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## **SR&ED Newsletter** **Edition 2011-2**

Welcome to the second 2011 edition of our newsletter regarding recent developments to Scientific Research and Experimental Development (SR&ED) project management and tax credit claims.

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## Recent SR&ED tax cases & related issue(s)

The past year has witnessed a release of a variety of smaller cases. The main issues and potential implications are outlined in the following pages. Copies of the judgments are available from the Tax Court of Canada's website.<sup>1</sup>

### Jentel – Illustrating “Technological Advancement” - lose<sup>2</sup>

#### Facts:

The appellant (Jentel) develops and manufactures engineered thermoformed plastic products.

In previous fiscal years, Jentel had developed Multi-Bins, a small-parts storage system.

The SR&ED work in question aimed to improve the existing product with respect to: size, weight, load, modularity & fastening methods.

Jentel grouped the work into four SR&ED “activities”:

- a. Bin Front and Back Panels
  - a. Tested “various” molding conditions
  - b. using 8 different plastic materials then
  - c. tested 2 plastics re. thickness vs. strength
- b. Stands
  - a. Built prototypes using combinations of wood, plastic & aluminum
  - b. Load tests showed aluminum best
- c. Sliders
  - a. tested “various” shapes and forms of sliders.
  - b. none worked satisfactorily
- d. Dividers
  - a. performed tests to mold a groove in the front panel
  - b. Including 3 molds,
  - c. each of different casting material &
  - d. “many” different groove designs
  - e. all failed to meet consistency

In respect to this work both sides agreed that,

- “contemporaneous records of this work were kept &
- the work was performed in a systematic manner.”

#### Issue(s):

Whether the work constituted SR&ED, as that term is defined in subsection 248(1) of the *Income Tax Act* (the “Act”).

The CRA argued that the,  
“Appellant failed to demonstrate a systematic investigation through experiment or analysis performed to **resolve any scientific or technical uncertainties.**”

#### Relevant legislation

##### Income tax act

**SR&ED** is defined for income tax purposes<sup>3</sup>, as follows:

“**scientific research and experimental development** means **systematic investigation** or search that is carried out **in a field of science or technology by means of experiment or analysis and** that is

(a) **basic research...**,

(b) **applied research... or**

(c) **experimental development**, namely, work undertaken **for the purpose of achieving technological advancement** for the purpose of **creating new, or improving existing,** materials, devices, **products or processes**, including incremental improvements thereto...”

#### Case law:

**1) CW Agencies:** In this case the judged noted,

“Five criteria have been used by the Courts to assist in determining whether a particular activity constitutes SR&ED ... (in **C.W Agencies**) summarized as follows<sup>4</sup>:

1. Was there a **technological risk or uncertainty** which could not be removed by routine engineering or standard procedures?

2. Did the person claiming to be doing SRED formulate **hypotheses** specifically aimed at reducing or eliminating that technological uncertainty?

3. Did the procedure adopted accord with the total discipline of the scientific method including the formulation **testing and modification of hypotheses?**

<sup>1</sup> Tax Court of Canada website [www.tcc-cci.gc.ca]

<sup>2</sup> JENTEL MANUFACTURING LTD.,  
V. THE QUEEN, 2011 TCC 261

<sup>3</sup> in subsection 248(1) of the Act

<sup>4</sup> Federal Court of Appeal in *C.W. Agencies Inc. v. The Queen*, 2001 FCA 393, 2002, DTC 6740, paragraph 17

4. Did the process result in a **technological advancement**?

5. Was a detailed **record of the hypotheses tested**, and results kept as the work progressed?

2) **Northwest Hydraulic**: “In discussing whether a **technological risk or uncertainty** existed, Justice Bowman (as he then was) noted the following in the **Northwest Hydraulic** decision at paragraph 16:

a. Implicit in the term “technological risk or uncertainty” in this context is the requirement that it be a type of uncertainty that **cannot be removed by routine engineering or standard procedures** ... If the resolution of the problem is **reasonably predictable** using standard procedure or routine engineering there is no technological uncertainty as used in this context.

b. What is “routine engineering”? It is this question, (as well as that relating to technological advancement) that appears to have divided the experts more than any other. Briefly it **describes techniques, procedures and data** that are **generally accessible to competent** professionals in the field.

