FEDERAL TAX AND NON TAX INCENTIVES MEMORANDUM

Innovation Project

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Abstract

This memo is part of a larger research project that analyzes the extent to which current governmental policies incentivize innovation in Canada. The research focuses on three industries prevalent in Canada: the aeronautics industry, the video game industry, and the film industry. The purpose of this memo is to review the primary incentives offered by the federal government that allegedly encourage innovation within Canada.

This memo will firstly review three federal tax credits incentives: the scientific research and experimental development tax credit, the Canadian film or video production tax credit, and the Canadian film or video production services tax credit.

This memo will then review federal non-tax incentives offered to the video game industry (the Business Innovation and Access Program and the Canadian Media Fund (Experimental Stream)); the film industry (the Micro Budget Production Program from the Canada Feature Film Fund and Canada Council for the Arts Grants) and the aerospace industry (the National Research Council of Canada Industrial Assistance Research Program, the Strategic Aerospace and Defence Initiative Program, and the Technological Demonstration Program).

1. SCIENTIFIC RESEARCH AND EXPERIMENTAL DEVELOPMENT TAX CREDIT

1.1 INTRODUCTION

The Scientific Research and Experimental Development (“SR&ED”) Program is a federal tax incentive program that is designed to encourage Canadian businesses of all sizes and in all sectors to conduct research and development (“R&D”) in Canada. The program gives claimants cash refunds and/or tax credits for their expenditures on eligible research and development work done.

More specifically, the benefit of the SR&ED program can be described as twofold: first, it lets the claimant deduct SR&ED expenditures from their income for tax purposes. Second, it provides the claimant with an SR&ED investment tax credit (“ITC”) that the claimant can use to reduce their income tax payable calculated under Part I of the Income Tax Act (“ITA”), if any. In some cases, the remaining ITC can be refunded.2

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The SR&ED program is the largest single source of federal government support for Canadian industrial R&D. Canada is one of the very few countries in the world to offer an R&D tax credit with this type of “cash refund” benefit.

The federal government has been using the ITA to stimulate research and development activities for many years. As early as 1944, companies could deduct immediately from their taxable income an amount equivalent to 100% of current expenditures related to research and development. The term “SR&ED” was introduced in 1986 as a new title in section 2900 of the ITR to clearly distinguish between eligible development and simply routine engineering and routine development. In 1996, the definition “scientific research and experimental development” was added to s. 248(1) of the ITA, with the meaning assigned by the ITR.

Since 2006 the Government has provided more than $9 billion in new resources to support science, technology and the growth of innovative firms -- bringing support to an all-time high and helping to foster a research and innovation system that supports Canadian business and economic growth. In 2014-2015, the SR&ED program processed 24,302 claims, and provided more than $3.1 billion in tax assistance in support of industrial research and development. Purportedly, 75% of claimants are small businesses.

1.2 OVERVIEW

How SR&ED is calculated:

The ITC laid out in s.127(9) of the ITA is calculated based on the expenditures laid out in s.37(1) of the ITA, according to the following:

“Allowable SR&ED expenditures” are expenditures that can be deducted from the claimant’s business income pursuant to s.37(1) of the ITA.

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1. Federal Tax and Non-Tax Incentives

2. 3. The SR&ED program is the largest single source of federal government support for Canadian industrial R&D. Canada is one of the very few countries in the world to offer an R&D tax credit with this type of “cash refund” benefit.


Expenditures that are deductible under s.37(1) of the ITA are also “qualified expenditures” under s. 127(9) of the ITA and will give rise to ITC’s (with some exceptions). Thus, from allowable SR&ED expenditures the qualified expenditures are calculated.

In calculating qualified expenditures, certain amounts are added to or deducted from the allowable expenditures. From this calculation of qualified expenditures the “SR&ED qualified expenditure pool” is calculated. The pool is used to calculate the ITC.

**How SR&ED is dispersed:**

Most Canadian controlled private corporations (“CCPC”) receive SR&ED benefits as a cash refund, even if the taxpayer has no taxable income or tax payable. Conversely, excessive taxable income and/or taxable capital can greatly reduce SR&ED benefits.10

For large and foreign owned corporations, SR&ED benefits are calculated at a lower rate and are paid out as an ITC which can only be used to reduce taxes payable. The ITC can either be applied immediately to reduce taxes in the current year, carried backwards up to 3 years or carried forward up to 20 years.11

Individuals, un-incorporated businesses and partnerships are also eligible to receive a cash benefit, but at a significantly lower rate than CCPC’s.12

**Roadmap for SR&ED section:**

The federal SR&ED program includes both SR&ED deductions, pursuant to s.37 of the ITA, and SR&ED ITC’s, pursuant to s.127 of the ITA. A claimant of SR&ED also has the option to either pay a third party to conduct SR&ED or contract a third party to perform SR&ED on their (the claimant’s) behalf. This memo will firstly review the SR&ED deductions in general and then specifically for third parties and for SR&ED contracts. This memo will then review SR&ED ITC’s in general and then specifically for third parties and for SR&ED contracts. Aspects of the two incentives overlap and so there will be repetition in this memo. Each incentive of the SR&ED program is complex and so the repetition will hopefully reinforce understanding.

**1.3 SR&ED DEDUCTIONS – GENERAL**

According to the definition of “qualified expenditure” in s.127(9) of the ITA, qualified expenditure means an expenditure incurred in the tax year by the claimant in respect of scientific research and experimental development carried on in Canada and is: an allowable expenditure of a current nature for SR&ED directly undertaken by the claimant; 80% of an expenditure which is

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a contract expenditure for SR&ED performed on behalf of the claimant or a third-party payment; an expenditure for shared-use-equipment (SUE) acquired before 2014; an allowable expenditure of a capital nature acquired before 2014; or a prescribed proxy amount (PPA) of the claimant for the tax year.

s.37(1) of the *ITA* enumerates the qualified expenditures according to the following categories:

1. SR&ED salary and wages;
2. SR&ED materials;
3. contract expenditures for SR&ED performed on behalf of the claimant;
4. lease expenditures;
5. overhead and other expenditures;
6. third party payments;
7. capital expenditures (acquired and available for use before 2014).\(^\text{13}\)

Expenditures of a capital nature or expenditures for the right to use capital property (lease) do not qualify for SR&ED tax incentives if incurred after 2013.\(^\text{14}\)

**a. WHO IS ELIGIBLE**

Any person carrying on SR&ED work in Canada can deduct SR&ED expenditures. This includes corporations, individuals, trusts and partnerships (although, as partnerships are not persons according to the *ITA*, the SR&ED expenditures incurred by the partnership require that the ITC be allocated to each member of the partnership).\(^\text{15}\)

No strict criteria exist to identify who can deduct SR&ED expenses. Instead, there are strict criteria relative to the type of work performed, and whether or not it constitutes “scientific and research and experimental development” such that it qualifies for the SR&ED program. These criteria will be discussed shortly.

**b. ALLOWABLE EXPENDITURES**

In performing SR&ED work (defined below), the following are allowable expenditures:

1. SR&ED salary or wages;
2. Expenditures for materials for SR&ED;
3. Contract Expenditures for SR&ED Performed on Behalf of a Claimant (see section 1.4, “Contract SR&ED Deductions,” below);
4. SR&ED Lease Expenditures, if the expenditure was made before 2014;

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\(^{15}\) Canada Revenue Agency, “SR&ED Claims for Partnerships Policy,” 18 December 2014
5. SR&ED overhead and other expenditures (traditional method only);
6. Third-party payments (see section 1.5, “Third Party SR&ED Deduction,” below);
7. SR&ED capital expenditures, for property acquired and available for use prior to 2014.\textsuperscript{16}

Because SR&ED expenditures must be incurred in the tax year the claimant performed the SR&ED, qualified expenditures are reduced by any expenditure of a current nature incurred for SR&ED that is unpaid within 180 days of the end of the tax year. An addition to qualified expenditures will be made in the year the expenditure is actually paid.\textsuperscript{17}

\textit{Traditional and Proxy Methods}

When calculating SR&ED expenditures, claimants choose between the traditional method and the proxy method.

\textit{Traditional Method}“: The traditional method involves specifically identifying and claiming all overhead and other expenditures, directly attributable to the SR&ED carried on in Canada that the claimant incurred during the year.\textsuperscript{18}

\textit{Proxy Method}”: The proxy method is an alternative method to the traditional method in computing SR&ED expenditures. Specifically, the proxy method involves calculating a substitute amount for SR&ED overhead and other expenditures, called the prescribed proxy amount (PPA).\textsuperscript{19}

\textit{Salary and Wages}

Pursuant to the definition of “salary and wages” found in s.248(1) of the ITA, means the income of a taxpayer from an office or employment as computed under subdivision a of Division B of Part I and includes all fees received for services not rendered in the course of the taxpayer's business but does not include superannuation or pension benefits or retiring allowance. Pursuant to s.37(1.4)-(1.5) of the ITA, SR&ED salary or wage expenditures generally includes any expenditure made in respect of a benefit that would be taxable to the employee under s.6 of the ITA, as well as vacation pay, statutory holiday pay, sick leave pay, pay in lieu of termination notice, bonuses, tips and gratuities, honorariums, director's fees, management fees and commissions. These amounts must be paid to or incurred for the employees in the year.\textsuperscript{20}

Salary or wages do not include amounts in respect of the employer's shares of the related benefits, amounts for extended vacation or sick leave, stock options benefits and retiring allowances. There is also a general rule that applies to exclude unpaid salary or wages.\(^2\)

**SR&ED Materials**

“Materials for SR&ED” does not refer to materials in general sense of the word.

Pursuant to s.37(8)(a)(ii)(B)(V) of the *ITA* and s. 2900(2)(a) of the *ITR*, the cost of materials for SR&ED can be claimed in two situations:

1. when materials are consumed in the prosecution of SR&ED, or
2. when materials are transformed in the prosecution of SR&ED.\(^2\)

The cost of materials consumed or transformed in the prosecution of SR&ED in Canada is an SR&ED expenditure under both the traditional method and the proxy method for determining SR&ED expenditures. To claim the cost of a material, the expenditure must be an expenditure of a current nature. Generally, expenditures such as for the purchase of equipment, data, or a software license, are not expenditures of a current nature. They are rather expenditures of a capital nature.\(^2\)

SR&ED material expenditures can result in an ITC as long as the amount in respect of the expenditure is paid in the tax year or within 180 days after the tax year, as mentioned above. Material can be purchased from Canadian or foreign suppliers and its cost can be claimed as a material consumed / transformed expenditure when the material is used directly in the prosecution of SR&ED in Canada.\(^2\)

**SR&ED Lease Expenditures, if the Expenditure was made before 2014**

As will be discussed more fully in section 1.6 “SR&ED ITC’s – General” (*recent changes*), below, after December 31, 2013, lease expenditures no longer qualify for the SR&ED program. Prior to 2014, and pursuant to s.37(8)(a)(ii)(A)-(B) of the *ITA*, lease expenditures for equipment that may be claimed for SR&ED differ according to whether the claimant uses the traditional or proxy method and to the extent the equipment was used in the prosecution of SR&ED carried on in Canada. Furthermore, the SR&ED usage of the equipment is determined as a percentage of the total operating time.\(^2\)

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Under the traditional method, lease expenditures that are either all or substantially all attributable or directly attributable to the prosecution of SR&ED carried on in Canada may be included in the pool of deductible SR&ED expenditures.26

**Overhead and Other Expenditures**

Within the context of the SR&ED program, the term “overhead and other expenditures” is often used to refer to certain expenditures of a current nature that may be directly attributable to the prosecution of SR&ED in Canada, pursuant to s. 2900(2)(c) of the ITA, or directly attributable to the provision of premises, facilities or equipment for the prosecution of SR&ED in Canada pursuant to s.2900(3) of the ITR. Pursuant to s.37(8)(a)(ii)(A)(II) of the ITA, overhead and other expenditures, for SR&ED purposes, consist of these directly attributable expenditures.27

It is important to not confuse SR&ED overhead expenditures with the term “overhead expenses”, which is commonly used under the generally accepted accounting principles in Canada. The accounting rules generally refer to overhead as an indirect cost. However, an indirect cost for accounting purposes may not be an allowable expenditure for the purposes of the SR&ED program.28

SR&ED overhead and other expenditures can only be claimed under the traditional method when calculating SR&ED expenditures. When a claimant elects to use the proxy method to calculate SR&ED expenditures, overhead and other expenditures are not included in the pool of deductible SR&ED expenditures or in the calculation of qualified SR&ED ITC purposes. Instead, the proxy method involves calculating a notional amount for overhead and other expenditures called the prescribed proxy amount (PPA). The PPA is not included in the pool of deductible SR&ED expenditures, and it cannot be deducted when calculating income for tax purposes. However, an ITC is earned on the PPA since it forms part of the qualified SR&ED expenditures, as mentioned above.29

**SR&ED Capital Expenditures, for Property Acquired and Available for use prior to 2014.**

As will be discussed more fully in section 1.6 “SR&ED ITC’s – General,” (recent changes), below, after December 31, 2013, capital expenditures no longer qualify for the SR&ED program. Prior to 2014, and pursuant to (the now repealed) s.37(1)(b) of the ITA, claimants who carried on a business in Canada in a tax year could, in calculating income from the business for the year, deduct capital expenditures for the prosecution of SR&ED carried on in Canada that relates to a business of the claimant. Capital expenditures made before 2014 for the prosecution of SR&ED carried on in Canada were only those expenditures that result in the acquisition of property that would be the claimant's depreciable property, other than a building or a leasehold interest in a

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building. Expenditures for non-depreciable property such as the acquisition of land, property that is described in a claimant's inventory, or eligible capital property (such as goodwill) could not be included in the pool of deductible SR&ED expenditures as an SR&ED capital expenditure.\textsuperscript{30}

Expenditures on capital property made before 2014 that was intended to be used during all or substantially all (ASA) of its operating time in the prosecution of SR&ED carried on in Canada, or ASA of its value would be consumed in the prosecution of SR&ED carried on in Canada, could qualify as SR&ED capital expenditures.\textsuperscript{31}

\textit{Shared Use Equipment}

Expenditures for capital property made before 2014 that do not meet the ASA criteria do not qualify as an SR&ED capital expenditure. However, where claimants perform SR&ED in an environment where their capital property is used for both SR&ED and commercial work, their capital property may qualify as shared-use-equipment (SUE) and be included in qualified SR&ED expenditures. An expenditure on capital property that is used primarily during its operating time in SR&ED may meet the requirements of SUE.\textsuperscript{32}

\textit{SR&ED Contract Expenditures and Third Party Payments}

The remaining expenditures from the “enumerated” expenditures found in s.37(1) of the \textit{ITA}, i.e., SR&ED contracts and third party payments, will be discussed in greater detail below. This memo will no longer discuss the 5 enumerated expenditures briefly introduced, above. The reason for this decision is that the focus of this memo is to review the ways in which federal tax and non-tax incentives encourage innovation. That is, SR&ED contract expenditures and third party payments involve parties, other than the claimant, who rely on the SR&ED program. Therefore, it is necessary to look at these expenditures in greater detail.

c. \textbf{REQUIREMENTS AND LIMITATIONS}

To qualify for the SR&ED program, the work must meet the definition of “scientific research and experimental development” in s.248(1) of the \textit{ITA}.

“\textit{scientific research and experimental development}” means systematic investigation or search that is carried out in a field of science or technology by means of experiment or analysis and that is:

a. basic research, namely work undertaken for the advancement of scientific knowledge without a specific practical application in view;

b. applied research, namely work undertaken for the advancement of scientific knowledge with a specific practical application in view; or

c. experimental development, namely, work undertaken for the purpose of achieving technological advancement for the purpose of creating new, or improving existing, materials, devices, products or processes, including incremental improvements thereto;

and, in applying this definition in respect of a taxpayer, includes:

d. work undertaken by or on behalf of the taxpayer with respect to engineering, design, operations research, mathematical analysis, computer programming, data collection, testing or psychological research, where the work is commensurate with the needs, and directly in support, of work described in paragraph (a), (b), or (c) that is undertaken in Canada by or on behalf of the taxpayer; the SR&ED work must be undertaken in Canada.

According to paragraphs (f)-(k) of the definition of SR&ED found in s.248(1), the following are ineligible for SR&ED:

e. market research or sales promotion;

f. quality control or routine testing of materials, devices, products or processes;

g. research in the social sciences or the humanities;

h. prospecting, exploring or drilling for, or producing, minerals, petroleum or natural gas;

i. the commercial production of a new or improved material, device or product or the commercial use of a new or improved process;

j. style changes; or

k. routine data collection.33

Support Work

Paragraph (d) of the definition of “scientific research and experimental development” found in s.248(1) refers to “support work”. This type of work may be eligible for SR&ED provided that it:

a. Be directly in support of the basic research, applied research, or experimental development work undertaken in Canada. That is to say, the work was carried out specifically to perform the related basic research, applied research, or experimental development work undertaken in Canada.

b. It must be with respect to one of the eight categories of work listed below:

i. engineering;

ii. design;

iii. operations research;

iv. mathematical analysis;

v. computer programming;

vi. data collection;

vii. testing; or

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psychological research.  

*The Three Central Criteria of SR&ED (Scientific or Technological Advancement; Scientific or Technological Uncertainty; and Scientific or Technological Content) and the Five Questions*

In 1986, the CRA issues Information Circular 86-4 “Scientific Research and Experimental Development,” which described how the term "experimental development and scientific research" could be applied. This document described the essential tests (namely the criteria of scientific or technological advancement, scientific or technological uncertainty, and scientific and technical content) that had to be met before work could be considered SR&ED. The three criteria became a tool on how to apply the term “experimental development,” especially in an industrial context, and became the cornerstone for identifying whether work met the definition of SR&ED in the ITA. Although revisions of Information Circular 86-4 were issued (the latest being IC 86-4R3 in 1994), the three criteria remained intact.

In 1998, Judge Bowman issued a decision in *Northwest Hydraulic Consultants Limited v. The Queen* based on his understanding of the concepts laid out in IC 86-4R3. He created an approach to determine whether the claimed work met the definition of SR&ED, looking at both the relationship between the three criteria and the legislative definition of SR&ED. Bowman J’s approach was affirmed in later jurisprudence; his approach forms the basis of the five questions now used to determine if there is SR&ED:

1. Was there a scientific or a technological uncertainty?
2. Did the effort involve formulating hypotheses specifically aimed at reducing or eliminating that uncertainty?
3. Was the overall approach adopted consistent with a systematic investigation or search, including formulating and testing the hypotheses by means of experiment or analysis?
4. Was the overall approach undertaken for the purpose of achieving a scientific or a technological advancement?
5. Was a record of the hypotheses tested and the results kept as the work progressed?

If the answer to all 5 questions is yes, then SR&ED such as to qualify an entity for the credit.

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There is scientific uncertainty in basic research or applied research. There is technological uncertainty in experimental development. Scientific or technological uncertainty means whether a given result or objective can be achieved (or how to achieve it), is not known or determined on the basis of generally available scientific or technological knowledge or experience.\(^{39}\)

According to the CRA, it is important to recognize that this question relates to more than simply identifying that how to achieve the objectives is unknown. The claimant needs to be able to identify specifically what is lacking in the scientific or technological knowledge base that is creating the uncertainty. This is necessary to formulate an appropriate hypothesis for further investigation. For example, the difference between experimental development work and development work is that the latter is based on the application of the existing scientific or technological knowledge base, such as directly adapting a known engineering or technological practice to a new situation, where there is reasonable certainty of meeting the technological objectives. Under these circumstances, there is no technological uncertainty.\(^{40}\)

In a similar vein, overcoming a technical problem will not lead to a technological advancement, although it may lead to the creation of a new or improved product or process. On the other hand, in the case of a technological uncertainty, the solution or the method of finding the solution to the problem is not known based on the existing scientific or technological knowledge base, and requires experimental development to resolve the problem.\(^{41}\)

Did the effort involve formulating hypotheses specifically aimed at reducing or eliminating that uncertainty? Use the plain meaning of the word “hypothesis.”

Was the overall approach adopted consistent with a systematic investigation or search, including formulating and testing the hypotheses by means of experiment or analysis?

The objectives of the SR&ED work, as well as the indicators and measures to be used to determine if those objectives have been met, must be clearly stated at an early stage in the work’s evolution. In addition, the method of experimentation or analysis by which the scientific or technological uncertainties are to be addressed must be clearly set out. Finally, the results of the SR&ED efforts that follow have to be properly identified. Often, this is an iterative process as new uncertainties are recognized and new or modified hypotheses are developed and tested based on the results of the prior iteration.\(^{42}\)


According to the CRA, the need for a systematic investigation or search does not preclude ideas that result from intuitive processes. These ideas can lead to hypotheses for testing that are part of experimental development. Thus trial and error is an acceptable method.\textsuperscript{43}

*Was the overall approach undertaken for the purpose of achieving a scientific or a technological advancement?*

One implication of advancement is that the new knowledge could be useful to other situations or circumstances beyond the current project in which the advance was made. Accordingly, by showing why a possible solution will not succeed or will not meet the desired objectives, advancement in science or technology is still possible.\textsuperscript{44}

Claimants must be careful as the creation of new, or improvement of existing, materials, devices, products, or processes can be achieved without technological advancement. Also, novelty, innovation, uniqueness, feature enhancement, or increased functionality alone does not represent or establish technological advancement. Instead, it is how these attributes or features arise (that is, whether or not they arise through technological advancement) that is important.\textsuperscript{45}

*Was a record of the hypotheses tested and the results kept as the work progressed?*

It is expected that the work be recorded, clearly showing why each major element is required and how each fits into the project as a whole. It is also expected that the indicators or measures that will be used to determine if the goals of the work are met will be identified and recorded at an early stage of the work. According to the CRA, it is important to note that this question pertains only to records that are naturally produced during the performance of SR&ED and simply expresses that a systematic investigation generally cannot be carried out without recording the work as it progresses. It is not suggestive of the types of information to support an SR&ED claim.\textsuperscript{46}

Ultimately, these questions follow the progression of SR&ED work from identifying the uncertainty, through carrying out the work for its resolution, to the resulting advancement. They are also interrelated, with question 1 and question 4 looking at why the work was done and questions 2, 3, and 5 looking at how the work was done. Because of the relationships between the questions, the five questions should be considered jointly across the entire body of work being evaluated.\textsuperscript{47}


\textsuperscript{44} Canada Revenue Agency, “Eligibility for Work for SR&ED Investment Tax Credits Policy,” April 24 2015, http://www.cra-arc.gc.ca/txcrdt/sred-srse/clmng/lgbltywrkfrsrdnvstmnttxcrdts-eng.html#s2_1


Furthermore, in answering the questions, the scientific or technological knowledge base and the business environment of the individual company should also be considered. Business environment characteristics include business size, competition, area of industry, and access to technical resources.\(^{48}\)

### Filing Due Dates

Pursuant to s.37(11) of the *ITA*, claimants generally must file their SR&ED expenditure and SR&ED ITC forms within 12 months after their filing due date, which is dependent on the type of taxpayer:

<table>
<thead>
<tr>
<th>Claimant (taxpayer)</th>
<th>Return</th>
<th>Filing due date of return</th>
<th>SR&amp;ED reporting deadline</th>
</tr>
</thead>
<tbody>
<tr>
<td>For individuals who have a business</td>
<td>T1, <em>Income Tax and Benefit Return</em></td>
<td>June 15 of the following year</td>
<td>17 ½ months after the calendar year end</td>
</tr>
<tr>
<td>Corporations</td>
<td>T2, <em>Corporation Income Tax Return</em></td>
<td>no later than 6 months after the tax year end</td>
<td>18 months after the tax year end</td>
</tr>
<tr>
<td>Non-Profit SR&amp;ED Corporations</td>
<td>T2, <em>Corporation Income Tax Return</em></td>
<td>no later than 6 months after the tax year end</td>
<td>6 months after the tax year end</td>
</tr>
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<td>T3, <em>Trust Income Tax and Information Return</em></td>
<td>no later than 90 days after the trust's tax year end</td>
<td>15 months after the tax year end(^{49})</td>
</tr>
</tbody>
</table>

### Duration of SR&ED Work

The duration of an SR&ED project is not a factor in determining whether the work performed meets the definition of SR&ED. Some projects are short—carried out fully within the tax year—while other projects extend over several tax years. The SR&ED project is complete when either the advancement has been achieved and the associated uncertainty resolved or when it is determined that the uncertainty cannot be resolved. Commercialization or certification might not necessarily mean that the SR&ED project is complete. Neither financial indicators (such as first sale) nor issuing warranties alone are enough to mark the end of an SR&ED project.\(^{50}\)

### Prescribed Expenditures

Pursuant to section 2902 of the *ITR*, the following constitute prescribed expenditures; they are neither eligible as a SR&ED deduction or a SR&ED ITC:


1. a legal or accounting fee;
2. interest and other financing costs described in any of paragraphs 20(1)(c) to (g) of the
   ITA;
3. an entertainment expense;
4. an advertising or selling expense;
5. a conference or convention expense;
6. a due or fee for membership in a scientific or technical society or organization; and
7. a fine or penalty.\(^{51}\)

**d. REFUNDABILITY**

The ITC is earned at the basic rate of 15% for tax years that end after 2013 and 20% for tax years
that end before 2014. In some cases, CCPC’s earn ITC at an enhanced rate of 35%.\(^{52}\) Refer to
section 1.6 “SR&ED ITC’s – General,” below.

As mentioned above, SR&ED qualified expenditures earned by a claimant carrying on SR&ED
work in Canada are accumulated in a “pool” of deductible SR&ED expenditures, from which the
ITC is calculated.

