The Canadian SR&ED Tax Credit Program and the Manufacturing Industry

Companies developing new products and technologies face unprecedented challenges, not only from a strong Canadian dollar and high business costs, but from the longer-term impacts of globalization and rapid technological change. They rely heavily on the Canadian government's Scientific Research and Experiment Development (SR&ED) Investment Tax Credit (ITC) programs to help fund their R&D work.

Over the past five years the Canadian manufacturing landscape has changed so drastically that companies who saw the SR&ED tax credits as a valuable, contribution to their R&D are now finding these credits a critical lifeline. For many the SR&ED tax credits are the only way to make R&D viable.

The SR&ED tax credits are refunded at 35% of eligible expenditures for qualifying Canadian Controlled Private Corporations. All other Canadian companies qualify for a 20% credit against taxes payable. Today, too many of the 20% companies are not in a taxable position, and thus receive no immediate benefit from the program. Manufacturing accounts for more than three-quarters of all private sector investment in research and development activity in Canada. Yet the need for improvements to the SR&ED program has only recently made the federal government's radar screen.

In a 2007 consultation with Canadian industry, virtually all industry sectors clearly stated that increased funding, improved administration and refundability for the 20% companies is now essential. Manufacturing companies, the major innovators and drivers of the Canadian economy, need their SR&ED tax credits now to help them survive and retain their place in the new global economy.

However, the program is administered by the Canadian Revenue Agency (CRA). The CRA are trained to recover money, not give it away. Their SR&ED compliance policies have created so many barriers that they can defeat the incentive aspect of the program. These policies lead to unpredictable, inconsistent, unnecessarily intrusive, and impractical auditing practices, resulting in escalating administrative costs. Consequently, many companies have given up in frustration.

The smaller, Canadian Controlled (CCPC) firms are particularly susceptible to these barriers. Their only options are: to hire costly SR&ED consultants; invest in SR&ED-claim management software; or muddle through it themselves. New tools such as the reClaim SR&ED in-a-Box software have been developed in response to this problem; promising to help simplify the complex process and reduce the cost of compliance and consultant fees.

Canadian manufacturers continue to struggle in this increasingly untenable situation with minimal improvements in the SR&ED program. Sherman Lang, of Canada's National Research Council (NRC), stated: "The government is funding a lot of R&D, but there isn't a focused investment strategy for manufacturing. And it's the small companies who are suffering. The high Canadian dollar is certainly going to push some companies over the edge, because the smaller companies really don't have the physical capacity to make that investment."

In response to the government's most recent attempt to improve the effectiveness of the SR&ED program in its 2008 budget, Canadian Manufacturers and Exporter (CME) president, Jay Myers said: “Disadvantage Canada, that’s what this budget represents for Canada’s manufacturing and exporting sectors. We were very specific in what the nation’s most innovative industry needed and we received recycled ideas and pocket change at a critical time when we needed tangible solutions. It’s disappointing”.

The tax credits stimulate the economy, according to a 2007 department of finance study. It concluded that for every $1.00 in SR&ED tax credits given out, the government receives back a benefit of $1.11.

In spite of its flaws, the SR&ED program remains a viable and lucrative way to fund internal innovation in Canadian businesses. Any Canadian business which thinks it qualifies for SR&ED but is not taking advantage of this opportunity should investigate how it can apply for SR&ED benefits.

In conclusion, the Canadian manufacturing industry is in crisis; innovation is a critical part of the solution. An effective SR&ED program may mean the difference between remaining globally competitive or watching manufacturing shrink away. The Canadian Manufacturing Coalition has called on the government to address the manufacturing crisis immediately; it has cited the federal Scientific Research and Experimental Development Tax Credit Program (SR&ED) as one of its immediate priorities.

However, if the 2008 Federal budget is an indicator, the current federal government is not listening; it almost appears as if it has given up on the Canadian manufacturing sector – the engine that drives the Canadian economy. One wonders if it learned anything at all from the US experience of the past ten years.

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