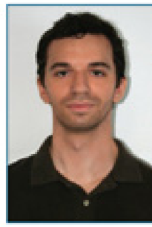
Performing R&D in your Business? SR&ED Changes Coming in 2014



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The Canadian government offers one of the most lucrative research & development (R&D) tax incentives in the world. It is known as the Scientific Research and Experimental Development (SR&ED) program. The SR&ED program has been an integral part of business growth across Canada because the program offers more than $3 billion dollars in tax credits to further R&D initiatives and to keep Canada competitive in the global marketplace.

The tax credits from SR&ED can help businesses gain a competitive edge by making it easier to hire workers, to expand into new markets or to purchase machinery. SR&ED has remained largely unchanged since its inception over 25 years ago. However, every now and then, changes have arisen, with the most recent being those outlined in the 2012 Federal budget. Here are some of the changes that are most relevant to businesses claiming SR&ED-related expenditures:
Contractor Payments Reduced

It is not uncommon for a company carrying out research and development activities to require the help of outside contractors. Currently, up to 100 percent of contractor expenses are eligible for SR&ED tax credits. However, beginning on January 1st, 2014, only 80 percent of outsourcing costs are eligible. The rationale behind the reduction is that arm's length contractors include profit margins into their fees. Mark-up does not contribute to fostering research and development goals and as such, the amount that is claimable will be reduced to reflect this.

General Rate Reduction

At the moment, the enhanced rate, which predominantly applies to Canadian controlled private corporations (CCPCs), is 35 percent. There will be no change in the enhanced rate. However, non-CCPCs will have the general rate reduced from 20 percent to 15 percent. The change will be effective January 1st, 2014. If this date falls in the middle of a business' taxation year, then the rate will be prorated. Furthermore, both of these rates will only apply to the first $3 million in qualifying expenditures.

Removal of Capital Expenditures

As of January 1st, 2014, capital expenditures will no longer be considered eligible SR&ED expenses. The cost of leasing equipment or property will also not be SR&ED eligible in 2014.

Overhead Proxy Rate Reduced

Overhead expenditures related to SR&ED can be claimed by either using the traditional method, which involves the identification of each overhead expenditure directly related to SR&ED activities on an item-by-item basis, or by using the elective proxy method. Through the proxy method, taxpayers in 2013 can claim 60 percent of the total salary and wages of employees directly engaged in SR&ED (65% in 2012). However, this number will be reduced to 55 percent starting in 2014.

Contingency Fees

After the government of Canada concluded its study into the effects of contingency fees for SR&ED, it was found that the effects of contingency fees do not reduce the benefits of the SR&ED program to claimants. That being the case, the government will still require claimants to specify whether or not they are paying a contingency fee as well as the amount that was paid out. A $1,000 penalty will be applied if the claimant does not provide the necessary information. This change will also take effect in January 2014.

With these changes coming at the beginning of next year, there is still time to fully take advantage of the SR&ED program in its current form. Despite the restrictions that these changes create for businesses, the SR&ED program still remains the best way of staying competitive and propelling R&D efforts forward.

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