

NUMBER 49 | MARCH 27, 2012

2012 Federal and Ontario Budgets Out This Week

[Watch for possible changes to R&D tax credits](#)

Canada and Ontario will each present their 2012-13 budgets this week. Ontario finance minister Dwight Duncan will present his budget in Toronto at 4:00 pm on Tuesday March 27th. Canada's Minister of Finance Jim Flaherty will table the federal government's budget in Ottawa at 4:00 pm on Thursday March 29th.

Scitax will participate in the pre-budget "lock-up" process and as such we will have the opportunity to analyze the legislation prior to its public release. We will be issuing a special bulletin containing a full analysis of how the combined effect of these budgets will impact science and technology business.

Austerity, innovation and economic development are keywords that have featured in much of the pre-budget talk from politicians at both levels of government. Ottawa probably has more room to maneuver than Ontario does: First because Mr. Flaherty has the backing of a majority government whereas Mr. Duncan is operating in a minority. Second, Ontario has a \$16B deficit and a debt-to-GDP ratio of 37.4% (second only to Quebec's which is 51.2%) and an imploding tax base in manufacturing. From a federal viewpoint Canada's economy is in rather good shape, buoyed by a strong Canadian dollar and high demand for natural resources that has kept tax revenues flowing particularly from the western provinces.

In a report issued March 26th, Royal Bank of Canada economists Craig Wright and Paul Ferley noted, "*Earlier fears of an austerity budget, with massive cuts in government spending, are giving way to speculation of a prosperity budget where the focus will be on a reallocation of government spending to priority areas to address some of the key long term challenges Canada currently faces, including weak productivity performance and an aging society.*"

Whether prosperity or austerity dominate, it is clear that both levels of government are likely to implement changes in R&D tax credits and other programs that fund private sector innovation.

What to Watch for – Canada Budget 2012

Over the last year there have been many indications that Ottawa is about to undertake some changes in how it distributes upwards of \$6B in innovation funding to the private sector. The following excerpts from Canadian government official releases are likely path-marks for Ottawa's direction on innovation funding in budget 2012:

In October 2011 the federally appointed R&D Expert Review Panel (a.k.a. the Jenkins panel) tabled a report that labelled R&D tax credits a "*blunt instrument*" and called on Ottawa to "*rebalance the mix of direct and indirect funding by decreasing spending through the SR&ED program.*"

Then on January 2012 in Davos Switzerland, Canadian Prime Minister Stephen Harper spoke to that report saying "*We will continue to make the key investments in science and technology necessary to sustain a modern competitive economy. But we believe that Canada's less than optimal results for those investments is a significant problem for our country.*"

On February 28th in Toronto, Canada's Science and Technology Minister – Hon. Gary Goodyear – hinted at a possible moderation of the Jenkin's report recommendation saying: "*We received the [Jenkins] report, and while we don't necessarily subscribe to all of its recommendations, we do agree with the direction of the changes that need to be made to address the challenges faced in business-related R&D, and we will act soon.*"

The 2012 Canadian federal budget will almost certainly bring some re-allocation of innovation funding with at least some cuts in SR&ED tax credits and diversion of the savings into so called "direct funding" grant / loan programs. Reductions in SR&ED tax credits could be achieved through either (or possibly some combination) of two possible strategies:

Strategy one would be to reduce the SR&ED benefit rate. At present Canadian controlled private corporations are eligible to receive a cash refund of up to 35% of qualifying R&D expenditures, and for other corporations the benefit rate is an investment tax credit of 20%. The rates for these two types of corporations could be equalized to 20% or some intermediate figure. A corollary measure to this would be to limit the time period for which cash refunds are provided.

Strategy two would be to restrict what types of expenditures qualify to attract SR&ED benefits. At present expenditures for labour, materials, equipment, and overhead are all eligible. Allowing only labour expenditures (i.e. deleting materials, equipment and/or overhead) would send a positive "jobs and employment" message while at the same time allowing the government to cut spending. It has also been suggested that this approach would "simplify" the SR&ED claims process both for taxpayers and for auditors at Canada Revenue Agency who administer the program.

