

## New CRA Guidance on SR&ED Claims By Physicians

- No new rules; highlights financial issues arising from various physician compensation schemes

The Canada Revenue Agency ("CRA") has issued a new communiqué dealing with Scientific Research & Experimental Development ("SR&ED") claims by physicians; it was initially published on their website on September 23, 2019 and was emailed to tax publications a few days later. We are calling this document a "communiqué" because it was not published as a numbered administrative policy, information circular, or other officially designated document.

The CRA communiqué defines "physician" as *"any regulated medical professional who practices a health care profession, whose activities may include medical research, and who is a member of the appropriate body regulating his or her profession."* We interpret this as encompassing medical doctors, dentists, physiotherapists, orthotists, chiropractors, and possibly even veterinarians.

It is important to understand that the CRA is not introducing any new rules or interpretation here; rather, its purpose is to clarify how existing SR&ED rules and legislation are to be applied to specific circumstances in the health care sector. Its core message is that any payment received by a taxpayer for performing R&D work reduces the amount of SR&ED ITC that the taxpayer can claim for that work. This is particularly significant for physicians because they often undertake R&D concurrent with their normal paid duties treating patients.

In this bulletin we review six factors which - based on our experience advising physicians - tend to "complicate" the claiming of SR&ED investment tax credits in the health care community. We've included a list of recommendations at the end and a "Learn More" section for deeper reading.

### #1 Is the Health Care Institution Eligible to Claim?

Private for profit businesses file their SR&ED claims as a component of their corporate income tax filing at each year end; the expenditures (salaries, wages, materials etc.) "roll-up" into the corporation's aggregate tax position.

However, because most Canadian Health Care Enterprises (HCEs) such as hospitals and universities are publicly funded entities that don't pay corporate income tax they are not themselves eligible to make SR&ED claims.

Therefore, most HCEs can benefit from SR&ED tax credits only indirectly; that is, by having the persons performing the R&D work make the claims. Generally this entails having the physicians make the claims, either personally (as individuals) or perhaps as a practice "unit".

Practice units can be groups of physicians who provide services to the HCE through various business structures. As noted below, each of these structures presents its own unique set of limitations and problems when it comes to filing SR&ED claims.

## #2 Individual, Sole Proprietorship, or Corporation?

Canada's federal *Income Tax Act* awards SR&ED Investment Tax Credits (ITCs) at different rates depending on the taxpayer's business structure. Furthermore, individual provinces also provide their own R&D tax credits which also vary according to business structure. Regardless of whether physicians are working within an HCE or in private practice, the same business structure rules apply.

Private corporations controlled by Canadian residents (which include medical professional corporations) earn federal SR&ED ITCs at the highest rate (35% of the R&D expenditures) and those ITCs are fully refundable (even if the corporation is not paying tax for the year). Such corporations are generally allowed the highest rates by most provinces as well.

However, un-incorporated (sole proprietorship) businesses earn federal SR&ED ITCs at a substantially lower rate (15%), and only 40% of the ITC will be refunded if the person is not otherwise paying federal tax. Furthermore, payments to the owner (e.g. the physician) or the owner's spouse (e.g. physician's wife) do not attract SR&ED and some provinces do not provide their R&D tax credits to non-incorporated entities.

If the physician is performing R&D work for an HCE (or any party other than himself) it is vital that any contractual documents pertaining to the work name the business entity (e.g. the MPC) that will be making the SR&ED claim as the R&D performer and not the physician as an individual: If the contract is written showing the individual physician as the performer, the SR&ED claim must be made by that individual and only the lower (and partially refundable) "individual" ITC rates described above will be earned. This may be problematic in certain provincial jurisdictions that restrict the ability of an HCE to enter contracts with MPCs.

## #3 R&D Performers Must Be Paid, Real Expenses Must Be Incurred

In order to generate an SR&ED ITC, real money must be spent - "sweat equity" doesn't count.

SR&ED ITCs are allowed only for actual amounts paid out for T4 salary, R&D services, and materials in the taxation year. The physicians and staff doing the work must be paid a salary, and that salary must be reported as taxable income to the individual. Likewise there must be proof (invoices, contracts, cancelled cheques, etc.) that any amounts claimed for services or materials were delivered in the tax year and paid for within 180 days of the tax year-end.

