

DIRECTORS:

David R. Hearn, Managing Director

Michael C. Cadesky, BSc, MBA, FCA

Are Tax Advisor Fees an Eligible SR&ED Expenditure?

Tax Court Canada says “Maybe”

In this bulletin we review two TCC cases – [Armada](#) in 2007 and [Val-Harmon](#) in 1995 – both of which address the issue of whether fees charged by tax preparers and other SR&ED consultants can be claimed as SR&ED. The answer from these cases is a firm “maybe”.

Check our recommendations at the bottom of the bulletin to see what this might mean in terms of including such fees in your own SR&ED claims. As usual, there's a "Learn More" section at the very end with URL references for those interested in further study on this topic.

Unfortunately, in neither [Armada](#) nor [Val-Harmon](#), does the court reporting identify if the Traditional or Proxy Overhead method was used. This information is particularly germane to the situation, as per our comments in the Conclusions and Recommendations section below

Past History: Val-Harmon in 1995

As an aid to settling this case ([Armada](#)), the court turned to an earlier (1995) case – [Val-Harmon v. Her Majesty The Queen](#). In this case, an amount of \$20,638 paid to a consulting company; [Gessat Inc.](#); that specialized in SR&ED that was neither an accounting nor legal firm. In this case, [Val-Harmon](#) had claimed [Gessat's](#) entire fee as an SR&ED expenditure and had not differentiated between the amounts charged for technical vs. accounting aspects of the services.

The quirk here is that in the [Val-Harmon](#) case, the Minister had – somewhat inexplicably – relied on ITA Regulation 2902(a) (i) to support its side of the case. Regulation 2902(a) (i) says that “a legal or accounting fee” is not an eligible SR&ED expenditure. The taxpayer based its arguments on Regulation 2900(2), which allows “other expenditures that are directly related to such prosecution and that would not have been incurred if such prosecution had not occurred”. [Val-Harmon](#) said that [Gessat's](#) fees were engineering and not legal or accounting and would not have been incurred had there been no SR&ED.

When Val-Harmon won the appeal in 1995, the Minister attempted to re-argue its case based on language in 2900(2) that requires the expenditure to be “directly related”. The court ruled that such a change in position was unfair to Val-Harmon and refused the request. The outcome of this action saw the Court allowing 75% of the \$20,638 fee amount to Val-Harmon as an eligible SR&ED expenditure. The Minister made another attempt at that same strategy during the Armada proceeding, hoping to regain ground lost back in 1995 and quash a potentially troublesome precedent.

Present: Armada Equipment Corp. in 2007

The May 2007 case was brought to TCC by Armada Equipment Corporation. Armada had paid a total of \$28,618 to two different consultants who assisted them in preparing their SR&ED claim. Of this amount, \$18,618 was paid to a retired engineer; the balance was paid to a chartered accounting firm. Armada included the \$18,618 in its SR&ED claim and CRA denied it as an eligible expenditure.

The court upheld the Minister’s position and found that none of \$18,618 claimed by Armada counted as an eligible SR&ED expenditure. However, the court stopped short of any change to its position on Val-Harman.

TCC’s finding that the consulting fees claimed by Armada were not SR&ED eligible was based on rationale that the fees were paid for a service rendered after the SR&ED was already complete. This is seen in the following phrase of the judgment: “a ““qualified expenditure”” must be incurred in connection with ongoing research and development, and not incurred after-the-fact because research and development have already taken place.”

Practical Considerations – Claim Professional Fees or Not?

Unfortunately, the Armada case was more indicative than definitive. On the surface TCC’s position on Armada would seem to indicate that the professional services fees paid for preparation of SR&ED claims are not an eligible expenditure and should not be claimed. However, before rushing to this conclusion, several important factors need to be considered:

Are the fees for engineering / technical services or for legal / accounting services? Legal / accounting services are specifically excluded in the Regulations; however, the act is silent on fees paid to engineers.

Traditional or Proxy Overheads Method? The traditional overhead method offers broader scope for technical work. CRA Application Policy #96-06 contains a table comparing eligibility of various activities under Traditional and Proxy overhead methods the last row of that table shows “preparation of the T661 for SR&ED projects carried out in the current year by employees” with a tick mark for eligible under Traditional method.

Timing - Services Rendered In The Claim Period? Tax Court Canada’s 2007 ruling denying Armada Equipment SR&ED benefits on professional services fees for SR&ED claim preparation was based largely on the timing of the services. Armada claimed fees for that were rendered after the claimed SR&ED work was complete. It is not clear if the fees claimed were incurred in the same fiscal period as the claimed projects or were claimed in a subsequent year. However, the Armada ruling becomes somewhat less relevant if the professional services performed are rendered in the same fiscal period as the R&D work being claimed and the amount of those fees are paid out within 180 days of the fiscal period end-date.

Conclusions and Recommendations...

There is still no definitive position on claiming professional service fees incurred in preparing SR&ED claims. There seems to be lots of “wiggle room” for both CRA and taxpayers in either direction. We think CRA will review claims for SR&ED preparation fees on a case-by-case basis. While we cannot say how they will react to any specific claim, here are some things that might help slant things in your favour if you do decide to claim preparation fees:

- > Use the traditional overhead method. Cite Application Policy 96-06 as grounds.
- > Get separate invoices for engineering / technical writing services. Avoid claiming legal / accounting fees.
- > Have the professional services rendered in the same time frame as the claimed R&D projects.
- > Claim the professional services fees in the fiscal year in which they are actually rendered; i.e. don't claim the cost of preparing the FY 2006 SR&ED claim in FY 2007.
- > Ensure that the fees are paid-out; i.e. cheque written; within 180 days of the fiscal year end date.

Learn More...

- > Tax Court Canada docket # 2005-4039(IT), Armada Equipment Corporation and Her Majesty The Queen
<http://decision.tcc-cci.gc.ca/en/2006/2007tcc260/2007tcc260.html>
- > CRA Application Policy #96-06
<http://www.cra-arc.gc.ca/taxcredit/sred/publications/sr9606-e.html>

For more information on this topic, contact:

David R. Hearn, Managing Director, Scitax Advisory Partners
(416) 350-1214 or dhearn@scitax.com

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.



Directors

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

Scitax Advisory Partners LP

TD Centre, 77 King Street West, Suite 2401, Toronto | 416-350-1214 | www.scitax.com

Disclaimer

This bulletin is provided as a free service to clients and friends of Scitax Advisory Partners and Cadesky and Associates. The content is believed to be accurate and reliable as of the date it is written, but is not a substitute for qualified professional advice.

© Copyright Scitax Advisory Partners LP, 2009. All rights reserved. "Scitax" is a trade-mark of Scitax Advisory Partners LP.