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North American Politicians Recognize R&D Tax Credits as a Useful Economic Fix

In the US ...

- > US federal R&E credit lapses again – will it be renewed?
- > Presidential candidates acknowledge need for a better federal-level program
- > California, Wisconsin and Indiana increase their state-level tax credits

In Canada ...

- > Ottawa hints at “SR&ED Overhaul” in 2008 budget

As North American economies have begun to slow over the last three months, R&D tax credits are getting unusual attention from politicians in both Canada and the US. In the US, R&D tax credits have appeared as a significant plank in the economic platform of most presidential candidates and several governors have already enacted significant increases in state-level benefits. In Canada, we are cautiously optimistic that the upcoming 2008 federal budget – set for Feb 26 – will see Ottawa acting on the results of its recent survey with improvements to our SR&ED program.

The inclusion of R&D tax credits as a specific feature in the platform of various US presidential hopefuls is unusual given that successive US governments of both stripes have traditionally shown little concern on this matter. The low priority afforded this issue is witnessed by the fact that Washington has let its Research & Experimentation (“R&E”) tax credit expire no less than 13 times since it was originally enacted into law in 1981. In Canada – and most other countries with similar credits – R&D tax credits are fixed in legislation. But in the US, congress must vote on renewing the R&E tax credit every year. And frequently they vote against renewing it, which means technology companies can’t really count on it.

The most recent lapse of the R&E credit – December 2007 – put the US in last place among the 20 OECD (Organisation for Economic Co-operation and Development) countries that offer R&D tax incentives. Even prior to the expiry, the US was only ranked number 17 on the OECD scale – a position four below the United Kingdom and eleven below Canada.

In its latest analysis – 2006 edition – the OECD reports 20 OECD member countries as having R&D tax credits as compared to 18 in 2004. The 2006 OECD report goes on to note that R&D tax credits are becoming more popular amongst both OECD and non-OECD governments: As of 2006, Spain, China, Mexico and Portugal provided the largest subsidies and made no distinction between large and small firms. Canada and the Netherlands continue to be significantly more generous to small firms than to large ones. Emerging economies are also implementing these policy instruments to encourage R&D investments. Brazil, India, Singapore and South Africa provide a generous and competitive tax environment for investment in R&D.

In Washington

As has been the case in the past, it is likely that sometime this spring the now lapsed US R&E credit will be reinstated retroactively. House Majority Leader Steny Hoyer, D-Md., recently said that he thinks a fiscal stimulus bill – including renewed R&E credits – can be completed within 30 days.

Meanwhile presidential candidates Clinton, Obama and McCain have all spoke about reinstating the R&E incentive. Although all these candidates have come out in favour of providing taxation-based support for industrial R&D, there has been little specific information on exactly what R&D tax credits they would support or even their position on the two current legislative proposals.

Clinton's main strategy is to keep the existing 20% incremental R&E tax credit scheme but make it a more effective economic stimulus by removing the uncertainty of the current annual renewal requirement.

McCain would make the existing R&E tax credit permanent setting at 10 percent of wages spent on research and development. He also proposes one-year write-off on equipment and technology expenditures.

Various lobby groups which have sprung up around the R&E issue are starting to shape the discussion and separate tax credit incentives from myriad other technology planks such as digital copyrights, net neutrality and telecom privacy. The most vocal of these lobby groups are the *R&D coalition* (www.investinamericasfuture.org/), the *National Association of Manufacturers* (www.nam.org) and the *Information Technology Industry Council* (<http://www.itic.org/>) for example, would like to renew and expand the credit as well as in most cases making it permanent.

In the State Capitals

In addition to federal R&D tax credits, 33 states provide benefits. The leaders are California, Michigan, New York, New Jersey, Maryland, Pennsylvania, Texas, Massachusetts, Washington and Illinois. Wisconsin and Indiana appear to be stepping up action to keep competitive with the leaders.

In several states, the credit is at a minimum equal to its federal counterpart. California – which currently offers the highest level of state R&D tax credits – has enacted legislation requiring state benefits to surpass federal levels especially for aerospace, biotech and high-tech industries.

