Extending forestry's R&D investments through SR&ED Program incentives

by Basu Gantotti¹

Introduction

Research and development (R&D) is pivotal for industries to remain competitive in the current market environment. Innovations and technological advancements resulting from R&D foster corporate growth and competitiveness. Forest industry must not only be on the leading edge of product quality but also diversify into new forest-product areas. Forest sector companies invest a significant amount of resources in R&D on the output (product and process) side as well as on the input (woodland) side. The bottom line is that R&D is rewarding. It gets even better as Canada's federal SR&ED Program literally rewards companies in the form of Investment Tax Credits for doing SR&ED.

SR&ED Program

The Scientific Research and Experimental Development (SR&ED) Program is Canada's largest federal program providing incentives to industrial R&D. Annually, the program receives more than 11 000 claims for approximately \$1.5 billion in tax incentives. The majority of these claimants are small companies in a wide range of industries. By international standards, Canada's SR&ED Program is viewed as one of the most generous incentive programs to support industrial R&D.

Canada Customs and Revenue Agency (CCRA) administers the SR&ED Program through offices located across Canada. CCRA strives to promote the program and to stimulate Canadian SR&ED by delivering the incentives quickly and consistently to all companies performing R&D. The program provides incentives in the form of cash refunds and/or tax credits for claimed expenditures incurred on eligible R&D work performed in Canada. The following sections provide general information on program benefits, qualifying work, claim process and services available from CCRA.

Program Benefits

The SR&ED Program provides incentives in three ways. First, one can deduct current and capital expenditures to reduce one's tax liability in the current year or carry them forward indefinitely for future years. Expenditures for SR&ED must be incurred in Canada and may include wages, materials, equipment, some overheads, SR&ED contracts, and payments to third parties such as to universities and research centres. Second, one can receive Investment Tax Credits (ITC) on qualifying expenditures as a cash refund, tax credits to reduce taxes payable, or both. The unused tax credits can be carried forward 10 years or back three years. Third, one can write off eligible capital items in a short period of time.

The companies that benefit from the program fall into three groups. First, qualifying Canadian-controlled private corporations

with less than \$200 000 of taxable income in the prior year can receive refundable tax credits of 35 per cent of qualifying expenditures. Second, other Canadian corporations such as public or large corporations receive non-refundable tax credits of 20 per cent of qualifying expenditures. Third, individuals, proprietorships, partnerships, trusts and other non-incorporated businesses can earn ITC at 20 per cent, with 40 per cent of the ITC being refundable.

With the exception of Alberta and Prince Edward Island, provinces provide additional 10 to 15 per cent tax credits to companies that are located in their respective provinces. Provincial governments offer these incentives based on the SR&ED Program determinations and these ITCs can also be carried forward and backward. Ontario and Quebec offer certain additional incentives to companies conducting R&D in their provinces. Companies should contact respective provincial governments to obtain more information on provincial incentives.

Qualifying Work

In order to qualify for the incentives, the R&D work must meet the legislative definition of SR&ED. In the Income Tax Act, SR&ED is defined as systematic investigation or search carried out in a field of science or technology by means of experiment or analysis. Such work must fall into one of the following categories:

Experimental Development: Refers to the work performed to achieve technological advancement to create new materials, devices, products or processes or improve the existing ones.

Applied Research: Work carried out to advance scientific knowledge with a practical application in view.

Basic Research: Work performed to advance scientific knowledge without any practical application in view.

Support Work: Work that directly supports and is commensurate with the needs of Experimental Development, Applied Research and Basic Research. This includes eight specific types of work (engineering, design, operational research, mathematical analysis, computer programming, testing, data collection and psychological research).

Experimental Development work carried out on product or process development will no doubt enhance industry's competitive edge. Development of laminated lumber and a process for regulatory compliance purposes are examples of Experimental Development. Such product or process development work would meet the definition of SR&ED. R&D on ecological aspects such as ecosystem characterization, criterion, indicators and biodiversity does not directly provide a competitive edge to industry. However, as this type of R&D falls under Basic and

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Applied Research categories, it meets the definition of SR&ED. It is in these areas that forest industries can leverage research dollars by participating in the SR&ED Program.

SR&ED work may be carried out either by the employees within a company or by others on the company's behalf on contract basis or through payments to such organizations as universities, research institutes, other Canadian companies and other approved organizations.

