

TAX BULLETIN

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Tax Benefits of SR&ED

In today's changing world, business is much more competitive. Diminishing trade barriers have forced Canadian businesses into global competition and rapid technological changes are forcing businesses to be constantly innovative, and leaders in their fields.

To maintain their competitive edge, Canadian businesses must devote significant resources to the scientific research and experimental development (SR&ED) of new products and processes. The Canadian government has recognized the benefits to the Canadian economy that are achieved through encouraging Canadian businesses to be more productive by investing resources into SR&ED and foreign businesses to perform their SR&ED in Canada. As a result, the Canadian tax benefits for SR&ED activities carried on in Canada are among the most generous SR&ED incentives in the world.

Surprisingly, not all businesses who are conducting qualifying SR&ED activities in Canada apply for these incentives. This bulletin explains both the federal and provincial SR&ED tax incentives available and how they could apply to your business. Ask yourself whether your business is performing SR&ED and how you could benefit. The savings will make it worth your while.

What is SR&ED?

Under Canadian tax rules, SR&ED is defined as “a systematic investigation or search carried out in a field of science or technology by means of experiment or analysis.” Most people interpret this to mean that SR&ED must be carried out in a laboratory by skilled scientists. This is simply not true.

In fact, SR&ED activities for small businesses are usually integrated with daily business activities. SR&ED can just as easily be carried out on the production floor of your business.

Generally, SR&ED occurs when a business’s objective is technological advancement, development occurs in a systematic manner through the efforts of individuals who are skilled in the technologies involved and technological obstacles or uncertainties are overcome. Three basic criteria must be met if an activity is to qualify as SR&ED under our tax rules. These criteria are:

- ◆ scientific or technological advancement;
- ◆ scientific or technological obstacle/uncertainty; and
- ◆ scientific or technological content.

Scientific or Technological Advancement

The project in question must be working towards a scientific or technological advancement. The Canada Revenue Agency (CRA) states that “the search carried out in the SR&ED activity must generate information that advances the understanding of scientific relations or technologies”.

This test is not as onerous as it sounds. What it means is whether you are creating something new – for example, a new product or simply an improvement to an existing one. It is important, however, that you are working towards something that is truly new and not information that is common knowledge or available in the public domain at the time.

Note that you do not have to be successful to qualify for SR&ED tax benefits. It is the attempt to achieve a scientific or technological advancement that is important in determining whether you are engaged in eligible SR&ED activities. Failure to achieve your objectives actually increases existing knowledge and is therefore SR&ED – you will have shown that your objectives cannot be met by the approach you used.

Scientific or Technological Obstacle/Uncertainty

There must be a scientific or technological obstacle or uncertainty to your endeavour. According to the CRA, “technological obstacles/uncertainties are shortcomings and/or limitations of the current state of technology that prevented you from developing the new or improved capability”. Technological obstacles or uncertainties must arise due to the fact that the solution to your problem is not obvious to people familiar with the available knowledge and technologies for your business. This means that, at the outset, you are unsure as to whether your goals can be achieved, or there is an obstacle or uncertainty as to the method by which you can attain your objectives. The obstacle or uncertainty would be removed by performing SR&ED.

Scientific and Technical Content

Basically, this means that your research must be conducted in a disciplined manner. The CRA indicates that your project must incorporate a systematic investigation going from “identification and articulation of the scientific or technological obstacles/uncertainties, hypothesis formulation, through testing (of the hypothesis) by experimentation or analysis, to the statement of logical conclusions.”

While this sounds a bit intimidating, in particular for experimental development, it really isn't. Basically, your SR&ED must be conducted in an orderly fashion and you must have documentation to support the work that you did. The CRA has placed great emphasis on a “repeatability criterion” – they expect that a knowledgeable person should be able to “repeat” the research that you did. Therefore, good documentation is critical to support your SR&ED claims. While a couple of cases have shown that it may be possible to convince a court that you did conduct SR&ED even though you didn't maintain good documentation (the SR&ED claims were allowed based on oral testimony of the taxpayers), a lack of documentation will almost certainly mean that the CRA will deny your SR&ED claims.

Remember that you do not have to be in a “high-tech” industry to be involved in SR&ED. Ask yourself the following questions to determine if you have any activities that may qualify for SR&ED benefits:

- ◆ Have you developed a new product, are in the process of developing one, or are adding improvements to an existing product?

- ◆ Are you improving the methods by which you produce an existing product? The development of an improved manufacturing technique or process, whether to improve product quality or just reduce production costs, could be SR&ED.
- ◆ Are you spending money on improvements with respect to the environmental impact of your manufacturing process? If you have developed techniques to cut pollution or reduce waste, these costs may qualify as SR&ED.

If you have questions as to whether a particular activity could qualify as SR&ED or related to other SR&ED matters as you read through this bulletin, contact your BDO advisor and they can refer you to a BDO SR&ED advisor for assistance.

What are the SR&ED Tax Incentives?

Under Canadian tax law, there are three major benefits for qualifying SR&ED expenditures. These are:

- ◆ A full tax deduction in the year the expenditures are incurred, even if they are capital in nature;
- ◆ The ability to "pool" SR&ED expenditures, which enables you to carry over deductions to the extent that they are not needed currently; and
- ◆ Eligibility for attractive investment tax credits (ITCs), which can be refundable in cash if you don't need them to reduce current taxes payable.

The ITCs are particularly attractive for Canadian-controlled private corporations (CCPCs) that carry on qualifying SR&ED activities.

In addition to the federal tax incentives, many of the provinces have their own SR&ED tax incentives. These are outlined later in this bulletin in the section titled *Provincial SR&ED Tax Incentives*.

Current Tax Deduction

SR&ED expenditures can be classified in one of two categories: current and capital.

Current SR&ED Expenditures

A current expenditure is an amount that you would ordinarily consider to be currently deductible for tax purposes. Examples would include amounts spent directly on SR&ED activities such as wages paid to employees who are engaged in this work and materials. In addition, overhead to support SR&ED activities is also a current expense. Examples of overhead expenses include general and administrative

costs such as office supplies, salaries of support staff and the costs related to maintaining the facilities in which the SR&ED activities are conducted.

Calculating overhead which qualifies as an SR&ED expenditure is often difficult. This is due to the fact that overhead must be "directly attributable" to SR&ED activities to qualify. This is generally interpreted to mean that the overhead must be incremental – in other words, the overhead expense would not have been incurred if there had been no SR&ED activity.

Calculating this incremental overhead has, over the years, proven to be difficult and has often been the source of disagreement between the CRA auditors and taxpayers, particularly for small businesses where SR&ED activities are often integrated with other activities. However, there is an alternative method to compute SR&ED overhead for purposes of calculating SR&ED ITCs, which generally eliminates this problem. This method, known as the "proxy method", is discussed in more detail under the heading "Investment Tax Credits".

Capital SR&ED Expenditures

A capital outlay is an amount paid for capital property such as machinery and equipment. Normally, these assets must be written off for tax purposes in accordance with the tax depreciation rules known as the capital cost allowance (CCA) system. Note that the cost of a building is generally not eligible for treatment as an SR&ED expenditure.

All qualifying SR&ED expenditures, including capital expenditures, can be deducted immediately for tax purposes. However, to qualify for full SR&ED tax incentives, depreciable capital assets must be acquired with the intent to use the property "all or substantially all" in SR&ED activities. The CRA interprets this to mean that they are used 90% of the time in that capacity.

Restricted SR&ED incentives are available for "shared-use" capital property – depreciable assets which are acquired to be used only part of the time for SR&ED purposes. This is discussed in more detail under the heading "Investment Tax Credits". Property qualifying as shared-use capital property is written off under the normal CCA rules, and therefore these expenditures are not currently deductible.

Pooling of SR&ED Expenditures

As mentioned above, SR&ED expenditures are accumulated separately or "pooled" for tax purposes.

This pool of expenditures can then be written off immediately, or the deduction can be deferred indefinitely for tax purposes. This is useful if you don't have sufficient taxable income to take advantage of the tax deductions now.