### Analysis:

Having reviewed the;

- evidence provided by the appellant vs.
- the clear **requirement to illustrate “hypotheses”**
- the judge cited the obvious weaknesses
- the **claimant provided RESULTS (i.e. what worked)**
- rather than **CONCLUSIONS (i.e. why this worked better than the other options)**

### Ruling & rationale:

In this case the judge concluded,

“The argument fails for the simple reason that the **Appellant did not establish** a *prima facie* case that it was **attempting technological advancement.**”

### Implications and author’s commentary

We hate to say we told you so but our [SR&ED newsletter 2010-2 \(Technological Advancement Edition\)](#) outlined

- exactly how this scenario would unfold
- if/when the claimant omits ANY of the **5 criteria**,
- forming the basis of **“technological advancement.”**

We propose that;

- typically several specific performance objectives
- will “stack up” to create technology objectives
- that require we put forward hypotheses as to
- the “key variables” effecting the outcome.

Perhaps this case lacked sufficient technical specificity?

### **Resources NOT cited:**

CRA’s “Plastics Guidance Document” provides 18 examples of “eligible projects” within the, Plastics Materials, Processing, Equipment & Tool Making industries.

In the author’s opinion this paper provided multiple examples of “hypotheses” which represent “valid” technological uncertainties with this or similar fields of technology.

### **Re-Write- how this project MIGHT have qualified**

Using these examples & concepts we have taken the facts provided in the case and outlined this project under 2 scenarios ( **next page**):

- 1) A **failing application** (i.e. as viewed by the judge) &
- 2) **Recast to eligibility** by illustrating,
  - **“technological advancement” including,**
  - **“hypotheses and conclusions.”**




### **Notable quote:**

**“If it can't be expressed in figures, it is not science; it is opinion.”**

**- Lazarus Long / Robert Heinlein**

**Table 1 - Jentel – “What if?” = eligibility**

**Jentel - revisited using the RDBASE.NET suggested SR&ED project description structure**

	<u>ELIGIBILITY: WHAT IF:?</u>	<u>Negative indicators</u>	<u>Positive indicators of eligibility</u>
<b>I</b> 	<b><u>PROJECT OBJECTIVE BEYOND STANDARD PRACTICE: (THINKING OUTSIDE THE BOX)</u></b>		
i)	<u>Benchmarking Existing technology: sources</u>	Relled on verbal representations of the company's owner regarding the state of existing technology.	Provided specific <b>evidence of known technology limits</b> via: articles, competitive products, expert opinions, patent searches, prior in house failures, blogs, etc.
ii)	<u>Objective(s)</u>	Testing of known plastic characteristics vs. known production techniques	Ideally we would provide <b>quantified objectives</b> such as cost, strength, weight, tolerances, failure rates.... which " <b>stack up</b> " to require " <b>experimentation</b> " in areas beyond "standard practice" (such as); 1) different configurations on measured structural integrity, 2) effects of plastic melting process conditions, 3) additive reagents &/or 4) modifying extrusion/forming techniques on produced plastic physico-chemical characteristics.
<b>II</b> 	<b><u>TECHNOLOGICAL UNCERTAINTIES</u></b>	No alteration of process or formulations = comparative assessment of knowns	a " <b>matrix</b> " of <b>variables (parameters)</b> were identified for testing under different described conditions. <b>HYPOTHESES</b> = can we improve the existing predictive model for effects re: altered <b>temperature of melt, mix time, order of reagent addition, type of reagents, rate of cooling, etc.</b> influence on measured final plastic characteristics/parameters.
<b>III</b> 	<b><u>EXPERIMENTATION (SYSTEMATIC INVESTIGATION)</u></b>	Focus on <b>RESULTS</b> (What happened?) <b>INSTEAD of CONCLUSIONS</b> (Why it happened?)	Provide evidence of " <b>testing or analysis</b> " to resolve <b>ANY</b> of the stated <b>VARIABLES of "technological uncertainty."</b>
<b>Jentel grouped the work into four SR&amp;ED “activities”: we have reproduced the first 2</b>			
	<b><u>1) Bin Front and Back Panels</u></b>	No alternate designs contemplated	<b>Analyzed or tested</b> effects of differing part geometries and structures on overall performance
	a. Tested “various” molding conditions	Tried the 3 methods used on other similar parts without understanding WHY they performed differently	<b>178 samples tested</b> to examine how the plastic melting process could be modified to optimize the combination of backpressure, altered max temperature, temperature profile in relation to mix time, mix speed, uniformity of the resin, melt & fibre distributions, order of reagent addition, etc. then <b>CONCLUDED why one better</b> (e.g. hi temp melt fibres proved optimal but only if we held max temp to 300 Deg C and increased mix time by 40% to ensure adequate fibre distribution)
	b. using 8 different plastic materials then	Used 8 different sheets without understanding WHY each performed differently	<b>Identified, analyzed or tested</b> expected causes of performance differences: e.g.. Viscosity, rheology, ...etc. A <b>CONCLUSION</b> would also help but it is <b>NOT</b> necessary to have on <b>EVERY</b> activity.
	c. tested 2 plastics re. thickness vs. strength	Testing to provide a "result" (e.g.. Plastic 1 is better) vs. a conclusion (i.e. why it's better)	<b>Analyzed or tested</b> thickness vs. strength vs. variables in the part design above for example: extrusion temperature, cooling time, humidity effects on embrittlement, flex or other characteristics (system uncertainty). <b>CONCLUDED</b> why one better (e.g. HDPE sample proved effective but required 17% more cooling time in order to maintain flex. We attribute this to a combination of the molding pressure and chemical effects of a new resin.)
	<b><u>2) Stands</u></b>		
	a. Built prototypes using combinations of wood, plastic & aluminum	Did mock-ups without a test matrix of alternatives & "extremely accurate measurements"	<b>Analyzed or tested</b> effects of differing part geometries (shape of parts, angles, thicknesses) vs. materials (specify gauges of metal, etc.) & fastening methods (clamping, adhesives, snap fit, ...)
	b. Load tests showed aluminum best	"load bearing strength" the only measured parameter	<b>Concluded</b> that a combination of 10 gauge polished aluminum had the optimum rigidity to support our newly designed plastic insert while maintaining price and load requirements.

