SCIENTIFIC RESEARCH AND EXPERIMENTAL DEVELOPMENT (SRED) & INVESTMENT TAX CREDIT (ITC)

Definitions

What is SRED?

- Qualified Scientific research and experimental development expenditures (SR&ED) get a generous tax treatment in Canada.
- The government is providing this tax incentive to encourage corporations to invest in research and innovation

What is ITC?

- ITC is a tax credit given for investing in new capital properties (only in Atlantic provinces & Gaspe) and for investing in scientific research and experimental development (available in all parts of Canada).
- ITC claimed on qualified capital assets reduces the tax cost of the asset (UCC) in the year following the claim.

Is all the Accounting Research & Development (R&D) = SRED?

- Not all accounting R&D is SRED because accounting research doesn't have to be scientific

Example of Accounting R&D i.e. considered as SRED

- Psychology
- Engineering
- Design
- Operations research
- Mathematical analysis
- Computer analysis
- Data collection - not routine
- Testing

Example of Accounting R&D i.e. not considered as SRED

- Market research
- Quality control
- Exploring or drilling for oil
- Style changes
- Routine data collection
- Humanities or social sciences
- Commercial production of a new or improved product

What are the tax advantages of SRED?

- Current SRED expenditures and most capital expenditures are 100% tax **deductible**
- Any allowable expenditure that is not deducted in a year can be deducted in any future year

- SRED expenditures are **also eligible for** investment tax **credits** (ITCs) – The percentage of credit varies with the type of corporation and also how much is refundable and non-refundable. Please check the Summary chart below for rates
- However this ITC credit reduces the SRED deduction next year and/or increases the taxable income if there is no SRED deduction available (Check example at the end of this document)

Category	SR&ED expenditures	ITC rate	Refundable portion of ITC earned on		Non-Refundable portion of ITC earned on	
			Current expenditures	Capital expenditures	Current expenditures	Capital expenditures
Canadian-controlled private corporations (CCPCs)	Up to your calculated Expenditure Limit*	35%	100%	40%	N/A	60%
	In excess of your calculated Expenditure Limit*	20%	40%	40%	60%	60%
Other corporations		20%	N/A	N/A	100%	100%
Proprietorships, partners of a partnership and trusts		20%	40%	40%	60%	60%

* The expenditure limit ($3 million maximum) is based on the previous year's taxable income and previous year's taxable capital. The limit is reduced when taxable income is greater than $400,000 or taxable capital is greater than $10 million. The maximum expenditure limit is $2 million for tax years ending prior to February 26, 2008.

Unused ITCs may be carried back three years or carried forward 20 years if

Explanation for the Chart above

Special Rule for CCPC'S

1. If you are a CCPC throughout the year
2. Previous year taxable income before loss carryback < the SBD limit $500K (Shared among associated corporations)

- **If both criteria's are met** - ITC rate is 35% and 35% * 100% of *current* expenditures and 35% * 40% of capital expenditures up to $3 million are refundable.

- If both criteria's are not met
  - ITC Rate is 20% and of that only 40% is refundable
  - Refundable = 20% * [(40% * current)+ (40% * capital)]
  - Non-Refundable = 20% * [(60% * current) + (60% * capital)]

  Therefore, for expenditures over $3 million and for individuals and other non-qualifying corporations, an ITC rate of 20% applies; and 20% * 40% of current and capital expenditures are refundable; the remainder is a non-refundable tax credit.

Must claim ITCs no later than 18 months after the year-end

Non-CCPC Corporations (public companies, non CC private companies)

SRED non-refundable credit = 20% * (100% of current + 100% capital)
Refundable portion = 0

Non-corporations (individuals, partnerships, trusts) - similar rule to CCPC who are over the 3M limit

Total SRED = 20% * (capital + current)
Refundable = 20% * (40% current + 40% capital)
Non-Refundable = 20% * (60% current + 60% capital)

Example of SRED and ITC CREDIT

If ABC corporation has SR&ED expenditures of $200,000 for December 31, 2009, and net income before SR&ED deduction is $600,000. Assume ABC has $300,000 income in 2010 and no SR&ED expenses. Also assume a 30% tax rate and ITC rate of 20% (for actual ITC rate refer to table above as it is different for each type of corporation).

Required: Determine the tax liability in 2009 and 2010

December 31, 2009:

Taxable income = $600,000 less $200,000 SR&ED = $400,000
Tax @30% =$120,000

Deduct: ITC = ($40,000) i.e. ($200,000 * 20% ITC rate)

Net Tax $80,000

December 31, 2010:

Taxable income = $300,000 less $0 SR&ED plus 2009 ITC of $40,000= $340,000
Tax @30% =$102,000

Deduct: ITC = ($0) i.e. ($nil SR&ED * 20% ITC rate)

Net Tax $102,000

If 2010 SR&ED expenditure was say $130,000, then taxable income would be $210,000 ($300,000 - $130,000 + 40,000). In addition, an ITC credit of $26,000 (i.e. $130,000 * 20%) can be claimed/deducted in computing the income tax for 2010.