Docket: 2011-2054(IT)G

BETWEEN:

LES ABEILLES SERVICE DE CONDITIONNEMENT INC.,

Appellant,

and

HER MAJESTY THE QUEEN,

Respondent.

[OFFICIAL ENGLISH TRANSLATION]

Appeal heard on June 18, 19, 20, 26 and July 11, 2013, at Montréal, Quebec.

Before: The Honourable Justice Gaston Jorré

Appearances:

Counsel for the appellant:	Julie Patenaude
Counsel for the respondent:	Christina Ham

JUDGMENT

In accordance with the attached Reasons for Judgment, the appeal from the reassessment made under the *Income Tax Act* for the 2009 taxation year is allowed, with costs, and the matter is referred back to the Minister of National Revenue for reconsideration and reassessment on the basis that projects 2007-01, 2007-02, 2009-01 and 2009-02[1] constitute experimental development within the meaning of the Act.

If the parties are unable to agree on costs by December 19, 2014, I will hear the parties' submissions at a date to be set by the Registry of the Court.

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[1] To clarify, the work undertaken as part of these projects is listed in the list of work and tests in Tab 5 of Exhibit A-1.

Signed at Ottawa, Ontario, this 23rd day of October 2014.

"Gaston Jorré"

Jorré J.

Translation certified true
on this 15th day of June 2015

François Brunet, Revisor

Citation: 2014 TCC 313
Date: 20141023
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REASONS FOR JUDGMENT

Jorré J.

Introduction

[1] On January 27, 2011, the Minister of National Revenue issued a reassessment for the 2009 taxation year. The Minister reduced the amount of the scientific research and experimental development tax credit claimed by the appellant for the following projects:

(a) 2007-01: Development of a new assembling process for motors for dryers (this project started in 2007).
(b) 2007-02: Development of a new assembling process for heating elements for dryers (this project started in 2007).
(c) 2009-01: Development of a new assembling process for control panels using pull flow with electronic sequencing.
(d) 2009-02: High-speed synchronization for the application of secondary components on a print component.

[2] The vast majority of expenditures giving rise to the credit claimed are salary expenditures incurred during testing on the production line.

[3] The Minister submits that the activities of the appellant involved no scientific uncertainty, that they were not based on a systematic investigation or search that was carried out in a field of science or technology and that they were merely routine activities with no basic research, no applied research and no experimental development. For these reasons, the Minister claims that he properly disallowed the appellant's claim.

[4] There is no doubt that the purpose of the projects in question was to increase production efficiency and, in one case,[1] to ensure innovative production.

[5] The appellant challenges the Minister's decision and submits that the projects were eligible for the credit claimed.

[6] Section 248 of the *Income Tax Act* defines "scientific research and experimental development" as follows:[2]

> "scientific research and experimental development" means systematic investigation or search that is carried out in a field of science or technology by means of experiment or analysis and that is
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> > (*a*) basic research, namely, work undertaken for the advancement of scientific knowledge without a specific practical application in view,
> > (*b*) applied research, namely, work undertaken for the advancement of scientific knowledge with a specific practical application in view, or
> > (*c*) experimental development, namely, work undertaken for the purpose of achieving technological advancement for the purpose of creating new, or improving existing, materials, devices, products or processes, including incremental improvements thereto,
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> and, in applying this definition in respect of a taxpayer, includes
>
> > (*d*) work undertaken by or on behalf of the taxpayer with respect to engineering, design, operations research, mathematical analysis, computer programming, data collection, testing or psychological research, where the work is commensurate with the needs, and directly in support, of work described in paragraph (*a*), (*b*), or (*c*) that is undertaken in Canada by or on behalf of the taxpayer,

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[1] 2007-02.
[2] As the Act read at the end of 2009.

but does not include work with respect to

(*e*) market research or sales promotion,
(*f*) quality control or routine testing of materials, devices, products or processes,
(*g*) research in the social sciences or the humanities,
(*h*) prospecting, exploring or drilling for, or producing, minerals, petroleum or natural gas,
(*i*) the commercial production of a new or improved material, device or product or the commercial use of a new or improved process,
(*j*) style changes, or
(*k*) routine data collection;[3]

[3] The French version of the text reads as follows:

« activités de recherche scientifique et de développement expérimental » Investigation ou recherche systématique d'ordre scientifique ou technologique, effectuée par voie d'expérimentation ou d'analyse, c'est-à-dire :

a) la recherche pure, à savoir les travaux entrepris pour l'avancement de la science sans aucune application pratique en vue;
b) la recherche appliquée, à savoir les travaux entrepris pour l'avancement de la science avec application pratique en vue;
c) le développement expérimental, à savoir les travaux entrepris dans l'intérêt du progrès technologique en vue de la création de nouveaux matériaux, dispositifs, produits ou procédés ou de l'amélioration, même légère, de ceux qui existent.

Pour l'application de la présente définition à un contribuable, sont compris parmi les activités de recherche scientifique et de développement expérimental :

d) les travaux entrepris par le contribuable ou pour son compte relativement aux travaux techniques, à la conception, à la recherche opérationnelle, à l'analyse mathématique, à la programmation informatique, à la collecte de données, aux essais et à la recherche psychologique, lorsque ces travaux sont proportionnels aux besoins des travaux visés aux alinéas *a*), *b*) ou *c*) qui sont entrepris au Canada par le contribuable ou pour son compte et servent à les appuyer directement.

Ne constituent pas des activités de recherche scientifique et de développement expérimental les travaux relatifs aux activités suivantes :

e) l'étude du marché et la promotion des ventes;
f) le contrôle de la qualité ou la mise à l'essai normale des matériaux, dispositifs, produits ou procédés;
g) la recherche dans les sciences sociales ou humaines;
h) la prospection, l'exploration et le forage fait en vue de la découverte de minéraux, de pétrole ou de gaz naturel et leur production;
i) la production commerciale d'un matériau, d'un dispositif ou d'un produit nouveau ou amélioré, et l'utilisation commerciale d'un procédé nouveau ou amélioré;
j) les modifications de style;
k) la collecte normale de données.

[7] If we remove those parts which are not relevant to this dispute, the definition reads as follows:

> Systematic investigation or search that is carried out in a field of science or technology by means of experiment or analysis and that is
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> > (*a*) . . .
> > (*b*) applied research, namely, work undertaken for the advancement of scientific knowledge with a specific practical application in view, or
> > (*c*) experimental development, namely, work undertaken for the purpose of achieving technological advancement for the purpose of creating new . . . devices . . . or processes, including incremental improvements thereto,
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> and, in applying this definition in respect of a taxpayer, includes
>
> > (*d*) work undertaken by or on behalf of the taxpayer with respect to engineering, design, operations research, mathematical analysis, computer programming, data collection, testing or psychological research, where the work is commensurate with the needs, and directly in support, of work described in paragraph (*a*), (*b*), or (*c*) that is undertaken in Canada by or on behalf of the taxpayer,
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> but does not include work with respect to
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> > (*e*) . . .
> > (*f*) quality control or routine testing of materials, devices, products or processes,
> > (*g*) . . .
> > (*h*) . . .
> > (*i*) the commercial production of a new or improved material, device or product or the commercial use of a new or improved process,
> > (*j*) . . .
> > (*k*) . . .

[8] Ultimately, the central isssue is whether the projects in question constitute:

> > (*c*) experimental development, namely, work undertaken for the purpose of achieving technological advancement for the purpose of creating new . . . devices . . . or processes, including incremental improvements thereto,[4]

[9] At the heart of the controversy is whether it is technological advancement; there is also a significant difference in perspective. The respondent is more likely

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[4] The corresponding French text is:

> *c*) le développement expérimental, à savoir les travaux entrepris dans l'intérêt du progrès technologique en vue de la création de nouveaux […] dispositifs […] ou procédés ou de l'amélioration, même légère, de ceux qui existent.

to look at each test conducted by the appellant in isolation; the appellant takes a broader view of all the tests performed within a project.

[10] I note in passing the context in which the appellant operates. The appellant performs, *inter alia*, sub-assembly operations for a company that assembles dryers in Montréal. Considering the cost of labour in Montréal, it is an operation that would have easily been relocated elsewhere, such as Mexico or Asia.

[11] The projects at issue are aimed at increasing the efficiency of the appellant's work obtained without excessive expense, which the appellant could not support while still remaining competitive. Three of those projects are related to the sub-assembly manufacturing of dryers; it is precisely this search for efficiency which allows the appellant and its client to avoid the offshoring of dryer manufacturing.[5]

[12] For the reasons that follow, the appeal will be allowed.

The facts[6]

[13] Serge Caouette is the president and, at the time of the hearing, the sole shareholder of Les Abeilles.

[14] The company was founded in 1987 by Mr. Caouette's mother. In the early years, the company provided various packaging and printing finishing services to tobacco companies. However, the restrictions on the advertising of tobacco products forced the company to diversify its activities.

[15] While continuing to perform printing finishing activities, the appellant began providing packaging services for businesses operating in the food and cosmetic industries.

[16] The appellant also broadened its activities in the industrial sector. That is when it started the assembly of mechanical components.

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[5] The Canadian economy stands to gain from having as many companies as possible undertake such efforts. This would not only help prevent offshoring, but could also perhaps encourage the opposite, reshoring.