This pooling of expenditures gives you, the taxpayer, the maximum flexibility in claiming your SR&ED expenditures for tax purposes. You have the option of claiming all, none, or a portion of your SR&ED pool in the current taxation year, or in any taxation year in the future. In other words, you can save the tax deductions for when you will need them.

Investment Tax Credits (ITCs)

Perhaps the most important tax benefit of SR&ED expenditures is the availability of generous ITCs, which reduce your income tax liability dollar for dollar. And if your available credits exceed your income tax, you may qualify to claim your ITCs as cash refunds from the government.

ITCs are calculated as a percentage of the cost of your SR&ED expenditures. Note that any government or non-government assistance received for your SR&ED activities reduces the amount of expenditures on which you claim ITCs.

For most taxpayers, the ITC rate is 20%. However, if you carry on your SR&ED activities in a CCPC, you may qualify for an enhanced ITC rate of 35%. A CCPC's eligibility for the enhanced 35% ITC rate will depend on its taxable income for the previous year, aggregated with the taxable incomes of any associated corporations. Any ITC you receive will reduce your SR&ED costs in the taxation year following the year in which the ITC is claimed and therefore will reduce the pool of SR&ED expenditures that you can deduct for tax purposes in the future.

Companies are considered "associated" if they are under common ownership and control, according to specific rules in the *Income Tax Act*. Note that certain relieving rules apply for small businesses raising funds from common investors effective for taxation years ending after March 22, 2004. Where certain conditions are met and the CRA is satisfied that a group structure was not set up to gain access to multiple expenditure limits (i.e. certain venture capitalists), corporations will not be considered associated and will not have to share the expenditure limit for purposes of determining their eligibility for the enhanced ITC rate.

If taxable income for your associated group of companies for the previous year is \$500,000¹ or less,

the first \$3 million of SR&ED expenditures of the associated group will qualify for the 35% ITC rate. For taxation years ending before February 26, 2008, the expenditure limit was \$2 million; for taxation years straddling February 26, 2008, the \$3 million limit is prorated based on the number of days in the year on or after February 26, 2008.

If the taxable income of your associated group for the previous year exceeded \$500,000¹, your access to the 35% ITC rate will be restricted. This is done by reducing the \$3 million expenditure limit by \$10 for each dollar by which the prior year's taxable income exceeds \$500,000. This effectively reduces the total annual amount of SR&ED expenditures eligible for the 35% ITC rate. This is best illustrated in Table A on the next page. Note that with taxable income of \$800,000, your corporation will become ineligible for the 35% ITC rate on any of your SR&ED expenditures. Your corporation will, however, still be eligible for the 20% ITC rate.

Access to the enhanced ITC rate is also restricted when taxable capital exceeds \$10 million. For taxation years ending on or after February 26, 2008, the expenditure limit is reduced by \$3 for every \$40 in taxable capital employed in Canada in excess of \$10 million and is eliminated when taxable capital reaches \$50 million. For taxation years ending before February 26, 2008, the expenditure limit was phased out for taxable capital between \$10 million and \$15 million on a straight line basis. For a taxation year straddling February 26, 2008, the limits are prorated.

¹ The \$500,000 limit applies for 2010 and subsequent years. For taxation years that end after 2007 and before 2010, the taxable income threshold that could not be exceeded was \$400,000. For taxation years that end after 2002 and before 2008, the taxable income threshold was \$300,000. For taxation years that end before 2003, the threshold was \$200,000. Note that the limits are prorated for non-calendar year-ends.

Table A

Effect of Taxable Income on the SR&ED Expenditure Limit, Assuming SR&ED Expenditures of \$3 million		
Taxable Income	Expenditure Limit	ITC
\$500,000	\$3,000,000	\$1,050,000
550,000	2,500,000	975,000
600,000	2,000,000	900,000
650,000	1,500,000	825,000
700,000	1,000,000	750,000
750,000	500,000	675,000
800,000	0	600,000

SR&ED Overhead – The Proxy Method

The proxy method is an alternative method to compute SR&ED overhead for purposes of calculating SR&ED ITCs, which is often beneficial to use. This will mean that you will not have to identify incremental overhead incurred for SR&ED purposes, which is usually difficult for small businesses.

Under the proxy method, the ITCs on SR&ED overhead are based on a "proxy amount". This amount includes salaries and wages of personnel directly engaged in SR&ED activities. If one of your employees is working on SR&ED projects 50% of the time, then 50% of their salary would be included in the proxy amount. Note that there are limits on the salaries of "specified employees" for this purpose (a "specified employee" is someone who owns 10% or more of the shares of the corporation or corporations within an associated group). This limitation is the lesser of 75% of the specified employee's salary and a prescribed ceiling which is \$118,000 for 2010 and \$120,750 for 2011.

If you choose this method, 65% of the proxy amount will be eligible for SR&ED ITCs. Note that the proxy method is only for purposes of determining SR&ED ITCs for overhead. If the proxy method is used, actual overhead costs will not be eligible for treatment as an SR&ED expenditure and are deducted as regular business expenses.

Using the proxy method will generally be beneficial to you if your incremental overhead (i.e. the extra overhead you incur because of your SR&ED activities) is low, or your SR&ED activities are labour intensive

(since the proxy amount is based on direct SR&ED salaries and wages). Your BDO SR&ED advisor can help you determine if using the proxy method will be beneficial for you.

Shared-Use Capital Property

As we have already stated, only capital property that is purchased to be used "all or substantially all" in SR&ED activities qualifies as an SR&ED expenditure. As capital assets usually have a life of several years, this test is extremely difficult to meet, particularly for small businesses that may use an asset partly for SR&ED purposes and partly for production.

Fortunately, our tax rules allow limited SR&ED ITCs on shared-use capital property. If property is used primarily (more than 50% of the time) for SR&ED activities, the asset will qualify for reduced SR&ED ITCs. The credit will be one-half of the regular SR&ED ITC and will be payable over two years.

Note that shared-use capital property is written off under the normal CCA rules and will not be eligible for pooling with other SR&ED costs. Capital property meeting the "all or substantially all" test, however, will still qualify as a capital SR&ED expenditure and will be eligible for full SR&ED ITCs.

Stock Option Benefits

The government has proposed rules, applicable to stock options granted and shares issued on or after November 17, 2005, to ensure that the amount of an expenditure on which a tax credit or deduction may be claimed, is limited to the amount actually disbursed. In other words, an expenditure will not be considered to have been made except to the extent of an actual outlay or expense incurred by the company. As a result, you cannot claim the value of stock option benefits of employees engaged in SR&ED as qualifying expenditures for SR&ED ITC purposes.

Getting Cash for Your SR&ED ITCs

If you don't have sufficient taxes payable to fully utilize your SR&ED ITCs, you may still benefit immediately. In certain circumstances, SR&ED ITCs can be refundable in cash from the government to help subsidize your SR&ED expenditures. This is a very attractive benefit as it can substantially reduce the costs of financing your SR&ED expenses.

Qualifying CCPCs are eligible for cash payments for all of their SR&ED ITCs on current expenses and 40% of their SR&ED ITCs on capital expenses, on the first

\$3 million of SR&ED expenditures. A \$2 million expenditure limit applied for expenditures before February 26, 2008. Reduced refunds are available for ITCs on expenditures over the expenditure limit. Other CCPCs also get attractive refunds on SR&ED expenditures which are eligible for the enhanced 35% rate, but get no refund of ITCs on expenses eligible for the 20% ITC rate. Individuals and unincorporated businesses can also get partial refunds of their SR&ED ITCs.

Since qualifying CCPCs get the most attractive refunds, it may be wise to ensure that your CCPC qualifies. For taxation years ending on or after February 26, 2008, a qualifying CCPC is one whose taxable income, together with associated corporations, does not exceed its qualifying income limit for the year. The qualifying income limit is the federal small business limit with a reduction when the corporation's taxable capital employed in Canada for its preceding taxation year, together with associated corporations, exceeds \$10 million. More specifically, the limit is reduced by \$12,500 for every \$1 million in taxable capital in excess of the \$10 million threshold and is eliminated when taxable capital reaches \$50 million. For taxation years ending before February 26, 2008, a qualifying CCPC is one whose taxable income, together with associated corporations, does not exceed its federal small business limit in the preceding year. For a taxation year straddling February 26, 2008, the taxable income threshold limits are prorated.

