



TaxNewsFlash

Canada

Businesses — Have Your Say on Potential SR&ED Changes

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Canadian businesses that conduct research and development (R&D) may be interested in responding to a consultation on Canada's Scientific Research and Experimental Development (SR&ED) program. Finance launched two consultations on January 31, 2024, in which it asks interested stakeholders to provide feedback on potential cost-neutral changes to modernize and simplify the SR&ED program, and also possible ways to encourage the development and retention of intellectual property (IP) in Canada, including through the introduction of a "patent box" regime. Interested taxpayers who wish to provide input can submit comments to Finance by April 15, 2024.

Background

The SR&ED program is Canada's single largest support program for R&D and provides tax incentives to more than 20,000 businesses that conduct R&D, according to Finance. The benefits of this program include a deduction against income as well as refundable and non-refundable investment tax credits. Finance first announced that it would review the SR&ED program in the 2022 federal budget. Finance last made significant changes to the program in 2012.

Modernizing and simplifying the SR&ED program

Finance advises that it is seeking input on cost-neutral ways to modernize and improve its SR&ED tax incentives, including changes to more effectively support innovative businesses and create economic opportunities in Canada. In particular, Finance is asking stakeholders to provide details in their SR&ED submissions on how it can finance or offset costs related to such changes from within the SR&ED program, including introducing

additional eligibility conditions, better targeting the scope of eligible expenditures or activities and re-examining the program's tax credit rate structure.

Finance is asking for feedback on the following specific questions:

- How can the SR&ED program remain effective in supporting R&D investment by businesses of all types in Canada? How can the SR&ED program better support the growth and success of R&D-intensive Canadian businesses going forward?
- What improvements to the definition of SR&ED, the program's eligibility criteria, and/or the program's overall architecture should be considered?
- How does the SR&ED program complement the existing suite of support programs for R&D in Canada? How could this complementarity be improved?
- Are there more effective ways in which the overall level of assistance provided within the SR&ED program could be targeted? If so, what changes could be made to the SR&ED program to offset the costs of any proposed enhancements?
- How can the SR&ED program effectively ensure the retention of intellectual property (IP) within Canada, particularly to support innovative Canadian businesses to remain Canadian-owned and operated?
- How can the SR&ED program be improved and streamlined to make it easier for entrepreneurs to access support?
- How can your suggested enhancements be funded by existing support available through the SR&ED program? What potential changes could best focus support to benefit Canada, including by creating economic opportunities for Canadians?

Patent box regime

Finance is also asking for feedback on encouraging developing and retaining IP resulting from R&D conducted in Canada through a patent box regime. A patent box regime, which has already been implemented by several EU member states, provides a preferential tax rate to income derived from certain types of intellectual property. Finance notes that, if a patent box regime were put in place, it would need to take into account the "nexus approach" agreed to by OECD countries in 2015, as reported in the OECD's *2015 Final Report on Action 5 of the Action Plan on Base Erosion and Profit Shifting*. Generally, the nexus approach only allows a taxpayer to benefit from the patent box regime to the extent the taxpayer itself incurred the qualifying R&D expenditures that gave rise to the IP income.

Finance is asking for feedback on the following specific questions:

- In contrast to its international peers, businesses in Canada outlay more to entities in other countries for the use of IP than they receive from international sources for

the same purpose. What sort of dynamics might be underlying this trend? What factors have contributed to Canada's negative balance?

- Would implementation of a patent box regime improve Canada's competitiveness as a location for developing, commercializing, and retaining ownership of IP? With respect to competitiveness as a location for developing IP, how would support through a patent box regime compare to support provided through the SR&ED program?
- How important are tax considerations in decisions regarding where to commercialize IP and where to locate IP? Which factors besides tax rates impact businesses' decisions around where to locate and commercialize IP derived from R&D conducted in Canada? How should Finance account for these factors in determining how businesses might alter their behaviour in response to implementation of a patent box regime?
- What would be a competitive combined federal-provincial/territorial tax rate under a Canadian patent box regime?
- The OECD has identified the IP assets that are in-scope of a nexus compliant approach. Should all these assets be eligible for a potential patent box regime in Canada? Are there differences in business practices with respect to different types of IP assets that should lead the Finance to expect that commercialization and IP location decisions for each asset would respond differently to a patent box regime?
- If Canada were to implement a patent box regime, compliance with the nexus approach would require businesses to report detailed information around expenditures incurred in the development of eligible IP, similar to requirements in place under regimes in other jurisdictions that are compliant with the nexus approach. Drawing on experience with nexus-compliant regimes in other jurisdictions, Finance is asking for comments on challenges and best practices in this regard.
- Are there design features of a patent box regime that Finance should consider specifically to limit new fiscal costs to the government?

KPMG observations

Note that some provinces in Canada have already enacted provincial patent box regimes. Quebec announced the Incentive Deduction for the Commercialization of Innovations (IDCI) in its 2020 budget to encourage taxpayers to retain IP in Quebec. Similarly, Saskatchewan introduced the Saskatchewan Commercial Innovation in its 2017 provincial budget for taxable income earned from the commercialization of a broad range of IP in Saskatchewan. It will be interesting to see if Finance looks to these provincial incentives when considering the design of a federal patent box regime.

We can help

Your KPMG adviser can help you assess the effect of these new developments. Additionally, if you currently conduct R&D in Canada but do not leverage these programs, consider connecting with your KPMG adviser to discuss whether your business may be eligible for benefits. For more details, contact your KPMG adviser.

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