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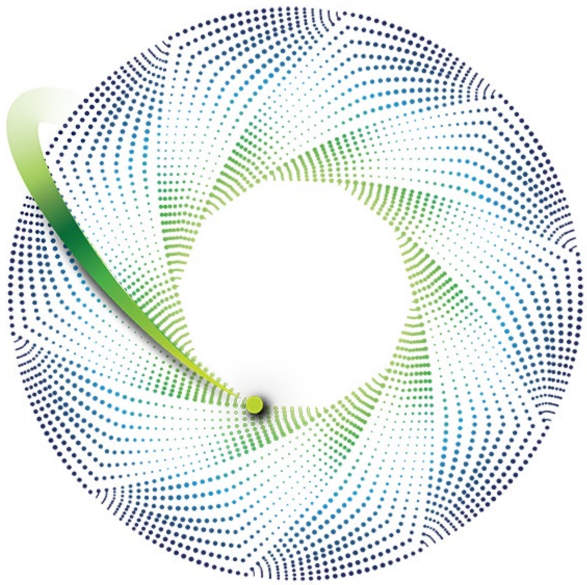

Canadian Tax & Legal Alert

Proposed reforms to Canada's Scientific Research and Experimental Development (SR&ED) program – making Canada's SR&ED program more globally competitive

December 20, 2024

Background

In response to several public consultations held in 2024 on Canada's Scientific Research and Experimental Development (SR&ED) Tax Incentive program, and following the government's intentions announced in Budget 2023 and 2024 to make **major changes to Canada's SR&ED program**, the Department of Finance Canada announced on December 13, 2024, **proposed reforms and enhancements to Canada's SR&ED program totalling $1.9 billion over the next six years**.[1]

These reforms are very important for Canada in terms of helping to improve its competitiveness in the global landscape and potentially attracting additional investment to Canada. It also represents a targeted policy focus on supporting high-intensity research and development (R&D) scaling companies in Canada. These are the first substantive reforms to Canada's SR&ED program in more than a decade.

As part of Deloitte's representations made during the consultations held last spring on Canada's SR&ED program, **we recommended that the changes proposed by these reforms be implemented**[2] to modernize the program so that it better reflects the increased investments in innovation that have occurred over the past decade. Our recommendations included

[1] Reforming and Enhancing the Scientific Research and Experimental Development (SR&ED) Tax Incentive Program - Canada.ca

[2] Re: Consultation on Scientific Research and Experimental Development – Deloitte's comments
Second phase of consultations on Scientific Research and Experimental Development Tax Incentive Program – Deloitte's comments

modernizing limits and thresholds for current economic realities (e.g., inflation, company formation, capital required to get to scale) while also focusing capital on productivity-improving investments. **We believe these reforms will better reflect the current economic environment for Canadian companies.**

Key proposed reforms

Increasing the maximum annual expenditure limit

The government is proposing to increase the maximum annual expenditure limit eligible for the enhanced 35% SR&ED tax credit rate from $3 million to $4.5 million. This means that the maximum annual SR&ED tax credit calculated at the enhanced 35% rate would increase from $1,050,000 to $1,575,000 per year. **This is an increase of $525,000 per year (+50%)**. This change will generate additional cash-flow to support qualifying Canadian-controlled private corporations (CCPCs) that are investing significant amounts in SR&ED in Canada each year.

Increasing taxable capital phase-out thresholds for determining the annual expenditure limit

To determine its annual expenditure limit, a claimant that is a CCPC must consider its taxable capital employed in Canada for the preceding taxation year, including that of its associated Canadian corporations for tax purposes. The thresholds for phasing out taxable capital employed in Canada to determine the annual expenditure limit will increase from the current $10 million and $50 million to $15 million and $75 million, respectively, once the reforms are enacted. **This change will allow CCPCs to raise 50% more capital than before being phased out of refundable rate. It also means that CCPCs will see the pace of their phase-out being 50% slower. In other words, they will maintain refundability for a much longer period as they are scaling.**

