



CMC | Canadian
Manufacturing
Coalition

November 3, 2011

The Honourable Gary Goodyear
Minister of State (Science and Technology)
(Federal Economic Development Agency for Southern Ontario)
Industry Canada
235 Queen Street
Ottawa, ON K1A 0H5

Dear Minister:

It is with great interest that we read the report of the independent expert panel on federal support to Research and Development (R&D), which was published on October 17, 2011.

First of all, we would like to congratulate you for commanding this important report; it shows how important innovation is for you and your government. Indeed, there is a broad consensus within the Canadian society that innovation, R&D and business productivity at the core of our nation's future quality of life and well-being. Governments, businesses and academic institutions are at the centre of Canada's innovation, and we look forward to working with all stakeholders in making sure that Canada fills the productivity and innovation gap that exists with other nations.

As you know, the Canadian Manufacturing Coalition (CMC) is composed of 45 business associations across the country, which collectively represents more than 10,000 businesses in all sectors of the manufacturing industry. Canadian Manufacturers & Exporters (CME) has recently published its response to the Independent panel's report, which is endorsed by all members of the Coalition. You will find this report attached.

While we generally agree with the state of the situation and the facts presented in the independent panel's report, the Canadian manufacturing sector is very concerned with some recommendations made in the report, especially the ones related to the Scientific Research and Experimental Development (SR&ED) Tax Credit. More specifically, the report recommends to:

- Simplify the SR&ED program by basing the tax credit for SMEs on labour-related costs, while increasing its rate; and
- Decrease the refundable portion of SR&ED over time.

While we agree with the expert panel that we need to achieve a better balance between direct and indirect support to business R&D, we strongly disagree that we should cannibalize the SR&ED program to fund new initiatives. The SR&ED tax credit is a very democratic program, available to all businesses, as long as they undertake R&D activities that are eligible. Restricting the access to such a program to fund initiatives that will reward the “winners” is not, in our view, the best way to ensure that we give all businesses similar incentives to undertake R&D. The Conservative Government has traditionally favoured broad-based initiatives available to all businesses, such as the decrease of corporate tax and the Accelerated Capital Cost Allowance for the acquisition of machinery and equipment, instead of specific support programs targeting specific companies. The same principle of a broad-based approach should apply to government support to R&D, and if the Government should intervene in any specific sector, it should not be done at the expense of other programs.

In addition, the manufacturing sector has always argued that we should improve SR&ED by making it more accessible and complement it with other direct government support for business R&D. The only result we will achieve by eliminating non labour-related expenses currently eligible under SR&ED and eliminate part of the tax refunds for Canadian Controlled Private Corporations (CCPCs) is to decrease business investment in R&D over time.

The report also makes other interesting recommendations in the field of innovative government procurements, and some specific programs related to the commercialization of products in Canada. For example, the idea of a Commercialization Vouchers Pilot Program is very interesting and would be worth exploring in more detail with businesses from all sectors. We strongly recommend however that the implementation of this program is not linked with the re-organization of the current federal support programs, for example the creation of an Industrial Research and Innovation Council (IRIC) and the transformation of the National Research Council’s institutes. While we do not oppose these changes in structure, we believe that the Commercialization Vouchers Pilot Program, as well as a strategy to use government procurements to drive innovation, does not have to wait for these structural changes to be implemented.

Finally, there are a number of important issues that are not raised in the report and that deserve attention from all stakeholders, and especially from the Federal government:

- The first issue is related to the greater use of consultants by private businesses to make their claims under SR&ED. The Coalition strongly believes that consultants, for the most part, have a very legitimate role to play in the SR&ED claims, as it is the case with any other service that businesses find more efficient to contract to a third party. SMEs, generally speaking, are managed by a small group of people who handle many responsibilities within the business, from R&D to sales, through production and marketing. Tax services, which includes SR&ED, are among the first services that a firm will contract outside to a third party since consultants provide technical advice and some guarantee of quality. If the government’s opinion is that the consultant business in claiming SR&ED is too expensive, we would suggest that we look at ways to regulate

the remuneration of consultants – the same way consultant lobbyists are regulated in the way they receive payments in exchange for helping companies to access subsidies or win government contracts. The government could consider that consultant lobbyists must move from a percentage commission of the SR&ED claims to a fixed rate or a retainer model, which would fluctuate depending on the size of the company and the amount of work required.

- The second one is the need for government to better support the commercialization of products in Canada. The panel's report is very thin on this issue. Except for the Commercialization Vouchers Pilot Program, very few recommendations aim at increasing the commercialization of products in Canada. As recommended by Mark Parson, the author of the CD Howe Institute paper on SR&ED reform, a good solution to explore would be to adopt a smarter tax system for products that are a result of a patent developed in Canada. The U.K. has an interesting model, which imposes a five per cent tax on income generated by products and patents that are related to a firm's R&D completed in the U.K. In Canada, products of innovation are taxed at the same rate as any other income. The Coalition strongly believes that this could be a very good complement to Canada's model, centered on basic and experimental research.
- The third issue is related to the role of the Canada Revenue Agency (CRA) reviewing claims submitted by private companies and resolving disputes under the SR&ED program. The Coalition strongly believes that the CRA is the wrong agency to resolve disputes over SR&ED claims. In the last year, many businesses have noticed significant changes in the way the CRA has audited their claims, and complained that some activities, which were eligible in previous years, are no longer eligible for claim. Although the CRA keeps denying the facts, this not only creates uncertainty among businesses, but it also raises the need for a clear policy mandate as it pertains to assessing SR&ED claims. This is why the Coalition strongly recommends that technical assessments be based on reviews by experts outside the CRA, as with IRAP's technology advisors, in order to provide more clarity and certainty.

Again, the Canadian manufacturing sector congratulates you and your government for this opportunity to comment on the government's current and future policies as it relates to R&D. We look forward to working with you and other stakeholders to improve Canada's performance in innovation, R&D and business productivity.

Yours sincerely,

CC: The Honourable James Flaherty, Minister of Finance
The Honourable Christian Paradis, Minister of Industry
The Honourable Rona Ambrose, Minister of Public Works and Government Services
The Honourable Gail Shea, Minister of National Revenue