



Sink or Swim: Managing Taxes in an Economic Downturn

Ernesto Basso , CA

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PRICEWATERHOUSECOOPERS 

Managing Taxes in an Economic Downturn

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Managing Taxes in an Economic Downturn

Agenda

- A Checklist for Recovery of Cash Taxes
- Key Tax Strategies

Managing Taxes in an Economic Downturn

Checklist for Recovery of Cash Taxes

- Maximize refundable tax credits and SR&ED claim
- Recover other overpaid taxes (GST/PST/Customs)
- Accelerate tax refunds

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Checklist for Recovery of Cash Taxes

Accessing cash refundable SR&ED tax credits

- Alberta (New!) offers a 10% cash refundable tax credit for companies conducting R&D in Alberta through a permanent in the province (no CCPC requirement).
 - Expenditures up to \$4,000,000 for a credit of up to \$400,000

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Checklist for Recovery of Cash Taxes

Accessing cash refundable SR&ED tax credits

- Quebec offers cash refundable tax credits for eligible expenditures incurred in the province
 - Salary and wages credit (no longer required to maintain a permanent establishment in Quebec) up to 37.5% of expenditures
 - Credit for R&D expenses pursuant to University, Public Research Centre or Research Consortium Contract – 35%

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Checklist for Recovery of Cash Taxes

Accessing cash refundable SR&ED tax credits

- Quebec continued
 - R&D Tax credit to members of R&D consortium certified by the Minister of Economic Development, Innovation and Export Trade – 35%
 - Credit for R&D pursuant to Private Partnership Pre-Competitive Research – 35%

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Checklist for Recovery of Cash Taxes

Accessing cash refundable SR&ED tax credits

- Ontario refundable credits:
 - Ontario Innovation Tax Credit (OITC), if within taxable capital and taxable income limits - 10% of qualifying expenditures
 - Ontario Business Research Institute Tax Credit (OBRI) - 20% on all qualifying contract payments

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Checklist for Recovery of Cash Taxes

Accessing cash refundable SR&ED tax credits

- Other Ontario:
 - (New!) Ontario's non-refundable R&D tax credit – up to 4.5% on qualifying expenditures (no taxable capital or income limitations)
 - Watch for issues arising from Ontario-Federal harmonization

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Checklist for Recovery of Cash Taxes

Maximizing existing SR&ED filing

- Federal limits have increased: \$3M / \$50M / \$500K.
- Up to 58% return (salaries and wages).
- File even if non-refundable (lobbying efforts!).
- No-recourse 18 month filing deadline.
- 2009 form different and more onerous (project descriptions).
- Expenditures incurred outside of Canada may qualify.

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Checklist for Recovery of Cash Taxes

Maximizing existing SR&ED filing

New Form T661 – rules of engagement have changed:

- No change in legislation or administrative policies
- Part 2 project description information required for **ALL** projects
- Word count limitations over technological advancement (350), technological obstacles (350), and work performed (700)
- IRAP proposal no longer accepted. Now require separate Part 2.

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Checklist for Recovery of Cash Taxes

Maximizing existing SR&ED filing

10 Common issues/oversights:

1. Focusing on core R&D projects and missing ancillary R&D activities critical for the SR&ED project (exp. Software development)
2. Extending beginning and end of project to include potentially eligible work such as:
 - technical feasibility studies or incremental improvement to product following regulatory approval or phase IV studies

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Checklist for Recovery of Cash Taxes

Maximizing existing SR&ED filing

Common issues/oversights:

3. Entitlement of ITC and interrelation with taxable supplier and contract payment rules
4. Structuring contracts to help maximize ITC
5. How to strengthen eligibility of Canadian Contribution in multinational clinical trials
6. Missing costs such as
 - Equipment used in pilot production (smaller scale)
 - Retain bonuses in an M&A situation

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Checklist for Recovery of Cash Taxes

Maximizing existing SR&ED filing

Common issues/oversights:

7. Just because trial sites are outside Canada does not mean that there is no SR&ED in Canada
8. There may be an opportunity to claim the cost of materials consumed outside Canada (depends on specific facts)
9. Payments to Canadian CRO's may not automatically qualify
10. Consider how you structure collaboration agreements to maximize SR&ED credits

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Checklist for Recovery of Cash Taxes

