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Canadian Government to Support SR&ED Lenders

EDC to underwrite bank loans for SR&ED refunds...

But before you borrow, we've got four tips to keep more of that cash in your pocket!

The Canadian Government has mandated Export Development Canada (EDC) to begin underwriting bank loans to exporters that receive research and development tax credits through the SR&ED program. The loans will be delivered primarily through chartered banks although other lenders may also participate if they meet EDC criteria.

The loans will only be available to companies that meet three conditions: First, the company is an exporter. Second, it must expect to receive their SR&ED benefit in the form of a cash refund. Finally, the company must have a history of successful SR&ED claims over at least the last two years.

It is also likely that EDC will require the lender to obtain some form of independent valuation (or at least validation) that the expected SR&ED benefit is reasonable and realistic. Generally this will be in the form of a "comfort" letter from a professional advisory firm – such as Scitax – with expertise in the field of SR&ED tax credits.

What is not clear at this point is whether these loans will be limited only to Canadian Controlled Private Corporations that qualify to receive SR&ED benefits in the form of a cash refund OR if such loans apply to any company expecting a refund as a result of an SR&ED benefit. For example will a non-CCPC that finds itself with a large pool of ITC's and deductions be able to collateralize an EDC-backed loan for a refund arising from applying the ITC's from the current year's SR&ED back against taxes paid in a prior year? Similarly, could a non-CCPC obtain the EDC loan if those ITC resulted in overpaid instalments in the current year?

However, companies considering applying for these loans should first make a careful examination of their overall tax planning strategies with a view to minimizing the amount of cash refund they are waiting for in the first place. In this regard there are four key planning points to consider:

1. Understand the increases in the maximum amount of SR&ED cash refund available to CCPC's arising from legislative changes to expenditure limits and grind thresholds in the 2008 and 2009 federal and provincial budgets. Many of these changes will be effective for tax filings made starting this year.
2. Use of current year ITCs to recover taxes paid in past years. Even for CCPC's some SR&ED ITCs – such as those on equipment - are not totally refundable. However, these ITC's can be “carried back” up to three years, which means they can be effectively converted to cash by applying them against any taxes that were paid in those years.
3. Wise use (or alternatively conservation) of “pooled” SR&ED expenditure deductions and ITCs. For tax year-ends starting Jan 1, 2009, the increase of the Small Business Limit (“SBL”) to \$500K means that more profit can be kept in the company where it is taxable at lower rate instead of being “bonused out” to shareholders. SR&ED ITC's can then be used to absorb the taxes on this additional corporate profit. Furthermore the company avoids the need to remit source deductions (which improves cash flow) and the shareholder's to whom the bonuses would normally be distributed enjoy reduced personal tax burden.
4. Minimize the instalment payments during the year by correctly estimating the taxes payable at year-end net of anticipated SR&ED benefits. This not an unreasonable approach for companies that have a history of successful SR&ED claims.

Historically, Export Development Canada's role has been to “insure” amounts receivable by Canadian companies in transactions with foreign customers – often agencies of foreign governments. EDC has been a significant factor in the continued success and sustained growth of many exporters in many sectors of the Canadian economy particularly in the aerospace, defence and automotive sectors.

Loaning money using SR&ED claims as collateral is not a new thing in Canada. However, it has been a highly “niche” business characterized by a small number of specialized private lenders. Only one of the chartered banks – Royal – has significant activity in the field of SR&ED financing and their operation is generally limited to certain specific certain sectors notably informatics and biotech.

EDC's initiative comes at a critical time in the recession cycle. Although interest rates in general have been extremely low, small companies that have intellectual property as their primary asset have suffered reduced access to credit and working capital. Private lenders typically view the business in the context of a “factoring” model and charge accordingly with rates in the range of 1.5% to 3% per month. Although neither EDC nor its “channel partner” lenders have released any information on terms or rates as of this date, it is not unreasonable to expect that the combined effect of EDC underwriting and more players in the market should moderate the cost of these loans somewhat.

Learn More...

- > Article describing SR&ED lending initiative in EDC publication “Exportwise”:
http://www.edc.ca/english/publications_16236.htm
- > Description of how maximum SR&ED cash refund benefits increased in 2008 and 2009 Canadian Federal Budgets in Scitax Bulletin 38:
<http://www.scitax.com/pdf/bul-038.pdf>

For more information on this topic, contact:

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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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