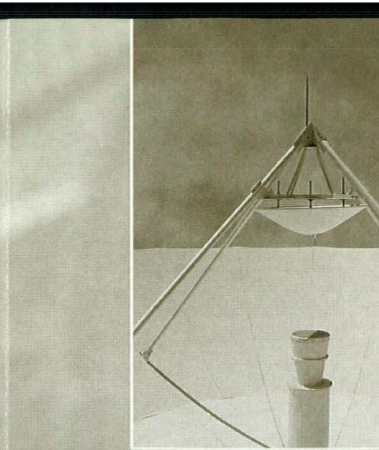

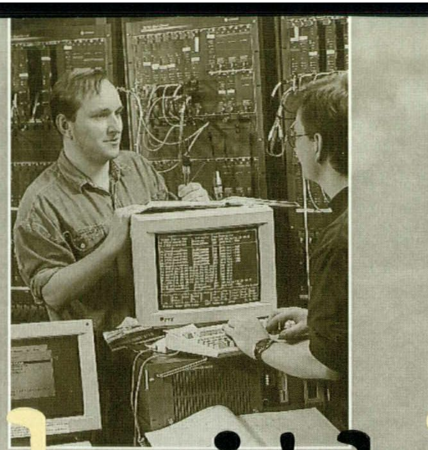

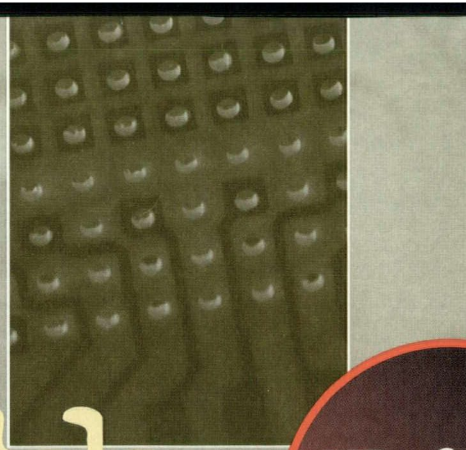

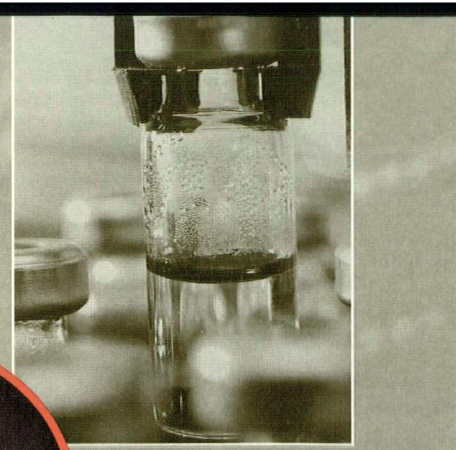

Canada welcomes research with Big Tax Savings

Canada Is a More Attractive R&D Investment Location than the U.S.

Significant savings await firms carrying on R&D in Canada. Canada's cheaper business costs, coupled with a high quality of life in Canadian cities, make it the preferred location for performing R&D in North America. R&D is further encouraged by a favourable regulatory environment and the most generous R&D tax credits offered among G7 nations. Recent studies have shown that Canada's R&D costs are among the lowest in the industrialized world.

The article on these pages, based on a study by Deloitte & Touche, describes how Canadian R&D tax credits work and compares them with those available in the United States.

Two Tax Benefits Offered

Both Canada and the United States offer two types of income tax incentives to firms carrying out research and development:

- **Tax DEDUCTIONS**, *reducing the amount of income subject to tax.*
- **Tax CREDITS**, *applied to reduce the tax payable.*

Activities viewed as research and development are similar in both countries.

The table below provides a comparative summary of R&D tax credits offered in both countries.

R&D Tax Credits: Comparing Benefits

Canada	United States
Option to defer claim	Deferral of claim is restricted
Total cost of contracted R&D eligible, where contract is at arm's-length	Only 65 percent of contracted R&D eligible
Equipment costs qualify	Equipment costs do not qualify
Canadian travel costs qualify	Travel costs do not qualify
Research funded by non-residents qualifies	Research funded by non-residents does not qualify
Option to claim tax credits on proxy amount instead of overhead	No provision for using proxy amount

Tax Deductions

Canadian taxpayers have greater flexibility in writing off R&D expenditures. They also benefit from a faster write-off for R&D capital equipment.

