R&D Tax Incentives: Canada, 2020

Design of R&D tax relief provisions

Canada provides R&D tax relief through a volume-based tax credit.

Table 1. Main design features of R&D tax incentives in Canada, 2020

<table>
<thead>
<tr>
<th>Tax incentive</th>
<th>Federal Scientific research and experimental development (SR&amp;ED) tax credit</th>
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</thead>
<tbody>
<tr>
<td>Type of instrument</td>
<td>Tax credit</td>
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<tr>
<td>Eligible expenditures†</td>
<td>Volume-based</td>
</tr>
<tr>
<td>Headline rates (%)</td>
<td>15 (35 for CCPCs*)</td>
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<tr>
<td>Refund</td>
<td>Immediate (CCPCs)</td>
</tr>
<tr>
<td>Carry-over (years)</td>
<td>20 (carry-forward), 3 (carry-back)</td>
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<tr>
<td>Thresholds &amp; ceilings</td>
<td>35% credits are available to CCPCs up to a baseline expenditure limit of CAD 3 million** (excess expenditure is eligible for 15% tax credit)</td>
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<tr>
<td>Refund-specific</td>
<td>Full refund at 35% rate up to expenditure limit of CAD 3 million (CCPC)**</td>
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* CCPC: Canadian-controlled Private Corporation. ** Before March 2019, the baseline limit of CAD 3 million was reduced as a function of taxable income and taxable capital and was fully phased out once a CCPC reaches a prior year taxable income of CAD 0.8 million or a prior year taxable capital of CAD 50 million. As of March 2019, the use of previous year taxable income is removed as a factor in determining a CCPC’s annual expenditure limit. The latter is a function of taxable capital only.

Note: For more details, see OECD R&D Tax Incentive Compendium and Eligibility of current and capital expenditure for R&D tax relief.


Key features:

- In case of insufficient tax liability, unused credits can be carried-forward (back) for 20 (three) years.
- R&D tax credit is fully refundable for Canadian-controlled Private Corporations (CCPCs) at an enhanced rate of 35% on expenditures up to a limit of CAD 3 million (1 CAD = 0.642 EUR, Q3 2020).
- R&D expenses in excess of this threshold qualify for a tax credit at a reduced rate of 15% that is 40% refundable if its prior-year taxable income does not exceed its qualifying income limit for the business group. The qualifying income limit starts at CAD 500 000 and is reduced when prior-year taxable capital is between CAD 10 million and CAD 50 million.
- The expenditure limit of CAD 3 million is reduced as a function of the taxable capital in the previous tax year and fully phased out once a CCPC reaches a prior year taxable capital of CAD 50 million.
- In addition to Federal tax support, Canada offers provincial R&D tax credits that range from 3.5% (Ontario) to 30% (Quebec). Many provinces provide refundable credits.

Generosity of R&D tax support in 2020

Differences in the design of R&D tax incentives drive significant variation in the expected generosity of tax relief per additional unit of R&D investment. In 2020, the marginal tax subsidy rate for profit-making (loss-making) SMEs in Canada is estimated at 0.31 (0.31), well above the OECD median of 0.20 (0.18). The implied tax subsidy rate for large enterprises is 0.13 (0.10) in the profit (loss) making scenario, close (equal) to the OECD median of 0.17 (0.15).

Figure 1. Implied tax subsidy rates on R&D expenditures: Canada, 2020

1-B-Index, by firm size and profit scenario

Note: Implied marginal tax subsidy rates, presented for different firm size and profitability scenarios, are calculated based on headline tax credit/allowance rates (see methodology and country-specific notes), providing an upper bound value of the generosity of R&D tax support, not reflecting the effect of thresholds and ceilings that may limit the amount of qualifying R&D expenditure or value of tax relief.

Only Federal tax incentives are modelled – the SR&ED tax credit and accelerated depreciation for machinery and equipment used in the process of R&D (immediate write-off), available from 2000 to 2014. According to SR&ED eligibility purposes, SMEs correspond to CCPCs.

**Recent developments in R&D tax relief provisions**

Regular reforms of R&D tax incentives lead to continuous changes in the availability, scope and generosity of R&D tax incentives. Such reforms relate to the launch of new tax incentives, the R&D definition adopted for tax purposes, changes in tax credit and allowance rates, adjustments of thresholds or upper ceilings on qualifying R&D expenditure or tax relief amounts, or changes in the terms and availability of refunds.

In 2020, changes in the availability and scope of R&D tax incentives represented the most frequent type of policy reform (OECD, 2020), along with adjustments to the headline R&D tax credit/allowance rates and adjustments of thresholds or upper ceilings on qualifying R&D expenditure or tax relief amounts. In response to the COVID-19 pandemic, several countries increased the generosity of R&D tax relief or introduced modifications to the administration of R&D tax incentives to facilitate and accelerate R&D funding.

