

Scientific Research & Experimental Development Program (SR&ED)

Financing Innovation

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- What the Scientific Research & Experimental Development program and related tax credits are about
- How your company and your innovation projects may be eligible

Business Improvement Group Inc. (BIG)

Consulting firm specializing in providing innovation tax credit services - Scientific Research and Experimental Development

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Every government program has a **purpose**.

Federal and provincial governments recognize that **innovation is key** to the financial health and competitiveness of Canadian firms.

Innovative firms better compete with imports, penetrate export markets, employ more workers, pay more taxes and have a sustainable future – **good for all Canadians**.

To encourage and reward businesses undertaking research and innovation, governments provide stimulus programs. SR&ED is by far the largest and most generous incentive program for Canadian businesses involved in technical development.

- Scientific Research & Experimental Development program provides federal innovation incentive funding
- Provincial R&D tax credits - substantial but smaller
- Canada Revenue Agency administers **a single claim for both federal and provincial credits, filed with business taxes**
- The combined tax credits are commonly referred to under the single name “SR&ED”.
- **The tax credits are provided to assist with finding the solution, not buying or implementing the solution.**

Technological – the challenge must be scientific or technical in nature. Not marketing or financing, etc.

Technological uncertainty.

How could we?

A known solution is not available.

Technological advancement. There must be learnings, acquired through systematic, documented trials, either positive or negative. Failures are not excluded; you learned.

Technical Capabilities

- You must prove you are **attempting to increase your technical capabilities:**
 - How will you exceed your prior performance?
 - What technical factors limited your ability to achieve your objective?
- The **solution must not be standard industry practice:**
 - The solution required is not in the public domain (a proven engineering practice)
 - The base solution must be altered or extended to suit your application
 - A competitor may have developed the technology, but it may not be standard practice or applicable to your condition or needs

From CRA's Website....

“If your company is developing new or improved products, processes, or materials, this work may qualify for substantial refunds and/or tax credits under the federal government’s Scientific Research and Experimental Development (SR&ED) program. Qualifying companies get money back in the form of **a refund, a reduction of taxes payable, or both.**”

- SR&ED tax credits have been a **part of the Tax Act for 40 years.**
- \$4 billion dollars is distributed annually to **18,000 Canadian companies** through this program.
- **All sectors are eligible. Agriculture and manufacturing sectors are core program participants.** Banks and toll roads collect SR&ED tax credits to offset some of their developmental costs.

- Most firms receive combined fed/prov R&D tax **credits equal to 41.5% of eligible development costs.**
- **No prior approval is needed.** If you conduct eligible R&D you are eligible – submit with your tax return
- **No disclosure** of findings is required
- **No program budget** limitations
- **18 months to claim** after year end. June 30, 2016 is the deadline for December 14 year end (project costs from January 14 – Dec 14)
- Projects can span multiple years

- Few agri-food firms conduct scientific research but many are involved in experimental development.
- Development encompasses, “Work undertaken for the purpose of achieving technological advancement for the purpose of creating new, or improving existing material, devices, products or processes, including incremental improvement thereto.”

- My company has introduced new or improved products.
- My company has changed/upgraded our growing/harvesting/packing/processing/storage processes.
- My company has tried to make our process or products better.
- My company has tried to make our process or products cheaper.
- My company has tried to handle our products more efficiently.
- My company has tried to make our products store better.
- My company has tried to reduce waste/seconds/culls.
- My company has engineers/technicians on staff or contract.
- My company has undertaken projects to improve our environmental impact – noise, water, air, energy.
- My company conducts crop/variety trials.
- My company has changed our packaging systems.

Questions to ask to help identify eligible projects, past or future.

- I wonder how we might
- What technical innovations could I develop to reduce labour hours and costs?
- What equipment improvements would I try to make if it cost less to do the work?
- What technical problem keeps you awake at night? Arriving at the solution may involve SR&ED eligible activity.
- What one-time purchases did we made last year? The answer will identify suppliers of equipment or services required for your innovation projects.

- Develop new fruit packaging materials or equipment
- Develop labour saving pruning, thinning or harvesting systems or equipment
- Trials to determine effectiveness and economics of pre-storage vegetable treatment technologies
- Testing the effectiveness of frost/heat damage prevention technology
- Varietal trials which are beyond those conducted by public research facilities – unique parameters required
- Environmental improvement – waste water efforts
- Improving production efficiencies

- Field testing of disease control strategies
- Conifer nursery, grub control trials and root ball enhancement/survivability testing
- Fertigation methodologies to deal with uneven nutrient distribution (ginseng)
- Packing line efficiency and product quality improvements (potatoes)
- Customized electronic control development for packing line equipment (tender fruit processing)

- **Meat slaughter facility – waste water problems**
 - High volume water user
 - Biological Oxygen Demand load
 - Multi-year tests of different technologies

Ineligible Projects

Only projects that address the three critical criteria will be deemed eligible. That is always the first test.

