

Federal research and development tax incentives

Federal Investment Tax Credits (ITCs) ¹					
Type of Entity	Nature of Expenditure	ITC Rate on Total Expenditures up to Expenditure Limit ²	Refund Rate	ITC Rate on Total Expenditures in Excess of Expenditure Limit ²	Refund Rate
Qualifying CCPCs ³	Current	35%	100%	20%	40%
	Capital	35	40	20	40
Other corporations	Current and capital	20	—	20	—
Individuals and unincorporated businesses	Current and capital	20	40	20	40

Notes

- (1) Federal research and development (R&D) ITCs earned in a taxation year after 1997 can either be applied against federal taxes payable in that year, refunded to the claimant (if applicable), carried forward and claimed in the 20 subsequent years or carried back and applied against federal taxes payable in the three prior years.

ITC claims must be identified on a prescribed form (T2SCH31) and filed with the Canada Revenue Agency (CRA) within 12 months of the entity's filing due date for its regular income tax return. The related prescribed forms (Forms T661 and T661 Part 2) must also be filed within this timeframe, to ensure a complete R&D filing.

ITCs claimed in one year are deducted from the entity's R&D expenditure pool in the subsequent year. Provincial ITCs, which are considered to be government assistance, are generally deducted from the R&D pool in the year claimed. The portion of federal ITCs that related to qualifying Ontario R&D expenditures was not deducted from the entity's R&D pool for Ontario purposes, for taxation years ending before 2009. Under the single corporate tax administration system in Ontario (applicable for taxation years ending after 2008), Ontario replaced this treatment with a 4.5% non-refundable Ontario tax credit on R&D expenses incurred in Ontario that qualify for the federal ITC.

- (2) The expenditure limit is generally \$3 million and applies to both current and capital expenditures. The expenditure limit must be shared by associated corporations. However, CCPCs that have a group of unconnected investors, such as venture capital investors, do not have to share the limit provided that the CRA is satisfied that the group of investors was not formed to gain access to multiple expenditure limits.
- (3) Qualifying CCPCs are those with taxable income (on an associated group basis) for the preceding year that does not exceed its "qualifying income limit". A corporation's "qualifying income limit" is determined by the formula $\$500,000 \times [(\$40,000,000 - A) / \$40,000,000]$. For taxation years that begin after February 26, 2008 and end before 2010, the reference to "\$500,000" in the formula should be replaced with "\$400,000". The variable "A" is nil if the corporation's prior year taxable capital employed in Canada is \$10 million or less. Otherwise, the variable "A" is equal to the portion of the corporation's prior year taxable capital employed in Canada that exceeds \$10 million (not to exceed \$40 million).

The expenditure limit (see note (2)) is phased out for CCPCs with taxable capital employed in Canada of between \$10 and \$50 million in the prior year (on an associated group basis). The expenditure limit is reduced by \$0.75 for every \$10 by which taxable capital exceeds \$10 million. The ability to claim the 35% ITC rate and related 100% ITC refund on current expenditures is eliminated once prior year taxable capital exceeds \$50 million or once taxable income exceeds \$800,000.

Federal research and development tax incentives (continued)

Federal R&D expenditure pool

Eligible Canadian R&D expenditures, both current and capital, are aggregated in a pool each year and may be deducted in whole or in part. Any amounts not deducted in the current year may be carried forward indefinitely.

Foreign current expenditures are also included in the R&D pool and may either be deducted in the year or carried forward. Such expenditures generally do not give rise to federal ITCs. However, R&D labour expenditures incurred outside Canada may result in federal ITCs, as discussed below.

Government assistance (which includes provincial ITCs), non-government assistance and contract payments reduce the amount of eligible expenditures in the year. Eligible expenditures are also reduced when R&D assets, for which the taxpayer received an ITC in any of the 20 previous years (for taxation years after 1997), are converted to commercial use or sold during the year.

Eligible expenditures incurred in the year, as well as project technical narratives and related project information, must be identified on prescribed forms (T661 and T661 Part 2) and filed with the CRA within 12 months of the entity's filing due date for its regular income tax return. The related prescribed form (T2 Schedule 31), must also be filed within this time frame, to ensure a complete R&D filing.

