Fall 2014

UPDATE
ON QUÉBEC'S ECONOMIC AND FINANCIAL SITUATION

Québec

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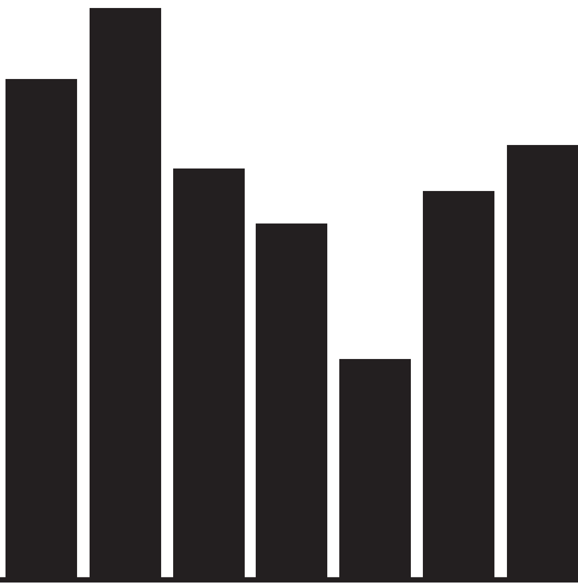

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UPDATE ON QUÉBEC'S ECONOMIC AND FINANCIAL SITUATION

Section D

REVENUE AND EXENDITURE MEASURES

❑ Maximizing economic activity, supporting strategic sectors and ensuring the predictability of tax assistance

The Québec Taxation Review Committee will continue its work to identify avenues for increasing the effectiveness of tax assistance and the tax system as a whole.

— Following the measures announced in this update, the government is committing to continue its work to not further reduce the overall support granted to businesses through tax assistance and the tax system as a whole.

— In this context, the government will continue to act to maximize the economic benefits of tax assistance and support sectors of excellence, particularly the emerging, cultural and innovative sectors of Québec's economy.

2.1.1 Introduction of minimum eligible expenditure thresholds for R&D tax credits and the tax credit for investments relating to manufacturing and processing equipment

Currently, many business claim tax credits for small amounts of expenditures. For example, in 2011:

— 40% of businesses that claimed R&D tax credits had eligible expenditures of less than $50 000, for an average expenditure of about $25 000 per business;

— 40% of businesses that claimed the tax credit for investments relating to manufacturing and processing equipment had eligible expenditures of less than $12 500, for an average expenditure of about $4 500 per business.

The tax credit does not seem to be an essential deciding factor for carrying out the activities or investments concerned. Moreover, the administration of all of these claims entails considerable administrative costs for the government and businesses. In some cases, the administrative costs related to claiming the tax credit can be higher than the tax assistance granted.

To refocus tax assistance and minimize the administrative burden tied to the granting of tax credits, the government is announcing the introduction of minimum eligible expenditure thresholds for R&D tax credits and the tax credit for investments relating to manufacturing and processing equipment.

— Accordingly, as of December 3, 2014, businesses will be able to claim from these tax credits for their eligible expenditures exceeding a certain threshold.

❑ Thresholds applicable to R&D tax credits

The minimum eligible expenditure thresholds for R&D tax credits as a whole will be:

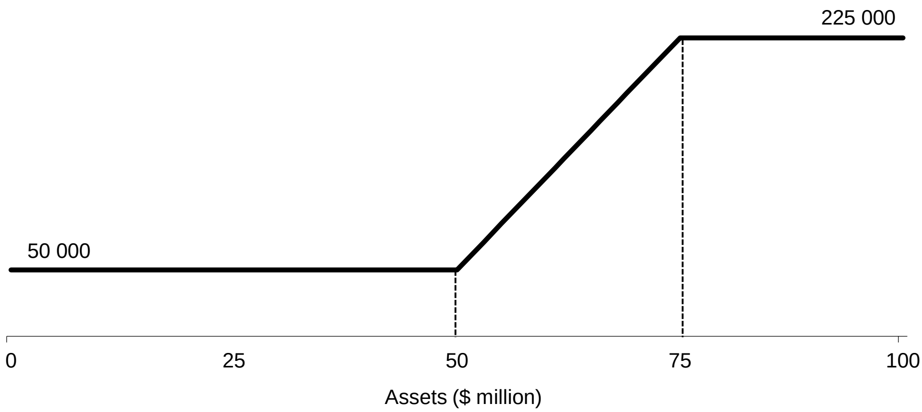
— $50 000 for corporations with assets of less than or equal to $50 million;

— $225 000 for corporations with assets of $75 million or more;

— an amount that increases linearly between $50 000 and $225 000 for corporations with assets between $50 million and $75 million.