*Pool of SR&ED Expenditures*

The pool concept allows a claimant the option of deducting the entire amount of SR&ED
expenditures available for the year or any portion thereof after certain adjustments. Any
unclaimed balance may be carried forward to be claimed (deducted in calculating the claimant's
income from business) in future years.\(^{53}\)

Generally, the pool of deductible SR&ED expenditures is increased by any of the following: the
7 expenditures enumerated above (“qualified expenditures”), the amount of expenditures of a
capital nature incurred on SR&ED carried on in Canada for capital acquired prior to 2014;
amounts that have been included in income in a previous tax year under paragraph 12(1)(v) of
the ITA; the pool of deductible SR&ED expenditures transferred on an amalgamation or wind-
up; the amount of SR&ED ITC recaptured the prior year.\(^{54}\)

Generally, the pool of deductible SR&ED expenditures is decreased by any of the following: the
amount of government assistance or non-government assistance that the claimant has received, is
entitled to receive, or can reasonably be expected to receive, for SR&ED expenditures included
in the pool; a "super-allowance benefit amount" for the year or for preceding taxation years in

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\(^{51}\) Canada Revenue Agency, “Total Qualified SR&ED Expenditures for Investment Tax Credit Purposes Policy,” 18 December 2014

arc.gc.ca/txcrdt/sred-rsde/clmng/srdnvstnstrctxcrdt-eng.html

\(^{53}\) Canada Revenue Agency, “Pool of Deductible SR&ED Expenditures Policy,” 18 December 2014,

\(^{54}\) Canada Revenue Agency, “Pool of Deductible SR&ED Expenditures Policy,” 18 December 2014,
respects of a province; SR&ED ITC’s applied or refunded in previous years; amounts deducted from the pool of deductible SR&ED expenditures in previous years; amounts the claimant has deducted with respect to insolvency in preceding years, to the extent these amounts did not exceed the balance of the pool of deductible SR&ED expenditures in the year in which the amount was claimed.\(^{55}\)

**No Deduction for Expenditures Made to Acquire Rights in, or Arising out of SR&ED**

SR&ED tax credits are granted to Canadian companies that bring their technology base to a higher level through work, which meets the requirements of SR&ED. If a company's technology base is raised by acquiring third-party know-how, then the expenditure related to this purchase is not allowable for SR&ED purposes. The underlying reasons for not allowing expenditures involving the acquisition of rights in, or arising out of SR&ED to be included in the pool of deductible SR&ED expenditures is twofold:

1. Only one claimant should receive SR&ED tax incentives on the SR&ED work. Since the performer is entitled to the SR&ED tax incentive, allowing the incentive to the purchaser of the rights would effectively result in duplication.
2. The aim of the SR&ED tax incentive is to encourage research and development in Canada. If the SR&ED, from which the rights resulted, was performed outside Canada, allowing the SR&ED tax incentive to the purchaser of the rights would be contrary to this goal.\(^{56}\)

Section 2902(c) of the *ITR*, which denies the acquisition of rights for SR&ED deductions and ITC also denies expenditures made by a claimant to purchase or to entitle the claimant to use the results of an SR&ED program in which the claimant did not participate. Such expenditures would include a royalty or other similar payments for products or processes that have use beyond the SR&ED stage, for example in marketing or sales. The restriction also applies in cases where intellectual property is acquired from a foreign source.\(^{57}\)

**Deduction Claimed in the Year**

In determining income for tax purposes for a particular year, a claimant cannot deduct an amount that is greater than the available balance in the pool of deductible SR&ED expenditures at the end of the tax year. A claimant can deduct all or a portion of their pool of deductible SR&ED expenditures, or they can accumulate their SR&ED expenditures and carry them forward to deduct them in future years; the choice is up to the claimant.\(^{58}\)


**Carry Forward**

A positive balance in the pool of deductible SR&ED expenditures does not expire. It may be carried forward indefinitely and deducted in a subsequent tax year against any business income. The CRA treats the pool of deductible SR&ED expenditures as a running balance; only the total balance carried forward is identified. The year to which each expenditure amount relates is not recorded or tracked. Since amounts in the pool can be carried forward indefinitely, it is not necessary to know the year to which an expenditure relates. For more information, and information on carry back rules, see section 1.6 “SR&ED ITC’s – General,” below.

**e. STATISTICS – GENERAL**

Canada's gross domestic expenditures on research and development (GERD) are expected to decline for a third consecutive year, down 0.7% from 2014 to $31.6 billion in 2015. There are six GERD performing sectors in Canada: business enterprises, private non-profit, higher education, federal government, provincial governments and provincial research organizations.

In 2015, all performing sectors anticipate declines in research and development (R&D) spending, except for the higher education and federal government sectors, which expect to increase their R&D expenditures. The business enterprise sector is forecast to spend $15.5 billion on R&D, down 2.6% from the previous year. This sector has historically been the largest performing sector of GERD. Although the sector is expected to account for 48.9% of GERD in 2015, it has recorded annual declines in R&D expenditures in recent years.

The higher education sector—the second largest GERD performing sector—anticipates spending $13.0 billion in R&D, up 1.0% from 2014. In 2015, this sector is expected to account for 41.1% of GERD among performing sectors (higher education defined below).

Overall, the business enterprise and higher education sectors are expected to perform 90.0% of R&D expenditures in 2015. The federal government sector expects to increase its R&D spending by 3.0% to $2.7 billion.

The business enterprise sector is expected to decrease its R&D funding by 2.8% from 2014 to $14.0 billion in 2015. Despite the decrease in funding, the sector remains the largest funder of R&D in Canada, accounting for 44.4% of total R&D funding.

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The next largest funding sectors, higher education and federal government, are anticipated to represent 20.2% and 19.6% of total R&D funding in 2015 respectively. The higher education sector is expected to increase R&D funding by 1.0% to $6.4 billion, while the federal government sector anticipates an increase of 1.8% to $6.2 billion.⁶⁴

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## f. STATUTORY SOURCES

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**Income Tax Regulations**

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<th>Description</th>
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<tr>
<td>Section 8201</td>
<td>Definition of &quot;permanent establishment&quot;</td>
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</tbody>
</table>

### 1.4 CONTRACT SR&ED DEDUCTIONS

As mentioned in the “SR&ED Deductions – General” section, above, allowable expenditures consist of SR&ED salary and wages; materials; contract expenditures for SR&ED performed on
behalf of the claimant; lease expenditures; overhead and other expenditures; third party payments; capital expenditures (capital acquired and available for use before 2014).  

To put it another way, pursuant to s.127(9) of the ITA (definition of “qualified expenditure”) claimants may either perform SR&ED themselves, have someone else do SR&ED on their behalf, or make payments to certain entities (such as approved entities, universities, or not-for-profit SR&ED corporations) to be used for SR&ED. The first option was covered under the “SR&ED Deductions – General” section, above; the second option consists of contract expenditures, which will now be explained; the third option consists of third party payments, which will be discussed in the following section.

a. WHO IS ELIGIBLE

Claimants

Pursuant to s. 37(1)(a)(i.01) of the ITA, Claimants who contract with an arm’s length party to have SR&ED performed on their behalf may deduct the contract as a SR&ED expenditure.

Special rules apply when non arm’s length (“NAL”) performers enter into a SR&ED contract. For SR&ED purposes, NAL is defined pursuant to s.251 of the ITA. Generally, where the claimant enters into a SR&ED contract with a NAL performer to perform SR&ED on their behalf, the claimant's can deduct the SR&ED contract expenditures, but these expenditures do not qualify for SR&ED investment tax credit (ITC) purposes (see more in section 1.7 “Contract SR&ED ITC’s, below).

Arm’s Length Performers

An arm’s length performer who has been contracted to perform SR&ED may claim the contract as a SR&ED expenditure if the performer is carrying out basic research, applied research, or experimental development work within the meaning of SR&ED as defined in s. 248(1) of the ITA.

Non Arm’s Length Performers

Pursuant to s.251 of the ITA, special rules apply when NAL performers enter into a SR&ED contract. The claimant may claim the expenditures in respect of the SR&ED contract, but these expenditures will not be eligible for the ITC. The NAL performer is the party who can claim SR&ED expenditures that are also eligible for the NAL performer’s ITC. Even though both performer and claimant may deduct their SR&ED expenditures, only the performer is permitted

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to claim SR&ED ITC’s, as this ensures ITC’s are only claimed on actual SR&ED costs incurred and not on any profit margin earned on the payment.\textsuperscript{70}

b. ALLOWABLE EXPENDITURES FOR CLAIMANT

For the claimant, the amount payable under the SR&ED contract is an allowable SR&ED expenditure (s.37(1)(a)(i.01) of the \textit{ITA}).\textsuperscript{71}

\textit{Contracts for SR&ED Work Carried on Outside of Canada:}

Where an entire contract relates to SR&ED work carried on outside Canada, technically no portion of the contract amount is allowed as an SR&ED expenditure in Canada. However, the claimant will be able to deduct from their business income the SR&ED contract as an expenditure for SR&ED work performed outside Canada under s. 37(2) of the \textit{ITA}

Where SR&ED work is carried on partially in Canada and partially outside Canada under the same contract, the claimant must allocate the contract amount between the SR&ED carried on in Canada and the SR&ED carried on outside Canada. So long as the allocation is reasonable, the CRA will not look-through the contract to identify the type of expenditures the performer incurred when the CRA is determining the allowable and qualified SR&ED expenditures of the claimant.\textsuperscript{72}

\textit{Mixed Contracts:}

The claimant may contract with an arm’s length party in a contract which includes SR&ED and non SR&ED work for a final price. Pursuant to s.37(1)(a)(i.01) of the \textit{ITA}, the claimant may deduct the SR&ED from its business income the amount that relates to SR&ED work performed under the contract by a taxable supplier to the extent that the SR&ED is related to a business of the payer and is performed in Canada in the tax year. This amount is also a qualified expenditure and eligible for ITC.\textsuperscript{73}

\textquotedblleft Taxable supplier	extquotedblright: a person resident in Canada; a Canadian partnership; or a non-resident person or non-Canadian partnership that carries on a business through a permanent establishment in Canada.\textsuperscript{74}

The portion of the contract amount that relates to non-SR&ED work is not allowed as an SR&ED expenditure and does not earn any ITCs.\textsuperscript{75}

**Support Work:**

Claimants who contract out only support work to an arm’s length party may claim the amount of a contract as an SR&ED expenditure under s.37(1)(a)(i.01) of the *ITA*. The SR&ED support work must be commensurate with the needs and directly in support of the basic research, applied research, or experimental development work performed on behalf of the payer.\textsuperscript{76}

> “Commensurate with the needs”: within the context of SR&ED, work that is commensurate with the needs must be corresponding in the amount, size, extent, or duration that is necessary to carry out basic research, applied research, or experimental development.\textsuperscript{77}

If these requirements have been met, a claimant may claim SR&ED support work done by a performer regardless of the choice of traditional or proxy method.\textsuperscript{78}

The costs for work that is not described in paragraph (d) of the definition of SR&ED in s.248(1) of the *ITA* are not allowable contract expenditures for SR&ED, but may still be deducted as allowable expenditures as overhead and other expenditures under the traditional method.\textsuperscript{79}

**Prepayments:**

A payment associated with any SR&ED work contracted but not performed is considered a prepaid expense. The *ITA* provision for prepaid expenses (s. 18(9)) treats the expenditure as not being made or the expense as not being incurred in the year (and therefore not deductible in the tax year). SR&ED contract expenditures are also subject to the unpaid amount rules, pursuant to s.127(26) of the *ITA*.\textsuperscript{80}

\begin{flushright}
\textbf{c. ALLOWABLE EXPENDITURES FOR PERFORMER}
\end{flushright}

Generally the arm’s length performer may claim their SR&ED expenditures. To prevent duplication of ITCs between a Canadian payer and a performer, the Canadian party that performs


the SR&ED work under the contract will be required to reduce the amount of its SR&ED expenditures for ITC purposes by payments received under the contract.\textsuperscript{81} (See section 1.7 “Contract SR&ED ITC’s,” below)

\textit{Support Work}

An arm’s length performer may not claim the contract amount if the SR&ED contract for which they have been contracted only involves carrying out work identified as support work only, because the support work is not SR&ED.\textsuperscript{82}

An exception to the rule that performers may not claim support work as a SR&ED expenditure arises in the case of a non-arm’s length (NAL) performer – s.37(13) of the ITA deems the support work of a NAL performer to be SR&ED provided that the support work would be SR&ED if it were performed directly by the payer.\textsuperscript{83}

d. REQUIREMENTS OF THE DEDUCTION

Claimants can claim contract expenditures for SR&ED when they award a contract to a contractor to perform SR&ED work on their behalf. The onus is on the claimant to show that the SR&ED work performed by the performer was carried out in Canada and was related to their (the claimant’s) business. It generally does not matter where the performer carries out the SR&ED work; it could take place at the claimant’s location, the performer’s location or elsewhere, but it must be carried out in Canada and must be related to the claimant’s business.\textsuperscript{84}

The contract expenditures for SR&ED work performed on behalf of the claimant are generally treated in the same manner under the traditional method and proxy method.\textsuperscript{85}

The key element is whether the payer requested the performer to carry out SR&ED on its behalf. In making this determination, the performance requirements under the contract will be examined by the CRA. That is, the nature of the contract and not the type of expenditures incurred by the

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\end{footnotesize}
performer is the deciding factor in determining whether the contract amount represents an allowable SR&ED expenditure of the claimant.\textsuperscript{86}

The CRA may be satisfied that SR&ED work was carried out if the contract requires that the performer research, design, develop, integrate, test, verify performance, etc., or contain specifications that the performer has to comply with when performing the tasks that resulted in the SR&ED.\textsuperscript{87}

Although an important element, the fact that SR&ED was required to be performed under the contract will not automatically make the amount of the contract an SR&ED expenditure for the performer. As mentioned, the most important element is whether the SR&ED work was done on behalf of the claimant.

When SR&ED carried out in Canada is undertaken “on behalf of” a claimant, this normally refers to a situation where the SR&ED work is contracted out to another party under circumstances where the claimant typically maintains ownership of the SR&ED work performed.\textsuperscript{88}

The following are three predominant (although not exhaustive) aspects the CRA may consider to determine if SR&ED work was carried out on behalf of the claimant:

I. \textit{Ownership of Intellectual Property}

If the resulting intellectual property belongs to the claimant, it is an indication that the work is being carried out on behalf of the payer.\textsuperscript{89}

In order for the intellectual property to qualify as intellectual property belonging to the claimant for SR&ED deduction purposes, the SR&ED information provided to the claimant by the performer must be usable by the claimant as they desire. That is, if the right to use the intellectual property is conditional, the CRA will not consider the SR&ED as carried out on behalf of the claimant. Or, for example, if the SR&ED work results in the delivery of a component to the claimant, this will not necessarily indicate a transfer of intellectual property.\textsuperscript{90}

Note: contractual practices in the specific industry can also help in determining ownership of the intellectual property.91

There are two particular situations requiring clarification with respect to the IP criteria:

1. For contracts with the Crown, it is Treasury Board of Canada Secretariat policy* that IP developed by a performer during the course of a crown procurement contract stay with the contractor.

2. For contracts with universities, the university usually owns the rights to the IP. Consider the following questions:
   - Does the university have the capacity or intent to exploit the results of the SR&ED done by the performer?
   - Is the SR&ED that was performed within the scope of research that would normally be done by the university?

Answering yes to these questions would indicate that the SR&ED was performed on behalf of the university.92

Note: the second scenario mentioned here is not referring to a third-party contract. A claimant who contracts a university to perform SR&ED on their behalf is not a third party contract. It can be difficult to distinguish between contracts for SR&ED performed on behalf of a claimant and payments that are made to certain third-parties to be used for SR&ED.93 This will be discussed in greater detail below.

II. Pricing vs Risk Assumed

From a claimant’s perspective, fixed-price contracts (contracts that include a ceiling price beyond which the performer will not get paid) generally reduce financial risk and typically include performance guarantees. Fixed-price contracts indicate that the performer is delivering a good, not providing SR&ED services. A cost-plus contract (where the performer is reimbursed for all costs incurred in performing the SR&ED work) normally indicates that the SR&ED work is being performed on behalf of the claimant.94

As mentioned above, payments that are made on a result-oriented basis are indicators that the performer is delivering a good, not SR&ED services. If the performer receives payments even

where the work does not meet the requirements of the work to be performed under the contract, this shows that the risks taken by the performer are limited. In these situations, the fact that risk mostly remains with the claimant supports the position that the SR&ED work was carried out on behalf of the player, even if there was a ceiling price clause.

A repayment because the work stopped or the other obligations of the performer were not fulfilled should not be considered in making the determination.95

III. Contract for Services vs Contract for Goods

This criterion is considered when a conclusion cannot be made based on the two previous criteria. A contract for services generally indicates that SR&ED work was carried out on behalf of the payer, while a contract for goods generally indicates that it is not. As stated previously, a fixed-price contract generally points to manufacture and delivery of a good, not SR&ED services.96

e. REFUNDABILITY

Where a claimant contracts another party to have SR&ED performed on their behalf, the amount payable under the contract may be an allowable SR&ED expenditure and 80% of the expenditure would be allowable as a qualified SR&ED expenditure of the claimant for ITC purposes. Consequently, the performer would be allowed to claim SR&ED expenditures in respect of the contract, but would have to reduce its qualified SR&ED expenditures for ITC purposes by payments received under the contract.97 In this way, there is no duplication of the ITC entitlement. The rate of the ITC, and whether or not it is refundable, depends on the type of claimant. See section 1.6 “SR&ED ITC’s - General,” below.

f. STATUTORY SOURCES

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### 1.5 THIRD PARTY SR&ED DEDUCTIONS
As mentioned in the “SR&ED Deductions – General” section, above, allowable expenditures consist of SR&ED salary and wages; materials; contract expenditures for SR&ED performed on behalf of the claimant; lease expenditures; overhead and other expenditures; third party payments; capital expenditures (capital acquired and available for use before 2014). To put it another way, pursuant to s.127(9) of the *ITA* (definition of “qualified expenditure”) claimants may either perform SR&ED themselves, have someone else do SR&ED on their behalf, or make payments to certain entities (such as approved entities, universities, or not-for-profit SR&ED corporations) to be used for SR&ED. The first option was covered under the “SR&ED Deductions – General” section, above; the second option was covered under the “Contract SR&ED Deductions” section, above; the third option consists of third party payments, which will now be explained.

**a. WHO IS ELIGIBLE**

*Claimants*

Claimants who make payments to the entities listed in s.37(1)(a)(i.1), (ii)(A-E), and (iii)(A-B) of the *ITA* are eligible for the SR&ED program. That is, the type of entity to whom the third party payment is made is of central importance (i.e., the payment must be made to approved entities to qualify for the SR&ED program). And, as mentioned above, assuring that the work meets the definition of SR&ED is the overarching eligibility criteria. The type of claimant is relevant only to the extent that it determines the rate of ITC and how the claimant may use their SR&ED ITC’s; see section 1.6 “SR&ED ITC’s – General,” below, for clarification on this last point.

**b. ALLOWABLE EXPENDITURES**

Payments made to one of the approved entities listed below are allowable expenditures so long as the payment made by the claimant is done for the purposes of SR&ED, is related to the business of the claimant, and the claimant is entitled to exploit the results. If the third party is not already an approved entity, they may apply to the Minister of National Revenue for approval.

*Types of Third Party Payments that Qualify for SR&ED*

1) Direct financial contributions (using the fair market value of the property or service, not including any quid pro quo’s or other liabilities).
2) Funding students or employees of the third party who are doing SR&ED.
3) Payments in kind.

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c. REQUIREMENTS AND LIMITATIONS OF THE CREDIT

Types of Entities to Whom Third Party Payments Can be Made

A Entities: Corporations resident in Canada (s.37(1)(a)(i.1) of the ITA).

B Entities: Approved associations (s. 37(1)(a)(ii) of the ITA).

C Entities: Approved universities, colleges, research institutes, or similar institutions (s.37(1)(a)(ii) of the ITA).

D Entities: Non-profit-SR&ED corporations resident in Canada and exempt from tax under paragraph 149(1)(j) of the ITA (s. 37(1)(a)(ii) of the ITA).

E Entities: Approved organizations (granting councils) that make payments to an association, institution, or corporation identified as a B, C, or D entity (s.37(1)(a)(ii) of the ITA).

F Entities: Non-profit-SR&ED corporations resident in Canada and exempt from tax under paragraph 149(1)(j) of the Act, for SR&ED that is basic or applied research carried on in Canada (s. 37(1)(a)(iii) of the ITA).101

Types of Entities to Whom Third Party Payments can be made: Research Chairs

In addition to making third party payments to A – F entities, payments made to research chairs may be eligible for the SR&ED program.

Research chairs are academic appointments for the main purpose of doing research in a specified area. The appointments come with all or part of the salary for the appointee, and may include money for research assistants and equipment. If a claimant makes a payment to a university or college to fund a research chair, and a portion of the payment meets the requirements of the ITA for third-party payments for SR&ED, this portion can be claimed as a third-party payment.102

The CRA requires a written agreement between the claimant and the research chair specifying:

a. What work the chair will fund, and how the money will be allocated
b. What portion of the payment is intended to fund the SR&ED activities of the chair
c. What percentage of the chair’s time will be spent on SR&ED (used to determine the portion of salaries attributable to SR&ED)
d. Schedule itemizing the SR&ED expenditures

e. If the payment is invested and only the investment income is used for SR&ED, only the principal portion of the payment paid in the year, or the portion thereof, that applies to the SR&ED, as specified in the written agreement, will be considered to be used for SR&ED.\textsuperscript{103}

\textit{Investment Income}

In the context of providing a third party payment to a research chair, a claimant can make an up-front payment, which may be held in a fund by the university or college, funding the chair over several years. Any investment income will not be considered as part of the third-party payment because when the money is transferred, the claimant gives up all rights to it, including the right to any income that is earned.\textsuperscript{104}

\textbf{Requirements}

\textbf{A Entities:} the third party payment must be paid to a corporation resident in Canada to be used for SR&ED carried on in Canada; the SR&ED must be related to a business of the claimant; and the claimant must be entitled to exploit the results of that SR&ED.\textsuperscript{105}

The SR&ED tax incentive earned on payments to an \textbf{A entity} is available only in the year in which the SR&ED is performed, rather than in the year in which it is paid. Whereas, third-party payments to other entities earn SR&ED tax incentives in the year in which it is paid.\textsuperscript{106}

\textbf{B to E Entities:} the third party payment must be used for SR&ED carried on in Canada; the SR&ED must be related to a business of the claimant; and the claimant must be entitled to exploit the results of that SR&ED.\textsuperscript{107}

\textbf{F Entities:} third party payments must be from a claimant that is a corporation; be to a corporation that is resident in Canada, that is exempt from tax due to paragraph 149(1)(j) of the \textit{ITA}; be for SR&ED that is basic or applied research, that also has applications in other types of businesses not related to the business of the claimant; and the primary purpose for the payment is for the claimant to use the results from the basic or applied research in conjunction with other SR&ED undertaken or to be undertaken, directly by or on behalf of the claimant, that relates to a business of the claimant.


Payments for this type of research must be made by a corporation to a non-profit corporation as defined under paragraph 149(1)(j) of the *ITA*. The non-profit corporation is set up specifically to carry on or promote SR&ED in Canada, whether directly or by payment to another institution. The intent is to allow the formation of consortia to carry out broadly based, precompetitive research that would have applications in more than one type of business.  

*Payment must be for SR&ED Purposes*

Third-party payments must be made only for SR&ED work. When a payment is made for a combination of SR&ED work and non-SR&ED work, the payment will not qualify as a third-party payment. An exception to this rule is made in the case of research chairs, where a portion of a payment for SR&ED is allowed as a third-party payment under certain circumstances. The onus is on the claimant to show the payments were made for SR&ED.

*Related to the Business of the Claimant*

For A to E entities, a third-party payment must be related to a business of the claimant.

Whether a payment is to be used for, or an expenditure is made on or in respect of, SR&ED that is related to a claimant's business is generally a question of fact, which must be determined on a case-by-case basis. Typically there must be some sort of “interconnection” or link between the SR&ED work and the claimant’s business:

- If the SR&ED results have a direct and beneficial application in the business carried on by the claimant it is generally successful at meeting the related to the claimant’s business criteria (s.37(8)(b) of the *ITA*).
- E.g., SR&ED related to a business includes any SR&ED that may lead to, 1) or facilitate, an extension of that business.

Note: basic research can be related to the business of the claimant. Although the outcome and applicability of basic research is inherently unpredictable, there may be beneficial results. So long as there is a potential to gain knowledge from the SR&ED that will have a direct or beneficial application to the claimant’s business, the criteria may be satisfied.

*Entitled to Exploit the Results*

To be entitled to exploit the results of the SR&ED, a claimant must have gained the right to use the results of the SR&ED in their business as a direct result of the payment.

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1. The SR&ED results in a product or patent (including royalties):
   - the claimant is entitled to distribute or market any resulting product
   - If the claimant cannot use the patent or can only obtain the product through normal commercial channels, this requirement would not be satisfied.

2) The SR&ED results in a gain of knowledge:
   - Publication of a paper
   - Preferential rights, such as access to unpublished results or early access
   - If results are presented at a conference or published in a journal, this requirement could be met if the sponsor received a prepublication print of the paper. However, if the results of the SR&ED are in the public domain before the sponsor receives them, then that would not be considered to be a preferential right.112


d. REFUNDABILITY

For the claimant, 80% of the third party payment is a qualified expenditure meaning that it can be deducted as an SR&ED expenditure and it is also added to the qualified expenditure pool, from which the ITC is calculated. The rate of the ITC, and whether or not the ITC is refundable, depends on the type of claimant. See section 1.6 “SR&ED ITC’s – General,” below.

e. STATISTICS

It is difficult to find individual statistics because not all entities are publicly identified as approved entities. The following is a list of approved entities that have consented to be publicly identified, as of June 4, 2003,

- Alberta Research Council, Edmonton, Alberta
- Canadian Arthritis Network, Toronto, Ontario
- Centre des technologies du gaz naturel (Québec) Inc., Montréal, Quebec
- Centre for Cold Ocean Resources Engineering, Memorial University of Newfoundland, St. John's, Newfoundland and Labrador
- Children's Hospital of Eastern Ontario (CHEO) Research Institute Trust, Ottawa, Ontario
- Field Crop Development Centre, Alberta Ministry of Agriculture, Food and Rural Development, Edmonton, Alberta
- Genesis Research Foundation, Toronto, Ontario
- Harvard University, Massachusetts, U.S.A (deductions under s.37(2)(b) of the ITA).
- L'institut de recherche et de développement en agroenvironnement (IRDA; Research and Development Institute for the Agri-Environment), Quebec
- London Health Sciences Centre Research Inc., London, Ontario
- McGill University-Montreal Children's Hospital Research Institute, Montréal, Quebec
- National Research Council of Canada, Ottawa, Ontario
- Ottawa Health Research Institute, Ottawa, Ontario
- Research Branch, Agriculture and Agri-Food Canada, Ottawa, Ontario

Spending on R&D in the Higher Education Sector 2013/2014

Total expenditures on research and experimental development (R&D) in Canada's higher education sector fell by 1.8%, from $13.0 billion in 2012/2013 to $12.7 billion in 2013/2014.114

“Higher education sector”: The higher education sector is composed of all universities, colleges of technology and other institute of post-secondary education, whatever their source of finance or legal status. It also includes all research institutes, affiliated research hospitals, experimental stations and clinics operating under the direct control of, or administered by, or associated with, the higher education establishments.115

Total expenditures on research and development (R&D) are classified into two fields of science: natural sciences and engineering, and social sciences and humanities.

