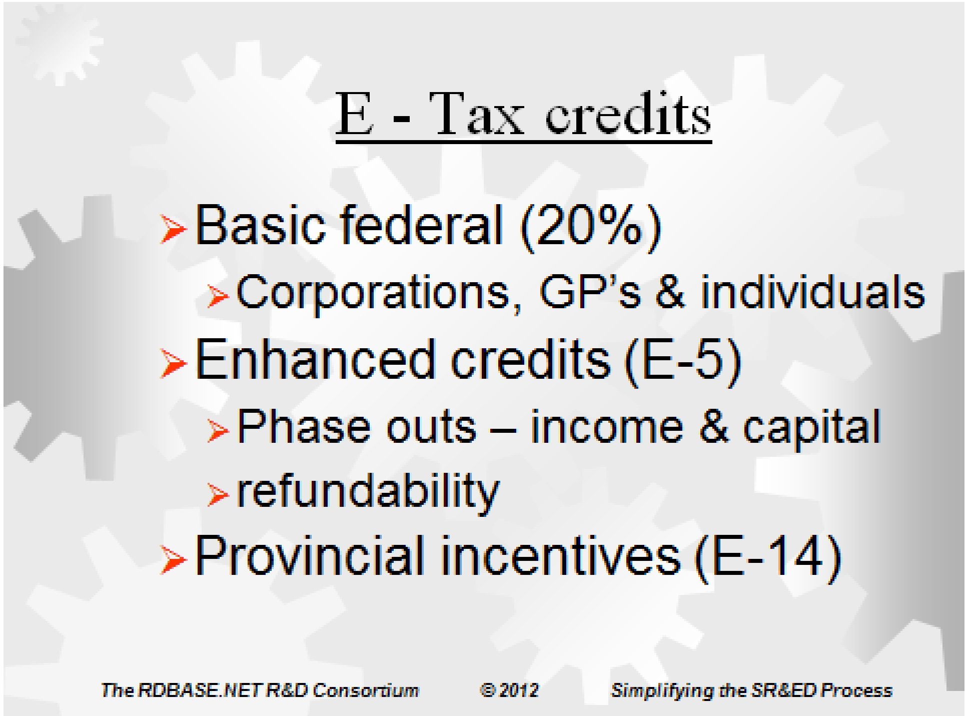

E.3 Federal SR&ED tax credits

There are currently two rates of federal investment tax credit for SR&ED in Canada:

- a general rate of 20 per cent and
- an enhanced rate of 35 per cent for qualified CCPCs (Canadian-controlled private corporations)

Generally speaking,

- CCPCs have <=50% of their shares controlled by "public corporations" or "foreign parties"
- "qualified" CCPCs are those with
    - prior-year taxable income under $ 400,000 and
    - prior-year taxable capital employed in Canada under $10 million.

E - Investment Tax Credit Rates - CCPC

- 35% ITC rate on all qualified expenditures up to the expenditure limit
- 20% ITC rate on all qualified expenditures in excess of the expenditure limit

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E - Investment Tax Credit Rates

Individuals and Certain Trusts

- ITC rate - 20% on all qualified expenditures
- Refundable - 40% of both current and capital ITC

Corporations (other than a CCPC)

- ITC rate - 20% on all qualified expenditures
- No refund

All Other Taxpayers

- ITC rate - 20% on all qualified expenditures
- No refund

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Federal SR&ED tax credit rates and rates of refundability (%)

