No SR&ED
Amount of Expenditure	(A)	\$100.00	\$100.00	\$100.00	\$100.00
Federal Tax Credit		(14.40)	(18.25)	(16.50)	-
URTC		(28.00)	-	-	-
Credit on private research contract		-	(8.75)	-	-
Credit on SR&ED Salaries		-	-	(17.50)	-
Deduction from taxable income		57.60	73.00	66.00	100.00

Tax Savings

Deduction from taxable income		18.77	23.78	21.50	32.58
Federal Tax Credit		14.40	18.25	16.50	-
URTC		28.00	-	-	-
Credit on private research contract		-	8.75	-	-
Credit on SR&ED Salaries		-	-	17.50	-
Total tax savings	(B)	61.17	50.78	55.50	32.58
Net cost of expenditure	[(A)-(B)]	38.83		44.50	67.42

Summary

Canada Offers:

- Generous SR&ED Incentives
- More expenditures qualify for credits
- Every dollar spent on SR&ED receives credits
- Wide range of services to assist claimants
- Most provinces have similar programs

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Questions ...



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