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Bulletin
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Canada Proposes to Increase SR&ED R&D Tax Credits ... but will it happen?

- Effective for taxation years that begin on or after December 16th, 2024
- Higher cash refunds for all
- R&D equipment cost now eligible
- Overall huge boost for public corporation
- Canadian-Owned public corps get almost same tax credits as CCPCs
- Likely to trigger proportionate increases in provincial R&D tax credits

On December 16th 2024 the Canadian Federal government announced its intention to implement substantial and significant measures to increase the Scientific Research & Experimental Development ("SR&ED") R&D tax credit program. It is important to note that in provinces where the expenditures eligible for the provincial R&D tax credit are defined as being the same as the federal (e.g. Ontario), these changes will result in a proportionate increase in the provincial benefits. This bulletin is written on the presumption that the announced measures will be enacted into law; however, there's no certainty of this given the highly dynamic political circumstances in which Canada's federal government currently exists.

Part 1 Synopsis

To grasp the potential magnitude of the proposed SR&ED changes, let's assume the following spends by an Ontario taxpayer: $3,000,000 in R&D T4 salary wages, $400,000 R&D subcontractors, $200,000 materials consumed in R&D and $500,000 capital equipment used all-or-substantially all for R&D. Also assume:
1) $1,650,000 of overhead by the proxy method, 2) The taxable income of the corporation and / or any associated group is not greater than $500K in either the current or preceding tax year, and 3) The prior years taxable capital, or prior years average gross revenue, of neither the corporation nor any associated group is greater than $15M.

Given the above, the estimated approximate changes in ITCs would be:

	∆ total ITC	∆ cash refund
Canadian Controlled Private Corporation	+31%	+41%
Canadian Owned Public Corporation	+101%	+722%
Other corporation	* +8%	0%

* change due only to inclusion of capital equipment

Part 2 Increased Expenditure Limit

Currently Canadian Controlled Private Corporations ("CCPCs") get a full cash refund at a benefit rate of 35% only on the amount of eligible R&D spends up to the $3M expenditure limit. The benefit rate on eligible spends in excess of $3M falls to 15%, only 40% is a cash refund with remaining 60% as an investment tax credit that can be applied to reduce (or eliminate) income tax payable in the current year, three years prior or the following 20 years. This expenditure limit is reduced ("ground down") if in the in the prior tax year, taxable income exceeds $500K (provincial only), or prior year taxable capital exceeds $10M.

Under the proposed changes, for CCPCs the upper limit for fully refundable ITCs would be increased such that the onset of this 40 / 60 split does not occur until R&D expenditures exceed $6M and the threshold for the onset of the expenditure limit grind arising from prior years taxable capital, or prior years average gross revenue, would increase to $15M. As noted below, for Canadian-Owned Public Corporations there is no cash refundable ITC on spends in excess of the expenditure limit.

Part 3 Equalization of ITC Benefit Rates Private and Canadian-Owned Public Corporations

Currently CCPCs get a benefit rate of up to 35% on eligible R&D spends up 100% can be as a cash refund while the maximum benefit rate for public corporations 15% none of which is as a cash refund.

Under the proposed changes Canadian-owned public corporations would get the same 35% cash refundable benefit (i.e. up 35%) as CCPCs on eligible R&D spends up to the $6M expenditure limit. ECPCs can only use prior years average gross revenue method and threshold, for the onset of expenditures limit grind increases to $15M. However, for spends in excess of the expenditure limit, the benefit rate for Canadian-owned public corporations falls to 15% none of which is as a cash refund.

A Canadian-owned public corporation is a corporation which, throughout the taxation year is resident in Canada; has a class of shares listed on a designated stock exchange or, if not, has elected, or been designated to be a public corporation; and is not directly or indirectly controlled by any non-resident person(s). Canadian-resident corporations all or substantially all owned by one or more eligible Canadian public corporations also qualify.

Part 4 Capital Equipment Used for R&D Eligible Again

Prior to 2013, various types of capital expenditures qualified for the SR&ED tax credit; most typically such expenditures were for items of equipment (measuring instruments, laboratory apparatus, software etc.) used in R&D but in some limited cases have included certain types of special purpose structures. As a result of legislative changes adopted in Canada’s 2012 federal budget, after 2013 no capital equipment qualified for the SR&ED tax credit.

Under the proposed changes, capital expenditures made in tax years beginning on or after 16-Dec-2024 would once again qualify for the SR&ED tax credit per the same rules as applied prior to 2013. While the rules on capital expenditure eligibility are nuanced, here are some general comments:

At most only 40% of an eligible capital equipment spend attracts a cash refund, the other 60% is as a non-refundable ITC.

