Written Submission for Pre-Budget Consultations in Advance of the Upcoming Federal Budget

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Ryan Recommendations for Pre-Budget Consultations

Recommendation 1: That the government temporarily allow enhanced refundability of Scientific Research and Experimental Development (SR&ED) Investment Tax Credits**.**

Recommendation 2: That the government implement a reduced tax rate on income from activities related to COVID-19 relief efforts**.**

Recommendation 3: That the government implement a modified "patent box" or "Innovation Box" system tied to research and development intensity and specific employment requirements.

Recommendation 4: That the government expand the GST/HST zero-rating provisions to include personal protective equipment (PPE).

Ryan Recommendations for Pre-Budget Consultations

Introduction

Ryan, one of the largest firms in the world dedicated exclusively to business taxes, welcomes the opportunity to provide input and recommendations to The Standing Committee on Finance as part of pre-budget consultations. Ryan is committed to helping the Canadian economy recover from the impact of the COVID-19 pandemic and recommends the following four improvements to Canada's tax system in furtherance of this objective.

Recommendations

Recommendation 1: Temporarily allow enhanced refundability of Scientific Research and Experimental Development (SR&ED) Investment Tax Credits.

For the economic recovery to occur as quickly as possible, there should be an emphasis on continued development of products, processes and technology to regain traction regarding wealth creation. To do this, it is essential that companies retain and/or hire staff in science, technology, engineering and math (STEM) fields.

To offset the wages of STEM employees, we propose a temporary measure to allow refundability of non-refundable SR&ED Investment Tax Credits (ITCs) that expire after twenty years and may currently only be used to reduce Part I tax otherwise payable. This measure could be selectively applied to either existing employees or new hires, or both. There are existing federal and provincial employment grants that could be leveraged to provide a framework for this measure.

Alternatively, the Department of Finance could implement refundability of otherwise non-refundable ITCs within the SR&ED framework by allowing refunds based on salaries or wages included in SR&ED Qualified Expenditures. SR&ED ITCs would be calculated under existing rules but would be refundable based on a percentage of qualifying wages up to 100%.

Many SR&ED claimants have non-refundable SR&ED ITCs carried forward from prior years. We propose that this measure be implemented on a prospective basis and not applied to any accumulated ITC balances earned in prior years.

Recommendation 2: Implement a reduced tax rate on income from activities related to COVID-19 relief efforts.

During the COVID-19 pandemic, many Canadian companies stepped up by changing what they do to support our drastically altered need for critical supplies, such as hand sanitizer, ventilators, masks and other protective equipment. There are multiple ways that the government can support these efforts, including direct grants and investment tax credits (ITCs).

We recommend implementing favourable tax treatment or a "Pandemic Box" for income resulting from COVID-19 relief efforts undertaken by Canadian corporations, whereby certain identified income would be taxed at a reduced rate. Suggested criteria for "Pandemic Box" eligibility include:

- The company must have altered existing processes or implemented new processes to produce COVID-19 related products not normally produced by the company (e.g., hand sanitizer, cleaning supplies, masks, face shields, protective clothing, and ventilators); and
- The company did not receive another form of government assistance to support initiatives related to COVID-19.

As part of this framework, the amount of income eligible for favourable tax treatment should be capped either in absolute terms or relative to corporate size.

Implemented in conjunction with direct grants and ITCs, this measure will allow more Canadian companies that actively undertook COVID-19 relief efforts to access much-needed government support and close the gap in the government's current platforms to support companies that acted in the best interests of Canada under exceptional circumstances.

Recommendation 3: Implement a modified "patent box" or "Innovation Box" system tied to research and development intensity and specific employment requirements.

Historically, Canada has been quite good at supporting early stage research and development (R&D) through both direct grants and the SR&ED program, but support for later R&D stages and commercialization of intellectual property (IP) have lagged behind other countries, despite a global economy that is becoming increasingly dependent on technology. Additionally, Canada is generally not considered to be an "IP-friendly" jurisdiction and domestically developed IP is frequently commercialized and exploited offshore, denying Canada most of the economic benefits, despite having funded the early stages.

Inevitably, as Canada emerges from the COVID-19 pandemic, some pre-pandemic jobs and economic activity will have been lost. It is imperative to replace those jobs and grow our economy. However, there is a significant wage rate differential between Canada and certain foreign jurisdictions for basic labour. Given these and other factors, Canada should focus on the creation and retention of high-tech and specialized jobs. Further, a system that encourages the commercialization of domestically developed IP will naturally lead to more employment opportunities in manufacturing and production. A modified "patent box" system or an "Innovation Box" could achieve these goals.

Evidence suggests that traditional patent box systems implemented by multiple European countries may not be effective policy. Evidence also supports, however, that a modified patent box system tied to R&D intensity and employment requirements can have a positive impact on

overall R&D spending, and the resulting economic benefits, including the creation of high-tech jobs. When this type of system was implemented in Mainland China in 2008, per OECD data, gross domestic R&D spending increased from US$140.4 billion in 2007 to US$526 billion in 2018, almost a four-fold increase. By contrast, OECD data for Canada shows that Canadian R&D spending was remarkably flat over the same period: US$27 billion in 2007 compared to US$26.5 billion in 2018.

