Canadian Manufacturers & Exporters

Manufacturiers et Exportateurs du Canada

2016-2017 Pre-Budget Submission

Canadian Manufacturers & Exporters

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Executive Summary

Canadian Manufacturers & Exporters (CME) is grateful for the opportunity to provide some recommendations as the Government is preparing its budget for fiscal year 2017-18. In our view, the next federal budget should implement a national industrial strategy that will accelerate Innovation, increase Investments and help manufacturers reduce their carbon footprint. CME's key-recommendations include:

- The Creation of national clusters dedicated to the development and adoption of digital manufacturing technologies;
- Increase direct investments in fast-growing companies by the creation of a risk-sharing loan program (conditionally repayable loans) that would help companies innovate, commercialize new products both domestically and internationally;
- Reform the Scientific Research and experimental Tax Credit (SR&ED) by conducting a complete legislative review;
- Implement a Patent Box Tax regime to increase commercialization of IP in Canada;
- Expand the Atlantic Investment Tax Credit Nation-Wide;
- Eliminate withholding tax requirements related to services performed in Canada where the non-resident certifies the income is exempt from Canadian tax because of a tax treaty;
- Provide exemption from employers that are already contributing to a retirement or capital accumulation plan for employees from any mandatory CPP cost increase;
- Leverage infrastructure spending to accelerate innovation and sustainable economic growth;
- Create a national Export Accelerator Program;
- Expand the Ontario's Green Investment Fund nationally.

Recommendation 1: Create national clusters dedicated to the development and adoption of digital manufacturing technologies

As the federal government is consulting and preparing the first phase of its innovation agenda, CME strongly recommends the creation of national industry-driven advanced manufacturing networks, with the mandates to use the knowledge from academic and public research centres and make them available to grow businesses and the economy. Growing businesses results in more companies doing R&D, more exports, more taxes for governments, and more high-skilled students finding jobs in the private sector. Clusters would be aligned to the top three (3D printing), Automation and Robotics, and the Internet of Things (including the Industrial Internet). Mandates of the clusters would include:

- **Leverage academic research for business needs**
- **Identify skills gaps**
- **Explore international opportunities for Canadian companies**
- **Enhance international investments in Canada**

These networks would be funded by federal funds and be matched by private sector investments to ensure that projects are industry-driven and meaningful in terms of job creation and economic growth.

Recommendation 2: Increase direct investments in high-potential firms by creating a risk-sharing funding program aimed at improving productivity and accelerating the commercialization of innovative products

An ageing population and low productivity levels are threatening Canada's long-term economic competitiveness. The adoption of new technologies such as advanced robotics and digital manufacturing offer Canadian manufacturers the opportunity to address those concerns, while also making them more competitive in international markets and reducing GHG emissions.

More importantly, these factors will hinder our ability to compete with companies in the EU, Korea and others with whom Canada has recently signed trade agreements.

CME's recommendation of a new risk-sharing program would take the form of a special operating agency of the Government of Canada with a mandate to provide funding support for strategic research and development and demonstration projects that produce economic, social and environmental benefits for Canadians.

Funds would be provided to businesses through conditionally-repayable loans for the long-term commercialization of R&D projects, market development and business expansion. By so doing, this program would fill an important gap in Canada's support for the commercialization of research and would be in line with the government's intent to provide more direct support for private sector R&D and innovation.

The program would be geared to pre-competitive projects across a wide spectrum of technological development, including environmental technologies, life sciences, information and communications technologies, and advanced manufacturing.

In our view the program would have three main components: Grow, Innovate and Export.

Grow: Conditionally repayable loans would be offered to help companies increase their manufacturing output and their productivity. Under this stream, companies could de-risk up to one-third of the costs of plant improvements (building modernization and expansions) as well as the acquisition of advanced manufacturing machinery and equipment, automation of production processes, adoption of digital manufacturing technologies such as additive manufacturing, or any other capital investment that would enhance a company's productivity and competitiveness.

Innovate: Conditionally repayable loans would be available for companies that have a plan to commercialize a product or a process that require R&D and that is in its early commercialization phase. The program would provide companies with conditionally repayable loans covering up to one-third of the costs of R&D. Repayment terms would be subject to the successful commercialization of the technology.

Export: The third component of the program would be to de-risk a company's plan to diversity and increase its exports without adding too much debt or diluting equity. The program would provide a long-term, conditionally repayable loan to help the company in its export activities. Repayments would be subject to the revenues originating from these new export markets.

Recommendation 3: Reform the Scientific Research and Experimental Development Tax Credit (SR&ED)

The federal government invests more than $3 billion every year through the SR&ED Tax Credit to support private sector R&D. Canada is one of the many jurisdictions worldwide that provides an R&D tax credit. Manufacturing companies, who account for 42 per cent of all SR&ED claimants, have expressed strong concerns about the increasingly onerous restrictions that the Canada Revenue Agency has imposed over the years. At the same time as manufacturers have been calling for improvements to the program, it has instead been subject to significant cuts between 2012 and 2015.

