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## Another TCC Ruling Favours Taxpayer on SR&ED

### New ruling may broaden scientific eligibility criteria

On March 31 2015, Justice Johanne D'Auray of the Tax Court Canada in Montreal reversed CRA assessments that denied 100% of SR&ED claims made by 6379249 Canada Inc. for tax years (TY) 2009 and 2010. The company had claimed SR&ED ITCs of \$103K for TY 2009 and \$50K for TY 2010 in respect of expenditures for R&D aimed at improving the performance of a battery-powered wireless portable printer which – per item [21] of the ruling – was submitted to be the smallest such printer "in the world".

6379249 Canada Inc. had previously submitted SR&ED claims for the initial development of this printer technology in 2006, 2007 (which were reviewed by CRA and allowed) and 2008 (which was "accepted as filed" and not audited by CRA).

This ruling covers some important ground on SR&ED jurisprudence including:

- Whether or not the commercial release of a product puts an end to technological uncertainty and hence to SR&ED. Items [68], [94]
- If for experimental development (ED) claims, "technological advancement" applies to furthering the functional performance of a product, or only to gains in one of CRA's specified fields of science or technology. Item [39], [102]
- The practical meaning of "system level" uncertainty as a criteria for SR&ED eligibility. Item [69]
- Oral testimony of a "credible witness" can make up for a lack of supporting documents. Item [72]
- Ongoing discrepancies in the French and English versions of the Act vis-à-vis what increment of progress constitutes "technological advancement" for ED. Item [101]

- The tendency of CRA auditors to "de-construct" SR&ED projects into pieces which are then ruled to be "routine engineering" and therefore not eligible. Item [103]
- How a "credible" witness can help satisfy the basic TCC criteria of "balance of probabilities" Items [65], [121]
- Whether or not project technical descriptions must be entered on the T661 form as has been required by CRA since 2008. Item [124]

One thing that was NOT an issue in this case was impartiality of the CRA employee (an RTA) who was acting as expert witness for the crown. Neither his qualifications nor his impartiality were challenged. Although he had been involved in assessing 6379249 Canada Inc.'s claims, he simply gave his opinion on scientific eligibility and avoided citing CRA policies as had posed problems for CRA employees in other recent SR&ED cases heard by the TCC. (e.g. Les Abeilles Service de Conditionnement Inc. and HLP Solutions Inc.)

In short, the work claimed as SR&ED by 6379249 Canada Inc. involved remedying service malfunctions that had resulted in a large number of printers being returned under warranty and ultimately the printer being withdrawn from the market. Specific failure modes mentioned in the ruling include poor battery life and paper jamming.

6379249 Canada Inc.'s SR&ED claims for 2009 and 2010 involved three projects: 1) Slip clutch performance, 2) Paper moisture analysis, and 3) New printer driver.

In its assessment of the 2009 and 2010 claims, CRA denied 6379249 Canada Inc. any of its claimed SR&ED ITCs on grounds that:

- A) Because the printers had been released to market, there was no longer any technological uncertainty. Items [50], [68], [94]
- B) The work claimed as SR&ED was "routine engineering". Item [9]
- C) Taxpayer had failed to file a complete form T661 for TY 2010 within the 18 month deadline and/or provide the required information using the prescribed form. Item [10]

With respect to the scientific eligibility of the work, 6379249 Canada Inc. argued that the "technological advancement" was sought with respect to the functional performance of the printer and that complexity of the electro-mechanical integration (motors, mechanics, electronics, software, ink characteristics and paper behaviour) constituted "system level" uncertainty per para 2.1.1 of CRA policy guidance document "Eligibility of Work for SR&ED Investment Tax Credits Policy" 19-Dec-2012. Item [66]

With respect to the timing of the filing of the claim: 6379249 Canada Inc. argued that it would "never have filed the return without the scientific report" and had done so. Item [117]

It is not clear from the ruling whether or not 6379249 Canada Inc. filed its project technical descriptions contained in the CRA form T661 or whether they had submitted these in a separate document as had been common practice prior to the release of the "new" T661 and attendant rules back in 2008. Based on item [116] it appears that CRA acknowledged receiving the T2 and – at item [119] – the T661, but not the project descriptions. Items [124] & [126] seem to imply that the 1,400 word project technical descriptions required to be contained in lines 240-244 of section B of the T661 may well have been submitted as a separate attachment to the T661. It is interesting to note that – per item [121] – 6379249 Canada Inc. did not call its accountant to testify that a complete filing had been delivered to the CRA; this despite asserting – per item [120] – that the accountant had hand delivered the T2 return and the "scientific report" to the CRA.