## Responsible “SR&ED”- preparers & journalists

Recently the CRA identified the **an increase in ineligible claims** which it attributed largely to a recent appearance of a **new type of “rogue” SR&ED consultants** who urge ineligible clients to attempt SR&ED claims.

This was detailed in our prior [SR&ED Newsletter 2011-1](#) (page 9).

To further “sensationalize” this issue **the Globe and Mail** ran an article entitled, [Flawed R&D scheme costs taxpayers billions](#)<sup>5</sup> which, **in the author’s opinion**,

- a) Provided examples of specific (inappropriate) practices used by one of these Rogue consultants
- b) presented “opinions” which may mislead readers.

### Globe & Mail issue #1 - % of cost paid to consultants

The article stated,

“This year, **Ottawa and the provinces will dispense \$4.7-billion** to more than 20,000 Canadian companies.

**But a third or more of that cash is being wasted and paid to consultants** as a result of hazy rules on what’s legitimate R&D and limited government auditing resources,

**according to dozens of interviews** with consultants, claimants and government officials.”

### Notable quote:

**“Some people change their ways when they see the light; others when they feel the heat.”**

**- Caroline Schoeder**

### Additional sources of information:

Statistics on Compliance costs<sup>6</sup>;

A 1996 survey conducted by Industry Canada<sup>7</sup> (reproduced in table 2 below) quoted “total compliance” costs ranging from 30% for small firms to <1% for large firms.

An additional report from the OECD quoted “total compliance” costs ranging from 15% for small companies to less than 7% for larger companies.

**Table 2: Compliance Cost % of SR&ED Claim**

\$ Claimed	Cost as a % of Claim	
	Mean	Median
<\$200K	29.50%	14.60%
\$200K-\$1M	4.30%	2.90%
\$1-10M	2.80%	2.10%
>\$10M	0.90%	0.70%
All firms	9.10%	2.80%

### Author’s commentary:

The majority of SR&ED funds is paid to about 4,000 of the 20,000 total claimants. These represent “large” claimants who qualify for a 20% federal credit.

In the author’s experience these large and relatively sophisticated companies are unlikely to spend more than 5% of the credits received in consulting or compliance fees.

Consulting Fees of 30+% may exist in the “Qualified CCPC” market but, as illustrated by the chart below, this represents less than 1/3 of the total government tax \$ invested each year.

As a result the **author proposes the claim that 1/3 of the \$4.7 billion “wasted on consultants” somewhat dubious.**

It would be interesting to evaluate the sources of this information including how many “large claimants” were included in their sample.