Governments in two other states – Wisconsin and Indiana – have recently crafted new R&D tax credit policies:

In Wisconsin, governor Jim Doyle recently announced that the State will adopt an incremental tax credit scheme by which companies would receive \$1 of tax credit for every \$1 of increase in R&D spending above a threshold of 25% over their three-year rolling average. In addition, certain equipment and machinery used in R&D would be exempt from sales and property taxes.

According to state secretary of commerce Nathan Feldman, Indiana is enacting a package of new tax policies that will soon give it the highest state-level research and development tax credit in the country.

At Home, Ottawa Hints at Improvements

As reported in our previous bulletin (June 18, 2007), Ottawa has been subject to mounting pressure from several different quarters to make SR&ED tax credits a more effective tool for economic stimulus. There are now growing indications that this might happen, possibly in the 2008 federal budget set to be delivered on February 26th.

Ottawa has already announced it will enact legislation to double the period Canadian businesses and individuals can carry forward unused investment tax credits – including SR&ED – from 10 to 20 years. While this move is good news for SR&ED claimants, it seems to be driven more by tax harmonization initiatives than by specific concern for SR&ED.

Canada's Federal Finance Minister, Jim Flaherty has recently made several interesting comments that suggest he may view R&D tax credit funding as a preferable alternative to industry specific subsidies, if some form of government assistance is required to aid Canadian industries troubled by the high exchange rate. For example, when Ottawa rejected auto industry pleas for direct sector specific assistance in early February, he made various comments suggesting he would not rule-out providing financial assistance to troubled sectors through a re-worked the federal innovation strategy, which includes SR&ED tax credits.

In a recent article on the government's likely priorities for the 2008 budget (*"Flaherty Vows to Protect Surplus"* – 12-Feb-2008) the Globe & Mail's Ottawa reporter Steven Chase, wrote: "The budget is expected to extend a temporary \$565-million annual tax break for manufacturers. It is also likely to overhaul government support for research and development."

Liberal Leader Stephane Dion is on record as saying that, if elected, a Liberal government would make the Science Research and Experimental Development (SR&ED) Tax Credit partially refundable according to. "Innovation is essential to the survival of our industries, but it can be an expensive undertaking," said Dion. "We want every company that puts money into R&D to be rewarded for innovating", he said (CanPlastics.com, Daily News, Jan. 21, 2008)

Learn More...

- > Organization for economic co-operation and development (OECD) OECD Science, Technology and Industry Scoreboard 2007
<http://fiordiliji.sourceoecd.org/vl=1436580/cl=27/nw=1/rpsv/sti2007/>
- > R&D Credit Coalition
The R&D Credit Coalition is a US based group of more than 100 trade and professional associations along with small, medium and large companies that collectively represent millions of American workers engaged in U.S.-based research throughout major sectors of the U.S. economy, including aerospace, agriculture, biotechnology, chemicals, electronics, energy, information technology, manufacturing, medical technology, pharmaceuticals, software and telecommunications.
<http://www.investinamericafuture.org/index.html>
- > Summary of International R&D Tax Credits
The R&D Credit Coalition offers a useful table that compares tax credits in various countries:
http://www.investinamericafuture.org/PDFs/Coalition_Interntl_RD_tax_5-18-07.pdf

References for Recent Developments In Canada

- > **Globe & Mail 2-Feb-2008:** Flaherty rejects direct government subsidies for auto industry, but hints that auto industry could qualify for research-and-development assistance as Ottawa redesigns its innovation strategy.
<http://www.theglobeandmail.com/servlet/story/LAC.20080202.EFLAHERTY02/TPStory?query=flaherty+sr%26ed>
- > **Globe & Mail 5-Feb-2008:** “The federal government is coming under heavy pressure to sweeten research and development subsidies for business – by as much as \$1-billion a year – ...”
<http://www.theglobeandmail.com/servlet/story/LAC.20080205.RFLAHERTY05/TPStory?query=flaherty+sr%26ed>
- > **Globe & Mail 5-Feb-2008:** “The budget is expected to extend a temporary \$565-million annual tax break for manufacturers. It is also likely to overhaul government support for research and development.”
<http://www.theglobeandmail.com/servlet/story/RTGAM.20080211.wbudget0211/BNStory/Business/>

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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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