The table below shows the variation in the annual expenditure limit eligible for the enhanced 35% refundable tax credit and the corresponding amount of tax credit based on the increase in taxable capital employed in Canada by the associated group of corporations:

Taxable capital employed in Canada by the corporation and its Canadian associated corporations	Annual expenditures limit	Maximum refundable tax credit at enhanced 35% rate
$15M and less	$4,500,000	$1,575,000
$20M	$4,125,000	$1,443,750
$30M	$3,375,000	$1,181,250
$40M	$2,625,000	$918,750
$50M	$1,875,000	$656,250
$60M	$1,125,000	$393,750
$70M	$375,000	$131,250
$75M and more	–	–

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Global Investment and Innovation Incentives (G*i*³)

***NEW ELECTION* -- CCPCs will also have the option to elect a phase-out structure for the annual expenditure limit based on their gross income**, as described below, rather than the phase-out structure based on taxable capital employed in Canada.

Expanding the eligibility for the enhanced 35% rate

Prior to the proposed reforms, only a CCPC could access the enhanced SR&ED tax credit rate of 35%. Any other entity or individual was generally eligible for the basic 15% tax credit rate. As we noted in our representations, we welcome the fact that the proposed reforms provide for the **expansion of eligibility for the 35% enhanced refundable tax credit to eligible Canadian public corporations up to an annual expenditure limit of $4.5 million.** Eligibility would be reduced based on the consolidated group's average gross revenue over the previous three years, with a phase-out scaling between $15 million and $75 million in revenues. Eligibility will also extend to corporations where all or substantially all of the shares are owned by at least one eligible Canadian public corporation.

Such companies typically continue to invest large sums of money into R&D in order to remain competitive in the global marketplace. Access to a refundable tax credit for Canadian public corporations was one of the issues raised in the public consultations on the SR&ED program held last spring. The availability of a refundable SR&ED tax credit is a key factor in better supporting R&D investment by Canadian public corporations. This change will certainly set Canada's SR&ED program apart from other SR&ED systems and is a particularly welcome change for several industries in Canada that have often had to access capital through Canadian stock exchanges when other sources of private capital were not available (e.g., biotech, deep tech, mining tech).

Reinstating the eligibility for SR&ED capital expenditures

Importantly, the eligibility of SR&ED capital expenditures, including, subject to certain conditions, lease costs and shared-use equipment, will be reinstated. This proposed change impacts both the deduction of such expenditures in calculating income (deductible SR&ED expenditures) and the eligibility of such capital expenditures for the SR&ED tax credit.

The rules for such property would generally be the same as those that existed before 2014 and would apply to property acquired on or after December 16, 2024. In the case of SR&ED equipment lease costs, the new rules would apply to amounts that first become payable on or after December 16, 2024, and for taxation years that begin on or after December 16, 2024.

In the case of CCPCs, tax credits earned on capital expenditures would only be eligible for partial refundability at a rate of up to 40%, as opposed to the fully refundable tax credit available on current expenditures, subject to the annual expenditure limit.

Note that certain recapture rules may apply for SR&ED tax credits granted on capital expenditures if a taxpayer subsequently sells the property or converts its use.

Impact on Canadian businesses

These proposed reforms come at a time when all Canadian companies are making important decisions about investments in productivity-enhancing assets, particularly those related to artificial intelligence. These reforms create an environment that further incentivizes the undertaking of these projects and potentially create an environment where both physical hardware and cloud computing costs may become eligible expenses for SR&ED purposes.

These reforms to the Canadian SR&ED program would be effective for taxation years that begin on or after December 16, 2024. This is therefore an important time for taxpayers who are contemplating capital expenditures and lease arrangements to consider how they approach the documentation of such agreements, given the complexity historically associated with these types of expenditures.

How can Deloitte help you?

Deloitte professionals can help you understand how these proposed reforms, or any previously announced measures, may impact your business. If you have any questions, please reach out to your Deloitte advisor or any of the individuals noted in this alert. More specifically, Deloitte's G*i*³ group is available to assist you in identifying potential incentives, current and/or forthcoming, to support your investments.

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