

MEMORANDUM

To: CRIM members and clients

From: Manon Labelle, Membership Services Administrator

Date: December 22, 2011

Objet: Tax measures concerning CRIM: tax credits for technological adaptation services and scientific research and development experimental activities

The Computer research institute of Montreal (CRIM) is an applied IT research centre as well as a liaison/transfer centre. Its clients and members may be eligible for various tax credits programs, including the tax credit program for technological adaptation services and the tax credit program for scientific research and experimental development (SR&ED). In an economy based on knowledge and inter-company competition, these tax measures, which may apply to CRIM clients and members, constitute a major incentive to take advantage of CRIM's well recognized expertise.

1. Tax credit for technological adaptation services

In support of companies' efforts to collect and process strategic information and to undertake research and innovation collaboration initiatives with various partners, the Quebec government has put in place a tax credit for technological adaptation services. This refundable tax credit represents 50% of the eligible expenditures incurred. Although it is a Quebec government credit, it is taxable at both the federal and provincial levels.

1.1 Eligible companies

Any company operating in Quebec during a given tax year may claim the tax credit for technological adaptation services.

In this regard, the eligible "technological adaptation" activities are as follows:

- Identifying and brokering research results.
- Evaluating company's needs.
- Fostering relationship developments between stakeholders.
- Conducting technical feasibility studies and evaluating the commercial potential of innovation projects.
- Accompanying companies during the various stages of innovation projects.

1.2 Eligible expenditures

In terms of the services provided by CRIM, the eligible expenditures are as follows:

- An amount corresponding to 80% of the fees charged for liaison and transfer services provided by CRIM. *The technological guidance provided by CRIM staff is also included in this category.*
- Fees charged for participating in training and information activities pertaining to CRIM's liaison and transfer services. *The fees for CRIM's training activities and the registration fees for CRIM's seminars are also included in this category. To download the tax credit form: http://incomequebec.ca/en/sepf/formulaires/co/co-1029_8_21_22.aspx*

2. Tax credit for SR&ED activities

Both the provincial and federal governments strongly encourage companies to invest in SR&ED activities by granting significant tax credits enabling companies to cut their SR&ED costs by nearly 50%—and sometimes more. In particular, Quebec encourages collaboration between companies and research centres such as CRIM.

Please note that companies engage in SR&ED activities whenever they carry out pure research, applied research, experimental development and support work meeting criteria in the following three areas:

- The scientific and technological advancement of the project.
- The scientific and technological uncertainty inherent to the project.
- The scientific and technological content of the activities.

Each company is responsible for demonstrating that these expenditures are SR&ED-eligible and that they meet the abovementioned criteria. A technical description of the projects should be submitted to the federal and provincial governments, including a summary of the expenditures incurred for each project and for all SR&ED tax credit claims. However, any government aid received should be deducted from the eligible SR&ED expenditures.

Please note that it is essential that you consult with your tax advisor to ensure that your tax return is filled out correctly and that your tax credits are maximized.

2.1 Eligible companies

Any company can benefit from these SR&ED tax measures provided that the research is carried out in Canada (federal credit) and/or in Quebec (provincial credit). Effective February 26, 2008, it is possible to include the labour costs for foreign employees in connection with a research project in Canada. The remuneration for foreign employees, however, should not be subject to foreign income tax; it is also limited to 10% of the total remuneration claimed in connection with SR&ED.

2.2 Federal tax credits

At the federal level, the basic tax credit works out to 20% of the SR&ED expenditures incurred; it is not refundable. Any unused balance may be carried back three years or carried forward 20 years. The tax credit is 35% on the first \$3 million in annual expenditures incurred by a small or medium-sized enterprise (SME). For the purposes of the federal program, an SME is a Canadian-controlled private corporation (CCPC) whose taxable income and taxable capital (for all group entities) in the previous tax year do not exceed \$500,000 or \$10 million respectively. The \$3 million expense limit is reduced if the company's taxable income is between \$500,000 and \$800,000 and its taxable capital is between \$10 million and \$50 million. The federal credit used is taxable in the following tax year at both the federal and provincial levels.

