



June-July 2009

## Comparing the world's R&D tax credits

**Over the past two years, foreign governments have been fine-tuning their R&D benefits**

By David Hearn

*\*This is an expanded version of a summary originally published in the June/July 2009 issue of CAmagazine.*

Canada still has the world's best R&D tax credit scheme, especially for small and medium-sized companies. But other countries, notably the UK, the Netherlands and France, are not far behind; in fact, France may be ahead of Canada where larger public companies are concerned.

These are just some of the key findings from the most recent edition of Overview of Research & Development Tax Incentives in Selected Global Knowledge Economies, published by Scitax Advisory Partners LLP, a Toronto-based consulting firm specializing in taxation of science and technology companies.

Getting a useful picture of R&D tax incentives around the world is more difficult than it might seem. While there is a lot of data available, much of it is out of date and tends to be presented for economists rather than business owners. Furthermore, the past two years have seen a proliferation of countries offering new R&D incentives and some significant increases in the existing rates.

The study, which is published in the form of a tabular report, covers R&D incentives in Australia, Ireland, Canada, The Netherlands, Spain, New Zealand, United Kingdom, United States, France, Austria, Mexico, South Africa and Germany. For each country, the report shows whether the benefit mechanism is incremental or actual, super-deduction or ITC and whether a cash refund is offered. It also lists what R&D expenditures are eligible and if work done outside that country is considered an eligible expenditure.

The Scitax investigators involved in the study note that tracking these benefits has become a moving target. Over the past two years, foreign governments have been fine-tuning their R&D benefits to attract the high-quality jobs that arise when a new scientific research centre opens.

### Tax credit terminology explained

While the term "R&D tax credit" is the common vernacular, the more correct term would be R&D tax incentive.

At the most basic level, any comparison of R&D tax incentive regimes involves consideration of two basic parameters: the eligible expenditure method; i.e. what kinds of expenditures the benefit applies to; and the benefit mechanism; i.e., how the allowed eligible expenditures get translated back into real money for the taxpayer.

There are two basic eligible expenditure methods:

**Actual** – The benefit applies to the *actual* eligible expenditures incurred in a given tax year. This is the method used in Canada and in several EU countries.

**Change** – The benefit applies to the *change* in eligible expenditures from year to year, including the difference between the current year's "base" amount of eligible expenditures and the amount of eligible expenditures in prior years.

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- + The twitter era
- + Internet to fuel recovery?
- + ERP and PSA survey
- + BI/CPM survey
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- + Work-life conflict
- + Hasty hiring
- + Managing email
- + Asking about pay/benefits
- + CEO compensation
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according to some mathematical formula (e.g., moving average, etc.). The US has historically used this method, but by 2010 may adopt a more simplified approach.

In addition to the actual versus incremental method, there are further considerations around what constitutes an eligible expenditure. Some countries may allow only wages, while others may include equipment, materials, supplies, contract payments and / or overheads.

There are five basic benefit mechanisms:

#### A. Deduction

Reduces taxable income like any other business expense

- \$100 spent on R&D = taxable income reduced by \$100
- Assuming nominal tax rate of 11% = tax payable reduced by \$11

#### B. Super-deduction

Taxable income reduced by more than the R&D expenditure

- Assuming benefit rate of 150%
- \$100 spent on R&D = taxable income reduced by \$150
- Assuming nominal tax rate of 11% = tax payable reduced by \$16.50

#### C. Immediate write-off or accelerated write-off

Faster depreciation of capital assets such as R&D equipment or purchased intellectual property (IP)

- \$100 spent on R&D equipment or IP
- Taxable income reduced by \$100 this year rather than \$33.33 per year over a three-year period
- Beneficial for research requiring costly capital assets or purchase of IP

#### D. Investment tax credit (ITC)

Direct reduction of taxes payable by some % of the R&D expenditure

- Assuming a 20% investment tax credit and a nominal tax rate of 11%
- \$100 spent on R&D
- Taxes payable reduced by \$20 for ITC plus normal business deduction of \$11 for those expenditures.
- Only useful to companies that are profitable and have tax payable
- In most jurisdictions the ITC can be applied in arrears to prior years or carried forward for use in future years. In some cases (e.g., Canada) there is an option to also carry the deduction associated with the R&D expenditure forward to a future year.
- Benefit may itself be taxable!