[6] The hearing lasted five days over the course of three different weeks. There were five witnesses (Serge Caouette, Martin Gariépy, Steven Kooi, Yves Hamelin and Denis Frayce) and numerous documents filed in evidence. Mr. Hamelin is the president of the Groupe HLP, which specializes in representing clients in connection with obtaining credit for scientific research and experimental development. He testified with respect to the audit and objection. Mr. Frayce, who is Mr. Kooi's supervisor, testified with respect to the audit. It is not necessary for me to review their testimonies, which are mostly related to the audit and assessment process.

[17] In essence, its activities involve the assembly of components supplied by the client. Once the sub-assembly is complete, it is sent to the client who inserts it in its [TRANSLATION] "main line" to obtain the end product.

[18] The appellant began development projects in 2002. Its first application for scientific research and experimental development dates back to 2003. Since then, it has made several applications per year.

The projects concerned

[19] For 2009, the appellant made applications to obtain credit for scientific research and experimental development for six projects. Only two were approved. The other four were denied.

Projects related to the sub-assemblies for Mabe/General Electric

[20] Three of the four projects denied were related to the sub-assemblies for Mabe. Mabe manufacturers General Electric dryers. These three projects are as follows:

(a) 2007-01: New assembling process for motors for dryers.
(b) 2007-02: New assembling process for heating elements for dryers.
(c) 2009-01: New assembling process for control panels using pull flow with electronic sequencing.

[21] The first two projects started in 2007 and were accepted by the Canada Revenue Agency in the years prior to 2009.

[22] The purpose of these projects is not only to increase efficiency, but also to do so while meeting very stringent quality standards.

[23] Mabe has a plant in Montréal which performs assembly operations for General Electric. General Electric holds 49% of the shares of Mabe and initiated the collaboration between Mabe and the appellant, as it was General Electric that requested that certain items be produced at the appellant's facilities. However, Mabe and the appellant are the ones under contract.

[24] It was in 2004 that discussions began with Mabe to obtain contracts from Mabe and undertake the projects at issue. Mabe benefited from collaborating with

the appellant as the appellant's projects were aimed at increasing efficiency of production at the appellant's and at Mabe's plants.

[25] Over the course of a project, extensive testing is performed on the production line.[7] This testing typically lasts several hours.

[26] When the appellant does not follow the normal process of production, it is a [TRANSLATION] "deviation" from normal production. There are three types of [TRANSLATION] "deviations", according to the appellant:

(a) substitution;
(b) change in engineering; and
(c) experimental development.

[27] The controversy here concerns only those tests that represent the last type of deviation.

[28] Prior to performing tests, approval from Mabe is required.[8] An application for tests is made to Mabe and, if Mabe agrees, Mabe submits a document entitled "DSI" providing authorization.

[29] Mabe provides the components used for testing for free and, after testing is completed, the sub-assemblies are sent to Mabe which sends them to Mexico to be disassembled.[9]

[30] Mr. Caouette explained that it was during daily operational meetings that it was decided whether tests would be performed the same day.

[31] During testing, commercial production stops, changes to be tested are installed or modified, the test is performed, everything is put back together as it was before the test[10] and, then, production starts again. Mr. Caouette explained that

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[7] In a project, it is not a line in the proper sense of the term; in such cases, it is a [TRANSLATION] "surgeon approach".

[8] During the presentation of the evidence, there was some confusion at times regarding the role of Mabe and General Electric. It is clear that General Electric, Mabe and the appellant collaborate closely and, in my view, for the purposes of this case, this does not have any impact in terms of something being done by Mabe rather than by General Electric or vice versa.

[9] The disassembled parts may be sent back to the appellant for retesting, but not necessarily (transcript, page 368).

[10] Transcript, page 142, line 16, page 144, line 13. The first four volumes of the transcript are numbered from page 1 to page 1141; in these notes, I make no reference to Volume V.

when performing a test, an attempt is made to ensure a large number of assemblies, thus allowing an evaluation of quality and cycle time.

[32] There are a series of specific problems that must be resolved to achieve the objective sought and several tests could be required to resolve one particular problem.

[33] Each test relates to a change in process.

[34] If the test is conclusive, or if the series of tests is conclusive, the project will have to be approved by both the appellant and General Electric before it can go to market. Once approved by the appellant, the project goes to the first piece stage. This involves, for example, producing approximately ten sub-assemblies and having them approved by General Electric. Then, the project must pass the pilot [run] A and pilot [run] B stages. Each stage entails providing more parts to General Electric, which must then approve production. During the pilot [run], the parts are placed in the dryers and sold on the market.[11]

[35] However, the stages that took place after the testing stage are not part of what is at issue here.

[36] It is possible to retrace the steps of the various projects through the log, the record or chronology of tests.[12] Mr. Caouette explained that the projects required many hours of work from many individuals. At a minimum, it took as many employees to conduct a test as it did to ensure regular commercial production.

[37] There are also detailed descriptions of the projects and tests produced.[13]

Project 2007-01: motors

[38] The appellant's project had several objectives.

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[11] The evidence does not reveal the frequency of these approvals by General Electric. It is unknown if, for example, it was typical to have successfully completed several changes prior to obtaining approval and completing a first piece or whether an approval request was generally submitted after most of the successful tests were performed.

[12] Mr. Caouette spoke of the "log"; I will call this the record of tests. This record can not only be found in tab 5 of Exhibit A-1, but also in the electronic spreadsheet in Exhibit A-12.

[13] See, for example, Exhibit I-1, which, apart from the first eleven pages, only contains such descriptions. There is no consecutive numbering in Exhibit I-1, but the project and test descriptions are about 1.5 inches, or 3.8 cm, thick. The same documents are mostly found in tabs 8 and 9 of Exhibit I-2.

[39] This project began in 2007 after the main conveyor was received. The objective was to increase production efficiency, which was measured in terms of the manufacturing time required, and to adapt the conveyor so that it could assemble all families of motors.

[40] Initially, the production of each different type of motor at Mabe was carried out on a different carousel. There was a different template for each type of motor. It took quite a long time to change the templates on the carousel.[14]

[41] In early 2009, the conveyor was in commercial operation and the appellant built one type of motor, regular motors. The appellant still used the carousel (or carousels[15]) for all other types of motors.

[42] For 2009, the primary objective of this project was to make it possible to assemble all the different types of motors[16] on the same production line. It was also hoped that a motor could be assembled every 9 seconds while meeting the required quality standards of the client, that is, a maximum of 300 sub-assemblies of motors rejected per million sub-assemblies, that is, a maximum of 3 rejects out of 10,000 motors; at the beginning of the year, the appellant was at approximately 14 seconds.[17]

[43] Not only did the appellant want to get rid of assembly carousels, which were less efficient, but the appellant also wanted to be able to change the production model without having to stop the production line so as to be able to quickly change the model of motor at the client's request.

[44] For these objectives to be met, the following problems had to be addressed:

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[14] Transcript, pages 117 and 118.

[15] I note that while it is not entirely clear from the evidence whether the appellant had a different carousel for each different type of motor, my conclusion is that this was the case. As I understand the evidence, Mabe initially had six production lines for dryers (for example [TRANSLATION], "regular", "international" and "quiet pack") and each production line had a different carousel that produced the sub-assemblies of motors: see Transcript, pages 98 and 99. In the beginning, the appellant started out in the same way for motors other than "regular" motors.

That was also the case for heating elements (2007-02); when Mabe was making them all in its plant, there were separate lines for the assembly of each type of heating element (see pages 169 and 170 of the Transcript). However, as I understand Mr. Caouette's testimony, in 2007, the appellant only started with the assembly of one heating element used only for the [TRANSLATION] "regular" model; however, in 2007, from the outset, the appellant had begun an assembly-line production using a type of heating element in mica which was new and which had never been used before.

[16] For example, "quiet pack" and "international".

[17] See, *inter alia*, the first page 2, in Tab 2007-01 of Exhibit I-1.

(a) the adaptation of equipment to the various types of motors (pulley press, jigs, mandrels);
(b) the synchronization of equipment.

[45] On the line developed by the company, there is only one motor template for all the families, rather than multiple templates on the carousel. On the new line, no there are no parts to change when a decision is made to produce a different model, which makes it possible to never stop the line.[18]

[46] At the end of 2009, all families of motors could be assembled on the line. The equipment was therefore adapted (pulley press, jigs, mandrels) and the carousel was eliminated.[19] The cycle time was reduced to approximately 10 seconds.

[47] Over the course of 2009, as part of this project, 32 tests were conducted. Appendix A to the judgment lists all the tests and certain other work undertaken for the project.

[48] In 2009, the appellant invested over 9,000 person-hours in this project. The breakdown of hours is provided in Appendix B to the judgment.[20] The expenses claimed for this project are approximately $137,000 in salaries and $1,300 in materials.[21]

[49] When the appellant began working with avec Mabe/General Electric, they tried to find solutions already available to achieve the required objectives.

[50] The appellant's agreement with the client provides the appellant access to all knowledge available in the Mabe/General Electric network, but despite all the experience available through the network, no one was able to provide more than general principles; no one had specific solutions. The appellant was unable to find any more information by speaking with its suppliers or from Web searches.[22]

[51] The appellant itself had to find the necessary solutions to meet the objectives.