<sup>5</sup> Globe & Mail, March 11, 2011 Link to article: <http://www.theglobeandmail.com/report-on-business/flawed-rd-scheme-costs-taxpayers-billions/article1939418/>

<sup>6</sup> [www.ic.gc.ca/eic/site/eas-aes.nsf/vwapj/wp06e.pdf/\\$FILE/wp06e.pdf](http://www.ic.gc.ca/eic/site/eas-aes.nsf/vwapj/wp06e.pdf/$FILE/wp06e.pdf)

*Canadian Tax Journal* 1996 Vol. 43, No. 6

<sup>7</sup> MEASURING THE COMPLIANCE COST OF TAX EXPENDITURES: THE CASE OF RESEARCH AND DEVELOPMENT INCENTIVES, Industry Canada, 2006

**Table 3: Companies claiming SR&ED credits<sup>8</sup>**

	Credits Earned by Rate			By Number of Corporations			
	By Value of Credits - \$ millions			By Number of Corporations			
	Earned at 35% rate	Earned at 20% rate	Total credits earned	Earning at 35% rate	Earning at 20% rate	Earning Both 35% & 20% rates	Total corporations earning credits
2002	865	2,397	3,262	11,603	4,133	325	16,061
2003	954	2,238	3,193	13,418	4,309	339	18,066
2004	1,083	2,271	3,354	15,295	4,051	339	19,685

**Table 4: Comparing R&D funding by country<sup>2</sup>**

If we want to make a rough comparison of Canada's funding vs. other industrialized countries we can use a ration named the "Beta Index" ( B-Index).

It is calculated as:

the After Tax Cost of \$1 of R&D / (1- the tax rate)

Simply stated the:

B-Index = before-tax income needed to break even on one dollar of R&D outlay.

The lower the B-Index the more favorable it is for a company to perform R&D in a particular country.

As we can see from this comparative Canada does in fact have one of the lowest B-Indices however, **many countries provide other "direct" funding** instead of "tax incentives."

The OECD report provides a further comparison of the total % of "business expenditures on research & development" (BERD) which are financed by the government.

This table (Table 5 – figure 1) indicates that the Canadian government finances approximately 4% of total business research whereas most other countries are significantly higher (e.g France, US & UK are all >10%).

As a result it appears that the Canadian government is not nearly as generous as other countries in funding SR&ED. Despite this fact the SR&ED credit appears to have created a scenario where a smaller amount of funding is in fact creating a significant amount of SR&ED.