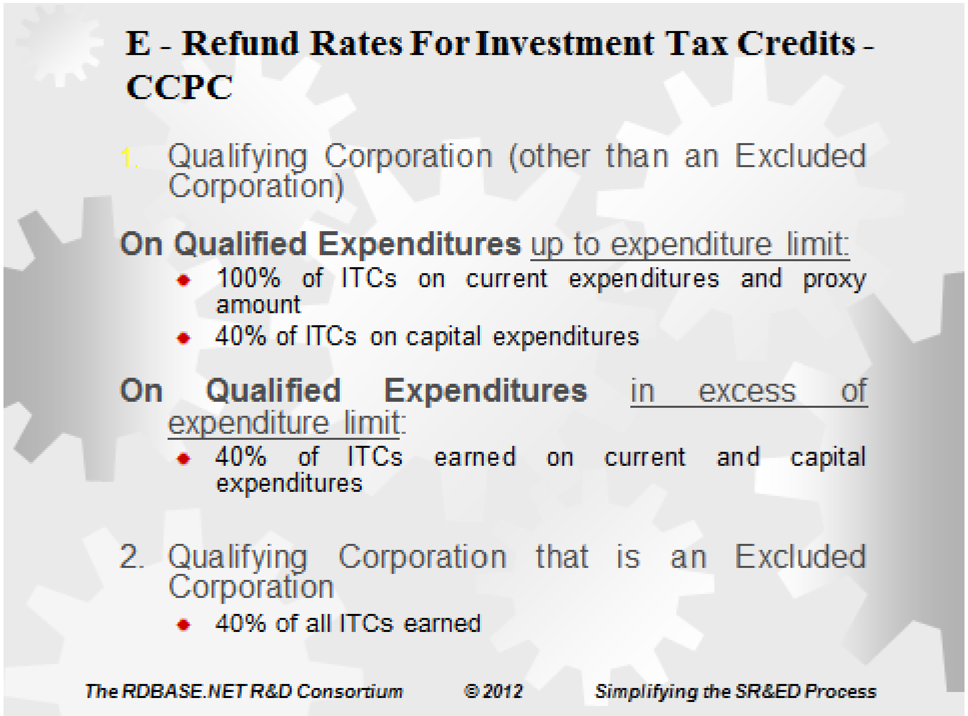
Business Type	Credit Rates	Refundability Rates	
		Current Expenditures	Capital Expenditures
Unincorporated Businesses	20	40	40
CCPCs with prior-year taxable income,			
- of $500,000 or less:			
Expenditures up to expenditure limit[1]	35	100	40
Expenditures over expenditure limit	20	40	40
- **between $500,000 and $800,000:**			
Expenditures up to expenditure limit[2]	35	100	40
Expenditures over expenditure limit	20	0	0
CCPCs with prior-year taxable capital employed in Canada between $10 million and $50 million:			
Expenditures up to expenditure limit[3]	35	100	40
Expenditures over expenditure limit	20	0	0
All Other Corporations	20	0	0

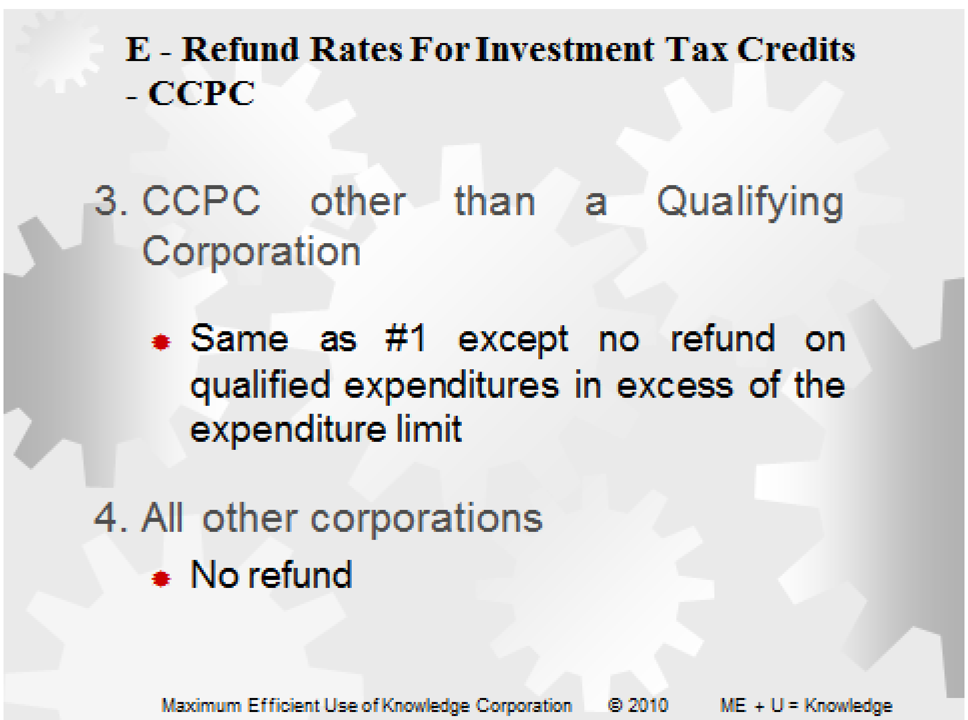
1. Expenditure limit is generally $3 million per annum for the "associated group of companies" (i.e. all companies under common control).
2. Expenditure limit for CCPCs is phased out for prior-year "group" taxable income between
   - $500,000 and $800,000 – see chart over page
3. Expenditure limit for CCPCs is phased out for prior-year taxable "group" capital employed in Canada between
   - $10 million and $50 million – see chart over page

