

The ROI of R&D

Tax credits are easier to obtain than you think

By Vanessa Chris

Like many manufacturers, Chris Copland, president of St. Catharines, Ont.-based Logical Control Systems (LCS), had heard of the Canada Revenue Agency's (CRA) Scientific Research and Experimental Development (SR&ED) tax credit program, but never actually considered taking advantage of it.

The owner of the automation company - which offers a wide range of services, including electrical and mechanical engineering assistance, PLC programming solutions, and motion control, drives and robotic solutions - believed that the process of getting money from the government was a burden that he just didn't have time for.

And because his company is small and frequently modifies existing automation systems rather than building new ones, he was pretty certain the returns - if he qualified - would be minimal.

"I had known it was out there for quite some time, but I thought it was a great behemoth," he says. "I just thought it would be much too difficult and painful to attempt."

It wasn't until he met SR&ED consultant Michael Horne, of Horne and Associates Consulting, that Copland started to seriously consider the possibility of applying. Horne explained the benefits of the program and of utilizing a consultant to perform most of the grunt work.

SR&ED OBSTACLES

Copland's hesitancy is quite common, Horne says. Part of this has to do with the fact that the SR&ED program isn't heavily marketed by the government, so many people are only vaguely familiar with it.

"It has to do with the optics of the situation," Horne says. "If the government is running on a deficit, they don't want to start advertising the program because it could appear that they're subsidizing businesses."

The program also features a very complex application process. "There are so many variables to this program. It's so confusing," Horne says. "Companies often throw their hands up in defeat after they try to do it themselves."

This is the opposite effect of what the CRA had in mind when it first introduced the program back in 1985. It was originally created to encourage Canadian businesses of all sizes and in all sectors to conduct research and development in Canada that would lead to new,

improved or technologically advanced products or processes, says CRA spokesperson Noel Carisse.

SR&ED claimants are required to apply for tax credits after they work on, and pay for, a project that requires research or experimental development. The credit will cover a portion of the company's costs from the project, including wages, materials, machinery, equipment, overhead and SR&ED contracts.

While this doesn't help businesses that are hoping to test a new, innovative technology they can't afford upfront, it does offer relief to companies that have to venture into uncharted waters for business purposes.

"If a certain project doesn't work, it allows the company to recoup some of its losses. If it's successful, it can use that money to employ new people or expand the project," Horne says. "It helps the company take that leap of faith."

While more than 18,000 SR&ED claimants were awarded tax credits in 2007 - equalling approximately \$4 billion in tax cuts - Horne estimates this equates to only 30 percent of eligible companies. The rest are either unwilling to wade through the red tape, or are unaware that the work they are doing qualifies as research and innovation.

This is something the federal government is hoping to change. The 2008 Federal Budget highlighted significant changes to the SR&ED tax incentive program - a move made in direct response to the complaints of Canadian businesses.

The program now offers an instructional CD-ROM, brochure and leaflet, as well as a newly revised form and guide for making a claim. The materials are said to be easier to read and contain helpful tips for completion.

The government also recently introduced a new web-based eligibility self-assessment tool that is designed to help businesses determine if a project is eligible before they apply.

DO YOU INNOVATE?

Before you look into the program, however, it is important to determine whether your company partakes in innovative practices. If you're creating any type of customized product, for example, it likely meets the SR&ED's criteria.

"For something to be considered innovation, there has to be some sort

of technological or scientific uncertainty," Horne says. "If you're doing something that might cost you money - something that you're taking a chance on - it will likely qualify for funding."

In the case of LCS, the company was awarded a tax credit for a project it did for American Graphics, a printing house that prints the logos of such companies as Home Depot and Wal-Mart.

The company had just won a contract to print daily papers, and its current press wasn't big enough to handle the increased volume. LCS was hired to help the company expand its existing mottle printing press - a task that was made difficult by the fact that the printing press was from the 1970s, and didn't match today's printing press technology.

The older press used a common line shaft, while current technology uses a shaftless drive. LCS needed to find a way to create a control and drive system that would electrically synch to the existing press, with no mechanical connection.

"It took the better part of a year to get it up and running," Copland says. "There was a lot of trial and error involved, a lot of technical uncertainty and a lot of testing."

Copland wasn't aware that this type of project would be considered innovation under the SR&ED program because the units weren't new and they were made by other companies. The work was also being done for a U.S. customer - another grey area that LCS wasn't certain about.

Horne cleared up all of the uncertainty by explaining that improving an existing process required just as much R&D as creating a new one from scratch. In addition, the SR&ED program applied to Canadian companies manufacturing products in Canada. After they were manufactured, they could be sent anywhere.

Horne spent a day and a half at the LCS plant, and two months afterwards exchanging e-mails and phone calls with Copland as he collected the necessary documentation.

"It was pretty straightforward once he got in," Copland says. "It might cost you a day and a half, but the benefits are well worth it. I'm sure any company could use an extra \$40,000 to \$200,000."

As it turned out, Copland ended up receiving 45 percent of what he spent on man hours, materials consumed and overhead costs such as heat and hydro. He currently has another claim in the works, and is approaching new projects with a completely fresh mindset.

"We look at new projects a different way now," he says. "We think about whether it could qualify ahead of time, and then we think about how we're going to execute it so it gets approved."

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