



Optimizing Innovation Through Tax Incentives

KPMG ENTERPRISE

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Agenda

Overview: R&D Incentive Program

Understanding and Accessing SR&ED – The Rules

R&D Product Life Cycle

Tax Incentive Application Process

Examples of SR&ED Eligible Work

Overview of Ontario Digital Media Tax Credit Program

KPMG's Role in R&D

Question & Discussion

Geoff MacDonald



Position

Geoff is a Partner in the Regions East Tax Incentives Practice and leads KPMG's Eastern and Northern Ontario group.

Qualifications

Geoff has more than 19 years of public accounting experience focused on providing SR&ED tax services to his clients. He is part of national and regional KPMG Committees that are focused upon the delivery of SR&ED services. He was a founding member and continues to sit on a joint CRA-Industry Software Committee that is focused on SR&ED issues in the Software Industry. He also helped to prepare KPMG's submission in response to Finance's Consultation on the SR&ED program and was recently named as one of Ottawa's Top Forty Under 40 Business People for 2009.

Experience

Geoff has provided advice and services to many technology and manufacturing companies in a variety of industries. This work often takes the form of the identification of eligible expenditures as well as the preparation and defense of their claims. He has written numerous articles and given many presentations on issues facing SR&ED claimants.



Dan Coccimiglio



Position

Dan is a Technical Advisor in the Regions East Tax Incentives Practice and aids clients prepare SR&ED claims across Northern and Southern Ontario.

Qualifications

Dan graduated with a Bachelor of Applied Science (B.A.Sc.) in mechanical engineering with a concentration in automotive engineering from the University of Windsor.

Experience

With over 5 years experience at KPMG, Dan is part of a multi-disciplinary team of engineers, scientists, accountants and tax experts that assist clients in a wide variety of industries to submit their SR&ED claims. Dan assists clients in identifying eligible SR&ED expenditures and undertakes the planning, scoping, investigation and preparation required of the technical and financial aspects of each project in order to process and submit a SR&ED claim.

Additionally, Dan has developed knowledge in global Research and Development programs through assisting clients in markets such as the United States and Australia.





Overview of SR&ED Program



Overview of the SR&ED Program

- **Scientific Research and Experimental Development (“SR&ED”) is the term used by Canada Revenue Agency (CRA) for Research & Development (“R&D”)**
 - Program is delivered through the tax system rather than a direct government grant
 - The program is designed to encourage SR&ED in Canada
 - It is also intended to attract foreign investment in SR&ED in Canada
- **To encourage Research, Development and Innovation in Canada and promote the knowledge economy.**
 - Is one of the world’s most lucrative R&D tax incentives program
 - Single largest Federal innovation funding source with over 18K claimants receiving approximately \$4.0 Billion per year

Overview of the SR&ED Program

- **What qualifies**
 - Technology advancement and research, with or without a specific practical application
 - Does not need to be “Rocket Science” and/or result in a “successful” outcome to qualify
- **How to Identify SR&ED eligible projects/activities**
 - Areas where projects hit roadblocks or unexpected challenges

Overview of the SR&ED Program

- **Current Tax Incentives**
- Tax Deductions
 - SR&ED is a deductible business expense for tax purposes
 - Includes both current and capital expenditures on SR&ED
- **Investment tax credits (ITC's)**
- Corporations earn ITC's at either the 20% or 35% rate on qualified expenditures
- ITC's are used to reduce taxes payable
- Can be carried over and applied against other year's taxes payable (3 yrs back and 20 yrs forward)
- Most provinces provide additional incentives – Refundable 10% OITC in Ontario as well as non-refundable ITC of 4.5%

ITC's Earned on the Following Qualifying SR&ED Expenditures

Labor Directly engaged in experimentation/testing to develop technological knowledge.	Contracts Testing, engineering, programming contracts by outside companies (within your country) supporting the resolution of technological obstacles.	Overhead Incremental and directly related expenditures such as supplies, heat, water, training etc. (Traditional vs. Proxy)
Materials Materials needed to conduct testing for a particular project.	Capital Equipment purchased for sole use in R&D projects.	Third Party Payments Payments to universities, colleges, research labs and other consortia

Future Focus: R&D Incentive Rules

Basic Research

Advances in scientific knowledge *without* a specific practical application in view

Applied Research

Advances in scientific knowledge with a specific practical application in view

Experimental Development

Work done to achieve technological advancement to create, or improve, new materials, devices, products or processes