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[18] If I understood Mr. Caouette's testimony correctly, there was a slight decrease in production at the time of the transition from one type of motor to another.
[19] According to Mr. Caouette, once these changes were made, not only could the changes be made quickly, but the different types of motors could be changed about twenty times a day; see bottom of page 119 of the Transcript.
[20] The source of information is set forth in the Appendix.
[21] For the salaries, see first page of Tab 6 of Exhibit I-2.
[22] See pages 158 to 162, 268, 365 and 366 of the Transcript.

Project 2007-02: heating elements

[52] It was in 2005 that discussions with Mabe about this project began. The idea was still to improve the productivity of Mabe's plant. Indeed, the assembly of the heating elements was done at the time on six production lines. The appellant's plan was to centralize this production on a single line, while adhering to a cycle time of 7 seconds and a quality standard of less than 300 rejects per million sub-assemblies.

[53] In 2009, new models of heating elements had to be added to the line. The required cycle time and desired quality standard still had to be met[23] in a safe manner (hence the use of "foolproof devices"[24]). To that end, it was necessary, among other things, to address the following problems: too much proximity between the heating element and the housing, false rejects caused by the test station, instability caused by concrete dust, uncleaned lubricant deposit formation in the equipment and overall stability.

[54] At the end of 2009, the cycle time was 8.9 seconds and the quality standard had yet to be met. However, the four families of elements could be assembled on the same line and the proximity and false reject problems were solved.

[55] The proximity problem was solved by the use of a cylinder system. This solution was the third of a series of three. The first was manual and required a special tool. The second was hybrid and included a thumb detector.

[56] The false reject problem was caused by the impact between the element and the stop designed to keep the element at the test station. The solution found was to install a linear motion stop that did not cause a shock that would move the element.

[57] To Mr. Caouette's knowledge, this type of assembly line does not exist elsewhere. Indeed, neither the General Electric network nor the appellant's suppliers, the Web search or the manufacturer of the heating elements were helpful in identifying a business that performed this type of assembly. Moreover, General Electric and the appellant were the first in America to use the mica heating elements.

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[23] The target was seven seconds, but at the beginning of the year the appellant was at approximately 9.6 seconds.

[24] Foolproof devices ensure that all the components are in their proper places. If a component is missing, or if a wrong component is installed, the assembly will not work.

[58] In 2009, the appellant conducted 19 tests and invested over 7,500 person-hours in this project.[25] The appellant claimed approximately $110,000 in salaries and $1,100 in materials.[26]

Project 2009-01: control panels (backguards)

[59] It was in 2009 that Mabe approached the appellant to centralize the assembly of dryer control panels on a single line. The objectives were to develop a system that (i) was capable of producing 174 variations of panels, variations made on the basis of 600 possible components, (ii) could achieve the particular variation ordered within four hours following the order;[27] and (iii) could produce the panels much faster than Mabe.

[60] To accomplish this, the appellant applied the [TRANSLATION] "surgeon approach" to its assembly method. This approach consisted of one employee[28] who would put together the components necessary to assemble a given panel model and bring everything to the assembler, who performs his or her work without having to move around, like a surgeon who is provided with the tools required for an operation.

[61] The so-called [TRANSLATION] "surgeon" approach was the appellant's second choice, as its first choice was too expensive to implement.

[62] Not only was it necessary to validate the idea of the [TRANSLATION] "surgeon approach" applied to the assembly of control panels, but it was also necessary to be able to assemble all models and change from one model to the other within 30 seconds. Here again, the quality standard sought was less than 300 rejects per million sub-assemblies and foolproof devices were necessary.

[63] In March 2009, it became apparent that it was necessary to automate the communication process between the various stakeholders, otherwise further improvements would have been impossible. To do this, new software had to be developed as none of the existing software products met the company's needs. To that end, the appellant sought the assistance of subcontractor ISG. The following modules were created: order automation module, import/export module for

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[25] See Exhibit A-12 at the page or tab entitled [TRANSLATION] "Accounting portion" in column J regarding Project 2007-02.
[26] See first page of Tab 6 of Exhibit I-2.
[27] Exhibit I-1, Tab 2009-02, first page.
[28] Called "water spider."

transferring information between the company's system and the client's system, survey module showing what the client has to produce, assembly module ensuring that the assembler is provided with the right model, shipping module allowing the client to confirm shipping of orders and know the status of the appellant's inventory of components.

[64] The appellant did not claim any credits for the "development" of the software, because ISG performed the task.

[65] At the end of 2009, many objectives had yet to be attained. The above-mentioned modules were nonetheless all developed and the [TRANSLATION] "surgeon approach" was validated.

[66] With regard to the problems encountered, a problem of static likely to produce a spark causing the electronic controls to burn out had to be resolved. The problem was solved with grounding placed between the assemblers.

[67] Assembly testing as such was not interrupted by the automation of communication. Tests were still being conducted with respect to the conveyor, templates, etc.

[68] This project continued in 2010.

[69] In 2009, the appellant conducted 22 tests and invested over 9,000 person-hours in this project.[29] The appellant claimed approximately $160,000 in salaries and $2,600 in materials.[30]

[70] Subsequently, Mabe/General Electric attempted to apply the knowledge developed by the appellant in plants in Mexico.[31]

Project 2009-02: printing finishings (application of secondary components)[32]

[71] This is the only project with no connection to Mabe/General Electric. Prior to 2009, the appellant had already established a printing finishing line that made it possible to handle a variety of printing components (magazines, cartons,

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[29] See Exhibit A-12 at the page or tab entitled [TRANSLATION] "Accounting portion" in column I regarding Project 2009-01.
[30] See the first page of Tab 6 of Exhibit I-2.
[31] See, *inter alia*, pages 268 and 320 of the Transcript.
[32] For example, a small sample or a coupon on a printing component.

advertising inserts) and to add secondary components; there was a suction conveyor and various equipment (a primary feeder, a secondary feeder, a glue applicator, a label maker, two folding modules, etc.).

[72] These operations were all conducted at a nominal rate of 6,000 applications per hour. Individually, the various equipment types could operate much faster than together.

[73] In 2009, the objectives were to (i) increase the speed at which all operations could be conducted together to 11,000 applications per hour; (ii) modify the secondary power supply so as to accommodate larger components; and (iii) add new secondary components.

[74] Among the issues to be addressed to achieve the key objectives were the irregularity in the amount of glue applied to the components, the positioning of a new module generating labels, the elements not detected by the detection module and the synchronization of equipment.

[75] In 2009, the secondary feeder that was modified to accommodate larger components was installed and its stability was confirmed. By the end of the year, the objective of 11,000 applications per hour still had not been reached when all the modules were working together.

[76] Once the testing was completed, the materials were recycled, and not disassembled as in the case of the other projects.

[77] To Mr. Caouette's knowledge, a Chicago-based company reportedly has similar facilities, but he did not wish to share that knowledge. Mr. Caouette had not been able to find an assembly line already capable of performing the required work. Certain modules, such as the glue application module and the label application module, were purchased "as is" but had to be adapted to the line developed by the appellant. Other modules were entirely developed by the appellant, including the primary feeder, the detection system, the secondary feeder, the modified secondary feeder and the folding modules.

[78] In 2009, the appellant conducted 13 tests and invested close to 6,000 person-hours in this project.[33] The appellant claimed approximately $74,000 in salaries and $300 in materials.[34]

Expert evidence[35]

[79] The appellant called Martin Gariépy as an expert witness. Mr. Gariépy has a bachelor's degree in pure mathematics, a master's degree in aerospace engineering and a doctoral degree in mechanical engineering. He taught some courses at the École polytechnique de Montréal and carried out various work related, *inter alia*, to aerodynamics.

[80] Mr. Gariépy was recognized as an expert.

[81] The respondent called Steven Kooi as an expert witness. Mr. Kooi has a Bachelor of Science in chemical engineering and master's and doctoral degrees in mechanical engineering. Prior to working for the Canada Revenue Agency, Mr. Kooi had 22 years of varied experience in the industry.

[82] He was a scientific advisor at the audit stage.

[83] The appellant objected to Mr. Kooi's recognition as an expert witness. The appellant did not challenge Mr. Kooi's training and experience, but rather his independence. I took the objection under reserve and allowed Mr. Kooi to testify. For reasons that will become apparent below, it is not necessary for me to adress that objection. I note that what is important is the impartiality of the expert witness rather than his independence.[36]

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[33] See Exhibit A-12 at the page or tab entitled [TRANSLATION] "Accounting portion" in column G regarding Project 2009-02.

[34] See the first page of Tab 6 of Exhibit I-2.

[35] I will now examine the expert evidence and analyze the first project at issue and will then come back to the other projects.

[36] The mere fact of being a Canada Revenue Agency employee is, in and of itself, insufficient to refuse to recognize someone as an expert. A more in-depth study of all the circumstances is required. The key issue is whether or not the witness is impartial. See *Hospira Healthcare Corporation v. Eli Lilly Canada Inc.*, 2010 FCA 282, in which the Federal Court of Appeal stated as follows:

> 8 While there has been judicial commentary on the desirability of experts being independent of the parties and impartial in their opinions (see, for example, *National Justice Campania Naveria SA v. Prudential Assurance Co. Ltd. ("The Ikarian Reefer")*, [1993] 2 Lloyd's Rep. 68, at pp. 81-82), one must distinguish between independence and impartiality. There is a corpus of law dealing with the question of independence as a bar to the admissibility of an expert's evidence, as opposed to a factor to be considered in assessing the weight to be given to that evidence. Those cases are

[84] The findings of the two expert witnesses are that the projects are or are not, scientific research and experimental development within the meaning of the Act. However, that is a question that must be answered by the Court and cannot be the subject of an expert opinion.[37] While the old rule that an opinion is never admissible when it concerns the very question to be decided by the judge has been discarded for some time now, "the closer an expert opinion comes to opining on the ultimate issue in dispute, the more the trial judge must scrutinize its probative value."[38]

[85] I note that, generally speaking, it would have been useful to have expert evidence that focused more specifically on the current state of practices and knowledge respecting assembly methods and techniques.