CHART D.5

Minimum eligible expenditure thresholds for R&D tax credits
(dollars, unless otherwise indicated)



❑ Threshold applicable to the tax credit for investments relating to manufacturing and processing equipment

Businesses that claim the tax credit for investments relating to manufacturing and processing equipment will be subject to a threshold of $12 500 for eligible manufacturing and processing equipment expenditures.

❑ Financial impact

The introduction of these thresholds will represent savings of $58 million in 2015-2016 and $120 million in 2016-2017.

TABLE D.22

Financial impact of the introduction of minimum expenditure thresholds
(millions of dollars)

	2014-2015	2015-2016	2016-2017
R&D tax credits	3	47	105
Tax credit for investments relating to manufacturing and processing equipment	1	11	15
TOTAL	**4**	**58**	**120**

2.1.2 Standardization of R&D tax credit rates

Québec offers corporations that carry out R&D activities an assistance regime consisting of four refundable tax credits:

— one tax credit for researchers' salaries;

— three enhanced tax credits for specific activities:

  — the tax credit for a research contract entered into with a university, an eligible public research centre or a research consortium;

  — the tax credit for private partnership research;

  — the tax credit for fees and dues paid to a research consortium.

With these enhanced tax credits, a business may benefit from:

— a tax credit rate of 28% compared to 14% for the regime applicable to researchers' salaries for large businesses;

— eligible expenditures including not only salary expenditures but also equipment expenditures.

Québec is one of the only provinces that offers enhanced R&D tax assistance for university research,[4] and the only one to offer enhanced tax assistance for private partnership research and the funding of private research centres or research consortiums.

4 Only two other Canadian provinces offer enhanced tax assistance for university research. Ontario offers a rate of 20% applicable exclusively to SMEs, and Manitoba allows full, rather than partial refundability of its R&D tax credit.

Since the regime applicable to researchers' salaries in effect in Québec is competitive, the rates of the three enhanced tax credits will be standardized with those of the R&D tax credit paid on researchers' salaries.

Accordingly, as of December 3, 2014, the applicable rates will go from:

— 28% to 30% for SMEs, which represents a two-percentage-point increase in tax assistance;

— 28% to14% for large businesses.

Despite this change, these tax credits will continue to apply to a larger set of expenditures, including equipment expenditures.

TABLE D.23

Summary of the changes to R&D tax credits

		Rate		Tax base
Tax credits	**Size**	**Before update**	**After[(1)] update**	
Researchers' salaries	SME	30%	30%	Salary or 50% of the amount of the subcontract entered into with a third party at arm's length
	Large business	14%	14%	
University research contracts	SME	28%	30%	80% of the amount of the subcontract entered into with a university, a public research centre or a research consortium
	Large business	28%	14%	
Private partnership	SME	28%	30%	100% of current expenditures related to R&D work in partnership or 80% of the amount of the subcontract
	Large business	28%	14%	
Funding of research consortiums	SME	28%	30%	100% of the amount of eligible fees and dues
	Large business	28%	14%	

(1) Each of the R&D tax credits has an increased rate of 30% applicable to the first $3 million of annual eligible expenditures in the case of Canadian-controlled corporations with assets of $50 million or less. A linear reduction in the rate of the tax credit from 30% to 14% applies in the case of Canadian-controlled corporations with assets between $50 million and $75 million. The rate is 14% when assets are $75 million or more.

These changes will enable the government to save $5 million in 2015-2016 and $15 million in 2016-2017.

TABLE D.24

Financial impact of the standardization of R&D tax credit rates
(millions of dollars)

	2014-2015	2015-2016	2016-2017
Standardization of R&D tax credit rates	—	5	15

Measures to support innovation and research and development

As part of Budget 2014-2015, the government implemented two new measures targeting SMEs to support innovative businesses:

- the Créativité Québec program;
- a holiday from the contribution to the Health Services Fund (HSF) to encourage the hiring of specialized workers.

Créativité Québec program

The Créativité Québec program, which has a budget envelope of $150 million, is intended to foster the acquisition of new technologies, the improvement of production processes and the development of new products for projects worth $500 000 or more.

Holiday from the HSF contribution to encourage the hiring of specialized workers in SMEs for innovation projects

The government has introduced a holiday from the HSF contribution, until the end of 2020, on the salaries of new specialized employees.

This measure is intended to facilitate the hiring of qualified workers to carry out the innovation projects of Québec SMEs.

Over five years, this holiday from the HSF contribution will represent nearly $155 million in tax relief for Québec SMEs.

