

Silicon Valley North – A Primer on Quebec’s Tax Incentives

R&D, E-Business and Patent Box Incentives

In recent years, Canada has sometimes been labelled “Silicon Valley North” and Montreal was recently ranked one of the best tech cities in the world to live in. In addition to being renowned for its outstanding quality of life, Montreal offers several other advantages, including low operating costs, a highly-educated multicultural work force, proximity to major U.S. cities, and relatively low corporate taxation (corporate tax rates in Quebec are significantly lower than U.S. corporate tax rates). In addition to lower corporate taxes, the governments of Canada and Quebec also offer some of the most generous tax incentives in the world to promote the advancement of scientific knowledge or technology activities and the use of local workforce. These tax incentives are generally available not only to Canadian businesses, but also to foreign investors carrying on innovation activities in Canada, and are offered in Quebec in various forms, including:

1. **SR&ED Incentives**
2. **Quebec E-Business Credit**
3. **Quebec’s 19% Patent Box Tax Rate**

Benefiting from the above tax incentives will drastically reduce a business’ innovation costs. Knowledge of the available tax incentives and, in the case of foreign investors, the proper structure to benefit from them, are the first steps towards efficiently incorporating tax incentives into a comprehensive innovation strategy. Businesses across a wide range of industries currently benefit from one or more of these incentives by having established a presence in Quebec, such as software, gaming (including some of the most prominent U.S. and European studios), pharmaceutical, healthcare, transportation and aerospace, to name a few.



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1 | SR and ED Incentives

The scientific research and experimental development (SR&ED) regime in Canada provides that qualifying R&D salaries are currently deductible from income, and also grants investment tax credits (ITCs) which reduce taxes payable. The base for calculating the amount of ITCs includes salaries paid to employees carrying out R&D activities. ITCs of up to 30% of qualifying R&D salaries are available in Quebec, and are supplemented federally by up to an additional 35% of eligible R&D expenditures (eligible R&D salaries are grossed up federally by 55%). Broadly speaking, to qualify, salaries must be engaged in connection with projects which involve overcoming a scientific or technological uncertainty. For example, developing new manufacturing processes or new source code could potentially meet the scientific or technological uncertainty criterion.

What makes the Canadian SR&ED incentives even more enticing is the potential for ITCs to be refundable, meaning that the company would receive a cash refund equal to the amount of the ITC even where it is in a loss position. Moreover, unclaimed SR&ED deductions that offset taxable income may be carried forward indefinitely, and the unused portion of non-refundable ITCs may be carried forward up to 20 years. For more details on credit and reimbursement rates, please see the tables at the end of this article.

2 | Quebec E-Business Credit

The Quebec E-Business Credit is equal to 30% of eligible salaries not exceeding \$83,333 per employee, and is comprised of a 24% refundable component and a 6% non-refundable component. The refundable component of the Quebec E-Business Credit is available even where a business is in a loss position. Any unused non-refundable component may be carried forward up to 20 years.

To the extent that a portion of salary expenses supports a claim for the Quebec E-Business Credit, the same portion cannot be used to claim the Quebec ITCs. Businesses must therefore consider how to allocate eligible salary expenses to the Quebec E-Business Credit versus to provincial ITCs in Quebec, so as to maximize the amount of refundable credits.

3 | Quebec Patent Box Regime

The Quebec innovative companies deduction (ICD) provides a further tax incentive at the commercialization stage of an innovative product. 50% of the income derived from an eligible patent will be taxed at a reduced corporate rate of 19% (generally lower than competing jurisdictions). The conditions to receiving ICD are:

1. The patent(s) must be held by a corporation with an establishment in Quebec;
2. The patent(s) must have been developed using Quebec SR&ED incentives;
3. The corporation must have more than \$15M of paid-up capital;
4. The corporation's activities must primarily consist of manufacturing and processing activities carried out in Quebec; and
5. In the five years preceding the filing of the patent(s) application(s), the corporation must have paid at least \$500,000 in qualified R&D expenditures.



The above overview is general in nature, and the rules governing the tax incentives are complex. We would be pleased to assist with determining the availability of incentives to your business and to advise on an optimal structure to maximize the value of these incentives.

APPENDIX – Canadian Federal and Quebec ITCs as at October 1, 2019

Net Innovation Cost of \$1 Million in Qualifying Salaries

A	Qualifying Salaries	\$1,000,000
B	Grossed-up Qualifying SR&ED Salaries (Federal)	\$1,550,000
C	Maximum Quebec SR&ED Credit	\$300,000
D	Maximum Federal SR&ED Credit	\$437,500
E	Total Maximum SR&ED Credits	\$737,500
F	Net Cost of Qualifying Salaries (A - E)	\$262,500
G	Net Cost of Qualifying Salaries/Qualifying Salaries (%)	26.25%

The net cost is about 26¢ on the dollar.

Federal ITCs

Type of corporation	Credit Rate		Refund Rate	
	R&D Salary Expenses up to \$3,000,000	R&D Salary Expenses Exceeding \$3,000,000	R&D Salary Expenses up to \$3,000,000	R&D Salary Expenses Exceeding \$3,000,000
Canadian-controlled private corporation (CCPC) having a taxable capital < \$10M	35%	15%	100%	40%
CCPC having taxable capital > \$50M*	15%	15%	0%	0%
Non CCPCs	15%	15%	0%	0%

* The \$3M expenditure limit (and by extension the credit rate and the refund rate) is gradually reduced and eliminated where taxable capital is between \$10M and \$50M.

Quebec ITCs

Type of corporation	Credit Rate		Refund Rate	
	R&D Salary Expenses up to \$3,000,000	R&D Salary Expenses Exceeding \$3,000,000	R&D Salary Expenses up to \$3,000,000	R&D Salary Expenses Exceeding \$3,000,000
Canadian-controlled corporation (CCC) < \$50M assets	30%	14%	100%	100%
CCC > \$75M assets**	14%	14%	100%	100%
Non CCCs	14%	14%	100%	100%

** The rate of 30% is gradually reduced where assets exceed \$50M. Where assets are equal to or exceed \$75M, the rate remains at 14%

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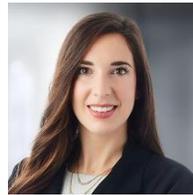
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