Spending in the natural sciences and engineering field, which accounted for 76.6% of R&D expenditures in 2013/2014, decreased 2.8% from the previous year to $9.7 billion. In the social sciences and humanities, spending increased 1.5% to $3.0 billion.116

There are six funding sources for R&D expenditures in the higher education sector: business enterprises, private non-profit organizations, the federal government, provincial governments, the foreign sector, and internal funding from the higher education sector itself.117

Overall, four of the six funding sources reduced their R&D funding in 2013/2014. The largest decrease in funding was posted by the provincial government sector, down $182.6 million or 13.4% to $1.2 billion, followed by the business enterprise sector, which declined by $83.1 million or 8.4% to $911 million in 2013/2014. Counterbalancing these declines was

increased funding by the higher education sector itself, up 1.5% to $6.2 billion, and the foreign sector, up 16.0% to $149.7 million.\textsuperscript{118}

\begin{figure}
\centering
\includegraphics[width=\textwidth]{chart}
\caption{Spending on research and development in the higher education sector, by source of funding and science field, 2013/2014.\textsuperscript{119}}
\end{figure}

As mentioned above, the higher education sector itself was the largest funder of R&D for each field of science. In 2013/2014, the sector itself funded 65.9% of total higher education sector R&D spending in social sciences and humanities and 43.9% in the natural sciences and engineering fields.\textsuperscript{120}

\section{f. RECENT CHANGES}

As discussed more fully in the “recent changes” section in section 1.6 “SR&ED ITC’s- General,” below, after 2013 expenditures for capital property, or for the use of or the right to use capital property, do not qualify for SR&ED tax incentives. Thus, third-party payments made after December 31, 2013 to certain entities used to acquire a building, a leasehold interest in a

building, or to pay an amount in respect of the rental expense, no longer qualify for SR&ED tax incentives.\textsuperscript{121}

Typically a claimant cannot claim the cost of a building unless it is a prescribed special-purpose building.\textsuperscript{122} However, the following exceptions apply so long as the building is committed solely for SR&ED within Canada:

- the claimant makes a payment to an approved entity and the approved entity uses the payment to acquire a building, a leasehold interest in a building, or to pay an amount in respect of the rental expense of a building, provided the claimant deals at arm’s length with the recipient entity.
- A claimant makes a payment to an approved university, college, or organization, and the recipient uses the payment to acquire a building, a leasehold interest in a building, provided the claimant has no ownership or leasehold interest in the building.

Note: the third party payment must still be used for SR&ED carried on within Canada, related to the business of the claimant, and the claimant must be entitled to exploit the results.\textsuperscript{123}

\textbf{g. ADVANTAGES AND DISADVANTAGES}

\textit{Advantages to Making Third Party Payments}

Working with education or research institutions may provide access to specialized tools and analysis techniques a claimant may not find in regular companies.

Making a third party payment to an education or research institution will probably save costs as graduate students or post-docs will most likely do a competent job while not being paid as well as their commercial counterparts.

Government programs may also match the claimant’s contributions to a specific research project with a 1:1 or 2:1 funding, e.g., the NSERC grants (Engage grants or Collaborative Research and Development Grants). Typically direct government assistance to the claimant’s company may reduce their SR&ED credits; however, if the money from the grant is provided directly to the university, then it may not impact the claimant’s SR&ED credit award.\textsuperscript{124}

\textit{Disadvantages to Making Third Party Payments}

\begin{flushleft}
\textsuperscript{124} The Ingenuity Group, \textit{SR&ED Education and Resources}, “Gaining Knowledge Through SR&ED: Contractors, Universities and Employees” http://www.sreducation.ca/gaining-knowledge-sred-contractors-universities-employees/
\end{flushleft}
It can be hard to differentiate between third party payments and contract expenditures for SR&ED performed on behalf of the claimant. The CRA has provided the following table that may clarify what constitutes a third party payment and what constitutes a SR&ED contract.

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<tr>
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<td>Non-exclusive (generally published) but preferential right to exploit results is required</td>
<td>Exclusive</td>
</tr>
<tr>
<td>Number of funders</td>
<td>Usually more than one payer</td>
<td>Usually limited to one payer</td>
</tr>
<tr>
<td>Type of SR&amp;ED</td>
<td>Often basic or applied research</td>
<td>Commercially focused</td>
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<td>Generally cash basis</td>
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h. STATUTORY SOURCES

*Income Tax Act*

- **Paragraph 18(9)(a)**: Limitation of prepaid expenses
- **Paragraph 18(9)(d)**: Limitation of prepaid expenses excluded for certain third-party payments
- **Subsection 37(1)**: Pool of deductible SR&ED expenditures
- **Subparagraph 37(1)(a)(i.1)**: Pool of deductible SR&ED expenditures - third-party payments to a corporation
- **Subparagraph 37(1)(a)(ii)**: Pool of deductible SR&ED expenditures - third-party payments to certain entities
- **Clause 37(1)(a)(ii)(A)**: Pool of deductible SR&ED expenditures - third-party payments to approved association
- **Clause 37(1)(a)(ii)(B)**: Pool of deductible SR&ED expenditures - third-party payments to university, college, research institute, other
- **Clause 37(1)(a)(ii)(E)**: Pool of deductible SR&ED expenditures - third-party payments to approved organization
- **Subparagraph 37(1)(a)(iii)**: Pool of deductible SR&ED expenditures - third-party payments to
**Income Tax Act** | **Description**
---|---
Subsection 37(1.1) | exempt corporations
Paragraph 37(2)(b) | SR&ED related to a business of a related corporation
Subsection 37(7) | Definition of “approved”
Paragraph 37(8)(b) | SR&ED expenditures related to a business, extended
Paragraph 37(8)(c) | SR&ED expenditures related to a business, restriction
Paragraph 37(8)(d) | SR&ED expenditures specifically excluded
Former paragraph 37(8)(d) | SR&ED expenditures specifically excluded
Subsection 127(9) | Definition of “qualified expenditure”
Subsection 127(26) | Unpaid amounts
Paragraph 149(1)(j) | Non-profit corporations for SR&ED
Section 241 | Provision of information
Subsection 241(5) | Disclosure to taxpayer or on consent
Subsection 248(1) | Definition of “SR&ED”
Paragraph 251(5)(b) | Control by related groups, options, etc. – by right

1.6 **SR&ED ITC’S – GENERAL**

The starting point in the *ITA* for calculating the total qualified SR&ED expenditures that qualify for ITC is the total allowable expenditures for SR&ED. These expenditures are set out in s.37(1) of the *ITA*: salary and wages; materials; contract expenditures for SR&ED performed on behalf of the claimant; lease expenditures; overhead and other expenditures; third party payments; capital expenditures (capital acquired and available for use before 2014).\(^{125}\)

The next step is calculating qualified expenditures. In calculating qualified expenditures, certain amounts are added to, or deducted from, the allowable expenditures. For example, any assistance

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payments (e.g., provincial credits or funding) received or receivable by the claimant are subtracted from the qualified expenditures.126

From qualified expenditures the SR&ED qualified expenditure pool is calculated. The SR&ED qualified expenditure pool of a claimant includes their qualified expenditures incurred in the year, plus the amount of qualified expenditures transferred to the claimant from a NAL performer, less the amount of qualified expenditures the claimant transferred to a NAL payer.127

The next step in determining the total qualified SR&ED expenditures for ITC purposes is the addition of any repayments of assistance or contract payments to the amount of the SR&ED qualified expenditure pool. Although assistance or contract payments received or receivable are initially subtracted from the qualified expenditures, as mentioned above, these amounts can be re-added if the amounts are repaid within the year of the SR&ED claim.128

The final step in determining the total qualified SR&ED expenditures for ITC purposes involves a further reduction made to the amount of the SR&ED qualified expenditure pool in the year for any amount in respect of an expenditure incurred in a business where income from the business is exempt from Part I tax (discussed below).129

a. WHO IS ELIGIBLE?

Taxpayers who are eligible for SR&ED incentives are CCPC’s (that can be further categorized as “qualifying corporation” or “excluded corporation”, discussed below) other corporations, individuals (sole proprietorship) and beneficiaries of trusts.130

b. ALLOWABLE EXPENDITURES

Pursuant to s.37(1) of the ITA, the allowable expenditures consist of SR&ED salary and wages; materials; contract expenditures for SR&ED performed on behalf of the claimant; lease expenditures; overhead and other expenditures; third party payments; capital expenditures (capital acquired and available for use before 2014).131 Expenditures of a capital nature or

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expenditures for the right to use capital property (lease) do not qualify for SR&ED tax incentives if incurred after 2013.\textsuperscript{132} If in need of conceptual guidance, think of these expenditures as the “enumerated” expenditures, in contrast with the “hybrid” expenditures, such as repayments of assistance, which are claimable as a SR&ED expenditure even though they are not technically identified as a “SR&ED expenditure” in the \textit{ITA}. Several other “hybrid” expenditures are discussed throughout this memo.

c. REQUIREMENTS AND LIMITATIONS OF THE CREDIT

Requirements

The requirements of the ITC are set out above, in section 1.4 “SR&ED expenditures – General.” To summarize, in order to claim the ITC, the claimant must have directly undertaken SR&ED work in Canada, or contracted to have SR&ED work performed on their behalf within Canada, or paid a third party to perform SR&ED within Canada. There are 7 broad SR&ED types of “enumerated” qualified expenditures, which are added to the qualified expenditure pool. Other amounts are added or deducted to the pool – the “hybrid” expenditures. For example, assistance payments, which are removed from the pool but may be re-added if they are repaid during the year.\textsuperscript{133}

As mentioned above, the strictest criteria is the actual qualification of the work as SR&ED. To that end, the CRA engages in a technical review with the claimant predominantly to ensure the work claimed meets the definition of SR&ED pursuant to s.248(1) of the \textit{ITA}, but also to resolve any issues with eligibility.\textsuperscript{134}

Technical Reviews

Technical reviews are conducted by research and technology advisors (“RTAs”). They report to research and technology managers (“RTMs”) who may become involved in a technical review. In some cases, outside consultants may also be involved in technical reviews or an RTA may get help from a national technology sector specialist.\textsuperscript{135}

When an SR&ED claim is filed, some claims are accepted as is. Others may require a site visit and detailed explanations of the SR&ED project. After a site visit, and taking into consideration any more representations from the claimant, the results of the RTA's work will be documented in an SR&ED Review Report, which will be given to the claimant. The SR&ED Review Report is a summary of the technical review. It documents the facts discussed with the claimant and

observed by the RTA, and explains and provides a rationale concerning the review decisions, most particularly on the eligibility of the work and other issues related to the eligibility. All RTA’s act in reference to the CRA’s “Claim Review Manual” which outlines their requirements in regards to review procedures.\(^{136}\)

The review of expenditures associated with claimed SR&ED work is called a financial review and is done by financial reviewers (FRs). RTAs and FRs work as a team during technical and financial reviews to co-ordinate the review of SR&ED claims. RTAs and FRs often make joint on-site visits, information requests, or interviews. The CRA advises claimants to expect that information obtained will be shared as needed between FRs and RTAs in order to avoid duplication of requests.\(^{137}\)

**Limitations**

*Goods and Services Purchased from Non Arm’s-Length Parties*

Where the claimant makes a purchase of goods or services from a NAL party, a reduction to their qualified expenditures (other than a PPA) may be required. In the context of an NAL transaction that is part of a contract for SR&ED performed on behalf of the claimant, the expenditures performed by the NAL person on behalf of the claimant do not qualify for ITC’s, and so reduce the total qualified expenditures for ITC purposes (see sections 1.4 and 1.7, below).

When the claimant purchases goods or services from an NAL party with whom they have not entered into a SR&ED contract, the amount eligible for an ITC to the claimant is limited to the cost to the NAL person of providing the goods or services. This amount is also deductible as a SR&ED expenditure – for a service provided to the claimant, either the expenditure the claimant incurred or the adjusted service cost, whichever amount is less; and for a good (property) sold to the claimant, either the capital cost of the good (property) to the claimant otherwise determined or the adjusted selling cost to the supplier of the property, whichever amount is less.\(^{138}\)

*Exempt Income*

For the purposes of calculating the ITC, a claimant cannot include any amount in respect of an expenditure incurred in the course or earning income in a particular tax year if any of the income is exempt income or is exempt from tax under Part I of the *ITA*. For example, SR&ED expenditures incurred by a Crown corporation are not eligible. The legislation ensures that an ITC can only be generated when the income from the business, to which a particular expenditure relates, is subject to Part I tax.\(^{139}\)

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d. REFUNDABILITY

The basic rate of SR&ED ITC is 15% for tax years that end after 2013 and 20% for tax years that end before 2014. For tax years that include January 1, 2014, the reduction in the basic ITC rate is pro-rated based on the number of days in the tax year that are after 2013.

The ITA sets out several ways a claimant may utilize their ITC’s: the claimant may apply the ITC in the current year, carry back 3 years, or carry forward 10-20 years their ITC to reduce their Part I tax otherwise payable according to the rules, and in some cases the ITC is refundable, depending on the claimant and certain factors. Any SR&ED ITC that is refunded in the year is deemed to be ITC applied to reduce Part I tax otherwise payable in the year. As a result, SR&ED ITC that is refunded in the year reduces the ITCs available to carry forward or carry back.140

Canadian Controlled Corporations

To qualify for SR&ED, CCPCs in general must be private corporations, resident in Canada not controlled directly or indirectly by one or more non-resident persons or public corporations.141

Generally, a Canadian-controlled private corporation (CCPC) can earn a refundable ITC at the enhanced rate of 35% on qualified SR&ED expenditures, up to a maximum threshold of $3 million. The $3 million threshold is called the “expenditure limit.” The 35% ITC is 100% refundable on qualified SR&ED expenditures and 40% refundable on qualified SR&ED capital expenditures incurred before 2014.142 A CCPC can also earn a non-refundable ITC at the basic rate of 15% on an amount over the $3 million threshold (“the expenditure limit”).143

Pursuant to ss.127(10.2)-(10.6) of the ITA, the expenditure limit may be reduced depending on the CCPC’s taxable income and taxable capital in the CCPC’s prior year. The expenditure limit begins to decrease when the taxable income of the CCPC (or in the case of a CCPC with associated corporations, the total of all their taxable incomes) for the previous tax year is more than $500,000 and becomes nil starting at $800,000. The expenditure limit beings to decrease when the taxable capital employed in Canada of the CCPC (or in the case of a CCPC with associated corporations, the total of all their taxable capital) for the previous tax year reaches $10 million and becomes nil starting at $50 million. Technically, the $3 million expenditure limit is reduced where the preceding year’s taxable income for the corporation and associated corporations exceeds a threshold linked to the maximum small business deduction business limit.

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for the year and when the taxable capital of the corporation (or associated group) for the preceding year exceeds $10 million.\textsuperscript{144}

Lastly, A CCPC and its associated corporations must allocate amongst themselves the annual expenditure limit for the purposes of calculating their ITCs earned at the enhanced 35% rate. The portion of the CCPC's expenditure limit that is not allocated to itself may be allocated to an associated corporation to the extent of the associated corporation's own expenditure limit. That is, the expenditure limit allocated to each particular corporation cannot exceed the expenditure limit for the associated group for the applicable tax year.\textsuperscript{145}

Pursuant to s.127.1(2) of the ITA, where a CCPC's qualifying income limit is reduced to zero because the CCPC's taxable capital is $50 million or greater in the immediately preceding year, the CCPC is not a “qualifying corporation” and would not be entitled to any refundable ITC, even though they still receive the enhanced ITC rate of 35%.\textsuperscript{146} A CCPC that meets the definition of a qualifying corporation can earn a refundable ITC at the basic rate of 15% on an amount over the $3 million threshold, of which 40% can be refunded.\textsuperscript{147}

\textit{The ITC Rate: CCPC’s (Other than Excluded Corporations and Qualifying Corporations)}

CCPC’s other than excluded and/or qualified corporations earn ITC at a rate of 35%; 100% is refundable. For SR&ED over the expenditure limit, the ITC rate is 15%; none is refundable.

\textit{The ITC Rate: Qualifying Corporations other than Excluded Corporations}

Qualifying corporations earn ITC at a rate of 35% up to the expenditure limit; 100% refundable. SR&ED expenditures over the expenditure limit earn ITC at a rate of 15%; 40% is refundable.

\textit{The ITC Rate: Excluded Corporations}

According to s.127.1(2) of the ITA, an excluded corporation is a corporation that is, at any time in the year, either controlled by (directly or indirectly, in any manner whatever), or is related to one or more persons exempt from tax under s.149 of the ITA or Her Majesty in right of a province, a Canadian municipality or any other public authority.

Excluded corporations earn ITC at a rate of 35% up to the expenditure limit; 40% is refundable. For SR&ED over the expenditure limit, the ITC rate is 15%; 40% is refundable.

\textit{The ITC Rate: Other corporations}

\begin{itemize}
\item \textsuperscript{146} Canada Revenue Agency, \textit{SR&ED Glossary}, “qualifying corporation,”
\end{itemize}
Other corporations earn ITC at the basic rate of 15%, below and above the expenditure limit. None of the ITC is refundable; the ITC can be applied to reduce tax payable.\textsuperscript{148}

\textit{The ITC Rate: Individuals, Trusts and Unincorporated Businesses}

Individuals, trusts and unincorporated businesses earn ITC at the basic rate of 15% below and above the expenditure limit; 40% is refundable, below and above the expenditure limit.\textsuperscript{149}

\textit{The ITC Rate: Trusts}

Generally for a trust, each beneficiary of which is either a qualifying corporation or an individual (other than a trust), the refundable ITC is 40% of the unclaimed balance of ITC earned in the current year for qualified SR&ED expenditures.\textsuperscript{150}

\textit{The ITC Rate: Members of a partnership}

Partners in a partnership earn ITC at the basic rate of 15%; 40% is refundable.\textsuperscript{151}

\textit{Carry Back Rules}

A taxpayer may apply their ITC available in the year to reduce to nil their Part I tax otherwise payable in the current tax year. Any SR&ED ITC that is refunded in the tax year is deemed to be ITC applied to reduce Part I tax otherwise payable in the year. As a result, SR&ED ITC that is refunded in the year reduces the ITCs available for carry forward or carry back. That is, the ITC available for carry back is any current year ITC in excess of the ITC needed to reduce Part I tax (if any) in the current year to nil. It is not necessary that the current year ITC is applied to reduce current year Part I tax (if any) to nil. However, the ITC amount that could reduce the current year Part I tax to nil (deductible) cannot be carried back. ITC may only be carried back to reduce to nil Part I taxes otherwise payable in the previous year. As already mentioned, ITC that is refunded in the tax year is deemed to be applied to reduce Part I tax otherwise payable in the year. Thus, determining the current year ITC available must take any ITC refunded in the current year into account and determining Part I tax otherwise payable in the previous year must take any ITC refunded in the previous year into account as well.\textsuperscript{152}

The CRA provides the following example to highlight the carry back rules:

<table>
<thead>
<tr>
<th>Tax year</th>
<th>Part I tax otherwise payable in the year</th>
<th>ITC available in the year</th>
<th>Part I tax otherwise payable in excess of ITC available in the year</th>
<th>ITC allowed for carry back</th>
</tr>
</thead>
<tbody>
<tr>
<td>Year 1 (previous year)</td>
<td>$10,000</td>
<td>$6,000</td>
<td>$4,000</td>
<td>N/A</td>
</tr>
<tr>
<td>Year 2 (current year)</td>
<td>$12,000</td>
<td>$15,000</td>
<td>Nil</td>
<td>Limited to $3,000 to Year 1</td>
</tr>
</tbody>
</table>

In this example the claimant may carry back up to the lesser of:

- $3,000 (the portion of ITC from Year 2 that was not deductible against Part I tax in Year 2)
- $4,000 (Part I tax otherwise payable in year 1 in excess of ITC available in Year 1)

Thus, the claimant may carry back up to $3,000 from Year 2 to Year 1. The claimant may choose how they utilize the remaining $12,000 of ITC in Year 2 subject to any other applicable rules.\(^{153}\)

**Carry Forward Rules**

An ITC that is not applied, refunded, or carried back may be carried forward and applied to Part I tax otherwise payable in a subsequent year. The number of tax years a claimant may carry forward their ITC will depend on the rule that applies for the tax year in which the ITC was earned. The ITC expires if it is not applied to reduce Part I tax otherwise payable within the applicable number of tax years:

a. An ITC earned in 2005 and earlier tax years generally may be carried forward 10 tax years. The ITC expires after 10 tax years.

b. ITCs earned in 2006 and 2007 tax years may be carried forward 20 tax years. The ITC expires after 20 tax years.

c. Legislation applicable to 2008 and later tax years allow the following ITCs to be carried forward 20 tax years:
   - ITC earned in 2008 and later tax years; and
   - ITC earned in the 10 preceding tax years that ended before 2008 (in other words, the ITC earned in tax years after 1997 that did not expire under the “2005 and earlier” rule before 2008).\(^{154}\)

e. **RECENT CHANGES**

The most substantive changes to the SR&ED program occurred on December 14 2012 when Bill C-45 became law. There are five major changes:


Firstly, the percentage at which SR&ED overhead and other expenditures are accounted for under the proxy method (found in Regulation 2900(4)) was amended to reflect the rate reduction from 65% to 55% over a two year period. The percentage for the 2012 and previous calendar years is 65%. The percentage is reduced to 60% for the 2013 calendar year and 55% for the 2014 and later calendar years.

Second, paragraph (a)(1) of the definition of “investment tax credit” in 127(9) was amended to lower SR&ED ITC rate from 20% to 15%.

Third, subsection 127(10.1) provides a 15% ITC in addition to the basic 20% ITC for certain SR&ED expenditure incurred by a CCPC. Subparagraph 127(10.1) is amended by replacing the reference to 15% with 20% in order to maintain the enhanced ITC rate of 35% (see section 1.6 “SR&ED ITC – General,” below).

Fourth, contract expenditures and third party payments are (as of 2012) only 80% eligible for ITC, as opposed to 100%. Thus, paragraph (a)(ii) of the definition of “qualified expenditure” in s. 127(9), which previously referred to an expenditure described in 37(1)(a), is amended to refer to 80% of an expenditure described in subparagraph 37(1)(a.01) to (iii).

The fifth major change is the repeal of s.37(1)(b) of the ITA; expenditures of a capital nature, including expenditures for the right to use capital property, are no longer eligible for the SR&ED program (after 2013). Several provisions were amended to account for this change. Additionally, subparagraph 37(1)(a)(i.01) was added to describe SR&ED carried out on behalf of a taxpayer (see sections 1.4 and 1.7, below). Contract expenditures had previously been located in subparagraph 37(1)(a)(i) of the ITA. As a result, Paragraph (b) of the definition of “contract payment” found in s.127(9) of the ITA was amended consequential to the repeal of paragraph 37(1)(b). Because of the addition of 37(1)(a)(i.01), subparagraph (a)(i) of the definition of “contract payment” in 127(9) is amended to replace the reference to 37(1)(a)(i), with 37(1)(a)(i.01); in the case of contract-SR&ED and third-party SR&ED, qualified expenditures of a performer are reduced by the amount of a payor’s contract payment to the performer (see sections 1.4 and 1.5, below).

As a corollary to the fifth change, s. 37(14) was added to the ITA. This provision provides for a look through rule to ensure that expenditures incurred by a claimant in respect of SR&ED performed on behalf of the claimant or by third party entities include only expenditures of a current nature consequential to the repeal of s. 37(1)(b) of the ITA.

f. STATUTORY SOURCES

The SR&ED ITC is regulated by s.127(9) et seq of the ITA. The definition of “SR&ED” is found in s.248(1) of the ITA.

1.7 CONTRACT ITC’S

a. WHO IS ELIGIBLE/BENEFICIARIES?

Pursuant to s.37(1)(a)(i.01) of the *ITA*, where a claimant contracts another party to have SR&ED performed on their (the claimant’s) behalf, the amount payable under the contract may be an allowable SR&ED expenditure. Pursuant to s.127(9) of the *ITA*, definition of “qualified expenditure” paragraph (a)(ii), 80% of the expenditure is a qualified SR&ED expenditure (to the claimant) for ITC purposes.\(^{156}\)

The performer is also allowed to claim SR&ED expenditures in respect of the contract, but the performer must deduct the payments received under the contract in calculating its allowable expenditures i.e., the expenditures that qualify for ITC purposes. In this way, there is no duplication of the ITC entitlement.\(^{157}\)

b. ALLOWABLE EXPENDITURES

Refer to section 1.3 “Contract SR&ED deductions,” above.

c. REQUIREMENTS AND LIMITATIONS OF THE CREDIT

As mentioned above, the work performed must meet the definition of SR&ED, set out in s.248(1) of the *ITA*, and must be performed in Canada. Specific to SR&ED contracts is the requirement that the work of the performer be undertaken “on behalf of” the claimant. This, and other criteria unique to SR&ED contracts, will now be addressed.

**SR&ED Contracts with Non-Taxable Suppliers**

One of the intentions of the SR&ED program is to promote Canadian SR&ED and foster the development of a domestic research and development infrastructure. The taxable supplier rules were implemented to encourage claimants to enter into SR&ED contracts with Canadians or non-Canadians that have a permanent establishment in Canada. Accordingly, when a claimant enters into SR&ED contracts with a non-resident person or non-Canadian partnership, it is not enough that the SR&ED be performed in Canada for them to receive SR&ED benefits – they must also be taxable suppliers.\(^{158}\)

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“Taxable supplier”: a person resident in Canada; a Canadian partnership; or a non-resident person or non-Canadian partnership that carries on a business through a permanent establishment in Canada.¹⁵⁹

Generally, if the expenditure relating to the SR&ED contract is paid or payable to or for the benefit of a person or partnership who is not a taxable supplier, then it will not be included in the calculation of total qualified SR&ED expenditures for ITC purposes.¹⁶⁰

The taxable supplier rules also serve to prevent “double dipping.” That is, if a claimant contracts to a non-resident corporation who in turn contracts the SR&ED work to a third, Canadian corporation, the taxable supplier rules will apply to prevent the double dipping of ITC by the two Canadian corporations on the same SR&ED project.¹⁶¹

The taxable supplier rules do not apply to SR&ED work directly undertaken by the claimant (as the claimant must perform SR&ED work in Canada to qualify for the SR&ED program).

