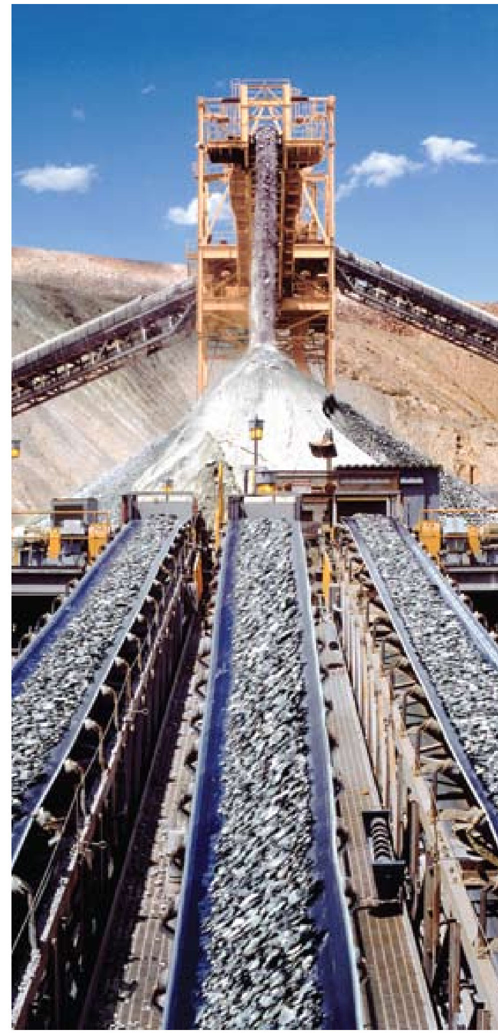

Research and Development
Make it work for you*
*connectedthinking
PRICEWATERHOUSECOOPERS



Canadian R&D tax incentives are among the most generous in the world.

Are you getting the benefits you deserve?

"Research and development" often evokes images of laboratory technicians, test tubes and lab rats. However, even basic development work – in most businesses and industries – may qualify for R&D incentives.

You probably conduct R&D already if your company uses a systematic process to:

- develop or modify technological capabilities, including computer software;
- manufacture an existing product for less cost; or
- develop, enhance or modify a new or existing product or process.

These activities may qualify as R&D whether they are successful or not.

Taxpayers engaged in eligible R&D activities now, or any time during the last 18 months, may:

- generate valuable federal and provincial R&D credits;
- apply federal tax credits directly against federal income tax liabilities;
- receive cash refunds of the tax credits; and
- deduct all R&D expenditures against taxable income.

Generally, there are no dollar limits on these valuable R&D tax credits.

What is R&D?

To qualify for R&D tax incentives, companies must perform work in Canada that is:

- **Basic research** – work undertaken to advance scientific knowledge, without a specific practical application in mind;
- **Applied research** – work undertaken to advance scientific knowledge, but with a specific practical application in mind; or
- **Experimental development** – the results of basic or applied research are used to create new, or improve existing, materials, devices, products or processes.

For most companies, qualifying R&D takes the form of experimental development.

Eligible activities

Activities that directly support basic research, applied research or experimental development are also eligible for R&D tax incentives, if they are:

- engineering or design;
- data collection;
- testing;
- operations research;
- psychological research;
- mathematical analysis; or
- computer programming.

Ineligible activities

Certain activities are ineligible, including: market research or sales promotion; routine testing or data collection; commercial production of a new or improved material, device or product; commercial use of a new or improved process; style changes; research in the social sciences or the humanities; and prospecting, exploring or drilling.

Which costs qualify?

Eligible costs can include the wages, salaries and related benefits of personnel directly involved in the research or development activities (e.g., engineers, technicians and scientists), material and supplies, certain contractor payments, and directly related incremental overhead costs (other than rent).

Certain capital expenditures also qualify for R&D benefits, depending on the extent to which the assets are used in R&D activities. These expenditures include the acquisition of new tangible assets used primarily for R&D, as well as certain prototypes and pilot plants. Capital costs that do not qualify include buildings and leasehold interests, the purchase of rights or patents, and capital items used primarily for other purposes.

