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CRA to Release New T661

Significant Changes in SR&ED Filing Requirements Expected

We're ready for them. Are you?

Over the last six months, Canada Revenue Agency has been revealing bits and pieces of a new SR&ED claim filing process. On the surface, the main effect of this new initiative seems to be a new form T661. However, the effect will be much more than just a new form – it will mean significant adjustment in how claims are filed. Beyond the new T661 and its implications, there are more subtle changes – mostly linked to provincial harmonization – that could have a significant effect on when you get your refund cheques.

You can skip to the “Recommendations” section at the end of this bulletin if you want the “bottom line” first.

Depending on exactly how and when this process is implemented; it is presently slated to begin in the spring of 2009 for year ends starting in January 2009; it could mean a major administrative backlog. Given that Director General Helene Dompierre, along with a long list of other SR&ED directorate dignitaries, are named to attend the 12th Annual Ontario Region SR&ED Practitioner Meeting on 14-Jan-2009, it is possible that CRA will use the occasion to formally unveil the new T661.

CRA has been showing samples of the new T661 at various stakeholder meetings over the last six weeks or so. We have attended most of these meetings and what we report here is based on what we have seen.

Be warned that details could change before the final version comes out. But one thing is certain: your 2009 SR&ED claim will look a lot different than your 2008. Our purpose here is not so much to document the new form, but rather to give advance warning of how the changes will affect you.

It is worth noting that other than the 2008 federal, Ontario and Quebec budgets; all of which boosted cash benefits for CCPCs; there have been no changes to the SR&ED aspects of the Income Tax Act; i.e. the definition of eligible R&D expenditures. Neither have the associated rules been changed.

So What's Changed?

In summary we see the following imminent changes to the SR&ED process within the next 12 months:

1. There will be no stand-alone “technical submission document”. Instead, SR&ED projects will be fully described on the T661 itself. Furthermore, the current practice of reporting on the 20 largest projects, has been superseded by a requirement to fully describe all projects.
2. Each project must be classified in a field of science or technology by means of a 5-digit-code with the syntax X.XX.XX. The T661 guide lists approximately 175 such codes under four major fields: Natural and Formal Sciences, Engineering and Technology, Medical and Health Sciences and Agricultural Sciences.
3. There will be a strict limit on the number of words that can be used to describe each project. While the number of words is sure to be a moving target before final release, the present limit is in the range of 1,500 words.
4. Project descriptions are text only. At this point the new T661 has no provision for diagrams, charts or photographs of any type. This is somewhat surprising given that diagrams ARE the language of science and technology.
5. The names of the three “key” employees whose wages are claimed in the project; presumably the leaders; must be given at line 260. Of even greater interest is line 261, where the qualifications of these people; e.g. university degree, diploma etc.; must be given. While this does not necessarily mean that persons without such qualifications will be excluded from SR&ED claims, it does signal that CRA might be considering using academic qualifications in its project pre-screening criteria.
6. At lines 253 to 259, the person; be it employee or external consultant; who prepared the claim, must be named.
7. The ever-contentious matter of contract payments gets its own set of screening flags: You must fill in Line 266, to state if you received payment for the claimed SR&ED work. Lines 267 through 269 identify any subcontractors that you paid to perform SR&ED work for you. There is also a requirement; in the guide and on the T661; that the taxpayer have contract documents including a statement of work at hand, in the event of a “detailed review”; i.e. audit.
8. Given the limited word count and exclusion of diagrams, there will be a substantially greater requirement for compliance and record keeping. CRA has made it clear that more claims will be audited and that more auditors; \$10 million worth to be exact; will be hired to do it. At lines 270 to 282, the new T661 includes a section specifically devoted to indicating what kind of “evidence” is available to substantiate the claim.
9. As a result of the harmonization of federal and provincial tax systems, Ontario SR&ED claimants will not get SR&ED benefit cheques until all tax filings are current. This means that even if your FY2007 SR&ED has been accepted, all expenditures allowed and a notice of assessment issued, CRA will not release your cheque until your subsequent year’s tax returns; i.e. FY 2008; are filed and your remittances; EHT, Ontario Capital Tax, GST etc.; are fully paid. Although implementation of this requirement seems to vary somewhat by region, we are already seeing the effects.