In 2020, Canada undertook three changes in its R&D tax relief provisions:

- Most refundable claims are to be processed as soon as possible with minimal burden on the claimants. Claims accepted at this time may be subject to review/audit at a future date to ensure eligibility. Small or medium businesses will generally not be contacted to initiate any SR&ED claim reviews.
- For claims due March 13, 2020 or later, the deadline to claim certain tax credits, including the SR&ED tax credit, has been extended to six months from the original due date or to December 31, 2020, whichever is earlier.
- The tax legislation was amended to grant Revenu Québec discretion to extend the time limit for filing applications for certain tax incentives, including the SR&ED tax credit, for up to one year following the otherwise applicable deadline.

All of these policy changes are related to the COVID-19 outbreak.

**Trends in the generosity of R&D tax support**

The generosity of federal R&D tax incentives has remained fairly stable in Canada over the 2000-20 period, with a reduction in implied R&D tax subsidy rates in 2014. In this year, the accelerated depreciation provision for machinery and equipment used in the process of R&D (immediate write-off) was abolished, capital expenditures and lease costs ceased to qualify for tax support under the SR&ED investment tax credit; and the general rate of the SR&ED investment tax credit was reduced from 20% to 15%.

This change in the rate of the tax credit did not affect SMEs which benefited from a fully refundable tax credit at an enhanced rate of 35% throughout the time period considered. If the SR&ED threshold applicable to SMEs is considered in the modelling of R&D tax subsidy rates, the rate for profitable (loss-making) SMEs slightly changes from 0.31 (0.31) to 0.31 (0.29).

**Figure 2. Implied tax subsidy rates on R&D expenditures: Canada, 2000-20**

1-B-Index, by firm size and profit scenario

![Graph showing implied marginal tax subsidy rates on R&D expenditures in Canada from 2000 to 2020.](image)

*Note: Implied marginal tax subsidy rates, presented for different firm size and profitability scenarios, are calculated based on headline tax credit/allowance rates (see methodology and country-specific notes), providing an upper bound value of the generosity of R&D tax support, not reflecting the effect of thresholds and ceilings that may limit the amount of qualifying R&D expenditure or value of tax relief.*

Policy support for business R&D: the policy mix

In 2018, Canada is placed above the OECD average in terms of total government support to business R&D as a percentage of GDP, at a rate equivalent to 0.22% of GDP.

Figure 3. Direct government funding of business R&D and tax incentives for R&D, 2018 (nearest year)

As a percentage of GDP

Note: Data on subnational tax support are only available for a group of countries.

Key points:
- From 2006 to 2018, government support for BERD (excluding subnational tax support) as a percentage of GDP decreased in Canada by 0.05 percentage point (pp), while the OECD average increased by 0.03 pp.
- During this period, business R&D intensity in Canada declined from 1.1% to 0.8%.
- In 2018, R&D tax incentives accounted for 76% of total government support for BERD in Canada.

Distribution of R&D tax relief recipients and government tax relief for R&D

The distribution of R&D tax relief recipients and government tax relief for R&D expenditures (GTARD) provide insights into what types of firms claim and benefit from tax relief.

Figure 4. Number of R&D tax relief recipients and value of government tax relief for R&D, 2017

By firm size*, share in percent

Note: Figures refer to the SR&ED tax credit. *SMEs are defined as Canadian Controlled Private Corporations (CCPCs).

Key points:
- While data on the share of R&D tax relief recipients accounted for by SMEs vis-à-vis large firms are not available for Canada, the available breakdown for GTARD suggests that R&D tax support in Canada was evenly distributed between SMEs (CCPCs) and large firms, amounting to 50% each.
Trends in the uptake of R&D tax incentives

Over the period 2014-2018 (for which relevant data are available), the number of R&D tax relief recipients decreased in Canada by nearly 25%, from 27 400 in 2014 to 20 900 in 2018. Most of this decline is attributable to the year 2017 where this count reached 20 700, a decline of around 4 200 firms compared to 2016.

Figure 5. Number of R&D tax relief recipients, Canada, 2014-2018

Note: Figures refer to SR&ED investment tax credit.

Trends in government support for business R&D

Between 2000 and 2018, the importance of tax incentives has been very high in Canada, both in absolute and relative terms, with a rebalancing of the policy mix noticeable in more recent years.

Figure 6. Direct government funding of business R&D and tax incentives for R&D, Canada, 2000-2018

As a percentage of GDP, 2015 prices (right-hand scale)


- The cost of R&D tax relief declined (in 2015 prices) from CAD 4 695 million in 2000 to CAD 3 523 million in 2018. From January 2014, the base of eligible expenditures was narrowed by removing capital expenditures and lease costs. The SR&ED tax credit was also reduced from 20% to 15%.
- As a percentage of GDP, R&D tax support oscillated between 0.18% and 0.20% of GDP from 2008 to 2013, declined to 0.13% of GDP after the tax credit reform in 2014 to reach 0.116% of GDP in 2018.
- Direct funding of BERD increased from 0.03% to 0.05% of GDP between 2000 and 2018.
- The share of R&D tax incentives in total government support fluctuated between 88% and 92% over the 2008-13 period, dropping to 83% in 2014 and declining further to 76% in 2018. Subnational tax incentives accounted for 29-34% of total tax support for R&D during the 2008-18 period (30% in 2018).


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