[86] I note that Mr. Gariépy's report is relatively general.

Mr. Kooi's testimony

[87] I have several difficulties with Mr. Kooi's testimony and report as an expert witness.

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reviewed in *United City Properties v. Tong*, 2010 BCSC 111. It is not necessary for us to settle this debate in order to dispose of this case. I would say though, that a review of many of those cases suggests that that which is being attacked under the name of lack of independence is often, in fact, lack of impartiality. Lack of impartiality is the mischief which has given rise to the recent amendments to the *Federal Courts Rules*, SOR/98-106, to which reference was made by counsel for Hospira.

9 None of the cases relied upon by Hospira are authority for the proposition that the testimony of a properly qualified expert may be rejected solely on the basis of the latter's lack of independence. *Merck & Co v. Apotex Inc*., 2004 FC 567, [2004] F.C.J. No. 684, deals with the issue of the appropriateness of a protective order. No decision was made as to the admission or rejection of expert evidence. In *Biovail Pharmaceuticals Inc. v. Canada (Minister of National Health and Welfare)*, 2005 FC 9, [2005] F.C.J. No. 7, the Court, after repeating the often quoted passage from *The Ikarian Reefer*, accepted as an expert witness the applicant's Vice-President, Pharmaceutical Technology, over the objections of the respondents who questioned his financial interest in the outcome of the litigation. In *Lundbeck Canada Inc. v. Canada (Minister of Health)*, 2009 FC 146, [2009] F.C.J. No. 249, the Court rejected a challenge to the qualification of a certain witness as an expert on the basis that the witness had testified for the same party 20 times in the past 30 years. The Court accepted his evidence after a reading of his cross-examination disclosed his objectivity.

As the Court of Appeal noted, there is a controversy as to whether partiality is a matter of weight or admissibility; given my findings below, it is not necessary for me to settle this controversy.

The serious problems I have with the testimony of the respondent's expert, which I express below, illustrate the dangers of having the scientific advisor testify at the audit stage as an expert witness.

[37] See, for example, the bottom of pages 8 to 23 of Exhibit A-10 and paragraph 7.5 at page 19 of Exhibit I-3.

[38] See *R. v. Jacobs*, 2014 ABCA 172, at paragraph 60; I recognize that *Jacobs* is in a completely different situation.

[88] My first difficulty is the following. In his testimony and in his report, there is some confusion between his role as a scientific advisor during the audit and that as an expert witness.

[89] As a scientific advisor at the audit stage, it is completely normal that Mr. Kooi would be guided by the Canada Revenue Agency guidelines with respect to scientific research and experimental development, including certain proof of facts standards that the taxpayer is required to establish to satisfy the Agency.

[90] However, his role is different as an expert witness, as it is his personal expertise on such matters as whether there is technological uncertainty. An expert may agree with a recognized authority within a field, but he or she must nevertheless form his or her own opinion.

[91] In his testimony and in his report, there are times when Mr. Kooi often seems to be guided more by the Canada Revenue Agency's guidelines and policies than his personal expertise.

[92] For instance, Mr. Kooi gave considerable importance to whether a degree of contemporaneous documentation exists as required by the Agency.[39] At the audit stage, the Agency is at liberty to decide what the taxpayer should normally do to convince it of certain facts.

[93] However, in the course of an expert's testimony, he or she expresses an opinion on the basis of certain facts; it is not the role of the expert witness to determine the facts.[40] If there is a controversy about the facts, it is for the court to decide what the facts are.

[94] Whether contemporaneous documentation exists, or not, and the fact that documents contain, or not, certain information are relevant to the resolution by the Court of controversy about facts. However, the existence of contemporaneous documentation, or contemporaneous documents with specific content, is not a condition to the recognition of scientific research or experimental development.[41]

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[39] See, for example, the last paragraph of page 23 of his report (Exhibit I-3) or paragraph 9.4.2 at page 34 of his report.

[40] Although there are situations in which an expert may testify to things he or she has personally observed; for example, a doctor who testifies as an expert upon examining a patient may certainly provide evidence of certain observations made in the course of the examination. That is not the case here.

[41] In *116736 Canada Inc. v. Canada*, [1998] TCJ No. 478 (QL), Judge Archambault explains that contemporary reports of any testing conducted are potentially very important evidence but not required. He states as follows:

[95] This confusion about roles is also illustrated by a number of references to the requirements of the Canada Revenue Agency, such as [TRANSLATION] "the Agency requires that the analysis take into account the following probative evidence" preceding a list of 14 elements about one page long.[42]

> 38 Essentially, the issue in this appeal is whether a systematic investigation took place. The scientific advisor to the Minister concluded that it did not because he was not given sufficient evidence to prove such an investigation had been carried out. Essentially, he was not provided with adequate reports describing the progress of the R&D projects and more specifically describing the types of tests performed, the results achieved, etc.
>
> 39 Counsel for the Respondent argued that a systematic investigation cannot have taken place in the absence of detailed reports evidencing step-by-step the investigation carried out by the Appellant. Here, there is no evidence of calculations having been done in the course of the investigation. Therefore, in counsel's view, there was not enough evidence to support the conclusion that a systematic investigation took place.
>
> 40 In my view, contemporary reports showing detailed records of each experiment attempted by a researcher could constitute evidence of a systematic investigation. Any taxpayer attempting to convince the Minister that he is entitled to deduct R&D expenditures without such evidence puts himself in a very precarious position. A taxpayer would be in a similar position when appearing before this Court to contest the Minister's refusal to allow the deduction of his R&D expenditures.
>
> 41 However, the Act and the Regulations do not require that such written reports be produced in order for a taxpayer to qualify for the deduction of such expenditures: it is possible to adduce evidence by way of oral testimony. Whether the Minister or a judge could conclude that the activities purported to have been carried out by the taxpayer were actually carried out then becomes a question of credibility.
>
> [Emphasis added.]

See also *RIS–Christie Ltd. v. Canada*, [1998] FCJ No. 1890 (QL), where the Federal Court of Appeal states:

> 14 …Although both documentary and viva voce evidence are admissible, the only sure-fire way of establishing that scientific research was undertaken in a systematic fashion is to adduce documentary evidence which reveals the logical progression between each test and preceding or subsequent tests.
>
> 15 Thus, it is reasonable to expect a taxpayer to adduce documentary evidence of systematic research, including testing. If, however, a taxpayer has a plausible explanation for the failure to adduce such evidence, it is still open to the court to hold that, on a balance of probabilities, systematic research was undertaken. For example, where research notes are accidentally destroyed, it should be permissible for the trial judge to infer that systematic research was conducted, having regard to the totality of the evidence. During oral argument, counsel for the Minister accepted this proposition, if only because that scenario was inapplicable in the present case. However, in my view, it should also be permissible to infer that a taxpayer had conducted systematic research where it is established that such research led to a technological advancement. I say this because the whole foundation of the scientific research provisions of the Act and Regulations should not rest solely on the repeatability criteria. Otherwise, repeatability would negate the validity of all other evidence pertaining to scientific research.

In reviewing the trial decision in *RIS-Christie*, it is clear that there was a limited documentation that did not meet all of the Agency's requirements.

Moreover, I note that in this case part of the documentation is contemporaneous; for example, the pages or tabs entitled [TRANSLATION] "Chronology 2009" (a form of log), "Data" and "Perf Dos" in the Excel spreadsheets in Exhibit A-12 are derived from the appellant's database, for which the data was collected as activities were being carried out. Further details about [TRANSLATION] "Data" are provided in note 59 below. I also note that Exhibits A-3 and A-4 are contemporaneous and contain certain limited information about the projects.

[42] Mr. Kooi's report, Exhibit I-3, pages 17 and 18. The list is duplicated on pages 24 and 25, 35 and 36, 44 and 45. See also the two last lines of paragraph 9.6 at page 37 of said Exhibit.

[96] The penultimate conclusion at page 47 of the report[43] is as follows:

> [TRANSLATION]
> We conclude that the documents adduced by Les Abeilles to support the testing claimed were not contemporaneous with the testing. Despite the fact that materials used for the testing were provided by the clients, and not claimed by Les Abeilles, the materials used and applied in the testing are part of the supporting documentation required for the progress, evolution and justification of the testing.

Once again, it is a matter of determination of facts and not expertise.[44]

[97] I conclude from all of this that Mr. Kooi was not impartial.

[98] Before moving on to my second difficulty, I note that Mr. Kooi's emphasis on the absence of certain documents is such that it is not always obvious what the factual basis of the opinion expressed is.[45]

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[43] Exhibit I-3.

[44] It is surprising to read the following in what is supposed to be an expert report [TRANSLATION]: "The information provided concerning project 2009-02 was false." See lines 6 and 7 of page 46 of the Respondent's report (Exhibit I-3).

