Developments

Information and updates on the scientific research and experimental development program

Update on SR&ED changes announced in the 2012 federal budget.

August 23, 2012

Legislative proposals confirm SR&ED changes

In the 2012 federal budget, the Department of Finance (Finance) announced a number of measures that reduce the benefits available under the Scientific Research and Experimental Development (SR&ED) tax incentive program.

Despite extensive industry feedback to reconsider or delay the measures, Finance has moved to implement their original, unmodified plans. Draft legislative proposals, released on August 14, 2012, include the following changes:

Eliminated

- Capital expenditures for SR&ED will no longer qualify for investment tax credits (ITCs), including shared-use equipment previously claimable for partial ITCs.

Reduced

- The rate used for the proxy method of claiming overhead expenditures will be reduced from 65% to 55%.
- Eligible contract payments and third-party payments will be only 80% claimable for ITCs.
- The ITC rate for large corporations will be reduced from 20% to 15%. (The 35% refundable ITC for Canadian-Controlled Private Corporations (CCPCs) remains unchanged.)

These changes are discussed further below.

Eliminated: ITCs for capital expenditures and shared-use equipment

Right now, you can claim ITCs for a SR&ED-related capital expenditure that was intended to be used "all or substantially all" (ASA), i.e., 90% or more, in SR&ED. Effective January 1, 2014, capital expenditures cannot be claimed, and the rules have been changed so that it won't matter who is spending the money and acquiring SR&ED capital: you, a contractor or any other third party doing SR&ED work for you. In addition, to be claimable any capital expenditures made before 2014 must be proven to be "available for use" before January 1, 2014.

Currently, shared-use equipment earns a partial ITC. This category encompasses machinery or equipment not intended to be used 90% or more in SR&ED, but used primarily (more than 50%) in SR&ED.

Shared-use equipment acquired after 2013 will no longer qualify for the partial ITC. Partial ITCs may still be claimed in taxation years ending after 2013 in respect of shared-use equipment acquired before 2014 that meets the shared-use equipment rules.

Reduced proxy rate

Under the proxy method, directly engaged labour is multiplied by a statutory rate (currently 65%) to determine the amount of overhead costs that can be claimed. The proxy method can be used in lieu of detailed accounting for item-by-item overhead (traditional method).

The rate used to calculate the proxy amount will be gradually reduced from the current 65% to 55% by January 1, 2014. Specifically, the 65% rate drops to 60% on January 1, 2013, and then to 55% on January 1, 2014. The proxy rate decrease will be prorated for non-calendar taxation years.

There is no change to the traditional method of claiming SR&ED overhead expenditures.

Reduced contract and third-party payments

Effective for expenditures made after December 31, 2012, only 80% (down from 100%) of:
- eligible payments to contractors; and
- third-party payments to approved research entities and to not-for-profit SR&ED corporations,

will be eligible for ITCs.

Reduced ITCs for large corporations

The ITC rate for large corporations will be reduced from 20% to 15%, for taxation years that end after 2013. The reduced ITC rate will be prorated for non-calendar taxation years. Although the 35% refundable ITC rate for CCPCs remains unchanged, CCPCs will still be affected by the other measures noted above.

Contingency fees

The 2012 federal budget also announced a study of the contingency fees charged by tax preparers, reflecting government concerns that those fees may be reducing the benefits of the SR&ED tax incentive program to Canadian businesses and the economy.

On August 2, 2012, Finance released a consultation paper regarding the impact of contingency fees on the effectiveness of the SR&ED tax incentive program. The consultations are directed to better understanding:
- why certain SR&ED performers use the services of tax preparers on a contingency fee basis to prepare their SR&ED claim;
- why these tax preparers charge such fees; and
- the effect of SR&ED contingency fees on the cost-effectiveness of the SR&ED incentive program in meeting its objective of providing broad-based support for the performance of SR&ED in Canada.

The government is interested in SR&ED stakeholders' views on contingency fee arrangements, including whether contingency fees result in higher costs to the SR&ED performer than more traditional billing methods and if contingency fee arrangements should be restricted. Comments are due by October 1, 2012.[1]

We encourage you to respond to the consultation request and provide your views on this important matter directly to Finance.

For more information

Please contact any of the PwC professionals listed on the next page for more information on the effect of SR&ED changes on your organization.

1. The consultation paper can be viewed at: http://www.fin.gc.ca/n12/12-086-eng.asp

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