In an un-incorporated (sole proprietorship) business the CRA deems that neither the owner (nor the owner's spouse) are employees and therefore will not allow either to receive a T4. This means that payments to the owner (the physician) or the owner's spouse cannot be included in an SR&ED claim made by an un-incorporated (sole proprietorship) business. Claiming their compensation as an R&D salary is out because they don't receive a T4, and claiming their compensation as a contract payment is out because they are not dealing "at arm's length". However, salaries paid to persons who are not owners of the business (and who do receive T4s) can be claimed.

## #4 "Assistance" - Payments Received for the R&D Work

The most confounding and troublesome obstacle to physicians making SR&ED claims is that of financial "assistance". The Act and the communiqué say that SR&ED expenditures are reduced, for tax purposes, by the amount of financial assistance or contract payments received by the taxpayer for the claimed work. When it comes to SR&ED, assistance means any payment that is received (or receivable) from a Canadian taxable supplier by the claimant for doing the work - more on taxable non-taxable supplier below, but for now lets stay focussed on the "assistance" issue.

In most cases the physician is being paid by someone (e.g. the HCE, an insurance scheme) to perform a therapeutic medical procedure on a patient. In order to claim SR&ED in relation to the procedure, the physician must be able to show that such payment did not cover the portion of the procedure that was required for the R&D. But again those extra costs must be "real", meaning the physician must be drawing a salary attributable to that extra work or incurring some other external expenses such as a lab fee.

For physicians conducting research in an HCE laboratory setting, it may be difficult to quantify the expenditures eligible for SR&ED. If physician P functions in a purely R&D role, then 100% of P's compensation is paid by the HCE is assistance and there is no SR&ED-eligible expenditure. If P has a mixed role (both patient care and R&D), then the SR&ED-eligible expenditure is the difference between what it cost P to perform the R&D and what the HCE paid P to do it. In other words the SR&ED-eligible expenditure equates to the "cost overrun" and again P must be able to show that that cost overrun arose from a real out of pocket cost, such as a T4 salary paid to him or to his assistants (and this only works if P is incorporated and providing the R&D services through an MPC). The obstacle here is that, for various reasons, HCEs are often unable (or unwilling) to provide "breakout" data showing how much of P's compensation was for patient care duties and how much was for R&D; without this the CRA is unable to quantify what if any "assistance" has been received and therefore cannot conclude an assessment of P's claim.

The only situation in which the physician might be eligible to claim 100% of the expenditures incurred would be a clinical trial situation, where a new medical technology is being tested on patients independent of the health care system (i.e. not funded by provincial or private health care plans). In such a scenario, 100% of payments to both the physicians and the patients might attract SR&ED investment tax credits.

## #5 Assistance from a non-Taxable Supplier?

There is a potentially interesting wrinkle in this, arising from the "taxable supplier" rules found in Income Tax Act paragraphs 127(9)"contract payment"(a), 127(9)"qualified expenditure"(g), the definition 127(9)"taxable supplier", and subsection 127(25). A "taxable supplier" is a person resident in Canada, a Canadian partnership (all partners resident in Canada), or a non-resident carrying on business through a permanent establishment in Canada. In short, these rules provide that payments received from a non-"taxable supplier" do not reduce SR&ED expenditures. Thus, if the payer is located outside Canada, the monies received do not count as "assistance" and do not reduce the taxpayer's SR&ED claim. As a result, a payment to a Canadian resident physician from a non-Canadian HCE (or pharma company) does not reduce the physician's SR&ED claim.

## #6 Scientific Eligibility

Although the field of medicine is fertile ground for work likely to meet the criterion for eligible R&D activity, the physician must be able to show that the claimed expenditures were incurred in conducting a "systematic investigation", aimed at resolving a technological uncertainty and achieving a scientific or technological "advancement", rather than routine therapeutic care of patients. Sometimes these two (patient care and systematic investigation) can co-exist, but the portion of the expenditure eligible for the SR&ED investment tax credit will be limited to whatever exceeds a routine "standard practice" treatment, taking into account technical, procedural and financial considerations.