What to Watch For – Ontario Budget 2012

In Ontario the focus on "austerity" could ultimately bring cutbacks or outright elimination of some of the provinces "special" technology tax credits such as the Ontario Interactive Digital Media Tax Credit (OIDMTC) or the Ontario Research Fund.

On other hand Ontario may not need to implement any specific innovation funding cuts if Canada changes the type of expenditures that attract the federal SR&ED tax credit. This is because Ontario's provincial R&D tax credits (the OITC and ORDTC) are both calculated based on the expenditures that qualify for the federal SR&ED benefit. Hence if Canada were to change the federal SR&ED rules to eliminate expenditure categories such as materials and equipment (i.e. leaving labour as the only eligible expenditure) there would be an automatic reduction in Ontario's tax credit pay-outs without any change in the legislation. Although this could leave Ontario with a substantially lower R&D tax credit than other provinces (esp. Quebec), the shortfall could be addressed as a good news story in a future budget.

Conclusion

While the 2012 budgets will almost certainly produce some change in R&D tax credits for Canada and Ontario, those changes are more likely to be an "adjustment" rather than a "termination". The changes are likely to have the biggest impact on small private companies who presently receive high-rate refundable benefits (i.e. 35%).

At the federal level, budget 2012 will almost certainly see an increase in the use of "direct funding" grant / loan programs to take up the slack left by tax credit reductions. Some examples of existing direct funding grant / loan programs that may be re-vitalized through budget 2012 include: FEDDEV Ontario, NRC IRAP and SDTC.

This switch to direct funding programs and away from tax credits has not been popular with all stakeholders: For example in a recent Financial Post article, the Canadian Federation of Independent Business (CFIB) stated that it is "*absolutely opposed*" to removing some of the SR&ED funding and redirecting it toward grants and contributions programs, such as NRC-IRAP.

The full details of exactly how all of this will be achieved – at least at the federal level – may not be fully described in the budget; Minister of State for Science and Technology Gary Goodyear has scheduled press conference for April 3rd, 2012 in Toronto. We may have to wait until then to understand the full scope of change.

Learn More....

Federal Budget Preview, Royal Bank of Canada (Craig Wright and Paul Ferley) 26-Mar-2012
<http://www.rbc.com/economics/market/pdf/fedbudpre12.pdf>

Full text of Prime Minister Stephen Harper's speech 26-Jan-2012 Davos Switzerland
<http://www.pm.gc.ca/eng/media.asp?category=2&pageId=46&id=4606>

Harper Government Strengthening Canada's Science and Technology Advantage 28-Feb-2012 Toronto Canada
<http://www.ic.gc.ca/eic/site/ic1.nsf/eng/07077.html>

Canadian Department of Finance Budget website
<http://www.fin.gc.ca/access/budinfo-eng.asp> OR <http://www.fin.gc.ca>

Ontario Ministry of Finance Budget website
<http://www.fin.gov.on.ca/en/budget/>

Event Announcement: Minister of State (Science and Technology) Gary Goodyear, Toronto 3-Apr-2012
http://www.economicclub.ca/events/Post-Budget_Address_By_Minister_Goodyear

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About Scitax...

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We offer a multi-discipline team of engineers, chartered accountants and tax lawyers to ensure that your SR&ED issues are covered from every angle.

While we normally work in concert with our client's existing accountants, our affiliated tax-dedicated chartered accounting firm – Cadesky and Associates LLP – is an expert resource for advice on any taxation matter such as may arise either during the planning and preparation of your claim or while dealing with CRA afterwards.

In addition to planning and preparing new claims, we also engage on claims that have been challenged by CRA auditors or that have received negative assessments for either scientific or expenditure eligibility. If a satisfactory settlement cannot be achieved with CRA at the local office level, we will appeal your assessment through either Notice of Objection or Tax Court of Canada procedures with the assistance of our affiliated firm of tax lawyers.



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