## Findings of Note

This judgment deals with several key SR&ED related issues. To access specific "items", access the judgment text via [http://www.scitax.com/pdf/Dckt\\_2012-3634-IT-G\\_31-Mar-2015.pdf](http://www.scitax.com/pdf/Dckt_2012-3634-IT-G_31-Mar-2015.pdf)

1. The commercial release of a product does not mean that no technological uncertainty remains and hence SR&ED has ended. Item [68]
2. System level uncertainty in a relatively simple integrated electro-mechanical device can satisfy SR&ED eligibility. CRA has typically discounted system level uncertainty for all but the most complex system topologies; attempts by taxpayers to cite such uncertainty are often met by de-construction of the system to pieces of non-eligible routine engineering. Items [66], [69]
3. "Technological advancement" as set in para c) of the definition of SR&ED as contained in the Income Tax Act, can occur in an attempt to improve the functional performance of a product. Items [102]. This dovetails with a similar finding by the TCC in the case "Les Abeilles" where (at Items [162] to [164]) Justice Jorré ruled that technological advancement had occurred because the claimed SR&ED had as a result *"a new process which consisted of some equipment arranged and adjusted in a particular way can now produce faster and more flexibly"*. In both cases the technological advancement that satisfied the criteria for experimental development eligibility under para c) was specific to the functionality of a commercial product or a manufacturing process versus one of the specific fields of "fields of science or technology" as defined in existing CRA policy and too often cited in recent SR&ED assessments.

4. SR&ED projects aimed at achieving an integrated system must be viewed as a whole and not "deconstructed" into fragments of "routine engineering", which are then ruled as non-eligible for SR&ED. Items [103] [38] [52] [95] [96]
5. Prior to this the only CRA guidance document to be sanctioned by the Tax Court was IC 86-4R3 "Scientific Research and Experimental Development" May 1994 which had previously been affirmed in NW Hydraulics in 1998. In this judgment, the court gave quasi-validation to CRA policy guidance document "Eligibility of Work for SR&ED Investment Tax Credits Policy" 19-Dec-2012 as a successor to IC-864R3. "Quasi" because this ruling notes that where conflicts exist between it and the Act, the court noted that the Act must prevail. Items [57], [58]
6. The lack of legislative requirement for a taxpayer to provide documentation to corroborate that a systematic investigation had been undertaken was again raised, but the court stopped short of ruling that such documents are not a requirement. Instead the judgement notes that "it would have been better if the appellant had produced such records" (at Item [71]) but in light of the "credibility" attributed to the taxpayers witness by the court, oral testimony by that witness was a sufficient alternative (at Item [72]). Generally this speaks to an existing precedent set by the FCA in Item [8] of RIS Christie back in 1998.
7. Taxpayers can call on differences in the wording of French and English versions of the definition of SR&ED as contained in the Income Tax Act vis-à-vis how much technological advancement is required for eligibility of work as Experimental Development under para c). The wording in question being "incremental improvements thereto" in the English version versus "l'amélioration, même légère, de ceux qui existent" in the French version, which translates to "even slight improvements" in English. In this case that difference in wording was significant to the court's decision that improving the functionality of the product once the base technology existed was still SR&ED. Items [98], [99], [100]
8. It is certainly vital to file an SR&ED claim within the specified 18 month filing deadline. The requirement to use the prescribed forms for filing an SR&ED claim is set-out in subsections 37(11) and 37(12) of the Act. Although the courts might not uphold CRA denying an SR&ED claim on grounds that the information was not submitted using the approved forms, the use of "attachments" to provide any of the required information (such as the project technical descriptions) poses a risk that such information will be either "lost" by CRA in the intake process or that the entire filing will be rejected or assessed as incomplete leaving the taxpayer to fight out the details in court. Items [10], [109], [112] – [113], [116], [119]

## Learn More

Tax Court Canada judgment for by 6379249 Canada Inc. March 2015 for tax years 2009 and 2010:  
[http://www.scitax.com/pdf/Dckt\\_2012-3634-IT-G\\_31-Mar-2015.pdf](http://www.scitax.com/pdf/Dckt_2012-3634-IT-G_31-Mar-2015.pdf)

Tax Court Canada order re expert testimony in HLP Solutions Inc. February 2015 for tax year 2009: the French language original and verbatim translation to English by Google Translate  
[http://www.scitax.com/pdf/Dckt\\_2012-671-IT-G\\_12-Jan-2015.pdf](http://www.scitax.com/pdf/Dckt_2012-671-IT-G_12-Jan-2015.pdf)

Tax Court Canada judgment for Abeilles service de conditionnement inc. October 2014 for tax year 2009: the French language original and verbatim translation to English by Google Translate  
[http://www.scitax.com/pdf/Dckt\\_2011-2054-IT-G\\_23-Oct-2014\\_Google\\_Translated.pdf](http://www.scitax.com/pdf/Dckt_2011-2054-IT-G_23-Oct-2014_Google_Translated.pdf)

Federal Court of Appeal judgment for RIS Christie Ltd. December 1998 for tax years 1982 and 1983  
[http://www.scitax.com/pdf/Dckt\\_A-710-96\\_21-Dec-1998.pdf](http://www.scitax.com/pdf/Dckt_A-710-96_21-Dec-1998.pdf)

List of CRA defined fields of science or technology (see pages 34 to 36 of PDF)  
<http://www.cra-arc.gc.ca/E/pub/tg/t4088/t4088-14e.pdf>

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## About Scitax

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

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

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

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



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