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R&D Tax Update

The evolving SR&ED landscape

December 11, 2012 (12-7)

Recently, a number of developments have affected Canada's scientific research and experimental development (SR&ED) tax incentive program, including the tabling of the second 2012 budget implementation bill (bill C-45), and another technical tax amendments bill (bill C-48) in the House of Commons. In addition, the Canada Revenue Agency (CRA) has asked for recommendations to improve the on-line SR&ED eligibility self-assessment tool (ESAT). While Canada makes these changes, other countries are improving their tax incentive programs.

Bill C-45

Bill C-45 received first reading in the House of Commons on October 18, 2012 and is currently awaiting third reading. The bill implements a number of important tax provisions from Budget 2012, including the SR&ED changes. Although bill C-45 removes capital expenditures as eligible for SR&ED tax incentives as outlined in the 2012 budget, it does retain the ability of R&D performers to claim capitalized soft costs as introduced in the August 14, 2012 draft legislation.

Bill C-48

Bill C-48 includes a significant number of outstanding legislative proposals, some from as far back as 1998. The bill received first reading on November 21, 2012. The main SR&ED changes are described below:

- Subsection 37(8) of the Income Tax Act (the Act) is amended to include the cost of materials transformed in the calculation of eligible expenditures using the proxy method, for costs incurred after February 23,1998;
- The recapture rules in subsection 127(27) of the Act are updated to include only the shared-use equipment (SUE) portion of the cost where applicable and to clarify the recapture rules where "all or substantially all" of SUE property is converted to commercial use or transferred to a non-arm's length party. This change was required to align the recapture to the benefit and applies to conversions or dispositions occurring after December 20, 2002.
- The definition of expenditures in section 143.3 of the Act effectively excludes stock options as of November 17, 2005. This change was introduced as a consequence of the *Alcatel Canada* decision and has been part of administrative policy since 2005.
- New subsection 220(2.2) of the Act confirms that the Minister of National Revenue cannot waive the filing deadline for SR&ED claims. As a result of this

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provision, which applies on or after November 17, 2005, it is no longer possible to request an extension of the 18 month deadline. Further, the enactment of this provision will put to an end any challenge that the legislation was not in effect for a particular year. The CRA has been applying this measure since 2005.

ESAT improvements

Following the commitment announced in the 2012 budget to improve the administration of the SR&ED program, the CRA will be taking steps to enhance the online SR&ED ESAT. Interested parties were invited to provide suggestions and recommendations to enhance the ESAT by November 30, 2012.

Since 2008, the ESAT has been a basic on-line tool created to help taxpayers determine whether their R&D activities qualify for the SR&ED program. The ESAT requires improvement to help taxpayers better understand the government's policy on the eligibility of R&D activities and to determine how it applies to their business. The enhanced ESAT may also provide some perspective to help taxpayers complete the required technical project descriptions. While these improvements will be welcome, the ESAT will not be able to address all of the complexities inherent in determining eligibility for SR&ED incentives or understanding the application of the guidelines to particular industries or projects.

The global landscape

While Canada is scaling back the SR&ED tax incentive program, many other countries are expanding their tax incentive regimes. As can be seen in Deloitte's updated **Global Survey of R&D tax incentives** released in September 2012, some of the countries that have recently introduced significant changes include:

- Hungary – introduction of a new capital gains exemption for qualifying intellectual property (IP) income;
- India – extension of the super deduction for in-house R&D expenditures until March 31, 2017 and introduction of a new deduction for R&D employee salary and materials consumed;
- Ireland – introduction of provision allowing credits received to be used by key R&D employees to offset their personal income tax liabilities;
- Italy – introduction of a new R&D wage credit for qualifying researchers;
- Russia – introduction of new direct and indirect tax benefits for R&D related activities;
- United Kingdom – introduction of an IP income tax rate effective April 1, 2013.

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