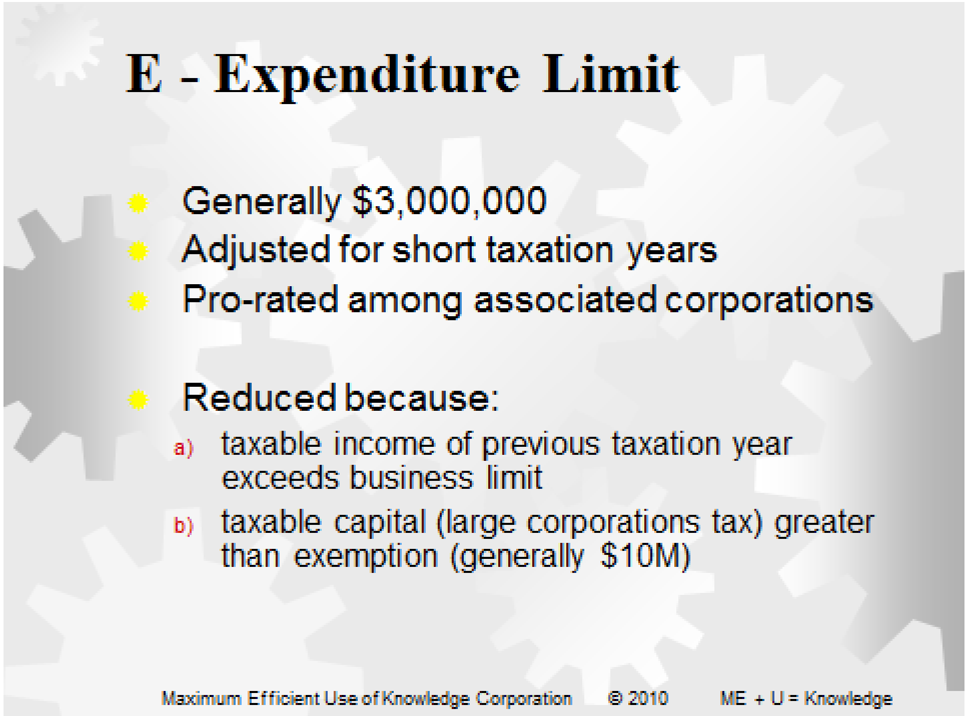
Ontario and Quebec include foreign or public companies and use ranges of $25 and $50 million for phasing out their enhanced credits to "Qualified Corporations".

E.3.1 Mechanics to determining expenditure limits for enhanced credits

The specific mechanics of the current phase-out formula are provided in the *Income Tax Act*