Qualifying current R&D expenditures

Qualifying Canadian current expenditures include the following:

- Salaries and wages of employees directly engaged in R&D—salaries and wages of specified employees (those individuals who directly or indirectly own greater than 10% of the shares of any class of the capital stock of the company, or who do not deal at arm's length with the taxpayer) are limited to five times the year's maximum CPP pensionable earnings and exclude remuneration based on profits or bonuses
- Salaries and wages of Canadian-resident employees carrying on R&D activities outside Canada—these salaries and wages (limited to 10% of the total R&D salary and wages carried on in Canada in the year) are eligible provided the R&D activities are directly undertaken by the taxpayer and done solely in support of R&D carried on by the taxpayer in Canada.
- Cost of materials consumed or transformed in R&D
- Lease costs of machinery and equipment used in R&D
- Eligible expenditures incurred by contractors performing R&D directly on behalf of the taxpayer
- Eligible expenditures incurred by certain third parties where the taxpayer may exploit the results of the R&D

Proxy election for overhead expenses

The proxy election adds 65% of qualifying R&D salaries and wages (excluding bonuses, taxable benefits and stock option benefits) to the expenditures eligible for federal ITCs (but not to the R&D pool itself). This "notional overhead" amount replaces administration and other overhead costs that are often difficult to support such as utilities, office and other types of supplies. Once the election is made, it is irrevocable for that taxation year.

The salary of specified employees (as discussed above) is limited in a number of ways when calculating the amount of salaries and wages eligible for the proxy election. Only 75% of such employees' salaries can be included as eligible salaries, and the maximum per employee is 2.5 times the year's maximum CPP pensionable earnings. Remuneration based on profits and bonuses are excluded from the proxy computation for both specified and non-specified employees.

Provincial research and development tax incentives

	Rate	Description
British Columbia ¹	10%	Refundable and non-refundable tax credit for eligible expenditures incurred in British Columbia after August 31, 1999 and before September 1, 2014, by a corporation with a permanent establishment (PE) in the province
Alberta ²	10%	Refundable tax credit for eligible expenditures incurred in Alberta by a corporation with a PE in the province
Saskatchewan ³	15%	Refundable tax credit for eligible expenditures incurred in Saskatchewan by a corporation with a PE in the province
Manitoba ⁴	20%	Non-refundable and refundable tax credit for eligible expenditures incurred in Manitoba by a corporation with a PE in the province
Ontario <i>Innovation Tax Credit (OITC)</i> ⁵	10%	Refundable tax credit for eligible expenditures incurred in Ontario by a corporation with a PE in the province
Ontario <i>Business-Research Institute Tax Credit (OBRITC)</i> ⁶	20%	Refundable tax credit for eligible expenditures incurred in Ontario by a corporation with a PE in the province as part of an eligible contract with an eligible research institute
Ontario <i>Research and Development Tax Credit (ORDTC)</i> ⁷	4.5%	Non-refundable tax credit for eligible expenditures incurred in Ontario by a corporation with a PE in the province

Current as of December 31, 2011

**Provincial research and development tax incentives
(continued)**

	Rate	Description
Québec <i>R&D Wage Tax Credit</i> ⁸	Canadian-controlled corporations—37.5% Others—17.5%	Refundable tax credit for R&D wages of Québec-based employees of a corporation that carries on business in Canada and performs R&D in Québec, or has such work carried out on their behalf in Québec. The corporation no longer needs to have a PE in Québec This credit is also available for 50% of amounts paid to an unrelated subcontractor for R&D performed by employees in Québec and for 100% of amounts attributed to wages paid to employees of a related subcontractor in Québec
Québec <i>Credit for contract payments to/for R&D entities and projects</i> ⁹	35%	Refundable tax credit for contract and other payments to certain eligible entities (only 80% of payments to unrelated persons are eligible)
New Brunswick ¹⁰	15%	Refundable tax credit for eligible expenditures incurred in New Brunswick by a corporation with a PE in the province
Nova Scotia ¹⁰	15%	Refundable tax credit for eligible expenditures incurred in Nova Scotia by a corporation with a PE in the province
Newfoundland ¹⁰	15%	Refundable tax credit for eligible expenditures incurred in Newfoundland by a corporation with a PE in the province

Current as of December 31, 2011

Provincial research and development tax incentives (continued)

Notes

- (1) Eligible expenditures in British Columbia are those that qualify for federal investment tax credit (ITC) purposes. Canadian-controlled private corporations (CCPCs) are eligible for the refundable credit on expenditures up to their expenditure limit (as it is defined for federal purposes). The credit is not refundable for other corporations or for a CCPC's expenditures in excess of the expenditure limit. The credit, which was set to expire in 2009, has been extended to September 1, 2014. Corporations that are active members of a partnership that incurs qualifying expenditures are also entitled to claim this credit.

The credit is considered to be government assistance and reduces federal expenditures for both the research and development (R&D) deduction and ITCs. The credit can be claimed only once all other tax credits have been claimed. Unused non-refundable credits may be carried forward 10 years and carried back three years. All or part of the non-refundable credit can be renounced each year.

