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In 2010, the federal budget called for a comprehensive review of federal programs that support business innovation. In October, 2011, the Jenkins Report, titled "Innovation Canada: A Call to Action" was released with many specific recommendations concerning the SR&ED program. In 2012, the government introduced into its budget, recommended changes to the SR&ED program, which have begun to take effect.

The anticipated effect of the budget changes will be to reduce the SR&ED program by approximately $150 Million, and to put that money into front end innovation programs such as a new Western Innovation Program, and, NRC-IRAP. While the majority of the $150 Million comes from reduced funding to large corporations and foreign-owned companies, there is some effect on CCPC's, your clients.
Despite these changes, Canada is still considered the most generous G8 country when it comes to funding R&D. Specifically, your clients can anticipate being refunded approximately 50% of their direct costs when attempting to innovate their products or processes, successfully or unsuccessfully. Later in this article, we will present specific examples detailing the refunds that your clients can anticipate from the SR&ED program.

First, let's look at the specific changes that are beginning to take effect and will be fully implemented by 2014:

- A reduction in the general SR&ED investment tax credit rate from 20% to 15% beginning for tax years that include January 1, 2014, with the 5% pro-rated based on the number of days in the taxation year that are after 2013. (note: the additional 15% add on for qualifying CCPC's has not changed).
- Capital expenditures will be excluded for expenditures after January 1, 2014.
- The proxy rate on salaried employee expenditures is being reduced from 65% to 60% for 2013, and 55% thereafter.
- Disallowance of the profit element of arm's length SR&ED contracts (including 3rd party payments) from the expenditure base for investment tax credits. Beginning in January 1, 2013, only 80% of the cost to the payer of the arm's length contract will be eligible.

With respect to most of your clients, here is what that means to them:

- Your client will now be reimbursed from CRA for 30% (15%+15%) of their SR&ED.
- Capital expenditures, which apply to equipment, used almost exclusively for SR&ED, and not for production, is a rarity in the CCPC world, and therefore, its elimination will be irrelevant to your clients.

Example 1 – Most Costs Are Salaried Employees

In this example, we will be dealing with a CCPC that spends $100,000 in salary costs on SR&ED, $5,000 in material consumed or transformed during the SR&ED process, and $10,000 in contractor costs. In this case, the clients' total expenditures are $115,000.

SR&ED ITC Calculation

	Before New Rules	After
salary costs	$ 100,000	$ 100,000
proxy	$ 65,000	$ 55,000
material costs	$ 5,000	$ 5,000
contractor costs	$ 10,000	$ 8,000
TOTAL Eligible Costs	$ 180,000	$ 168,000
Provincial ITC	$ 18,000	$ 16,800
Eligible Federal Portion	$ 162,000	$ 151,200
ITC rate	35%	30%
Federal ITC	$ 56,700	$ 45,360
TOTAL REFUND	$ 74,700	$ 62,160
Difference		$ 12,540
Percentage Decrease		17%

Example 2 – Most Costs Are Contractors

In this example, let's look at a client who primarily hires contractors to do the SR&ED innovation. So, using the same expenditure of $115,000, let's assume that the clients' salaried employee costs are $25,000, material is still $5,000, but now, contractor expenditures are $85,000. Here's how his ITC's would be affected.

	Before New Rules	After
salary costs	$ 25,000	$ 25,000
proxy	$ 65,000	$ 55,000
material costs	$ 5,000	$ 5,000
contractor costs	$ 85,000	$ 68,000
TOTAL Eligible Costs	$ 180,000	$ 153,000
Provincial ITC	**$ 18,000**	**$ 15,300**
Eligilble Federal Portion	$ 162,000	$ 137,700
ITC rate	35%	30%
Federal ITC	**$ 56,700**	**$ 41,310**
TOTAL REFUND	**$ 74,700**	**$ 56,610**
Difference		**$ 18,090**
percentage decrease		24%

Summary – The Good News!

As you can see, the less work that the client does with salaried employees, the worse is his reduction in SR&ED tax credits. Nevertheless, from an out of pocket expenses point of view, the client in example 1 spent $115,000 for a refund of $62,160 and in the second case, spent the same $115,000 for a refund of $56,610. In each case, the province plus the federal government are funding approximately 50% of out of pocket SR&ED costs for your clients. The federal government recognizes that in order to maintain a manufacturing base in Canada, domestic manufacturers need to continue to innovate. With an approximate 50% cost refund, Canada is doing its share to encourage that innovation, and with your help, your clients can be taking advantage of that support.