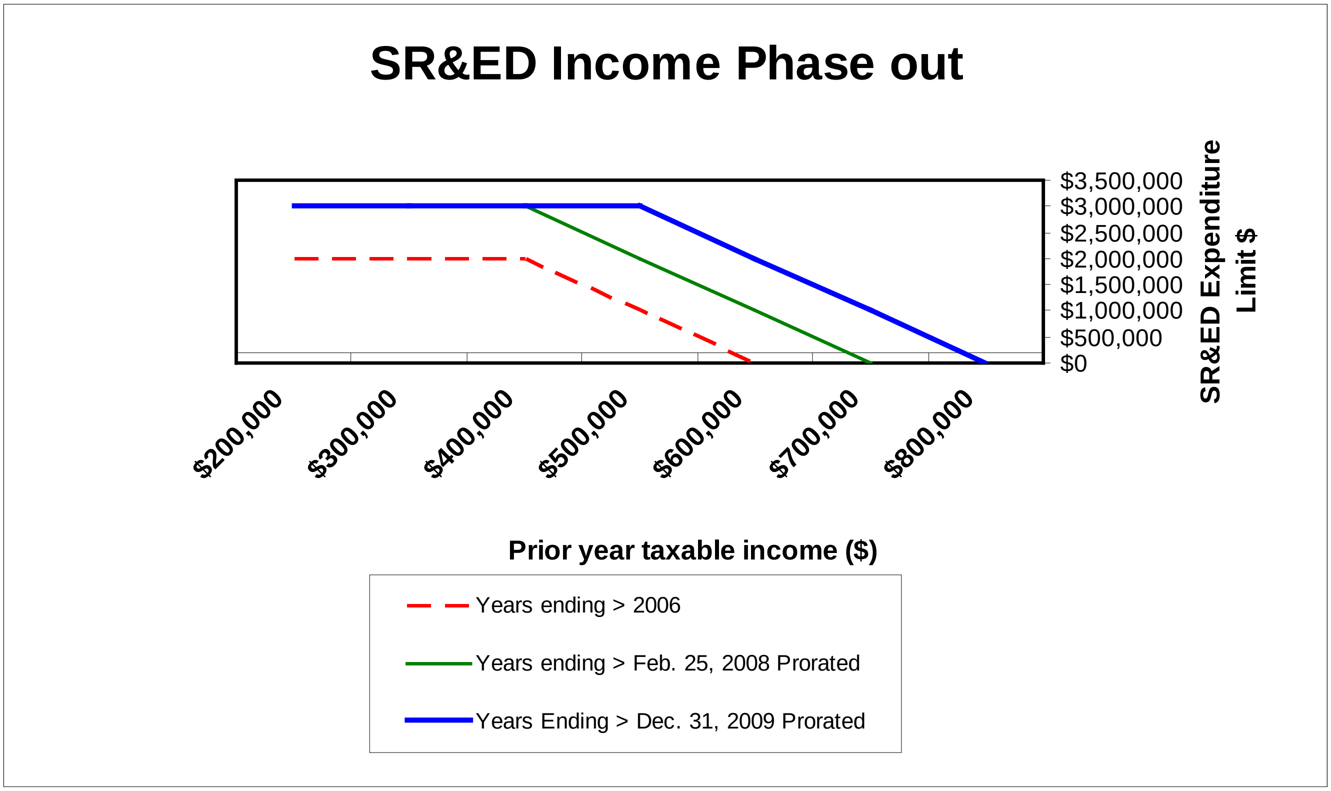
The amount of SR&ED expenditures that can earn tax credits at the enhanced rate is referred to as the expenditure limit. The expenditure limit is generally $3 million for CCPCs with prior-year taxable income of $500,000 or less. This expenditure limit is reduced on the basis of the following two criteria[41].

