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R&D tax update

Revised SR&ED forms and guide effective January 1, 2014

December 30, 2013 (13-9)

On October 31, 2013, the Canada Revenue Agency (CRA) released several new and revised documents related to the scientific research and experimental development (SR&ED) tax incentive program. These include:

- T1146 Agreement to Transfer Qualified Expenditures Incurred in Respect of SR&ED Contracts Between Persons Not Dealing at Arm's Length
- T1145 Agreement to Allocate Assistance for SR&ED Between Persons Not Dealing at Arm's Length
- T661 Scientific Research and Experimental Development (SR&ED) Expenditures Claim
- T4088 Scientific Research and Experimental Development (SR&ED) Expenditures Claim - Guide to Form T661
- SR&ED T661 claim preparer information sheet

The revised Form T661 and the related T4088 Guide have introduced some changes with which claimants should familiarize themselves. This new version - Form T661(13) - will be mandatory for all filings after December 31, 2013, regardless of the taxation year in question.

Key changes

The key changes to Form T661 include the following:

- Descriptions of work associated with experimental development (Section B) and basic or applied research (Section C) under Part 2 – Project Information has been combined into a single section. There is no longer any distinction made in how experimental development and scientific research are described, and claimants must now identify the scientific uncertainty associated with the scientific research that they are claiming. This is a return to the model that existed prior to version 8 of Form T661 (issued in 2008).
- Line 240, describing advancements sought, has been removed but the information originally requested therein has been moved to line 242 (Uncertainties). Claimants are now asked to describe the technological or scientific objectives of their work on line 242, along with the scientific knowledge or the new or improved capability being sought. In addition, now under line 242, claimants are asked to describe how the uncertainties could not be resolved by applying practices, techniques or methodologies that are

known or available in the public domain, i.e., the scientific or technological baseline.

- Line 246 has been added, introducing a new requirement to provide a description of the advancements achieved as a result of the work.
- A new Part 9 has been added for the provision of claim preparer information. This information is mandatory as of January 1, 2014. Penalties may be assessed where this information is missing, incomplete or inaccurate.
- Modifications have been incorporated to reflect the legislative changes with respect to capital expenditures and leases that take effect on January 1, 2014.

Implications

According to the CRA, these and other recent releases do not represent any change in policy. We welcome this clarification and anticipate that the application of these policies to taxpayers' claims will confirm these statements over time. However, some claimants have reported experiences that may reflect a somewhat different application of policy than in the past. For example, taxpayers have seen a greater focus by the CRA on the nature and/or form of the work undertaken. The CRA also appears to have placed an increased emphasis on the planning of the work in assessing its nature and eligibility. Certain of the changes to Form T661 appear to correlate to these claimant experiences.

It will be important for claimants to consider the above in describing their work in the revised form. Some basic considerations in this regard are provided below.

Define the advancement in technology (or science) that is sought by the work

Claimants should be clear as to what technology is being advanced by their work. Where this advancement arises from the combination of technologies, it is essential to demonstrate that the combination is not evident based on existing knowledge and that the development of additional knowledge at the interface of the technologies is required to achieve the objectives, or that the combination involves advancement in one or more of the underlying technologies.

Go beyond the description of the experiment

Generally, a discussion of the experiment may not be sufficient to describe the "systematic process" as defined by the CRA. To comply with the CRA's requirements, describing the following additional elements may help:

- preliminary investigative work that led to the development of the hypotheses to be studied, and
- post-experiment analysis, along with relevant conclusions.

The hypothesis and the analysis should demonstrate an understanding of the underlying scientific or technological principles at play.

Clearly distinguish from standard practice

Work that represents "standard practice" is excluded from eligible SR&ED. However, the identification of what constitutes standard practice can be sufficiently vague, leading to widely varying interpretations of a given body of work. Establishing a clear set of facts to define what constitutes standard practice, and/or the limitations of this practice in a given situation, is an effective way to overcome this challenge. In order to demonstrate that legitimate technological-scientific uncertainty existed, and to

differentiate the undertaking from standard practice or routine work, a good approach would be to describe how it was determined that scientific or technological uncertainty existed, by outlining the due diligence undertaken by the team to ascertain the limitations of existing knowledge before embarking on the project.

Can we assist?

We are available to assist you on how to apply the provisions of the SR&ED program in your business and industry, to interpret the CRA's published policy in your specific situation, and to adapt to the new Form T661. If you would like to discuss these or any other matters related to SR&ED, please contact your local Deloitte SR&ED consultant or any of the Deloitte practitioners listed in this newsletter.

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