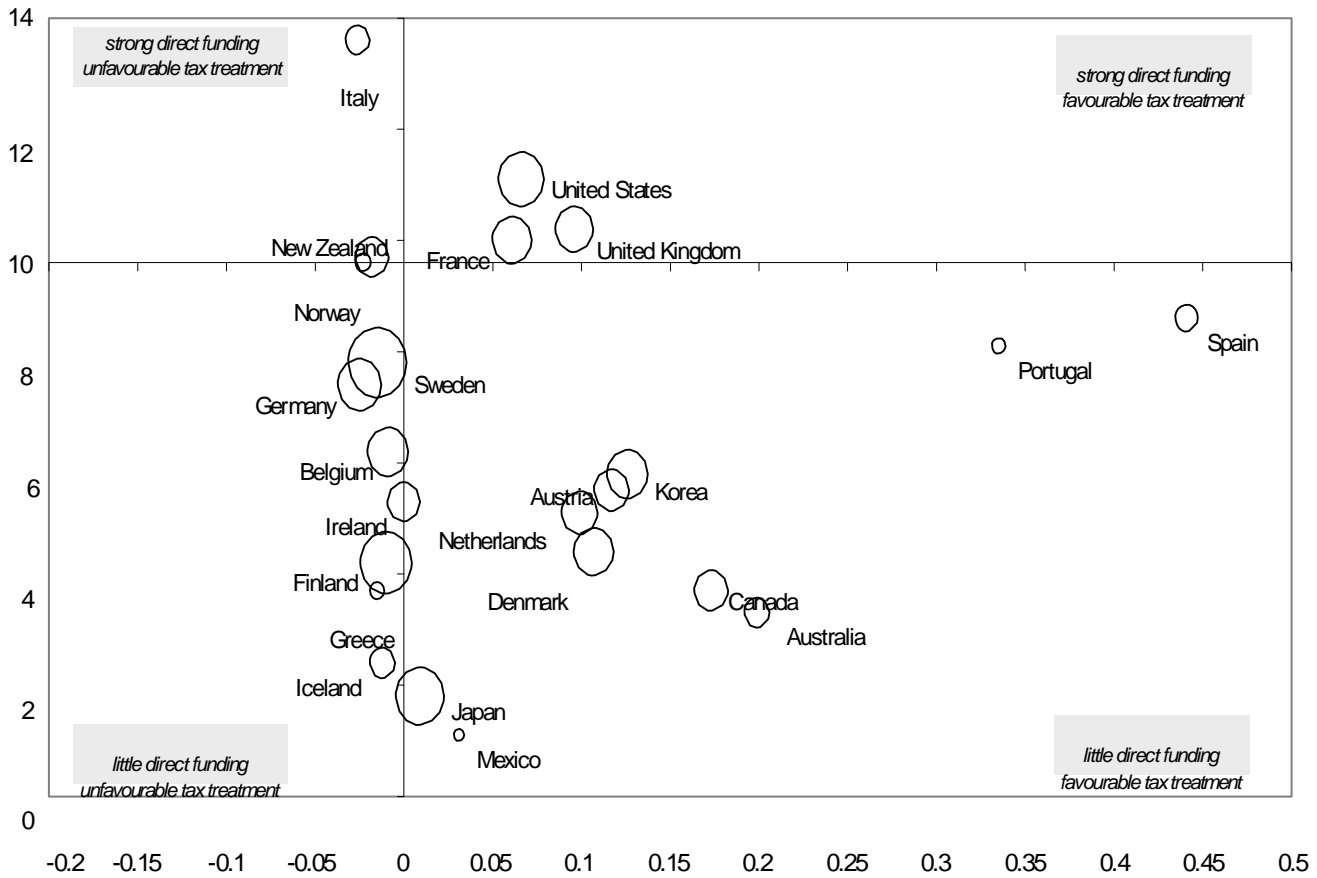
Comparing the value of B-indexes 2002		
(manufacturing companies, by country)		
Country	Large company	Small company
Australia	0.801	0.801
Austria	0.875	0.875
Belgium	1.009	1.006
<b>Canada</b>	<b>0.827</b>	<b>0.678</b>
Denmark	0.893	0.893
Finland	1.01	1.01
France	0.939	0.939
Germany	1.025	1.025
Greece	1.015	1.015
Iceland	1.012	1.012
Ireland	1	1
Italy	1.026	0.557
Japan	0.991	0.879
Korea	0.874	0.821
Mexico	0.969	0.969
Netherlands	0.901	0.647
New Zealand	1.023	1.023
Norway	1.018	0.768
Portugal	0.665	0.665
Spain	0.559	0.559
Sweden	1.015	1.015
Switzerland	1.01	1.01
United Kingdom	0.904	0.894
United States	0.934	0.934

<sup>8</sup> Tax Incentives for Scientific Research and Experimental Development, October 2007 consultation Paper, Department of Finance Canada

<sup>9</sup> TAX INCENTIVES FOR RESEARCH AND DEVELOPMENT: TRENDS AND ISSUES, OECD, 2002

**Table 5 - Direct and indirect government funding of business (OECD)**

Percentage of BERD financed by government, 2000 or latest year



**Relative generosity of tax treatment (1 - B-index)**

**Notes:**

The size of the bubble indicates the ratio BERD/DPI

B-Index = before-tax income needed to break even on one dollar of R&D outlay;

BERD = business expenditures on research and development ;

DPI = business value-added. Source: OECD.

**Notable quote:**

**“If it can't be expressed in figures, it is not science; it is opinion.”**

**- Lazarus Long / Robert Heinlein**

## Issue #2 – net “benefits” for every \$ of taxes

The Globe Article stated,

“The result, experts said, is that Canadian taxpayers are spending billions on a **program that too often delivers little or no new R&D...**

In fact, the government's own studies have found the program **generates almost no economic benefits.**”

### Additional sources of information:

#### ‘1) Canadian Department of Finance

Finance Canada estimates for every dollar of assistance provided via the SR&ED ITC, there is a net economic gain of 11 cents.<sup>10</sup>

Thus, with about \$3.4 billion in assistance provided each year, the annual net economic gain is about \$370 million.