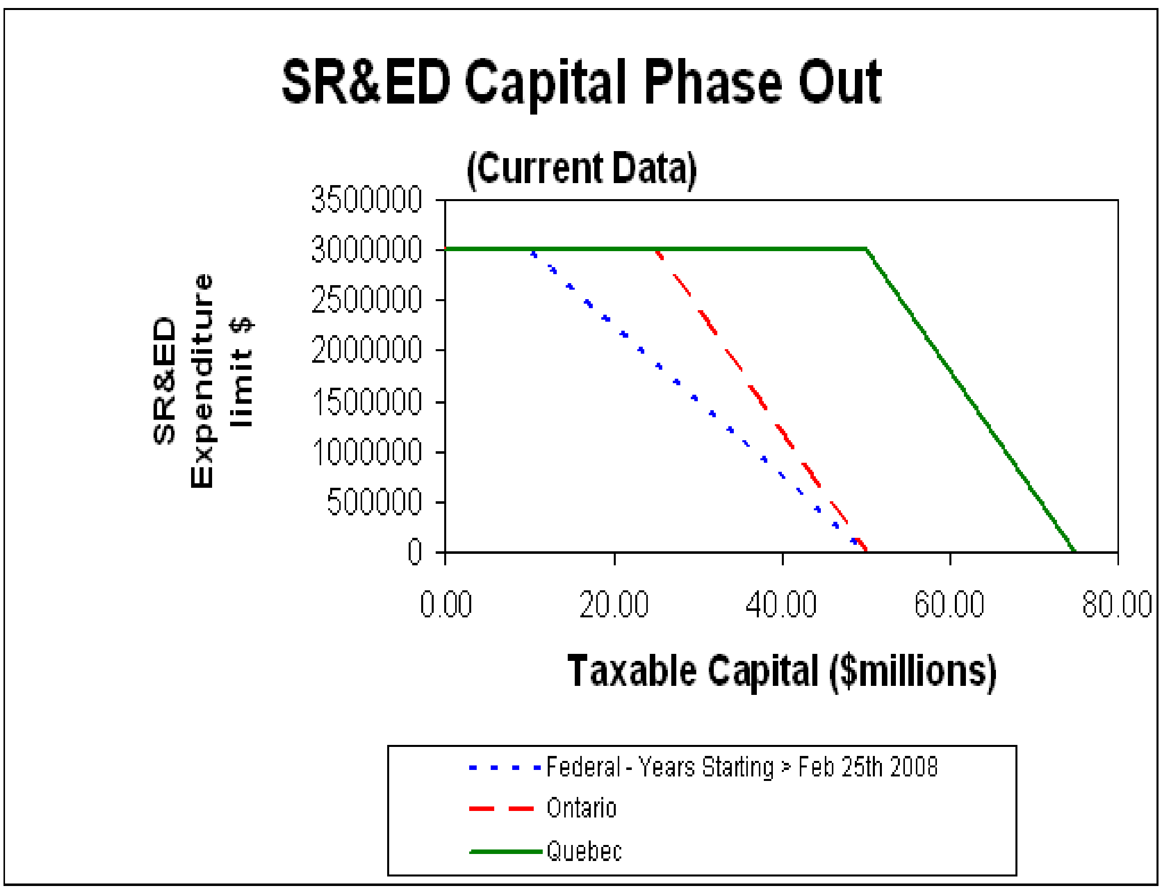
1. First, the expenditure limit is phased out for CCPCs with prior-year taxable income between $500,000 and $800,000.
    - For each dollar by which taxable income for the prior year exceeds $500,000,
    - the SR&ED expenditure limit for the year is reduced by $10.

2. In addition, the expenditure limit is phased out for CCPCs with prior-year taxable capital employed in Canada between $10 million and $50 million.
    - For every $10 by which taxable capital employed in Canada for the prior year exceeds $10 million,
    - the SR&ED expenditure limit for the year is reduced by $0.75 .

In a worst case scenario, the loss of this enhanced status could cost a company $700,000 annually in lost cash flows from the phase-out of the enhanced Federal Investment Tax credits. This loss becomes significantly higher in provinces where additional ITCs are provided to small businesses based on their eligibility for the enhanced Federal credits.

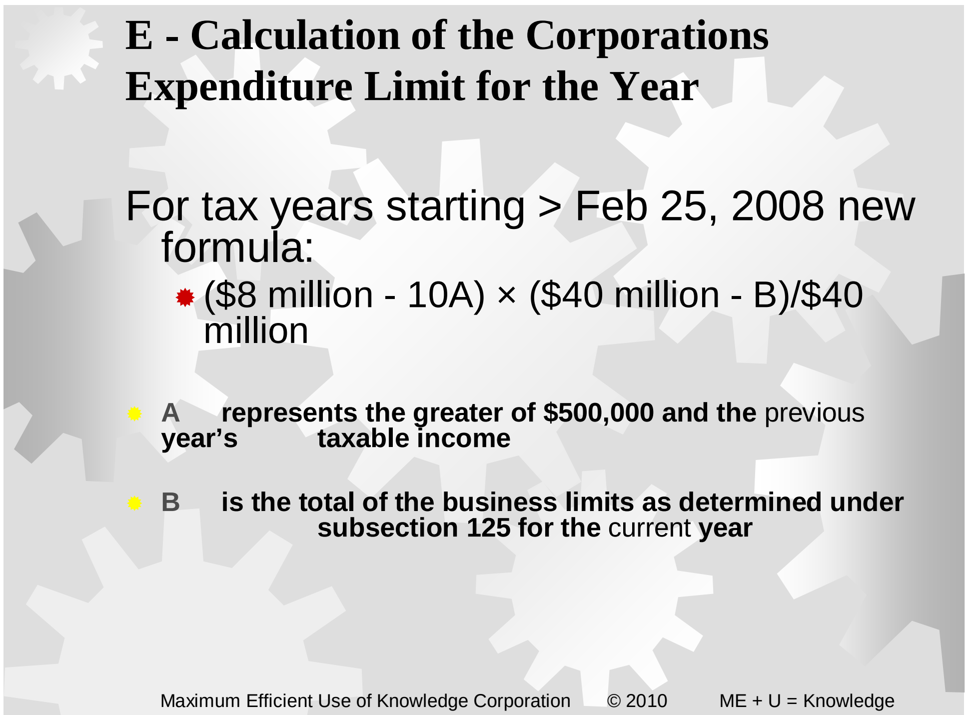
[41] ITA subsection 127(10.2)