If you have any questions concerning the SR&ED tax credit program, you can speak with a representative of the Canada Revenue Agency (CRA) by dialling (800) 959-7775 or you can consult the CRA's website (<http://www.cra-arc.gc.ca/txcrdt/sred-rsde/menu-eng.html>).

Eligible expenditures

At the federal level, the eligible expenditures are usually divided into two categories (current expenditures and capital expenditures).

The eligible current expenditures directly incurred for SR&ED activities are as follows:

- Salaries.
- Materials consumed or transformed.
- Fees charged by sub-contractors.
- Equipment rental.
- Payments made to third parties conducting research on the taxpayer's behalf.
- Overhead expenses: however, it is possible to select the replacement method, in which case 65% of the direct salaries (replacement amount) would be claimed, instead of the actual overhead expenses.

Eligible capital expenditures include the acquisition of new depreciable property used in SR&ED activities for 90% or more of its useful life.¹

2.3 Provincial tax credits

At the provincial level, the basic refundable tax credit works out to 17.5% of the eligible expenditures incurred. This refundable tax credit may be increased to 37.5% on the first \$3 million of eligible expenditures incurred by an SME. For the purposes of the provincial program, an SME is a Canadian-controlled private corporation (CPCC) with less than \$50 million in assets on the consolidated financial statements (all group entities). Please note that the 37.5% rate is progressively reduced to 17.5% for companies with assets valued at \$50 million to \$75 million. Quebec's SR&ED tax credits are always refundable, i.e. a company can receive the credit even if it has no income tax payable. The Quebec credit is not taxable in Quebec, although it is taxable at the federal level in the current year.

For further information, Revenu Québec's website can be a very useful resource (<http://www.mrq.gouv.qc.ca/en/ministere/index.asp>).

Eligible expenditures

At the provincial level, the eligible SR&ED expenditures are as follows:

- Salaries paid in Quebec.
- In the case of sub-contractors dealing at arm's length and conducting research in Quebec on the taxpayer's behalf, 50% of the amount paid.
- In the case of individuals or corporations not dealing at arm's length, 100% of the salary portion included in the amount paid.

¹ Capital expenditures and the specific features of the tax treatment of these credits are not discussed in this document.

Specific provisions for contracts with a research centre such as CRIM

In order to increase collaboration between companies and the research sector, the Quebec government grants a refundable tax credit of 35% to a company that signs a research contract with a certified research centre such as CRIM, regardless of the value of the assets of the associated corporate group. In that case, the credit is applied to 80% of the eligible SR&ED expenditures instead of 50% in the case of day-to-day sub-contracting.

An advance tax ruling should be requested by the applicant; the ruling should stipulate that Revenu Québec has authorized the contract's eligibility for the purposes of the SR&ED tax credit. An advance tax ruling must be requested no more than 90 days following the signing date of the contract (under certain circumstances, no more than three years following the signing date).

Specific provisions for research partnership contracts

In its budget of March 24, 2008, the provincial government extended the credit for precompetitive research conducted by a partnership, thereby enabling publicly-funded organizations such as CRIM to be parties to such contracts. However, at least two unrelated privately-held companies must also take part in the research.

Under this type of contract, companies can claim a credit of 35%, regardless of the value of the assets of the corporate group associated with the following expenditures:

- Salaries.
- Materials consumed or transformed.
- 80% of the sub-contracting fees.
- Equipment rental.
- Overhead expenses: however, it is possible to select the replacement method, in which case 65% of the direct salaries (replacement amount) would be claimed instead of the actual overhead expenses.

3. Scope of this document

This document was prepared by CRIM in collaboration with Raymond Chabot Grant Thornton based on public documents. It is designed to provide CRIM members and clients with information on the tax features of various joint projects in which they may be involved.

However, neither CRIM nor Raymond Chabot Grant Thornton can guarantee that the information contained in this document or that any modifications thereto will fully apply to your situation. Since each company has its own specific set of circumstances, CRIM and Raymond Chabot Grant Thornton encourage you to contact Michel Rheault, M.Sc., Tax, Research and Development at (514) 393-4825 or a tax advisor in your area for further information on the rules and benefits applicable to your company.