Support Work

Future Focus: R&D Incentive Rules

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Future Focus: R&D Incentive Rules

Basic Research

Applied Research

Experimental Development

Support Work

- Engineering
- Design
- Operations Research
- Testing
- Mathematical Analysis
- Computer Programming
- Data Collection
- Psychological Research

Future Focus: R&D Incentive Rules

Activities/projects generally must exhibit:

1. Technological Uncertainty (Obstacles)

- Whether a given result or objective can be achieved, or how to achieve it, is uncertain or cannot be determined based on current and generally available scientific or technological knowledge and experience
- Taking base-level technology (product/process) to the next level
- Solution not publicly available

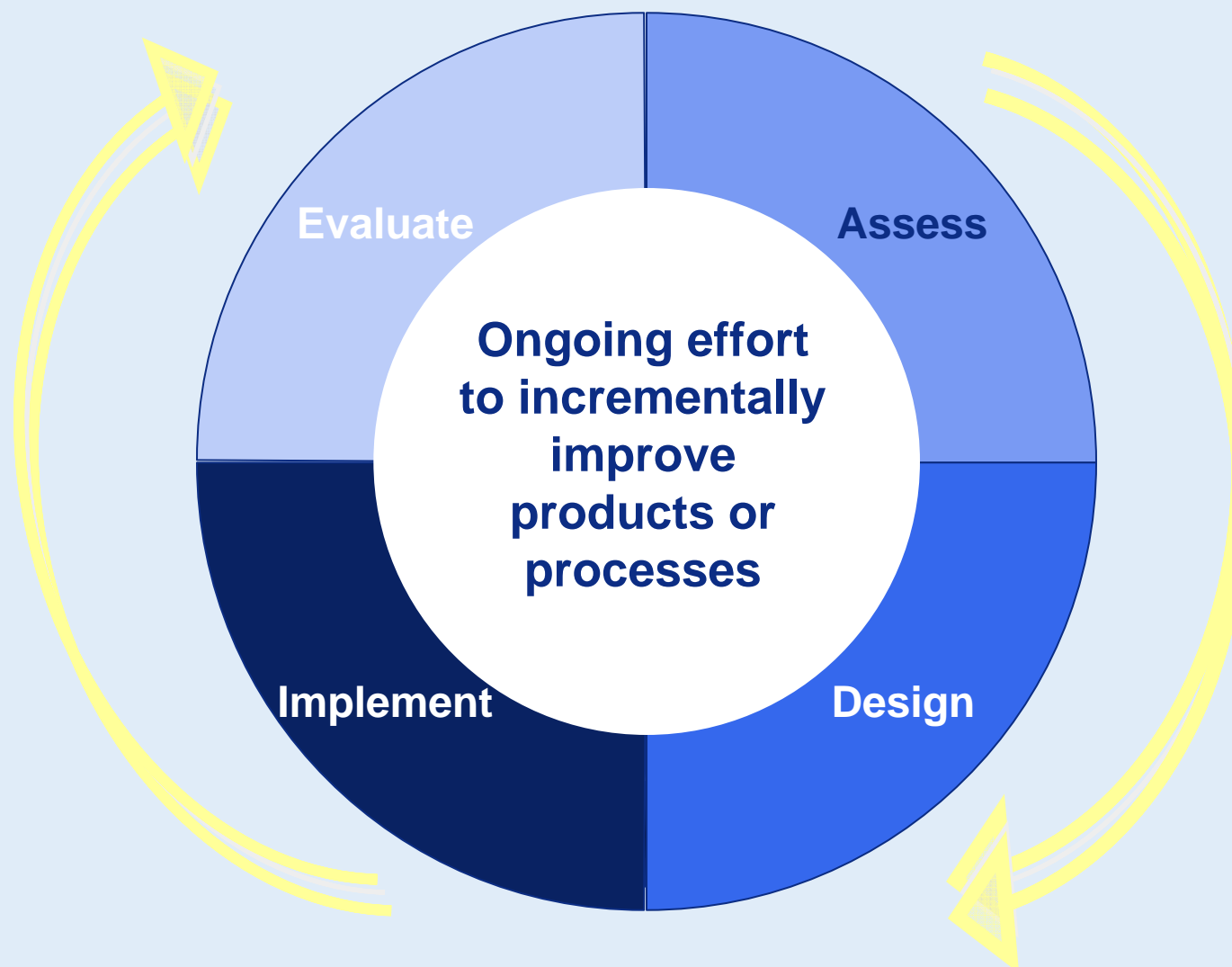
2. Technological Advancement

- Advances the understanding of scientific relations or technologies

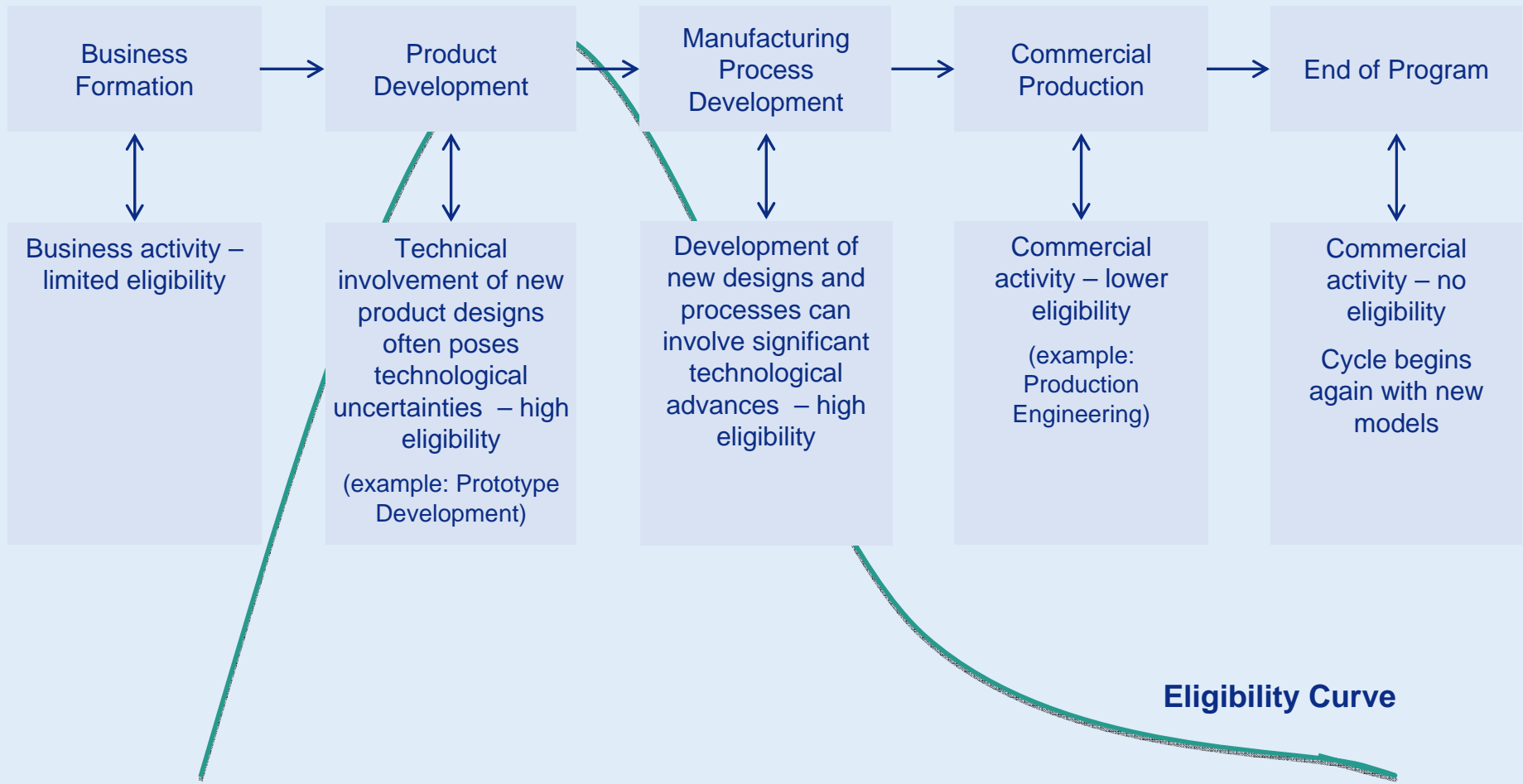
3. Scientific and Technical Content

- Systematic investigation through experiment or analysis
- Includes “Shop Floor” SR&ED
- Supporting Documentation

Future Focus: R&D – Four Phase Process



Future Focus: R&D Life Cycle



R&D Tax Incentive Application Process

Financial or Technical Audits

Tax authority review of claim submitted and final approval of application.

Project Analysis

Technical analysis of any R&D projects conducted in tax year to determine tax incentive eligibility.

