

Improving the Accuracy and Timeliness of the Scientific Research & Experimental Development (SR&ED) Program

The shift of government support away from indirect funding sources (i.e. Scientific Research and Experimental Development investment tax credits) to more direct funding sources may not achieve the government's objective of more effectively supporting research and development and innovation due to inherent inefficiencies in the delivery of funding through government assistance programs.

In the recently announced 2012 Economic Action Plan, the federal government introduced a number of measures geared toward achieving its strategy to support the commercialization of new products, processes and services that create high-value jobs and economic growth. As part of this strategy, the government is seeking to alter the existing funding model to focus a greater proportion of its support of innovation through direct supports. These direct supports include the provision of \$400 million for venture capital activities for private sector investments; \$110 million per year to the National Research Council's Industrial Research Assistance Program (IRAP); as well as funding for new or existing programs including the Industrial Research and Development Internship Program; Business-Led Networks of Centres of Excellence Program; Canadian Innovation Commercialization; and the National Research Council.

As a result of the increases in funding through direct supports, funding provided via the Scientific Research and Experimental Development (SR&ED) program, an indirect source of funding for research and development, has been reduced through a number of measures. These measures include a reduction in the general investment tax credit rate from 20 per cent of eligible expenditures to 15 per cent on January 1, 2014; the elimination of capital expenditures from the base of eligible expenditures on January 1, 2014; a reduction on the prescribed proxy amount from 65 per cent to 60 per cent for calendar 2013 and to 55 per cent for calendar 2014; and the reduction in the eligibility of arm's length contract expenditures from 100 per cent to 80 per cent effective January 1, 2013.

In October 2011, the Jenkins panel provided recommendations on the following questions:

- What federal initiatives are most effective in increasing business R&D and facilitating commercially relevant R&D partnerships?
- Is the current mix and design of tax incentives and direct support for business R&D and business-focused R&D appropriate?
- What, if any, gaps are evident in the current suite of programming, and what might be done to fill the gaps?

Our recommendations should be considered as part of, and in the context of the overall review of the program.

Currently any Canadian Controlled Private Corporation (CCPC) can apply for Scientific Research & Experimental Development (SR&ED) investment tax credits for expenditures such as wages, materials, machinery, equipment, some overhead and SR&ED contracts. The SR&ED tax incentive program is generally very well suited to the needs of industry. The SR&ED program helps companies mitigate financial risks typically associated with technological uncertainties. Yet, despite being an excellent financial incentive tool for CCPCs and a crucial tool in eliminating these financial risks, the SR&ED program falls short in ensuring that claims are processed efficiently and effectively. The program execution and administration by the CRA requires review and refining to increase the timeliness and accuracy of SR&ED claim processing and maximize benefits to Canadian companies' research and development.

In today's fast paced, quick changing and very challenging economy, timely and accurate processing of SR&ED claims on an annual basis, corresponding to corporations' annual fiscal plans is highly critical for small- and medium-sized enterprises (SMEs). Late or poor SR&ED claim processing can have adverse

and irreversible effects on SMEs, affecting CCPC's income, business plans, etc. Therefore, timely and accurate execution of SR&ED claims by the CRA is highly critical to the overall successes of Canada's research and development.

Furthermore, several consecutive annual SR&ED claims by CCPCs may be reviewed at one time in a single year by the CRA. Reduced or denied SR&ED claims from the past two years may dangerously accumulate liability of such claims, and may increase costs of such claims incurred by CCPCs which potentially may hinder current and future business.

Administration of the SR&ED program needs to reward and not hurt businesses as it serves a critical role in fostering and encouraging innovation and growth of Canadian corporations. A review of the program's execution and administration would prove valuable in increasing accountability and transparency, reducing fraudulent claims, and ensuring that businesses benefit from the SR&ED program through an efficient claim review process.