Table B summarizes the refund rates available to all businesses.

How Much Does SR&ED Cost You?

The generosity of the federal SR&ED incentives can be illustrated by looking at the after-tax cost of performing SR&ED. Let's assume that you own a CCPC and would qualify for the 35% enhanced SR&ED ITC rate. The after-tax cost of performing \$10,000 of SR&ED as compared with incurring regular current and capital expenditures is shown in Table C on page 7. As the numbers indicate, the after-tax cost of SR&ED is only about 55% of the actual expenditure. Regular current and capital expenditures have an after-tax cost of approximately 85% and 98% of the expenditures respectively.

The after-tax cost of performing \$10,000 of SR&ED for businesses that do not qualify for the 35% enhanced rate, either because they are not CCPCs or their

Table B

Table of Refundable Rates for SR&ED ITCs		
Type of Taxpayer	Current SR&ED Expenditures	Capital SR&ED Expenditures
Individuals and Unincorporated Businesses	40%	40%
Qualifying CCPCs	100% (on SR&ED expenditures up to the annual expenditure limit) 40% (on remaining balance)	40%
Other CCPCs	100% (on SR&ED expenditures up to the annual expenditure limit) 0% (on remaining balance)	40% (on SR&ED expenditures up to the annual expenditure limit) 0% (on remaining balance)
Other Corporations	0%	0%

taxable income is too high, as compared with regular current and capital expenditures is also shown in Table C.

Note that this analysis does not take into account any provincial SR&ED incentives that may be available. Provincial incentives are outlined later in this bulletin.

Table C

After-Tax Cost of SR&ED			
<i>CCPC Qualifying for the 35% ITC Rate</i>			
	Regular expenditures		SR&ED expenditures
	Current	Capital	Current or Capital
Expenditure	\$10,000	\$10,000	\$10,000
SR&ED ITC @ 35%	0	0	(3,500)
Net expenditure	\$10,000	\$10,000	\$ 6,500
Value of tax deduction @ 15.5%	(1,550)	(233)	(1,008)
After-tax cost of expenditure	\$ 8,450	\$ 9,767	\$ 5,492
<i>Corporation Qualifying for the 20% ITC Rate</i>			
Expenditure	\$10,000	\$10,000	\$10,000
SR&ED ITC @ 20%	0	0	(2,000)
Net expenditure	\$10,000	\$10,000	\$ 8,000
Value of tax deduction @ 28%	(2,800)	(420)	(2,240)
After-tax cost of expenditure	\$ 7,200	\$ 9,580	\$ 5,760
Notes to Table C:			
1. The value of the tax deduction for a regular capital expenditure is only for the first year, assuming a capital cost allowance rate of 30% for the asset. The remaining undeducted cost of the asset can be deducted in future years. The value of these deductions has not been reflected in this table.			
2. This analysis has assumed a provincial corporate small business tax rate of 4.5% for CCPCs (Ontario's rate effective July 1, 2010) qualifying for the 35% ITC rate.			
3. The tax rate used for corporations qualifying for the 20% ITC rate is the top corporate rate at July 1, 2011, assuming an Ontario corporate rate of 11.5%. If the company is a manufacturer, the top 2011 combined federal and Ontario corporate rate is 26.5%.			
4. The value of provincial SR&ED incentives has not been taken into account in this analysis.			

How Do You Apply for SR&ED Incentives?

To claim the SR&ED tax incentives, the CRA's Form T661, *Scientific Research and Experimental Development (SR&ED) Expenditures Claim*, must be completed and filed with your corporation's tax return. Form T661 was significantly revised in late 2008 and stakeholder feedback has resulted in further revisions to the form, with a revised T661 released in 2010 and again in 2011. You are required to keep detailed project information for all of your SR&ED projects. Not all information must be submitted to the CRA with your claim, however, you need to keep it available should the CRA request the information. You should work with your BDO SR&ED advisor to ensure you submit the appropriate project information on your T661 and keep the necessary records to ensure your project expenditures will not be disallowed on your SR&ED claim.

To calculate your SR&ED ITCs, you must also file T2 Schedule 31, *Investment Tax Credit - Corporations* or Form T2038(IND), *Investment Tax Credits (Individuals)*.

To qualify for benefits, these forms must be filed within one year after the filing due date for the taxation year in which the SR&ED expenditures were incurred. For corporations, this is 18 months after the taxation year-end. This rule exists to ensure that claims are filed on a current basis. If you don't file all of the required information (including the necessary project descriptions) within this timeframe, you will lose your ability to claim SR&ED tax incentives on your SR&ED expenditures for that taxation year.

Note that while previously the Minister of National Revenue had the discretion to waive the filing deadline, under proposed amendments, this is no longer the case for claims for SR&ED treatment and ITCs made on or after November 17, 2005.

To ensure qualification for benefits, it is prudent to file the required forms early to allow time for the CRA to review your filing before the reporting deadline. You will be allowed additional time, up to the reporting deadline, to provide any missing information. In early 2010, the CRA announced that beginning April 1, 2010, as part of their review process, the CRA will advise of any work that appears to be eligible for an SR&ED claim but has not been included and you will be allowed to resubmit your claim if this is done within the reporting deadline.

Your BDO SR&ED advisor can assist you in preparing your SR&ED application.

Will Your Claim be Reviewed by the CRA?

Generally first time SR&ED claims are reviewed. The initial review is usually the technical review performed by the CRA based on the technical descriptions you have submitted. You will be visited by a Research and Technology Advisor to verify or clarify the information in the reports. Also, a Financial Reviewer may contact you to set up an appointment to review the financial side of the claim. The length of the review is generally determined by the size and complexity of your claim.

Your BDO SR&ED advisor can help you deal with the CRA during the review of your claim to ensure that you obtain the maximum benefits from the SR&ED program.

Other Matters

If you perform SR&ED, you should also be aware of the following items:

Contract Payments to Non-Arm's Length Persons - If you contract out SR&ED work to a non-arm's length person, only the performer of the work can claim SR&ED incentives on the work done. This rule ensures that SR&ED tax incentives are only claimed on actual SR&ED costs incurred and not on any profit margin earned on the contract payment. However, the person to whom you contracted the work out can transfer the ITCs back to you, if a joint election is filed (Form T1146).

Contract Payments to Arm's Length Suppliers - You are required to identify contractors and report their CRA Business Number in your claim although, with the T661 form changes made in 2008, you are no longer required to provide details of the work performed. You are, however, required to retain evidence of expenditures to contractors in the event of a review by the CRA.

SR&ED Activities Carried on Outside of Canada - Historically, SR&ED activities must have been performed in Canada to qualify for the tax incentives. However, the 2008 federal budget extended the availability of ITCs to certain activities carried on outside Canada, which are done solely in support of SR&ED activities carried on by the taxpayer in Canada. In particular, an ITC will now be available for certain salary or wages incurred by a taxpayer in respect of Canadian resident employees carrying on SR&ED

activities outside Canada and who were not subject to paying taxes in the foreign country. Expenses eligible will be limited to a maximum of 10% of the Canadian SR&ED labour expenditure. This will apply to salary or wages incurred by a taxpayer in respect of SR&ED carried on outside Canada on or after February 26, 2008 subject to proration for the first taxation year ending after February 25, 2008. Note that there has been significant case law in the area of expenditures incurred outside of Canada and your SR&ED BDO advisor should be consulted in this area.

Recapture of ITCs on Sale of Property - ITCs on property which qualified for SR&ED incentives in any one of the preceding 10 years will be recaptured if the property, or property which incorporates it, is converted to commercial use or otherwise disposed of.

Carryforward of Unused ITCs - Unused ITCs earned in tax years after 1997 may be carried forward for 20 years.

Planning to Maximize Your SR&ED Claim

Here are some tips to ensure that you get the maximum benefit from the SR&ED rules.

