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SR&ED - Tax Incentives for Startups

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The Scientific Research and Experimental Development Program, also known as "**SR&ED**" (pronounced "shred"), is a federal tax incentive program for businesses carrying out eligible research and development activities. SR&ED can play an essential role in a startup's financing by extending runway until products or services can be monitized. SR&ED is not just for large businesses; startups have equal access to the program.

SR&ED is administered by the Canada Revenue Agency ("**CRA**") and is comprised of two main incentives: (1) income tax credits and (2) cash refunds based on eligible SR&ED expenditures. The Canadian government's purpose behind SR&ED is to support research in Canada, retain skilled labour and develop leading-edge technologies.

Key Concept: Investment Tax Credits

Through Investment Tax Credits ("**ITCs**"), claimants may be able to obtain a cash refund or a reduction of taxes payable (or both) for qualifying SR&ED expenditures. The amount of ITCs that can be claimed depends on whether a claimant is a Canadian-Controlled Private Corporation ("**CCPC**") – a private corporation that resides in Canada and is controlled by Canadian shareholders.[1] A CCPC qualifies for preferential rates of ITCs.

In general, a CCPC with taxable income of $500,000 or less can claim ITCs at a rate of 35% on SR&ED expenditures up to a maximum of $3 million, plus additional provincial credits dependant on where the claimant's headquarters are located. A CCPC that exceeds this $3 million threshold can claim credits at a rate of 15% on the excess.

Non-CCPCs are eligible for ITCs, but they may only recoup 15% of qualifying SR&ED expenditure as credits that can be carried back three years, or carried forward 20 years. This carrying back or forward can help to reduce past tax liabilities or offset future taxes payable when a company is not currently profitable. Moreover, if the total value of ITCs exceeds the taxable income limit in a given year, allocating the excess to other years can also help to capture value from the ITCs that would otherwise be lost.

Types of Work that Qualify as SR&ED

Work qualifying as SR&ED must adhere to the scientific method. It must also be conducted with an aim to eliminating a scientific or technological uncertainty that cannot be removed by standard practice. While the work will be eligible if it creates new or improves pre-existing products, it does not have to have a specific practical application.

A range of expenditures toward SR&ED can be claimed. These include:

- salaries and wages of employees who directly perform or supervise the SR&ED, including but not limited to activities related to performance or scalability challenges leading to new algorithms or methods;
- integration of third-party components resulting in development of middleware;
- failed prototypes requiring additional expenditures and time to resolve; and
- extending software to new platforms or environments.

An expenditure must be directly related to the SR&ED in order for it to be allowable. Further, all or substantially all of such expenses must have been incurred for SR&ED purposes and the intellectual property must be owned by the potential applicant. Eligible companies have 18 months from the end of the fiscal year in which the activity took place to submit a claim. Applicants commonly claim years back-to-back as projects tend to overlap taxation periods.

1 Designation of the CCPC status is determined by the provisions of the *Income Tax Act* (Canada).

The SR&ED program provides businesses with incentives for pursuing scientific and technological research and development. If your business is conducting research and development, you may be able to benefit from tax deductions, credits and refunds. Check the CRA website for more information on how to qualify for the program.

**This article was drafted with assistance from Chris Bodnar, PwC SR&ED Corporate Development Manager. The statements contained herein are for general informational purposes only and are not intended, nor should they be construed as, legal advice.*

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