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Bulletin

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New TCC Ruling Defines Key SR&ED Terms

- Meaning of para (i) in SR&ED Definition: "Commercial Work" Excluded from SR&ED
- Meaning of "In Respect of" SR&ED

On February 6th 2015, Justice Judith Woods in Tax Court Canada, Calgary Alberta, issued a ruling in the case of Feedlot Health Management Services Ltd. (FHMS).

FHMS is a private corporation located in Alberta that is engaged in providing consulting services in the veterinary science field.

This ruling makes two recent Tax Court Canada cases (the other being "Abeilles" in October 2014) in which the courts have made substantial reversals in CRA SR&ED assessments. What is even more intriguing here is the guidance that the court provided to the parties in resolving the issue. See item [31].

In FY 2010, FHMS made SR&ED claims that included a payment of $1.6M to G.K. Jim Farms (JF), for providing access to cattle for use as test subjects in experiments. Jim Farms (JF) is owned by an individual who also owns 42.5% of FHMS through a holding company. The claims were made under the proxy method.

It appears that the cattle were not actually "purchased" by FHMS and were not therefore claimed as a "material"; rather FHMS paid JF for access and to "husband" the cattle according to a prescribed technical protocol, and to provide FHMS with access to those cattle as when required for R&D purposes. Presumably FHMS applied experimental therapeutic procedures to the cattle and measured the results.

Although all the R&D activity of the SR&ED claims was allowed as eligible (i.e. all projects were ruled as "science" eligible), CRA denied $1.6M payment made by FHMS to JF for providing the cattle to its researchers.

Key points in this ruling are:

LOSE: COMMERCIAL PRODUCTION:
This is one of the only cases (perhaps the only) that deals with para (i) of the definition of SR&ED in subsection 248(1) of the Income Tax Act, which excludes "commercial" activity from SR&ED. Until now there has been no solid definition of what constitutes "commercial activity". In short the court ruled that the para (i) exclusion applied because the cattle (although experimented upon with vitamins and vaccines) were ultimately sold on to a packing house in essentially the same way as any other cattle raised by JF for commercial purposes; therefore no activity associated with those cattle could be SR&ED "work" as set out in paragraphs a), b), c) or d) of the definition of SR&ED in subsection 248(1) of the Act.

This was significant to the ruling in that it sets the stage for the court's ruling on "in respect of" described below. See items [53] to [55] of the ruling for details of this.

LOSE: LEASING:
FHMS further argued that they "leased" the cattle and as such the $1.6M should attract SR&ED as a lease expense. The court rejected this on grounds that FHMS did not ever physically take possession of the cattle or have care of them; they simply accessed them. Given that capital is now excluded from attracting SR&ED benefits, this point is somewhat moot.

WIN: "IN RESPECT OF":
The TCC disagreed with the CRA's denial of the $1.6M of expenditures and ruled that this amount – although not in itself "SR&ED work" – was an expenditure "in respect" of SR&ED and hence eligible under Clause (II) of s. 37(8)(a)(ii)(B) of the Act. In short, the court ruled that an expenditure need only be for something necessary for the conduct of SR&ED, but that there is no need for that "something" itself to meet the criteria of SR&ED.

The term "in respect of" appears in many areas of SR&ED legislation but is poorly (if at all) defined in law. In this case TCC ruled that the term "in respect of" means something that is broadly in aid of SR&ED versus being something that is itself an SR&ED activity. The court has ruled that "in respect of" is to be given broad interpretation – probably broader than anything CRA has ever considered in the past. This has implications both with respect to the scope of eligible scientific activity (especially para "d") AND various financial issues.

In particular it likely expands the scope of what can be claimed for "supporting" or "linked" activity to be much broader than what has been seen in CRA's recent assessments, especially vis-à-vis "engineering" activities (e.g. skilled trades, computer programming, construction of experimental prototypes) that are "linked" to the core work.

Learn More

Read the ruling here:
http://www.scitax.com/pdf/Dckt_2012-1292-IT-G_06-Feb-2015.pdf

Abeilles ruling in Tax Court Canada Oct 2014 (with English translation by Google Translate)
http://www.scitax.com/pdf/Dckt_2011-2054-IT-G_23-Oct-2014_Google_Translated.pdf

Scitax Bulletin #57 Abeilles New TCC Ruling Favours Taxpayer on "Shop Floor" SR&ED
http://www.scitax.com/pdf/Bulletin.57.Abeilles.in.TCC.8-Dec-2014.pdf

Scitax Bulletin #51 Appealing an SR&ED Claim
http://www.scitax.com/pdf/Bulletin.51-Appealing.SRED.Claims.05-Jun-2012.pdf

About Scitax

Scitax Advisory Partners LP is a Canadian professional services firm with specialist expertise in all aspects of planning, preparing and defending Scientific Research and Experimental Development (SR&ED) tax credit claims.

We offer a multi-discipline team of engineers, chartered accountants and tax lawyers to ensure that your SR&ED issues are covered from every angle.

While we normally work in concert with our client's existing accountants, our affiliated tax-dedicated chartered accounting firm – Cadesky and Associates LLP – is an expert resource for advice on any taxation matter such as may arise either during the planning and preparation of your claim or while dealing with CRA afterwards.

In addition to planning and preparing new claims, we also engage on claims that have been challenged by CRA auditors or that have received negative assessments for either scientific or expenditure eligibility. If a satisfactory settlement cannot be achieved with CRA at the local office level, we will appeal your assessment through either Notice of Objection or Tax Court of Canada procedures with the assistance of our affiliated firm of tax lawyers.

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