Properly Account for Your SR&ED Expenditures

It's very important to have both good documentation of your SR&ED project and good accounting records for your SR&ED expenditures. Pay particular attention to the following items:

- ◆ Make sure you identify all of your SR&ED activities. This is best done by persons who are familiar with the CRA's SR&ED rules. BDO has the experts who can help you.
- ◆ Set up your accounting system to capture all SR&ED expenditures separately. Watch in particular for staffing costs, and ensure that your system picks up the portion of salaries and wages for employees who work on SR&ED projects only part of the time.
- ◆ Ensure that your system identifies any incremental overhead that is attributable to your SR&ED activities and that this is recorded separately.

Consider Using the Proxy Method for Overhead

Using the proxy method can increase your SR&ED ITCs. Compare the ITCs calculated under this method with ITCs calculated on actual incremental overhead to determine which maximizes your SR&ED claim. Your

BDO SR&ED advisor can help you analyze which method is better for you.

Keep Taxable Income Below \$500,000

If your SR&ED activities are carried out in a CCPC, you should ensure that the taxable income of your company, together with any associated companies, is kept below \$500,000² each year. This is important to ensure that the maximum amount of SR&ED expenditures will qualify for the enhanced 35% SR&ED ITC rate, as opposed to 20% for other taxpayers. Also, ITCs on current SR&ED expenditures for qualifying CCPCs can be fully refundable.

As a result of changes to the taxable capital restrictions, this consideration now applies to even more corporations. As previously noted for taxation years ending after February 25, 2008, access to the enhanced ITC rate will not be completely phased-out until taxable capital in the preceding year exceeds \$50 million (increased from \$15 million).

Carry on Your SR&ED Activities in a Corporation

If you are an individual carrying on SR&ED activities, strongly consider incorporating in a CCPC to qualify for the higher ITC rates.

Provincial SR&ED Tax Incentives

ONTARIO

Ontario provides several SR&ED tax incentives. With the transition to the harmonized tax system for corporations, changes have been made to provide a non-refundable tax credit as outlined below. As well, there are other incentives available for businesses and investors which are discussed below.

SR&ED Incentives - Changes Due to Harmonization

Deduction for Federal SR&ED Investment Tax Credit (for taxation years ending prior to 2009)

For taxation years commencing after February 2000 and ending prior to 2009, Ontario permits a deduction from Ontario taxable income of the amount of federal ITCs claimed in the preceding taxation year. The Ontario deduction is limited to the part of the federal ITCs that can reasonably be considered to relate to Ontario SR&ED expenditures. This amount is grossed up

² When applying the threshold you generally need to look back to the previous year. Note that the threshold has increased in recent years. For details, refer to Note 1 on page 4.

by (i.e. divided by) the Ontario allocation factor for the year.

Transition to the Harmonized Tax System

For taxation years ending after 2008, the federal government is administering and collecting Ontario's corporate income tax. Under the harmonized tax system, Ontario corporations will adopt the federal tax attributes for the SR&ED pools available for deduction as the tax basis. Corporations will frequently have differences between the federal and Ontario SR&ED tax pools, resulting in either a transitional debit or credit at the time of transition, which will be the first day of the taxation year of the corporation that ends after December 31, 2008.

When Ontario SR&ED pools available for deduction are greater than federal SR&ED pools, a transitional credit will result. Because Ontario corporate taxpayers are required to adopt the federal balances, they will essentially lose the benefit of the higher Ontario balances and will be compensated with a non-refundable transitional credit which can be claimed up to the corporation's Ontario corporate income tax amount for any taxation year that falls within a five year amortization period.

On the other hand, when Ontario SR&ED pools available for deduction are less than federal SR&ED pools, a transitional debit will result. Taxpayers will be "paying for" these higher federal balances through the transitional tax which must be paid in equal instalments over a five year amortization period. To alleviate the hardship of a transitional debit specifically for SR&ED pools, taxpayers will have the option to defer the payment of the transitional tax for seven years as long as the corporation incurs sufficient ongoing SR&ED in that seven year period. In order to defer the transitional tax, an election was required to be made in writing in the corporation's tax return for its first taxation year ending after December 31, 2008.

Ontario Research and Development Tax Credit (for taxation years ending after 2008)

Under the harmonized system for 2009 and subsequent years, Ontario provides a non-refundable 4.5% Ontario Research and Development Tax Credit (ORDTC). This tax credit is intended to compensate companies for the elimination of the Ontario deduction for federal ITCs as a result of harmonization. The ORDTC will be based on eligible expenditures that qualify for the federal ITC incurred at a permanent establishment in Ontario and can be carried forward 20 years and carried back three years, to taxation years ending

after 2008. This credit reduces eligible SR&ED expenses for federal purposes and therefore reduces the federal SR&ED ITCs. The credit can be waived (in full or in part), if in your situation it is better to maximize the federal credits and not claim the provincial credit.

Other SR&ED Incentives

In addition to the Ontario incentives discussed above, there are other tax benefits for businesses carrying on SR&ED activities in Ontario and for investors in research companies.

Ontario Innovation Tax Credit (OITC)

The OITC is a refundable tax credit calculated at 10% of eligible SR&ED expenditures incurred in Ontario up to the expenditure limit of \$3 million. (For taxation years ending before February 26, 2008 the limit was \$2 million.) The expenditure limit must be shared by associated corporations. Similar to the expenditure limit for federal ITC purposes, there is a phase-out of the expenditure limit based on the previous year's taxable income and taxable capital of an associated group. The expenditure limit is phased-out where taxable capital exceeds \$25 million and is eliminated where taxable capital reaches \$50 million. For taxation years ending after December 31, 2009, the taxable income phase-out range is \$500,000 to \$800,000 (increased from a phase-out range of \$400,000 to \$700,000).

100% of current SR&ED expenses and 40% of SR&ED capital expenditures qualify for this refundable credit. This credit reduces eligible SR&ED expenses for federal purposes and therefore reduces the federal SR&ED ITCs. A corporation may waive the OITC if it wants to avoid reducing its federal ITCs. The OITC also reduces the ORDTC, as the OITC is considered government assistance.

Ontario Business-Research Institute Tax Credit

This 20% fully refundable tax credit is available for corporations carrying on business through a permanent establishment in Ontario that incur SR&ED expenditures in the province under approved contracts with eligible research institutes (e.g. universities, colleges, hospital research institutes and certain non-profit research organizations). The limit on annual expenditures which qualify for the credit is \$20 million, which applies to an associated group. This credit reduces eligible SR&ED expenses for federal purposes and therefore reduces the federal SR&ED

ITCs. This credit also reduces the ORDTTC, as this credit is considered government assistance.

Extra Credit for Research Oriented Labour-Sponsored Investment Funds

Investments in research oriented labour-sponsored investment funds ("LSIF") carry a 10% Ontario tax credit to a maximum of \$750 for 2011. The federal government will grant its matching credit for these investments up to 15% to a maximum of \$750 per year. Therefore, the combined federal and Ontario non-refundable tax credit for 2011 is 25% on the first \$5,000 of investments and 10% on the next \$2,500 of investments.

A research oriented LSIF is a LSIF that has at least 50% of its capital available for investment in companies whose SR&ED expenses are at least 50% of their total expenses. Note that a fund is authorized for the extra credit on a year-by-year basis.

Note that the credit for LSIF investments is being phased-out. The credit was reduced from 20% (maximum credit of \$2,500 per year) to 15% (maximum credit of \$1,125) for 2010 and, as noted above, to 10% for 2011. No credit will be allowed for 2012 and later years.

How Much Does SR&ED in Ontario Cost You for Taxation Years Ending After 2008?

Table 1 on page 16 illustrates the after-tax cost of paying a \$10,000 salary to an SR&ED employee by a CCPC in Ontario that qualifies for the federal 35% ITC rate, the 4.5% ORDTTC and the 10% OITC. As the numbers indicate, the after-tax cost of the SR&ED salary is only about 23% of the actual expenditure. Regular salary has an after-tax cost of approximately 85% of the expenditure. For capital expenditures, the after-tax cost of the SR&ED equipment at the end of the first taxation year is about 50% of the expenditure compared to about 98% of regular capital expenditures.

The after-tax cost of performing \$10,000 of SR&ED for businesses that do not qualify for the 35% enhanced federal ITC rate, either because they are not CCPCs or their taxable income is too high, as compared with regular current and capital expenditures is also shown in Table 1.