#### ‘2) In its report, the European Commission concluded,

- “One can say with some caution that fiscal incentives stimulate business R&D.
- It is difficult to evaluate the amount of additional R&D per unit of forgone public revenue.
- Evaluations show a positive, but moderate, level of additionality
- Additional potential R&D spillovers would strengthen the positive impact of any tax credit”

#### ‘3) In the 2002 report by the OECD<sup>11</sup> stated,

- “Depending on national circumstances, R&D tax incentives can be an effective instrument for inducing a certain degree of private sector research.
- Studies show that, depending on their design, tax incentives can **increase private research spending by an amount equal to the loss in tax revenue** on average.
- Most studies also find that **social returns to such R&D far outweigh private returns.**

<sup>10</sup> Parsons, Mark and Nicholas Phillips. “An Evaluation of the Federal Tax Credit for Scientific Research and Experimental Development.” *Department of Finance Working Paper 2007-08*. September 2007.

<sup>11</sup> OECD, *Tax Incentives for Research and Development: Trends and Issues* (2002) 25 (“OECD 2002 Report”); available at: <http://www.oecd.org/dataoecd/12/27/2498389.pdf>.

According to the 2006 OECD report, “Econometric studies find that;

- **social rates of return to R&D**
- **can be up to five times higher**
- **than private rates** of return..

The report sites these **social “spillovers”** of value since;

- ideas once produced,
- can diffuse widely and be used by
- other firms, industries & countries.

**Table 6: Comparing R&D payback per tax \$<sup>12</sup>**

OECD summary: Effectiveness of R&D Tax Credits			
Study	Estimated Elasticity of R&D to Tax Credit	Period of Analysis	Country
Australian Bureau of Industry Economics (1993)	-1	1984-94	Australia
McFetridge and Warda (1983)	-0.6	1962-82	Canada
Mansfield and Switzer (1985)	-0.04 to -0.18	1980-83	Canada
Bernstein (1986)	-0.13	1981-88	Canada
Bernstein (1996)	-0.14 (short run) -0.3 (long run)	1964-92	Canada
Mansfield (1986)	-0.35	1981-83	United States
Berger (1983)	-1.0 to -1.5	1981-88	United States
Bally and Lawrence (1987, 1992)	-0.75	1981-89	United States
Hall (1993)	-1.0 to -1.5	1981-91	United States
McCutchen (1993)	-0.28 to -1.07	1982-85	United States
Hines (1993)	-0.28 to -1.07	1984-89	United States
Nadri and Mamuneaus (1996)	-0.95 to -1.0	1966-88	United States
Bloom, Griffith and Van Reemen (1999)	-0.16 (short run) -1.1 (long run)	1979-94	G7 and Australia

#### Author’s commentary:

Though the Canadian government funding seems to represent a larger proportion of “tax credits” vs. other incentives, **MOST other countries provide other forms of “incentive” specifically for R&D (tables 4 & 5).**

Even though the studies show that there is approximately

- “**equal” economic payback** of tax \$ invested (**table 6**)
- in direct tax revenues **BUT**
- **another 500% social return** on this investment by way of “spillovers!”

Mathematically speaking the “full picture” **indicates up to 600% (economic + social) return of every tax \$ invested.**

<sup>12</sup> Ibid OECD 2002

### Issue #3 – that certain industries don’t advance technology & others automatically do

- a) Could food & material sciences involve “technological advancement?”

The Globe Article stated,

“Money is often paid out to decidedly low-tech and routine manufacturing, such as

- baking gluten-free cake,
- making injection-moulded auto parts or
- growing potted roses.”

Author’s commentary:

The Canada Revenue Agency has in fact

- [published sector-specific guides](#)
- containing examples of eligible work
- for EACH of these industries
- **because they may conduct eligible work.**

#### Notable quote:

**“The essence of science: ask an impertinent question, and you are on the way to a pertinent answer.”**

**- Jacob Bronowski**

- b) Do other industries automatically qualify for “technological advancement?”

The Globe Article stated,

“Toronto-based iSkin Inc., which developed antimicrobial covers and wireless accessories for iPads and iPhones, recently ran into the CRA's get-tough policy.

The company applied for \$1.8-million in tax credits, but was **rejected** after an audit on the grounds that its work amounted to **routine engineering**.

"The act is vague to begin with, and interpretive," complained Ron Juliani, iSkin's **director of business** affairs. "One company can get approved for something minor, while another like us, is summarily dismissed ... We should be the poster child for R&D, yet we're punished for it."

There seems to be a "**mandate from the top**" to **reduce the number of claims**, whether they're legitimate or not, Mr. Juliani said.”

Author’s commentary:

A number of companies assume that they “automatically qualify” due to the industry they are in.

