



**Certified
Management
Accountants**

**Submission to the
Expert Panel on the Review of Federal Support
to
Research and Development**

February 17, 2011



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INTRODUCTION

Certified Management Accountants of Canada (CMA Canada) is pleased to participate in the Government of Canada's consultations on federal support to research and development. The importance of this issue to Canada's future economic prosperity is summarized perfectly in the opening paragraph of the Expert Panel Consultation Paper: "Innovation by business is a vital part of maintaining a high standard of living in Canada and building Canadian sources of global advantage." We agree.

For the past seven years, CMA Canada has consistently advocated policies aimed at stimulating the growth of productivity, the essential components of which are well documented – human capital, physical capital, and innovation. We prefer to focus on innovation, or what we call creativity, because it represents the extraction of value from the other two components of productivity – human and physical capital – through inventiveness. In this submission, we focus our attention on innovation supported by the Scientific Research and Experimental Development Tax Incentive Program (SR&ED) and by protecting intellectual property rights.

WHO WE ARE AND WHAT WE DO

Certified Management Accountants (CMAs) are strategic management accounting® professionals who combine accounting expertise and business acumen with professional management skills to provide leadership, innovation and an integrating perspective to organizational decision making. They apply contemporary and emerging best management practices in a wide array of business functions, including strategic planning, sales and marketing, information technology, human resources, finance and operations. CMAs bring a strong market focus to strategic management accounting and resource deployment, synthesizing and analyzing financial and non-financial information to identify new market opportunities, ensure corporate accountability, and help organizations maintain a competitive advantage.

CMA Canada has more than 50,000 members ranging from senior level managers in the public and private sectors, to sole practitioners operating as consultants and auditors.

SR&ED TAX INCENTIVE PROGRAM

A key public policy tool encouraging business expenditures on research and development (BERD) is the SR&ED tax incentive program. The former Clerk of the Privy Council describes it as “the mainstay of Canada’s innovation support to business...”¹ The SR&ED tax credit is well-known by and generally popular with the Canadian business community. In successive recent budgets, the Government of Canada has made a series of sound improvements to the SR&ED program. Despite these changes, and as noted in the Consultation Paper, Canada continues to underperform in business research relative to comparator countries. CMA Canada believes that more can and should be done to this program that would improve Canadian BERD.

a) Refundability for Companies of All Sizes

Marketplace realities make the SR&ED tax credit less attractive than it appears to be. The following examples highlight some of the challenges faced by business leaders as they decide where in the world to invest in research and development:

- Although Canada’s tax credit program is generous from the perspective of nominal tax rates, the reality is that many companies do not have sufficient taxable income to take immediate advantage of the tax credits. Consequently they accumulate pools of earned but unclaimed tax credits.
- According to testimony provided in 2007 to the House of Commons Standing Committee on Finance by the SR&ED Tax Credit Coalition – consisting of major companies from across Canada representing virtually every sector of the economy – its members had accumulated SR&ED credits well in excess of \$2 billion. The aggregate number of banked credits is much larger. These banked tax credits do not attract any additional investments in Canada, do not lead to a new technological breakthrough, and do not create a single new job in the country.
- Business decision makers will heavily discount the tax credits to reflect the time lag between the research and development investment and the use of the tax credit. This discounted value has a negative impact on investment decisions because it is uncertain whether the credits will ever be claimed.
- After-tax costs of R&D spending increase if companies are unable to use their tax credits at the time they make their investments. The practical consequence is to make Canada a less attractive place to make R&D investments than those countries where companies can immediately access R&D incentives. This can also have a direct impact on a company’s ability to raise new capital.

¹ Canada’s Innovation Deficit; Kevin Lynch. Policy Options. March 2010. Page 33.

a) Refundability for Companies of All Sizes (continued)

Moreover, according to the April 2009 report of the Council of Canadian Academies entitled *Innovation and Business Strategy: Why Canada Falls Short*, Canada has a three-tiered structure, relative to ownership, of R&D and innovation behaviour.² The companies most likely to innovate and spend on research and development are Canadian-owned multinationals. The second most likely are Canadian subsidiaries of foreign multinationals. The lowest incidence of R&D spending is done by Canadian companies solely with domestic operations. The Council concludes that a key contributor to Canada's weakness in R&D is our failure to develop a greater number of innovative Canadian-based multinationals.

CMA Canada believes this conclusion points to an easily remedied design flaw in the program. The refundability provision of the SR&ED tax credit applies only to Canadian-controlled private corporations. The program would be improved by extending the refundability provision of the program to claimants of all sizes. This would have the twin benefits of continuing to encourage smaller businesses to grow and recognizing the considerable innovation advantage of larger companies, particularly Canadian-owned multinationals. Furthermore, the Council of Canadian Academies asserted that a refundable SR&ED credit for companies of all sizes would "strengthen the incentive for larger firms to sustain the pace and continuity of R&D through downturns."³

Claimants should be permitted to use their accumulated but unused tax credits first to offset taxes until the pool has been used up. As an alternative, the government could permit larger claimants to apply the tax credit against other federal government levies such as EI premiums.

