

Abeilles on SR & ED Eligibility

On October 23, 2014, the TCC allowed the appeal in *Abeilles service de conditionnement inc.* (2014 CCI 313) for the tax year 2009, and concluded that the projects were experimental development for the purposes of the SR & ED credit. Although the TCC in *Abeilles* does not change the SR & ED criteria, it highlights the value of expert witness testimony and offers potentially useful arguments for a taxpayer seeking redress for an SR & ED claim denied on the grounds of scientific ineligibility. According to CRA statistics, SR & ED-related objections increased 25-fold from 2007 to 2013; thus, SR & ED-related appeals are likely to increase sharply in the near future.

Abeilles is located in the east end of Montreal and is 49 percent owned by General Electric. The company is engaged in the automated manufacturing of electric motors and other component subassemblies such as heating elements and control panels used in household appliances. *Abeilles* has made SR & ED claims since 2003.

For 2009, *Abeilles* claimed total expenditures of about \$400,000 in salaries and \$5,000 in materials for four projects that it believed were R & D. All four projects were intended to improve the efficiency of automated processes for assembling appliances, not the efficiency of the appliances themselves. Two projects were continued from prior tax years (in which the CRA allowed SR & ED claims), and two new projects began in 2009.

The CRA rejected *Abeille's* claim for SR & ED ITCs on the grounds that the work did not meet the definition of SR & ED-eligible activity in subsection 248(1): the work undertaken was standard practice and/or routine engineering with no technological uncertainty, no technological advancement, and no systematic investigation. The CRA also said that there was no contemporaneous documentation to corroborate that the work had actually been done.

Both the taxpayer and the Crown called well-qualified expert witnesses. The taxpayer's expert witness had a bachelor of science degree in pure mathematics, a master's degree in aerospace engineering, and a PhD in mechanical engineering. The Crown's expert (the same CRA science adviser who had assessed the claims) held a bachelor's degree in chemical engineering and both a master's degree and a PhD in mechanical engineering.

Currently, the dominant jurisprudence on the scientific eligibility of SR & ED claims is *Jente!* (2011 TCC 261; aff'd. 2011 FCA 355), in which scientific expert witness testimony also played a key role: the taxpayer failed to call an independent scientific expert and lost. In *Abeilles*, the CRA expert had audited and assessed the disputed claim, and counsel for *Abeilles* objected that the CRA's expert was not independent. The court concluded that his testimony was shaped by CRA administrative policies and not by his own personal experience; he failed to distinguish between his role as a CRA auditor and his role as an expert witness.

Abeilles offers the following important guidance on the criteria for the scientific eligibility of claims for experimental development as defined.

- New manufacturing processes, increases in productivity rates, and flexibility of processes may constitute technological advancement. The *Abeilles* decision classified improvements in performance as technological advancement, in contrast to recent CRA assessments that denied eligibility for performance improvements because there was no advancement of scientific knowledge.
- A project should be assessed as a whole and may span years. Increasingly, CRA assessments view each year in isolation and each project as if it were new in each year. For example, if the claimed activity in year 1 is devoted to setting up an apparatus or prototype and actual experimental testing is begun only in year 2, the CRA may disallow the claim for the work done in year 1.
- Technological uncertainty is predicated on the knowledge available to the taxpayer from within the community of competent professionals accessible to it. If the taxpayer conducts a diligent search that reveals a lack of information in the public domain about how to achieve the outcome sought, that search is adequate evidence of technical uncertainty. Many CRA assessments are based on the higher standard found in its current policy documents. For example, the Eligibility of Work for SR & ED Investment Tax Credits Policy of December 19, 2012 on the CRA website says: "Technological uncertainties may arise from shortcomings or limitations of the current state of technology that prevent a new or improved capability from being developed. In other words, the current state of technology may be insufficient to resolve a problem." *Abeilles* clarifies that what the taxpayer knows or ought to have known is the relevant test; the same standard was set in 1998 in *Northwest Hydraulic* (1998 CanLII 553 (TCC)).
- The need to develop a cost-effective solution can constitute technological uncertainty if existing solutions and knowledge are not commercially practical. Recent assessments appear to favour a more limited view of the "state of technology" definition than is set out in the CRA's policy.
- The decision clarifies that "[a]djusting a manufacturing process can constitute systematic investigation"; "[t]echnological progress in the manufacturing process equates to advancement"; and "[r]epairs/corrections can be an activity of systematic investigation." (Unofficial translation.) CRA assessments often classify these activities as routine troubleshooting and not as eligible SR & ED.
- Contemporaneous documents may be necessary to help establish facts or settle disputed facts in court, but the existence of those documents with specific content is not a precondition for SR & ED eligibility (116736 *Canada Inc. v. The Queen*, 1998 CanLII 560 (TCC)). Increasingly, CRA auditors suggest that a taxpayer's inability to produce contemporaneous documents (technical notes and time records) indicate that SR & ED has not occurred. The CRA's pre-audit request for information asks a taxpayer to submit contemporaneous documentation to support its SR & ED claims; failure to produce those documents is often cited as grounds for a claim's denial. *Abeilles* seems to cast doubt on this practice.

The TCC in *Abeilles* says that the five criteria for scientific eligibility set out by it in *Northwest Hydraulic* in 1998 (affirmed by the FCA, most recently in *Jente!*) are "not absolute" (unofficial translation), but it stops short of establishing new criteria. However, *Abeilles* shows that a taxpayer's expert witness can help it demonstrate SR & ED eligibility by mapping the relevant facts onto those five criteria.

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