Generally, a capital expenditure is for an item that has "enduring value" over time (more than one year).

Eligible capital items are classified as either All-Or-Substantially-All ("ASA") or Shared Use ("SUE"). The full amount of an expenditure on ASA items qualifies for the SR&ED tax credit, whereas for SUE only a pro-rated (substantially lower) portion of the expenditure qualifies. The test for an ASA item is that it was intended for R&D use when purchased and is in fact used at least 90% of its useful life for R&D. A SUE item one that is not ASA, but is used for a mix of both R&D and non-R&D (i.e. commercial) purposes.

Items must be purchased from an "arm’s-length" supplier and must be "new" qualify; in some cases, an item that is "refurbished" to new condition by, may qualify.

The item must be "available for use" in the tax year in which the expenditure is claimed.

Subject to above, software and software licences for programs that are useful for more than more than one year (e.g. CAD programs) will now qualify as eligible; as would computer workstations used to run these programs. Software that is embedded as a component of an R&D result (e.g. a real time operating system) would be considered a "current" (not capital) expenditure and would continue to eligible as a "material".

Finally, no capital cost allowance ("CCA") can be deducted claimed in respect of an expenditure that is also claimed as a "capital expenditure" for SR&ED purposes.

Part 5 Planning Points

While these changes may (if / when implemented) present significant financial gain opportunities for technology businesses; taking full advantage of them will require careful planning. With over 20 years of success in the field of SR&ED tax credits, Scitax is will help you navigate and maximize the benefits from these changes.

Here are just a few of the planning points you should be considering:

1. Canadian-owned public corporations should confirm their status vis-à-vis the high rate (35%, refundable SR&ED ITCs) and re-visit / bolster their compliance accordingly based on the increased cost / benefit / risk.
2. There will be less need for CCPC owners to "bonus-down" corporate retained earnings to get below the $500K small business limit for SR&ED-only purposes, which may in turn change the calculus of personal tax planning.
3. Partnerships with significant R&D spends should consider restructuring to be Canadian-owned corporations (ideally Canadian Controlled Private Corporations but otherwise corporations that meet the definition of Canadian-owned).
4. Individuals and sole-proprietorships with significant R&D spends should consider restructuring to be corporations (ideally Canadian Controlled Private Corporations).
5. Pending / recent purchases of capital items should be reviewed to assess opportunities for inclusion in tax years beginning on or after 16-Dec-2024.
6. Taxpayers with year ends on or before 16 Dec 2024, should consider rescheduling equipment purchases to the next year end.
7. Items claimed as "capital expenditure" for SR&ED must be removed from calculation of the capital cost allowance; this may require adjustments to accounting procedures.
8. Purchase orders for items of capital equipment should to be used in R&D should be marked as "Intended for R&D Purposes" and potentially allocated a unique / distinct accounting code.
9. When multiple identical items of equipment are being purchased that might be used for a mix of R&D and production purposes (e.g. 5 type XYZ measuring instruments), each unit be designated (by serial number) as used for R&D or other.
10. Buy only new or "manufacturer refurbished" equipment.
11. Watch for a new / updated edition of CRA publication SR&ED Capital Expenditures Policy; since current revision is 18-Dec-2014 a new version may be released.

Learn More

Full text of Canadian Federal Government's Fall Economic Update which includes a description of the proposed SR&ED-related measures:
https://www.budget.canada.ca/update-miseajour/2024/report-rapport/toc-tdm-en.html

CRA publication: SR&ED Capital Expenditures Policy
https://www.canada.ca/en/revenue-agency/services/scientific-research-experimental-development-tax-incentive-program/capital-expenditures-policy.html

Scitax Bulletin #50 Canada's 2012 Federal Budget (describes deletion of capital expenditures from SR&ED that came into force in 2013)
https://www.scitax.com/pdf/bulletin.50.30-mar-2012.pdf

About Scitax

Scitax Advisory Partners LP is a Canadian professional services firm with specialist expertise in all aspects of planning, preparing and defending Scientific Research and Experimental Development (SR&ED) tax credit claims.

We offer a multi-discipline team of engineers, chartered public 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 professional accounting firm – Cadesky Tax – 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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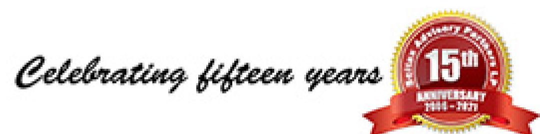

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