If the CRA developed an approach to SR&ED that mirrored the Canada Border Services Agency's Customs Self Assessment (CSA) program, it could focus its attention on SR&ED claims made by claimants it does not know or deems high risk while expediting the processing of claims and issuance of payment from reputable claimants the CRA knows are legitimate. In short, to mirror the CBSA's CSA program, the CRA could establish a program that:

- Is client focused.
- Requires CCPC's to follow specified policies and procedures in the preparation and submission of its SR&ED claims.
- Allows the CCPC's to be audited and certified by the CRA as known and compliant with the program requirements.
- Employs an Administrative Monetary Penalty System (AMPS) for non-compliance. An AMPS could be implemented by the CRA to secure compliance with a preferential SR&ED claim certification program through the application of monetary penalties. An AMPS would authorize the CRA to assess monetary penalties for non-compliance with a preferential SR&ED claim certification program requirements. Like the CBSA's AMPS regime, the CRA could impose monetary penalties based on the type, frequency, and severity of the infraction. Penalties should be graduated and take the compliance history of the client into consideration.

With regard to the SR&ED program specifically, it is recognized that Canadian businesses find it to be complex and cumbersome from an administrative standpoint, and that the distribution of support of business research and development in Canada is more heavily weighted toward tax-incentives as opposed to direct expenditures relative to other countries. As such, the re-shifting of support to direct supports is viewed as a positive initiative in enabling the government to more effectively support innovative firms and public-private research collaborations.

However, caution must be exercised to ensure the effective deployment of support through direct approach sources. While, the Jenkins report found that the federal government supports numerous programs aimed at promoting business innovation, it also notes that Canadian businesses find it difficult to identify and pursue such programs hence creating inefficiencies.

As well, most government assistance programs typically involve onerous application and reporting requirements. Many programs require the submission of detailed business plans and other supporting documentation. In most cases, government assistance programs are designed to be non-entitlement and discretionary in nature. Therefore, despite meeting the program eligibility and evaluation criteria, the availability of funding is unpredictable and subjectively determined. In addition to this, many programs require on-going reporting requirements and other support for the use of awarded funds.

Careful consideration is required on the part of the government to ensure that newly introduced or re-designed direct funding programs provide for an effective and efficient means of support.

Recommendations

That the federal government:

1. Establish a "SR&ED Claim Certification Program" that CCPC's can voluntarily apply to.
2. Set up a specific department (from within existing structure) to work with CCPCs that are certified to the "SR&ED Claim Certification Program".
3. Set up a preferential and expedited claim and payment process for CCPCs that are certified to the "SR&ED Claim Certification Program", allowing claims to be processed within a guaranteed first three months of CCPCs fiscal year.
4. Establish an Administrative Monetary Penalty System that promotes compliance for CCPCs that are certified to the "SR&ED Claim Certification Program".
5. Ensure SR&ED eligibility and evaluation criteria for federal funding programs are clearly defined and specific to appropriately and effectively establish the intended recipient pool.
6. Ensure all funding programs have clearly defined submission and evaluation protocols to provide for a fair and transparent evaluation process.
7. Ensure all funding programs have pre-screening mechanisms to provide timely guidance to prospective applicants as to the potential for success in the evaluation process.
8. Ensure that only necessary application support is requested of applicants and minimize on-going reporting requirements to reduce the administrative burden associated with the submission process.
9. Ensure programs and funding are available to appropriately address the needs of existing Canadian business as well as those being pursued in identified strategic priority industries.

SUBMITTED BY THE WINDSOR-ESSEX REGIONAL CHAMBER OF COMMERCE AND THE MISSISSAUGA BOARD OF TRADE.

THIS RESOLUTION UPDATES AND REPLACES THE 2011 RESOLUTION "IMPROVING THE ACCURACY AND TIMELINESS OF THE SCIENTIFIC RESEARCH AND EXPERIMENTAL DEVELOPMENT (SR&ED) PROGRAM"

The Taxation Committee reviewed recommendations 1 to 4. The Taxation Committee supports these recommendations. The Taxation Committee defers to the Innovation Committee on the remaining recommendations.

The Innovation Committee supports this resolution.