This sentence follows a sentence quoted by the appellant appearing in paragraph 1.2.1.1.6 on the first page 5 of the Tab entitled "2009-02" (Exhibit I-1) which describes test 2305. Although there is an error in the sentence quoted by Mr. Kooi and, as stated by Mr. Kooi, the appellant mixes up project 2009-02 and the three other projects, I note that at paragraph 1.2.1.2.6 the appellant only says that the materials were provided by the client. The same is true with respect to paragraphs 1.2.1.3.6, 1.2.1.4.6, 1.2.1.5.6, 1.2.1.6.6, 1.2.1.7.6, 1.2.1.8.6, 1.2.1.9.6, 1.2.1.10.6, 1.2.1.11.6, 1.2.1.12.6 and 1.2.1.13.6.

Project 2009-02 is the only one that does not involve Mabe/General Electric, and Mr. Caouette's testimony, which I accept, was that the materials for project 2009-02 were provided by the client and that everything was sent for recycling at the end of the test.

I also note that the report's last conclusion (page 47) is as follows [TRANSLATION]:

> The claim for experimental production must meet the criteria outlined in *Application Policy SR&ED 2002-02R2*.
>
> [Emphasis in the original.]

[45] For example, the third paragraph under "8.4.3" of Mr. Kooi's report (Exhibit I-3, page 24) states as follows [TRANSLATION]:

> For example, in test 2282, the purpose was to validate the addition of pneumatic valve actuators. Indeed, 56 persons were involved in performing this test and related labour expenditures were claimed. However, success was achieved after some adjustments. Based on the operation of the machine on a twenty-four hour basis, there were 627.25 hours of testing corresponding to twenty-six days of operations. The corresponding supporting documentation was not submitted. We do not have the means to verify the validity of the activities claimed by these employees in the project.

When I read this passage, I ask myself the following questions: Does Mr. Kooi accept that test 2282 was conducted while at the same time questioning the length of the test and the number of persons assigned to the test? Does the witness question the description of the test found at the bottom of page 10 of Tab 8b of Exhibit I-2? (This same document is found on page 001365 of Tab 4 of Exhibit A-1. Provided elsewhere in the documents is a similar page where the description at the bottom of the page is shorter. Pages 56 to 58 also pertain to test 2282 and are found at Tab 9 of Exhibit I-2.)

[99] Second, in view of contain numerical errors, it is quite clear that, in reaching his conclusions, Mr. Kooi's perception of part of the context was somewhat flawed.

[100] Specifically, it is clear that in preparing his report, the witness believed that the amount of time claimed for production-line testing was greater than it actually was.

[101] Mr. Kooi's report regarding project 2007-02, reads, in part:

> [TRANSLATION]
> In reviewing Table 2, eighteen tests were conducted and between 11 (test 2456) and 56 persons (test 2282) were involved in said tests. We found that in these two extreme cases, the estimated time spent on these tests and claimed as experimental production, based on the machine operating twenty-four-seven, were 11 days and 26 days. The justifications for these lengthy tests, such as test data, the report and reasons for continuing testing following tests, were not established. It is difficult for us to confirm the validity of the claim.[46]

[102] It is apparent from this paragraph that the witness assumed that the two production tests in question, 2456 and 2282, lasted the equivalent of 11 and 26 days, respectively, operating continuously on a 24-hour basis.

[103] In Table 2, there is a summary of all the tests conducted during the year for project 2007-02. Test 2282 is the one with the most number of hours, 627.25 hours. Test 2325 is the one with the least number of hours, 113 hours. That is the equivalent of 4.7 periods of 24 hours, approximately five days.

[104] The total hours in Table 2 is over 6,000 [TRANSLATION] "hours of tests." It is the equivalent of 250 periods of 24 hours or 250 days.

[105] If that particular production line operated 365 days per year, 24 hours per day, the tests would represent over 68% of the annual operation of the production

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In this example, in the context of the title of section 8.4.3 at page 24 of the report, I am inclined to believe that it is rather the quantum of time that is being questioned. However, if quantum is the issue, it is not clear why this would have an impact on the characterization of the activity described.

As we will see below, the figures in the paragraphs quoted are incorrect. There were 28 persons involved at different times of the test and not 56; there were not 28 persons present at the same time. We will also see that the test did not last 26 twenty-four-hour days, but rather lasted a much shorter period of time, probably about 20% of the time indicated in the report, as there were 627.25 person-hours of work on the test and not 627.25 hours of testing.

[46] Mr. Kooi's report, Exhibit I-3, page 26, middle paragraph.

line in question. However, if the line 24 hours per day, 5 days per week, it would be the equivalent of close to 100% of the annual operation of the line.

[106] If that were the case, I could see how this would raise doubts from a factual perspective given that it is an operational production line.

[107] This error does not occur only with project 2007-02. In the last paragraph of page 43 pertaining to project 2009-02, the same type of presumption of fact is made according to which the 537.5 hours represent a test that lasted 22 days.

[108] In the report, there is a Table 1,[47] similar to Table 2, pertaining to project 2007-01.[48] The total [TRANSLATION] "hours of tests" in Table 1 is over 8,000 hours or 330 periods of 24 hours. In the light of how the witness construed the hours of testing, this implies that he understood the claim as being for hours of tests, which is almost the entire use of the production line for the year.

[109] However, in reviewing the evidence, it is clear that it is person-hours of work over the course of testing, not hours of operation of the production line. The tests lasted far less time than the witness thinks.[49]

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[47] Exhibit I-3, page 13 of the report, Table 1.

[48] There are similar tables for projects 2009-01 and 2009-02.

[49] It is obvious from the evidence that it is person-hours of work, not hours of testing.

I recognize that in the appellant's documents, there is, *inter alia*, one page for each test with a description, including the name of the employees who participated in the production and the number of [TRANSLATION] "hours of tests." Mr. Kooi interpreted [TRANSLATION] "hours of tests" literally. The respondent would have been more precise in describing it as [TRANSLATION] "person-hours of work spent on the test."

However, it is clear that it is person-hours. If we take for instance project 2009-02, the amount of salaries claimed is $110,416 (see paragraph 21q) of the Reply to the Notice of Appeal). It is obvious that $110,000 is not enough to cover over 6,000 hours of operation of the production line when there are several employees. If the employees were paid only $10 per hour, there would be 11,000 hours of work, which would be equivalent to fewer than two employees on average per hour of production. The sheets pertaining to each test show that there were a number of persons involved in each test (see, for example, page 3 of Tab 8b of Exhibit I-2).

Furthermore, spreadsheets are in evidence at Exhibit A-12. At the page or Tab entitled "Data," there is a list for each employee who worked over the course of a test: the name or number of the employee, the date, the time of the test, the start time and the number of hours of work. It is clear from this data that there were still several employees working over the course of each test, which is not surprising as they production tests.

While I did not perform a detailed analysis, after reviewing the information under "Data" for all the tests of project 2007-02, I am satisfied that in terms of size, there were typically five employees or more who participated and worked at the same time during each test of project 2007-02.

For example, for test 2282, already discussed, all this information is provided in lines 3081 to 4242 of "Data" under "Mic 2007-02" of column M. It is therefore necessary to divide the number of person-hours by a minimum of five to get an idea of the number of hours of duration of the tests on the production line.

As for the other three projects, when we look at the page or Tab entitled "Data," it is also clear that several persons participated in each test.

[110] In the paragraph cited above, the report also says that 56 persons were involved in test 2282. However, the witness corrected that at the beginning of his testimony and indicated that it should have been 28 persons instead of 56.

[111] More generally in Table 2, he corrected the column entitled [TRANSLATION] "Number of persons in Table 2;" the number indicated on each line must, as a general rule, be divided by two.[50]

[112] I conclude that, in preparing his report, Mr. Kooi's findings were drawn from, *inter alia*, a factual basis where the tests pertaining to the four projects in question accounted for the primary use of the four production lines for the majority of the year. The evidence shows that the tests lasted far less time.[51]

[113] Such a contextual error must necessarily affect one's opinion.[52]

[114] For these reasons, I give very little weight to Mr. Kooi's testimony as an expert witness.[53]

[115] However, insofar as Mr. Kooi testified about what he did as a scientific advisor at the audit stage, I accept his testimony, but I note that it is not expert evidence.

[116] The reasons that led Mr. Kooi, as a scientific advisor, to conclude that it was not experimental development are summarized in his technical review report dated November 18, 2010.[54]

[117] Except for project 2009-01, Mr. Kooi concluded that there was no technological obstacle, as they were engineering challenges and the solutions were based on current standard engineering practice.

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[50] He made the same correction in Tables 1, 3 and 4.

[51] With the possible exception of project 2009-02 where, according to the witness' reasoning, there were over 170 days, of twenty-four hour duration, of tests. That would be approximately 47% of the line's use per year if the lien were operating twenty-four hours per day, 365 days per year. It is highly likely that the 170 days represent over 50%.

[52] I note that for part of project 2009-01, Mr. Kooi did not provide an opinion. On page 38 of his report, (Exhibit I-3) in the last paragraph, he stated that part of the project [TRANSLATION] "was uncorroborated." In his testimony, he explained (pages 870 and 871 of the Transcript) that [TRANSLATION] "uncorroborated" meant that he was unable to provide an opinion.

[53] Insofar as he testified about what he did as a scientific advisor at the audit stage, I accept his testimony, but I note that it is not expert evidence.

[54] Exhibit I-2, Tab 7.