❑ Competitiveness of Québec's R&D tax regime

Despite the changes to R&D tax credits, Québec's tax system remains competitive within Canada for SMEs and large businesses. The portion of tax assistance for a typical R&D expenditure incurred in Québec will correspond to:

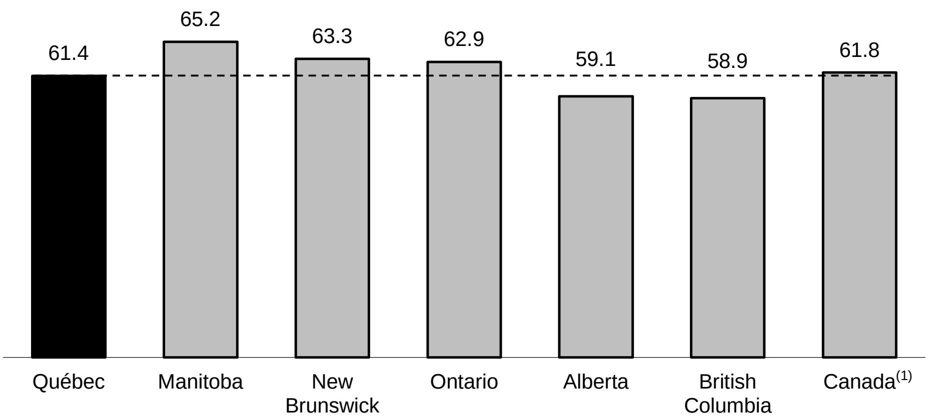
- 61.4% for an SME, i.e. a level similar to the Canadian average (61.8%);
- 44.4% for a large business, i.e. a level slightly above that of Ontario (42.1%) and equivalent to the Canadian average (44.0%).

In addition, tax assistance for R&D in Québec still offers certain major advantages for large businesses, in particular:

- it is refundable in full, whereas it is refundable in part in Manitoba and British Columbia and non-refundable in Ontario;
- it is not capped, contrary to that of Alberta.

CHART D.6

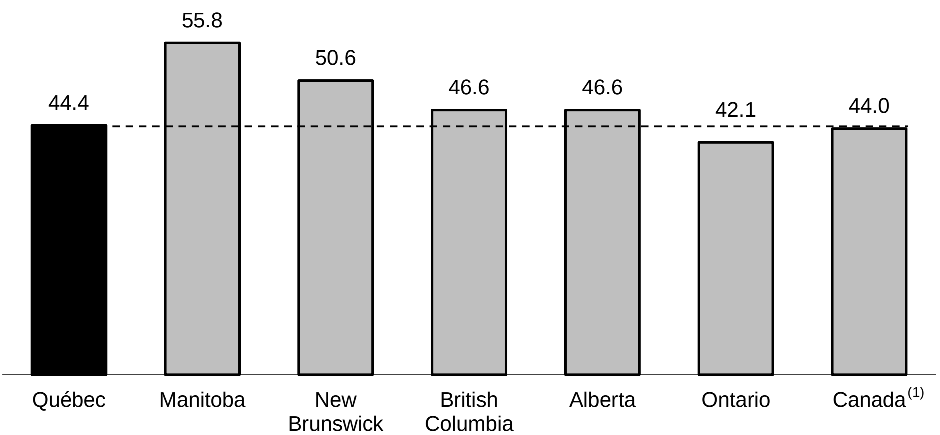
Illustration of the portion of provincial and federal tax assistance applicable to an R&D expenditure of $300 000 incurred by an SME
(per cent)



Assumptions: The R&D is carried out in-house. The business is profitable. The tax assistance includes R&D tax credits and the deduction allowed in calculating taxable income, including the capital cost allowance (assumption: depreciation rate of 20%). The R&D investment consists of 60% salaries, 35% equipment and 5% capital assets. The proxy method was used to calculate the federal tax credit and the tax credit of certain provinces.
(1) The Canadian average, excluding Québec, is weighted based on R&D expenditures in each Canadian province.

CHART D.7

Illustration of the portion of provincial and federal tax assistance applicable to an R&D expenditure of $3 million incurred by a large business
(per cent)



Assumptions: The R&D is carried out in-house. The business is profitable. The tax assistance includes R&D tax credits and the deduction allowed in calculating taxable income, including the capital cost allowance (assumption: depreciation rate of 20%). The R&D investment consists of 60% salaries, 35% equipment and 5% capital assets. The proxy method was used to calculate the federal tax credit and the tax credit of certain provinces.
(1) The Canadian average, excluding Québec, is weighted based on R&D expenditures in each Canadian province.