Specifically, we believe that the federal government should undertake a complete legislative review of the program, with a strong focus on:

- updating the definitions of innovation for today's standards;
- unlock the $10 billion in unused SR&ED credits among Canada's large corporations by making a portion of it refundable;
- clarify the definition of government assistance under the *Income Tax Act* for the purpose of the SR&ED program;
- Fast tracking of SR&ED claim process;
- Increase the threshold for cash refund of the SR&ED tax credit for SMEs to $1 million;
- Clarify evidence requirements in the administration of the program by the Canada Revenue Agency.

Recommendation 4: Adopt tax reforms that would increase the competitiveness of the Canadian manufacturing sector

- **Implement "Patent Box" Tax measures to improve commercialization of technologies developed in Canada.** Canada has a great track record of inventing new technologies, but has a poor track record in commercializing those technologies**.** A "patent box" is a tax incentive that provides relief from corporate tax on income generated from certain types of qualifying intellectual property (IP), particularly patents. Patent box regimes provide tax relief at a later stage of the innovation lifecycle, in the years when income is generated from exploiting IP. Relief can be given either as a reduced tax rate or a deduction for a portion of the patent box income. Patent boxes generally target the commercial or manufacturing activities that follow development rather than R&D activities themselves. A patent box tax incentive would support companies at a critical point in their product development and financing cycle while encouraging them to commercialize new products in Canada.
- **Expand the Atlantic Investment Tax Credit Nation-Wide**: In order to regain a strong position in manufacturing, Canada needs to accelerate its investments, expand and modernize its existing manufacturing facilities, and build new ones to replace those that are gone. The federal government is currently offering a 10 per cent Investment Tax Credits *(Atlantic Investment Tax Credits)* to incentivize investments in manufacturing equipment in the Atlantic Provinces. CME recommends expanding the Atlantic Investment Tax Credits to all provinces. CME further recommends that the credit be made refundable in order to improve its effectiveness and facilitate the financing of investment project

- **CME recommends the <u>elimination withholding tax requirements</u> related to services performed in Canada where the non-resident certifies the income is exempt from Canadian tax because of a tax treaty.** Section 105 of the Income Tax Regulations impose withholding tax on payments on services rendered in Canada by non-residents. Under the regulation, legal obligations are imposed on the payer to withhold, remit and report – this means that foreign companies have to set up a payroll account, obtain a tax id number and issue T4's (and possibly T4A-NRs) in Canada (even where no tax may be applicable due to treaty exemption). Administrative practices and costs that hamper the ability of Canadian companies in this regard should be eliminated. We would like to note that in many cases, these non-resident employees described above are ultimately not subject to tax in Canada (thus no revenue leakage to Canada) due to the availability of exemption provisions in Canada's many bilateral income tax treaties. These provisions exist to eliminate double-taxation.

Recommendation 5: CME does not support any mandatory CPP cost increase to employers given the significant regulatory/cost burdens that manufacturers are facing. Canada must remain focused on creating a more competitive environment for manufacturers to grow. If the government intends to proceed, a non-universal approach is preferred that would exempt employers that are already contributing to a retirement or capital accumulation plan for employees. Incentives or offsets of equal value to the new cost must be provided to employers to avoid adverse and unintended economic consequences.

Recommendation 6: Leverage infrastructure spending to accelerate innovation and sustainable economic growth

While we applaud the government's intent to boost infrastructure spending in Canada, we are concerned that most of these investments do not fully maximize the economic benefits for the Canadian economy. While the vast majority of our trading partners have adopted policies to maximize domestic content and spur domestic innovation using government procurement, including infrastructure projects (ex: Buy American policies in the United States), the federal government has never taken advantage of its infrastructure spending to do the same. As a result, Canadian manufacturers, especially in the fields of steel fabrication and water & wastewater equipment, are competing on an un-level playing field both domestically and abroad. This limits our ability to innovate with new products and our capacity to export those products globally to maximize economic benefits for Canada.

CME recommends that the federal government:

- **Leverage federal infrastructure spending and adopt a strategic procurement policy for all its infrastructure projects**, which will emphasize the need to maximize domestic economic benefits for the manufacturing sector, creating jobs and enabling economic growth, while respecting its current international trade obligations.

Recommendation 7: Create a National Export Accelerator Program

- Specifically, CME recommends the federal government work with Canada's robust community of public and private sector trade experts to build on Canada's existing Technology Accelerator Program and offer a ***National Export Accelerator Program*** similar to what is available in other countries. This national accelerator program would focus on preparing successful applicants for new markets and addressing company-specific barriers to exporting, including training, technology gaps, productivity gaps, access to value or supply chains or financing gaps.

Recommendation 8: Expand the Ontario's Green Investment Fund nationally

As part of the Province of Ontario's Green Investment Fund, CME is partnering with the government in the delivery of the SMART Green program. This $25 million fund will offer 50:50 matching grant funding up to $200,000 to manufacturers across Ontario to implement capital investment projects that will deliver emission reductions, energy efficiency technologies, and best practices through process and/or product improvement.

We believe now is the time to launch a national program similar to the existing SMART program funded by FedDev and the new SMART Green program funded by the Province of Ontario. Specifically we suggest the program should be:

- Funded by the Federal Government;
- Administered by the private sector for reduced administration and faster, more flexible implementation;
- Available to manufacturers across the country;
- Matching and grant based;
- Directed at support investment in new machinery, equipment and clean technology; and
- Objective based with a focus on reducing GHG emissions and improving productivity and competitiveness.