Expenses eligible for the R&D tax deduction are similar in Canada and the U.S..

However, restrictions can apply in Canada for salaries paid to certain shareholders and for R&D performed within a corporate group.

Federal Benefits - Canada

Taxpayers may immediately write off current and capital expenditures for R&D performed in Canada. They may also choose to defer these claims to any future year.

Taxpayers are similarly entitled to write off current R&D expenses incurred outside the country. Capital expenditures for R&D performed abroad are subject to normal tax depreciation rules.

Provincial Benefits - Canada

For provincial tax purposes, all provinces allow the deductions established for the federal tax system.

Ontario offers an R&D Superallowance, which permits an additional deduction of 25 percent (for large firms) or 35 percent (for smaller firms) for R&D spending equal to a firm's three-year average. This deduction jumps to 37.5 percent and 52.5 percent for R&D expenditures exceeding this base period amount.

As a special incentive, Quebec allows a tax holiday in some circumstances to foreign researchers working for Quebec firms.

United States' Benefits

In the U.S., a taxpayer may elect either to deduct current R&D expenditures or amortize the costs over at least five years, beginning when the first benefits from the R&D are realized.

Capital equipment costs must be depreciated. There is no immediate write-off.

Tax Credits

Canada offers a more generous tax credit system than does the United States. In both countries, R&D tax credits are available at both the federal and the provincial or state levels.

Note, however, that the U.S. R&D tax credit expired on July 1, 1995. Congress later reinstated the credit, to take effect July 1, 1996. This credit has been revised to allow a new alternative method of calculation. This new method is effective up to July, 1997 when it will be up for renewal.

In Canada, the tax credits are considered government assistance. They reduce the amount of expenditures that can be used as a tax deduction.

Canadian R&D Tax Credit - Federal

The basic federal tax credit, the "investment tax credit", is a non-refundable, 20 percent credit, available to all taxpayers in Canada. It is offered for qualifying R&D expenditures, after government or other assistance is subtracted. Payments received from Canadian firms or individuals under contract arrangements must similarly be subtracted.

The credit may be used to reduce federal tax payable in the current year or be carried forward up to 10 years or back three. [When claimed, the federal credit then reduces the amount of R&D expenditures available for deduction in the next year.]

Smaller, Canadian-controlled private corporations (CCPCs) may qualify for an enhanced credit of 35 percent for the first $2 million of R&D expenditures. This credit is fully refundable if earned on current R&D, and 40 percent refundable for capital R&D expenditures.

To be eligible, a corporation along with its associated corporations, must have taxable income not exceeding $200,000 in the preceding year and taxable capital not exceeding $10 million. It must be a CCPC throughout the year. The tax credit is phased out for corporations with higher earnings and higher levels of taxable capital.

A joint venture corporation owned 50/50 by a U.S. company and a CCPC could potentially benefit from Canada's enhanced R&D tax credit.

Canadian R&D Tax Credit - Provincial

Six provinces offer their own tax credits to further reduce the provincial tax payable.

Manitoba and New Brunswick add on non-refundable R&D tax credits of 15 percent and 10 percent respectively. Newfoundland offers a refundable R&D tax credit of 15 percent. Nova Scotia allows a refundable 15 percent credit to all corporations subject to the province's tax; such companies need not be eligible for the federal R&D tax benefit.

Ontario provides a 10 percent fully refundable tax credit - the Ontario Innovation Tax Credit - to small and medium-sized CCPCs on expenditures eligible for the enhanced federal credit.

Quebec offers an R&D wage tax credit equal to 20 percent of a company's wage costs for R&D activities in the province. The credit can be increased to 40 percent on the first $2 million of wages if the corporation is Canadian-controlled and, with its associated companies, has assets of less than $25 million or net shareholders' equity of less than $10 million. For companies meeting these assets or equity tests, the credit is refundable.