- (2) Eligible expenditures in Alberta are those that qualify for federal ITC purposes. The qualifying expenditures must be incurred after December 31, 2008 and cannot exceed \$4 million. The Alberta expenditure base is reduced by federal ITCs earned in the prior year on that portion of federal eligible expenditures which generated Alberta ITCs in that year.
- (3) Eligible expenditures in Saskatchewan are those that qualify for federal ITC purposes. The provincial government has made the 15% non-refundable tax credit fully refundable for qualifying expenditures incurred after March 18, 2009. The credit is considered to be government assistance and reduces federal expenditures for both the R&D deduction and ITCs. Unclaimed non-refundable tax credits will remain available, to be claimed against taxes payable for the existing 10-year carryforward period. Unused credits could also be carried back three years.
- (4) Eligible expenditures in Manitoba are those that qualify for federal ITC purposes. The 20% tax credit is refundable if the eligible expenditures are incurred after 2009 and are carried on in Manitoba under contract with a qualifying research institute in Manitoba. This refundable tax credit has been enhanced to include eligible in-house R&D expenditures incurred in 2011 and subsequent years. The refundability of this credit has been extended as follows: 25% of the credit for in-house R&D will be refundable beginning in 2011 and this amount will increase to 50% beginning in 2012.

For eligible expenditures incurred prior to 2010, the tax credit was non-refundable. Unused non-refundable credits earned in taxation years ending after 2003 may be carried forward 10 years and carried back three years. Unused credits earned in prior years may only be carried forward seven years.

The tax credit (refundable and non-refundable) is considered to be government assistance and reduces federal expenditures for both the R&D deduction and ITCs. All or part of the credit can be renounced each year but must be renounced no later than six months after the filing due date for that taxation year. The tax implications for federal purposes are different depending on whether the credit is renounced by the filing due date or after the filing due date (but no later than 12 months after the filing due date). Requests to renounce the Manitoba ITCs after the deadline will be denied.

Provincial research and development tax incentives (continued)

- (5) Eligible expenditures in Ontario are those that qualify for federal ITC purposes and are not in excess of the expenditure limit. The expenditure limit is \$3 million. All current expenditures and 40% of capital expenditures qualify for the credit. The credit is available to corporations with taxable income under the federal small business income threshold, and taxable paid-up capital (for Ontario capital tax purposes) of less than \$25 million, in the preceding year. The corporation's expenditure limit will be reduced where either of these restrictions are exceeded by the associated group, and, for taxation years ending after 2009, will be eliminated once taxable income of the group reaches \$800,000 or taxable paid-up capital exceeds \$50 million, in the preceding year. Transitional rules apply if a corporation does not have a calendar year end.
- (6) In Ontario, an eligible research institute contract is an R&D contract with an eligible research institute (i.e., certain post-secondary and hospital research institutions, and prescribed non-profit research organizations). Eligible expenditures, as defined for federal ITC purposes, are limited to \$20 million per year.
- (7) Eligible expenditures in Ontario are those that qualify for federal ITC purposes. The credit is non-refundable and is applicable for taxation years ending after 2008. Unused credits may be carried forward 20 years and carried back three years (but only back to taxation years ending after 2008).
- (8) In Québec, to be eligible for the 37.5% rate in respect of a maximum of \$3 million in qualifying expenditures, the Canadian-controlled corporation must have less than \$50 million in assets on an associated worldwide basis in the preceding year. For corporations with assets between \$50 million and \$75 million, this rate is proportionally reduced to 17.5%. The limit must be shared by associated corporations. The credit reduces eligible expenditures for federal purposes, but is not taxable in Québec.
- (9) In Québec, eligible entities include universities, public research centres, and private research consortiums. These entities must carry on business in Canada and perform R&D in Québec, or have such work carried out on their behalf in Québec. They no longer need to have a permanent establishment in Québec.

Other types of eligible payments include expenditures in respect of pre-competitive research projects. This requires an Advance Ruling request. A processing fee of \$250 is payable to the Québec Ministry of Revenue at the time the Advance Ruling request is made.
- (10) In New Brunswick, Nova Scotia and Newfoundland, eligible expenditures are those that are considered qualified expenditures for federal purposes, as defined under the federal *Income Tax Act*. The credit is considered to be government assistance and reduces federal expenditures for both the R&D deduction and ITCs.

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The information contained herein is of a general nature and is not intended to address the circumstances of any particular individual or entity. Although we endeavor to provide accurate and timely information, there can be no guarantee that such information is accurate as of the date it is received or that it will continue to be accurate in the future. No one should act on such information without appropriate professional advice after a thorough examination of the particular situation.

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