

Income Tax

IMP. 1029.7-1 **Credit for research and development**

Date of publication: **January 30, 1987**

Reference(s): *Taxation Act* (R.S.Q., c. I-3), sections 32 to 58.1, 222, 225, 312, paragraph *h* and sections 1029.7 and 1029.8
Regulation respecting the Taxation Act (R.R.Q., 1981, c. I-3, r.1, as amended), sections 192R1, 222R1, 222R2 and 985R1

The purpose of this bulletin is to specify how the *Taxation Act* applies to the computation of the credit for research and development.

APPLICATION OF THE ACT

Definition of scientific research

1. "Scientific research" means systematic investigation or search carried out in a field of science or technology by means of basic or applied research undertaken for the advancement of scientific knowledge or by means of use of the results of research for the purpose of creating new or improving existing materials, devices or products.

This definition includes activities with respect to engineering or design, operations research, mathematical analysis or computer programming and psychological research, if such activities are undertaken directly in support of basic or applied research and of the use described in the previous paragraph, but does not include activities with respect to:

- a) market research or sales promotion;
- b) quality control or routine testing of materials, devices or products;
- c) research in the social sciences or the humanities;
- d) prospecting, exploration or drilling for minerals, petroleum or natural gas;
- e) the commercial production of a new or improved material, device or product, or the commercial use of a new or improved process;
- f) style changes; or
- g) routine data collection.

2. For example, the design, building and testing of software prototype systems constitutes scientific research. It includes the development of real time systems and products and process control, as well as the programs and systems used to support or analyze activities which, per se, constitute scientific research. On the other hand, routine data collection, i.e. accumulation of data to complement the production process does not constitute scientific research.

Furthermore, expenditures made to acquire software as a finished product do not constitute scientific research expenditures. They are rather expenditures of capital nature for the acquisition of depreciable property.

Taxpayers who qualify for the credit for research and development

3. To benefit from the credit for research and development provided for in section 1029.7, a taxpayer must:

- a) carry on a business in Canada; and
- b) undertake or cause to be undertaken, after May 10, 1983, scientific research.

The tax credit for research and development is only available when the taxpayer undertakes or causes to be undertaken scientific research on his behalf. Thus, a taxpayer who undertakes scientific research for various governments in Canada, for a corporation or any other person, would not be eligible to claim this tax credit for research and development.

Taxpayers who do not qualify for the credit

4. The following do not qualify for the credit:

- a municipality;
- a Canadian public body performing a government function;
- a corporation, commission or association the shares, capital or property of which are at least 90% owned by Her Majesty in right of Canada or a province or by a Canadian municipality;
- a subsidiary wholly owned corporation of a corporation, commission or association described in the previous paragraph, except a subsidiary wholly owned corporation of a corporation mentioned in paragraphs a to w of section 192R1 of the *Regulation respecting the Taxation Act*.

Computation of the credit

5. A taxpayer who qualifies for the credit for scientific research is deemed to have paid to the Minister, for the taxation year during which the scientific research was undertaken, as partial payment of his tax payable for that year pursuant to Part I of the act, an amount equal to 10% of:

- 1) the wages he has paid during the year in respect of the research to his employees of an establishment situated in Québec, and

- 2) the portion of the remuneration that he has paid during the year in respect of the research to a person who has undertaken all or part of the research, that may be attributed to the wages of the employees of an establishment of that person situated in Québec or would be if he had such employees.

Furthermore, the second paragraph of section 1029.7 provides that for the purposes of the payments that a taxpayer is required to make under section 1026 or 1027, the latter will be deemed to have paid to the Minister, as partial payment of his tax payable pursuant to Part I of the act, on the date on which each quarterly or monthly payment is required to be paid, the amount which would be determined in conformity with the previous paragraph if it applied only to the period covered by the payment, and on the date the last payment is required to be paid, the balance of the amount thus determined.

