

Improving Access to Scientific Research and Experimental Development (SR&ED) Incentives in Canada

Stimulating business spending on research and development (R&D) will ensure that Canada remains at the forefront of scientific capability, enhancing our ability to shape and improve our nation's future. Over time it can lead to higher productivity growth, economic growth and living standards. The SR&ED tax incentive program has been effective in encouraging investment in R&D and in boosting profitability and cash flow. However, the program can be improved to maximize its effectiveness and impact.

SR&ED investment tax credits (ITCs) are only marginally effective for corporations that do not qualify for refundable ITCs such as publicly-controlled corporations; non-resident controlled corporations; a combination of the above; and certain CCPCs due to restrictions on taxable income and taxable capital for the prior year, or by virtue of certain association rules. When ITCs are not fully refundable, they do not provide the critical assistance that firms need to weather a sustained downturn. Instead, they are only available to these companies if they have taxes owing.

In the current economic environment, many companies who are keen to continue R&D no longer have access to the credits because they are in a loss position.

"The problem is that the structure of the SR&ED tax credit rules is an all or nothing structure. Either one can use credits (through refundability for small CCPCs or against taxes payable for profitable companies) or one cannot." (Source: Information Technology Association of Canada (ITAC). *An Alternative for Extending Refundability of SR&ED Tax Credits*. January 2007). The Canadian Chamber of Commerce recommends that the federal government make all SR&ED ITCs fully refundable.

Canada would also benefit from restructuring the SR&ED tax incentive program to attract foreign investment in SR&ED activities. For profitable Canadian subsidiaries of multinationals, SR&ED tax credits provide no direct incentive to maintain or expand R&D in Canada. ITCs reduce corporate income taxes payable in Canada making foreign MNCs less eligible to receive tax credits in their home country, increasing their income tax liability there. The SR&ED tax incentive program can be made more attractive to foreign investors by allowing corporations in Canada to offset the ITC against a pre-tax levy, such as employer Employment Insurance premiums. This would result in an increase in Canadian corporate income tax payable and an equal offsetting decrease in the pre-tax levy. Because Canadian corporate income tax payable is not reduced, the amount of foreign tax credit available to the foreign investor would not change.

The government should also consider expanding the ITC for collaborative R&D. Firms are likely to under invest in collaborative research (whether in partnership with a university, national laboratory, or industry consortium) because it tends to be more basic and exploratory. Moreover, research results are shared and firms cannot capture the full benefits. Countries like Norway, Spain, the UK, Denmark, Hungary and Japan provide firms tax incentives/deductions for collaborative R&D.

Recommendations

That the federal government:

1. Expand refundability of the SR&ED Tax Credit to all R&D performers and that any changes to refundability of credits be made retroactive to two complete fiscal years prior to the date of the change announcement. .
2. Offset SR&ED tax credits against a pre-tax levy.
3. Consider expanding the ITC for collaborative R&D, i.e. industry-industry, industry-university, and industry-government efforts. Continue to build linkages and relationships between the public and private sectors by fostering collaboration among university, college and government researchers.
4. Implement a focused and sustained effort to encourage SMEs to enter the SR&ED tax incentive program. Continue to clarify and simplify forms and publications to facilitate access for small business and reduce compliance costs.
5. Review administrative procedures relating to the SR&ED program in other countries and adopt best practices.
6. Continue to increase awareness of the SR&ED program both at home and abroad.