Identify Expenditures

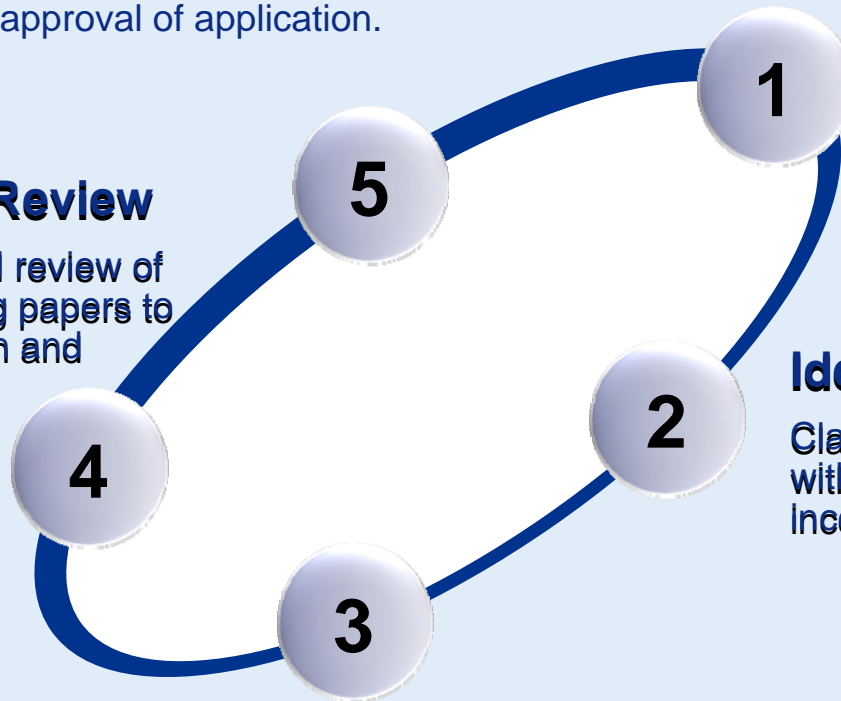
Classification of costs in accordance with their possibility of qualifying for tax incentives.

Draft Technical Reports

Prepare technical summaries to outline project details to satisfy eligibility criteria.

Documentation Review

Technical and financial review of documentation/working papers to support project position and auxiliary calculations.



Examples of SR&ED eligible work

R&D is found in many industries, including:

Energy and Natural Resources

- Remote sensing equipment
- Innovative drilling & mining methods
- Extraction efficiency innovations
- Sustainable practices, incl. water conservation, resource efficiency
- Site remediation innovations



Manufacturing

- New or improved materials, devices, products or processes
- Process automation
- Alternative feedstocks & materials
- Innovative control systems,
- Smart metering
- Resource and energy efficiency
- Bioplastics, light weighting, ...

Examples of SR&ED eligible work

Software/IT

- Integration of new software programs with existing and aging legacy software systems
- Development of software, programs and systems to support plant operations, industrial processes etc.
- Development of reliable wireless communication systems in areas of high interference on the shop floor
- Development of computer programs to improve speed, throughput or meet performance, scalability, high availability and security specifications.
- Use of new, emerging technologies or use of existing technologies in a way it was not intended or designed.
- Development of complex programs to simulate and manage risk, process very large volumes of real-time data.



Examples of SR&ED eligible work

Pharmaceuticals/Nutraceuticals

- Tablet development for extended time release profiles of active ingredients
- Developing tablet coating processes to eliminate premature tablet disintegration



Food Production/Packaging

- Resolving manufacturing issues of food ingredients to extend shelf life
- Developing techniques to improve productivity of sterilization processes
- Methods to control Foreign Materials
- Sensory and Consumer Research Testing





Overview of Ontario Digital Media Tax Credit Program



Overview of the Digital Media Tax Credit

- **Ontario Interactive Digital Media Tax Credit (“OIDMTC”)**
 - Refundable credit to promote development of digital media industry
 - Includes products designed to educate, inform or entertain end-users using at least two of text, sound or images
 - Digital products must not be used primarily to present, promote or sell the products or services of the corporation
- **Examples of Digital Media Products can include:**
 - Interactive Web sites
 - E-learning and educational products
 - Simulation applications with high user interactivity
 - Video games, cell phone games, PDA software

OIDMTC Program – Financial Overview

Two types of OIDMTC products:

