Canada

Canada offers volume-based credits ranging from 15%–35%, including refundable credits for Canadian-Controlled Private Corporations.

Background

The combined federal and provincial corporate tax rate on business income is between 11% and 31% in 2015. The tax rate depends on the size of the corporation, ownership, and the province in which a company is located. Scientific Research and Experimental Development (SR&ED) tax credits are available to taxpayers for eligible R&D work carried on in Canada. These credits can be used to reduce federal and provincial taxes payable. In some cases, the credit is refundable.

The SR&ED tax credit is legislated in the Income Tax Act and administered by the Canada Revenue Agency (CRA). SR&ED claims are submitted as part of the claimant's tax return and must be filed using prescribed forms and schedules. Strict filing deadlines apply (18 months after the end of the taxation year for corporations; no extensions are allowed).

Nature of incentives

Incentives for SR&ED in the form of deductions and tax credits are available to corporations, individuals, general partners of a partnership and trusts that carry on eligible activities in Canada. Taxpayers must incur expenditure in respect of SR&ED carried on in-house or by subcontractors acting on their behalf. Claims are filed for each tax year and may be reviewed by the CRA. Taxpayers must be prepared to support their claims with contemporaneous documentation and other technical and financial evidence of activities and expenditure.

SR&ED deductions: Eligible SR&ED current expenditure is added to a separate tax pool that carries forward from year to year. Capital expenditure is not eligible for SR&ED treatment after 31 December 2013. At the end of the year, all or a portion of the pool can be deducted in the year, with any unclaimed balance carried forward indefinitely to be deducted in future years.

Investment tax credits (ITC): After 31 December 2013, federal investment tax credits are earned at 15% of qualified expenditure. Prior to this date, the rate was 20% of qualified expenditure. These credits can be used to offset federal tax liabilities in the taxation year. Unused credits can be carried forward 20 years and carried back three years.

Refundable ITCs: Small Canadian-Controlled Private Corporations (CCPCs) earn refundable investment tax credits at a rate of 35%. The federal SR&ED program does not offer refunds to foreign controlled or public corporations.

Refundable credits are available for the first CAD 3M of qualified expenditure per year (expenditure limit). Tax credits on expenditure over the expenditure limit are calculated at a basic rate of 15%. Only a 40% portion of the 15% refundable credit is allowed on expenditure that exceeds the expenditure limit.

The expenditure limit must be shared by all corporations in an associated group. The maximum expenditure limit of CAD 3M for the associated group is reduced pro rata if taxable income exceeds CAD 200K and taxable capital employed in Canada (TCEC) exceeds CAD 10M. If taxable income reaches CAD 800K or TCEC reaches CAD 50M, the expenditure limit is eliminated and the company no longer qualifies for refundable credits. These amounts are based on the results of the prior year.

As noted above, there is an annual cap on refundable credits, but there is no cap on the total amount of nonrefundable credits available through SR&ED incentives.

Provincial SR&ED incentives: Provincial ITC rates range from 4.5% (Ontario) to 30% (Quebec). Many provinces offer refundable or partially refundable credits.

Enhanced provincial tax credits are available for research conducted by universities, research centers, and research consortia. Special federal and provincial tax credits exist for selected industries including interactive digital media, video game development, film and television, and industries involved in the development of new technologies that address issues of climate change, clean air, and water and soil quality.

All SR&ED credits are taxable to the claimant. Federal credits are taxed in the year following the year in which they are used to reduce taxes or generate a refund. Provincial credits are taxable in the year the claimed expenditure is incurred, regardless of whether or not the credit is refunded or applied to offset taxes.

Some restrictions apply to carry forward balances, including restrictions on use of the preacquisition pools of SR&ED expenditure and ITCs after an acquisition of control of the taxpayer corporation.

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Eligible industries and qualifying costs

Eligibility is broad and is not limited to particular industries. To qualify for SR&ED incentives, work must be performed in Canada to advance the understanding of scientific relations or to advance technologies, to address known scientific or technological obstacles, and to incorporate a systematic investigation or search by qualified personnel. Qualifying activities include the following:

- Experimental development to achieve technological advancement to create new materials, devices, products, processes, or to improve existing ones.
- Applied research to advance scientific knowledge with a specific practical application in view.
- Basic research to advance scientific knowledge without a special practical application in view.