A company can use one of two methods to calculate the overhead costs eligible for R&D tax credits. It can either track and analyze overhead costs to determine which are directly attributable to R&D, or use the "proxy amount," which is a prescribed percentage of the salaries and wages of employees directly engaged in R&D activities.

Choosing the appropriate method will maximize your R&D claim.

Canada's R&D tax Incentives: Too good to ignore

Lucrative R&D tax incentives promote the development of new or technologically upgraded products, processes and services in Canada.

All companies conducting R&D may be eligible to:

- immediately write off current R&D expenditures and certain capital expenditures used 90% or more for R&D activities, or carry them forward to a future tax year;
- claim a federal tax credit, equal to 20% of those R&D expenditures, against federal income tax liability;
- claim a reduced federal tax credit for capital expenditures used 50% or more for R&D; and
- carry unused federal R&D credits back three taxation years and forward twenty.

For certain Canadian-controlled private corporations (CCPCs), the incentives are even better. CCPCs may be eligible for additional federal tax credits of up to 15%, for a total of 35% of R&D expenditures. Tax credits earned by CCPCs, in contrast to other corporations, may be refundable. That means the Canadian government will pay the credits in cash even if the company has no federal income taxes payable.

Most provinces offer their own R&D incentives, which work in conjunction with the federal tax program. Companies deciding where to perform research and development should consider all provincial R&D incentives.

In a global marketplace that demands innovation, Canada's R&D tax incentives reflect government recognition that R&D is essential not only to the success of individual companies, but also to that of Canada as a whole.

R&D Manager®

Details

Provincial Research & Development Tax Incentives

Details

Canadian-Controlled Private Corporations

Details

Canada's R&D tax incentives could reduce your R&D costs by more than 63%.[1]

Make your R&D work for you

PricewaterhouseCoopers professionals can help you identify and claim your eligible R&D activities, to ensure that you obtain the maximum tax saving. PricewaterhouseCoopers can make your R&D work for you.

The benefits are simply too good to ignore.

www.pwc.com/ca/rd

Canadian-Controlled Private Corporations

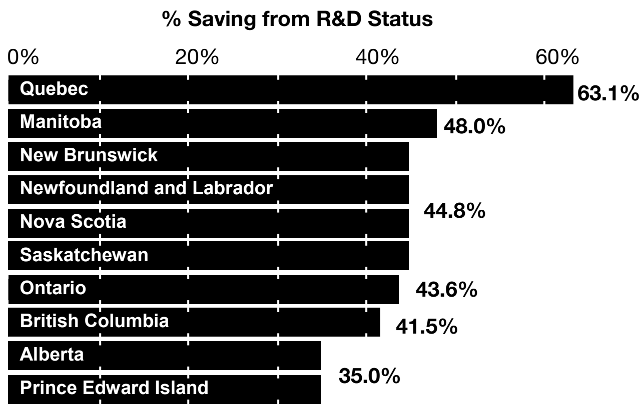
Back to Menu

Canadian-controlled private corporations (CCPCs) may receive enhanced research and development (R&D) tax incentives. (The rules governing these tax incentives are outlined on the other side.)

The figures below compare the after-tax cost of $100 expenditures in Canada for non-R&D and R&D activities. The bar chart shows the percentage saving that R&D status provides in each province.

After-Tax Cost of $100 Expenditure in Canada for CCPCs

Non-R&D	R&D	
$81.00	$29.91	Quebec
$87.00	$45.24	Manitoba
$84.00	$46.41	New Brunswick
$84.00	$46.41	Newfoundland and Labrador
$84.00	$46.41	Nova Scotia
$84.50	$46.69	Saskatchewan
$83.50	$47.12	Ontario
$85.00	$49.73	British Columbia
$86.00	$55.90	Alberta
$85.53	$55.59	Prince Edward Island



These figures assume:

- the corporation has a December 31, 2008 year end;
- the corporation is eligible for the top federal and provincial R&D tax incentive rates (except for Ontario OBRI and Quebec university, public research centre, research consortium and private partnership tax credits);
- the small business tax rate applies;
- the corporation generates sufficient federal and provincial income taxes to use the tax incentives available; and
- the small business deduction clawback does not apply.

