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Taxpayer Awarded 95% of Legal Costs in Successful SR&ED Appeal

Software developer had contract for health records system in Belize

The Tax Court of Canada has awarded generous (95%) legal costs to a software developer who successfully appealed a denied SR&ED claim to the Tax Court of Canada and subsequently filed a motion to the court for increased costs. Such cost awards are often less than 50%; awards in the range of 80% are seen if there have been settlement offers; 95% is almost unheard of.

On 2-Jan-2013 ACIS EHR (Electronic Health Record) Inc. of Fredericton NB filed a general procedure appeal to the Tax Court of Canada seeking redress for a total of \$239K in SR&ED ITCs claimed in respect of a total of \$548K R&D expenditures in TY2005 and TY2006. Given the ratio of ITCs to expenditures, it would appear that ACIS is a CCPC eligible to receive SR&ED ITCs in the form of a cash refund.

The R&D work for which the ITCs were claimed entailed development of a computer networking system (specifically database replication technology) capable of operating on poor quality / low reliability telecommunications networks found in Belize. ACIS conducted this R&D work in order to fulfill a fixed price contract it was awarded by the government of Belize in 2004. The fixed price nature of the contract is important for SR&ED purposes because it helps show that the taxpayer (ACIS) was "on risk" which is one of the factors the CRA applies in order to determine if the taxpayer is entitled to claim SR&ED in respect of fulfilling such a contract. Another important factor is whether or not the buyer is a "taxable supplier" in Canada, although this is not mentioned in the ruling.

The CRA denied 100% of ACIS's SR&ED claims for these years on grounds that – since suitable technology capable of performing the required functionality was known and available – there was no "technological uncertainty". The taxpayer argued that while such technology was available it was too costly and not capable of providing sufficient data protection (privacy) for health records.

On 27-Oct-2015 the Tax Court of Canada ruled in favour of ACIS and allowed 100% of its 2005 and 2006 SR&ED claims plus 50% of legal costs. This was the latest in a series of taxpayer-favourable SR&ED rulings in which the Tax Court of Canada has wholly reversed negative assessments by the CRA on SR&ED.

On 26-Nov-2015 the taxpayer made a Notice of Motion to the Tax Court of Canada seeking an increase in the original cost award. The Crown responded that the cost award should be limited to no more than 50 percent of the Appellant's fees plus disbursements starting from the date of the taxpayer's first settlement offer which was 2-May-2014.

In this motion, the taxpayer argued that it had made two pre-trial settlement offers to the CRA; The first of the two settlement offers – made on 2-May-2014 – seems to have been ignored until 11-Mar-2015 at which time it was rejected. The second offer was made on 16-Mar-2015; the Crown made a counter offer (which ACIS rejected) to allow the taxpayer to withdraw its appeal (forfeiting all the SR&ED ITCs) without paying the Crown's costs.

On 26-Feb-2016 Honourable Justice Diane Campbell of the Tax Court Canada ruled that ACIS would be allowed costs of 95% of invoiced fees and disbursements from the date of its first settlement offer (i.e. 2-May-2014) on the following grounds:

- 1) ACIS had attempted reasonable settlement offers.
- 2) Poor participation by the CRA and Dept. of Justice in the settlement process.
- 3) The appeal was successful.

The following are notable in the cost motion ruling:

at [8], [14] and [16] Hon. Justice Campbell comments on various aspects of how this matter was handled by Dept. of Justice and the CRA.

at [13] the cost implications of the Court rejecting of the taxpayer's expert witness are discussed

at [16] Hon. Justice Campbell notes Crown as having missed an opportunity to dodge the cost award by objecting to the Taxpayer's re-submission of supplementary detailed invoices

Lessons learned from this trial and the subsequent cost motion include:

- Taxpayers are entitled to recover some of their costs incurred when appealing an SR&ED claim to the Tax Court of Canada, but only if they win. Otherwise the Crown may be entitled to recover its costs from the taxpayer.
- The Tax Court normally allows costs in the range of 50% or less, but higher percentages are possible. (see [5], [14])
- It is important to make a realistic settlement offer to the Crown early in the process. This must be done in writing and a record kept of the delivery, i.e. registered mail. (see [3], [8] & [12])
- Costs can include fees of lawyers and scientific expert witness; however if the expert is not "qualified" (accepted) by the court, then the expert's fees will not be covered.
- To be eligible for reimbursement, costs must be properly documented from the start. At minimum this means detailed invoices, timesheets (with names and rates) and receipts for disbursements. (see [16])



Learn More

Tax Court Canada judgment on motion of ACIS EHR (Electronic Health Record) Inc. for additional legal costs incurred in the appeal of its SR&ED claims for tax years 2005 and 2006

http://www.scitax.com/pdf/Dckt_2012-4645-IT-G_26-Feb-2016.pdf

Tax Court Canada judgment on SR&ED claims of ACIS EHR (Electronic Health Record) Inc. 27-Oct-2015 in tax years 2005 and 2006:

http://www.scitax.com/pdf/Dckt_2012-4645-IT-G_27-Oct-2015.pdf

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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 Tax – 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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