[118] For example, his conclusion regarding project 2007-01 is as follows:

> [TRANSLATION]
> . . . we found that tests were conducted to address issues that did not constitute a technological obstacle. The issues to be addressed for these projects as described were as follows. . .: improvements in the hub of the pulley press capable of working on all types of motors, the alignment of motors, the alignment of pulleys, improvements in cycle time, the validation and confirmation of the operation of equipment, etc., are engineering challenges. The solutions applied to address these issues are based on current standard engineering practice by trial and error. We conclude that, with respect to this claim, some of the work performed is related to the application of developed technology to a new situation to stabilize the process and improvement of several assembly stations.[55]

[119] The case of project 2009-01 is a little different, as the report concluded that [TRANSLATION] "the work was uncorroborated" and therefore no opinion was provided.[56]

[120] In reading the report dated November 18, 2010, given the importance Mr. Kooi attached to it during his testimony, there is surprisingly no mention of a lack of contemporaneous documents.[57]

A note on the facts and documents

[121] It is useful at this point to note that the documents were filed by consent and their content was not disputed.[58]

[122] Therefore, I assume that the factual descriptions of the projects and tests in these documents correctly reflect the purpose and accomplishments of the projects as well as what was done during testing.[59]

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[55] Exhibit I-2, Tab 7, report dated November 18, 2010, page 4.

[56] Exhibit I-2, Tab 7, report dated November 18, 2010, page 5 (middle paragraph) and page 6.

[57] Nor was there reference to the absence of a log or the almost complete absence of material expenses on the appellant's part.

I pause here to note that during his testimony, Mr. Kooi repeatedly attached great importance to the almost complete absence of material expenses: see, among the many examples, Mr. Kooi's testimony at pages 904 and 905 of the Transcript. I cannot understand why the fact that the appellant had no material expenses, in circumstances where the material was supplied by the client, is an indicator that there was no experimental development.

If the Minister does not believe that material was used and that no tests were performed, or if the Minister believes that it was simply production that was actually sold, he should issue an assessment that is based on such assumptions of fact and the Court would have to determine what happened. However, that is not the case here; the evidence is that the material was supplied by the client.

[58] In preparing his report on November 18, 2010, it is clear that Mr. Kooi consulted, *inter alia*, all the documents contained in Tabs 8 and 9 of Exhibit I-2 (see page 2 of the report in Tab 7 of the same Exhibit). Mr. Kooi did not appear to have had any hesitation in relying on these documents to render his decision in the report.

Mr. Gariépy's testimony[60]

[123] Mr. Gariépy began testifying by providing some definitions. First, he explained what "scientific uncertainty" means. On the one hand, he cited the definition by the Canada Revenue Agency and, on the other hand, he gave his interpretation of the phrase. According to him, there is scientific uncertainty when a specific objective is identified but it is unknown whether and how it will be achieved. He then defined the concept of "systematic investigation." This means that once the uncertainties have been identified, a literature review will have to be completed to find existing solutions, make hypotheses and perform tests to support or disprove them. He added that the systematic investigation need not assume a particular form.[61]

[124] Finally, he explained what "technological advancement" is. It is, based on his understanding of the Agency's policy, an advancement of the company's knowledge or processes that is not easily accessible; for example, such an advancement is not attainable through a literature review or the purchase of a machine.[62]

[125] Then, Mr. Gariépy provided his opinion on the presence of uncertainties in the various projects. With respect to project 2007-01, pertaining to the assembly of motors, Mr. Gariépy was of the view that it was obvious that there were scientific

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[59] Mr. Kooi stated in his report and testimony that many documents were not contemporaneous. That is correct, but because the documents were admitted by consent and their content was not questioned, their content remains detailed evidence of the projects' accomplishments.

I note that Mr. Kooi testified that no contemporaneous log or logbook was kept; I am unable to understand this statement, as the page or tab entitled [TRANSLATION] "Chronology 2009" of the Excel spreadsheet in Exhibit A-12 is a form of "log" kept contemporaneously by the appellant in its database. The content of [TRANSLATION] "Chronology 2009" may not contain all the information that according to the Agency ought to be in a log, but I do not see how it can be said that there is no contemporaneous log. Parts of [TRANSLATION] "Chronology 2009" are elsewhere in the documentary evidence and the portion relevant to project 2007-01 is reproduced in Appendix A of these reasons.

I also note that the page or tab entitled "Data" details all the hours worked during testing (name of the employee or sometimes the employee number instead of the name, date, time of arrival, time of departure, nature of the employee's work, for example the project and test number). Moreover, "Data" also appears to include the hours of work not related to the project. It is data that was recorded contemporaneously in the appellant's database. Mr. Caouette explained that each employee had a barcode and that each type of task had a barcode— for example, there was a barcode for each test. When the employee started work, for example, on test number 1, he or she scanned his or her personal barcode with a barcode reader and then scanned the barcode for the test; all this was saved in the appellant's database.

I have already indicated in a note that Exhibits A-3 and A-4 are contemporaneous documents that contain certain limited information pertaining to the projects.

[60] I note that the witness made repeated references to the documents and definitions of the Agency.

[61] Transcript, pages 548 to 552.

[62] Transcript, pages 556 and 557.

uncertainties in this project. It was unknown, at first, whether the objective of achieving a nine-second cycle time was attainable. The same is true for the basic objective of assembling all motor types on the same line.

[126] As for project 2007-02, regarding heating elements, there were uncertainties with respect to cycle time, rejection rates and the assembly of the various models on the same line.

[127] As for project 2009-01, pertaining to control panels (backguards), Mr. Gariépy stated that the sum total of what was being sought was uncertain. Although lean manufacturing is a known theoretical concept, its practical application requires development.

[128] Finally, project 2009-02, regarding printing finishings, was also uncertain. The fact that each separate element has the potential of achieving the intended objectives does not preclude uncertainty about the overall objective of having everything work together.

[129] Mr. Gariépy stressed the fact that it is necessary to look at the projects [TRANSLATION] "from the highest level," that is to say, that it is necessary to look at a project as a whole. To look at every little step would be tantamount to distorting the project. He noted that it is possible that a secondary objective does not represent uncertainty, which does not preclude the validation of the project as a whole. Later in his testimony, Mr. Gariépy stated that, according to his interpretation of the Canada Revenue Agency's directives, it is necessary to look at the project in its entirety, not just in the fiscal year concerned.[63]

[130] According to Mr. Gariépy, there is no question that there was a systematic investigation on the appellant's part. Team meetings were held to determine objectives, accessible solutions were sought in the literature, tests were planned and documented, and conclusions were drawn.

[131] Mr. Gariépy then provided his opinion about technological advancement in each project.[64] For project 2007-01, (the fact of)attaining 10.9 seconds is an advancement. The adaptation of the hub, of the pulley press, etc., are advancements.

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[63] Transcript, page 607.
[64] Transcript, pages 575 to 583.

[132] As for project 2007-02, numerous advancements were also made. The mere fact of making the assembly process more stable is an advancement.

[133] Project 2009-01 itself is an advancement. A [TRANSLATION] "new assembly line concept" was developed that did not exist before, at least not in practice. In Mr. Gariépy's view, a major indicator of the level of advancement was the subsequent technological transfer to Mexico.

[134] As regards project 2009-02, the more than 50% increase in the number of applications per hour by increasing synchronization is a major advancement.

[135] Mr. Gariépy was critical of the report by Mr. Kooi, the respondent's expert, on the grounds that he looked at the projects far too closely, instead of looking at them from the highest level. He also expressed doubt as to Mr. Kooi's understanding of the various projects.[65]

[136] Mr. Gariépy then addressed the issue of TRANSLATION] "current practices" that is often referred to in Mr. Kooi's report. According to Mr. Gariépy, [TRANSLATION] "current practices are processes or methods. . .that are introduced on a regular basis." Again, his definition is a clear and simple explanation of the Canada Revenue Agency's definition. According to him, there is no harm in resorting to current practice if it can help us achieve our objective.[66]

[137] In his cross-examination, Mr. Gariépy explained that the fact of completing a project at a lower cost when the technology is available elsewhere, but at a greater cost, can represent an advancement. He then referred to the software developed as part of project 2009-01.

Analysis

[138] The central issue is: Do the four projects in question constitute "experimental development" as defined in the Act?

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[65] Transcript, pages 583 to 586.

[66] The witness also explained that the projects completed by the appellant were not arrived at by mere [TRANSLATION] "trial and error," that there were reasons for wanting to conduct such tests and validate such things and that it was not enough to make a thousand and one changes to see which would yield the best results (see pages 597 and 598 of the Transcript).

[139] The phrase "experimental development" is defined as follows:[67]

> . . . work undertaken for the purpose of achieving technological advancement for the purpose of creating new . . . devices . . . or processes, including incremental improvements thereto,[68]

[140] Thus, the following questions must be answered:

(a) Were the projects undertaken for the purpose of achieving technological advancement?
(b) Were they undertaken for the purpose of creating new processes, including incremental improvements?