SR&ED Contracts with Non-Arm’s Length Performers

s.127(9) of the ITA, definition of “qualified expenditure,” paragraph (f) specifically removes expenditures in respect of SR&ED contracts between persons or partnerships not dealing at arm’s length from the calculation of total qualified SR&ED expenditures for ITC purposes.¹⁶² That is, even though both performer and claimant may deduct their SR&ED expenditures related to the contract, only the performer can claim SR&ED ITC’s, as this ensures ITC’s are only claimed on actual SR&ED costs incurred and not on any profit margin earned on the payment.

The amount received or receivable is not considered to be a contract payment and it will not reduce the NAL’s performer’s qualified expenditure for ITC purposes.¹⁶³

Although the performer is the party allowed to claim the expenditures for ITC purposes, pursuant to s.127(13) of the ITA, the NAL performer can also transfer all or a portion of its qualified SR&ED expenditures in the year to the payer up to a maximum of the contract amount.¹⁶⁴ That is, the performer can transfer the ITC’s back to the claimant if the joint election is filed.¹⁶⁵

The performer cannot transfer to the payer more than the amount that their qualified SR&ED expenditures would have been at the end of the tax year had it not been for this transfer. If the performer attempts to do so, the *ITA* states that no amount can be transferred (s. 127(14)).

A partnership cannot transfer or receive qualified SR&ED expenditures to or from a NAL party since a partnership is not considered to be a person for the purpose of these rules.

Note: these last points on transferring expenditures refer to the statement from section 1.6 “SR&ED ITC’s – General,” above, whereby “the SR&ED qualified expenditure pool of a claimant includes their qualified expenditures incurred in the year, plus the amount of qualified expenditures transferred to the claimant from a NAL performer, less the amount of qualified expenditures the claimant transferred to a NAL payer.”

Lastly, the *ITA* provides two anti-avoidance rules. The first anti-avoidance rule in s.127(24) of the *ITA* reduces the qualified expenditure to nil where a claimant attempts to circumvent the NAL rules by including an arm’s length party between a payer and a NAL performer. The second anti-avoidance rule in s.127(16) of the *ITA* reduces to nil the addition in the claimant's (transferee's) qualified SR&ED expenditure for the transferred qualified SR&ED expenditures when the claimant and the performer (transferor) do not deal at arm’s length as a result of a transaction, event or arrangement, or a series of transactions, events or arrangements, the principal purpose of which was to enable the claimant and the performer to enter into the agreement.

**SRE&ED Contracts with Non Arm’s Length Performers for Support Work Only**

In an SR&ED contract with NAL parties for support work only, the claimant (payer) cannot claim SR&ED expenditures because of the NAL rules mentioned above. But in addition, the NAL performer cannot claim SR&ED expenditures because the work performed does not meet the definition of SR&ED. As a result, one would expect that no expenditures incurred either by the claimant (payer) or the NAL performer are qualified expenditures for ITC purposes. However, s. 37(13) of the *ITA* deems the support work of a NAL performer to be SR&ED.

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provided that the support work would be SR&ED if it were performed by the claimant (payer).\textsuperscript{170}

Thus, one might think of this as a “hybrid” SR&ED expenditure.

\textit{SR&ED Contracts that Include Work Carried on Outside of Canada}

SR&ED expenditures carried on outside of Canada qualify for a deduction under s.37(2) of the \textit{ITA} but do not qualify for ITC’s.

In cases where the SR&ED results in IP, although there are no restrictions on the location of IP, the Canadian company must have the right to exploit the results of the sub-contracted research.

Generally research must be undertaken in Canada; however, where employees of the claimant are working outside of Canada, the amount of eligible wages for SR&ED performed outside Canada is limited to 10\% of eligible wages claimed for SR&ED performed in Canada.\textsuperscript{171}

If the contract contains some work performed inside Canada, some out, the work must be allocated reasonably and only the portion within Canada is eligible to ITC. In situations where a contracts combines SR&ED work and non SR&ED work, neither an SR&ED deduction nor an ITC is available on the amount of non SR&ED work.\textsuperscript{172}

\textit{ITC Recapture}

The SR&ED ITC recapture rules apply where a payer gives a contract to an arm’s length performer for SR&ED, or SR&ED and other work, to be performed on their behalf; and

a) the contract results in the acquisition of property (other than intellectual property) that will be used in the payer's SR&ED, or

b) that will be used in their business, or that will be sold.

The SR&ED ITC recapture rules apply when the payer disposes of the property or converts it to commercial use.\textsuperscript{173}

\textit{Contract Payments, Government Assistance and Non-Government Assistance}

The intent of SR&ED legislation is to provide tax incentives to businesses on the net costs of performing SR&ED in Canada. SR&ED is also meant to provide tax incentives on the net cost of performing SR&ED in Canada. Therefore, pursuant to s.37(1)(d) of the \textit{ITA}, any government assistance, non-government assistance, and contract payments in respect of SR&ED work that a claimant has received, is entitled to receive, or can reasonably be expected to receive in the year


\textsuperscript{171} Deloitte, \textit{Global Survey of R&D Tax Incentives}, March 2014, at 8


reduces the total qualified SR&ED expenditures for ITC purposes. As mentioned above, the performer of SR&ED carried out on behalf of the claimant generally must reduce from their own qualified expenditures the payment received under the contract. Refer to section 1.8 “Third Party Payment ITC’s,” below, for the definitions of government and non-government assistance.

“Contract payment:” an amount paid or payable to a claimant by a taxable supplier in respect of the amount for SR&ED

- for, or on behalf of, a person or partnership entitled to a deduction for the amount as a current expenditure or as a third-party payment to a corporation; and
- at a time when the claimant and the person or partnership (the taxable supplier) are dealing at arm’s length;
- or an amount for an expenditure of a current nature payable by a Canadian government, municipality or other Canadian public authority or by a person exempt from Part I tax under s.149 of the ITA for SR&ED to be performed for it or on its behalf.

To clarify, “SR&ED contract expenditure” is the term used for the payment by the claimant to the performer they hired to do SR&ED work on their behalf; “contract payment” refers to the same payment but from the perspective of the performer (who is also a “claimant” of SR&ED).

Based on the terms of a contract, it may be difficult to determine whether it is the person who paid the amount (the claimant) or the contractor (the performer) who is entitled to an ITC. This question can arise when a contract does not specify whether an amount paid to the contractor who performed the SR&ED work is a contract payment for the purpose of calculating an ITC. Even though a contract states that a payment is, or is not, a contract payment, this may not be conclusive. There is no unique test or jurisprudence that will determine if an amount paid is a contract payment.

Assistance and contract payments reduces SR&ED expenditures on a project-by-project basis; assistance for one SR&ED project cannot reduce the SR&ED expenditures of another project. Also, assistance and contract payments can only reduce the SR&ED expenditures of a project to nil. In cases where the amount of assistance or contract payment is more than the SR&ED expenditures of a project, the excess amount will be included as income in the tax year.

Note on the prescribed proxy amount: The amount of assistance or contract payment that relates to the prescribed proxy amount will not reduce the pool of deductible SR&ED expenditures.

expenditures. This is because the PPA is not an expenditure that is included in the pool of SR&ED deductible expenditures. The PPA is a notional amount that is used in lieu of the actual overhead expenditures in calculating qualified SR&ED expenditures with the proxy method (in contrast to the traditional method). The portion of assistance or contract payment that relates to the PPA should be included in income in the tax year that it is received.\textsuperscript{178}

The definition of an ITC provides for calculating the amount of ITC that is earned by a claimant at the end of a tax year. This calculation is based on the SR&ED qualified expenditure pool. Therefore, qualified SR&ED expenditures are themselves reduced by any amounts of assistance and contract payments that the claimant has received, is entitled to receive, or can reasonably be expected to be received for SR&ED work performed in the tax year, pursuant to s.127(18) of the ITA.\textsuperscript{179}

\textit{Non-Arm’s Length Assistance or Contract Payment}

If the claimant receives assistance or a contract payment from a NAL party that is greater than the total qualified SR&ED expenditures that the claimant and the NAL party incurred in the year for the SR&ED, the claimant’s qualified expenditures are reduced. That is, the assistance or contract payment received must be subtracted by all amounts of assistance and contract payment relating to a previous year to reduce the qualified SR&ED expenditures of the claimant and the NAL party. If, following this, the remaining amount of assistance or contract payment is greater than the SR&ED expenditures of the project, qualified SR&ED expenditures of the claimant and the NAL party are reduced to nil.\textsuperscript{180}

Assistance and contract payments that were not applied to the claimant’s qualified SR&ED expenditures must be allocated among the members of a non-arm’s length group if each member of the group performs the SR&ED when the performer is not dealing at arm’s length with the claimant who received the assistance, and the amount of the assistance is less than the total qualified SR&ED expenditures of the non-arm’s length members of the group on the SR&ED in respect of which the assistance was received.\textsuperscript{181}

\textit{Repayment of Assistance and Contract Payments}

Pursuant to s.37(1)(c) of the ITA, if a claimant repays assistance and contract payments, the pool of deductible SR&ED expenditures increases to the extent that the assistance or contract payment repaid had previously reduced the pool, increasing the amount of ITC earned in the year.

The following is very technical: since the repayments are not qualified SR&ED expenditures as defined in the ITA but they are “hybrid” expenditures (pursuant to s.127(10.8) of the ITA), ITC earned on them will not be refundable in the year the repayment is made but can be applied to reduce taxes payable, carried back 3 years or forward 20 years, pursuant to s. 127(9), definition of “investment tax credit,” paragraphs (e.1), (e.2) of the ITA.

Treatment of Unpaid SR&ED Contract Expenditures

Pursuant to s.127(26) of the ITA, when calculating total qualified SR&ED expenditures for ITC, as well as the refundable ITC calculation, a claimant’s expenditure for SR&ED of a current nature that is unpaid on the day that is 180 days after the end of the tax year in which the expenditure is otherwise incurred is deemed not to have been incurred in the year and to be incurred at the time it is paid.\textsuperscript{182}

Note: these unpaid amounts rules are for ITC purposes only. The expenditures are still included in the pool of deductible SR&ED expenditures in the tax year that they are incurred.\textsuperscript{183}

When filing, the claimant who has not paid the performer within 180 days of tax year end must make two deductions. They may claim the entire amount as a deduction under s.37(1)(a)(i.o1) of the ITA. But for ITC purposes, the claimant must first reduce the arm’s length contract by 20%, as only 80% of the contract is eligible for ITC (pursuant to s.127(9), definition of “qualified expenditure,” paragraph (a)(ii) of the ITA). The second reduction will identify the remaining 80% of the arm’s length contract as incurred in the year but not paid within 180 days of the tax year-end. This ensures the total amount of the unpaid expenditure is not included as a qualified SR&ED expenditure in the year where it was not paid. Accordingly, in the year the expenditure is paid, only 80% of the amount that was identified is added to the qualified SR&ED expenditures.\textsuperscript{184}

d. REFUNDABILITY

Not all claimants may refund their ITC’s (refer to section 1.6 “SR&ED ITC’s – General,” above). Assuming the claimant qualifies for an ITC refund, generally, where a claimant contracts another party to have SR&ED performed on their behalf, the amount payable under the contract is an allowable SR&ED expenditure and 80% of the expenditure is allowable as a qualified SR&ED expenditure for ITC purposes (from the payer’s perspective). Consequently, the performer is allowed to claim SR&ED expenditures in respect of the contract, but would have to

reduce its qualified SR&ED expenditures for ITC purposes by payments received under the contract.\textsuperscript{185} In this way, there is no duplication of the ITC entitlement.

\textit{Non Arm’s-Length SR&ED Contracts}

Where a claimant (payer) enters into an SR&ED contract with a NAL performer, special rules apply, whereby the claimant's expenditures in respect of the SR&ED contract are allowable SR&ED expenditures, but do not qualify for any SR&ED ITC purposes.\textsuperscript{186}

The NAL performer can claim its SR&ED expenditures relating to the SR&ED work performed on behalf of the payer. The amount received or receivable is not considered to be a contract payment and it will not reduce the NAL’s performer’s qualified expenditure for ITC purposes.\textsuperscript{187}

\textbf{e. STATISTICS}

Aside from the total number of claims submitted and gross amounts refunded by the federal government (see section 1.1 “Introduction,” above), it is difficult to ascertain the amounts refunded as an ITC. That amount depends on the tax liability of the claimant for the tax year, and such information is confidential.

\textbf{f. STATUTORY SOURCES}

\begin{tabular}{|l|l|}
\hline
\textit{Income Tax Act} & \textit{Description} \\
\hline
Subsection 18(9) & Limitation respecting prepaid expenses \\
Subsection 37(1) & Pool of deductible SR&ED expenditures \\
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- **Subsection 127(26)**: Unpaid amounts
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- **Paragraph 2900(2)(c)**: Other expenditures directly related and incremental to the prosecution of SR&ED – traditional method
- **Section 8201**: Definition of "permanent establishment"

### 1.8 THIRD PARTY ITC’S

**a. WHO IS ELIGIBLE**

Claimants who make payments to the entities listed in s.37(1)(a)(i.1), (ii)(A-E), and (iii)(A-B) of the *ITA* are eligible for the SR&ED program. That is, the type of entity to whom the third party payment is made is of central importance (i.e., the payment must be made to approved entities to qualify for the SR&ED program). And, as mentioned above, assuring that the work meets the definition of SR&ED is the overarching eligibility criteria. The type of claimant is relevant only to the extent that it determines the rate of ITC and how the claimant may use their SR&ED ITC’s; refer to section 1.6 “SR&ED ITC’s – General,” above, for clarification on this last point.

**b. ALLOWABLE EXPENDITURES**

Generally, where a claimant makes a third-party payment to an entity;

- a. To be used for SR&ED carried on in Canada;
- b. that is related to the claimant’s business; and
- c. the claimant must be entitled to exploit the results of the SR&ED;
80% of the third party payment qualifies for an ITC.\textsuperscript{188}

For more information, refer to section 1.4 “Third Party Deductions,” above.

\textbf{c. LIMITATIONS OF THE CREDIT}

\textit{Government Assistance and Non-Government Assistance}

The definition of an ITC provides for calculating the amount of ITC that is earned by a claimant at the end of a tax year. This calculation is based on the SR&ED qualified expenditure pool. Therefore, qualified SR&ED expenditures are themselves reduced by any amounts of government or non-government assistance and contract payments that the claimant has received, is entitled to receive, or can reasonably be expected to be received for SR&ED work performed in the tax year, pursuant to s.127(18) of the \textit{ITA}.\textsuperscript{189}

Put another way, the intent of SR&ED legislation is to provide tax incentives to businesses on the net costs of performing SR&ED in Canada. SR&ED is also meant to provide tax incentives on the net cost of performing SR&ED in Canada. Therefore, pursuant to s.37(1)(d) of the \textit{ITA}, any government assistance, non-government assistance, and contract payments in respect of SR&ED work that a claimant has received, is entitled to receive, or can reasonably be expected to receive in the year reduces the total qualified SR&ED expenditures for ITC purposes.\textsuperscript{190} As mentioned above, the performer of SR&ED carried out on behalf of the claimant must reduce from their own qualified expenditures the payment received under the contract.

"\textit{Government assistance}" is defined in s.127(9) of the \textit{ITA} as assistance from a government, municipality, or other public authority whether as a grant, subsidy, forgivable loan, deduction from tax, investment allowance, or any other form of assistance other than the federal ITC. Government assistance also includes assistance provided by a crown corporation or a foreign government.\textsuperscript{191}

s. 12(1)(x) of the \textit{ITA} and related provisions concerning government assistance also apply to claimants who receive assistance indirectly from a government organization. For example, assistance received from a non-profit entity that, in turn, receives its funding from a government organization.\textsuperscript{192}

"\textit{Non-government assistance}" is defined in s.127(9) of the \textit{ITA} as an amount that can reasonably be considered to have been received as an inducement, reimbursement,\textsuperscript{188}
\textsuperscript{189}
\textsuperscript{190}
\textsuperscript{191}
\textsuperscript{192}

\begin{itemize}
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contribution, allowance or as assistance for the cost of a property or for an outlay or expense. Non-government assistance may be in the form of a grant, subsidy, forgivable loan, deduction from tax, allowance or any other form of inducement or assistance. Specifically, non-government assistance are amounts that would be included in a claimant's income under s.12(1)(x) of the ITA, read without reference to ss. 12(1)(x)(v) to (vii).193

Some of the factors considered to determine if the payment amounts to assistance are:

i. lack of firm terms of repayment or optional repayment suggests the payment is assistance;
ii. absence of a business motive on the part of the payer suggests assistance;
iii. forgivable loans, etc.

For example, if an agreement for government assistance includes provisions for repayment only in the event of profits earned from the project and characterizes the repayments as royalties, the CRA considers the amounts to be government assistance, not a business loan.194

Differences between assistance and contract payments:

i. Assistance involves predominantly a donative intent, rather than a business motive. An assistance agreement between the grantor and the recipient of the assistance will show that the main purpose of the agreement from the grantor's point of view was something other than profit.
ii. The key element to consider is whether the payer requests the contractor perform SR&ED work on their behalf.
iii. Any repayment provisions in an assistance agreement are not strictly enforceable. A contract is a commercial arrangement between two or more parties, subject to legal liabilities and enforceable in the case of default.
iv. A contract arrangement implies authority of the payer over the deliverables and sometimes over the whole work process. Assistance does not generally extend such implications. However, some assistance agreements could include restrictions in respect of such things as how the work is to be done or where a product can be sold.195

Government or non-government assistance reduces SR&ED expenditures on a project-by-project basis; assistance for one SR&ED project cannot reduce the SR&ED expenditures of another project. Also, government or non-government assistance can only reduce the SR&ED

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expenditures of a project to nil. In cases where the amount of assistance is more than the SR&ED expenditures of a project, the excess amount will be included as income in the tax year.\footnote{Canada Revenue Agency, “Assistance and Contract Payments Policy,” December 18, 2014, http://www.cra-arc.gc.ca/txcrdt/sred-rsde/clmng/ssstncndcntrctpymnts-eng.html}

\textit{Note on the prescribed proxy amount}: The amount of government assistance or non-government assistance that relates to the prescribed proxy amount will not reduce the pool of deductible SR&ED expenditures. This is because the PPA is not an expenditure that is included in the pool of SR&ED deductible expenditures. The PPA is a notional amount that is used in lieu of the actual overhead expenditures in calculating qualified SR&ED expenditures with the proxy method (in contrast to the traditional method). The portion of assistance that relates to the PPA should be included in income in the tax year that it is received.\footnote{Canada Revenue Agency, “Assistance and Contract Payments Policy,” December 18, 2014, http://www.cra-arc.gc.ca/txcrdt/sred-rsde/clmng/ssstncndcntrctpymnts-eng.html}

\textit{Non-Arm’s Length Assistance}

If the claimant receives assistance from a NAL that is greater than the total qualified SR&ED expenditures that the claimant and the NAL party incurred in the year for the SR&ED, the claimant’s qualified expenditures are reduced. That is, the assistance received must be subtracted by all amounts of assistance relating to a previous year to reduce the qualified SR&ED expenditures of the claimant and the NAL party. If, following this, remaining the amount of assistance is greater than the SR&ED expenditures of the project, qualified SR&ED expenditures of the claimant and the NAL party are reduced to nil.\footnote{Canada Revenue Agency, “Assistance and Contract Payments Policy,” December 18, 2014, http://www.cra-arc.gc.ca/txcrdt/sred-rsde/clmng/ssstncndcntrctpymnts-eng.html}

Assistance payments that were not applied to the claimant’s qualified SR&ED expenditures must be allocated among the members of a non-arm’s length group if each member of the group performs the SR&ED when the performer is not dealing at arm’s length with the claimant who received the assistance, and the amount of the assistance is less than the total qualified SR&ED expenditures of the non-arm’s length members of the group on the SR&ED in respect of which the assistance was received.\footnote{Canada Revenue Agency, “Assistance and Contract Payments Policy,” December 18, 2014, http://www.cra-arc.gc.ca/txcrdt/sred-rsde/clmng/ssstncndcntrctpymnts-eng.html}

\textit{Repayment of Assistance}

Pursuant to s.37(1)(c) of the \textit{ITA}, if a claimant repays government assistance or non-government assistance, the pool of deductible SR&ED expenditures increases to the extent that the assistance repaid had previously reduced the pool, increasing the amount of ITC earned in the year. Repayments can be thought of as “hybrid” SR&ED expenditures. The following is very technical: since the repayments are not qualified SR&ED expenditures pursuant to s.127(10.8) of the \textit{ITA}, any ITC earned on repayments will not be refundable in the year the repayment is made but can be applied to reduce taxes payable, carried back 3 years or
forward 20 years, pursuant to s. 127(9), definition of “investment tax credit,” paragraphs (e.1), (e.2) of the \textit{ITA}.

d. \textbf{REFUNDABILITY}

The rate of ITC and the refundability depends on the type of claimant; see section 1.6 “SR&ED ITC’s –General,” above.

Typically, 80\% of the third party payment is eligible for the ITC. If eligible for a refund, the SR&ED ITC refund may only be claimed in the year in respect of a property that is purchased or an expenditure incurred that qualifies for an SR&ED ITC.\footnote{Canada Revenue Agency, “SR&ED Investment Tax Policy,” December 18, 2014, http://www.cra-arc.gc.ca/txcrdt/sred-rsde/clmng/srdnvstmnttxcrdt-eng.html#s4_0}


Specific to third party payments, non-profit SR&ED corporations (“D entities”) cannot claim the ITC.\footnote{Canada Revenue Agency, “SR&ED Filing Requirements Policy,” December 18\textsuperscript{th}, 2014, http://www.cra-arc.gc.ca/txcrdt/sred-rsde/clmng/flngrqrmnts-eng.html#s6_3_1}

e. \textbf{STATISTICS}

Aside from the total number of claims submitted and gross amounts refunded by the federal government (see section 1.1 “Introduction,” above), it is difficult to ascertain the amounts refunded as an ITC. That amount depends on the tax liability of the claimant for the tax year, and such information is confidential.

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**1.9 POLICY CONSIDERATIONS**

As mentioned above, in 2012 the government imposed changes to the SR&ED program that significantly lowered SR&ED eligibility (80% of SR&ED contracts and third party payments are eligible for S&ED as opposed to 100% prior to 2012; capital expenditures no longer qualify whatsoever). SR&ED claimants were upset with the change, even though the government increased business subsidies. That is, the government posited that the increased amounts of cash given to businesses directly (to encourage innovation) counteracted the changes to the SR&ED
program. However, these loans qualify as “government assistance” and so in effect further reduced the SR&ED credits that claimants could claim.\textsuperscript{203}

Interestingly, when identifying whether SR&ED work has taken place, the CRA explicitly acknowledges that a technological uncertainty may arise that is imposed by economic considerations. That is, sometimes there is little doubt that a product or process can be developed when cost targets are no barrier. In commercial reality, however, a reasonable cost target is always an objective. Although such cost targets on their own do not create scientific or technological uncertainty, trying to meet them might. Hence the existence of a costly technologically certain alternative does not negate the possibility that SR&ED work was performed to develop a product or a process.\textsuperscript{204}

Even with a program as generous as the SR&ED program, the fact remains that claimants are still required to pay for the SR&ED work themselves; they are refunded by the CRA four, 8 or sometimes 12 months after they file. But the SR&ED program is quite lucrative, and in recognition of this, a new industry of specialized SR&ED lenders developed. These firms provide financing to claimants that is secured by the anticipated receipt of their tax credits, for both pre-file and post-file claims.\textsuperscript{205} Strictly speaking, this kind of financing is better suited to small or medium businesses; it allows them to get capital faster to fund new SR&ED work and/or other expenditures. Financing is usually 70-80% of the refund with the rest sent when the claim is approved. That said, there are some disadvantages: evidently, if the claim is denied, the claimant must still repay the loan. But lenders usually also charge fees for using their services that can include a percentage of the entire claim, SR&ED reviewer fees and possible legal fees.\textsuperscript{206}

Some specialized SR&ED lenders insist on reviewing the SR&ED claim when it is complete to confirm that the claim is completed properly, and that the claim is legitimate. Some firms waive this requirement where the claim is prepared by SR&ED consultants and not the claimants themselves.\textsuperscript{207} On this latter point, there was a large scandal back in 2011 where SR&ED consultants where falsifying SR&ED claims so that they would receive higher contingency fees. The “cottage industry consultants” submitted avalanches of claims that met the CRA’s minimum filing guidelines, yet represented highly dubious R&D. The result is that Canadian taxpayers are spending billions on a program that too often delivers little or no new R&D. According to a


\textsuperscript{205} Some financing firms include Revenue Services Group (http://www.revenueservices.ca/funding); Espresso Capital (http://www.northinnovationfund.com/north-sred-financing.php); and the Business Development Bank of Canada (http://www.sredducation.ca/bdc-sred-financing-service/).


