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R&D tax update

Recent jurisprudence on SR&ED eligibility favours taxpayers

November 14, 2014 (14-4)

On October 23, 2014, Tax Court of Canada (TCC) Judge Gaston Jorré issued his decision in *Les Abeilles Service de Conditionnement Inc. v. The Queen*, an appeal regarding the eligibility of work claimed by the taxpayer as scientific research and experimental development (SR&ED). The decision, which was in favour of the taxpayer, contains several interesting elements related to SR&ED undertaken in industrial settings.

Nature of taxpayer's SR&ED claim

The taxpayer's SR&ED claim was in respect of four projects that involved the development of new or improved manufacturing processes for mechanical and electrical systems, and included both labour and trials expenditures. All four projects were considered by the Canada Revenue Agency (CRA) to involve standard practices or routine engineering with no technological uncertainty or advancement. As such, the SR&ED claim was rejected.

TCC decision

The court found in favour of the taxpayer and determined that all four projects constituted SR&ED. In coming to this conclusion, Judge Jorré considered two questions:

- Was the work undertaken in the interest of technological advancement?
- Was the work undertaken with a view to creating new or improving existing processes, even slightly?

The court held that the technological work should not have been evaluated by the CRA at the level of each individual activity on a standalone basis; rather, each project should have been examined in its entirety.

The five criteria established in *Northwest Hydraulic Consultants Ltd. v. The Queen* for assessing whether work constitutes SR&ED were noted by Judge Jorré with the following comments:

- The five criteria serve as considerations in determining whether the work involved scientific advancement and was undertaken in the interest of technological progress.
- The nature of the five criteria is not absolute. Specifically, it is not necessary to actually achieve advancement - undertaking work with a view to achieving advancement is sufficient.

The court subsequently concluded that it is clear that the taxpayer did not know *a priori* how to achieve its technological objectives and that there was technological

uncertainty. As well, it concluded that the work undertaken was in the interest of technological progress. The court rejected the CRA's arguments that the work constituted standard practice on the basis that there was technological uncertainty. The implication of these conclusions appears to be that where technological uncertainty exists, and is addressed with the aim of achieving technological advancement, the work undertaken cannot be considered standard practice. This approach is in line with Judge Bowman's position on *Northwest Hydraulic Consultants*. It should be noted, however, that the taxpayer was able to demonstrate that it had undertaken reasonable due diligence in discarding established practice as a solution prior to undertaking its development work.

An observation

It is noteworthy that while both the taxpayer and the Crown representing the CRA put forth expert witnesses during the trial, the Crown's expert witness was the CRA's research and technology advisor responsible for the SR&ED review in question. The court found that his testimony as an expert was not impartial, and more closely reflected CRA policy rather than his own professional opinion. It will be interesting to see whether this finding affects the CRA's practice of using its own staff as expert witnesses in future cases.

What next?

To some degree, this judgment (which was rendered under the general procedure of the TCC) is similar to that in the 2012 decision *1726437 Ontario Inc. o/a Airmax Technologies v. The Queen* (which was rendered under the TCC's informal procedure). In both cases, the court took a broader view of eligibility for SR&ED incentives than the CRA.

This case is a welcome decision in an environment in which the burden of establishing eligibility for the SR&ED incentive program is becoming more challenging for taxpayers. It should be noted that in this case the taxpayer was successful in demonstrating that it had undertaken good systematic investigation, and had put forward a credible expert witness.

It remains to be seen whether the CRA will appeal this decision.

Can we assist?

Deloitte's Global R&D/Government Incentives professionals are experienced in the implementation of new or revised methodologies for assessing eligibility for SR&ED incentives. We would be happy to discuss how our expertise and tools can be used to your advantage.

Albert De Luca, National Leader, Global R&D/Government Incentives

Announcing CPA Canada's 2015 SR&ED symposium

CPA Canada's first SR&ED symposium will be held on February 5-6, 2015 in Toronto. This event was initiated by the SR&ED Advisory Committee of CPA Canada, which is co-chaired by the CRA and Albert De Luca of Deloitte. The symposium will include a blend of technical and financial/accounting sessions, with insights from practitioners and government representatives. The content will be of interest to both specialists and generalists while featuring panel discussions and debates with some of the field's experts, including representatives from Deloitte's R&D practice.

For more information: www.cpacanada.ca/SREDSymposium

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