[141] The case law has developed a number of useful criteria to determine whether or not activities constituted scientific research or experimental development. These criteria, which were listed by Judge Bowman, as he then was, were approved by the Federal Court of Appeal. These criteria are summarized in *CW Agencies Inc. v. Canada*,[69] where the Court of Appeal states as follows:

> 17 Both sides in front of us relied on the test outlined in *Northwest Hydraulic Consultants Limited v. Her Majesty the Queen*, 98 D.T.C. 1839. In that case, Judge Bowman of the Tax Court outlined five criteria which are useful in determining whether a particular activity constitutes SRED. Those criteria have been approved by this Court in *RIS-Christie v. Her Majesty the Queen*, 99 D.T.C. 5087 at page 5089. The criteria are as follows:
>
> 1. Was there a technological risk or uncertainty which could not be removed by routine engineering or standard procedures?
> 2. Did the person claiming to be doing SRED formulate hypotheses specifically aimed at reducing or eliminating that technological uncertainty?
> 3. Did the procedure adopted accord with the total discipline of the scientific method including the formulation testing and modification of hypotheses?
> 4. Did the process result in a technological advancement?
> 5. Was a detailed record of the hypotheses tested, and results kept as the work progressed?

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[67] In paragraph (*c*) of the definition of "scientific research and experimental development" of section 248 of the Act.
[68] The corresponding French text is as follows:

> […] les travaux entrepris dans l'intérêt du progrès technologique en vue de la création de nouveaux […] dispositifs […] ou procédés ou de l'amélioration, même légère, de ceux qui existent.

[69] 2001 FCA 393.

[142] It must be borne in mind that these crateria are used to help determine whether or not a technological advancement has occurred. The first crateria, technological uncertainty, is one way of dealing with the technological advancement criteria; there can hardly be a technological advancement if one already knows how to achieve the end result; the second and third criteria are, *inter alia*, one way of ensuring that the work was undertaken for the purpose of achieving technological advancement and that it was not, for example, an advancement achieved by accident rather than work undertaken for the purpose of achieving technological advancement.

[143] The five criteria are not absolute. For example, there is no requirement that the work must result in a technological advancement; if the work was unsuccessful but undertaken for the purpose of achieving technological advancement, it may still qualify.[70]

[144] I will begin with a review of project 2007-01, motors for dryers.

[145] The evidence is very clear.

[146] There were two objectives at the beginning of the year: first, to increase the production rate for the sub-assembly of motors from every 14 seconds to every 9 seconds. Second, the appellant sought to produce all the different types of motors on the same production line, which, at the beginning of the year, could only produce [TRANSLATION] "regular" motors without having to stop production to change the motor size.

[147] At the end of the year, the appellant reached a production sub-assembly of approximately every ten seconds, an increase of about 40% and the appellant was able to carry out the sub-assembly of all motor sizes on the same line. As a result, not only was there an increase in productivity, but there was also a dramatic increase in the flexibility of production as the appellant was able to change the size of the motors many times per day.

[148] There is no doubt that not only did the appellant seek significant improvements in its production processes, but there were also significant improvements in the production processes of motors.

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[70] Similarly, with respect to the fifth criteria, while it may be desirable for an appellant to have the best contemporaneous documentation possible, as this would strengthen his or her case, it is not an absolute requirement (see paragraph 94 and note 41 above).

[149] Is this technological advancement, or the application of standard procedures or routine engineering, as the respondent contends?

[150] It is true that when reviewing individual tests they often do not appear to be, in and of themselves, a significant advancement.[71]

[151] In argument, the respondent took the position that Mr. Gariépy went too far by looking at project 2007-01 in its entirety from its outset in 2007.

[152] I fully agree that experimental development was required in the year in question. However, this does not mean that one cannot examine the history of a project that began in a previous year by considering whether, in the particular year at issue, "experimental development" was carried out within the meaning of the Act.

[153] Furthermore, it is important to consider each project globally in the year and not each test individually.[72]

[154] The evidence is very clear that the appellant did not know at first how it would go about increasing the production rate of motors from every 14 seconds to every 9 seconds; nor did it know how it would go about changing the production line to able to produce all motors on the same line.

[155] The appellant had access to the knowledge network of Mabe/General Electric. Mabe/General Electric engineers were only able to provide general principles. The appellant was unable to find a ready-made solution by speaking with its suppliers or by conducting Web searches.

[156] The appellant had to come up with its own solutions, at relatively modest cost—its total claim for this project was less than $239,000.[73]

[157] I accept, as Mr. Gariépy testified, that there was "systematic investigation". This can be seen very clearly in the numerous documents produced, including those found in Tabs 8 and 9 of Exhibit I-2. It is clear from these documents that

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[71] For example, on March 16, 2009, the increase in the diameter of the main air hose.

[72] Of course, there is always the possibility of a controversy, namely, as to whether a stage or test is part of an experimental development project, but in this appeal it has never been suggested that a particular test was not part of one of the projects. The discussion proceeded on the basis that each project was or was not experimental development.

[73] We do not know the value of the material contribution by Mabe/General Electric.

hypotheses were formulated and that the scientific method was applied.[74] I note that this is also true for the three other projects.

[158] To find solutions, the appellant had to conduct 32 tests and invest over 9,000 person-hours. For each test the appellant had to make necessary changes to the production line and, after the testing, the appellant restored the line to the same state it was in prior to the changes made for the tests. The sub-assemblies were then disassembled.

[159] These were not tests where adjustments were made to a known production process. They entailed a series of changes, some of which helped with the objectives and others that were unsuccessful. There was no certainty of the result, and indeed, the appellant, despite all of its efforts, was unable to achieve its sub-assembly objective of every nine seconds in 2009.

[160] As for the tests that were successful, it was only later, with the approval of Mabe/General Electric, that the changes were finally put in place on the production line.[75]

[161] I do not see how, under these circumstances, what the appellant did in 2009 can be classified as an application of standard procedures or routine engineering. There was technological uncertainty.[76] These were not standard procedures.

[162] At the end of the year, the appellant had a new process that consisted of certain equipment arranged and adjusted in such a specific way so as to henceforth produce more quickly and with greater flexibility.

[163] There is no doubt that it is technological advancement and that the work was undertaken for that purpose.[77]

[164] The situation is rather similar for the other projects.

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[74] The second and third criteria listed above.
[75] See paragraph 34 above.
[76] The first criteria above.
[77] As for the fourth criteria, as noted earlier, although the purpose must be technological advancement, a project may be unsuccessful. Here, as it turns out, the appellant was successful. As for the fifth criteria, as already stated, although the Act does not require any particular documentation, adequate documentation is instrumental in helping an appellant demonstrate that experimental development was carried out. In any event, in the present case, there is some contemporaneous documentation, and there is also significant evidence before me.

[165] In the case of project 2007-02, in early 2009, the appellant had three objectives: first, to achieve the speed sought—sub-assembly every 7 seconds—but at the beginning of the year it had only achieved 9.6 seconds; second, to achieve the desired quality standard, less than 300 rejects per million; third, to integrate new models of heating elements in addition to the [TRANSLATION] "regular" model that was already in production.[78]

[166] Again, the appellant did not know how it was going to achieve its goals. Information on how to achieve them did not exist elsewhere.

[167] As in the first project, the appellant had to conduct numerous tests to find solutions. Specifically, the appellant conducted 19 tests and invested over 7,500 person-hours in this project. As was the case for the other projects, most of the tests consisted of a significant number of production hours and a significant amount of production. The sub-assemblies produced were disassembled in Mexico as were those produced for the first project.

[168] As part of the project, the appellant undertook a systematic investigation and, at the end of the year, it was partially successful in achieving its objectives. It successfully integrated the new models of heating elements, but it was only partially successful in achieving its objective in relation to assembly time. The appellant achieved a time of 8.9 seconds, an improvement of slightly less than 8%.[79] Finally, as for the quality, the goal had yet to be attained as of the end of the year.

[169] This came at a rather modest cost of approximately $111,000.[80]

[170] Again, I have no doubt that there was technological uncertainty and that it was experimental development within the meaning of the Act.

[171] As for project 2009-01, regarding dryer control panels, it was a very ambitious project that began in 2009. With the [TRANSLATION] "surgeon approach" the appellant wanted to be able to have very flexible production processes while improving productivity when compared to what it originally was at the Mabe/General Electric plant.

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[78] For safety reasons, it was very important to ensure that the appropriate heating element was used in each sub-assembly.

[79] However, a production increase of 8% per hour with the same team represents a real improvement in the cost of production.

[80] Plus the contribution of Mabe/General Electric of which the monetary value is unknown.

[172] It is not surprising that this project had significantly more difficulties when one considers how ambitious the objectives were: a system (i) capable of making 174 variations of panels; (ii) ensuring the attainment of the particular variation ordered within four hours of the order being placed; and (iii) while increasing the production rate.

[173] The appellant systematically carried out the project. In late 2009, the appellant validated the [TRANSLATION] "surgeon approach," but overall it was not successful in achieving its objectives, despite 22 tests, approximately 9,000 person-hours and $163,000 invested in the project.[81]

[174] It is clear that the appellant did not know how it was going to achieve its objectives and that there was technological uncertainty. It was work undertaken for the purpose of achieving technological advancement. The procedures were not standard.

[175] Finally, as for project 2009-02, regarding printing finishings, early in the year the appellant's objective was to increase by over 80% the number of secondary components that could be added to printed materials,[82] enable the secondary feeder to accommodate larger components and add new secondary components.

[176] The appellant conducted 13 tests and invested over 6,000 person-hours and approximately $74,000.

[177] Again, it is clear that there was technological uncertainty; the appellant did not know at the outset how it was going to achieve its goals and, indeed, it was only partially successful in achieving them—at the end of the year the secondary feeder could accommodate larger components, but the goal of 11,000 applications per hour had yet to be attained. The appellant tried to obtain the necessary knowledge elsewhere, but was unable to do so[83] and therefore had to develop its own solutions.

