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INFORMATION TECHNOLOGY
ASSOCIATION OF CANADA

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ASSOCIATION CANADIENNE
DE LA TECHNOLOGIE DE L'INFORMATION

A Pre-Budget Submission by the Information Technology Association of Canada

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The Information Technology Association of Canada (ITAC) is the voice of the Canadian information and communications technologies (ICT) industry. ITAC represents a diverse ICT community spanning telecommunications and internet services, ICT consulting services, hardware, microelectronics, software and electronic content. ITAC's community of companies accounts for more than 70 per cent of the 572,000 jobs, \$140.5 billion in revenue, \$6.0 billion in R&D investment, \$31.4 billion in exports and \$11.4 billion in capital expenditures that the ICT industry contributes annually to the Canadian economy. ITAC is a prominent advocate for the expansion of Canada's innovative capacity and for stronger productivity across all sectors through the strategic use of technology.

Canada's ICT sector is the most mature knowledge-based sector in the Canadian economy. The orientation of ITAC's counsel on tax policy continues to focus on measures that will accelerate Canada's competitiveness in a global economy driven by the acquisition and commercialization of new knowledge. Our recommendations continue to focus on the themes of research and development and productivity. Prudent management and our resource wealth have combined to place Canada in a relatively prosperous position. These conditions are exactly right for progressive measures to spur our competitiveness and ensure future prosperity.

Research and Development

Representing, as we do, the most research and development intensive sector in the Canadian economy, ITAC has advocated the need for a full review of the SR&ED program for several years. Budget 2008 marked the end of a five-month review process in which ITAC and many of our members actively participated. While we welcomed the many measures undertaken to improve the administration of SR&ED, we were disappointed in the relatively minor improvements to the SR&ED program announced in the Budget, noting that they constitute a mere 1.1 per cent improvement in the level of support the program provides. We believe that small measures of this nature will do little to address the relatively poor Business Enterprise Research and Development performance of Canada in relationship to our global competitors. We continue to believe, along with many members of the Canadian Manufacturing Coalition that our best course is that all investors in R&D in Canada have access to the SR&ED tax credits they have earned. We believe that the tax credits should be refundable.

We recognize the impact that refundability will have upon the size of the SR&ED program. But we also note Finance Canada's own estimates of an 11 per cent return on the program's investment. Properly viewed, the SR&ED is not a drain on Canada's fiscal resources but a key engine of 21st century growth.

Nevertheless, ITAC has been at pains to propose measures that would be less costly than full refundability. We continue to believe that alternative designs are worthy of exploration.

The alternative design we proposed in our 2007 Pre-Budget Submission allows companies to choose between a refundable wage credit (similar to that in effect in Quebec today) and a non-refundable SR&ED credit as it now exists. The choice could be made in each taxation year. The taxpayer would be choosing between immediate cash of a lower amount or a higher credit that might be useful in the future.

This would focus the refundable credit on companies with significant R&D work forces in Canada, helping to keep and grow our R&D centers here. The level of the non-refundable SR&ED credit and the wage credit could be set at whatever level resulted in an acceptable/affordable level of tax expenditure. To the extent that companies choose the refundable wage credit over the non-refundable SR&ED credit, this would actually lower the tax expenditure while representing a more effective incentive.

The effect of the wage credit approach would be to focus the value of the credit on research and development wages. It would have several ancillary benefits. It would simplify the audit process for both the claimant and for CRA. It would also focus refundable credits on wages of SR&ED personnel, which would attract and retain knowledge workers in Canada. Unlike SR&ED credits for material and equipment (which can be sourced from anywhere in the world) a wage credit would contribute towards salaries which in turn contribute to personal tax, EI and CPP payments back to the Government.

Extending refundability in this fashion will require no new definitions and minimal changes to tax legislation. Overall it would achieve the objective of ensuring that SR&ED does serve as an incentive for any and all investors in business research and development in Canada.

In addition, we also support the Canadian Manufacturing Coalition's recommendations for exclusion of the tax credits from the Federal revenue base, provisions for international collaborative R&D and an extension of the tax credit to cover costs for patents, prototypes, testing and other pre-commercialization activities.

SR&ED is frequently cited by Finance Canada officials as the most generous R&D incentive in the world and as the primary fiscal instrument to encourage R&D investment in Canada. But other countries are adopting and improving their programs and providing other mechanisms to support R&D investment. For example, the United States has recently introduced a refund

offering up to \$30 million of R&D tax credit carry-forwards. This is a fiercely competitive endeavour and Canada must vigilantly ensure that our programs make Canada an attractive investment location.

R&D investment is highly mobile. Companies of any significant size can place their R&D jobs anywhere in the world where a strong supply of highly qualified people exists. In fact, there are many good reasons for them to do so. Canada has always been a relatively high-cost jurisdiction in which to locate research and development jobs. Dollar parity has made this situation even worse. Unless measures are taken to ensure that Canada can compete effectively with its emerging and established R&D rivals, we face the prospect of losing opportunities for new investment and eroding the R&D base we currently enjoy.

Productivity

While Canada needs to address its capacity for product innovation, it also must reflect upon its relatively poor performance in process innovation which in turn contributes to weak productivity.

Process innovation is inextricably tied to global competitiveness. If Canadian goods and services fail to use technology to drive quality, speed-to-market and value, their markets will simply disappear.

Canada has an advanced economy, a well-educated population and reasonably high costs as compared to developing economies. Our future success must be based on world-leading development and application of technology, otherwise we will revert back to reliance on basic extraction of resources while we let the competitive position of our manufacturing and service economy erode and leave it for others to capture the high value jobs that relate to the transformation of our natural resources. This is neither necessary nor acceptable. But it means that we must do better in business innovation. Yet Canada's ranking has been slipping in various international comparisons when it comes to business innovation. And innovation, competitiveness and technology are inextricably linked in an economy like Canada's.

Market forces do not seem to be sufficient to address our chronic under-adoption of productivity enhancing technology. Dollar parity has had a cost-reducing impact upon ICT investment yet

this has had little impact on accelerating adoption rates. Neither has the recent commodities boom which presents an excellent opportunity for technology investment for as long as it lasts.

Fiscal measures are needed to encourage Canadian business people, particularly in the small and medium-sized business tranche, to understand the wisdom of Prime Minister Harper's declaration that "no country can remain prosperous and healthy without reinvesting a substantial portion of its wealth in science and technology".

ITAC believes that an explicit tax credit program based upon the model offered by the Telecom Policy Review Panel is still worthy of consideration as a measure to accelerate Canadian business efficiency. While ITAC would welcome an accelerated capital cost allowance structure, we believe that an ICT adoption tax credit would have the most direct impact on accelerating investment in ICTs. Such a program will imply significant communications activity around the importance of productivity and competitiveness of technology which would raise consciousness about the importance of productivity and so bring value in addition to the credit itself.

We also believe that incentives for the employment and training of skilled ICT workers are also important measures to spur the adoption of technology.