Based on the definition of the SR&ED, three eligibility criteria have been formulated. These criteria are applied to determine if the claimed work meets the definition of SR&ED. They are:

Scientific or Technological Advancement where the work must generate information that advances the understanding of scientific relations or technologies.

Scientific or Technological Uncertainty where it should be determined that, based on generally available scientific or technological knowledge or experience, a given result or objective can not be achieved or how to achieve it can not be determined.

Scientific or Technical Content in which it should be established that qualified personnel have performed systematic investigation through experiment or analysis. Qualified personnel are persons with relevant education and/or experience in science, technology, or engineering.

The following types of work are not eligible for incentives:

- research in the social sciences or the humanities,
- commercial production or use of a new or improved material, device, product, or process,
- style changes,
- market research and 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.

Claim Process

Claimants must carry on a business in Canada, the SR&ED work should be related to the claimant's business, and the work must be performed and expenditures incurred in Canada. Claims should be filed with tax returns. If this is not possible, SR&ED claims should be filed no later than 12 months after the filing due date for tax returns. Since the due date for filing tax returns is six months after the fiscal year end, there is a total of 18 months from the fiscal year end to file a SR&ED claim. Companies conduct SR&ED and file a claim for the work on an annual basis even if the work continues beyond a year.

Claims received by the CCRA will be checked for completeness. If they are incomplete and lacking key information, CCRA will send a letter requesting missing information. CCRA can not process incomplete claims until all the necessary information is obtained. CCRA reviews all claims and either processes the claims as filed or assigns them to a Research and Technology Advisor for further review. While the Research and Technology Advisor reviews the claims for the scientific and technical aspects of the work, Financial Reviewers verify the eligibility of expenditures claimed. These reviewers will meet with a claimant at the claimant's site to review with the scientific/technical and financial personnel of the company any relevant supporting information such as reports or prototypes.

Refundable claims are generally processed within 120 days of receiving a complete claim. In the case of non-refundable claims, the claimants are informed within 120 days whether their claims will be processed as filed or further review is required. If there is going to be a further review, the claim will be processed within one year of receiving a complete claim.

Recent Program Improvements

To address industry concerns about certain problems related to SR&ED Program delivery, a joint industry-CCRA conference was held in Vancouver in 1998. An action plan was developed as a result of that conference and the SR&ED Steering Committee was formed to oversee the implementation of the plan. Various organizational and operational changes occurred to make the program more client-focussed. Several new initiatives, including National Technology Sector Specialists, Pre-Claim Project Review Service, Account Executive Service and industry-CCRA sector committees were implemented. As a result of such initiatives, there has been significant progress in the timeliness of claim processing, client-focussed program delivery and productive consultation and dialogue.

Help from CCRA

CCRA developed and introduced the following three services to assist both new and continuing claimants:

First Time Claimant Service: This service is designed to help companies new to the program. In addition to providing all the necessary information for first-time claimants through our Web site, companies can contact their local Tax Services Office and request an information package. They can also attend the public information seminars held periodically by CCRA at various locations and/or contact SR&ED staff for additional information. A SR&ED representative can also visit companies to provide information seminars explaining program requirements in detail.

Pre-Claim Project Review: This optional service provides a review and preliminary opinion on the eligibility of work and expenditures either before a SR&ED claim is prepared or even prior to the work being undertaken. Through this service potential claimants learn how the eligibility criteria apply to their work, understand which of their R&D projects would meet the definition of SR&ED, and receive valuable guidance on how to substantiate their claims with appropriate supporting information. The preliminary opinion can be provided verbally on an informal discussion basis or in writing.

Account Executive Service: This is also an optional service where a SR&ED staff member will be assigned to a company as an Account Executive. This Account Executive will act as a single point of contact for all the company's SR&ED information needs and provides guidance on a continuing basis. For example, an Account Executive will brief the company's staff on program requirements, help identify eligible work, provide guidance on claim substantiation needs and claim preparation, review the process and provide a Pre-Claim Project Review. This service provides year to year continuity in order for company personnel to develop expertise on various aspects of the SR&ED Program requirements in a timely manner.

For more information, visit our Web site at www.ccra.gc.ca/sred, contact local the Tax Services Office in your area, or contact the author.