Testing new or innovative technology in an area larger than required to conduct the trials will not be eligible. If only two acres is needed for the experimentation, only the costs incurred in those two acres will be eligible. The rest of the field is not required to expand technical knowledge.

Buying and employing new technology as purchased is not eligible. For example, bringing in a new packing line, even if the first of its kind in North America is ineligible. Required modifications may be eligible.

- **Salaries, wages and benefits** of personnel performing, supervising or supporting on the project from concept to completion;
 - * You and your staff working on the project *
- **Material consumed** or transformed;
 - * What the team worked with *
- **Contract payments** and third party payments;
 - * Suppliers (in Canada) paid to help you *
- Other incremental costs including allocated **overhead and cost to lease equipment**;
 - * costs that would have been less if you hadn't tried the projects *

Market demand is highest and returns are best for highly coloured peaches. The challenge is how to increase peach colour efficiently.

- 1) Scientific or technical?** Producing peaches is a technical undertaking and enhancing colour will require technical intervention.
- 2) Technical uncertainty?** Producers in other production areas employ foil on the orchard floor to enhance colour through sunlight reflection. Will that approach work under Ontario weather patterns and sunlight intensity? Are there conditions that improve its effectiveness – orchard row orientation? extent and type of foil used? How long does the foil need to be in place to be effective and can it be reused under Ontario conditions?
- 3) Knowledge advancement?** The findings. Answers to the questions above and related learnings.

An example project

The project would involve researching the topic, planning the trials, placing the foil, recording weather and sunlight conditions, measuring colour enhancement vs the control, analysing data and reaching conclusions.

The project could take more than one crop year or business year. Subsequent experimental development could investigate the impact of canopy style and thickness, the impact of various degrees of fruit thinning or lower leaf removal, unintended fruit quality impacts.

If more than one business (farm) was involved, each would submit a claim for their own share of the eligible costs.

Eligible costs:

• personnel - 1 person year	\$50,000
• CRA-mandated proxy to cover overhead – 55% of labour	27,500
• Contracted fruit colour assessment/analysis (80% of 10,000)	8,000
• Scrapped materials	14,500
• Capital – new equipment	not eligible
• Total eligible cost	100,000
• Federal and provincial tax credits at 41.5%	\$41,500

•Eligibility and tax credit rates vary by circumstance and are subject to periodic change. This example is for a Canadian Controlled Private Corporation with taxable income of less than \$400,000.

Reduced Tax Credits

- Canadian-controlled, incorporated businesses (under \$400,000 taxable income) are eligible for the 41.5% credits.
- Unincorporated, foreign-controlled and larger firms are eligible for 15% credits.
- The wages of owners of unincorporated firms are not eligible.
- Unincorporated and foreign-controlled firms do not receive tax credits in the form of refunds. Their credits can only be used to reduce future taxes payable.

Eligible Labour Costs

- The only eligible labour payments to owners of incorporated firms are wages or salary that appear on a T4 slip. Dividends as a form of owner compensation are not accepted as eligible costs.

Once a business has determined that a project will be undertaken, **it is important to document** specific matters:

- The technical challenge
- What you know and what you are hoping to learn
- The names and hours/days that each eligible employee or owner spends on the project
- Any materials purchased and services contracted
- Findings

Recording of project time and expense is often cited as a reason businesses do not pursue SR&ED tax credits. “It is too time demanding.” This need not be the case. While good documentation is required to substantiate a claim, CRA is more lenient for first time claimants. And the **documentation requirements are not that onerous.**

1. Scoping

- Develop listing of all potential projects / assess eligibility
- Group any related improvement activities into projects by technology (if required)

2. Claim Preparation

- Interview project leaders and draft technical reports
- Review costing / validate documentation.

3. Finalize Claim

- Assemble final technical and costing package
- Accountant or BIG files for client
- Archive required support information
- Prepare for CRA review

CRA website: www.cra-arc.gc.ca/sr&ed

OMAFRA factsheet

SR&ED service provider - Look for:

- A team of specialists who can uncover all projects and identify all costs – engineers, scientists, IT and accounting (BIG has 30 professionals)
- A firm with a SR&ED track record (BIG staff have prepared thousands of claims – 99% success rate)
- A firm with positive CRA relations (legitimate claims)
- A firm that appreciates the demands on your time and which employs processes that minimize your time commitment – both in claim preparation and throughout the year

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