What's behind all this?

The existing practice of separate technical submission documents, each prepared in its own peculiar fashion; some five pages, some two hundred pages; is simply too non-standard to be administered efficiently. While separate technical submission documents were workable in the early days when the SR&ED program was under-subscribed, it is too unwieldy now that the number of claims has increased exponentially. Some form of standardization was required to manage the workload, particularly in large CTSO's such as Toronto and Mississauga.

Similarly, CRA needs to control its internal labour costs and improve its file-clearance time. Paying CRA science reviewers to read through hundreds of pages of wandering technical narrative is just too costly. File-clearance time; i.e. time to process a claim; is one of the primary metrics by which CRA management and government auditors benchmark CRA's performance as an organization. Central processing, or at least a method of triaging claims, is also triggering the changes.

Traditionally, SR&ED claims were forwarded to the local CTSO assessment. As the number of claims grew, there were various moves towards a more centralized approach. The new T661 is far more structured with features such as tick boxes, etc., that facilitate much more extensive profiling and pre-screening at regional taxation centres; for example, Sudbury. Presenting the claim in this new highly-structured manner, will make the whole SR&ED screening and review process far more amenable to full scale "industrialization"; complete with standard procedures, quality control and continuous improvement initiatives.

The move to centralized processing should mean more consistent and uniform application of the rules across the country. Hopefully, this will eliminate the extraordinary variances in the interpretation of SR&ED eligibility criteria, which are seen far too often in different parts of the country.

Finally, electronic filing and processing is about to be implemented. There are two aspects to this: Not only will claimants be able to file SR&ED submissions electronically with the rest of the tax return document, but CRA will be able to automate both its internal workflow and certain aspects of the claim pre-screening process; e.g. flagging project descriptions that contain certain key words or phrases. In fact, given the highly structured and consistent format, CRA may be working toward automated screening by means of artificial intelligence.

Recommendations:

1. If your year end date falls in the first half of the year; i.e. January through June 2009; mark the implementation date for the new T661, so that you file your SR&ED claim correctly and in plenty of time. You will probably need to allow extra time to gather information and prepare the project technical descriptions. It is likely that most accounting firms, and even some SR&ED consultants, will be caught by the magnitude of these changes. The good ones will cope but there will be delays in adjusting. Finally, CRA itself might run into some glitches as they roll out this process and re-organize their human resources to cope with it. The glitches could delay claim processing and lead to prolonged audits.

2. Plan your tax affairs so that more of the expected SR&ED benefit is absorbed to reduce taxes payable at year end, so as to reduce dependence on the refund cheque. Otherwise the refund cheque could be delayed twelve months or more while you get your filings current.
3. Because of the new screening flags for incoming and outgoing contract payments, in addition to the requirement to have a “statement of work”; it is now more important than ever, to have formal written contracts for all transactions; buying or selling. You do not always know which ones will be included in your SR&ED claim.
4. Implement a time tracking system: Do not wait until the end of the year to identify the projects and write the story. Define a list of projects and then map out the associated activities in real-time throughout the year. Log the time entries using a project management coding system.
5. Assemble a database of qualifications; degree, institution, year graduated etc.; for all employees likely to be engaged in SR&ED activity. It is worth noting that “qualifications” need not necessarily be limited to university degrees; technicians and skilled trades personnel also carry designations worth recording. It would be preferable if you could tie the qualifications into the time tracking system.
6. Implement a document management system: Use your corporate server as a repository to store and organize specific documents that evidence SR&ED work. Set up the document management system to store and organize documents using the same project management coding used for time tracking.

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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