Globe and Mail article reporting on the scandal, “at a time when experts worry Canada is falling badly behind in the global innovation race, Ottawa often touts its Scientific Research and Experimental Development program as a key part of the answer - a powerful lure to get companies to invest here and generate wealth. According to the Globe and Mail, the government's own studies have found the program generates almost no economic benefits.208 And the low risk of getting caught means too much of the money winds up in the hands of people who do little or no R&D, including small manufacturers, consultants and lenders.”209 According to the article, many of the CRA officials who helped design SR&ED are now working as consultants for major accounting firms, such as Ernst & Young, Price Waterhouse, and Deloitte Touche. The “revolving door” between the government and the industry means that many SR&ED consultants know the ins and outs of the claims process better than government auditors.210

The rapid birth of SR&ED financing firms (and probably the discovery of copious amounts of fraudulent SR&ED claims prepared by “cottage industry SR&ED consultants” in 2011) prompted the Department of Finance to implement a Consultation Regarding the Impact of Contingency Fees on the Effectiveness of the Scientific Research and Experimental Development Tax Incentive Program in August 2012.211 According to the Consultation, in 2009 roughly two thirds of SR&ED claimants rely on third parties to prepare their SR&ED claims. The Consultation sought to understand the motivations of SR&ED consultants for charging on a contingency-fee basis, the relative importance of this type of revenue for SR&ED consultants, and why so many claimants relied on SR&ED consultants. The Consultation concluded that, as the fee received by tax preparers charging on a contingency basis is related to the size and result of the claim, this billing practice provides an incentive for tax preparers to encourage their clients to take aggressive positions that push the bounds of the law and its interpretation.212

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208 Although the Globe and Mail did not cite which “government study” they are referring to, I believe it may be the Department of Finance’s 2007 Review of SR&ED, which concluded that “direct assistance in the form of grants appears likely to leverage more research (crowding in) than tax credits, but also appears likely to generate lower spillovers, with an ambiguous net effect on welfare; i.e., neither of the above conditions is met on an ‘all else equal’ basis.” Mark Parsons and Nicholas Pillips, Department of Finance Canada, “Working Paper: An Evaluation of the Federal Tax Credit for Scientific Research and Experimental Development,” September 2007, at p 32.


unprecedented increase in litigation was noticed by all parties involved in SR&ED – i.e., consultants and lenders – not just claimants.\textsuperscript{213} Government statistics show that SR&ED related notice of objection filings increased by a factor of 25 since 2007. However, as the following graph demonstrates, there was a significant peak in 2012, after the CRA implemented the 5 major changes discussed in section 1.6 “SR&ED ITC’s – General,” above:

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\includegraphics[width=\textwidth]{graph.png}
\caption{SR&ED Notice of Objection Filings}
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\textit{Review of the Authority and Appeal Process}

The \textit{ITA} lists the following requirements for all taxpayers as well as authorities for RTAs:

- S. 230(1) of the \textit{ITA} requires taxpayers to keep books and records in an organized form so that the CRA can determine their taxes payable.
- S. 230(3) of the \textit{ITA} outlines the CRA's authority when a claimant does not keep adequate books and records.
- S.231.1(1) of the \textit{ITA} gives an authorized person (for example, an RTA or an outside consultant) the right to conduct a review, which includes among other things examining books and records and requiring the claimant to help and answer questions.
- S.231.5 of the \textit{ITA} gives the CRA the authority to make or get copies of documents.


- S. 239 of the ITA outlines the legal consequences to taxpayers of not providing information and of providing information that is not correct.
- S.163(2) of the ITA outlines the penalties applicable for false statements or omissions.\textsuperscript{215}

Claimants who disagree with a RTAs decision are encouraged to attempt to resolve the dispute with the RTA or FR directly; then with the RTM or financial review manager, and lastly to request an administrative review by the assistant director. If a claimant does not agree with a notice of assessment or reassessment, they have the right to a formal review of it by filing a notice of objection with the CRA. They have up to 90 days from the date of the notice of assessment or reassessment to file an objection. Objections are handled by the Appeals Branch at the CRA.\textsuperscript{216}

According to the CRA, in order to consider the application of a penalty under s.163(2) of the ITA in respect of a SR&ED claim, the claimant must have knowingly, or under circumstances amounting to gross negligence, been involved in filing an overstated SR&ED claim. According to the CRA, the burden of proof is on the Department for any subsection 163(2) penalty assessed by the Minister.\textsuperscript{217}

\textit{CRA's Response}

Whatever the cause of the increased litigation, frustrations began to mount. As a result, in 2014, the CRA released a Self-Assessment Learning Tool (SALT). SALT helps claimants understand the eligibility requirements for SR&ED work; helps claimants determine if their company project might include SR&ED work; helps claimants identify the extent of eligible work performed during the course of the project, and estimates allowable expenditures associated with the work and the potentially claimable ITC.\textsuperscript{218} In 2015, the CRA released a revised Financial Claim Manual Review Guide (the review procedures for FRs).\textsuperscript{219} In 2016, the CRA hosted a SR&ED practitioners session; practitioners from many different firms were invited to listen to the CRA, directors of the SR&ED department from Ottawa, and regional directors and managers within the SR&ED department; the practitioners also participated in a Q&A.\textsuperscript{220} According to one participant, the CRA listened actively to complaints, and promised to work to ensure that reviews are conducted fairly. That is, the SR&ED department will work to improve consistency and additional training will be given to reviewers to ensure that there is consistency from region to region and reviewer to reviewer across the entire department, and that reviewers are being trained to conduct reviews with an open mind, with more transparency and improved communication with claimants throughout the review process. Reviewers are to be instructed to

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\item \textsuperscript{218} Canada Revenue Agency, “SR&ED Self Assessment and Learning Tool,” 27 January 2014
\item \textsuperscript{220}
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share their assessments of the claim as soon as possible – either during the onsite meeting or before sending a proposal letter to the claimant. According to the CRA and SR&ED department, “the goal of the SR&ED division is to not leave claimants feeling positive about how the review went only to then receive a proposal with an unexpected result.”

Reading between the lines, the CRA and SR&ED department have clearly assigned the abuse of SR&ED funds to the consultants and lenders, not the claimants themselves. In fact, the CRA’s Summary of the Corporate Business Plan 2014-2015 to 2016-2017 states that the CRA’s new strategy to simplify the SR&ED program by increasing its accessibility and predictability will also address overly aggressive positions taken by some SR&ED consultants and claimants. The CRA hypothesises that providing more accurate and faster assessments of SR&ED claims will lead to increased reports of non-compliance.

Lastly, the problems surrounding SR&ED consultants and lenders have highlighted the absence of existing regulation within the SR&ED consultation field. There is some preliminary discussion of creating a SR&ED Practitioner’s Association, with the goal of representing and serving a network of professionals who prepare technical and financial SR&ED claims, as well as the companies conducting R&D. The Association would strive to provide leadership by developing a voluntary, non-governmental professional accreditation for SR&ED consultants, as well as regular education seminars to complement the CRA SR&ED information sessions. The Association would advocate on behalf of its members for policy and program efficiency at the federal and provincial level.

2. CANADIAN FILM OR VIDEO PRODUCTION TAX CREDIT

Introduced in 1995, the primary objective of the Canadian Film or Video Production Tax Credit (CPTC) is to encourage Canadian programming and to stimulate the development of an active domestic independent production sector.

2.1 OVERVIEW

The CPTC program, governed by s.125.4 of the ITA and section 1106 of the ITR, offers a fully refundable tax credit of 25% of the qualified labour expenditure of an eligible production by a qualified corporation.

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The Minister’s authority under the *ITA* is delegated to a senior official of Canadian Heritage. Thus the CPTC program is jointly administered by the Department of Canadian Heritage, through the Canadian Audio-Visual Certification Office (CAVCO), and by the Canada Revenue Agency (CRA).

CAVCO is responsible for certifying that the production is a Canadian film or video production (CFVP) and issuing certificates that allow Canadian producers to claim the CPTC. The CRA verifies the qualified labour expenditures used in determining the CPTC and issues the tax refunds.

a. **WHO IS ELIGIBLE**

The CPTC program gives a tax credit to qualified corporations producing Canadian film or video productions. Canadian control requirements are in place specifically to ensure that the incentive is available only to Canadian-controlled companies.

Generally, to be eligible for the CPTC, the applicant must demonstrate the following:

1. the company is Canadian-owned and controlled and is in the business of producing Canadian content productions;
2. their producer-related personnel and a minimum number of key creative personnel are Canadian citizens or permanent residents;
3. they have an agreement with either a Canadian broadcaster or a Canadian distributor to show the production in Canada within 2 years;
4. their productions are not ineligible genres listed in section 1106(1) of the ITR;
5. they meet the minimum Canadian production and post-production expenditure requirements;
6. they have copyright ownership of the production.

These general eligibility requirements are divided under two overarching eligibility criteria: the requirement that the applicant be a “qualified corporation,” and the requirement that the film or video production be a “Canadian film or video production.” The criteria of “qualified corporation” will be discussed here; the criteria of “Canadian film or video production” will be discussed below.

**Qualified Corporation**

Pursuant to s.125.4(1) of the *ITA* (definition of “qualified corporation”) a qualified corporation is a corporation that is, throughout the tax year, a “prescribed taxable Canadian corporation” whose activities consist primarily of conducting a “Canadian film or video production business” through a permanent establishment in Canada.\(^{231}\)

Pursuant to section 1106(1) of the *ITR*, a “prescribed taxable Canadian corporation” is a taxable Canadian corporation that is controlled by Canadian citizens or permanent residents, as defined by ss.26-28 of the *Investment Canada Act*.\(^{232}\) A corporation must be both *de jure* and *de facto* Canadian-controlled respecting voting shares.\(^{233}\)

A corporation does not qualify if it is:

(i) controlled directly or indirectly in any way by one or more persons, all or part of whose taxable income is exempt from tax under Part I;\(^ {234}\) or

(ii) a prescribed labour-sponsored venture capital corporation.\(^ {235}\)

A “Canadian film or video production business” is not defined in the *ITA*. According to the CRA, to qualify for the CPTC, a corporation’s activities must consist primarily (more than 50% of its activities) of conducting a business that is a Canadian film or video production business.\(^ {236}\)

To determine whether the activities of a corporation consist primarily of carrying on a business that is a Canadian film or video production business, all the facts surrounding each of the various activities undertaken by the corporation must be examined and compared. Some (non-exhaustive) factors considered:

(i) the profits realized from each of the corporation’s activities;

(ii) the volume and value of the gross sales or transactions from each activity;

(iii) the value of the assets devoted to each activity;

(iv) the capital used in each of the corporation’s activities; and

(v) the time, attention, and efforts the employees, agents, or officers of the corporation spend on each activity.\(^ {237}\)

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\(^{234}\) Regulation 1106(2)(a)

\(^{235}\) Regulation 1106(2)(b)


Consequently, if the business of a corporation primarily includes other activities such as renting equipment or studios or distributing films or videos, it may not be considered a qualified corporation for the CPTC.\textsuperscript{238}

Furthermore, if the corporation produces films or videos that do not qualify as “Canadian film or video productions”, the corporation may also not be considered a qualified corporation. It is therefore possible that a corporation will be denied the CPTC because of its activities in the year.\textsuperscript{239}

The CRA is the body which determines whether a production company is a qualified corporation, but Canadian Heritage (through CAVCO) decides if a qualified corporation is a “prescribed taxable Canadian corporation.” In circumstances where production companies are unsure whether they would be deemed a “qualified corporation” for tax credit purposes, they can contact their regional Film Services Unit of the CRA before submitting a certification application to CAVCO – the FSU will evaluate the corporation.\textsuperscript{240}

As mentioned above, the production company (applicant) must be the exclusive worldwide copyright owner (whether alone, with one or more domestic co-producers, or jointly with other prescribed persons) in the production for the 25-year period that begins at the earliest time after the production was completed (i.e., that it is commercially exploitable.)\textsuperscript{241}

Such ownership must be exclusive, except to the extent of an interest in the production held by a prescribed taxable Canadian corporation acting as a co-producer of the production, or by a prescribed person.

\textit{Co-Production}

A production is a Canadian co-production (involving only qualified corporations) if more than one qualified corporation owns it. If the production is a Canadian co-production, each qualified corporation must claim its own CPTC based on its share of expenditures.\textsuperscript{242}

Otherwise known as a “domestic co-production,” where more than one Canadian production company holds copyright ownership in and incurs expenses in relation to a production, CAVCO still issues a single certificate for a production (see discussion on certificate, below). Each co-

\textsuperscript{238} Canada Revenue Agency, “Canadian Film or Video Production Tax Credit – Guide to Form T1131,” http://www.cra-arc.gc.ca/E/pub/tg/rc4164/rc4164-13e.html
\textsuperscript{239} Canada Revenue Agency, “Canadian Film or Video Production Tax Credit – Guide to Form T1131,” http://www.cra-arc.gc.ca/E/pub/tg/rc4164/rc4164-13e.html
producer must claim the relative portion of the tax credit with the CRA. Domestic co-productions typically involve inter-provincial partnerships.\textsuperscript{243}

Note: where two or more partnering Canadian production companies incorporate a subsidiary company as the sole copyright owner in a production, the production should not be reflected as a domestic co-production in an application to CAVCO.\textsuperscript{244}

\textit{Prescribed Persons}

A prescribed person, as defined in subsection 1106(10) of the ITR, means:

(a) a corporation that holds a television, specialty, or pay-television broadcasting licence issued by the Canadian Radio-Television and Telecommunications Commission (CRTC);
(b) a corporation that holds a broadcast undertaking licence and that provides production funding because of a significant benefits commitment made to the CRTC;
(c) a non-profit organization described in paragraph 149(1)(l) of the Act, if that person has a fund used to finance Canadian film or video productions;
(d) a Canadian government film agency (federal, provincial or territorial);
(e) a non-resident person who does not carry on a business in Canada through a permanent establishment in Canada, when the person’s interest in the production is acquired to comply with the certification requirements of a treaty co-production twinning arrangement; and
(f) a person:
   • that is a registered charity to which paragraph 149(1)(f) of the \textit{ITA} applies;
   • that has a fund that is used to finance Canadian film or video productions, all or substantially all (90% or more) of which financing is provided by way of a direct ownership interest in those productions; and
   • that, after 1996, has received donations only from persons described above in (a) to (e).\textsuperscript{245}

Finally, the production company must have the right to produce the production, evidenced through a clear chain-of-title. To claim the CPTC, the corporation must also have incurred any claimed labour expenditures (see below). Once the tax credit has been claimed, the copyright may be assigned to a related prescribed taxable Canadian corporation.\textsuperscript{246}

\textsuperscript{245} Canada Revenue Agency, “Canadian Film or Video Production Tax Credit – Guide to Form T1131,” http://www.cra-arc.gc.ca/E/pub/tg/rc4164/rc4164-13e.html# Toc298395636
b. ALLOWABLE EXPENDITURES

The CPTC is a refundable tax credit equal to 25% of the qualified labour expenditure. Pursuant to s.125.4(1) of the ITA, the qualified labour expenditure is the lesser of the amount of labour expenditures and 60% of the net production cost.247

Eligible Cost of Production

“Production cost” is not explicitly defined in the ITA. However, the definition of “qualified labour expenditure” found in s.125.4(1) of the ITA (above) states that the net production cost is one of two amounts used to calculate the qualified labour expenditure (the other amount being labour expenditures, discussed below). That is, net production cost is the total production cost minus any deferral and non-deductible expenses, and assistance received, receivable, or entitled to receive, the whole as defined in s.12(1)(x) of the ITA.248 Assistance will be discussed in greater detail below.

As the qualified labour expenditures may not exceed 60% of the cost of the production net of assistance, the tax credit will not exceed 15% of the total cost of production net of assistance.249

Production costs are limited to those amounts which have been incurred in respect of the production. Where a production is a treaty co-production, eligible production costs include only those incurred by the Canadian production company.250

As “production cost” is not defined in the ITA, the CRA has held that if there is a provision in the ITA providing for specific treatment or rules to calculate the expenditure, that provision prevails. If not, Courts will rely on jurisprudence. If there is no jurisprudence on the point in issue, courts rely on interpretive aids like well-accepted business principles (mostly the generally accepted accounting principles, GAAP).251

The CRA has otherwise stated that, absent legislation, paragraph 8 of Interpretation Bulletin IT-285R2, Capital Cost Allowance - General Comments is used to establish the capital cost of a property (in this case, a film, television or video production).252 It reads:

251 Canada Revenue Agency, “Completing Form T1131, Claiming a Canadian Film or Video Production Tax Credit,” http://www.cra-arc.gc.ca/tx/nnrsdnts/flm/ftc-cip/cmplt-eng.html
8. The term "capital cost of property" generally means the full cost to the taxpayer of acquiring the property and includes:

(a) legal, accounting, engineering or other fees incurred to acquire the property; and

(b) in the case of a property a taxpayer manufactures for the taxpayer's own use, it includes material, labour and overhead costs reasonably attributable to the property, but nothing for any profit which might have been earned had the asset been sold.\(^{253}\)

Next, both the "cost of production" and the "labour expenditure" (<em>see below</em>) should only include the “reasonable” amounts paid for the production.\(^{254}\)

According to the CRA guideline, producer fees paid to incumbents of producer positions who are either not dealing at arm’s length or who have an ownership interest in the production or the production corporation, or the financiers of the production or their nominees, are generally considered reasonable in the circumstances when they are within the reference threshold of 10% of the total actual costs in parts B and C of the standardized production budget. This “threshold” is not a cap and can sometimes be greater.\(^{255}\)

The CRA developed the 10% “objective component principle” pursuant to the interpretation of “reasonable” found in <em>Mohammad v MNR</em> [1998] 1 FC 165, 97 DTC 5503; “When evaluating the reasonableness of an expense, one is measuring its reasonableness in terms of its magnitude or quantum. Although such a determination may involve an element of subjective appreciation on the part of the trier of fact, there should always be a search for an objective component.”\(^{256}\)

Producer fees paid to incumbents of producer positions who are dealing at arm’s length or who have no ownership interest in the production or the production corporation, or those who are not financiers of the production or their nominees) are generally considered reasonable in the circumstances when they are incurred and paid pursuant to a valid contractual obligation for services.\(^{257}\)

\(^{253}\) Canada Revenue Agency, Interpretation Bulletin IT-285R2, <em>Capital Cost Allowance - General Comments</em>

\(^{254}\) Canada Revenue Agency, “How to Claim Your Canadian Film or Video Production Tax Credit,” http://www.cra-arc.gc.ca/tx/nrrsdnts/flm/ftc-cip/clm-eng.html


If the production is co-owned by a prescribed person (see definition above), the applicant must also include in the production cost those production expenditures incurred by the qualified corporation for or on behalf of the prescribed person.258

However, the applicant must not include expenditures on behalf of a co-producer of the Canadian film or video production if the co-producer is another qualified corporation. Each qualified corporation must claim its own expenditures.259

**Labour Expenditures**

Pursuant to the definition of “labour expenditure” found in s.125.4(1) of the *ITA*, eligible labour expenditures must meet four basic criteria:

(i) They must be reasonable in the circumstances (see definition of “reasonable,” above);
(ii) They must be included in the cost or, in the case of depreciable property, the capital cost to the corporation, of the property;
(iii) They must be incurred for the stages of production of the property from the production commencement time to the end of post-production stage;
(iv) And they must be directly attributable to the production of the property.260

Only the labour expenditures incurred in the taxation year, or the preceding taxation year, and paid by the corporation in the taxation year or within 60 days after the end of that year, will qualify as labour expenditures for the production when applying to the CRA for the CPTC.261

“Production Commencement Time,” as defined in s.125.4(1) of the *ITA*, describes the time that is the earlier of:

a) the date the principal photography of the Canadian film or video production began, or
b) the latest of:
   i. The date the qualified corporation (or its parent corporation) first incurred labour expenses for the development of the script material.
   ii. The date the qualified corporation (or its parent corporation) first acquired a right to the story that is the basis of the final script (such rights might include a published literary work, play, or screenplay).

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iii. two years before the date the principal photography of the
Canadian film or video production began

Pursuant to the definition of “labour expenditure” in s.125.4(1)(a)-(c) of the ITA, the labour
expenditures of a corporation are equal to the total of three categories: salaries or wages,
remuneration other than salaries or wages, and reimbursement by a wholly-owned corporation to
its parent. Finally, and pursuant to the definition, labour expenditures include some post-
production costs.

Salaries or Wages

For the purpose of calculating the labour expenditure of a qualified corporation, salary or wages
means income from an office or employment, but does not include stock options and any
amounts determined by reference to profits or revenues. Thus, the salary or wages of an
employee includes vacation pay, statutory holiday pay, sick leave pay, and any benefit taxable in
the hands of the employee under s.6 of the ITA.262

Salary or wages do not include the employer's contributions to:
• the Canada Pension Plan or the Quebec Pension Plan;
• Employment Insurance;
• the Worker's Compensation Board or the Commission de la santé et de la sécurité
du travail du Québec; or
• any registered pension plan, dental care plan, or medical care or optical care plan
for the employee.
• extended vacation or extended sick leave of an employee.263

Remuneration other than Salaries or Wages

The portion of the remuneration, other than salary or wages, is a labour expenditure where it is
paid to:

a) An individual who is not an employee of the corporation, to the extent that the amount
paid relates to services rendered by the individual for the production, or to the salary and
wages of the individual's employees who are rendering services for the production.264

b) Another taxable Canadian corporation to the extent that the amount paid is attributable to
and does not exceed the salary or wages of the other corporation's employees for
rendering services for the production.265

262 Canada Revenue Agency, “Completing Form T1131, Claiming a Canadian Film or a Video Production Tax
263 Canada Revenue Agency, “Completing Form T1131, Claiming a Canadian Film or a Video Production Tax
264 Canadian Heritage, Canadian Audio-Visual Certification Office, “CPTC Program Guidelines,” April 2012,
http://canada.pch.gc.ca/DAMAssetPub/DAM-PCH2-Arts-FilmVideo/STAGING/texte-
text/cptcGuide_1455637343203_eng.pdf
c) Another taxable Canadian corporation, all the issued and outstanding shares of the capital stock of which (except directors' qualifying shares) belong to an individual and the activities of which consist mainly of the provision of the individual's services, to the extent that the amount paid is attributable to services rendered by the individual for the production. If the recipient corporation meets all of these criteria, the whole remuneration qualifies as a labour expenditure.

d) A partnership that is carrying on business in Canada, to the extent that the amount paid relates to services rendered to the production by an individual who is a member of the partnership, or to the salary or wages of the partnership’s employees rendering services to the production.

Reimbursements by a Wholly-Owned Corporation to its Parent

Where a production company is a wholly-owned subsidiary company of another taxable Canadian corporation, and it reimburses expenditures incurred for the production by the parent company that would be included in the labour expenditures of the production company based on either of the two categories listed above, if:

a) the corporation had such a particular taxation year; and

b) the expenditures were incurred by the corporation for the same purpose as it was by the parent and were paid at the same time and to the same person or partnership as it was by the parent,

then expenses covered by such reimbursements will be eligible labour expenditures. Note that where all the criteria are not met, payments to the parent company will become payments to another taxable Canadian corporation.

Post-Production Labour Expenditures

Where post-production labour is done in-house, payments are made in the form of salary or wages.

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Where labour expenditures are paid to another taxable Canadian corporation, producers may only include those services that are rendered by a person performing one of the post-production duties set out in paragraph 125.4 (2)(b) of the *ITA*. These include most post-production roles such as an assistant colourist, an assistant mixer, a sound-effects technician, a colourist, a computer graphics designer, an optical effects technician, or a special effects editor.

**c. REQUIREMENTS AND LIMITATIONS OF THE CREDIT**

**Requirements**

To get a CPTC, the applicant must first apply to CAVCO for a Canadian Film or Video Production Certificate (Part A) and/or a Certificate of Completion (Part B).

There is no specific deadline to apply for a Canadian Film or Video Production Certificate (Part A). However, to get a CPTC refund, the applicant must file, with the CRA, the CAVCO certificate and a completed Form T1131 with the T2 Corporation Income Tax Return (T2 return) no later than three years after the end of the corporation’s tax year.

The application for a Certificate of Completion (Part B) must be received by CAVCO no later than 24 months after the end of the qualified corporation’s tax year in which the principal photography began.

Producers may apply for both the Canadian film or video production certificate (Part A) and the certificate of completion (Part B) once a production is completed. In this instance, the Part A certificate and the Part B certificate will be issued at the same time.

Failure to meet the final application deadline results in CAVCO revoking a previously issued Part A certificate or refusing a Part A/B application. If a certificate is revoked, it is considered to have never been issued. Consequently, any previously issued CPTC refunds for the production will be recaptured by the CRA.

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The applicant must pay a fee for the application for a CAVCO “Canadian film or video production certificate.” The fee is calculated as follows:

a) Part A: 0.15% of Eligible Production Cost
b) Part B: 0.15% of Eligible Production Cost
c) Part A/B: 0.30% of Eligible Production Cost (minimum fee of $200).275

The CAVCO certifies that the production is a "Canadian film or video production". A Canadian film or video production means a film or video production, other than an "excluded production", produced by a "prescribed taxable Canadian corporation" and that is either a treaty co-production or a film or video production that meets certain specific requirements found in section 1106 of the ITR.276

Co-productions between Canada and another country are eligible for the CPTC program only when co-produced under an official treaty. Telefilm Canada is responsible for the certification of treaty co-productions. However, in order to obtain a certificate to access the CPTC program, the producer must apply directly to CAVCO.277

Specifically, section 1106 of the ITR stipulates that, to qualify as a Canadian film or video production, a production must meet the following requirements related to the producer of the production, and the production itself:

**Canadian Producer**

The producer must be an individual who is:

(i) in control and the central decision maker of the production;
(ii) directly responsible for the acquisition of the production story, or screenplay, as well as for the development, creative and financial control, and exploitation of the production; and
(iii) identified in the production as the producer of the production.278

All positions related to the producer function (including producer, line producer, and production manager) must be held by Canadians. An exemption is granted for treaty co-productions and in

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limited circumstances to non-Canadian producers (such as executive producer or associate producer) as courtesy credits.  

The producer must be a Canadian from the start of the production to the completion of post-production, without interruption.  

A “Canadian” is defined as a Canadian citizen according to the Citizenship Act, a permanent resident according to the Immigration and Refugee Protection Act, or a corporation that is Canadian-controlled as determined for the purposes of the Investment Canada Act.  

**Canadian Production: Live Action**  

To be recognized as a “Canadian film or video production,” (other than where it is a treaty co-production) a live action production must earn a minimum of six points based on the following key creative personnel qualifying as Canadians as set out in paragraph 1106(5)(a) of the ITR.  

<table>
<thead>
<tr>
<th>Key creative Personnel</th>
<th>Point</th>
</tr>
</thead>
<tbody>
<tr>
<td>Director</td>
<td>2 points</td>
</tr>
<tr>
<td>(either the director or the screenwriter must be Canadian)</td>
<td></td>
</tr>
<tr>
<td>Screenwriter</td>
<td>2 points</td>
</tr>
<tr>
<td>(either the director or the screenwriter must be Canadian)</td>
<td></td>
</tr>
<tr>
<td>Highest-paid lead performer</td>
<td>1 point</td>
</tr>
<tr>
<td>(either the highest-paid or the second-highest-paid lead performer must be a Canadian)</td>
<td></td>
</tr>
<tr>
<td>Second-highest-paid lead performer</td>
<td>1 point</td>
</tr>
<tr>
<td>(either the highest-paid or the second-highest-paid lead performer must be a Canadian)</td>
<td></td>
</tr>
<tr>
<td>Art director</td>
<td>1 point</td>
</tr>
</tbody>
</table>

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### Minimum point requirements

<table>
<thead>
<tr>
<th>Key creative Personnel</th>
<th>Point</th>
</tr>
</thead>
<tbody>
<tr>
<td>Director of photography</td>
<td>1 point</td>
</tr>
<tr>
<td>Music composer</td>
<td>1 point</td>
</tr>
<tr>
<td>Picture editor</td>
<td>1 point</td>
</tr>
</tbody>
</table>

**Canadian Production: Animation**

To be recognized as a “Canadian film or video production,” (other than where it is a treaty co-production) an animation production must earn a minimum of six points based on the following key creative personnel qualifying as Canadians and the following services provided in Canada as set out in paragraphs 1106(5)(b) to (d) of the ITR.

