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Ottawa Launches Another SR&ED Satisfaction Survey

CRA seeks your views in new on-line survey – closes Nov 30th

Ottawa recently announced a new survey to learn your views on how the SR&ED tax credit system can be improved. The survey opened October 5th and responses will be accepted until November 30th. Do not miss this opportunity to communicate your views to CRA!

In this bulletin we review some of the past efforts, examine the motives behind this one and share our own views on some of the key issues that need to be addressed. Finally, there's the "Learn More" section at the end with links to all documents cited here and a few related topics for those who want to dig a little deeper.

This is the third time in two years that the Conservative government in Ottawa has sought insight on how to boost science and technology in Canada. Although the first two – one by the *Council of Canadian Academies* commissioned by Industry Canada in the summer of 2006 and the other a series of presentations to the *Standing Committee on Finance* by various industry associations through the fall of 2006 – did not have SR&ED as their core mandate, SR&ED played a large part in both.

In late November 2006, industry association CATAAlliance undertook its own survey of the SR&ED program to help the federal government along. In summing up the findings, CATA's president John Reid said, "The consultations clearly show that the SR&ED tax credit system needs to be improved so that all Canadian businesses have access to its benefits". See the "Learn More" section at the end of this article for a link to the full text of these findings.

Ottawa's most recent effort is aimed directly and exclusively at the SR&ED program. The general method is a write-in survey in which respondents submit their comments via email, fax or even by post. The addresses for these can be found on-line at http://www.fin.gc.ca/activty/consult/sred_e.html.

A knowledgeable source close to the survey process said that this effort is directly linked to the promises made by this government in the document “*Mobilizing Science & Technology to Canada’s Advantage*” released as back up to a speech made by Prime Minister Stephen Harper in Canada’s SR&ED tax credit program, specifically “Identifying opportunities to improve the Scientific Research and Experimental Development (SR&ED) program, including its administration”.

This same source went on to say that, this online consultation differed from the earlier efforts in that “It is the first time the government will seek input on SR&ED directly from the individual persons in the scientific community and by-pass special interest groups, lobbyists and associations”.

This seems a reasonable enough approach in these politically turbulent times where “targeted spending” is the watchword. We probably saw the first of this targeted spending concept on October 5th when Stephen Harper, speaking from Churchill Manitoba, announced \$150 million of expenditures on “scientific and infrastructure” projects linked to Canada’s Northern sovereignty initiatives. In our view for such a survey to be effective, respondents need to identify specific issues in their submissions. Our firm – Scitax – has ten staff, all of whom have at least ten years of experience with SR&ED. Here's what we'll be saying:

No Availability without Accessibility:

If the government wants to increase rates, it should not reduce availability by changing administrative practices, or the law, to make it more difficult to qualify.

Clarify the Rules:

Better yet clarify the **law**. There are about 500 words in the Income Tax Act that define what qualifies as SR&ED in Canada. You can find most of them here http://laws.justice.gc.ca/en/showdoc/cs/l-3.3/bo-ga:l_XVII/en#anchorbo-ga:l_XVII The problem is that these 500 words are hardly definitive. For example exactly what does “*with respect to*” mean in 248(1) where it says “...*with respect to engineering, design, operations research, mathematical analysis, computer programming*”. Does “engineering” mean the practice of professional engineers only? Or, does it also include the work of engineering technicians and technologists who assist engineers? What about a machinist who builds an experimental prototype according to an engineer’s instructions?

Truth in Advertising:

To help solve the rules problem, CRA’s SR&ED administration has built a huge web site with a tremendous set of information circulars, application policies, sector specific guidelines and other documents which – as close as we can figure – come up to total almost 40,000 words. Now this would be very helpful to the taxpayer except for two details: First, none of these 40,000 have the force of law. Second, taxpayers citing these publications as grounds for having filed a claim; and expected some cash from the program; are routinely told by CRA auditors that these publications do not apply. They say, “We go by the Act”. So why bother having all these documents? If they do not apply, take them off the CRA website so taxpayers are not misled into making claims that will not be allowed.