We believe this single enhancement to the SR&ED tax credit would significantly improve the operation of the program, thereby encouraging more innovation, enhancing Canada's productivity performance, and improving the living standards of individual Canadians.

b) Faster Access to Tax Credits

In addition to encouraging greater BERD through extending the refundability provision, we believe the SR&ED program would be improved if businesses were able to receive the credits sooner than is now the case. Today, when a company invests in qualifying R&D, it makes cash outlays and can, depending upon when in the year the spending occurs, wait for over a year to receive the tax credit. In many cases, companies are facing restricted cash flow as they focus on research and are not necessarily generating a strong revenue flow.

² Report in Focus, *Innovation and Business Strategy: Why Canada Falls Short*; Council of Canadian Academies. April 2009. Page 12.

³ Ibid. Page 18.

b) Faster Access to Tax Credits (continued)

Using up working capital to finance an investment in R&D can put the company at risk of going out of business or force the owners to give up a significant equity stake to venture capital firms or other investors.

One way to address this issue would be to permit claimants to make claims for qualifying spending on a quarterly or bi-annual basis rather than waiting until the end of the firm's fiscal year. Given that faster access achieved through more frequent claims would increase administrative burden and costs, claimants would have the choice whether or not to make use of this opportunity – they would be able to do a cost-benefit analysis to determine which works best in their circumstances.

c) Administrative Improvements

As noted in Budget 2010, the Canada Revenue Agency (CRA) is identifying and implementing ways to improve the administration of the program. Our observation is that if an industry of private consultants specializing in helping businesses access the program can be created, the program must still be too complex. Continual improvement in simplifying the program is a desirable goal.

Moreover, recent reports of an increase in dubious claims being made to the CRA suggest that enforcement mechanisms should be examined. One measure that we put forward for consideration is to prohibit "SR&ED consultants" from charging their clients contingency or so-called success fees. A precedent for such a measure currently exists in the federal *Lobbying Act*. CRA would need to launch an initiative to educate the SR&ED community about such a prohibition and introduce an effective compliance/enforcement mechanism.

PROTECTING INTELLECTUAL PROPERTY RIGHTS

We acknowledge that the legal framework protecting the intellectual property (IP) rights of creators is not directly part of the federal government's suite of R&D initiatives and therefore is outside the scope of the Expert Panel's mandate. Nevertheless, CMA Canada believes that strongly protecting IP rights can promote business innovation and should, therefore, be encouraged by the Expert Panel.⁴ The flip-side is that rampant counterfeiting and piracy of IP can blunt innovation and creativity.

In 2007, the House of Commons Standing Committee on Industry, Science and Technology and the House of Commons Standing Committee on Public Safety and National Security independently conducted major studies of counterfeiting and piracy in Canada.

⁴ Lessons for Canada from International Productivity Experience; Andrew Sharpe. International Productivity Monitor, Number 14, Spring 2007. Page 27.

PROTECTING INTELLECTUAL PROPERTY RIGHTS (continued)

Committee members reported major concerns with the impact of counterfeit and pirated goods and intellectual property on competitiveness and innovation in the Canadian economy, as well as on the health and safety of Canadians. Their recommendations illustrated the role the federal government can play in establishing a legal framework that vigorously protects copyrights and trademarks and strongly enforces intellectual property laws. They included:

- Making it a criminal offence to manufacture, reproduce, import, distribute and/or sell counterfeit and pirated goods and intellectual property.
- Introducing an administrative monetary penalty regime for the importation and exportation of counterfeit and pirated goods.
- Giving authority to the Canada Border Services Agency to target, detain, seize, and destroy counterfeit and pirated goods.
- Amending the Proceeds of Crime Regulations to permit the seizure of income and property derived from copyright piracy.
- Encouraging prosecutors to seek greater penalties, including imprisonment when warranted, for counterfeiting and piracy violations.

In addition to such measures aimed at combating piracy and counterfeiting of IP, CMA Canada believes that updated copyright legislation would provide better protection for Canadian innovators. We note that Bill C-32, *an Act to Amend the Copyright Act*, is currently being studied by a special committee of the House of Commons. Without getting into the details of this Bill, we hope that the work currently underway on the *Copyright Act* will improve Canada's legal regime and further encourage business investment in research and development by protecting the fruits of such investments.

CONCLUSION

The Expert Panel Consultation Paper makes it clear that Canada is not well positioned to be a leader in innovation. We can and must do better. Canadians' living standards are influenced considerably by how they innovate and create. While the Government of Canada invests considerably in numerous beneficial R&D initiatives, CMA Canada believes that one of the best ways to encourage BERD intensity is to improve Canada's flagship research and development program, namely the SR&ED tax incentive program. This is why we recommend expanding refundability to claimants of all sizes, getting credits more quickly into the hands of innovators, and reducing the complexity of program administration. Measures such as these, implemented in tandem with a legal framework protecting the intellectual property of our creators, would contribute to the federal government's ultimate objective – increasing the living standards of its citizens.