SR&ED Income Phase out
$3,500,000
$3,000,000
$2,500,000
$2,000,000
$1,500,000
$1,000,000
$500,000
$0
SR&ED Expenditure Limit $
$200,000
$300,000
$400,000
$500,000
$600,000
$700,000
$800,000
Prior year taxable income ($)
Years ending > 2006
Years ending > Feb. 25, 2008 Prorated
Years Ending > Dec. 31, 2009 Prorated


SR&ED Capital Phase Out
(Current Data)
SR&ED Expenditure limit $
3500000
3000000
2500000
2000000
1500000
1000000
500000
0
0.00
20.00
40.00
60.00
80.00
Taxable Capital ($millions)
Federal - Years Starting > Feb 25th 2008
Ontario
Quebec

Mechanics of the phase-out formulas

E.3.2 2009+ expenditure limit phase-out increased to 500-800K



The proposed legislation[42] provides the following formula;
"…a particular corporation's **expenditure limit for the 2010 and subsequent taxations year** is the amount determined by the formula

($8 million - 10A) × ($40 million - B)/$40 million where

A is the greater of
- (a) $500,000, and
- (b) the amount that is
  - (i) …..the particular corporation's **taxable income** for its immediately **preceding taxation year** …

B is
- (a) nil, if the following amount is less than or equal to $10 million:
  - (i) …the amount that is its taxable capital employed in Canada … for its immediately preceding taxation year" or
- (b) in any other case, the lesser of $40 million and the **amount by which** the amount determined under subparagraph (a)(i) **[i.e taxable capital]… exceeds $10 million.**

[42] ITA proposed subsection 127(10.2)

E.4 Income – Expenditure limit phase out example

E - CCPC Investment Tax Credit on $3M of current expenditures – (assumes taxable capital in prior year was below $10M)

2009 Taxable income (Preceding Year)	2010 Expenditure Limit	2010 Current SR&ED Expenditures	2010 Refundable ITC	2010 Non-Refundable ITC
$400,000	$3,000,000	$3,000,000	$1,050,000	Nil
$550,000	$2,247,945	$3,000,000	$937,192	$150,411
$700,000	$ 747,945	$3,000,000	$261,781	$450,411
$800,000	Nil	$3,000,000	Nil	$600,000

Example of related mechanics – for $35 million scenario above

The next 3 pages illustrate:

- how the tax form (Sch. 31)
- phases out the Expenditure limit and related ITCS
- using a threshold of $550,000 prior year taxable income &
- $10 million prior year taxable capital

E.5 Capital - Expenditure limit Phase out example

E - CCPC Investment Tax Credit - $3M Current Expenditures

2009 Taxable Income (Preceding Year)	2009 Taxable Capital ($ million)	2010 Expenditure Limit	Total Credit Earned	Maximum refundable ITC	Non-refundable ITC
$400,000	$10.0	$3,000, 000	$1,050,000	$1,050,000	NIL
$400,000	$20.0	$2,250,000	$850,500	$787,500	$150,000
$400,000	$35.0	$1,125,000	$768,750	$393,750	$375,000
$400,000	$50.0	Nil	$600,000	Nil	$600,000
>=$700,000	N/A	Nil	$600,000	Nil	$600,000

