

Restoring Canada's Innovation Competitiveness

Issue

In a global economy where technology and innovation are increasingly important, Canada trails most of its peer countries in innovation and research. The Government of Canada needs to act quickly to address this, particularly by restoring faith in and simplifying a tax credit regime that nurtures private sector investment across all industries in R & D and technology.

Background

In the 2016 edition of the Top 10 Barriers to Competitiveness, the Canadian Chamber of Commerce identifies the need for an aggressive and effective innovation strategy that capitalizes on the innovation in both the public and private sectors. The report suggests more effective tax or grant strategies and calls on research and development parameters to include intellectual property and technology-based Canadian start-ups to scale. These recommendations speak to a holistic approach to innovation that will be required to ensure Canada remains competitive in the innovation space. For the purposes of this resolution the focus is on the taxation side.

The Canadian Chamber of Commerce has proposed an “innovation box” regime in Canada that would see any sales/revenues earned on a patent or a new technology developed here in Canada taxed at a much lower rate.¹

As part of its 2016 federal budget, the federal government recently released an outline of its direction for an inclusive innovation agenda. Along with a call for national collaboration, six areas of action were identified including entrepreneurial and creative society, global science excellence, world-leading clusters and partnerships, grow companies and accelerate clean growth, compete in a digital world, and ease of doing business.²

Firms in Canada find it difficult to compete with those in the rest of the world on price, but they can compete on the basis of innovation. To do this, we need to be technologically advanced and devote ourselves to research and development, but Canada is far from a leader in these fields.

The World Economic Forum ranks Canada as 22nd in capacity for innovation, 22nd in technological readiness, and 27th in company spending on R&D.³ Canada's R&D spending as a percentage of GDP has been declining for over a decade and is now 1.69%, compared to the OECD average of 2.4%.⁴ Business spending on R&D is near the bottom of all OECD countries.⁵

Canada is the only developed country in the world with an intellectual property deficit – we spend more importing technology from other countries than we earn selling technology abroad. This gap costs \$4.5 billion a year.⁶

The innovation shortfall is also not being made up at the provincial level. In Ontario, the Ontario Research and Development Tax Credit was cut from 4.5% to 3.5% in the 2016 budget, and the Ontario

¹ Canadian Chamber of Commerce (2015). A Canada That Wins Retrieved July 5, 2016 from file:///Users/PtboChamber/Downloads/150526_A_Canada_that_Wins.pdf

² Government of Canada. (2016). *Canada: A Nation of Innovators* Retrieved July 4, 2016 from [https://www.ic.gc.ca/eic/site/062.nsf/vwapj/InnovationNation_Report-EN.pdf/\\$file/InnovationNation_Report-EN.pdf](https://www.ic.gc.ca/eic/site/062.nsf/vwapj/InnovationNation_Report-EN.pdf/$file/InnovationNation_Report-EN.pdf)

³ KPMG, *Canadian Manufacturing Outlook 2014: Leveraging Opportunities, Embracing Growth*, 2014.

⁴ OECD, *Science, Technology and Industry Scoreboard 2015*.

⁵ Ibid.

⁶ Standing Committee on Industry, Science and Technology, *The Canadian Intellectual Property Regime – Dissenting Opinion of the New Democratic Party*

Innovation Tax Credit from 10% to 8%.⁷ Quebec's R&D tax credit rates have been reduced from 37.5% to 30%, effective as of June 4, 2014.⁸ Alberta recently implemented a suite of programs directed to the innovation space, but these programs have not had the benefit of time to measure success.

The SR&ED program is currently the federal government's main R&D investment vehicle. Canada Revenue Agency has reported that based on 2011 projections, the total value of federal SR&ED tax credit expenditure is approximately \$3.6 billion.⁹ The tax credits also stimulate the economy. According to a 2007 Department of Finance study, for every \$1 in SR&ED tax credits given out, the government receives back a benefit of \$1.11.¹⁰

Finance Canada and the Revenue Canada (1997) found that the federal SR&ED credit generates \$1.38 in incremental R&D spending per dollar of foregone tax revenue, and that private sector R&D spending is 32 per cent higher than it would be in the absence of SR&ED tax incentives.

What this tells us is that while the SR&ED program has had a positive impact more needs to be done. Restoring the tax credit limit for innovation to 20% would be a start. To regain the effectiveness of a tax program, it must be made easier to use and access for employers of all sizes and industries, allow for inclusion of capital expenditures, and reduce the eligible labour, overhead, and contract payments cost.

Chamber members also report that the audit component of the SR&ED program has become onerous and time-consuming, and that the uptake and efficiency of the program are hampered by overly frequent changes. A tax regime, perhaps using SR&ED as the backbone, must be sustainable with a simple reporting mechanism and changes that are inline and timely with respect to the issues businesses are facing.

Recommendations

The federal government:

1. Develop an innovation stream tax credit to complement the SR&ED program and start the innovation program at 20% of eligible expenses;
2. Simplify the process of the Innovation Tax Credit (former SR&ED) application, using the following as a base: improving the pre-claim project review service, simplifying the base on which the credits are calculated, and introducing incentives that encourage SME growth – so that Canadian companies of all sizes and across all industries can move forward with confidence to bring their innovations to market;
3. Create an innovation environment that encourages private sector investment in R&D and technology across all industries focussing on the following factors for success: ease of use for businesses, consultation with the business community to ensure programs are in line with the real time needs of business, achieved and sustainable growth of participating businesses, export readiness and enables operational scale-up.

⁷ Government of Ontario, *2016 Ontario Budget – Chapter V* (<http://www.fin.gov.on.ca/en/budget/ontariobudgets/2016/ch5a.html>)

⁸ SR&ED Education and Resources, *SR&ED Gets Cut in the 2014-2015 Quebec Budget* (<http://www.srededucation.ca/sred-funding-in-2014-quebec-budget/>)

⁹ Government of Canada. (2012). *Do Your Research in Canada: It Pays Off!* Retrieved January 2, 2013 from <http://investincanada.gc.ca/eng/publications/rd-tax-credit-fact-sheet.aspx>

¹⁰ Department of Finance Canada and Revenue Canada. (1997). *The Federal System of Income Tax Incentives for Scientific Research and Experimental Development: Evaluation Report*. Retrieved January 2, 2013 from <http://publications.gc.ca/collections/Collection/F32-1-1997E.pdf>