We recommend that Canada adopt an "Innovation Box" to stimulate R&D spending. A suggested framework for this measure would include the following elements:

- Eligible income derived from domestically developed IP;
- Minimum annual R&D spend as a percentage of gross revenue;
- Minimum percentage of workforce employed in R&D or high-tech positions and completed post-secondary education;
- Minimum percentage of gross revenue derived from domestically developed IP;
- Sliding cap on income eligible for the reduced tax rate for more R&D intensive companies;
- Sliding tax rate reduction percentage for more R&D intensive companies; and
- In recognition of the fact that many companies do not patent their IP to avoid public disclosure, eligible domestically developed IP would include know-how and technological advancements resulting from successful SR&ED projects.

Recommendation 4: Expand the GST/HST zero-rating provisions to include personal protective equipment (PPE).

From the outset of the COVID-19 outbreak, it became clear that efficient access to personal protective equipment (PPE), such as gloves, masks, respirators and protective gowns, is a critical component of an effective response to a pandemic. Furthermore, any plan to move forward during the current pandemic or prepare for future epidemics will necessitate the use of significant quantities of PPE. From all levels of government to multinational corporations to local restaurants to individual consumers, the use of PPE has become part of the "new normal" for everyone. Consequently, the government's plan to restart the Canadian economy must consider the requirement for vast amounts of PPE.

Whether manufactured domestically or procured internationally, PPE generally attracts GST/HST. Regardless of the type of organization acquiring it, GST or HST is paid on the purchase of PPE in Canada and, in the absence of specific tariff relief (which is currently in place for the current pandemic), GST is paid at the border on imports of this equipment. At times when organizations are scrambling to secure the PPE required to help combat a pandemic or manage another medical crisis, the GST/HST represents an additional cost – and the bigger the crisis, the greater the cost.

By expanding the GST/HST zero-rating provisions to include prescribed PPE, the government can lower the cost of this equipment for individual consumers and many public service bodies

(PSBs). In addition, for many taxpayers, including commercial organizations, this measure will alleviate part of any potential cashflow issues associated with the acquisition of PPE.

For organizations involved exclusively in commercial activities (i.e., organizations that are GST/HST registrants, collect and remit GST/HST on taxable supplies, and are entitled to recover the full amount of any GST/HST paid by claiming input tax credits), the additional cost of the tax on PPE is strictly a cashflow issue. However, given the massive quantities of PPE required to fight a pandemic and keep the economy going during such a crisis, this additional cost can exacerbate financial concerns and inhibit economic recovery.

For organizations not involved exclusively in commercial activities, including hospitals, school boards, universities and colleges, non-profit organizations and charities, many of which only recover a portion of the GST/HST paid on their inputs (through ITCs in respect of any commercial activities and PSB rebates in respect of exempt supplies), the GST/HST on PPE represents an additional cost during times of economic turmoil. Indeed, many PSBs are currently grappling with historically low donation levels and rising operating costs due to new pandemic protocols, and these organizations would benefit greatly from a PPE cost reduction at a time when financial assistance is dearly needed. PSBs will see varying levels of tax savings, depending on how much PPE is acquired for their operations and their GST/HST recovery rate (i.e., PSB rebate percentage) for a given period. Individual consumers who find themselves having to purchase their own PPE will also appreciate the cost savings.

By making PPE zero-rated through the addition of prescribed supplies to the *Excise Tax Act* (ETA), Schedule VI, Part II – Medical and Assistive Devices, the government can provide some level of financial support to all taxpayers acquiring such equipment. This can be accomplished by prescribing supplies of PPE through Regulation, as Schedule VI, Part II, section 31 of the ETA zero-rates supplies prescribed in the Regulations (and none are currently prescribed). Alternatively, the zero-rating of eligible items can be enacted through amendments to the ETA, by adding a new section to Part II or a separate Part to Schedule VI specifically for "personal protective equipment". The latter approach would provide greater clarity and transparency for taxpayers.

Introducing a GST/HST zero-rating provision (as opposed to other measures, such as direct funding) to provide financial support to taxpayers while restarting the Canadian economy will allow the government to efficiently target relief to specific requirements, with no need for oversight (other than routine audit activity). Where considered necessary, conditions can be included in the legislation to ensure that only PPE intended for a valid use qualifies for zero-rating. For example, limitations can be placed on the eligibility of respirators (e.g., rated N95 or greater) or gloves (e.g., designed for use by medical professionals to treat patients in a health care facility). While an overly restrictive approach to prescribing eligible items is not recommended, it is an option to address concerns regarding potential abuse of the zero-rating provision.

The level of funding provided through GST/HST relief on specific PPE items will automatically be

adjusted by the quantity purchased. The greater the need, the more relief will be provided as consumers purchase equipment to meet their requirements.

Conclusion

We trust that you will find this information helpful in designing tax policy to speed Canada's economic recovery during these uncertain times, and we would be pleased to appear before the Committee to expand on any of our recommendations.

About Ryan

Ryan, an award-winning global tax services and software provider, is the largest firm in the world dedicated exclusively to business taxes. With global headquarters in Dallas, Texas, the Firm provides an integrated suite of federal, provincial and international tax services on a multi-jurisdictional basis, including recovery, consulting, advocacy, compliance, and technology services. Ryan's multi-disciplinary team of more than 2,700 professionals and associates serves over 14,000 clients in more than 50 countries, including many of the world's most prominent Global 5000 companies. More information about Ryan can be found at ryan.com/canada.