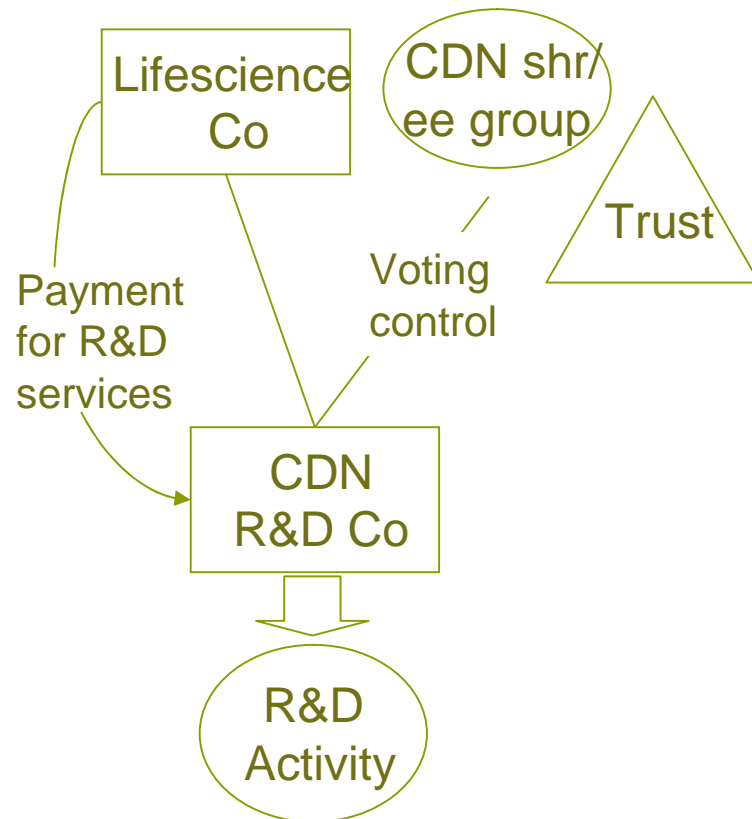
Structuring for cash refundable SR&ED tax credits

- Eligible SR&ED work performed in Canada qualifies for tax credits that can be used to offset taxes otherwise payable or where performed by an eligible corporation (CCPC) are refundable.
- Companies establishing R&D operations in Canada or Canadian companies with R&D operations that are not currently refundable may want to consider to reduce overall economic cost of R&D.

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Checklist for Recovery of Cash Taxes

Structuring for cash refundable SR&ED tax credits



Cost of \$100 of R&D performed in BC assuming 30 /15% tax rate and 15% mark-up

- With SR&ED claim = **\$101** (\$23 ITC carry-forward)
- With cash refundable SR&ED claim = **\$66**
- With cash refundable SR&ED claim (standalone) = **\$65**

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Checklist for Recovery of Cash Taxes

Structuring for cash refundable SR&ED tax credits

- Requires
 - R&D must be performed by eligible corporation
 - Favorable specific facts
 - Detailed planning
 - comfort / ability with necessary business structuring
 - clear business purpose

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Checklist for Recovery of Cash Taxes

Cash recovery of PST

- Ontario PST manufacturing exemptions from (8%) at “point of sale”, for example, on;
 - Machinery and equipment used directly in R&D and the manufacture of tangible personal property (TPP);
 - TPP to be incorporated into other TPP for the purpose of sale;
 - Certain pollution control machinery and;
 - Certain safety equipment.
- **Watch (!) PST self-assessment requirements on importation of TPP, software, and insurance.**

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Checklist for Recovery of Cash Taxes

Cash recovery of GST

- GST incurred on most property and services acquired or **imported** for consumption, use, or supply in the course of a commercial activity.
- GST incurred on costs in the R&D process.
- GST incurred on certain costs relating to pension plans *may* be recoverable.

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Checklist for Recovery of Cash Taxes

Cash Recovery of Customs Duties:

- Incorrect, high duty rate tariff classification;
- Failure to claim preferential tariff treatment, e.g. NAFTA or other FTAs;
- Unclaimed deductible amounts included in value for duty (e.g., freight and related costs);
- Special relief measurements (temporary importations / duty deferral programs).

