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Scitax Advisory Partners LP
R&D Tax Credit Specialists, Canada & Abroad

DIRECTORS:
David R. Hearn, Managing Director
Michael C. Cadesky, BSc, MBA, FCA

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SR&ED Features in the 2008 Canadian Federal Budget

> Increased cash refund benefit for CCPCs

> Limited eligibility for salaries paid to Canadians working on R&D outside Canada

Ottawa, February 26, 2008 – Finance Minister Jim Flaherty delivered the 2008 federal budget to parliament today. Although still subject to parliamentary review, it is generally expected that the budget will garner sufficient votes to pass into law in early March.

While this is the third budget to emerge from Stephen Harper's Conservative government, it is the first to make any real changes to the SR&ED program.

From an SR&ED perspective, the main attraction of Flaherty's 2008 budget is that it allows small and medium sized Canadian controlled corporations (i.e. "CCPCs") access to a larger portion of their SR&ED benefits in the form of a cash refund instead of investment tax credits. In short this means that these companies can access more of their SR&ED credits sooner to bootstrap growth now instead of waiting until they become taxable - which for many high-tech start-ups is a five year horizon.

However, the budget stopped short of allowing cash refund benefits to non-CCPC (i.e. foreign owned or publicly traded) entities as had been strongly lobbied for by many industry groups – most notably the biotech sector. We remain hopeful that Ottawa may yet introduce a flow-through share scheme. This would be particularly welcome in the biotech community, where there are relatively few CCPC's, since even early stage start-ups must recruit venture capital to offset the high cost of clinical trials and related approval work unique to that sector.

More Cash for CCPC's

The budget delivers more cash to CCPC's by adjusting three different aspects of the SR&ED tax credit mechanism:

1. **Expenditure Limit:** Currently CCPC's get a full cash refund benefit on only the first $2million of R&D expenditures. The benefit on expenditures in excess of $2million is 40% refund and 60% investment tax credit. Under the 2008 budget, the upper limit for fully refundable ITC's is increased such that the onset of this 40 / 60 split does not occur until R&D expenditures exceed $3million. This means that a qualifying "ideal" CCPC (i.e. 35% rate, taxable income <=$400K, taxable capital <$10M) claiming $3million R&D expenditures would get a cash refund of $1.05million as compared to only $780K under the existing $2million limit.

2. **Taxable Income Phase-Out Range Extended:** The expenditure limit discussed above is reduced ("ground down") as a function of the CCPC's taxable income in the prior fiscal year. The rate of this reduction is a $10 decrease in the expenditure limit for every $1 by which prior year taxable income exceeds the taxable income phase-out threshold. Currently taxable income phase-out range starts at $400K and ranges up to $600K above which the expenditure limit is reduced to $0 with the result that the benefit rate is ground down from 35% to 20% only 8% of which (i.e. 40% of 20%)is refundable. Under budget 2008, the upper limit will increase from $600K to $700K (the lower limit will remain unchanged at $400K). This means that taxable income can increase by an additional $100K before the 35% benefit rate is ground down to 20%, and the cash refund portion falls to 40%. In addition to leveraging the amount and form of the available SR&ED benefit, this change may help reduce the personal tax burden on CCPC owners to whom income in excess of the threshold value is typically distributed (i.e. as "bonus") in order to preserve the corporation's favourable position vis-à-vis refundable SR&ED benefits.

3. **Taxable Capital Phase-Out Range Boundaries:** The expenditure limit is further reduced by the corporation's taxable capital position. Currently the taxable capital threshold is $10 million which means that – despite being a CCPC – a company with taxable capital in excess of $15 million is not eligible for either the 35% benefit rate nor is it eligible for a 100% cash refund on any portion of its SR&ED benefit. Under budget 2008, the upper boundary of the taxable capital phase-out range will increase to $50million which will significantly preserve the CCPC's access to refundable SR&ED benefits. For example, the same CCPC mentioned above with $15million taxable capital (presuming taxable income <=$400K) now retains access to a maximum refundable benefit of approximately $900K as compared to $0 under existing rules.

Canadian Researchers Working Outside Canada

Budget 2008 proposes to make wages paid by Canadian companies to Canadian-resident persons who undertake R&D work outside Canada eligible as SR&ED. To receive this treatment, the work done outside Canada must be in support of an otherwise SR&ED eligible project for which the majority of the work is otherwise being done within Canada. The amount of wages so claimed are limited to not more than 10% of the total SR&ED wages claimed by the Canadian company in that fiscal period.

Learn More...

> Complete English Language budget document
http://www.budget.gc.ca/2008/pdf/plan-eng.pdf

For more information on this topic, contact:

David R. Hearn, Managing Director, Scitax Advisory Partners
(416) 350-1214 or dhearn@scitax.com

About Scitax...

Scitax Advisory Partners is a professional services firm with specialist expertise in Scientific Research and Experimental Development (SR&ED) tax credits.

We offer a team of senior technical consultants all of whom have ten or more years experience in the SR&ED field. All Scitax technical consultants have engineering or science backgrounds and at least twenty years industry experience in their particular field prior to consulting.

Our primary function is to produce a technical submission package that most effectively communicates your SR&ED claim to CRA in a way that highlights eligibility and expedites processing. We assist you in identifying and preparing all required documentation including project technical descriptions, cost schedules, and everything else your tax preparer needs to file the claim. Once your claim is filed, Scitax will advocate for you with CRA and help you negotiate fair settlement of your claim.

While we normally work with our client's existing tax advisors, our affiliated firm Cadesky and Associates can provide a full package of tax services if required.

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TD Centre, 77 King Street West, Suite 2401, Toronto | 416-350-1214 | www.scitax.com