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[81] Plus, as in the other cases, the material provided by Mabe/General Electric, which, as with the first two projects, then disassembled the panels.
[82] Eleven thousand applications per hour instead of six thousand.
[83] See paragraph 77 above.

Conclusion

[178] In summary, the four projects in question constitute experimental development within the meaning of the Act.

[179] Accordingly, the appeal will be allowed, with costs, and the matter is referred back to the Minister of National Revenue for reconsideration and reassessment on the basis that projects 2007-01, 2007-02, 2009-01 and 2009-02[84] constitute experimental development within the meaning of the Act.

Signed at Ottawa, Ontario, this 23rd day of October 2014.

"Gaston Jorré"

Jorré J.

Translation certified true
on this 15th day of June 2015

François Brunet, Revisor

[84] To clarify, the work undertaken as part of these projects is listed in the list of work and tests in Tab 5 of Exhibit A-1.

APPENDIX A

Project 2007-01[1]

9-Jan-09	Meeting on planning and roles	Discussions with Serge and Sébastien to determine how to speed up the line and shut-down dates
12-Jan-09	**Universal hub production testing**	**Installation and validation of a new hub on press no. 2 to produce all types of pulleys**
20-Jan-09	**Electronic system recalibration testing (relay)**	**Use two contacts per relay instead of one on press no. 2 to prevent the contacts from fusing together and validation**
22-Jan-09	**Validation testing of cycles for pulley press 2**	**Test with press no. 2 to validate work cycles with different pulleys**
2-Feb-09	**Validation testing of universal press (9-second cycle target)**	**Universal press speed test (16.2 seconds/9 seconds), need for entire line to improve cycle time**
4-Feb-09	Connection of pulley press 2	Replacement of press no.1 with press no. 2
9-Feb-09	**Universal line validation testing (9-second cycle target)**	**Validation test of the universal line with press no. 2 (14.2 seconds/9 seconds)**
23-Feb-09	**Universal hub production testing**	**Test with actuator positioner on automatic hub**
24-Feb-09	Actuator positioner (unsuccessful)	Production testing with press no. 2 (universal hub) and actuator positioner
26-Feb-09	**Plate positioning test before universal hub**	**Motor plate positioning test on work template with actuator positioner**
9-Mar-09	**Universal line validation testing (9-second cycle target)**	**Validation test of modified universal line (cycle of 13.7 seconds/9 seconds)**

[1] This table is taken from Exhibit A-12, which contains an Excel spreadsheet by the appellant. It has been slightly modified to more clearly show which events are tests. Specifically, it is the part related to project 2007-01 of the page entitled [TRANSLATION] "Chronology 2009." Table 1 of Mr. Kooi's report (pages 13 to15) is a list of the same tests included in the table here except that Table 1 of the report only refers to the tests and not other events, and the descriptions are those of Mr. Kooi. It should be noted that Mr. Kooi corrected his Table 1 at the beginning of his testimony. The number of persons involved must be reduced by half or, in some cases, by half, rounded down to the closest integer. For example, for test 2231 in Table 1, Mr. Kooi indicates 27, but if we look at Exhibit I-1 in Tab "2007-01" on the page describing 2231, in reviewing the list of names, there are 13 persons and not 27, which is the total of the two columns, including the last line, which is a description. The page describing 2231 includes in the first line at the top the date of [TRANSLATION] "September 3, 2009," and is numbered 26 at the bottom. It is page 26 in the third group of pages numbered in the tab.

16-Mar-09	Calibration of pulley press 2	Recalibration of press no. 2 (increase in downtime to ensure proper position of the pulley on the shaft)
16-Mar-09	Recalibration of compressed air system	Increase in diameter of the main air hose to ensure constant flow
16-Mar-09	**Validation testing with new calibration**	**Increase in diameter of the main air hose to ensure constant flow**
30-Mar-09	**Universal line validation testing (cycle of 13.2 seconds versus 9 seconds target)**	**Validation test of the universal line after modifications (cycle of 13.2 seconds/9 seconds)**
13-Apr-09	**Universal hub production testing**	**Production testing with universal hubs**
6-May-09	Reconfiguration of magnets for pulley press 2	Replacement of magnets for pulley press no. 2 with stronger magnets to prevent the pulleys from falling
8-May-09	**Validation testing of the new magnetic configuration**	**Test to validate the new magnetic configuration**
22-Jun-09	**Universal line validation testing (9-second cycle target)**	**Validation test of the universal line after modifications (cycle of 13.0 seconds /9 seconds)**
23-Jun-09	**Universal line validation testing (9-second cycle target)**	**Validation test of the universal line after modification of the press (cycle of 11.3 seconds /9 seconds)**
29-Jul-09	**Validation testing of the new magnetic configuration**	**Validation test no. 2 with the new magnetic configuration**
20-Aug-09	Connection of pulley press 2	Connection of pulley press no. 2
24-Aug-09	**Universal line validation testing (9-second cycle target)**	**Production validation test of the universal line (cycle of 14.1 seconds/9 seconds)**
26-Aug-09	Modification of pulley press 2	Replacement of pneumatic signal relays that tend to stick with larger relays
26-Aug-09	Modification of the press program (programmable logic controller condition)	Addition of a condition in programming to prevent a pneumatic signal conflict
27-Aug-09	**Universal line validation testing (9-second cycle target)**	**Validation test of the universal line after modifications (cycle of 12.3 seconds/9 seconds)**
2-Sep-09	**Universal line validation testing (cycle of 14.0 seconds versus 9 seconds target)**	**Validation test no. 2 of the universal line after modifications (cycle of 14.0 seconds/9 seconds)**
3-Sep-09	**Universal hub production testing**	**Production testing with new universal hubs**

9-Sep-09	**Universal line validation testing (9-second cycle target)**	**Validation test of the universal line with new universal hubs (cycle of 27.1 seconds/9 seconds)**
14-Sep-09	**Universal line validation testing (9-second cycle target)**	**Validation test of the universal line (cycle of 11.3 seconds/9 seconds)**
16-Sep-09	Validation of pulley press cycle time	Validation of pulley press cycle time
17-Sep-09	Validation of pulley press cycle time	Test to validate the cycle times of pulley press no. 2
17-Sep-09	**Universal line validation testing (9-second cycle target)**	**Validation test no. 2 of the universal line (cycle of 10.9 seconds/9 seconds)**
18-Sep-09	Calibration of pulley press 2	Pneumatic recalibration of pulley press no. 2, redefine minimal operating pressure
21-Sep-09	**Universal line validation testing (9-second cycle target)**	**Validation test no. 2 of the universal line after modification of the press (cycle of 11.7 seconds/9 seconds)**
30-Sep-09	Change in configuration of universal hubs	Addition of universal hub limit detectors
1-Oct-09	**Hub configuration validation testing**	**Test to validate the change in universal hubs**
1-Oct-09	Change in universal hub configurations	Change in universal hub depth to allow for the constant manoeuvring of motor pulleys
6-Oct-09	**Universal hub production testing (confirmed)**	**Production test with deeper hubs**
13-Oct-09	Universal hub correction	Replacement of the hub with a median diameter
14-Oct-09	**Universal line validation testing (9-second cycle target)**	**Validation test of the universal line. Validation of the corrected hub, negative too many Magellan motors remain blocked. We have determined that clearance is probably a factor (cycle of 19.7 seconds/9 seconds).**
20-Oct-09	Universal hub correction	Universal hub diameter correction
21-Oct-09	**Test: validation of the corrected, larger, hub**	**Validation of the corrected hub, negative too many motors are not blocked, probably because diameter too large.**
9-Nov-09	**Test: validation of the pad to prevent jamming**	**Addition and validation of a rubber pad on the automatic hub to prevent jamming**

11-Nov-09	**Universal line validation testing (9-second cycle target)**	**Validation test of the universal line after the addition of a rubber pad (cycle of 10.8 seconds/9 seconds)**
13-Nov-09	**Universal line validation testing (9-second cycle target)**	**Validation test no. 2 of the universal line (cycle of 10.2 seconds/9 seconds)**
16-Nov-09	Change in universal hub limits	Suppression of the air reservoir on the universal hub
16-Nov-09	**Universal line validation testing (9-second cycle target)**	**Validation test of the universal line after the suppression of the air reservoir (cycle of 10.7 seconds/ 9 seconds)**
30-Nov-09	Change in universal hub limits	Addition of a flow control valve to limit the speed of the automatic hub and vibrations upon release of the pulley
1-Dec-09	**Universal line validation testing (9-second cycle target)**	**Validation test of the universal line (cycle of 10.0 seconds/9 seconds)**

APPENDIX B

Project 2007-01[1]

Employees	Hours
Gérard Gorce	589
Jacques Plante	227
Marcel Brossard	267
Sébastien Dufour	0
Serge Caouette	23
Alexandre Quinta	0
Bernard Sallafranque	0
Youssef Houboub	0
David Bourque	0
Production employees	8,261.5
Total	**9,367.5**

[Marcel Brossard is the appellant's quality engineer.]

[1] This is also taken from Exhibit A-12, which contains an Excel spreadsheet. Specifically, it is the part related to project 2007-01 of the page or tab entitled [TRANSLATION] "Accounting portion."

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APPEARANCES:

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