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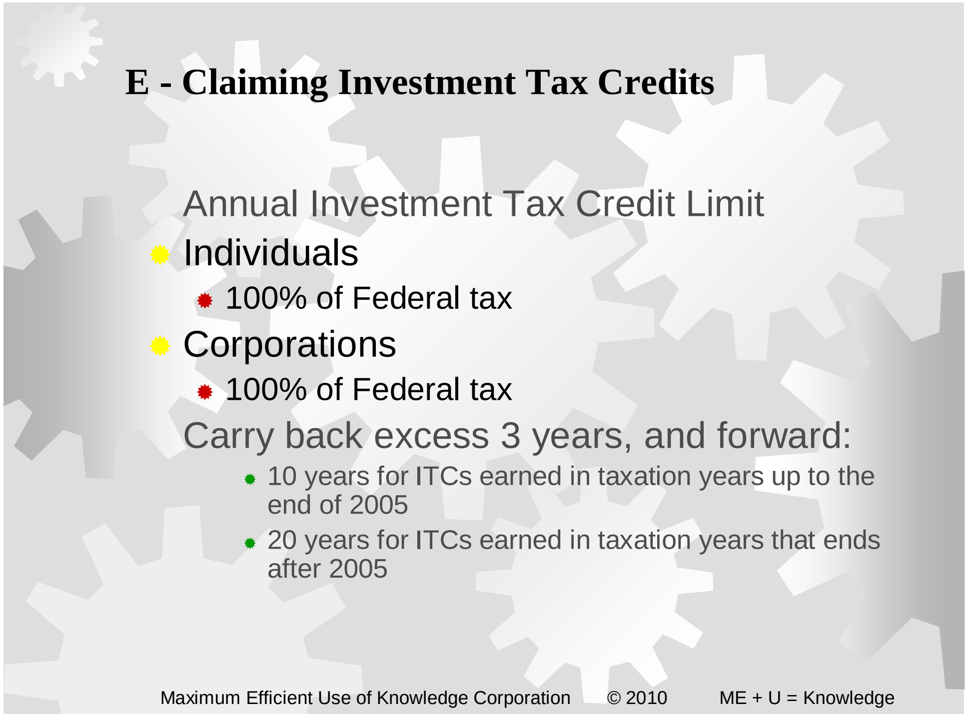
Example of related mechanics – for $35 million scenario above

The next 4 pages illustrate:

- how the tax form (Sch. 31)
- phases out the Expenditure limit and related ITCS
- using a threshold of $35 million prior year taxable capital &
- $400,000 prior year income.

It should be noted that the calculation is close (but not exactly equal to) that proposed in the legislation.



E.6 Methods of using SR&ED tax credits

Investment tax credits may be deducted from federal taxes otherwise payable. Prior to 2006 unused tax credits can be carried back three years (to the extent that they were not deductible in the year they were earned) or carried **forward 10 years.**

To increase the ability of these companies to use these balances the **2006 budget proposes** to extend the non-capital loss and ITC **carry-forward period to 20 years.**[43] This measure will apply to non-capital losses and **ITCs earned for SR&ED in taxation years that end after 2005**.

Corporations can also assign expected refunds of SR&ED tax credits to lenders as security for bridge financing for their operations. Such assignments, however, are not binding on the Crown.

[43] Notices of Ways and Means Motions March 2006 paragraph 28

E - Qualified Expenditures (for ITC)

Includes:

- amounts re: shared use equipment;
- SR&ED expenditures under s.37(1)(a) – current;
- SR&ED expenditures under s.37(1)(b)(i) – capital;

  and
- prescribed proxy amount.

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E - Qualified Expenditures

Do not include:

- prescribed expenditures Reg. 2902 (see N's)
- payments to non-arm's-length person for SR&ED performed on behalf of the taxpayer
- payments to non-taxable suppliers (other than for SR&ED payments for expenditures such as material, capital assets)
- qualified expenditures that have been paid for by government or non-government assistance or compensated by contract payment

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E.6.1 Inclusion of SR&ED tax credits in current and future taxable income

Both federal and provincial SR&ED ITCs are subsequently included in the calculation of federal taxable income as well as that of each of the provinces, except for the provinces of Ontario and Quebec. The taxation of SR&ED investment tax credits from current expenditures is performed through the SR&ED expenditures pool. Provincial credits are taxed on an accrual basis however, federal credits are only taxed the year after their use.

To the extent that an investment tax credit deducted or refunded may reasonably be considered to relate to a shared use credit on capital equipment, it will reduce the capital cost[44] of the separate prescribed class of the property acquired.