### Minimum point requirements

<table>
<thead>
<tr>
<th>Key creative Personnel</th>
<th>Point</th>
</tr>
</thead>
<tbody>
<tr>
<td>Director</td>
<td>1 point</td>
</tr>
<tr>
<td>(the director, or both the principal screenwriter and the storyboard supervisor, must be Canadian)</td>
<td></td>
</tr>
<tr>
<td>Principal screenwriter and storyboard supervisor</td>
<td>1 point</td>
</tr>
<tr>
<td>(the director, or both the principal screenwriter and the storyboard supervisor, must be Canadian)</td>
<td></td>
</tr>
<tr>
<td>Highest-paid or second-highest-paid lead voice</td>
<td>1 point</td>
</tr>
<tr>
<td>(the highest-paid or the second-highest-paid lead voice must be a Canadian)</td>
<td></td>
</tr>
<tr>
<td>Design supervisor (art director)</td>
<td>1 point</td>
</tr>
<tr>
<td>Camera operator (done in Canada)</td>
<td>1 point</td>
</tr>
</tbody>
</table>

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**Minimum point requirements**

<table>
<thead>
<tr>
<th>Key creative Personnel</th>
<th>Point</th>
</tr>
</thead>
<tbody>
<tr>
<td>Music composer</td>
<td>1 point</td>
</tr>
<tr>
<td>Picture editor</td>
<td>1 point</td>
</tr>
<tr>
<td>Layout and background (done in Canada)</td>
<td>1 point</td>
</tr>
<tr>
<td>Key animation (done in Canada)</td>
<td>1 point</td>
</tr>
<tr>
<td>Assistant animation and in-betweening (done in Canada)</td>
<td>1 point</td>
</tr>
</tbody>
</table>

As mentioned above, it is important to indicate as "labour expenditure" on Form T1131 only the claimant corporation's share of the salary or wages as well as the claimant corporation's share of each category of remuneration paid to individuals, taxable Canadian corporations (multi-owned and solely owned), and partnerships.286

There are additional requirements related directly to the labour expenditures but are not requirements for the labour expenditure per se. That is, to qualify as a Canadian film or video production, a production must meet the two following requirements relating to Canadian expenditures:287

(i) at least 75% of the total of all costs for services (other than post-production work) must be for services provided to or by individuals who are Canadians; and

(ii) at least 75% of the total of all costs incurred for the post-production work must be incurred for services provided in Canada.288

Certain costs are not included in these calculations, such as:

(i) costs determined by reference to the amount of income from the production;

(ii) remuneration paid or payable to the producer or the key creative personnel (in point positions); and

(iii) amounts paid for insurance, financing, brokerage, legal and accounting fees, and similar amounts, when they relate to the production stage.289

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Limitations

As mentioned above, the definition of “Canadian film or video production” includes a production “other than an excluded production.” Section 1106(1) of the ITR provides a list of genres that are categorically ineligible for CPTC:

(i) news, current events or public affairs programming, or a programme that includes weather or market reports,
(ii) a talk show,
(iii) a production in respect of a game, questionnaire or contest (other than a production directed primarily at minors),
(iv) a sports event or activity,
(v) a gala presentation or an awards show,
(vi) a production that solicits funds,
(vii) reality television,
(viii) pornography,
(ix) advertising,
(x) a production produced primarily for industrial, corporate or institutional purposes, or
(xi) a production, other than a documentary, all or substantially all of which consists of stock footage.290

Additionally, section 1106(1) of the ITR states that a production will also be excluded if:

(i) the qualified corporation has not filed an application for a Certificate of Completion (Part B) before the production’s application deadline (see the deadlines, above);
(ii) CAVCO has not issued a Certificate of Completion (Part B) within six months after the production’s application deadline;
(iii) there is no written agreement, at fair market value, with a Canadian distributor, or a broadcaster holding a Canadian Radio-Television and Telecommunications Commission licence, to have the production shown in Canada no later than two years after production is complete; or
(iv) a person, who is not a Canadian, distributes the production in Canada within two years following the completion of the production.291

Except for treaty co-productions, a production will be an excluded production if neither the qualified corporation nor a prescribed taxable Canadian corporation that is related to the qualified corporation

The production is the exclusive worldwide copyright owner of the production, for all commercial exploitation purposes, for at least 25 years starting at the completion of the production, except if an interest in the production is held by either a prescribed taxable Canadian corporation or a prescribed person as a co-producer; and

controls the initial licensing of commercial exploitation of the production.\textsuperscript{292}

As mentioned above, the CPTC is calculated at a rate of 25\% of actual qualified labour expenditures capped at 60\% of total production costs (although there is no cap as to what the 60\% may be equal to). Effectively, the CPTC represents a budgetary contribution of approximately 15\% of the total cost of production (i.e., 25\% of 60\%), net of assistance.

\textbf{d. ASSISTANCE AND OTHER GOVERNMENT INCENTIVES}

Any assistance received in respect of an eligible production will reduce the cost of production that is eligible for the tax credit. Assistance refers to any financial assistance from public or private Canadian sources or from foreign sources, where it is in the form of grants, subsidies, provincial tax credits, forgivable loans, services and any other similar form of assistance.\textsuperscript{293}

"Assistance" defined in s. 125.4(1) of the \textit{ITA}, includes amounts that are taxable under s.12(1)(x) of the \textit{ITA}. In particular, this paragraph includes amounts paid in order for the payer to "achieve a benefit or advantage" and are, in respect of the recipient, an inducement, refund, reimbursement, or contribution.\textsuperscript{294} S.12(1)(x)(ii)-(iv) of the \textit{ITA} includes “deductions from tax” from “government, municipality or other public authority,” meaning that provincial tax credits received by the applicant must be deducted from the net production cost calculation for the purposes of calculating the CPTC.

The definition of “assistance” as defined in s.125.4(1) of the \textit{ITA} makes reference to a “prescribed amount” which is not considered assistance. Pursuant to section 1106(11) of the \textit{ITR}, a “prescribed amount” refers to an amount paid or payable under the License Fee Program of the Canadian Television Fund or as a licence-fee top-up contribution from the Canada Media Fund. These amounts are not considered assistance.

Pursuant to s. 125.5(4) of the \textit{ITA}, if the claimant files for a CPTC they may not file for a Film or Video Production Services Tax Credit (PSTC, \textit{see below}) for the same production.\textsuperscript{295}

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\textsuperscript{292} Canada Revenue Agency, “Canadian Film or Video Production Tax Credit- Guide to Form T1131.”

\textsuperscript{293} Canadian Heritage, \textit{Canadian Audio-Visual Certification Office}, “CPTC Program Guidelines,” April 2012,

\textsuperscript{294} Canada Revenue Agency, “Canadian Film or Video Production Tax Credit- Guide to Form T1131.”

\textsuperscript{295} Canada Revenue Agency, “Canadian Film or Video Production Tax Credit- Guide to Form T1131.”
As mentioned above, any assistance received, receivable, or expected to be received for the production reduces the eligible cost of production for the purpose of calculating the qualified labour expenditure.  

The CRA makes the final determination as to whether a source of funding will be deemed to be assistance.  

**e. REFUNDABILITY**

A qualified corporation can receive the CPTC at the rate of 25% of qualified labour expenditure incurred for the production of a Canadian film or video production. The qualified labour expenditure may not exceed 60% of the cost of production at the end of the year net of assistance. That is, the CPTC represents a budgetary contribution of approximately 15% of the total cost of production (i.e., 25% of 60%) net assistance. That said, there is no limit on the amount of CPTC that an applicant can receive for a production.  

The CPTC is fully refundable to the qualified corporation. Where no tax is payable for a given fiscal year, the corporation will be reimbursed by the amount of the tax credit, subject Part I tax otherwise payable.  

The CPTC claimed is considered assistance received in the year for the purposes of determining the income of the qualified corporation. The amount must either be included in income or, if the Canadian film or video production is depreciable property, used to reduce the capital cost of the property for capital cost allowance purposes.  

**f. STATISTICS**

Many Canadian film and video productions receive approximately 8 to 12% of their funding from the CPTC.  

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g. RECENT CHANGES

The CRA guide and Form T1131, Canadian Film or Video Production Tax Credit, have been updated to accommodate most of the Canadian film or video production tax credit (CPTC) claims that are currently filed with the Canada Revenue Agency (CRA). The guide and Form T1131 include only those rules that were introduced on November 14, 2003.

In February 2016, CAVCO launched public consultations to clarify the definitions of ineligible genres through a call-for-comments public notice (PN), currently posted on its website.

h. ADDITIONAL THOUGHTS

Crowdfunding may limit the eligibility for the CPTC available under s.125.4 of the *ITA*.

i. STATUTORY SOURCES

S. 125.4 of the *ITA* and Regulation 1106 of the Income Tax Regulations

3. CANADIAN FILM OR VIDEO PRODUCTION SERVICES TAX CREDIT

The Film or Video Production Services Tax Credit (PSTC), introduced in 1997, replaced legislation that provided tax incentives to production services limited partnerships. The PSTC is designed to enhance Canada as a location of choice for film and video productions employing Canadians, as well as to strengthen the industry and secure investment. The PSTC is modelled after the CPTC, but its primary purpose is the attraction of foreign producers to Canada, whereas the CPTC is aimed at domestic producers.

3.1 OVERVIEW

The refundable federal tax credit, PTSC, is equal to 16% of the qualifying labour paid to Canadian residents during the making of a qualified production, net of any assistance received.
receivable, or entitled to receive. There is no limit to the amount of PTSC an applicant can received for a production.\textsuperscript{309}

CAVCO co-administers the PSTC program with the CRA.\textsuperscript{310} CAVCO is responsible for:

i. confirming that a production is an accredited production (AP);

ii. confirming the copyright owner(s) of the accredited production;

iii. issuing the Accreditation Certificate so that Canadian producers can claim the PSTC.\textsuperscript{311}

The CRA verifies the qualified Canadian labour expenditure used in determining the PSTC. The CRA is responsible for:

i. determining if the corporation claiming the PTSC is an eligible production corporation;

ii. interpreting and applying section 125.5 of the Act and all other provisions in the Act and Income Tax Regulations that may have an impact on the tax credit;

iii. reviewing PSTC claims;

iv. assessing the corporations' T2 income tax returns; and

v. issuing timely refund cheques.\textsuperscript{312}

\textbf{a. WHO IS ELIGIBLE}

\textit{Eligible Production Corporation}

To qualify for the PSTC program, the applicant must be an “\textit{eligible production corporation}.”

Pursuant to the definition of “eligible production corporation” found in s.125.5(1) of the \textit{ITA}, an “eligible production corporation,” in respect of an accredited production for a taxation year, means a Canadian taxable corporation or foreign-owned corporation that carries on, through a permanent establishment\textsuperscript{313} in Canada, a business that is primarily (more than 50\%)\textsuperscript{314} a film or video production business, or a film or video production services business. See definition of “accredited production,” below.

Pursuant to paragraphs (a) and (b) of the definition of “eligible production corporation” found s.125.5(1) of the \textit{ITA}, the corporation must either:

\begin{footnotesize}
\begin{itemize}
\item \textsuperscript{309}Canada Film Capital, “Tax Credit Overview,” 2012, \url{http://www.canadafilmcapital.com/Tax-Credit-Overview.aspx}
\item \textsuperscript{310}Government of Canada, “Film or Video Production Services Tax Credit” February 17 2016, \url{http://canada.pch.gc.ca/eng/1455567039116/1455567163153}
\item \textsuperscript{311}Canada Revenue Agency, “Administration,” \url{http://www.cra-arc.gc.ca/tx/nnrsdnts/flm/pstc-cisp/pstcdmn-eng.html}
\item \textsuperscript{312}Canada Revenue Agency, “Administration,” \url{http://www.cra-arc.gc.ca/tx/nnrsdnts/flm/pstc-cisp/pstcdmn-eng.html}
\item \textsuperscript{313}Defined in section 8201 of the ITR.
\item \textsuperscript{314}Canada Revenue Agency, “Administration,” \url{http://www.cra-arc.gc.ca/tx/nnrsdnts/flm/pstc-cisp/pstcdmn-eng.html}
\end{itemize}
\end{footnotesize}
(a) own the copyright in the film for which a claim is being made; or
(b) have contracted directly with the owner of the copyright, where the owner of the copyright is not an eligible production corporation.\footnote{Canada Revenue Agency, “Film or Video Production Services Tax Credit,” http://www.cra-arc.gc.ca/tx/nnrstdnts/lm/pstc-cisp/menu-eng.html}

See discussion of “copyright owner,” below.

Pursuant to paragraphs (c), (d) and (e) of the definition of “eligible production corporation” in s.125.5(1) of the ITA, the following corporations are categorically ineligible:

(a) persons who are exempt from tax under Part I (such as a charitable or non-profit organization;
(b) who are controlled directly or indirectly by any person whose taxable income is exempt under Part I;
(c) labour-sponsored venture capital corporations (defined in section 6701 of the ITR) for the purposes of s.127.4 of the ITA.

The ITA does not define a “film or video production business” nor a “film or video production service business.” According to the CRA, the former type of business produces films or videos; the latter type of business subcontracts with a film or video production business to produce films or videos.\footnote{Canada Revenue Agency, “Film or Video Production Services Tax Credit, Guide to Form T1177,” http://www.cra-arc.gc.ca/E/pub/tg/rc4385/rc4385-13e.pdf}

To determine whether the activities of a corporation consist primarily of carrying on a business that is a Canadian film or video production business, all the facts surrounding each of the various activities undertaken by the corporation must be examined and compared. Some (non-exhaustive) factors considered:

(i) the profits realized from each of the corporation’s activities;
(ii) the volume and value of the gross sales or transactions from each activity;
(iii) the value of the assets devoted to each activity;
(iv) the capital used in each of the corporation’s activities; and
(v) the time, attention, and efforts the employees, agents, or officers of the corporation spend on each activity.\footnote{Canada Revenue Agency, “Film or Video Production Services Tax Credit, Guide to Form T1177,” http://www.cra-arc.gc.ca/E/pub/tg/rc4385/rc4385-13e.pdf}

Consequently, if the business of a corporation primarily includes other activities such as renting equipment or studios or distributing films or videos, it may not be considered a qualified corporation for the PTSC.\footnote{Canada Revenue Agency, “Film or Video Production Services Tax Credit, Guide to Form T1177,” http://www.cra-arc.gc.ca/E/pub/tg/rc4385/rc4385-13e.pdf}

\textit{Copyright Owner}
As mentioned above, the eligible production corporation must either own the copyright in the film for which a claim is being made or, if they are not the copyright owner, have contracted directly with the owner of the copyright. CAVCO is responsible for confirming the copyright owners of an accredited production.\textsuperscript{319}

For the PSTC, the owner or an owner of the copyright is the person or entity that has the rights to produce the accredited production (based on having acquired the underlying rights) and which will retain legal copyright ownership when the production is completed, allowing for exploitation of the production for which the rights were acquired.\textsuperscript{320}

There may be several copyright owners of various aspects of a production, ranging from literary rights to music rights. If, for example, an animated character already exists, the owner for PTSC purposes would not be required to acquire all the rights to that character. To be the copyright owner for the PSTC, one would, at minimum, have to acquire a licence to produce a production based on that character and retain legal copyright ownership of the finished production.\textsuperscript{321}

The term “copyright owner” refers to both to a single copyright owner and to multiple copyright owners as ownership in a production may be jointly held.\textsuperscript{322}

CAVCO requires documentation which demonstrates chain of title ownership from the time of initial development of the story idea to the writing of the final script. The types of documents required include option agreements, transfer agreements, licence agreements, script purchase agreements or script writing agreements.\textsuperscript{323}

While services to a production may be provided by any number of eligible production corporations, CAVCO issues a single certificate for the production to the copyright owner, whether or not this entity itself is an eligible production corporation. All service providers should ensure that the copyright owner applies to CAVCO and provides them with a copy of the certificate so that they may claim the applicable portion of the PSTC with the CRA.\textsuperscript{324}

\textsuperscript{320} Canada Revenue Agency, “Film or Video Production Services Tax Credit, Guide to Form T1177,” http://www.cra-arc.gc.ca/E/pub/tg/rc4385/rc4385-13e.pdf
Where the corporation who owns the copyright is an eligible production corporation, only this corporation is entitled to claim the PSTC.\textsuperscript{325}

\textbf{b. ALLOWABLE EXPENDITURES}

The PTSC is a refundable tax credit, given to eligible production corporations at the rate of 16\% of its qualified Canadian labour expenditure. The CRA has the responsibility of confirming the “qualified Canadian labour expenditure” of an eligible production corporation, in respect of an accredited production.\textsuperscript{326}

The first step in determining the qualified Canadian labour expenditure of a corporation is to determine the amount of "Canadian labour expenditure" incurred. In general terms, to qualify as a Canadian labour expenditure, the expenditure must be:

\begin{itemize}
  \item a. reasonable in the circumstances;
  \item b. incurred by the eligible production corporation for the production stages of the property, from the final script stage to the end of the post-production stage;
  \item c. paid to persons who were resident in Canada when the payments were made;
  \item d. paid for services rendered in Canada;
  \item e. directly attributable to the film or video production (there must be a clear link to specific work on the production); and
  \item f. paid in the year, or no later than 60 days after the end of the year.\textsuperscript{327}
\end{itemize}

The term “final script stage” is not defined in the \textit{ITA}. The CRA considers it to be the stage of production that begins at the point in time when a producer has either developed or acquired a final script.\textsuperscript{328}

Pursuant to the definition of “Canadian labour expenditure” in s.125.5(1) of the \textit{ITA}, the total Canadian labour expenditure for an eligible production corporation is the total of the salary or wages paid to employees of the corporation; remuneration, other than salary or wages, paid to a person or partnership; and reimbursement by a wholly-owned corporation to its parent.

\textit{Salary and Wages}

Salary or wages paid for services rendered in Canada and directly attributable to the production are eligible Canadian labour expenditures. The employees who receive salary or wages must be Canadian residents, and the services must have been rendered in Canada. Conversely, salary or

\begin{flushleft}
\textsuperscript{327} Canada Revenue Agency, “Film or Video Production Services Tax Credit, Guide to Form T1177,” http://www.cra-arc.gc.ca/E/pub/tg/rc4385/rc4385-13e.pdf
\textsuperscript{328} Canada Revenue Agency, “Film or Video Production Services Tax Credit, Guide to Form T1177,” http://www.cra-arc.gc.ca/E/pub/tg/rc4385/rc4385-13e.pdf
\end{flushleft}
wages paid to non-resident employees are not eligible; salaries or wages paid to Canadian residents who perform services outside Canada are also not eligible.\textsuperscript{329}

The salary or wages of an eligible production corporation include amounts paid to employees such as vacation pay, statutory holiday pay, sick leave pay, and taxable benefits (e.g., a corporation’s contribution to its employees’ registered retirement savings plan, group insurance plan, or meals).

Salary or wages do not include:

a. stock options or amounts determined with reference to profits or revenues;

b. the employer’s part of payments to the Canada Pension Plan, the Quebec Pension Plan, or the Employment Insurance Commission; or

c. the employer’s part of payments to workers’ compensation boards or Quebec’s Commission de la santé et de la sécurité du travail, or to any approved employee pension plan, dental care plan, or medical care or optical care plan for the employee (unless it is a taxable benefit to the employee).\textsuperscript{330}

\textit{Remuneration other than Salary or Wages}

The portion of remuneration that meets all of the criteria set out above and that is paid to a person or partnership carrying on business in Canada through a permanent establishment is considered a Canadian labour expenditure when it is paid to:

(i) An individual resident in Canada at the time the amount is paid and who is not an employee of the corporation. The amount paid must attributable to services personally rendered by the individual in Canada for the accredited production, or be attributable to but does not exceed the salary or wages of the individual’s own employees, at the time they were resident in Canada for personally rendering services in Canada for the accredited production.\textsuperscript{331}

- If the payment to non-employees includes a non-labour component (e.g. goods provided by the service provider) only the labour component is eligible for inclusion in the calculation of the labour expenditure.\textsuperscript{332}

(ii) Another taxable Canadian corporation to the extent that the amount paid is attributable to and does not exceed the salary or wages of the other corporation’s


employees at a time when they were resident in Canada for personally rendering services in Canada for the accredited production.
- Only the labour portion of the invoice sent to the production company, net of any profit margin, materials or the employer's share of government deductions, may be included as a labour expenditure.
- Technically, the salary or wages must be paid to the corporation's employees.
- The corporation must be Canadian and taxable. Some Canadian broadcasters are not taxable corporations, e.g. Radio-Québec, TVOntario, Knowledge Network, SCN.333

(iii) Another taxable Canadian corporation all the issued and outstanding shares of the capital stock of which (except directors' qualifying shares) belong to an individual who was resident in Canada and the activities of which consist principally of the provision of the individual's services, i.e. a loan-out corporation or personal services corporation.
- Again, this is to the extent that the amount paid is attributable to services rendered personally in Canada by the individual in respect of the accredited production.334

(iv) A partnership carrying on business in Canada, to the extent that the amount paid is either attributable to services personally rendered for the accredited production by an individual who is resident in Canada and who is a member of the partnership, or is attributable to and does not exceed the salary or wages of the partnership's employees at a time when they were resident in Canada for personally rendering services in Canada for the accredited production.335

Reimbursement by a Wholly-Owned Corporation to Its Parent

To qualify for the reimbursement provision, the eligible production corporation must be a wholly-owned subsidiary of another taxable Canadian corporation (the "parent"), and the eligible production corporation and the parent must have filed an agreement with the CRA that the reimbursement provision applies.336

The reimbursement must be made by the eligible production corporation to the parent within the tax year, or within 60 days of the years end. In terms of the expenditure incurred by the parent, it

must be in respect of the production and would otherwise qualify as a Canadian labour expenditure in the same manner as noted above for individuals, taxable Canadian corporations, loan-out corporations and partnerships. The expenditure incurred by the parent must have been incurred for the same purpose it would have been incurred by the eligible production corporation.337

If all the criteria of the reimbursement provision are not met, payments to the parent company will become payments to another taxable Canadian corporation (as described above). Consequently, only the Canadian labour expenditure with respect to the salary or wages of the parent corporation's employees will qualify. The Canadian labour expenditure that has been paid to a subcontractor will not qualify.338

Post-Production Labour Expenditures

Pursuant to s.125.5(2)(b) of the ITA, the only post-production expenditures eligible as a Canadian labour expenditure include only the services that are rendered at that stage by a person who performs the duties of animation cameraman, assistant colourist, assistant mixer, assistant sound-effects technician, boom operator, colourist, computer graphics designer, cutter, developing technician, director of post production, dubbing technician, encoding technician, inspection technician — clean up, mixer, optical effects technician, picture editor, printing technician, projectionist, recording technician, senior editor, sound editor, sound-effects technician, special effects editor, subtitle technician, timer, video-film recorder operator, videotape operator or by a person who performs a prescribed duty.

Pursuant to s.125(5)(2)(d) of the ITA, any costs associated with advertising, marketing, promotion, market research, or amounts related in any way to another film or video production are not eligible.

c. REQUIREMENTS AND LIMITATIONS OF THE CREDIT

Requirements

Accredited Production

To receive the PSTC, the owner of the copyright (or an official designee, if the copyright owner is not an eligible production corporation) must obtain an accredited film or video production

certificate from CAVCO for the production.\textsuperscript{339} Accreditation Certificate’s require a $5000 application fee.\textsuperscript{340}

There is no specific deadline to apply for an Accreditation Certificate. However, to get a PSTC refund the applicant must file, with the CRA, the CAVCO certificate and a completed Form T1177 with the applicant’s T2 Corporation Income Tax Return (T2 return) no later than three years after the end of the corporation’s tax year.\textsuperscript{341}

Pursuant to the definition of “accredited production,” found in section 9300(1) of the \textit{ITR}, in order to be eligible for the PTSC the production must meet the following minimum cost requirements:\textsuperscript{342}

(i) the aggregate expenditures (included in the cost of the production) for the 24-month period after principal filming or taping has begun must be more than $1,000,000 (CDN), except in the case of a series consisting of two or more episodes or a pilot for a series.

(ii) The cost for each episode in a series or a pilot for a series which has a running time of 30 minutes or less must be more than $100,000 (CDN) per episode.

(iii) The cost for each episode in a series or a pilot for a series with a running time greater than 30 minutes must be more than $200,000 (CDN) per episode.\textsuperscript{343}

Note: Each episode in a television series is considered an individual production that has to satisfy the minimum cost and eligible genre requirements.\textsuperscript{344}

Furthermore, pursuant to the definition of “accredited production,” found in section 9300(2) of the \textit{ITR}, the production must be of an “eligible genre,” meaning it cannot be any of the following genres:

(a) news, current events or public affairs programming, or a programme that includes weather or market reports;

(b) a talk show;

(c) a production in respect of a game, questionnaire or contest;

(d) a sports event or activity;

(e) a gala presentation or awards show;

(f) a production that solicits funds;

(g) reality television;

(h) pornography;

(i) advertising; and

\textsuperscript{339} Canada Revenue Agency, “Film or Video Production Services Tax Credit, Guide to Form T1177,” http://www.cra-arc.gc.ca/E/pub/tg/rc4385/rc4385-13e.pdf


\textsuperscript{341} Canada Revenue Agency, “Film or Video Production Services Tax Credit, Guide to Form T1177,” http://www.cra-arc.gc.ca/E/pub/tg/rc4385/rc4385-13e.pdf

\textsuperscript{342} There is no minimum cost requirement for the CPTC.


\textsuperscript{344} Canada Revenue Agency, “Film or Video Production Services Tax Credit, Guide to Form T1177,” http://www.cra-arc.gc.ca/E/pub/tg/rc4385/rc4385-13e.pdf
(j) a production produced primarily for industrial, corporate or institutional purposes.

