

April 15, 2024

Director General
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Department of Finance Canada
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Via email: SRED-PB-RSDE-RPB@fin.gc.ca

Re: CME's comments on the Scientific Research and Development (SR&ED) tax incentives

On behalf of Canadian Manufacturers & Exporters (CME) and our member companies from across Canada, we are pleased to provide our comments with you on the federal government's review of the Scientific Research and Development (SR&ED) program.

The manufacturing sector is a key pillar of Canada's economy, playing a crucial role in creating jobs, fostering innovation, and driving economic growth. The nation's 90,000 manufacturers directly generate 10 per cent of Canada's real gross domestic product (GDP), make up one-quarter of its business research and development spending, and account for 60 per cent of the country's outbound goods. Taken together, the sector's direct, indirect and induced impacts amount to 27.5 per cent of Canada's total economic activity. In addition, by employing 1.79 million Canadians and supporting 3.43 million more jobs through supply chain activity and employee spending, the manufacturing industry undoubtedly makes substantial contributions to all communities across Canada.

The review of the SR&ED program is coming at a necessary time, as Canada suffers from a low rate of business R&D spending, which is one of a number of critical factors holding back our ability to grow the economy and create jobs. Reversing this trend could be best accomplished by enhancing and reforming the Scientific Research and Experimental Development Tax Credit Program (SR&ED), one of the main mechanisms through which the federal government supports business R&D.

Improving the accessibility of the SR&ED program will increase economic growth and government revenues. A 2007 report by Finance Canada—[An Evaluation of the Federal Tax Credit for Scientific Research and Experimental Development](#)—stated clearly “that the SR&ED tax credit generates a net economic gain for Canada.” Section 2.1 of the report cites two studies that quantify the economic benefits of the program using the incrementality ratio, which measures the change in R&D spending per dollar of tax revenue foregone by the government due to the tax incentives. A 1997 Finance Canada and Revenue Canada study found an incrementality ratio of 1.38 using a survey approach. Similarly, Klassen, Pitman and

Reed, in a 2004 econometric study of 58 Canadian firms between 1991 and 1997, estimated that one dollar of tax incentives stimulates \$1.30 in R&D.

We support the government's past evaluation of the SR&ED credit that clearly shows that this review should look for ways to increase the SR&ED program envelope to generate a return on the tax credit for our country via direct investment and spillover benefits.

To help develop our recommendations, CME hosted a roundtable discussion with manufacturers to hear their feedback on SR&ED program access, eligibility and financial supports the program provides to improve the claimant experience. Based on this feedback, CME proposes the following recommendations to improve and enhance the SR&ED program:

Recommendation 1: Streamline administration to improve certainty in claims.

A fundamental component of the SR&ED program is that it is meant to act as a mechanism to encourage R&D investment, meaning it is meant to offset business risk. Clearly, business investment in R&D inherently carries uncertainty regarding viable outcomes. However, the outcomes of the SR&ED program should be predictable.

Our members clearly expressed that unclear definitions of eligibility and the SR&ED program's onerous audit process makes it difficult for them to participate. Additionally, they face an unnecessary allocation of internal resources and financial strain due to delays in processing. These delays occur as they prepare for SR&ED reviews and documentation, without any gainful ability to rely on current or future year's claims.

To address these issues, CME would support an alignment of the SR&ED tax credit eligibility definition with the government's existing [Technology Readiness Levels \(TRLs\)](#). By aligning the SR&ED program to TRLs, business would gain certainty in eligibility as well as an understanding of, and access to, other federal government supports. The program would also benefit from codifying definitions and principles related to eligible activities and expenditures. This would be especially beneficial for small manufacturers that often lack the resources to navigate complex regulatory requirements.

Recommendation 2: Expand the list of SR&ED eligible activities to include capital investment.

Before 2014, the SR&ED program provided an accelerated write off and an investment tax credit to support investment in Shared Use Equipment and Capital used (ASA) for SR&ED work. Our members would like to see a reinstatement of capital as an eligible SR&ED expenditure to support their R&D activity.

Notably, the elimination of capital as an eligible expense from the SR&ED program has coincided with a stagnation of member's investment in new and technologically advanced equipment. As has been widely reported, Canada has experienced a prolonged period of weak business capital spending, which is a key reason Canada's manufacturing sector and overall economy is failing to reach its full potential. In fact, the level of business investment in non-residential structures and machinery and equipment to this day remains below its 2014 level. Most critically, low business investment is one of the main culprits behind Canada's lagging labour productivity performance and stagnant living standards.

Recommendation 3: Increase the refundable portion of the tax credit and return the rate to 20 per cent.

Business should not be penalized based on their equity structure. Under the current SR&ED program model, businesses are required to meet identical expenditure, technical, timeline and processing requirements. However, based on their equity structure, they receive vastly different refundability and credit rates. For example, in the past it was commonplace for a business to be self-funded by an individual or group of Canadian private owners, but funding models and economic prosperity have fundamentally changed since the last SR&ED review. Crowd-funding, private equity, and venture capital are now frequently accessed by small business to support innovative industries. We argue that by decreasing the tax credit rate for non-CCPC's, Canada is limiting its economic potential by hindering the growth of Canadian-based R&D businesses and reducing its attractiveness to foreign investors. We recommend expanding the credit rates to allow for alternative ownership structures to help spur foreign investment and accelerate access to capital, thus ultimately boosting our economic growth.

Recommendation 4: Support business scale-up by reducing the SR&ED grind down for growing companies.

Currently, the refundable tax credit expenditure limit is "grinded down" if taxable capital employed in Canada in the previous tax year exceeds \$10 million and is eliminated at \$50 million. This threshold should be eliminated as it reduces the attractiveness of existing businesses to grow and scale and reduces the impetus for large R&D-intensive multi-nationals to locate in Canada. As previously stated, the incrementality ratio of the program is net positive, so expansions made to SR&ED program expenditures will have positive net economic and taxation revenue benefits to industry in Canada.

Recommendation 5: Implement a complementary patent box regime to support the development and retention of intellectual property (IP).

Canada also struggles with relatively low rates of commercialization and intellectual property (IP) generation. To support the development and retention of IP, many countries have adopted patent box regimes that grant preferential tax treatment for income derived from patented inventions. Unfortunately, Canada has yet to follow suit and is therefore not competing on a global scale to attract foreign direct investment.

Indeed, patent boxes are growing in popularity as a tool to provide firms with an incentive to commercialize innovations in the local jurisdiction, which would generate more investment. Only two countries – France and Ireland - had patent box regimes until the early 2000s. But over 20 countries have some form of patent box regime today, including 14 in Europe alone, and other countries are exploring the possibility of introducing one.

Empirical research also supports patent box regimes. For example, a [2017 OECD study](#) found that lower corporate taxes, either in the form of a lower statutory rate or a preferential IP regime (patent box), are associated with more patent applications. In fact, it found that a 5 percentage-point cut in the preferential tax rate on patent income is associated with a 6 per cent increase in patent applications. This is consistent with prior studies that also find a significant influence of corporate taxation on the location of patents, intangible assets, and R&D investment.

Thank you for the opportunity to comment. As representatives of 1.8 million Canadians and 10 per cent of Canada's total economic activity, CME would be pleased to meet with you along with our member companies to provide our support, ideas, and insights as you review the SR&RD program. Please do not hesitate to contact us if we can be of further assistance on this or any other issue.

Sincerely,



Alan Arcand
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