U.S. R&D Tax Credit - Federal

A non-refundable 20 percent R&D federal tax credit has been available for some R&D expenditures. It applies only to incremental expenditures, and the credit amount can not exceed 10 percent of a firm's total R&D spending, either incurred or paid in the year. Also, a new alternative method to determine the incremental credit is available in the U.S..

U.S. R&D Tax Credit - State

Thirteen U.S. states offer some form of tax credit. These are generally calculated as percentages of R&D expenditures. The average credit in these states is 6 percent. It is refundable only in Iowa.

Expenditure qualifying for R&D tax credits - Canada and U.S.

Expenditures eligible for the credit are similar in Canada and the U.S. except for the following:

- In the case of contracted R&D, Canadian firms are credited for the full amount of their expenditure, while the U.S. allows only 65 percent of spending. The allowable amount may be limited in Canada, however, where the contracting parties are not dealing at arm's length.

Continued on page 6

R&D in Canada vs the U.S.

	Ontario	Quebec	Other Cdn. Provinces	U.S. Base Spending Only	U.S. Incremental[9]
Small Company					
R&D Expenditure	$1,000,000	$1,000,000	$1,000,000	$1,000,000[1]	$1,000,000[2]
Provincial/State R&D Credit	(100,000)	(400,000)	(150,000)[3]		(60,000)[4]
Federal R&D Tax Credit	(315,000)	(210,000)	(297,000)		(200,000)
Tax Saving from Deduction[7]	(135,000)	(98,000)	(127,000)	(330,000)[5]	(244,000)
Ontario Super Allowance	(29,000)[6]				
After-Tax Cost	**$ 421,000**	**$ 292,000**	**$ 426,000**	**$ 670,000**	**$ 496,000**
Large Company					
R&D Expenditure	$1,000,000	$1,000,000	$1,000,000	$1,000,000[1]	$1,000,000[2]
Provincial/State R&D Credit		(200,000)	(150,000)[3]		(60,000)[4]
Federal R&D Tax Credit	(200,000)	(160,000)	(170,000)		(200,000)
Tax Saving from Deduction[7]	(352,000)	(258,000)	(299,000)	(410,000)[5]	(303,000)
Ontario Super Allowance	(47,000)[8]				
After-Tax Cost	**$ 401,000**	**$382,000**	**$381,000**	**$590,000**	**$437,000**

NOTE: The figures here are abstract, and may not represent a particular company's real life situation. Readers are advised to consult their own lawyer or accountant before making an investment decision arising from this material. These calculations assume the R&D expenditures are in-house wages and salaries.

1. Assumes the expenditure is non-incremental or for other reasons does not qualify for a U.S. credit.
2. Assumes the U.S. firm spent $6 million (Can.) in direct salaries and wages related to qualified R&D in the current taxation year, compared to $5 million (Can.) spending in its base period.
3. 15 percent is used as an average rate for the four other provinces offering tax credits.
4. 6 percent is the average rate in the 13 U.S. states offering an investment tax credit.
5. A 33 and 41 percent tax rate represents respectively the top combined effective federal and state corporate tax rate for small and large U.S. corporations. The maximum state tax rate is currently 9 percent.
6. Expenditures net of investment tax credits, times the percentage for incremental costs for small performers, times the provincial tax rate [($1,000 - $200) x .525 x 9.5 percent]. For non-incremental R&D expenditures, the tax saving is $28. The multiple becomes .35 instead of .525.
7. Effective provincial tax rates may vary. Newfoundland, Nova Scotia, New Brunswick and Manitoba have special tax incentives that further reduce after-tax cost.
8. Expenditures net of investment tax credits, times the percentage for incremental costs for large performers, times the provincial tax rate [($1,000 - $200) x .375 x .155]. For non-incremental R&D expenditures, the tax saving is $31. The multiple becomes .25 instead of .375.

9 A new alternative method to determine the incremental credit is available and may affect calculations. This credit, instated in July, 1996 is up for renewal in July, 1997.

Source: Deloitte & Touche.

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