Lastly, as mentioned above, an eligible production corporation can only claim the PSTC for an accredited production:

- (a) if the eligible production corporation owns the copyright for the accredited production throughout the entire period of its production in Canada; or
- (b) if the owner of the copyright is not an eligible production corporation, the eligible production corporation has contracted directly with the owner of the copyright to provide production services for the production.  

For the PSTC, the owner or an owner of the copyright is the person or entity that has the rights to produce the accredited production (based on having acquired the underlying rights) and to exploit that production for which the rights were acquired.

Eligible services may be provided to the production by any number of eligible production corporations. However, CAVCO will issue a single certificate for the production to the copyright owner, whether that entity is an eligible production corporation or not. As a result, the service provider is responsible for ensuring that the copyright owner will apply to CAVCO for an accreditation certificate. The service provider also has to ensure that the copyright owner provides a copy of the certificate so that the service provider may claim the relevant part of the PSTC.

**Co-Treaty Productions**

Similar to the CPTC, official treaty co-productions between Canada and another country (as determined by Telefilm Canada) are eligible for the PTSC. Like other productions, they may qualify under the PSTC program or the CPTC program, not both.

**Limitations**

The "qualified Canadian labour expenditure" for an eligible production corporation for a taxation year is the total of all Canadian labour expenditures for that year and preceding taxation years less:

1. Assistance received, or reasonably expected to be received, in respect of those expenditures;
2. Amounts that are part of the qualified Canadian labour expenditure that are for a preceding taxation year; and

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(iii) Where the corporation is a parent, amounts that are the subject of a reimbursement agreement with a subsidiary wholly-owned corporation.\(^{349}\)

See discussion on assistance payments, below.

(ii) The calculation of the PSTC is done on an annual basis, according to the fiscal year end of the eligible production corporation. Consequently, any amounts claimed in previous years for the Canadian labour expenditures will not be eligible for the year.\(^{350}\)

(iii) Where there has been a reimbursement by a wholly-owned subsidiary to its parent, the parent may not then claim such amounts as "qualified Canadian labour expenditures" to the extent that those same amounts are claimed by the wholly-owned subsidiary.\(^{351}\)

The copyright owner of a production may contract with a number of different eligible production corporations for the provision of services to the production. In such a situation, each eligible production corporation may claim the portion of the tax credit related to the amount of qualified Canadian labour expenditure.\(^{352}\)

d. ASSISTANCE AND OTHER GOVERNMENT INCENTIVES

Assistance

Assistance for the purposes of the PSTC is defined according to s.12(1)(x) of the ITA. Generally, assistance means financial assistance from any source, including grants, subsidies, provincial tax credits, forgivable loans, contributions, services or certain advances and any other similar forms of assistance. Any assistance received will reduce the amount of PSTC available.\(^{353}\)

That said, although provincial tax credits will reduce the amount of PSTC, the PSTC can still be “stacked” with other provincial tax credits.\(^{354}\) Although the PSTC can be claimed in conjunction with complimentary provincial tax credit programs, it cannot be combined with a claim for the federal refundable CPTC, pursuant to 125.5(4) of the ITA.

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Similar to third party payments and contract expenditures under the federal SR&ED program, assistance payments that are repaid in the year are no longer counted.\textsuperscript{355}

**Accreditation Certificate Fee Rebate**

As mentioned above, the copyright owner who applies for the Accreditation Certificate from CAVCO (who may or may not be the eligible corporation) must pay an application fee of $5000; if submitted as an application for a series of episodes, only one fee is payable. However, if a pilot episode is applied for under a separate application, an application for the remainder of the episodes in that broadcast season is subject to an additional application fee. Similarly, if episodes for one season are split among applications, a separate fee is payable for each application made.

As this can become quite costly, where the aggregate tax credit received in respect of an application is less than C$25,000 (excluding amounts which may reduce the tax credit receivable, such as taxes owing), the applicant may be entitled to a partial rebate of the administrative fees payable to CAVCO for accreditation, based on the following table:

<table>
<thead>
<tr>
<th>Aggregate Tax Credit</th>
<th>Final Fee</th>
<th>Rebate</th>
</tr>
</thead>
<tbody>
<tr>
<td>$25,001 +</td>
<td>$5,000</td>
<td>$0</td>
</tr>
<tr>
<td>$20,001 - $25,000</td>
<td>$4,000</td>
<td>$1,000</td>
</tr>
<tr>
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</tr>
<tr>
<td>$10,001 - $15,000</td>
<td>$2,000</td>
<td>$3,000</td>
</tr>
<tr>
<td>$0 - $10,000</td>
<td>$1,000</td>
<td>$4,000\textsuperscript{356}</td>
</tr>
</tbody>
</table>

\textbf{e. REFUNDABILITY}

As a fully refundable tax credit, an eligible production corporation is entitled to a refund of the PSTC where the corporation has no federal income tax payable in a particular taxation year or where the credit is more than the amount owed in federal income tax.\textsuperscript{357}

Although the PTSC is limited to 16\% of the qualified Canadian labour expenditures for the year in respect of the cost of production (net assistance), there is no cap on the actual amount that may be refunded as a PTSC.\textsuperscript{358}


f. STATUTORY SOURCES

The PTSC is regulated by s.125.5 of the ITA and section 9300 of the ITR.

g. STATISTICS


h. ADDITIONAL THOUGHTS

- The sale of the copyright ownership, after final script stage but before the completion of production in Canada, may pose some complications in applying for the PSTC; the effect of such a transfer will vary depending on the nature of the ownership. Where the copyright owner is also an eligible production corporation, copyright ownership must remain with this entity during the production in Canada. However, once the production in Canada is complete, the production corporation is free to sell ownership in the production without affecting its eligibility for the PSTC. On the other hand, if the copyright owner is not an eligible production corporation, an eligible production corporation(s) must have contracted directly with the copyright owner. CAVCO requires that the copyright owner at the time of the application must apply to CAVCO. Any changes in ownership up to this time must be demonstrated in the chain of title documentation, to be submitted with the application.359

3.2 POLICY CONSIDERATIONS

The PSTC is particularly interesting in that it attracts innovation to Canada rather than simply funding current innovation within Canada. However, the extent to which this encourages innovation within Canada for the sake of the Canadian economy rather than simply prepares innovation within Canada to then be exported to another country is unclear. That is, CAVCO and the CRA are clear that once the production is complete, copyright ownership need not stay within Canada.


One website refers to the CPTC as Canada’s “Cultural-based Canadian Content” tax credit, and refers to the PSTC as Canada’s “Economic-based Production Services” tax credit.\textsuperscript{360}

\textit{Privacy and Confidentiality}

For both the CPTC and the PSTC, the CRA provides the following notice: “Privacy Notice and Confidentiality of taxpayer information.” It reads:

“For the purpose of the CPTC program or the PSTC program, The Department of Canadian Heritage requires certain personal information. The collection and use of personal information is in accordance with the federal Privacy Act and is authorized by ss. 125.4 and 125.5 of the \textit{ITA}. It is required for the participation of an applicant to either program. The personal information included is used as part of an application for the purpose of determining whether a production is eligible under the applicable program.”\textsuperscript{361}

“Information collected in support of an application under either tax credit program may be disclosed to the Canada Revenue Agency (CRA), which co-administers both federal tax credit programs.”\textsuperscript{362}

All information provided to CAVCO as part of an application for the CPTC or the PSTC is subject to the confidentiality provisions found in s.241 of the \textit{ITA}. These provisions restrict how government officials can use or communicate information obtained for the purpose of administering the Act.\textsuperscript{363}

\textit{Provincial and Federal Rate Competition}

There is a lot of indirect dialogue between the federal and provincial tax incentives. That is, assistance provided at the provincial level changes from time to time due to industry pressure on government to remain competitive with foreign tax credit programs. As well, competitive pressures between provinces result in a similar degree of fluctuation in the incentives offered at the provincial level. As one province enhances its film and television program, the remaining provinces are pressured to boost their support of film and television industries.\textsuperscript{364}

\textit{Ability to Assign Credit}

Pursuant to ss. 220(6) and (7) of the \textit{ITA}, the PSTC and CPTC may be assigned to lenders as security for bridge financing of the Canadian film or video production. However, the CRA has no obligations towards the assignee; they will still issue the refund cheque in the name of the

qualified corporation.\textsuperscript{365} This stands out as a bizarre situation by which the CRA, normally so insistent on documentation, provides for a transfer of credits without any relating paperwork.

\textit{Lack of Appeal Process}

In situations where CAVCO denies the certificate (because it does not meet the requirements of the \textit{ITA} or \textit{ITR}), CAVCO notifies the applicant of the ineligibility of their production and provides the applicant with a 30-day notice period to submit any new information. The ITA does not provide for an appeal mechanism to challenge a certification decision. An applicant may challenge the final decision by filing a judicial review application with the Federal Court of Canada.\textsuperscript{366}

\textit{The Canadian Film and Television Production Association Recommendations for the 2015 Federal Budget}

The CMPA is Canada’s trade association for independent producers, representing more than 350 companies across the country engaged in the production and distribution of English-language television programs, feature films and digital media. Given that production has an enormous impact on the Canadian economy (CMPA members were responsible for generating a significant portion of the $7.6 billion in GDP, $2.3 billion in export value, and 127,700 high-quality full-time equivalent jobs that our the production sector created in 2014), the CMPA submitted three central recommendations: eliminating the “grind” on the CPTC; providing tax credits that remove the need for bridge financing through banks; and the creation of a new fund to promote Canadian productions and to enable Canadian producers to attend international trade shows and events where they can seek financing from international sources and access export markets. By the “grinds,” the CMPA is referring to the fact that provincial credits, other federal subsidies, and private financing reduce the value of the CPTC available to a claimant.\textsuperscript{367}

\section*{4. FEDERAL NON-TAX INCENTIVES}

\subsection*{4.1. VIDEOGAME INDUSTRY}

\subsubsection*{4.1.1 BUSINESS INNOVATION ACCESS PROGRAM (BIAP): PART OF THE INDUSTRIAL RESEARCH ASSISTANCE PROGRAM (IRAP)}

\begin{thebibliography}{9}
\bibitem{367} Canadian Film and Television Production Association, “Recommendations for the 2015 Federal Budget to the House of Commons Standing Committee on Finance,” 6 August 2014.
\end{thebibliography}
a. WHO IS ELIGIBLE/BENEFICIARIES?

Small and medium enterprises (SMEs) in Canada that are incorporated and profit oriented, with 500 or fewer full-time equivalent employees, and have the objective to grow and generate profits through development and commercialization of innovation, technology driven new or improved products, services, or processes can apply for the BIAP reimbursement.\textsuperscript{368}

b. ALLOWABLE EXPENDITURES

The Business Innovation Access Program (BIAP) provides financial contributions to help small and medium sized enterprises (SMEs) access business services or technical assistance offered at Canada’s learning institutions and publicly-funded research organizations in order to “bring better innovations to market faster”.\textsuperscript{369}

Business projects funded through BIAP include: market research, business model analysis, marketing and communication strategies, distribution channel analyses, organization development and planning, website optimization and analytics development, IT strategy evaluation and development, certification and supply chain optimization.\textsuperscript{370}

Technical projects funded through BIAP include: investigations of available technology options, optimization and design, measurement of prototype properties, system performance/experimental investigations, specialized testing and engineering challenges, data analytics, mechanical or electronic prototype design, design or system tool selection and user experience investigations.\textsuperscript{371}

c. REQUIREMENTS AND LIMITATIONS OF THE FUNDING

The maximum amount payable to any recipient looking to fund a short-term project in any fiscal year is $50,000 for a business-related project and $50,000 for a technical-related project.\textsuperscript{372} Examples of eligible business services include market research, marketing strategy development, competitive analysis and business strategy development. Eligible technical services include product optimization, process development, analysis or optimization and specialized testing.\textsuperscript{373}

d. STATISTICS

The list of recipients of BIAP funding is not provided on the National Research Council’s website, but the funding provided to SMEs throughout the country is summarized in the BIAP Evaluation Report in the following tables:\textsuperscript{374}

\textsuperscript{369} National Research Council, “BIAP”.
\textsuperscript{371} Ibid.
\textsuperscript{372} National Research Council, “Details of Transfer Payment Programs (TPPs).”
\textsuperscript{373} National Research Council, “BIAP”.
However, a success story of NRC-IRAP funding concerning the Vancouver-based video game production company, Koolhaus Games Inc., is advertised on both the NRC’s website and the company’s website. With the help of IRAP funding and the connections of the NRC’s advisors, Koolhaus developed software which demonstrated how a 3D gaming experience could be reproduced in 2D. This product and other projects based on technology that the NRC-IRAP supported have contributed to Koolhaus Games Inc.’s success.

### e. RECENT CHANGES

The BIAP is a pilot program which was announced in the 2013 Budget. The program ends on March 31, 2016 and it is unclear whether it will be renewed.

### f. ADDITIONAL THOUGHTS

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376 National Research Council, “Plays Well with Others: Koolhaus Games”.

377 Ibid.

The June 2015 Evaluation Report found that the SMEs which received BIAP funding were satisfied with the program, but many suggested that a grant model, rather than the contribution model in place would better suited to the financial mechanisms in place in learning institutions (i.e. it would be easier to receive a grant than a reimbursement).  

**g. STATUTORY SOURCES**

BIAP is administered by the National Research Council of Canada Industrial Research Assistance Program (NRC-IRAP). The NRC is a Government of Canada organization mandated by the National Research Council Act.  

### 4.1.2 CANADA MEDIA FUND (CMF) EXPERIMENTAL STREAM

**a. WHO IS ELIGIBLE**

Eligible applicants include taxable Canadian corporations that have their head office in Canada and are Canadian-controlled for the purposes of sections 26 to 28 of the Investment Canada Act as well as Canadian broadcasters, public or private, that are licensed to operate as such by the Canadian Radio-Television and Telecommunication Commission (CRTC).  

**b. ALLOWABLE EXPENDITURES**

Eligible costs must be directly related to the project and include:

- Research and preparation of content;
- Salaries and benefits/wages/contracts for project teams;
- Technology infrastructure (hardware and software);
- Expenses to put content online, including copyright clearance, documentation, design, development and translation costs;
- Travel and accommodations;
- Project audit fees;
- Other technical and administrative expenses; and
- Marketing and promotion.

**c. REQUIREMENTS AND LIMITATIONS OF THE FUNDING**

The Canada Media Fund (CMF) provides funding for the creation of convergent television and digital content in order to “[get] governance and accountability right; focus the investment on

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what Canadians want; reward success and require innovation; and level the paying field.”383 The CMF funds grants in the Convergent Stream (for television production and videos on demand) as well as the Experimental Stream (for leading-edge, interactive and innovative digital media content and software applications which includes videogames, whether for PC, console, handheld console, mobile, or other platforms).

Currently, there are two additional programs in place within the context of the Experimental Stream: the Accelerator Partnership Pilot Program (A3P) and the International Coproduction and Codevelopment Incentives. The A3P aims to connect Experimental Stream recipients with Canadian and foreign accelerators.384 The International Coproduction and Codevelopment Incentives encourages producers to find funding partners from Australia, Belgium, Brazil or New Zealand (the CMF only has agreements with these four countries) and the CMF matches the funds provided by these funding organizations in these countries to support the creation of innovative projects that have at least one Canadian and one international producer.385

In order to ensure that the funding contributes to the Canadian economy, “eligible projects must be owned, and significantly and meaningfully developed, by Canadians; produced in Canada with at least 75% of its Eligible Costs being Canadian costs for development and production; and at least 50% of its Eligible Costs being Canadian costs for marketing”386

Finally, the CMF emphasizes that eligible projects must be innovative. The CMF does not define innovation, but it rates eligible projects on a scale of innovation ranging from mere iteration (which refines features of an existing product or service) to a revolutionary project which “creates market turbulence”.387

d. STATISTICS

At the development stage, the maximum contribution to a project is the lesser of 75% of the Project’s Eligible Costs or $300k. At the production stage, the maximum contribution to a project is 75% of its Eligible Costs or $1.2M. However, the combined maximum contribution to a project at the development, production and marketing stage is $1.2M.388

386 Ibid.
387 Ibid., p.10.
CMF has recently announced that it will be contributing $6.3M in development support and marketing support to 31 innovative digital media projects.\(^{389}\)

### DIGITAL MEDIA PROJECTS FUNDED BY THE CMF IN 2016

<table>
<thead>
<tr>
<th>Title</th>
<th>Applicant</th>
<th>Commitment</th>
</tr>
</thead>
<tbody>
<tr>
<td>Bloodlines : Hunters</td>
<td>Hibernum Créations Inc.</td>
<td>$136,370</td>
</tr>
<tr>
<td>Bring to Light</td>
<td>Red Meat Games Inc.</td>
<td>$195,252</td>
</tr>
<tr>
<td>Emoji Warriors</td>
<td>Yellow Bear Studios Inc.</td>
<td>$133,950</td>
</tr>
<tr>
<td>Gepeto</td>
<td>Yugen Inc.</td>
<td>$168,703</td>
</tr>
<tr>
<td>Interface humaine (L’)</td>
<td>Productions Neweb.TV inc.</td>
<td>$300,000</td>
</tr>
<tr>
<td>Matt Cook's Sabotage</td>
<td>Stompy Bot Productions Inc.</td>
<td>$300,000</td>
</tr>
<tr>
<td>Maya - La chanteuse virtuelle</td>
<td>Productions Neweb.TV inc.</td>
<td>$298,114</td>
</tr>
<tr>
<td>Memories</td>
<td>Dissident Interactive Inc.</td>
<td>$223,157</td>
</tr>
<tr>
<td>Nights &amp; Days of Zikverländ</td>
<td>9082-8773 Québec Inc.</td>
<td>$272,000</td>
</tr>
<tr>
<td>Ombra</td>
<td>Cardboard Utopia Inc.</td>
<td>$224,447</td>
</tr>
<tr>
<td>Project Agile</td>
<td>qaqaq Inc.</td>
<td>$55,076</td>
</tr>
<tr>
<td>Project Galaxy Wars</td>
<td>9329-8958 Québec inc.</td>
<td>$150,000</td>
</tr>
<tr>
<td>Project Red I - DM</td>
<td>9300-2665 Québec inc.</td>
<td>$100,103</td>
</tr>
<tr>
<td>Quand la foule devient cirque</td>
<td>9309-4076 Québec Inc.</td>
<td>$292,500</td>
</tr>
<tr>
<td>Snowballs and Sorcery</td>
<td>Darned Sock Productions Inc.</td>
<td>$36,055</td>
</tr>
<tr>
<td>Social Magnet</td>
<td>Covalent Media Inc.</td>
<td>$300,000</td>
</tr>
</tbody>
</table>

\(^{389}\) CMF, “$6.3M awarded to Canadian innovative digital media projects”, February 2, 2016, online: http://www.cmf-fmc.ca/industry-advisory/article/2016/02/6-3m-awarded-to-canadian-innovative-digital-media-projects/
<table>
<thead>
<tr>
<th>Star Whack Virtual Reality</th>
<th>Game Pill Inc.</th>
<th>$76,230</th>
</tr>
</thead>
<tbody>
<tr>
<td>Tower</td>
<td>SkyBox Labs Inc.</td>
<td>$300,000</td>
</tr>
<tr>
<td>Trance VR</td>
<td>9286721 Canada Inc.</td>
<td>$300,000</td>
</tr>
<tr>
<td>Virtual Director</td>
<td>Rubber Match Productions Inc.</td>
<td>$300,000</td>
</tr>
<tr>
<td>Voodoo Noir</td>
<td>Fourth Monkey Media Inc.</td>
<td>$100,500</td>
</tr>
<tr>
<td>WayPoints</td>
<td>Studio Sauropode Inc.</td>
<td>$300,000</td>
</tr>
</tbody>
</table>

### e. RECENT CHANGES

The changes applicable to the experimental stream include:  
- a decrease in the maximum contribution for development from $400k to $300k;  
- an increase in the maximum contribution for production from $1M to $1.2M;  
- an increase in the overall cap for development, production and marketing of a project from $1M to $1.2M;  
- a change to the evaluation grid which now considers the criterion of the “historical success working with the CMF”;  
- the inclusion of “e-learning application, software and technologies” as eligible curriculum-based projects; and  
- a change to the definition of “interactivity” as to include immersive technologies that engage and stimulate the user’s senses to create perceptually-real sensations.

### f. STATUTORY SOURCES

The CMF is administered by Telefilm Canada which is a federal Crown corporation mandated by the *Telefilm Canada Act* to “foster and promote the audio-visual industry in Canada” by making loans, awards and grants to audio-visual producers in Canada.  
Section 18 of the Act appropriates “$25 million to be paid out of the Consolidated Revenue Fund from time to time pursuant to this Act”.

The CMF receives the majority of its funding from Canadian cable and satellite companies (broadcasting and distribution undertakings or BDUs) and the Department of Canadian Heritage

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390 CMF, Funded Projects Search, online: http://www.cmf-fmc.ca/funded-projects/funded-projects-database/1/?program=Experimental&activity=Development&fiscalYear=2015-2016&selectionRound=2&displayCommitment=0
(PCH) of the Government of Canada. From fiscal years 2010-2011 to 2013-2014, PCH has provided $134 million annually to the CMF.394

Telefilm Canada is subject to annual audits by the Auditor General of Canada and must submit annual reports within three months of the end of the fiscal year.395

4.1.3 POLICY ANALYSIS

Grants provided by the Canada Media Fund have steadily increased. The CMF Experimental Stream has notably increased its maximum contribution per recipient to $1.2 million and has recently announced that it will be providing $6.3 million in development and marketing support for 31 innovative digital media projects.396

However, the BIAP grant program managed by the National Research Council is not set to be renewed for 2016/2017. BIAP was a pilot program which was allocated $20 million in the 2013 budget “to bring innovations to market faster” from 2014 to 2016.397 It is unclear why the program has not been renewed given its success.398

4.2. FILM INDUSTRY

4.2.1 MICRO-BUDGET PRODUCTION PROGRAM (CANADA FEATURE FILM FUND)

a. WHO IS ELIGIBLE

The project must first be recommended by one of Telefilm’s selected partners. The partner must confirm that the key members of the project are either alumni of the partner’s program or film cooperative (Main component), a self-declared Aboriginal (Aboriginal component), an Anglophone living in Quebec or a Francophone living outside Quebec (OLMC component). The audiovisual project must be a feature length film of 75 minutes or more or other audiovisual content between 10 and 74 minutes made in a format for online audiences. The project must be distributed on one or more digital platforms and the maximum budget must be no higher than $250,000.399

395 Telefilm Canada Act, s.22-23.
b. ALLOWABLE EXPENDITURES

Telefilm’s contribution must be used towards direct expenses relating to the development, production, postproduction, distribution and promotion of the project.\textsuperscript{400}

c. STATISTICS

As part of the Micro-Budget Program, Telefilm provides a non-repayable financial contribution that may cover up to 100% of the project’s financing. The maximum contribution for a feature film is $127,500. The maximum contribution for a narrative based web project is $15,000 for each full 10-minute segment up to $112,500. An amount of $7,500 of Telefilm’s contribution must go towards hiring a digital marketing expert and at least 15% of Telefilm’s contribution (excluding the amount to hire a digital marketing expert) must be used for promotion and distribution expenses.\textsuperscript{401}

In June 2015, Telefilm funded 15 micro-budget productions.\textsuperscript{402} Most recently, Telefilm also announced it was providing over $8 million in funding the production of 12 English-language feature films in the context of other programs of the Canada Feature Film Fund: Hunting Pignut (Martine Blue), Maudie (Aisling Walsh), nineteenseventysomething (Bruce McDonald), Goon: Last of the Enforcers (Jay Baruchel), Mean Dreams(Nathan Morlando), Milton’s Secret (Barnet Bain), Operation Insanity (Érik Canuel), The Other Half (Joey Klein), Juliana and the Medicine Fish (Jeremy Torrie), Loneliness of a Sewer Trucker (Hakan Sahin), Lovesick (Tyson Caron) and Entanglement (Jason James).\textsuperscript{403}

d. RECENT CHANGES

The main changes to the Micro-Budget Program are the following:\textsuperscript{404}

- Web-content is now an eligible format, but they must be narrative-based projects specifically created for online distribution and comprised of one or more segments which, in total, are between 10 and 74 minutes in length;
- Telefilm has increased its financial contribution by $7,500 to be used to cover the cost of a digital marketing and social media expert per selected project;
- At least 15% of Telefilm’s contribution (excluding the digital expert contribution) must be allocated to promotion and distribution expenses; and
- All funded projects must be made available no later than 18 months after completion on the Telefilm Canada channel which will be featured the National Film Board of Canada’s paid streaming platform.

\begin{flushright}
\textsuperscript{400} Telefilm Canada, “Micro-Budget Guidelines”, (February 3, 2016), p.6.
\textsuperscript{401} Ibid., p.6.
\textsuperscript{404} Telefilm Canada, “Micro-Budget Production Program”, online: https://www.telefilm.ca/en/funds-and-programs/micro-budget-production-program
\end{flushright}
e. STATUTORY SOURCES

The Canada Feature Film Fund is administered by Telefilm Canada which is a federal Crown corporation mandated by the Telefilm Canada Act to “foster and promote the audio-visual industry in Canada” by making loans, awards and grants to audio-visual producers in Canada. Section 18 of the Act appropriates “$25 million to be paid out of the Consolidated Revenue Fund from time to time pursuant to this Act”.

4.2.2 CANADA COUNCIL FOR THE ARTS GRANTS

a. WHO IS ELIGIBLE

Canadian citizens or permanent residents as defined by the Citizenship and Immigration Canada who meet the Council’s definition of a professional artist can apply for these grants. A professional artist is defined as an artist who has specialized training in the artistic field (but not necessarily in academic institutions), is recognized as a professional by his or her peers (working in the same artistic tradition), is committed to devoting more time to artistic activity, if possible financially, and has a history of public presentation. Established, mid-career and emerging artists are all eligible for these grants.

b. ALLOWABLE EXPENDITURES

The Canada Council for the Arts provides “Grants to Film and Video Artists” including Scriptwriting Grants, Production Grants and Research/Creation Grants.

c. REQUIREMENTS AND LIMITATIONS OF THE FUNDING

Scriptwriting grants range from $3,000 to $20,000. Production grants and Research/Creation grants for established or mid-career artists range from $3,000 to $60,000, but emerging artists are only eligible for amounts from $3,000 to $20,000.

d. STATISTICS

405 Telefilm Canada Act, R.S.C. 1985, c.C-16, s. 10.
406 Telefilm Canada Act., s. 18.
407 Canada Council for the Arts, “General Eligibility”, online: http://canadacouncil.ca/council/grants/general-eligibility
During the 2014-2015 fiscal year, 111 individual film and visual artists received grants from the Canada Council for the Arts within the context of this program. These grants ranged between $4,000 and the maximum contribution of $60,000.