Rules governing R&D tax incentives for CCPCs

Qualifying CCPCs carrying on R&D activities in Canada may be eligible for an enhanced federal tax credit rate of 35%, which may be fully refundable. The 35% rate and refundability depend on the corporation's taxable income, taxable capital and the amount of qualifying R&D undertaken, as follows:

A	Qualifying CCPCs with: • taxable income less than $400,000;[1] **and** • taxable capital less than $10 million.[1]	The first $3 million ($2 million for taxation years ending before February 26, 2008)[2] of annual R&D expenditures (shared among associated companies) are eligible for a 35% federal tax credit. A company that does not need the full federal tax credit to offset the current year's federal income tax liability will be entitled to a cash refund of 100% of the tax credit on current expenditures (40% on capital expenditures). On expenditures exceeding $3 million ($2 million for taxation years ending before February 26, 2008),[2] a 20% federal tax credit is available, which is 40% refundable.
B	CCPCs with: • taxable income over $700,000 ($600,000 for taxation years ending before February 26, 2008);[1, 2] **or** • taxable capital over $50 million ($15 million for taxation years ending before February 26, 2008).[1, 2]	These CCPCs are not eligible for the refundable 35% federal tax credit on their R&D expenditures. Rather, they are eligible for a 20% federal tax credit, 40% of which may be refundable in certain circumstances.
C	CCPCs between the thresholds in **A** and **B**.	These CCPCs are eligible for the refundable 35% federal tax credit rate on a portion of their R&D expenditures. In addition, they are eligible for a 20% federal tax credit on the excess, 40% of which may be refundable in certain circumstances.

Unused non-refundable federal credits can be carried back three taxation years and forward twenty. (Under draft legislation, the 20-year carryforward is extended retroactively to unused credits earned in the 1998 to 2005 taxation years.) There are *no dollar limits* on these valuable R&D tax credits.

1. Tests are based on the preceding taxation year and encompass the particular CCPC and all of its associated companies.
2. Transitional rules apply for a taxation year that includes February 26, 2008.

Provincial Research & Development Tax Incentives

Back to Menu

In addition to federal tax incentives, Canada's research and development (R&D) program includes provincial tax incentives. These work in conjunction with the federal tax incentives and range from enhanced deductions to fully refundable tax credits.

Eligibility for the provincial R&D tax incentives generally is determined by the Canada Revenue Agency (or by Revenu Québec for Quebec R&D tax incentives) and, except for Quebec, the corporation must have a permanent establishment in the particular province.

Generally, provincial R&D incentives reduce R&D expenditures eligible for federal R&D tax credits and are included in both federal and provincial taxable income. However, for Ontario tax purposes, the portion of the federal R&D tax credits relating to qualifying Ontario R&D expenditures will not be taxed. In addition, the Quebec R&D tax credits are not included in Quebec taxable income.

Summary of Provincial Research and Development Tax Incentives

<table>
<tr><th rowspan="3" colspan="2"></th><th rowspan="3">Provincial R&D Tax Incentive</th><th colspan="4">Provincial R&D Tax Credits</th></tr>
<tr><th rowspan="2">Credit against</th><th rowspan="2">Is Credit Refundable?</th><th colspan="2">Unused credits</th></tr>
<tr><th>Carry back</th><th>Carry forward</th></tr>
<tr><td colspan="2">Manitoba</td><td>20% credit</td><td rowspan="8">Provincial income tax payable</td><td rowspan="3">No</td><td rowspan="3">3 taxation years</td><td rowspan="3">10 taxation years</td></tr>
<tr><td colspan="2">Saskatchewan</td><td>15% credit</td></tr>
<tr><td rowspan="2">British Columbia</td><td>Corporations in general</td><td rowspan="3">10% credit</td></tr>
<tr><td>Qualifying CCPCs[1]</td><td rowspan="9">Yes</td><td rowspan="9" colspan="2">N/A</td></tr>
<tr><td>Alberta[2]</td><td>R&D after 2008</td></tr>
<tr><td colspan="2">New Brunswick</td><td rowspan="3">15% credit</td></tr>
<tr><td colspan="2">Newfoundland and Labrador</td></tr>
<tr><td colspan="2">Nova Scotia</td></tr>
<tr><td rowspan="2">Quebec</td><td>R&D Wage Tax Credit</td><td>17.5% to 37.5% credit[3]</td><td rowspan="4">Provincial income tax and capital tax payable</td></tr>
<tr><td>University Research, Public Research Centre, Research Consortium and Private Partnership Tax Credits</td><td>35% credit[4]</td></tr>
<tr><td rowspan="3">Ontario</td><td>Innovation Tax Credit</td><td>10% credit[5]</td></tr>
<tr><td>Business Research Institute Tax Credit</td><td>20% of qualifying payments (up to $20 million annually on an associated basis) to an Ontario eligible research institute</td></tr>
<tr><td>R&D for taxation years ending after 2008[6]</td><td>4.5% credit</td><td>Provincial income tax payable</td><td>No</td><td>3 taxation years (to years ending after 2008)</td><td>20 taxation years</td></tr>
<tr><td colspan="2">Prince Edward Island</td><td colspan="5">No provincial R&D tax incentives</td></tr>
</table>

