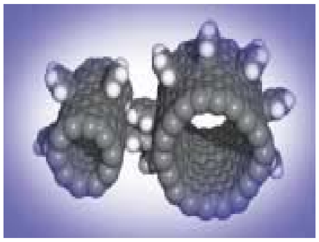
Government of Canada Gouvernement du Canada

# Do Your Research and Development In Canada ... IT PAYS OFF!



Innovation, entrepreneurship and a dynamic economy are on Canada's mind. To prove it, Canada has one of the most favourable tax treatments for scientific research and experimental development (SR&ED) expenditures in the world.

## Canada's SR&ED Program

Generally, in addition to tax deductions for SR&ED expenditures, a tax credit is also available based on qualifying SR&ED expenditures carried out in Canada.

Small Canadian-controlled private corporations (CCPCs), with taxable income of up to $300,000 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 $2 million of expenditures per year. Over the $2 million SR&ED expenditure threshold, the credit rate is reduced to 20%, of which 40% may be refundable.

Most other Canadian corporations, proprietorships, partnerships and trusts can receive a non-refundable tax credit of 20% of qualifying SR&ED expenditures. (See Table 1)

To top all of this off, various provinces have their own additional tax incentive programs (ranging from a 10% to 35% credit) for SR&ED activities carried out in their respective provinces. (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.

The benefits of doing SR&ED in Canada are numerous. A refundable tax credit represents a reinjection of cash back into a company, which in turn can be used for sustaining future SR&ED activities. The potential exceeds $700,000 of tax refund per year. 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 10 years. Furthermore, the company can choose not to deduct its SR&ED expenditures in the current year, and these expenditures can be carried forward indefinitely to reduce income in any future year.

Other benefits of carrying out SR&ED activities in Canada include use of favourable exchange rates, access to a world-class infrastructure, a superior workforce, easy access to markets, operations in the same time zones, protection and retention of intellectual property, and lower overall business costs.

## How can U.S. companies qualify for the Canadian SR&ED tax benefits?

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

Through a Canadian-controlled private corporation

A CCPC is a private corporation that is not controlled directly or indirectly by a public corporation, a non-resident, or a combination of the two, and is a resident of Canada. A U.S. corporation can set up a CCPC in Canada so 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.

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SR&ED carried out by a CCPC is eligible for a refundable tax credit of 35%. Additionally, CCPCs enjoy various other tax advantages, including access to a small business deduction, which results in a reduced income tax rate.

## Eligible criteria and activities

For the purpose of the tax program, SR&ED is defined as "systematic investigation or search carried out in a field of science or technology by the means of experiment or analysis." Only SR&ED that is done in Canada qualifies under the program. Claimants can carry out the SR&ED in-house or contract it to a third party to be done on their behalf.

Eligible activities can 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.

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 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 doing SR&ED in a province with its own R&D tax incentive program will considerably increase the amounts shown here):

| | **Small Canadian-controlled Private Corporations** | | | | **Large Public or Foreign-controlled Corporations** | | | |
|---|---|---|---|---|---|---|---|---|
| | Credit Rate | % Refund | Refundable Tax Credit (Cash Back) | Non-Refundable Tax Credit (Reduce Taxes) | Credit Rate | % Refund | Refundable Tax Credit (Cash Back) | Non-Refundable Tax Credit (Reduce Taxes) |
| First $2 million in SR&ED expenditures | 35% | 100% | $700,000 | – | 20% | – | – | $400,000 |
| Remaining $3 million in SR&ED expenditures | 20% | 40% | $240,000 | $360,000 | 20% | – | – | $600,000 |
| **Total** | | | **$940,000** | **$360,000** | | | **–** | **$1,000,000** |

## Table 2:

Combined Provincial and Federal SR&ED tax credits

| | **Small Canadian-controlled Private Corporations** | | | | | **Large Public or Foreign-controlled Corporations** | | | | |
|---|---|---|---|---|---|---|---|---|---|---|
| | Provincial Credit | | Federal Credit | | Combined Credit Rate[1] | Provincial Credit | | Federal Credit | | Combined Credit Rate[1] |
| | Rate | Refund? | Rate | Refund? | | Rate | Refund? | Rate | Refund? | |
| Alberta | – | – | 35% | Yes | 35.00% | – | – | 20% | No | 20% |
| British Columbia | 10% | Yes | 35% | Yes | 41.50% | 10% | No | 20% | No | 28% |
| Manitoba | 20% | No | 35% | Yes | 48.00% | 20% | No | 20% | No | 36% |
| New Brunswick | 15% | Yes | 35% | Yes | 44.75% | 15% | Yes | 20% | No | 32% |
| Newfoundland | 15% | Yes | 35% | Yes | 44.75% | 15% | Yes | 20% | No | 32% |
| Nova Scotia | 15% | Yes | 35% | Yes | 44.75% | 15% | Yes | 20% | No | 32% |
| Ontario[2] | 10% | Yes | 35% | Yes | 41.50% | – | – | 20% | No | 20% |
| Prince Edward Is. | – | – | 35% | Yes | 35.00% | – | – | 20% | No | 20% |
| Quebec[2,3] | 37.5% | Yes | 35% | Yes | 60.94% | 17.5% | Yes | 20% | No | 34% |
| Saskatchewan | 15% | No | 35% | Yes | 44.75% | 15% | No | 20% | No | 32% |

1 In calculating the combined credit, the federal tax credit is reduced by the provincial tax credit receivable.
2 Ontario and Quebec offer additional R&D programs, which are not covered by the scope of this table.
3 In Quebec, only R&D wages are eligible for R&D tax credits, not materials, equipment or overhead.

## Additional information on Canada's SR&ED

- CRA's SR&ED Web site: http://www.cra-arc.gc.ca/taxcredit/sred/menu-e.html.
- An introduction to the SR&ED Program: http://www.cra-arc.gc.ca/E/pub/tg/t4052/t4052-04e.pdf
- CRA's SR&ED services and workshops: http://www.cra-arc.gc.ca/taxcredit/sred/services-e.html
- Provincial and territorial governments SR&ED Programs: http://www.cra-arc.gc.ca/taxcredit/sred/prov-e.html