Although "shop floor R&D" may be eligible, commercial production and routine development are not.

The SR&ED claim must be substantiated by contemporaneous documentation that supports the project as "systematic investigation or search" through a process of experimentation or analysis for the purpose of resolving a problem that cannot currently be addressed with known technologies. A company must be prepared to provide supporting documentation when its claim is reviewed by the tax authorities.

Qualified R&D expenses include salaries and wages for employees in Canada, materials (consumed or transformed in the course of the SR&ED), 80% of the cost of subcontracted SR&ED performed in Canada by Canadian taxable suppliers, incremental overhead (or a proxy amount in lieu of overhead (see below), payments to Canadian universities, colleges, and consortia. Special computation rules apply for contract SR&ED to prevent duplicate claims by Canadian companies.

Recent changes to the SR&ED program in Canada

A number of changes to the SR&ED program took effect in 2013 and 2014:

- The federal ITC rate was reduced from 20% to 15% on 1 January 2014.
- Capital expenditure and lease payments were excluded from the program for property acquired and available for use after 31 December 2013. This applies to shared use equipment, as well as the capital portion of third-party payments.
- The prescribed proxy amount for overhead was reduced from 65% of salary costs of directly engaged labor to 60% for 2013, and 55% for years after 2013.
- Qualifying expenditure to arm's-length contractors was limited to 80% of the contract payment for expenditure incurred after 31 December 2012.
- Claim preparer information requirements and penalties were introduced for missing or incomplete information.

IP and jurisdictional restrictions

The SR&ED program does not impose any restrictions on the ownership of IP that may be produced by the R&D, although the Canadian company must have the right to exploit the results of any subcontracted research.

Research generally must be undertaken in Canada to qualify as SR&ED; however, where employees of the claimant are working outside of Canada, the amount of eligible wages for SR&ED performed outside Canada is limited to 10% of eligible wages claimed for SR&ED performed in Canada.

Some provinces offer tax holidays for revenue earned from patents. These incentives apply to provincial taxes on income earned from assigning and licensing a qualified patent to a nonresident. Income derived from selling goods and/or providing services related to a qualified patent also are eligible.

Other concerns

Taxpayers must submit detailed information on prescribed forms in order to claim the federal R&D credit. Provincial credit forms are also required for each jurisdiction of the claim. The deadline for filing research credits is 18 months after the end of the company's tax year. No extension to this deadline is available, and incomplete claims will be rejected if not corrected before the 18 month deadline. Prescribed Form T661 requests detailed technical information for each eligible project (pre-approval is not required).

Documentation must be maintained to support the claim in the event of an audit by the tax authorities. The CRA may conduct a review of the technical eligibility and the expenditure claimed. Refundable claims must be reviewed within 120 days of receipt by the CRA of a complete claim (240 days for an amended return). Nonrefundable claims must reviewed within 365 days.

Canada

Nature of benefit available	Income tax benefit generally available	Specific pre-approval required from government	Refundable/ Carryforward
Tax credits	1. 15% federal tax credit for all qualifying R&D costs. 2. Small Canadian-controlled private corporations (CCPCs) earn refundable investment tax credits at a rate of 35%. 3. Tax credits also are available from provincial authorities.	No	Federal SR&ED investment tax credits are refundable on the first CAD 3M of annual expenditure if earned by a small CCPA. The CCPA of companies must have less than CAD 800K of taxable income and less than CAD 50M in taxable capital in prior year to be eligible. Other unused credits may be carried forward 20 years (10 years in some provincial jurisdictions) and carried back three years.

R&D activities must occur in country	Cap/Limitations on benefits	IP must be retained in country	Industry eligibility restriction
Research generally must be undertaken in Canada, but 10% of eligible wages incurred outside of Canada may be claimed for the R&D tax credit.	No cap on nonrefundable credits.	No	No