

Innovation in Canada: Preserve and Strengthen the Scientific Research and Experimental Development Tax Incentive Program

Issue

The Scientific Research and Experimental Design credit is vital to the continued growth, diversification, and strength of the Canadian economy. Despite this, the federal government has passed changes to reduce the amounts of this credit available to Canadian innovators.

Background

The federal Scientific Research and Experimental Development (SR&ED) Investment Tax Credit (ITC) was introduced in the 1980s and provides an incentive to Canadian businesses to conduct research and development (R&D) in Canada that will lead to advancements in technological products or processes. The majority of Canada's provinces and territories also provide tax incentives, including Alberta. The Canadian government is to be applauded for supporting SR&ED.¹

"The SR&ED Program provides more than \$3 billion in tax incentives to over 20,000 claimants annually, making it the single largest federal program that supports business research and development in Canada."² The tax credits act as a major stimulate for the economy. According to a 2007 Department of Finance study, for every \$1 in SR&ED tax credits given out, the government receives back a benefit of \$1.11.³ Finance Canada and the Revenue Canada (1997) found that the federal SR&ED credit generates \$1.38 in incremental R&D spending per dollar of foregone tax revenue, and that private sector R&D spending is 32-per-cent higher than it would be in the absence of SR&ED tax incentives. Because the program utilizes tax credits as opposed to subsidies or other expenditures, it provides a simple and effective approach to supporting innovation with minimal distortion to regular functioning of the market.⁴

Despite its success in promoting research and development, and having a net benefit, the SR&ED program has seen a number of changes that has reduced its effectiveness. Recent changes to the SR&ED program have seen the elimination of capital expenditures as an eligible expenditure, reduced the

¹ The Canadian Chamber of Commerce. (2011). *The Scientific Research and Experimental Development (SR&ED) Tax Incentive Program*. Retrieved January 2, 2013 from http://www.chamber.ca/images/uploads/Reports/2011/SR-ED_Program-20110419.pdf

² Evolution of the SR&ED Program – a historical perspective. <http://www.cra-arc.gc.ca/txcrdt/sred-rsde/vltnsrdrprgm-eng.html>

³ Department of Finance Canada and Revenue Canada. (1997). *The Federal System of Income Tax Incentives for Scientific Research and Experimental Development: Evaluation Report*. Retrieved January 2, 2013 from <http://publications.gc.ca/collections/Collection/F32-1-1997E.pdf>

⁴ For example, see Feldstein, M. (1999). *Tax Avoidance and the Deadweight Loss of the Income Tax*. 81(4), Review of Economics and Statistics or Watkins, T. (unknown). *The Impact of an Excise Tax or Subsidy on Price*. San Jose State University Department of Economics Website.

eligible labour, overhead, and contract payments cost. In 2014 the general SR&ED investment tax credit was reduced from 20% to 15% and lease costs could no longer be claimed.⁵

The Canadian economy is struggling as we attempt to manage a fluctuating Canadian dollar, volatile commodity prices, and a generally a shaky and more competitive world economy. As a result, creating growth has become more difficult and less reliable. Adding pressure, countries around the world are seeing the value of supporting R&D. Twelve of the top 24 economies have recently improved their R&D incentives and this global trend is predicted to continue. We believe the Canadian government has a major role in ensuring Canadian businesses keep R&D in Canada and in making Canada a more attractive global destination for innovative businesses. The SR&ED program is critical to supporting innovation, attracting new, and keeping existing R&D activities in Canada, and diversifying the economy. Canada's historic leadership in encouraging innovation is under threat with the global competition for attracting global R&D investments is intensifying.

The government appointed an independent panel to review federal support for R&D. The panel produced recommendations, *Review Panel of Federal Support to Research and Development*, otherwise known as the Jenkins Report.⁶ There are many good recommendations in the Jenkins Report. However, we believe the measures "to streamline and improve the SR&ED tax incentive program" could indeed harm Canada's innovation economy and the high-value jobs and economic growth it provides.

Investing in Research and Development leads business to find innovations, create efficiencies, and develop technological breakthroughs. A robust Scientific Research and Experimental Development tax credit is key to creating a diversified and competitive Canadian economy.

The Alberta Chambers of Commerce recommends the Government of Canada:

1. Maintain the Scientific Research and Experimental Design credit at pre-2012 levels and index with inflation.
2. Identify the Scientific Research and Experimental Design credit as vital to economic growth in Canada and should be altered only with significant accountability to stakeholders and industry, and would require consultation with major industry representatives, including the Canadian Chamber of Commerce, at least 12 months prior to legislative changes taking place.

⁵ Canada Revenue Agency. "Evolution of the SR&ED Program – a historical perspective. <http://www.cra-arc.gc.ca/txcrdt/sred-rsde/vltnsrdprgm-eng.html>

⁶ Jenkins, T., Dahlby, B., Gupta, A., Leroux, M., Naylor, D., Robinson, N. (2011). *Innovation Canada: A Call to Action*. Review of Federal Support to Research and Development – Expert Panel Report. Retrieved January 2, 2013 from http://rd-review.ca/eic/site/033.nsf/eng/h_00287.html