Eligible wages for the purposes of computing the credit for research and development

6. “Wages” means the income computed pursuant to Chapters I and II of Title II of Book III of Part I of the act.

Thus, this income will not include the gratuities an employee is not required to include in computing his income from office or employment.

Consequently, the employer’s contributions to non-taxable fringe benefits, such as contributions to the registered retirement plan or a health insurance plan, should not be included in computing the wages for the purposes of computing the credit for research and development. However, to be more exact, the income or wages mentioned in section 1029.7 shall include all fringe benefits taxable under Chapter II of Title II of Book III of Part I of the act.

As regards the remuneration a corporation pays during the year in respect of scientific research to a person who has undertaken all or part of the research, only the part that may be attributed to the wages of the employees of an establishment of that person situated in Québec, or would be if he had such employees, qualifies for the purposes of computing the credit for research and development.

The expression “or would be if he had such employees” mentioned in section 1029.7 of the act refers to the case of an autonomous person who has no employee to carry out the contract under which he makes scientific research for the benefit of the corporation that claims the credit for research and development. In this case, the amount that would be paid as wages if the person carrying out the contract had had employees to carry out the contract must be determined.

Taxpayer member of a partnership

7. According to section 1029.8 of the act, where a partnership carries on a business in Canada and undertakes or causes to be undertaken in Québec, after May 10, 1983, scientific research, every taxpayer who is a member of the partnership and who is not a taxpayer mentioned in 4 above may take advantage of the credit for research and development.

The taxpayer must be a member of the partnership at the end of the fiscal period during which the research was undertaken.

The taxpayer will be deemed to have paid to the Minister, for the taxation year in which ends the fiscal period during which the research was undertaken, as partial payment of his tax payable for that year pursuant to Part I of the act, his portion of an amount equal to 10% of:

- 1) the wages the partnership has paid during its fiscal period after May 22, 1984, in respect of the research to his employees of an establishment situated in Québec, and
- 2) the portion of the remuneration that the partnership has paid during its fiscal period after May 22, 1984, in respect of the research to a person who has undertaken all or part of the research, that may be attributed to the wages paid to the employees of an establishment of that person situated in Québec or would be if he had such employees.

According to the second paragraph of section 1029.8 and for the purposes of computing the payments that a taxpayer referred to above is required to make under section 1026 or 1027 for his taxation year in which the fiscal period of the partnership ends, the taxpayer will be deemed to have paid to the Minister, as partial payment of his tax payable for the year pursuant to Part I of the act, the amount determined for the year in his respect under the previous paragraph, either on the date on which the fiscal period ends where that date coincides with the date on or before which the taxpayer is required to make such a payment or, in other cases, on the first date following the end of the fiscal period which is the date on or before which he is required to make such a payment.

Taxation of the credit for research and development

8. Since the credit for research and development is not, in conformity with paragraph *h* of section 312, an amount received as a grant to carry on research or any similar work, it shall not be included in computing the income of a taxpayer according to paragraph *h* of section 312.

Also, since such a credit for research and development is not an amount referred to in section 225 of the act, it will not reduce the expenditures related to research and development.

Payments of tax on capital

9. Finally, as provided for in the second paragraph of sections 1029.7 and 1029.8 of the act, the 10% tax credit is deemed to constitute a payment or partial payment of tax payable pursuant to Part I of the act. Thus, such a credit cannot be used to compensate for payments of tax on capital, because this tax is provided for by Part IV of the act.

Refund of the credit

10. The mechanism of the credit for research and development has been set up in such a way that it is refundable when the taxpayers entitled to it have no tax to pay in a year. Section 1029.7 of the act considers that a payment of tax was made and section 1051 of the act stipulates that where a taxpayer has paid as tax for such year an amount greater than that due, the Minister must refund the excess to the taxpayer who applies for it. Thus, if the taxpayer had no tax to pay, his credit for research and development will be refunded to him on his application. Therefore, such a credit cannot be deferred to a subsequent year.