### e. STATUTORY SOURCES

The Canada Council for the Arts is a federal, arm’s length Crown corporation created by the *Canada Council for the Arts Act* in 1957 to “foster and promote the study and enjoyment of, and the production of works in, the arts”.

The Canada Council for the Arts reports to Parliament through the Minister of Canadian Heritage. The Endowment Fund of $50 million and the University Capital Grants Fund of $50 million allocated from Parliament comes from the Consolidated Revenue Fund. This annual budget allocated from Parliament is supplemented by endowment income, donations and bequests.

The Council’s accounts and financial transactions are subject to annual audits by the Auditor General of Canada. The Council must also submit an annual report including financial statements within three months after the end of each fiscal year.

In 2014-2015, the Council awarded 599 grants and provided $143.6M in total funding.

### 4.2.3 POLICY ANALYSIS

The Canada Feature Film Fund (managed by Telefilm Canada) and the Canada Council for the Arts Grants provide a wide variety of financial incentives for the development, production and marketing of Canadian films, especially if the films produced are in a minority language. Most recently, Telefilm announced that it will fund 15 micro-budget productions and provide $8 million in funding for 12 larger productions. The Canada Council for the Arts provides grants to individual artists, including film and video artists, ranging from $3,000 to $60,000. In 2014-2015, the Council awarded 599 grants and provided $143.6M in total funding.
With respect to the 2016 federal budget, Melanie Jolie, the current Heritage Minister, has stated that CBC/Radio-Canada will receive $75 million in new funding in the 2016-2017 budget, to be followed by $150 beginning in 2017-2018, and that the annual federal contribution to the Canada Council of the Arts will double, from $180 million to $360 million, while also restoring $25 million in funding to Telefilm Canada and the National Film Board. Joly has also stated that the government may be amending current Broadcasting and Telecommunications Acts, which have apparently not changed much in the past 30 years. Finally, Joly also plans to launch a series of consultations about CBC's new focus on digital, asking, "how can we support Canadian content in a digital age?"  

4.3. AEROSPACE INDUSTRY

4.3.1 NATIONAL RESEARCH COUNCIL OF CANADA INDUSTRIAL RESEARCH ASSISTANCE PROGRAM (NRC-BIAP) AEROSPACE

a. WHO IS ELIGIBLE

Small and medium enterprises (SMEs) in Canada that are incorporated and profit oriented, with 500 or fewer full-time equivalent employees, and have the objective to grow and generate profits through development and commercialization of innovation, technology driven new or improved products, services, or processes can apply for these grants.  

b. ALLOWABLE EXPENDITURES

The IRAP Aeronautical Product Development Technologies program, the Aeronautics for the 21\textsuperscript{st} century program, the Air Defence Systems program, Civilian Unmanned Aircraft Systems program, the Reducing Aviation Icing Risk program and the Working and Travelling on Aircraft program provide technical and advising services in addition to funding:  

a. Access to a research infrastructure and expertise, combined with competitive rates, customized service options and measures to ensure partner data integrity and confidentiality;

b. Maximal opportunities and connections between Canadian companies at all levels of the supply chain;

c. Access to a network of research development test and evaluation providers; and

d. Fosters relationships with regulators.

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\textsuperscript{422} ADPT, online: http://www.nrc-cnrc.gc.ca/eng/solutions/collaborative/aeronautical_product_dev.html
c. REQUIREMENTS AND LIMITATIONS OF THE FUNDING

The NRC offers many opportunities to collaborate on projects regarding aeronautical product development technologies, aeronautics for the 21st century, air defence systems, civilian unmanned aircraft systems, reducing aviation icing risk as well as working and travelling on an aircraft.\textsuperscript{423} However, the NRC provides specific grants to corporations through the Industrial Research Assistance Program (IRAP).

The constraint on the power of the NRC to provide these grants can be found in s.16 of the \textit{National Research Council Act} whereby “all receipts and expenditures of the Council are subject to examination and audit by the Auditor General of Canada”.\textsuperscript{424}

d. STATISTICS

According to the NRC’s Financial Statements for 2014-2015 and the accompanying Discussion and Analysis document, the grants and contributions expenses like the Industrial Research Assistance Program decreased by $14.6M to $263.8M.\textsuperscript{425}

Information regarding the recipients of funding will be requested online.

e. STATUTORY SOURCES

IRAP is administered by the National Research Council of Canada (NRC). The NRC is a Government of Canada organization mandated by the \textit{National Research Council Act}.\textsuperscript{426} The \textit{National Research Council Act} does not stipulate the origin of the funding for the NRC’s programs.

4.3.2 STRATEGIC AEROSPACE AND DEFENCE INITIATIVE PROGRAM (SADI)

a. WHO IS ELIGIBLE

Small, medium or large corporations incorporated in Canada and carrying on business in Canada are eligible recipients. The project must comprise either industrial research (aimed at the discovery of new knowledge which may be useful to improve or develop new products, services or processes) or pre-competitive development (using industrial research to improve or design new products, services or processes).\textsuperscript{427}

\begin{footnotesize}
\begin{enumerate}
\item \textit{Ibid.}
\item Strategic Aerospace and Defence Initiative Program Guide, April 2014, p.3, online: https://www.ic.gc.ca/eic/site/ito-
\end{enumerate}
\end{footnotesize}
The Applicant must comply with the *Lobbying Act* throughout the application process and throughout the duration of the SADI-funded project.  

**b. ALLOWABLE EXPENDITURES**

The project must comprise either industrial research (aimed at the discovery of new knowledge which may be useful to improve or develop new products, services or processes) or pre-competitive development (using industrial research to improve or design new products, services or processes). Eligible costs may include labour, material, overhead, specialized equipment.

**c. REQUIREMENTS AND LIMITATIONS OF THE FUNDING**

1% of the project costs must be allocated to post-secondary education institutions in Canada. The Applicant must comply with the *Lobbying Act* throughout the application process and throughout the duration of the SADI-funded project.

The Minister may make loans, guarantee the repayment of a financial obligation undertaken by any person, provide loan or credit insurance, make grants and contributions to any person under the Act. However, the Minister will seek Treasury Board approval prior to authorizing contributions in excess of $10 million and also Cabinet approval when in excess of $20 million.

The combined government funding (federal, provincial, municipal, tax credits) cannot exceed 75% of eligible costs.

**d. STATISTICS**

The SADI program provides repayable contributions, as opposed to loans, covering up to 40% of the total eligible project costs. Repayments are unconditional or based on the recipient’s gross business revenue. They begin two years after the completion of the R&D and typically are repaid over 15 years. There is no minimum or maximum SADI contribution. However, the combined total government funding (federal, provincial, municipal and tax credits) cannot exceed 75% of eligible costs.

To date, project sizes range from $276,000 to $300 million.

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429 SADI Program Guide, p.4.
435 SADI Program Guide, p.3.
As of March 31, 2014 the SADI portfolio was comprised of 34 projects (with 27 recipients) and a combined authorized assistance of $1.16 billion. Many projects are still in the research and development phase and have yet to enter the repayment phase.439

<table>
<thead>
<tr>
<th>Status</th>
<th># of Projects</th>
<th>Authorized Assistance ($)</th>
<th>Disbursements ($)</th>
<th>Repayments ($)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Research and Development Phase</td>
<td>19</td>
<td>988,776,716</td>
<td>606,408,136</td>
<td>N/A; projects in Research and Development Phase</td>
</tr>
<tr>
<td>Repayment Phase</td>
<td>11</td>
<td>118,108,624</td>
<td>115,184,998</td>
<td>5,064,110</td>
</tr>
<tr>
<td>Inactive</td>
<td>4</td>
<td>48,220,991</td>
<td>26,898,860</td>
<td>6,162,957</td>
</tr>
<tr>
<td>Total</td>
<td>34</td>
<td>1,155,106,331</td>
<td>748,491,994</td>
<td>11,227,067440</td>
</tr>
</tbody>
</table>

The following table describes the 34 SADI projects and the amount of authorized assistance provided to each recipient:

<table>
<thead>
<tr>
<th>Company</th>
<th>Project Description</th>
<th>Authorized Assistance</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>2007–2008</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>1 Diamond D-Jet Corporation</td>
<td>Single-engine, five-passenger jet aircraft</td>
<td>$19,600,000</td>
</tr>
<tr>
<td><strong>2008–2009</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>2 Integran Technologies Inc.</td>
<td>Nanotechnology enabled tooling</td>
<td>$4,596,000</td>
</tr>
<tr>
<td>3 Magellan Aerospace Limited</td>
<td>Structural components for the F-35</td>
<td>$43,391,600</td>
</tr>
<tr>
<td>4 Héroux Devtek Inc.</td>
<td>Advanced landing gear technology</td>
<td>$26,964,430</td>
</tr>
</tbody>
</table>

## SADI Portfolio Recipients and Amount of Authorized Assistance

<table>
<thead>
<tr>
<th>Company</th>
<th>Project Description</th>
<th>Authorized Assistance</th>
</tr>
</thead>
<tbody>
<tr>
<td>5 Norsat International Inc.</td>
<td>Microwave, wireless &amp; portable satellite technologies</td>
<td>$5,975,200</td>
</tr>
<tr>
<td>6 CMC Electronics Inc.</td>
<td>Integrated cockpit &amp; communications system</td>
<td>$52,287,784</td>
</tr>
<tr>
<td>7 EMS Technologies Canada Ltd.</td>
<td>Next generation mobile satellite communications</td>
<td>$8,718,634</td>
</tr>
<tr>
<td>8 SkyWave Mobile Communications Inc.</td>
<td>Fleet management, shipping security</td>
<td>$3,127,200</td>
</tr>
<tr>
<td>9 CAE Inc.</td>
<td>Enhanced simulation technology</td>
<td>$250,000,000</td>
</tr>
<tr>
<td>10 Sputtek Inc.</td>
<td>Advanced protective coating technologies</td>
<td>$360,285</td>
</tr>
<tr>
<td><strong>2009–2010</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>11 AXYS Technologies Inc.</td>
<td>Unifying data from monitoring &amp; surveillance sources</td>
<td>$1,836,900</td>
</tr>
<tr>
<td>12 PCI Geomatics</td>
<td>Earth observation information extraction</td>
<td>$7,665,000</td>
</tr>
<tr>
<td>13 BelAir Networks Inc.</td>
<td>Radio technology with advanced security</td>
<td>$9,690,706</td>
</tr>
<tr>
<td>14 Kongsberg Mesotech Ltd.</td>
<td>Acoustic instrumentation for underwater security</td>
<td>$4,968,000</td>
</tr>
<tr>
<td>15 Integran Technologies Inc.</td>
<td>Cadmium replacement coatings</td>
<td>$276,284</td>
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<tr>
<td>16 Integran Technologies Inc.</td>
<td>Hard chrome alternative</td>
<td>$807,399</td>
</tr>
<tr>
<td><strong>2010–2011</strong></td>
<td></td>
<td></td>
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<tr>
<td>17 2154331 Canada Inc.</td>
<td>Flight simulation</td>
<td>$18,570,000</td>
</tr>
<tr>
<td>18 D-TA Systems Inc.</td>
<td>Advanced sensor processing</td>
<td>$1,790,140</td>
</tr>
<tr>
<td>19 ASCO Aerospace Canada Ltd.</td>
<td>Structural components for the F-35</td>
<td>$7,688,288</td>
</tr>
<tr>
<td>20 Pratt &amp; Whitney Canada Corp.</td>
<td>Gas turbine engine applications</td>
<td>$300,000,000</td>
</tr>
</tbody>
</table>
### SADI Portfolio Recipients and Amount of Authorized Assistance

<table>
<thead>
<tr>
<th>Company</th>
<th>Project Description</th>
<th>Authorized Assistance</th>
</tr>
</thead>
<tbody>
<tr>
<td>21 Thales Canada Inc.</td>
<td>Fly-By-Wire flight control system</td>
<td>$12,988,800</td>
</tr>
<tr>
<td>22 FLYHT Aerospace Solutions Ltd.</td>
<td>Automated flight information reporting system</td>
<td>$1,967,507</td>
</tr>
<tr>
<td>23 Ultra Electronics Canada Inc.</td>
<td>Tactical high capacity radio</td>
<td>$32,447,400</td>
</tr>
<tr>
<td><strong>2011–2012</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>24 Integran Technologies Inc.</td>
<td>Nanostructured alloys as an alternative to copper beryllium</td>
<td>$399,386</td>
</tr>
<tr>
<td><strong>2012–2013</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>25 Engineering Services Inc. (ESI)</td>
<td>Intelligent security robot</td>
<td>$778,800</td>
</tr>
<tr>
<td>26 GasTOPS Ltd.</td>
<td>Oil systems diagnostics</td>
<td>$1,275,000</td>
</tr>
<tr>
<td>27 NGRAIN</td>
<td>3D tools</td>
<td>$9,500,000</td>
</tr>
<tr>
<td>28 Héroux Devtek Inc.</td>
<td>Advanced landing gear technology</td>
<td>$48,957,693</td>
</tr>
<tr>
<td>29 Norsat International Inc.</td>
<td>Improvements to satellite terminals, microwave components &amp; radio frequency antennas</td>
<td>$13,270,265</td>
</tr>
<tr>
<td><strong>2013–2014</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>30 AXYS Technologies Inc.</td>
<td>Port waterside application &amp; data</td>
<td>$2,000,000</td>
</tr>
<tr>
<td>31 Dominis Engineering Ltd.</td>
<td>Naval propulsion impellers &amp; high skew monoblock propellers</td>
<td>$544,500</td>
</tr>
<tr>
<td>32 Ultra Electronics Maritime Systems Inc.</td>
<td>Advanced underwater sensing systems</td>
<td>$8,231,222</td>
</tr>
<tr>
<td>33 CAE Inc.</td>
<td>Project Innovate</td>
<td>$250,000,000</td>
</tr>
</tbody>
</table>
SADI Portfolio Recipients and Amount of Authorized Assistance

<table>
<thead>
<tr>
<th>Company</th>
<th>Project Description</th>
<th>Authorized Assistance</th>
</tr>
</thead>
<tbody>
<tr>
<td>Avcorp Industries Inc.</td>
<td>Advanced metal-bond manufacturing capability development</td>
<td>$4,431,208</td>
</tr>
</tbody>
</table>

Notably, 85% of SADI funding assists large corporations and 87.1% of the total SADI funding supports aerospace research and development.442

<table>
<thead>
<tr>
<th>SADI Authorized Assistance by Sectors (Percent)</th>
<th>SADI Projects by Firm Size (Percent)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Aerospace</td>
<td>Large</td>
</tr>
<tr>
<td>Defence</td>
<td>Medium</td>
</tr>
<tr>
<td>Space</td>
<td>Small</td>
</tr>
<tr>
<td>Security</td>
<td></td>
</tr>
<tr>
<td>87.1%</td>
<td>85%</td>
</tr>
</tbody>
</table>

e. RECENT CHANGES

Industry Canada plans to slightly decrease its spending on SADI in order to further fund the Technology Demonstration Program (TDP) which provides non-repayable contributions to large corporations which collaborate with SMEs and higher education institutions.443

Planned and forecast spendings for Strategic Aerospace and Defence Initiative

<table>
<thead>
<tr>
<th>Forecast</th>
<th>Planned Spending ($)</th>
</tr>
</thead>
</table>

f. STATUTORY SOURCES

SADI is managed by Industry Canada’s Industrial Technologies Office which is mandated by the Department of Industry Act.\(^{444}\)

4.3.3 TECHNOLOGY DEMONSTRATION PROGRAM (TDP)

a. WHO IS ELIGIBLE

Original Equipment Manufacturer or Tier 1 corporation, incorporated pursuant to the laws of Canada and carrying on business in Canada are eligible to receive TDP funding.\(^{445}\)

b. ALLOWABLE EXPENDITURES

TDP funds direct labour costs to undertaking the R&D, materials, equipment, and overhead at a rate of 75 percent of direct labour. Applicants may request support for R&D infrastructure, such as shared facilities accessible by all group members during the project that are broadly available as ongoing innovation hubs. In the case of significant investment in infrastructure, the recipient will be expected to have a plan to maintain the project’s infrastructure and make it available for use after the project is completed.\(^{446}\)

c. REQUIREMENTS AND LIMITATIONS OF THE FUNDING

Proposals are assessed based on the following criteria:\(^{447}\)

\[\text{The economic benefits the project provides for Canada in the long term;}\]

\[\text{Footnote g}\]

Changes in Planned Spending reflect the amounts allocated to the Technology Demonstration Program (TDP) as per the approved TDP funding profile. The total amounts that have been reallocated were $14 million in 2015–16, $18 million in 2016–17 and $22 million in 2017–18.

\[\text{Return to footnote g}\]

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\({}^{444}\) \textit{Ibid.}, p.3.


\({}^{446}\) \textit{Ibid.}

b. The broader social, environmental, health and other benefits the project provides to Canada;

c. The project must foster collaboration with at least one Canadian SME and one accredited Canadian university, college or affiliated research institute led by an Original Equipment Manufacturer or a Tier 1 company;

d. The project must be innovative and technologically feasible;

e. The applicant must show that the lead corporation has the financial capability to complete the project, but that the TDP funding would lever incremental private sector investment in R&D; and

f. The lead corporation and its project members must show a commitment to further develop the technology for a potential commercialization and sustain the infrastructure after the completion of the project.

d. STATISTICS

One new project is expected to be approved per year. The projects are of $108M in size or larger and are typically conducted over a 5-year period. The TDP provides non-repayable contributions supporting 50% of total eligible project costs up to a maximum of $54M per project.\textsuperscript{448}

e. RECENT CHANGES

Industry Canada forecasts a steady increase in spending for the TDP. By 2018, the funding provided for TDP contributions will increase threefold due to the transfer of funds from SADI.\textsuperscript{449}

<table>
<thead>
<tr>
<th>Planned and forecast spendings for Technology Demonstration Program</th>
<th>Forecast Spending 2014–15 ($)</th>
<th>Planned Spending ($)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Total contributions</td>
<td>16,181,560</td>
<td>27,181,560</td>
</tr>
<tr>
<td>Total transfer payments</td>
<td>16,181,560</td>
<td>27,181,560</td>
</tr>
</tbody>
</table>

f. STATUTORY SOURCES

TDP is managed by Industry Canada’s Industrial Technologies Office which is mandated by the Department of Industry Act.\textsuperscript{450}

4.3.4 POLICY ANALYSIS

The most substantial direct financial incentives provided by the federal government are awarded to Canadian corporations in the aerospace industry. Notably, the SADI and TDP programs can

\textsuperscript{448} \textit{Ibid}, p.4.


provide up to $300 million and $54 million in funding respectively.\textsuperscript{451} The NRC-IRAP program for Aerospace also had $263.8 million at its disposal in its 2014-2015 budget, but the amounts recipients received are not available.\textsuperscript{452} SADI has provided financial assistance totalling 1.16 billion dollars to 34 projects carried out by 27 recipients.\textsuperscript{453} Although small, medium and large corporations are eligible for SADI repayable contributions, 85\% percent of recipient are large corporations such as CAE Inc. and Pratt & Whitney Canada Corporation.\textsuperscript{454} However, Industry Canada plans to slightly decrease its spending on SADI in order to fund TDP which provides non-repayable contributions to large corporations that collaborate with SMEs and Canadian university, college or affiliated research institute.\textsuperscript{455} This shift towards non-repayable contributions may have two possible motivations: it could foster greater cooperation in the aerospace industry between small, medium and large corporations as well as higher education research institutions or it may be a manoeuvre which simply provides large Tier 1 corporations or Original Equipment manufacturers with free funding.

\textit{The Need for Transparency}

Some agencies have not been transparent about how their funds have been allocated and how much each recipient has received. The National Research Council does not advertise which projects it has funded in the aerospace industry or in the videogame industry, with the exception of the 3D gaming experience project conducted by Koolhaus Games Inc.\textsuperscript{456} Telefilm occasionally posts press releases on its website concerning new projects, but does not disclose the amounts awarded to filmmakers. In order to hold government officials accountable, the allocation of these financial contributions should be publicized.

On the other hand, the Canada Media Fund (Experimental Stream) and the Canada Council for the Arts both provide complete lists of the videogame companies and artists who have received funding and the amount of the grant they have received. Also, Industry Canada publishes the list of corporations who have received SADI funding and hopefully it will be equally transparent when awarding TDP funding to aerospace corporations.

5. CONCLUSION

One should bear in mind that the predominant sources of information on the federal tax incentives come from either the body that offers the incentive (the CRA, CAVCO, Telefilm, etc.,) or, additionally in the case of SR&ED, the SR&ED consulting or lending firms. With the

\textsuperscript{451} Industry Canada, “TDP vs. SADI”, online: https://www.ic.gc.ca/eic/site/ito-oti.nsf/eng/h_00860.html


\textsuperscript{453} Industry Canada, “SADI: Program Highlights”, online: https://www.ic.gc.ca/eic/site/ito-oti.nsf/eng/00922.html

\textsuperscript{454} Industry Canada, “SADI”, online: https://www.ic.gc.ca/eic/site/ito-oti.nsf/eng/00922.html


exception of government statistics, little information is provided directly by claimants. Because contextually specific information (i.e., the statistics of SR&ED on a micro level) is confidential, it is hard to state with certainty the impact that these incentives have on Canadian innovation at this stage in the project. The confidentiality of tax liability may be the reason why there is much more accessibility to micro statistics on federal non-tax incentives than the tax incentives.

The idea that SR&ED (in particular) did little to encourage innovation, predominant in 2011-2012, arguably may have simply arisen from the high volume of inaccurate or fraudulent SR&ED claims submitted by SR&ED lenders and SR&ED consulting firms. The Department of Finance and the CRA undertook efforts to reduce claimant’s reliance on these third parties, implementing a self-assessment tool (SALT), and holding a practitioner’s Q&A session in early 2016. However, these steps do not mitigate the 2012 cuts to the SR&ED program; these steps do nothing to counteract the further SR&ED reduction via a vis governments increasing use of “direct” funding (i.e., loans) to businesses (as these assistance payments reduce available SR&ED ITC’s). The Liberal Party has promised to “kickstart investment in innovation;” the 2016 Federal Budget promises $2 billion over three years for targeted, short-term infrastructure projects under the Post-Secondary Institutions Strategic Investment Fund; $95 million per year in new annual funding for “discovery research,” including $30 million for NSERC; up to $800 million to support creation of innovation network and clusters (the Budget analogizes Waterloo to Silicon Valley); and an additional $50 million in 2016-2017 to increase services offered IRAP. Unfortunately, the 2016 Federal Budget makes no mention of changes to the SR&ED program, the best example of indirect R&D funding in Canada.457

Despite the CRA’s rhetoric, the federal government has continually admitted that there is considerable debate about whether the tax incentives for SR&ED are cost-effective. According to the Parliamentary Information and Research Service’s 2006 SR&ED Tax Policy, “tax incentives are considered to be cost-effective if the increase in SR&ED investment attributable to the incentives exceeds the amount of tax revenue forgone. Research on the cost-effectiveness of SR&ED tax incentives has focused primarily on tax policy in the United States; American studies generally support the conclusion that the benefits of SR&ED tax incentives exceed the costs. Empirical research in Canada demonstrates some or little cost-effectiveness [Dagenais, Mohnen and Therrien (2004); Department of Finance and Revenue Canada (1997)], but also suggests that Canadian tax incentives produce significantly less SR&ED per dollar of tax revenue forgone than do American tax incentives [Klassen, Pittman and Reed (2004); MacDonald (2004)]. Studies by Warda (1990; 1999) and KPMG (2006) nonetheless suggest that Canada is a leading promoter of SR&ED and provides one of the most favourable investment climates for SR&ED among OECD countries.”458

Comparing the CPTC/PTSC with SR&ED shows that the CPTC and PTSC share the predominant issues of the SR&ED program: firstly, the fact that provincial credits, other federal subsidies, and private funding reduce the value of the credit available to the claimant. And

secondly, because producers only receive their refunds a long time after they have submitted their claims (typically 18-24 months after filing their claims), producers are typically required to rely on bridge financing with financial institutions, just as SR&ED claimants rely on SR&ED lenders. While I did not find any widespread reports of these finance institutions submitting abusive claims, the Canadian Media Production Association has complained that interest costs and related fees on bridge financing amount to an estimated $22 million of lost value for producers per year.459

One semi-positive aspect of the SR&ED program is that it does work hard to keep the incentives within Canada. For example, SR&ED contract expenditures are only eligible to the extent they are paid to a “taxable supplier,” i.e., a Canadian resident or permanent establishment. The taxable supplier rules do not apply to claimants who undertake SR&ED work directly as a basic eligibility criteria for the SR&ED program is that the work be carried on within Canada. Furthermore, work performed outside of Canada is generally ineligible, except in specific situations, i.e., the salary of employees, and even that is limited to 10% of eligible wages claimed for SR&ED performed in Canada.

The same can be said of the CPTC, which not only requires that the film or video production take place in Canada, but that certain key members of the production (e.g., the producer, lead actress/actor, etc.) are Canadian residents as well. The PTSC focuses on bringing film and video production into Canada; offering attractive tax incentives to producers that produce the film or video within Canada and/or who hire Canadians to work on or in the production. And the CPTC and PSTC are very attractive incentives – no cap on the amount that can be received, in contrast with the SR&ED (in the sense that some ITC’s are not refundable). As mentioned above, this last statement may hold less true for the PTSC than the CPTC, as the PTSC does not require the copyright remain within Canada.

The need for transparency seems to be a consistent issue with all of these incentives. That said, the notion of transparency as an issue is somewhat circumscribed by the confidentiality of taxpayer’s tax liability. Although there can be a lot of movement of the funds between federal tax claimants – think of NAL performers transferring their expenditures to the payer; or CTPC/PSTC claimants using their refunds as security – these movements all require the filing of specific forms and extensive documentation with the CRA or associated office. Unfortunately, once these forms are filed, they tend to become confidential. Thus, interviews with the beneficiaries of the tax incentives will likely provide valuable information on the actual impact of these incentives on innovation within Canada; interviews with the SR&ED financing and/or consulting firms could also provide further insight. Lastly, we should keep our eyes open to the development of a possible SR&ED Practitioner’s Association, as well as the creation of so-called “innovation network and clusters,” as discussed in the 2016 Federal Budget.