

Developments

Information and updates on the scientific research and experimental development program

Gives an overview of "Innovation Canada: A Call to Action," also referred to as the Jenkins report.

October 17, 2011

Jenkins report provides much-anticipated recommendations

The report, "Innovation Canada: A Call to Action," was released by the Independent Panel on Federal Support to Research and Development (R&D) on October 17, 2011. It provides "advice in respect of the effectiveness of federal programs to support business and commercially oriented R&D, the appropriateness of the current mix and design of these programs, as well as possible gaps in the current suite of programs and what might be done to fill them."

In brief, the report (referred to as the Jenkins report) makes six recommendations aimed at promoting business innovation, which include:

- simplifying the Scientific Research and Experimental Development (SR&ED) tax credit and redeploying funds from the credit to direct initiatives that support small and medium-sized enterprises (SMEs);
- transforming the institutes of the National Research Council (NRC); and
- helping high-growth innovative firms access risk capital.

As part of the panel's consultation process PricewaterhouseCoopers LLP (PwC) was consulted on various SR&ED program issues. In addition, PwC made a written submission to the panel in response to the panel's consultation questions on business innovation and federal R&D initiatives.

Background

The report stems from a 2010 federal budget proposal calling for a comprehensive review of federal programs that support business innovation. The federal government recognizes that, despite its high level of federal R&D support, Canada continues to lag other countries in business R&D spending, rates of commercialization of new products and services, and productivity growth. The objective is to encourage Canada's business innovation by using resources more effectively, thereby improving our global competitiveness.

Panel's mandate and approach

The panel asked:

- What federal initiatives are most effective in increasing business R&D and facilitating commercially relevant R&D partnerships?
- Is the current mix and design of tax incentives and direct support for business R&D and business-focused R&D appropriate?
- What, if any, gaps are evident in the current suite of programming, and what might be done to fill the gaps?

It reviewed three types of federal programs intended to support R&D:

- the SR&ED program tax credit;
- programs that support business R&D through:
 - general support; or
 - sector-specific support; and
- programs funded through the federal granting councils, departments and agencies that support commercially focused R&D, often performed by academic institutions.

The panel also studied business innovation in Canada and in relation to our peer group of highly developed countries.

Panel's recommendations

In brief, the panel concludes that “rationalization of programs is required to increase scale, reduce duplication, improve delivery efficiency and create much greater awareness among potential business sector clients.” The panel's six recommendations to achieve this aim are:

- **Recommendation 1:** Create an Industrial Research and Innovation Council (IRIC), with a clear business innovation mandate (including delivery of business-facing innovation programs, development of a business innovation talent strategy, and other duties over time), and enhance the impact of programs through consolidation and improved whole-of-government evaluation.
- **Recommendation 2:** Simplify the SR&ED program by basing the tax credit for SMEs on labour-related costs. Redeploy funds from the tax credit to a more complete set of direct support initiatives to help SMEs grow into larger, competitive firms.

- **Recommendation 3:** Make business innovation one of the core objectives of procurement, with the supporting initiatives to achieve this objective.
- **Recommendation 4:** Transform the institutes of the NRC into a constellation of large-scale, sectoral collaborative R&D centres involving business, the university sector and the provinces, while transferring NRC public policy-related research activity to the appropriate federal agencies.
- **Recommendation 5:** Help high-growth innovative firms access the risk capital they need through the establishment of new funds where gaps exist.
- **Recommendation 6:** Establish a clear federal voice for innovation, and engage in a dialogue with the provinces to improve coordination and impact.

Each recommendation has detailed sub-recommendations and further analysis. These are the sub-recommendations for Recommendation 2 from Chapter 6, which focus on "Program Mix & Design":

2.1 Simpler compliance and administration

- The tax credit benefiting small and medium-sized Canadian-controlled private corporations (CCPCs) should be based on labour-related costs in order to reduce compliance and administration costs. Because the credit would be calculated on a smaller cost base than at present, its rate would be increased. Over time, the government should also consider extending this new labour-based approach to all firms, provided it is able to concurrently provide compensatory assistance to offset the negative impacts of this approach on large firms with high non-labour R&D costs.

2.2 More predictable qualification - Improve the Canada Revenue Agency's preclaim project review service to provide firms with pre-approval of their eligibility for the credit.

2.3 More cost effective - Reduce the amount of SR&ED tax credit assistance by introducing incentives that encourage the growth and profitability of SMEs while decreasing the refundable portion of the credit over time. Redeploy the savings to fund new and/or enhanced support for innovation by SMEs, as proposed in the Panel's other recommendations.

2.4 More accountable - Provide data on the performance of the SR&ED tax credit on a regular basis to permit evaluation of its cost effectiveness in stimulating R&D, innovation and productivity growth.

2.5 Phased implementation and consultation - Adopt the proposed changes through a phased-in approach to give the business sector time to plan and adjust smoothly. There should be early consultations with the provinces on the proposed changes, given that they may want to consider adopting the same base as the federal government.

The panel welcomes the opportunity to meet government officials, business leaders, and post-secondary institutions to discuss its recommendations.

Summary

The report recommends several changes for SMEs, including basing the SR&ED tax credit primarily on labour-related costs (see 2.1 above). The report further suggests extending this approach over time to large corporations (but with compensatory assistance to offset negative effects).

In general, the report recommends allocating more funds through direct funding (i.e., grants, loans and procurement) and less through indirect funding (i.e., SR&ED tax credits) for SMEs.

Time is needed for further study (i.e., with provincial governments) and ultimately to implement any of the recommendations. However, the panel recommends that the government should rebalance the mix of direct and indirect funding for SMEs by decreasing spending through the SR&ED program and directing the savings to complementary initiatives strategically focused on serving the needs of innovative Canadian firms, especially SMEs.

Shortly, PwC will release a more comprehensive version of this *Developments* that includes our observations on the panel's recommendations. Also, on Friday, October 21, 2011, PwC will release a podcast on this topic at www.pwc.com/ca/taxtracks.

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