QUÉBEC

Like the federal government, Québec allows a 100% tax deduction for current and capital SR&ED expenditures. Federal SR&ED ITCs are taxable and accounted for in

the Québec SR&ED pool at the same time that they are accounted for at the federal level. However, the amount used as a basis for calculating the various Québec SR&ED tax credits is not affected by the federal ITC.

SR&ED Incentives

17.5%/37.5% Credit for SR&ED Wages (QTC)

Québec offers a refundable tax credit for SR&ED equal to 17.5% of wages paid in Québec. Where the corporation is not controlled by non-residents of Canada, the rate is increased to 37.5% of the first \$3 million of SR&ED wages in Québec. Where the assets of the corporation (and associated corporations) are greater than \$50 million based on prior year financial statements, the enhanced credit is reduced from 37.5% to 17.5% on a straight-line basis, as assets increase from \$50 million to \$75 million.

The 17.5%/37.5% credits are available to corporations which contract to have SR&ED done on their behalf. Where unrelated subcontractors are used, Québec allows the above credit to apply to 50% of the consideration paid to the unrelated subcontractor attributable to SR&ED undertaken by the subcontractor's employees in Québec. Where the subcontractor is related, the amount of the credit is based on the portion of contract remuneration that is attributable to the subcontractor's Québec SR&ED, or would have been so attributable had there been employee salaries.

Québec SR&ED credits are not taxable for Québec purposes. However, they are taxable for federal purposes and reduce the amount on which the federal SR&ED ITC is calculated.

Other Québec SR&ED Incentive Programs:

- ◆ A 35% refundable credit for SR&ED expenses pursuant to University, Public Research Centre or Research Consortium contracts.
- ◆ 35% refundable credit for SR&ED expenses pursuant to Pre-Competitive Research contracts.
- ◆ 35% refundable credit for dues and fees paid to an eligible Research Consortium.

How Much Does SR&ED in Québec Cost You?

Table 2 on page 17 illustrates the after-tax cost of paying a \$10,000 salary to an SR&ED employee by a CCPC in Québec that qualifies for the federal 35% ITC rate and the 37.5% QTC rate. As the numbers indicate, the after-tax cost of the SR&ED salary is only about

11% of the actual expenditure. Regular salary has an after-tax cost of 81% of the expenditure. For capital expenditures, the after-tax cost of the SR&ED equipment at the end of the first taxation year is about 53% of the expenditure compared to about 97% of regular capital expenditures.

The after-tax cost of performing \$10,000 of SR&ED for businesses that qualify for the federal 20% ITC rate and the 17.5% QTC rate, as compared with regular current and capital expenditures is also shown in Table 2.

BRITISH COLUMBIA

British Columbia provides a SR&ED credit of 10% on qualifying SR&ED expenditures incurred in the province by qualifying corporations after August 31, 1999 and before September 1, 2014. The credit was expanded to include qualifying partnership expenditures incurred after February 20, 2007. For partnerships which have qualified corporations as members, the corporations can claim their share of a partnership's SR&ED credit. The corporation's share will be based on their partnership interest (determined as if the partnership were a corporation).

The 10% credit is refundable for CCPCs if the expenditures are within the federal expenditure limit. For expenditures made by CCPCs in excess of the limit or by other corporations, including corporations claiming a partnership credit, a non-refundable credit is available.

Unused non-refundable credits can be carried forward ten years and back three years if they can't be used in the current year. The credit generally reduces eligible SR&ED expenses for federal purposes, and therefore reduces the federal ITCs. The BC SR&ED credit does not reduce the BC eligible expenditures for purposes of calculating the credit. Note that non-refundable credits may be renounced to maximize federal credits, if it is beneficial to do so.

In a taxation year in which a small business tax holiday credit is claimed, the SR&ED credit is not available and cannot be claimed in that taxation year.

BC matches the federal recapture provision where property on which the BC SR&ED credit has been claimed is disposed of, or converted to, commercial use within ten years of acquisition.

How Much Does SR&ED in British Columbia Cost You?

Table 3 on page 18 illustrates the after-tax cost of paying a \$10,000 salary to an SR&ED employee by a CCPC in BC that qualifies for the federal 35% ITC rate

and the BC 10% SR&ED tax credit. As the numbers indicate, the after-tax cost of the SR&ED salary is only about 27% of the actual expenditure. Regular salary has an after-tax cost of approximately 87% of the expenditure. For capital expenditures, the after-tax cost of the SR&ED equipment at the end of the first taxation year is about 51% of the expenditure compared to about 98% of regular capital expenditures.

The after-tax cost of performing \$10,000 of SR&ED for businesses that do not qualify for the 35% enhanced federal ITC rate, either because they are not CCPCs or their taxable income is too high, as compared with regular current and capital expenditures is also shown in Table 3.

ALBERTA

A refundable SR&ED tax credit was introduced in Alberta's 2008 budget. The credit is available to corporations with a permanent establishment in Alberta for expenditures incurred after December 31, 2008 which are eligible for the federal SR&ED ITC. The credit is worth 10% of a company's eligible expenditures up to \$4 million of qualifying SR&ED expenditures in Alberta, for a maximum credit of \$400,000 and will be refundable for all companies. Associated companies must share the \$4 million limit. For a taxation year straddling January 1, 2009, the limit is prorated, subject to special transitional rules. Note that the credit is not available to individuals, trusts, partnerships and partners.

The credit reduces eligible SR&ED expenses for federal purposes and therefore reduces the federal SR&ED ITCs. The Alberta SR&ED credit does not reduce the Alberta eligible expenditures for purposes of calculating the credit. However, the federal SR&ED ITC associated with expenditures in Alberta will reduce the eligible expenditure base used to calculate the Alberta credit in the following year.

How Much Does SR&ED in Alberta Cost You?

Table 4 on page 19 illustrates the after-tax cost of paying a \$10,000 salary to an SR&ED employee by a CCPC in Alberta that qualifies for the federal 35% ITC rate and the Alberta 10% SR&ED tax credit. As the numbers indicate, the after-tax cost of the SR&ED salary is only about 27% of the actual expenditure. Regular salary has an after-tax cost of 86% of the expenditure. For capital expenditures, the after-tax cost of the SR&ED equipment at the end of the first taxation year is about 50% of the expenditure compared to 98% of regular capital expenditures.

The after-tax cost of performing \$10,000 of SR&ED for businesses that do not qualify for the 35% enhanced federal ITC rate, either because they are not CCPCs or their taxable income is too high, as compared with regular current and capital expenditures is also shown in Table 4.

MANITOBA

A 20% SR&ED non-refundable tax credit is available to corporations with a permanent establishment in Manitoba and that incur SR&ED expenditures in that province. The non-refundable credit can be carried forward ten years (seven years for tax years ended before 2004) and back three years if it can't be used in the current year.

The credit reduces eligible SR&ED expenses for federal purposes and therefore reduces the federal SR&ED ITCs. The credit can be renounced if, in your situation, it is better to maximize the federal credits and not claim the provincial credit.

Effective for 2010, the credit is refundable for expenditures incurred by a corporation with a permanent establishment in Manitoba where the SR&ED is carried on in Manitoba under an eligible contract with a qualifying research institute. Refundability of the tax credit will be extended to in-house SR&ED expenditures. Beginning in 2011, one-quarter of the credit for in-house SR&ED expenditures will be refundable and beginning in 2012, one-half of the credit will be refundable.

How Much Does SR&ED in Manitoba Cost You?

Table 5 on page 20 illustrates the after-tax cost of paying a \$10,000 salary to an SR&ED employee by a CCPC in Manitoba that qualifies for the federal 35% ITC rate and the Manitoba 20% SR&ED tax credit. As the numbers indicate, the after-tax cost of the SR&ED salary is only about 19% of the actual expenditure. Regular salary has an after-tax cost of 89% of the expenditure. For capital expenditures, the after-tax cost of the SR&ED equipment at the end of the first taxation year is about 46% of the expenditure compared to 98% of regular capital expenditures.

The after-tax cost of performing \$10,000 of SR&ED for businesses that do not qualify for the 35% enhanced federal ITC rate, either because they are not CCPCs or their taxable income is too high, as compared with regular current and capital expenditures is also shown in Table 5.