Another potential scientific eligibility obstacle is that so-called "pharmacological dissection" (i.e. deducing pathology by drug response) may be viewed by the CRA as "trial and error" and thus not meeting the key eligibility criterion of "systematic investigation".

## Case Study: Sunnybrook Research Institute

In 2010, one of Canada's largest HCEs the Sunnybrook Health Sciences Centre formed a new private entity called the Sunnybrook Research Institute (SRI); one of the main motivations for this was to gain access to SR&ED Investment Tax Credits at the organization level which was not possible for the hospital itself because it is publicly funded.

SRI can claim SR&ED ITCs like any other business, the amounts paid to physicians and support staff are claimed directly by SRI on its corporate tax filings without involving the physician's tax filings in the process. Furthermore, since SRI is exclusively engaged in R&D there is little need for breakout of salaries between patient care and R&D; essentially all its expenditures would be eligible to attract SR&ED ITCs.

## Conclusions and Recommendations

- A. If a physician is not incorporated (i.e. operates as a "sole proprietorship"), he cannot claim SR&ED ITCs on any payments made to himself or to his spouse; only to his employees. This plus the low ITCs rate, make filing SR&ED claims in un-incorporated businesses a suboptimal proposition.
- B. Physicians with significant involvement in R&D should form medical professional corporations (MPCs) and thereby enjoy SR&ED Investment Tax Credits at the highest possible rate.
- C. When joining an HCE, physicians intending to expend significant time on R&D should attempt to negotiate contracts that provide for breakout of their compensation to distinguish between patient care and R&D work.
- D. To earn the highest possible SR&ED ITC rate, physicians who are incorporated must ensure that any research contracts they undertake are written to name the corporation (not the individual physician) as the performer.
- E. HCEs with significant R&D interests should consider forming a separate independent research institute structured as a Canadian Controlled Private Corporation and thereby gain access to SR&ED ITCs at the organization level.
- F. Physicians contemplating engaging in development / manufacturing of a new medical technology or product should consider forming a separate private corporation explicitly for that purpose, independent of their MPC. That corporation can be owned by Canadian-residents other than the physician. It should pay the physician and other research workers a salary, which will attract SR&ED at the highest possible rates. Income from the sale of the technology can be "sheltered" in that corporation and disbursed to others (in lower tax brackets) through dividends. Note however that the new Tax on Split Income rules, in effect since 2018, can cause dividends to family members to be taxed at very high rates.
- G. Physicians making SR&ED claims should maintain time records that clearly demarcate time expended in routine patient care versus R&D activity.
- H. The March 2019 federal Budget eliminated the expenditure limit grind by which Canadian Controlled Private Corporations with income in excess of \$500,000 suffered reduced SR&ED ITC rates. This change offers the opportunity for high-earning private corporations (including MPCs) to enjoy substantially higher R&D tax credits. For full details, see [Scitax Bulletin #72](#).  
[Scitax Bulletin #72 - Budget 2019 Has Good News on R&D Tax Credits](#)
- I. Canadian companies performing R&D on behalf of non-Canadian customers should review their SR&ED filings to ensure that incoming contract payments are not unduly reducing ITCs.

## Learn More

- Link to the CRA document "SR&ED claims made by physicians and Medical Professional Corporations - Information for claimants":  
<https://www.canada.ca/en/revenue-agency/services/scientific-research-experimental-development-tax-incentive-program/claims-made-physicians-medical-professional-corporations.html>
- Scitax publication "Introduction to R&D Tax Credits in Canada":  
[Intro to R&D Tax Credits in Canada \[PDF\]](#)
- Scitax publication "What To Do If You Disagree With The CRA":  
[What to do if you Disagree with CRA \[PDF\]](#)

## About Scitax

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

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

While we normally work in concert with our client's existing accountants, our affiliated tax-dedicated chartered accounting firm - Cadesky 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.



### DIRECTORS:

David R. Hearn, Managing Director  
Michael C. Cadesky, FCPA FCA BSc MBA

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### Scitax Advisory Partners LP

Exchange Tower, 130 King Street West, Suite 2300, PO Box 233, Toronto ON M5X 1C8 | 416-350-1214  
[www.scitax.com](http://www.scitax.com)

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