The mechanics of this add back to the expenditure pool are illustrated on working paper T-1.3 of the case study. In this example the company had no prior year investment tax credits and therefore the pool has only been reduced by the current year provincial credits. In this case, the company has also elected to defer a large amount of the expenditure pool in order to avoid the creation of "non capital losses" for the purposes outlined above.

E.7 Administration of the SR&ED tax incentives – Federal vs. Provincial

The CRA is responsible for administering the SR&ED tax incentives provided by the federal government and, in accordance with the Tax Collection Agreements, the tax incentives for research and development provided by Manitoba, New Brunswick, Newfoundland and Nova Scotia.

Ontario and Quebec do not have agreements with the federal government for administering their provincial corporate income tax and, accordingly, administer their own research and development tax incentives.

A summary of the Federal and Provincial incentives is provided on the next page. Specific details with respect to additional Ontario and Quebec legislation have also been outlined in this section.

E.7.1 Overview of Federal & Provincial credits

Currently all but one province and two territories offer additional tax incentives to attract SR&ED work. The resulting effects on claimants can be illustrated by the following tables.

[44] under paragraph 13(7.1)(e)

Qualified CCPC*				
Provinces & Territories	Prov./Terr. Credit	Prov./Terr. Refundable? *(Federal is refundable)*	Federal Credit Refundable (reduced by Prov./Terr. credit)	Combined
AB	10%	Yes	31.50%	41.50%
BC	10%	Yes	31.50%	41.50%
MB	20%	No	28.00%	48.00%
NB	15%	Yes	29.75%	44.75%
NL	15%	Yes	29.75%	44.75%
NS	15%	Yes	29.75%	44.75%
ON	**10%**	**Yes**		
ON	**4.5%**	**No**	**29.93%**	**44.43%**
PEI	0%	N/A	35.00%	35.00%
QC	20%	Yes	28.00%	48.00%
SK	15%	No	29.75%	44.75%
YK	15%	Yes	29.75%	44.75%
NWT	0%	N/A	35.00%	35.00%
NV	0%	N/A	35.00%	35.00%

Other companies (non Qualified CCPC)				
Provinces & Territories	Prov./Terr. Credit	Prov./Terr. Refundable? *(Federal is non-refundable)*	Federal Credit Non-refundable (reduced by Prov./Terr. credit)	Combined
AB	10%	Yes	18%	28%
BC	10%	No	18%	28%
MB	20%	No	16%	36%
NB	15%	Yes	17%	32%
NL	15%	Yes	17%	32%
NS	15%	Yes	17%	32%
ON	**10%***	**Yes**		
ON	**4.5% ****	**No**	**17.10%**	**31.60%**
PEI	0%	N/A	20%	20%
QC	10%	Yes	18%	28%
SK	15%	No	17%	32%
YK	15%	Yes	17%	32%
NWT	0%	N/A	20%	20%
NV	0%	N/A	20%	20%

Notes to the above tables:

1) The federal tax credit is reduced by the provincial tax credit receivable.
2) Ontario and Quebec offer additional SR&ED incentives, which are not covered within this table.

E.8 Lists of SR&ED schedules by province – see section Y at back or course:

For simplicity the current case study illustrates the interaction of the provincial incentives assuming that all costs were incurred in one province (Ontario) however, the mechanics of the calculations would similar for each of the other provinces (expect Quebec) as follows:

- Claim Qualified (Current & Capital) expenditures incurred in the province (T661 line #'s 557 + 558 - not reduced by the provincial ITCs themselves - see WP T-1.4)
- Deduct resulting government assistance to reduce the (T661 line #'s 430 (pool) & 534/536 (qualified expenses) - see WP T-1.3)
- Claim the related ITC via the province (see forms in section Y)

Province		**Form**
Quebec	a's	RD-222-V Deduction Respecting SR&ED
	b's	RD-1029.7-T Tax Credit for Salaries and Wages (R&D)
	c's	RD-1029.8.6-T Tax Credit for University Research Additional schedules available for pre-competitive research
BC		Schedule 666
MB		Schedule 380
NB		Schedule 360
NL		Schedule 301
NS		Schedule 340
ON		OITC - See case study (T-5-7's)
SK		Schedule 403
YK		Schedule 442
NWT		NONE
NV		NONE
PEI		NONE
AB		