NEWFOUNDLAND & LABRADOR

A 15% refundable tax credit is available for corporations with a permanent establishment in Newfoundland & Labrador that incur SR&ED expenditures in that province. The credit generally reduces eligible SR&ED expenses for federal purposes and therefore reduces the federal SR&ED ITCs. Note that the expenditures which qualify for the Newfoundland & Labrador credit are not reduced by the provincial SR&ED credit received.

How Much Does SR&ED in Newfoundland & Labrador Cost You?

Table 6 on page 21 illustrates the after-tax cost of paying a \$10,000 salary to an SR&ED employee by a CCPC in Newfoundland & Labrador that qualifies for the federal 35% ITC rate and the provincial 15% SR&ED tax credit. As the numbers indicate, the after-tax cost of the SR&ED salary is only about 22% of the actual expenditure. Regular salary has an after-tax cost of 85% of the expenditure. For capital expenditures, the after-tax cost of the SR&ED equipment at the end of the first taxation year is about 47% of the expenditure compared to about 98% of regular capital expenditures.

The after-tax cost of performing \$10,000 of SR&ED for businesses that do not qualify for the 35% enhanced federal ITC rate, either because they are not CCPCs or their taxable income is too high, as compared with regular current and capital expenditures is also shown in Table 6.

YUKON

The Yukon provides a 15% fully refundable tax credit for eligible SR&ED expenditures incurred in respect of SR&ED carried on in the Yukon after June 30, 2000 by corporations with a permanent establishment in the Yukon. The credit is similarly available to individuals resident in the Yukon after 2000. An additional 5% credit is added for qualified SR&ED expenditures made to the Yukon College.

The credit reduces eligible SR&ED expenses for federal purposes and therefore reduces the federal SR&ED ITCs. Note that the expenditures which qualify for the Yukon credit are not reduced by the provincial SR&ED credit received.

How Much Does SR&ED in the Yukon Cost You?

Table 7 on page 22 illustrates the after-tax cost of paying a \$10,000 salary to an SR&ED employee by a CCPC in the Yukon that qualifies for the federal 35%

ITC rate and the Yukon 15% SR&ED tax credit. As the numbers indicate, the after-tax cost of the SR&ED salary is only about 22% of the actual expenditure. Regular salary has an after-tax cost of 85% of the expenditure. For capital expenditures, the after-tax cost of the SR&ED equipment at the end of the first taxation year is 47% of the expenditure compared to about 98% of regular capital expenditures.

The after-tax cost of performing \$10,000 of SR&ED for businesses that do not qualify for the 35% enhanced ITC rate, because they are not CCPCs or their taxable income is too high, as compared with regular current and capital expenditures is also shown in Table 7.

SASKATCHEWAN

Saskatchewan provides a 15% SR&ED tax credit to corporations with a permanent establishment in Saskatchewan and that incur SR&ED expenditures in that province. The tax credit is refundable for qualifying expenditures incurred after March 18, 2009. For expenditures made prior to and on that date, the credit is non-refundable.

The non-refundable credit can be carried forward ten years and back three years if it can't be used in the current year. Any unclaimed amounts will still remain available to be claimed in the carryforward/back period after conversion to the refundable credit. The non-refundable credit can be renounced if, in your situation, it is better to maximize the federal credits and not claim the provincial credit.

Both the non-refundable and refundable credits will reduce eligible SR&ED expenses for federal purposes and will therefore reduce the federal SR&ED ITCs. Note that the expenditures which qualify for the Saskatchewan credit are not reduced by the provincial SR&ED credit received.

NEW BRUNSWICK

New Brunswick provides a 15% refundable tax credit for eligible SR&ED expenditures incurred in respect of SR&ED carried on in New Brunswick after December 31, 2002 by corporations with a permanent establishment in New Brunswick. Also effective January 1, 2003, New Brunswick implemented similar rules to those provided federally with respect to the recapture provisions. The credit can be renounced if, in your situation, it is better to maximize the federal

credits and not claim the provincial credit. The credit will reduce eligible SR&ED expenses for federal purposes and will therefore reduce the federal SR&ED ITCs. Note that the expenditures which qualify for the New Brunswick credit are not reduced by the provincial SR&ED credit received.

Prior to January 1, 2003, a non-refundable tax credit of 10% of eligible SR&ED expenditures was provided, which could be carried back three years and forward seven years.

NOVA SCOTIA

A 15% refundable tax credit is available for corporations with a permanent establishment in Nova Scotia and that incur SR&ED expenditures in that province. The credit reduces eligible SR&ED expenses for federal purposes and therefore reduces the federal SR&ED ITCs. Note that the expenditures which qualify for the Nova Scotia credit are not reduced by the provincial SR&ED credit received.

The Nova Scotia credit can be renounced if, in your situation, it is better to maximize the federal credits and not claim the provincial credit. Nova Scotia also provides similar rules to those provided federally with respect to the recapture provisions.

OTHER PROVINCES and TERRITORIES

There are no other special provincial or territorial tax incentives for SR&ED activities.

Summary

Now is the time to look at your activities as they take place and not wait until the end of your taxation year to determine what qualifies. The better your understanding of these programs as you plan and perform your work, the better opportunities there are to identify projects and retain documentation. This makes for much stronger claims.

The tax incentive system for SR&ED activities in Canada is very generous. Don't miss the opportunity to apply for these benefits if you're involved in qualifying activities. Talk to your BDO SR&ED advisor for more information on how you can benefit from the SR&ED tax incentives. For BDO SR&ED group contact information, visit our website at:
<http://www.bdo.ca/services/sred/index.cfm>.

The information in this publication is current as of June 1, 2011.

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APPENDIX:

After-Tax Calculation of SR&ED Expenditures for Selected Provinces

Table 1

After-Tax Cost of Performing SR&ED Activities in Ontario (under Harmonization)				
CCPC qualifying for the 35% federal ITC, 4.5% ORDTC and 10% OITC	Regular expenditure - Salary	SR&ED expenditure - Salary (using proxy method)	Regular expenditure - Capital	SR&ED expenditure - Capital
Expenditure	\$ 10,000	\$ 10,000	\$ 10,000	\$ 10,000
Add proxy @ 65%	n/a	6,500	n/a	n/a
Qualified expenditure for OITC	0	16,500	0	4,000
OITC @ 10%	0	(1,650)	0	(400)
Qualified expenditure for ORDTC	0	14,850	0	9,600
ORDTC @ 4.5%	0	(668)	0	(432)
Qualified expenditure for federal ITC	0	14,182	0	9,168
Federal ITC @ 35%	0	(4,964)	0	(3,209)
Net expenditure	\$ 10,000	\$ 2,718	\$ 10,000	\$ 5,959
Value of tax deduction @ 15.5%	(1,550)	(421)	(233)	(924)
After tax cost of expenditure	\$ 8,450	\$ 2,297	\$ 9,767	\$ 5,035
Corporation qualifying for the 20% federal ITC, 4.5% ORDTC and 10% OITC	Regular expenditure - Salary	SR&ED expenditure - Salary (using proxy method)	Regular expenditure - Capital	SR&ED expenditure - Capital
Expenditure	\$ 10,000	\$ 10,000	\$ 10,000	\$ 10,000
Add proxy @ 65%	n/a	6,500	n/a	n/a
Qualified expenditure for OITC	0	16,500	0	4,000
OITC @ 10%	0	(1,650)	0	(400)
Qualified expenditure for ORDTC	0	14,850	0	9,600
ORDTC @ 4.5%	0	(668)	0	(432)
Qualified expenditure for federal ITC	0	14,182	0	9,168
Federal ITC @ 20%	0	(2,836)	0	(1,834)
Net expenditure	\$ 10,000	\$ 4,846	\$ 10,000	\$ 7,334
Value of tax deduction @ 28%	(2,800)	(1,356)	(420)	(2,054)
After tax cost of expenditure	\$ 7,200	\$ 3,490	\$ 9,580	\$ 5,280

Notes

1. The value of the tax deduction for a capital expenditure is only for the first year, assuming a capital cost allowance rate of 30% for the asset. The remaining undeducted cost of the asset can be deducted in future years. The value of these deductions has not been reflected in this table.
2. This analysis has assumed an Ontario corporate small business tax rate of 4.5% for CCPCs qualifying for the 35% ITC rate.
3. The tax rate used for corporations qualifying for the 20% ITC rate is the top corporate rate at July 1, 2011, assuming an Ontario tax rate of 11.5%. If the company is a manufacturer, the 2011 combined federal and Ontario corporate rate is 26.5%.
4. For purposes of the OITC, qualified expenditures are not reduced by the ORDTC. However, for purposes of the ORDTC, qualified expenditures are reduced by the OITC.