Current to October 16, 2008.

1 British Columbia's refundable R&D tax credit is limited to 10% of the lesser of: (a) eligible British Columbia R&D expenditures and (b) the federal R&D expenditure limit (i.e., $3 million or less for taxation years ending after February 25, 2008).

2 In Alberta, a new 10% refundable tax credit can be claimed on eligible R&D expenditures incurred after December 31, 2008 (maximum annual credit is $400,000).

3 Quebec Canadian controlled corporations with under $50 million in assets* may claim the 37.5% rate on up to $3 million ($2 million for taxation years ending before March 14, 2008)** of R&D wages, on an associated basis.

For those with assets* between $50 million and $75 million, the rate is gradually reduced to 17.5%. The rate is 17.5% for all other taxpayers.

50% of the payments made to unrelated subcontractors are eligible for the credit.

4 Quebec's 35% credit is available on 80% of payments to certain eligible entities (e.g., universities and public research centres).

5 The Ontario Innovation Tax Credit (OITC) is available on expenditures up to $3 million ($2 million for taxation years ending before February 26, 2008)** annually for corporations that have taxable income under $400,000 and taxable capital under $25 million.*

A partial OITC is available for corporations, including associated corporations, with taxable income between $400,000 and $700,000 ($400,000 and $600,000 for taxation years ending before February 26, 2008**) or taxable capital between $25 million and $50 million.* The OITC is applied to 100% of current expenditures and 40% of capital expenditures.

6 Commencing taxation years ending after 2008, Ontario's deduction for the portion of the federal investment tax credit relating to Ontario R&D expenditures will be replaced with a 4.5% non-refundable tax credit.

* Assets, taxable income and taxable capital thresholds are in respect of the preceding year on a worldwide associated basis.

** Transitional rules apply for a taxation year that includes March 13, 2008 (Quebec) and February 26, 2008 (Ontario).

R&D Manager®

Back to Menu

R&D Manager® is a unique, web-enabled, tax-intelligent software application. It provides an integrated central repository for all your research and development information. It is designed to provide robust project management capabilities in three key areas.

Scientific and Engineering Project Management

R&D Manager® can:
- capture and allocate all direct employee hours incurred on R&D and non-R&D projects;
- consolidate multiple divisions or sites;
- contemporaneously track R&D expenditures, time and activities on a project basis;
- capture R&D information easily and efficiently in real time;
- link projects and capture expenses or reports, at any level, in a hierarchical presentation;
- support multiple entity/multiple group use, allowing for more than one entity or work group to record R&D expenditures; and
- produce management and budgeting reports.

Finance and Administration

R&D Manager® allows you to:
- import and export general ledger data without the need to re-key;
- produce audit and cost reports;
- convert and present information and reports in any currency;
- capture all direct expenditures incurred on R&D and non-R&D projects;
- allocate overheads to eligible projects;
- provide central control and monitoring for recording R&D information on a global basis;
- archive data at year end; and
- generate both custom-built and user-defined reports.

Taxation

R&D Manager® can:
- tag eligible and non-eligible projects;
- allow for review of project eligibility and reclassification of all related expenditures at any time;
- compare investment tax credits generated using proxy or traditional methods;
- prepare project specification documentation and prescribed tax forms required by federal and provincial governments;
- transfer R&D tax information electronically into corporate tax software packages; and
- help you be "tax smart" with the automatic calculation and allocation of costs.