Eligible products

- 40% refundable credit on costs incurred after March 2009 (20% to 30% if before)
- Qualifying costs: 100% of employee and contractor costs (50% of contractors if prior to April 2009) and marketing & distribution costs (max of \$100K per product)

Specified products (ie. developed under fee-for-service agreement)

- 35% refundable credit for employee salary costs (only) incurred after March 2009 (20% to 25% if before)

How to Recognize SR&ED

SR&ED Tax Credits are possible if the answer is “yes” to one or more of the following:

- Do you employ engineers or scientists?
- Are your products technology-centric or based on emerging or rapidly changing technologies?
- Is time being spent developing new ways of doing things?
- Is time being spent adapting processes before saleable products/services go out?
- Do your products go through rapid, constantly changing development cycles?
- Are there projects that failed for technical reasons?
- Are there projects with significant cost over-runs?
- Are software or technical consultants involved?
- Is money invested to develop better products or faster processes?
- Is shop floor experimentation being performed?
- Are significant amounts of scrap being generated?
- Are there patents involved?
- Has other government funding (e.g. IRAP) been received?

Session Key Takeaways

- **Tax credits resulting in tax savings and cash refunds are out there and are ready for the claiming!**
- **We have successfully increased claims as more qualifies than people realize and smaller projects have been ignored**
- **Companies who believe they have no R&D, overlook experimental development**
- **We have an excellent reputation with CRA**
- **We can help identify the projects, costs and file claims and offer flexible billing arrangements**

KPMG is a leader in R&D incentives across a number of markets, Nationally and Globally

Canada

- National Service Line
- 120 people
- 80+ engineers/scientists
- Our value proposition: We help clients get money back from the government on money already spent with no risk or out of pocket cost
- Primary focus: Federal SR&ED Tax Incentive Program
- Also assist clients with provincial incentives such as ODMTC, OCASE, OBRITC, Quebec University Research Tax Credit, etc.

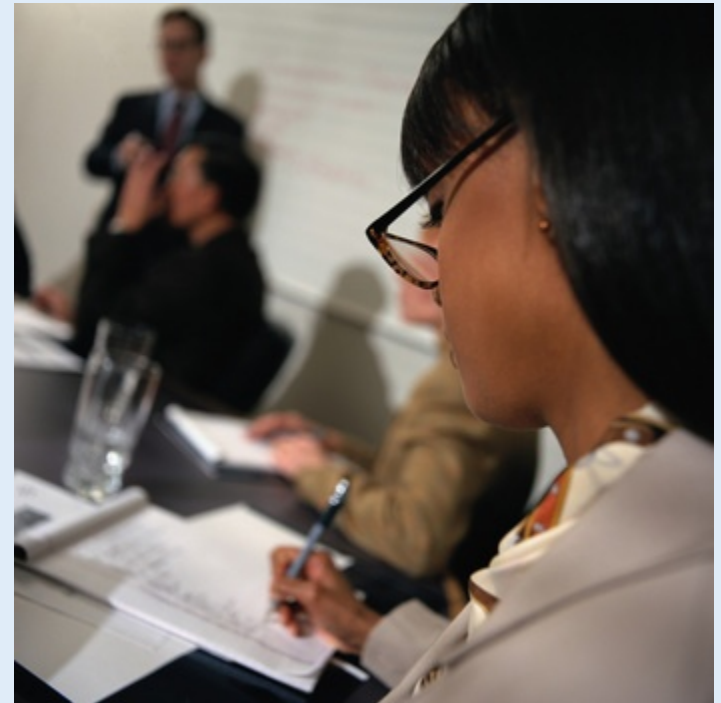
Engineering/scientific plus business capabilities

- Deep industry expertise across many sectors
- Technical expertise across many fields
- Understanding of applied and theoretical scientific methods
- Deep analytical capabilities
- Commercial acumen
- Focus on individual projects and project portfolios
- Understanding of technological innovations
- Relationships with universities, research centres and other centres of innovation
- Diverse client base including large corporates, SMEs and start ups

What Do We Do?

Services provided by SR&ED Group include:

- **Allows companies to be more competitive in the global market.**
- **Help clients with R&D Tax Compliance Services**
- **From full service to specific aspects of R&D tax compliance**
- **Turn Key/Full Service**
 - Identify projects
 - Write the required technical reports
 - File tax returns
 - Support the claim when reviewed by CRA
 - Train client staff and improve tracking systems
- **From full service to specific aspects of R&D tax compliance**





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Questions?