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Checklist for Recovery of Cash Taxes

Accelerating tax refunds

- If in PST / GST refund position (exemptions, net credit position) file on a monthly or quarterly basis rather than annual or semi-annual
- SR&ED refunds typically take 2-4 months to process with a slow period from July – October. File early / off-cycle for an accelerated refund
- Manage / reduce tax installments

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Tax Strategies

- Monetization of tax losses and other attributes
- Canadian IP Migration
- Deferral taxable income using partnerships
- Factoring AR for sales tax recovery
- Tax optimizing contract terminations
- Outsourcing tax considerations
- Replacing cash with tax enhanced equity compensation
- Other

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Tax Strategies

Monetization of tax losses and other attributes

- Typically buyer driven transaction
- Often interested in very large balance of tax attributes – i.e. greater \$50 - \$75 million
- Very low return makes it very expensive source of financing - typically 4 cents to 6 cents per dollar of tax attribute
- Must be cognizant of loss streaming rules and tax shelter promotion rules

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Tax Strategies

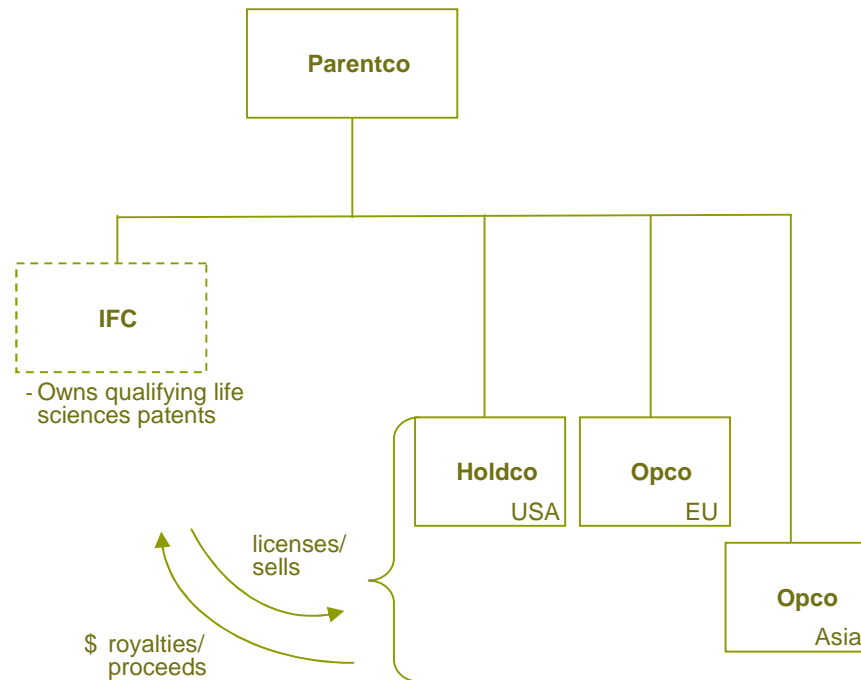
BC IFC Structure - Canadian IP Migration

- Qualifying for refund of BC income tax paid on the international commercialization of a life sciences patent under the *International Financial Activity Act*
- May be viewed as “value add” on exit

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Tax Strategies

BC IFC Structure - Canadian IP Migration



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Tax Strategies

Deferral taxable income using partnerships

- Transferring profitable business into partnership to defer corporate tax liability
- Fiscal and taxation periods of partnership and corporation are different
- Consider implications on SR&ED claims if LP structure

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Tax Strategies

Factoring AR for sales tax recovery

- When amounts are written off the A/R ledger as bad debts, only the person who made the original supply can claim bad debt adjustment for sales tax purposes
- The adjustment has only a 4 year refund opportunity
- Consider if best course of action in many cases is to sell (factor) the accounts receivable on a recourse basis or risk losing the tax

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Tax Strategies

Tax optimizing contract terminations

- Sales tax treatment upon termination of commercial contracts will be dependant upon characterization of the payment streams. In certain cases, consideration under a contract is considered to include a tax amount
- Structure commercial contracts to ensure beneficial sales tax scenarios on termination, for example;
 - gross up clauses; and;
 - provisions around unbundled settlement costs.
- Structure employment terminations to ensure SR&ED eligibility

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Tax Strategies

Outsourcing tax considerations

- Very complicated sales tax issues when they involve the use of software and related assets
- Ability to recover GST may be hampered if not structured properly
- Potential application of PST and foreign VAT
- Withholding tax obligations (Reg. 105)
- Exposure to foreign tax where carrying on business
- Onerous compliance burdens

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Tax Strategies

Replacing cash with tax enhanced equity compensation

- Equity compensation is incentive / retention tool
- Ex. Stock options, performance share units
- Value proposition
 - Capture value of eventual market recovery tax efficiently
 - Reduction of cash compensation outlay
 - Incentive / retention tool

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Tax Strategies

Other

- Sale / leaseback of equipment (cash flow)
- Consider factoring refundable ITC's (cashflow)
- Access available government funding (IRAP, BIP, NRC, WED)
- Recover sales tax on repossessed property
- Debt restructuring / foreign exchange