Refundability and Monetization Issues:

Canada is one of the few countries to offer an R&D incentive in the form of a cash benefit. In short, this means that even companies that have no taxable benefit can get a cheque at the end of the year. This is a very good way for technology start-ups to boot strap themselves to life. At present, this cash benefit is only available to small Canadian-owned private companies (CCPCs). There has; and will be more; clamouring to extend this refundability to a broader range of companies. The Biotech sector is particularly concerned about this since even small biotech start-ups are often public and cannot monetize their SR&ED benefit. We urge “caution” here. Foreign companies already have many options for reducing their taxable income in Canada; transfer pricing, management fees etc. Allowing foreign companies access to refundable SR&ED benefits has high potential for abuse; i.e. transfer profits to foreign parent, reduce taxable income to zero and claim the cash.

Alternatives to Increased Refundability:

We suggest solving the monetization problem in either of two ways: One option would be to allow companies operating on certain designated small- and micro-cap junior stock exchanges to retain their SR&ED refundability. This might fit well with the growing ties between the NASDAQ and CDNX exchanges. The other option, which we prefer, would be to introduce a flow-through share scheme like the one that has worked so well to promote mineral exploration in Canada’s oil and gas sector.

Define Acceptable Record Keeping:

CRA SR&ED auditors are always asking for “records”, they want time records and technical records showing what you did and when you did it. They will often deny your claim if you do not have them. However, when they are asked what level of detail would be acceptable, they are unable to provide that information. This seems a simple enough thing to do. Other government departments and agencies have had good luck with industry standard project management approaches such as the Work Breakdown Structure (WBS); perhaps it would be a good starting point for CRA.

Eligibility of Fees for SR&ED Claim Preparation:

The Income Tax Act Regulations are very clear that expenditures on legal and accounting services are not SR&ED eligible – even if they are solely incurred to make an SR&ED claim. However, what about professional fees paid to engineers and technical writers who help identify and document work either while it is being done or afterwards, when the claim is being prepared for filing? Although probably offside under the proxy overhead method, claim preparation fees paid to other than accountants or lawyers should qualify under the traditional overhead method, particularly if claimed in the year in which they are incurred. There needs to be greater clarity on this, a recent Tax Court Case; Armada Equipment; offers some direction but a clearly defined rule in the Income Tax Act would be better.

Learn More...

- > The new survey on the Department of Finance Website
<http://www.fin.gc.ca/news07/07-078e.html>
- > CATA *Alliance* SR&ED Findings
http://www.cata.ca/Media_and_Events/Press_Releases/cata_pr07160701.html
- > OECD Study on R&D tax credits around the world -
Seems to be at the root of Ottawa's anxiety on this issue
<http://www.oecd.org/dataoecd/12/27/2498389.pdf>
- > CRA SR&ED Website – Forms and Publications –
can somebody please help us count those words
<http://www.cra-arc.gc.ca/taxcredit/sred/publications-e.html>
- > Government Policy Document *Mobilizing Science and Technology to Canada's Advantage*
– From Stephen Harper's in Waterloo, Ontario on 17th May 2007 (includes those magic go-forward policy commitments on SR&ED):
<http://ic.gc.ca/cmb/welcomeic.nsf/ICPages/CorporatePublications#s-t>
- > Council of Canadian Academies report
http://www.scienceadvice.ca/documents/Summary_and_Main_Findings.pdf
http://www.scienceadvice.ca/documents/The_State_of_Science_and_Technology_in_Canada.pdf
- > Here's a nice primer on junior small- and micro-cap stock exchanges including CDNX. In addition, some interesting ideas on way they might want to merge (courtesy of Mike Volker at BC Tec.com):
<http://www.bctechnology.com/statics/mvolker-jan2601.html>
- > Flow-through Share Primer (courtesy Lang Michener LLP)
<http://www.langmichener.ca/index.cfm?fuseaction=content.contentDetail&ID=9054&tID=244>

For more information on this topic, contact:

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About Scitax...

Scitax Advisory Partners is a professional services firm with specialist expertise in Scientific Research and Experimental Development (SR&ED) tax credits.

We offer a team of senior technical consultants all of whom have ten or more years experience in the SR&ED field. All Scitax technical consultants have engineering or science backgrounds and at least twenty years industry experience in their particular field prior to consulting.

Our primary function is to produce a technical submission package that most effectively communicates your SR&ED claim to CRA in a way that highlights eligibility and expedites processing. We assist you in identifying and preparing all required documentation including project technical descriptions, cost schedules, and everything else your tax preparer needs to file the claim. Once your claim is filed, Scitax will advocate for you with CRA and help you negotiate fair settlement of your claim.

While we normally work with our client's existing tax advisors, our affiliated firm Cadesky and Associates can provide a full package of tax services if required.



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