Table 2

After-Tax Cost of Performing SR&ED Activities in Québec				
CCPC qualifying for the 35% federal ITC rate and 37.5% QTC rate	Regular expenditure - Salary	SR&ED expenditure - Salary (using proxy method)	Regular expenditure - Capital	SR&ED expenditure - Capital
Expenditure	\$ 10,000	\$ 10,000	\$ 10,000	\$ 10,000
Add proxy @ 65%	n/a	6,500	n/a	n/a
Qualified expenditure for QTC	0	10,000	0	0
QTC @ 37.5%	0	(3,750)	0	0
Qualified expenditure for federal ITC	0	12,750	0	10,000
Federal ITC @ 35%	0	(4,463)	0	(3,500)
Net expenditure	\$ 10,000	\$ 1,787	\$ 10,000	\$ 6,500
Value of tax deduction @ 19%	(1,900)	(640)	(285)	(1,235)
After-tax cost of expenditure	\$ 8,100	\$ 1,147	\$ 9,715	\$ 5,265
Corporation qualifying for the 20% federal ITC rate and 17.5% QTC rate	Regular expenditure - Salary	SR&ED expenditure - Salary (using proxy method)	Regular expenditure - Capital	SR&ED expenditure - Capital
Expenditure	\$ 10,000	\$ 10,000	\$ 10,000	\$ 10,000
Add proxy @ 65%	n/a	6,500	n/a	n/a
Qualified expenditure for QTC	0	10,000	0	0
QTC @ 17.5%	0	(1,750)	0	0
Qualified expenditure for federal ITC	0	14,750	0	10,000
Federal ITC @ 20%	0	(2,950)	0	(2,000)
Net expenditure	\$ 10,000	\$ 5,300	\$ 10,000	\$ 8,000
Value of tax deduction @ 28.4%	(2,840)	(1,713)	(426)	(2,272)
After-tax cost of expenditure	\$ 7,160	\$ 3,587	\$ 9,574	\$ 5,728
Notes				
1. The value of the tax deduction for a capital expenditure is only for the first year, assuming a capital cost allowance rate of 30% for the asset. The remaining undeducted cost of the asset can be deducted in future years. The value of these deductions has not been reflected in this table.				
2. This analysis has assumed a Québec corporate tax rate of 8% for CCPCs with taxable income of \$500,000 and less qualifying for the 37.5% ITC rate.				
3. The tax rate used for corporations qualifying for the 20% ITC rate is the top corporate rate, assuming a Québec tax rate of 11.9%.				
4. The Québec tax credit (QTC) is not taxable for Québec purposes.				

Table 3

After-Tax Cost of Performing SR&ED Activities in British Columbia (BC)				
CCPC qualifying for the 35% federal ITC and 10% BC credit	Regular expenditure - Salary	SR&ED expenditure - Salary (using proxy method)	Regular expenditure - Capital	SR&ED expenditure - Capital
Expenditure	\$ 10,000	\$ 10,000	\$ 10,000	\$ 10,000
Add proxy @ 65%	n/a	6,500	n/a	n/a
Qualified expenditure for BC credit	0	16,500	0	10,000
BC credit @ 10%	0	(1,650)	0	(1,000)
Qualified expenditure for federal ITC	0	14,850	0	9,000
Federal ITC @ 35%	0	(5,198)	0	(3,150)
Net expenditure	\$ 10,000	\$ 3,152	\$ 10,000	\$ 5,850
Value of tax deduction @ 13.5%	(1,350)	(426)	(203)	(790)
After-tax cost of expenditure	\$ 8,650	\$ 2,726	\$ 9,797	\$ 5,060
Corporation qualifying for the 20% federal ITC and 10% BC credit	Regular expenditure - Salary	SR&ED expenditure - Salary (using proxy method)	Regular expenditure - Capital	SR&ED expenditure - Capital
Expenditure	\$ 10,000	\$ 10,000	\$ 10,000	\$ 10,000
Add proxy @ 65%	n/a	6,500	n/a	n/a
Qualified expenditure for BC credit	0	16,500	0	10,000
BC credit @ 10%	0	(1,650)	0	(1,000)
Qualified expenditure for federal ITC	0	14,850	0	9,000
Federal ITC @ 20%	0	(2,970)	0	(1,800)
Net expenditure	\$ 10,000	\$ 5,380	\$ 10,000	\$ 7,200
Value of tax deduction @ 26.5%	(2,650)	(1,426)	(398)	(1,908)
After-tax cost of expenditure	\$ 7,350	\$ 3,954	\$ 9,602	\$ 5,292

Notes

1. The value of the tax deduction for a capital expenditure is only for the first year, assuming a capital cost allowance rate of 30% for the asset. The remaining undeducted cost of the asset can be deducted in future years. The value of these deductions has not been reflected in this table.
2. This analysis has assumed a BC corporate small business tax rate of 2.5% for CCPCs (BC's rate in effect since December 1, 2008) qualifying for the 35% ITC rate.
3. The tax rate used for corporations qualifying for the 20% ITC rate is the top corporate rate, assuming a BC tax rate of 10% (in effect since January 1, 2011).

Table 4

After-Tax Cost of Performing SR&ED Activities in Alberta				
CCPC qualifying for the 35% federal ITC and 10% Alberta credit	Regular expenditure - Salary	SR&ED expenditure - Salary (using proxy method)	Regular expenditure - Capital	SR&ED expenditure - Capital
Expenditure	\$ 10,000	\$ 10,000	\$ 10,000	\$ 10,000
Add proxy @ 65%	n/a	6,500	n/a	n/a
Qualified expenditure for Alberta credit**	0	16,500	0	10,000
Alberta credit @ 10%	0	(1,650)	0	(1,000)
Qualified expenditure for federal ITC	0	14,850	0	9,000
Federal ITC @ 35%	0	(5,198)	0	(3,150)
Net expenditure	\$ 10,000	\$ 3,152	\$ 10,000	\$ 5,850
Value of tax deduction @ 14%	(1,400)	(441)	(210)	(819)
After-tax cost of expenditure	\$ 8,600	\$ 2,711	\$ 9,790	\$ 5,031
Corporation qualifying for the 20% federal ITC and 10% Alberta credit	Regular expenditure - Salary	SR&ED expenditure - Salary (using proxy method)	Regular expenditure - Capital	SR&ED expenditure - Capital
Expenditure	\$ 10,000	\$ 10,000	\$ 10,000	\$ 10,000
Add proxy @ 65%	n/a	6,500	n/a	n/a
Qualified expenditure for Alberta credit**	0	16,500	0	10,000
Alberta credit @ 10%	0	(1,650)	0	(1,000)
Qualified expenditure for federal ITC	0	14,850	0	9,000
Federal ITC @ 20%	0	(2,970)	0	(1,800)
Net expenditure	\$ 10,000	\$ 5,380	\$ 10,000	\$ 7,200
Value of tax deduction @ 26.5%	(2,650)	(1,426)	(398)	(1,908)
After-tax cost of expenditure	\$ 7,350	\$ 3,954	\$ 9,602	\$ 5,292
Notes				
1. The value of the tax deduction for a capital expenditure is only for the first year, assuming a capital cost allowance rate of 30% for the asset. The remaining undeducted cost of the asset can be deducted in future years. The value of these deductions has not been reflected in this table.				
2. This analysis has assumed an Alberta corporate small business tax rate of 3% for CCPCs qualifying for the 35% ITC rate.				
3. The tax rate used for corporations qualifying for the 20% ITC rate is the top corporate rate, assuming an Alberta tax rate of 10%.				
** For purposes of calculating the Alberta SR&ED tax credit in the following year, the qualified expenditures will be reduced by the federal SR&ED ITC calculated in the chart above.				

