

R&D Tax Credit (also known as Scientific Research and Experimental Development – SR&ED)

Did you know...?

The SR&ED program is a federal tax incentive program administered by the Canada Revenue Agency (CRA). It encourages Canadian businesses of all sizes, and in all sectors to conduct research and development (R&D) in Canada. The SR&ED program gives claimants cash refunds and/or tax credits for their expenditures on eligible R&D work done in Canada.

Claimants can apply for SR&ED investment tax credits for expenditures such as wages, materials, machinery, equipment, some overhead, and SR&ED contracts.

Who qualifies?

Sole-proprietorships, Partnerships & Trusts

These types of business structures (including trusts) can earn an Investment Tax Credit (ITC) of 20% of qualified expenditures for SR&ED carried out in Canada. The ITC earned by a proprietorship or certain trusts may be partially refunded after applying these tax credits against taxes payable.

Canadian Controlled Private Corporation (CCPC)

A CCPC can earn an ITC of 35% for the first \$3 million of qualified expenditures for SR&ED carried out in Canada, and 20% on any excess amount. Generally, a CCPC with a taxable income in the immediately preceding year that does not exceed the *qualifying income limit* (\$500K less certain deductions) may receive a portion of the ITC earned as a refund, after applying these tax credits against taxes payable.

Other Canadian corporations

All other Canadian corporations can also earn an ITC of 20% of qualified expenditures for SR&ED carried out in Canada. The ITC earned by a Canadian corporation that is not a CCPC is non-refundable, but may be used to reduce any taxes payable. The ITC earned by a proprietorship or certain trusts may be partially refunded after applying these tax credits against taxes payable.

SR&ED Federal ITCs and Refund

A taxpayer may carry unused ITCs and reduce federal taxes payable back three (3) and forward twenty (20) years. CCPCs will generally claim the 35% ITC for current scientific research expenditures before capital expenditures as only current expenditures qualify for the 100% refund. This summary applies to SR&ED expenditures incurred after December 31, 2010.

	Taxpayer	ITC RATE	REFUND RATE
SR&ED expenditures in Canada	<i>CCPCs</i>	35% of up to \$3M or less of expenditures PLUS 20% of expenditures above the \$3M limit (not eligible for the 35% rate)	100% of the 35% ITC calculation on <i>current expenditures</i> PLUS 40% of ITCs on <i>capital expenditures</i> computed at 35% and 20% rate
	<i>Other Canadian Corporations</i>	20% of all expenditures	Not available for a refund
	<i>Sole-proprietorships, Partnerships & Trusts</i>	20% of all expenditures	40% of the ITCs calculated at 20% rate

The SR&ED ITCs on salary or wages may include those incurred in respect of SR&ED carried on outside Canada that is related to the taxpayer's business. The salary or wages incurred outside Canada is limited to 10% of the total salary and wages directly attributable to SR&ED carried on in Canada.

In addition to federal incentives, corporations carrying on SR&ED may also benefit from provincial or territorial tax credits. Provincial and territorial tax credits are considered to be government assistance for federal tax purposes, and therefore reduce expenditures that are eligible for the federal SR&ED deduction and federal ITCs.

Ontario Innovation Tax Credit

The Ontario Innovation Tax Credit (OITC) is a refundable tax credit. It is available to all corporations that perform scientific research and experimental development (SR&ED) in Ontario.

The Canada Revenue Agency (CRA) administers the program on behalf of Ontario through the federal income tax system.

The OITC is calculated as **10%** of **qualifying SR&ED expenses**. Qualifying expenses are:

- 100% of current expenses and
- 40% of capital expenses

The maximum annual credit is \$300,000.

A qualifying corporation:

- has a permanent establishment in Ontario
- carries on SR&ED in Ontario during the year and
- is eligible to claim the investment tax credit under section 127 of the federal Income Tax Act.

Corporations must claim the tax credit on Schedule T2SCH566, and file it with their T2 return.

Ontario Research and Development Tax Credit

The Ontario Research and Development Tax Credit (ORDTC) is a non-refundable tax credit. It is available to corporations that carry out scientific research & experimental development (SR&ED) work in Ontario. The ORDTC replaced the Ontario SR&ED tax deduction for tax years ending after December 31, 2008.

The Canada Revenue Agency (CRA) administers the program on behalf of Ontario through the federal income tax system.

The ORDTC provides a **4.5%** tax credit based on eligible SR&ED expenses carried out in Ontario. The credit may be used to reduce corporate income tax payable. Any unused credit may be:

- carried back three years to tax years ending after December 31, 2008 or
- carried forward 20 years.

Corporations that incur eligible expenses may claim the credit. An eligible expense must be:

- on account of SR&ED carried on at a permanent establishment in Ontario and
- a qualified expense in respect of SR&ED for purposes of the federal Investment Tax Credit.

Corporations may claim the tax credit on Schedule T2SCH508, filed with their T2 Corporation Income Tax Return.

What kind of projects qualify?

To qualify for the SR&ED program, work must advance the understanding of scientific relations or technologies, address scientific or technological uncertainty, and incorporate a systematic investigation by qualified personnel.

Work that qualifies for SR&ED tax credits includes:

- **experimental development** to achieve technological advancement to create new materials, devices, products, or processes, or improve existing ones;
- **applied research** to advance scientific knowledge with a specific practical application in view;
- **basic research** to advance scientific knowledge without a specific practical application in view; and
- **support work** in engineering, design, operations research, mathematical analysis, computer programming, data collection, testing, or psychological research, but only if the work is commensurate with, and directly supports, the eligible experimental development, or applied or basic research.

The following activities are **not** eligible for benefits under the program:

- social science and humanities research;
- commercial production of a new or improved material, device, or product, or 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;
- prospecting, exploring, or drilling for or producing minerals, petroleum, or natural gas; and
- development based solely on design or routine engineering practice.

How do businesses apply for the tax credit?

To make an SR&ED claim you must file an income tax return along with the following prescribed forms:

- Form T661, *Scientific Research and Experimental Development (SR&ED) Expenditures Claim*, and **one of the following two forms**:
 - Form T2 SCH 31, *Investment Tax Credit – Corporations*; or
 - Form T2038 (IND), *Investment Tax Credits (Individuals)*.

The claim should be submitted with the T2 Corporation or the T1 Individual Income Tax Return, or within 12 months of the income tax return's filing due date for the year in which the SR&ED expenditure was incurred. As a result, corporations have 18 months to file Form T661 and Schedule T2SCH31, while individuals have 17 1/2 months to file Form T661 and T2038(IND).

What is Preclaim Project Review (PCPR) Service?

The Preclaim Project Review (PCPR) Service is a free advisory service designed to help businesses in planning and investment decisions by:

- identifying which R&D projects and work may qualify for SR&ED tax incentives;
- providing a preliminary opinion on the eligibility of SR&ED projects without having to generate extensive paperwork, potentially reducing the time and cost of claim preparation;
- helping understand what supporting documentation should be kept; and
- establishing open communication and building a stronger working relationship between the taxpayer and the CRA.

The PCPR Service is available before SR&ED tax incentives are claimed and, ideally, **early in the R&D process** or even before the work is undertaken. This provides greater up-front certainty about the eligibility of R&D work for SR&ED tax incentives.

Note: The PCPR Service is neither an advanced income tax ruling nor a pre-approval of an SR&ED claim. A final determination on any SR&ED claim must be based on the actual work done and can only be made after the claim is filed.

This article is presented only for informational purposes and does not constitute legal advice. You should retain legal counsel if you require legal advice regarding your individual situation.