

DOVICO™

SOFTWARE

Get Time on Your Side

SR&ED TAX INCENTIVES

White Paper

SR&ED Tax Incentives

INTRODUCTION

In an effort to encourage companies to further invest in research and development (R&D), the Canadian government offers some of the world's richest R&D tax incentives. However most companies are overlooking this source of revenue because of lack of time, resources or expertise needed to identify and manage the claims.

For Canadian controlled private corporations (CCPCs), the federal government provides a refundable tax credit at a rate of 35%. If you meet certain criteria, you will receive this tax credit as a cash payment to use in your business in any way you choose. Beside the federal credit, provinces also offer research incentives. In Ontario, you can receive a 10% refundable tax credit.

Public companies and foreign controlled businesses are eligible for a 20% federal SR&ED tax credit. While not refundable, this will reduce the enterprise's federal tax liability dollar for dollar. And if all the credits cannot be used in the current year, they can be applied back up to three years or carried forward for ten to offset future federal taxes.

Source: Grant Thornton LLP, 2005

However, while companies can provide a «guestimate» of the time invested while performing SR&ED activities, they might be underestimating, which results in less refundable tax credits for that company.

Study Objectives

By using the computer integrated recording system such as DOVICO Timesheet™, the applied work environment had two objectives. Firstly, it allowed the company to learn tangibly how new technologies can help in process improvement in replacing a manual system to record time. Secondly, it provided management with a tool to easily and quickly record and report time spent on relevant SR&ED activities necessary to document their claims.

METHODS

1. THE PROGRAM

The government gives fiscal incentives to companies supporting experimental development, which meet the criteria of the program. These incentives are deductions for R&D expenses in the calculation of taxable revenue and tax credits.

The Canada Customs and Revenue Agency defines the program as follows:

What is the SR&ED Program?

The Scientific Research and Experimental Development (SR&ED) program is a federal tax incentive program to encourage Canadian businesses of all sizes and in all sectors to conduct research and development (R&D) in Canada that will lead to new, improved, or technologically advanced products or processes. The SR&ED program is the largest single source of federal government support for industrial research and development.

Claimants can apply for SR&ED investment tax credits for expenditures such as wages, materials, machinery, equipment, some overhead, and SR&ED contracts...

Who qualifies?

Generally, a Canadian-controlled private corporation (CCPC) can earn an investment tax credit (ITC) of 35% up to the first \$2 million of qualified expenditures for SR&ED carried out in Canada, and 20% on any excess amount. Other Canadian corporations, proprietorships, partnerships, and trusts can earn an ITC of 20% of qualified expenditures for SR&ED carried out in Canada.

Generally, a CCPC with a taxable income in the immediately preceding year that does not exceed the business limit may receive a portion of the ITC earned as a refund, after applying these tax credits against taxes payable.

The ITC earned by a Canadian corporation that is not a CCPC is non-refundable, but may be used to reduce any taxes payable. The ITC earned by a proprietorship or certain trusts may be partially refunded after applying these tax credits against taxes payable.

What kind of projects qualify?

To qualify for the SR&ED program, work must advance the understanding of scientific relations or technologies, address scientific or technological uncertainty, and incorporate a systematic investigation by qualified personnel.

Work that qualifies for SR&ED tax credits includes:

- ***experimental development*** to achieve technological advancement to create new materials, devices, products, or processes, or improve existing ones;
- ***applied research*** to advance scientific knowledge with a specific practical application in view;
- ***basic research*** to advance scientific knowledge without a specific practical application in view; and
- ***support work*** in engineering, design, operations research, mathematical analysis, computer programming, data collection, testing, or psychological research, but only if the work is commensurate with, and directly supports, the eligible experimental development, or applied or basic research.

Source: Canada Customs and Revenue Agency, December 21, 2004

2. PROBLEMS

The rules and Revenue Canada's administrative position in this area are constantly changing and past leniency has been replaced by stricter assessing policies. One of which includes the need for companies to provide better documentation for time spent on projects and activities to support their SR&ED claims.

While companies can provide a «guestimate» of the time invested while performing SR&ED activities, they might be underestimating. In fact, without proper documentation, Revenue Canada can easily contest the percent in time spent performing these activities, which results in less refundable tax credits for that company. Furthermore, without proper documentation to support their claims, companies might have to wait longer for their refund since those claims require a more in-depth examination. In fact, claims can even be refused if the documentation isn't provided in a timely manner.

3. THE TECHNOLOGY

DOVICO Timesheet™, makes efficient use of available technologies by including easy to understand interfaces and reporting capabilities. While project and activity titles are defined in the web based DOVICO Timesheet™, program, recent versions include the use of patent pending Offsite and Offline technologies to record time as well as an easy to use online web interface to capture project and activity duration's in minutes, hours and/or days. Once captured DOVICO Timesheet™, produces a variety of reports and graphs, which are used for analysis. This process eliminates manual transcription while facilitating meaningful data recording. Finally, the possibility of using the Offline Timesheet means DOVICO Timesheet™, can be adapted to a workers' variable work environment.

The computer software interface is menu-driven, guiding the user easily through options originally in either in a pull-down menu or a tree view control.

4. APPLYING THE TOOL

Approved SR&ED projects and activities as well as administrative and support tasks were entered by the appropriate manager in DOVICO Timesheet™, and assigned to each employee. The tool was used in a real-time environment where time relating to SR&ED activities was recorded by each staff member during a one-year period, the company's fiscal year. At the end of the year, the Chief Financial Officer printed a report showing the number of hours worked, the percent of time spent and the costs associated with each project and task for each employee. The report took approximately 3 minutes to prepare and the information was based on accurate information entered daily by each employee and approved by each manager on a weekly basis.

RESULTS

Feedback regarding the tool used in this context was obtained by using it in a real-time environment and creating reports. The reports were used during an official company audit by Canada Customs and Revenue Agency. While the initial technical assessment report would have resulted in the claim being reduced by 50% or more, the reports generated by the tool provided sufficient foundation for the auditor to amend the technical assessment hence reducing the claim by less than 4% instead. As a result, the company was able to receive its claimed value for the SR&ED activities performed of \$89,682. Would the company not have used the tool for time entry of the qualified SR&ED projects and activities, the company would have lost \$44,841.

All commented on the greater capacities and ease of use of the timesheet entry tools. Interestingly, staff members noted their tendency to reduce the accuracy of their time recordings when manual recording was involved, underlining the value-added by the use of this technology.

REFERENCES

- Canadian Advanced Technology Alliance (CATA Alliance) is Canada's leading, most influential and entrepreneurial technology alliance <http://www.cata.ca/default.html>
- Canada Customs and Revenue Agency <http://www.ccradrc.gc.ca/taxcredit/sred/aboutus-e.html>
- DOVICO Software is a software development leader that provides proven project time and cost saving solutions. Established in 1989 in response to the emerging global demand for improved operating efficiency, their time and project tracking software products have been embraced by thousands of the world's best-known and most successful companies. DOVICO has created and continually refined their time management software tools that let companies stay focused on what they do best and while they strive to constantly exceed their business needs and expectations. <http://www.dovico.com>
- Grant Thornton LLP is a leading firm of chartered accountants, management consultants and other professional advisers serving entrepreneurial people and organizations Canada-wide http://www.grantthornton.ca/tax/S6-9_SR-ED.asp

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