Table 5

After-Tax Cost of Performing SR&ED Activities in Manitoba				
CCPC qualifying for the 35% federal ITC and 20% Manitoba credit	Regular expenditure - Salary	SR&ED expenditure - Salary (using proxy method)	Regular expenditure - Capital	SR&ED expenditure - Capital
Expenditure	\$ 10,000	\$ 10,000	\$ 10,000	\$ 10,000
Add proxy @ 65%	n/a	6,500	n/a	n/a
Qualified expenditure for Manitoba credit	0	16,500	0	10,000
Manitoba credit @ 20%	0	(3,300)	0	(2,000)
Qualified expenditure for federal ITC	0	13,200	0	8,000
Federal ITC @ 35%	0	(4,620)	0	(2,800)
Net expenditure	\$ 10,000	\$ 2,080	\$ 10,000	\$ 5,200
Value of tax deduction @ 11%	(1,100)	(229)	(165)	(572)
After-tax cost of expenditure	\$ 8,900	\$ 1,851	\$ 9,835	\$ 4,628
Corporation qualifying for the 20% federal ITC and 20% Manitoba credit	Regular expenditure - Salary	SR&ED expenditure - Salary (using proxy method)	Regular expenditure - Capital	SR&ED expenditure - Capital
Expenditure	\$ 10,000	\$ 10,000	\$ 10,000	\$ 10,000
Add proxy @ 65%	n/a	6,500	n/a	n/a
Qualified expenditure for Manitoba credit	0	16,500	0	10,000
Manitoba credit @ 20%	0	(3,300)	0	(2,000)
Qualified expenditure for federal ITC	0	13,200	0	8,000
Federal ITC @ 20%	0	(2,640)	0	(1,600)
Net expenditure	\$ 10,000	\$ 4,060	\$ 10,000	\$ 6,400
Value of tax deduction @ 28.5%	(2,850)	(1,157)	(428)	(1,824)
After-tax cost of expenditure	\$ 7,150	\$ 2,903	\$ 9,572	\$ 4,576
Notes				
1. The value of the tax deduction for a capital expenditure is only for the first year, assuming a capital cost allowance rate of 30% for the asset. The remaining undeducted cost of the asset can be deducted in future years. The value of these deductions has not been reflected in this table.				
2. This analysis has assumed a Manitoba corporate small business tax rate of 0% for CCPCs (Manitoba's small business tax was eliminated effective December 1, 2010) qualifying for the 35% ITC rate.				
3. The tax rate used for corporations qualifying for the 20% ITC rate is the top corporate rate, assuming a Manitoba tax rate of 12% (in effect since July 1, 2009).				

Table 6

After-Tax Cost of Performing SR&ED Activities in Newfoundland & Labrador (N&L)				
CCPC qualifying for the 35% federal ITC and 15% N&L credit	Regular expenditure - Salary	SR&ED expenditure - Salary (using proxy method)	Regular expenditure - Capital	SR&ED expenditure - Capital
Expenditure	\$ 10,000	\$ 10,000	\$ 10,000	\$ 10,000
Add proxy @ 65%	n/a	6,500	n/a	n/a
Qualified expenditure for N&L credit	0	16,500	0	10,000
N&L credit @ 15%	0	(2,475)	0	(1,500)
Qualified expenditure for federal ITC	0	14,025	0	8,500
Federal ITC @ 35%	0	(4,909)	0	(2,975)
Net expenditure	\$ 10,000	\$ 2,616	\$ 10,000	\$ 5,525
Value of tax deduction @ 15%	(1,500)	(392)	(225)	(829)
After-tax cost of expenditure	\$ 8,500	\$ 2,224	\$ 9,775	\$ 4,696
Corporation qualifying for the 20% federal ITC and 15% N&L credit	Regular expenditure - Salary	SR&ED expenditure - Salary (using proxy method)	Regular expenditure - Capital	SR&ED expenditure - Capital
Expenditure	\$ 10,000	\$ 10,000	\$ 10,000	\$ 10,000
Add proxy @ 65%	n/a	6,500	n/a	n/a
Qualified expenditure for N&L credit	0	16,500	0	10,000
N&L credit @ 15%	0	(2,475)	0	(1,500)
Qualified expenditure for federal ITC	0	14,025	0	8,500
Federal ITC @ 20%	0	(2,805)	0	(1,700)
Net expenditure	\$ 10,000	\$ 4,720	\$ 10,000	\$ 6,800
Value of tax deduction @ 30.5%	(3,050)	(1,440)	(458)	(2,074)
After-tax cost of expenditure	\$ 6,950	\$ 3,280	\$ 9,542	\$ 4,726

Notes

1. The value of the tax deduction for a capital expenditure is only for the first year, assuming a capital cost allowance rate of 30% for the asset. The remaining undeducted cost of the asset can be deducted in future years. The value of these deductions has not been reflected in this table.
2. This analysis has assumed a N&L corporate small business tax rate of 4% for CCPCs (N&L's small business tax rate in effect for fiscal periods beginning on or after April 1, 2010) qualifying for the 35% ITC rate.
3. The tax rate used for corporations qualifying for the 20% ITC rate is the top corporate rate, assuming a N&L tax rate of 14%. If the company is a manufacturer, the combined federal and N&L corporate rate is 21.5% for 2011.

Table 7

After-Tax Cost of Performing SR&ED Activities in the Yukon				
CCPC qualifying for the 35% federal ITC and 15% Yukon credit	Regular expenditure - Salary	SR&ED expenditure - Salary (using proxy method)	Regular expenditure - Capital	SR&ED expenditure - Capital
Expenditure	\$ 10,000	\$ 10,000	\$ 10,000	\$ 10,000
Add proxy @ 65%	n/a	6,500	n/a	n/a
Qualified expenditure for Yukon credit	0	16,500	0	10,000
Yukon credit @ 15%	0	(2,475)	0	(1,500)
Qualified expenditure for federal ITC	0	14,025	0	8,500
Federal ITC @ 35%	0	(4,909)	0	(2,975)
Net expenditure	\$ 10,000	\$ 2,616	\$ 10,000	\$ 5,525
Value of tax deduction @ 15%	(1,500)	(392)	(225)	(829)
After-tax cost of expenditure	\$ 8,500	\$ 2,224	\$ 9,775	\$ 4,696
Corporation qualifying for the 20% federal ITC and 15% Yukon credit	Regular expenditure - Salary	SR&ED expenditure - Salary (using proxy method)	Regular expenditure - Capital	SR&ED expenditure - Capital
Expenditure	\$ 10,000	\$ 10,000	\$ 10,000	\$ 10,000
Add proxy @ 65%	n/a	6,500	n/a	n/a
Qualified expenditure for Yukon credit	0	16,500	0	10,000
Yukon credit @ 15%	0	(2,475)	0	(1,500)
Qualified expenditure for federal ITC	0	14,025	0	8,500
Federal ITC @ 20%	0	(2,805)	0	(1,700)
Net expenditure	\$ 10,000	\$ 4,720	\$ 10,000	\$ 6,800
Value of tax deduction @ 31.5%	(3,150)	(1,487)	(473)	(2,142)
After-tax cost of expenditure	\$ 6,850	\$ 3,233	\$ 9,527	\$ 4,658

Notes

1. The value of the tax deduction for a capital expenditure is only for the first year, assuming a capital cost allowance rate of 30% for the asset. The remaining undeducted cost of the asset can be deducted in future years. The value of these deductions has not been reflected in this table.
2. This analysis has assumed a Yukon corporate small business tax rate of 4% for CCPCs qualifying for the 35% ITC rate. If the company is a manufacturer, the combined tax rate for manufacturing and processing profits eligible for the small business deduction is 13.5%.
3. The tax rate used for corporations qualifying for the 20% ITC rate is the top corporate rate, assuming a Yukon tax rate of 15%. If the company is a manufacturer, the combined federal and Yukon corporate rate is 19% for 2011.