In the article above we have an opinion from the “**director of business development**” that the system is “unfair.”

The author would be much more convinced if, **instead** the company provided representations from the “**director of research**” providing examples of specific technological **hypotheses** or advancements.

The author proposes that this company’s SR&ED submission likely contained weaknesses similar to those illustrated in the Jentel case (earlier in this newsletter).

In the author’s experience the **CRA**;

- **reviews** are based on **objective criteria &**
- **do not** attempt to reduce legitimate claims.

## Issue #4 – that CRA risk controls aren't working

The Globe Article stated,

“The result is that CRA is rubber stamping large volumes of smaller claims that look legitimate because more thorough reviews are too costly and time consuming.

Meanwhile, many larger claims are being arbitrarily scaled back or rejected.”

### Author's commentary:

In the author's experience the CRA risk criteria are effective at isolating the companies who do NOT meet the eligibility criteria.

While some of the smaller claims may require less detail the review criteria appears to be consistent.

## Issue #5 – alternatives to refundable credits

The Globe Article stated,

“Mr. Hearn of Scitax suggested that **a better alternative to refundable credits for all companies would be a flow-through share scheme**, similar to those currently offered in the mining and resource sector.”

### Author's commentary:

While the author does NOT claim to be an economist we propose that the following table provides a basic summary of the political and economic question to be addressed.

It summarized the pros & cons of;

- fiscal incentives (tax credits) vs.
- direct financial support (R&D grants),

reproduced as Table5.

**Table 5: Comparative R&D funding measures**<sup>13</sup>

<b>Direct Financial Support (Grants)</b>	<b>Fiscal Incentives (tax credits)</b>
More targeted	More neutral
- Social return >>> Private return	- Business knows better
	- Avoid picking winners
	- Market friendly
Better budget control	More predictable for
	Wider reach
	Administrative cost can be very low
	More accessible

### Notable quote:

**“Celebrate what you want to see more of.”**

**- Tom Peters**

<sup>13</sup> B Van Pottelsberghe, S Nysten and E Megally, *Evaluation of Current Fiscal Incentives for Business R & D in Belgium* (Working Paper; Solvay Business School; Universite Libre de Bruxelles; 2003); available at: <http://www.belspo.be/belspo/stat/rap/fiscRDJune03.pdf>

## Recent CRA pronouncements

During 2011 the CRA release a series of 4 DRAFT policy papers.

- Salary & wages
- Capital equipment
- Leases &
- Shared use equipment

In the author's opinion these papers do not contain any significant changes. They do however, illustrate or clarify a few concepts which are worth highlighting.

### SR&ED Lease Expenditures Policy – draft<sup>14</sup>

#### 3.5 Meaning of “building”

**Building** is a broad term covering any structure with walls and a roof affording protection and shelter that is affixed to the land. For example, a mobile home would be considered a building if the wheels, the trailer hitch, brakes and emergency lights are removed and the unit is **affixed to cement pads on the ground and services**, such as hydro and water, are installed.

**Portable shelters** such as housing, office and other service units are regarded as buildings if they are **installed and intended to remain** in a particular location.

Property that is **attached to a building**, however firmly, is included in capital cost allowance (CCA) Class 8 if it is acquired exclusively for those purposes stated in CCA Class 8.

For example,

Concrete footings, foundations and structural steel exclusively for the support of machinery are regarded as CCA Class 8 property.

Stairs and platforms, the sole purpose of which is to provide access to machinery, also fall within CCA Class 8, whether they are attached to the building or the machinery.

#### **Bandwidth allowed as lease of equipment under proxy method<sup>15</sup>**

It may be difficult to determine whether the lease of **bandwidth is an overhead** expenditure covered by the proxy amount **or the lease of equipment**.

The Tax Court of Canada dealt with a similar issue in the case of *Data Kinetics*. In this case the claimant used the proxy method to calculate its SR&ED expenditures and included the cost to lease a dedicated telephone line and a mainframe located outside of Canada.

The Judge concluded that the amount represented the lease of equipment.

Applying the principles asserted in *Data Kinetics*, the cost associated with bandwidth would be allowed as a lease of equipment under the proxy method because it was dedicated for SR&ED.

#### Author's commentary:

Based on a quick read of this information it appears there may be **opportunities** to claim;

- **Structural costs related to SR&ED machinery &**
- **“leases” for bandwidth**

which may not have been claimed previously.

#### Notable quote:

**“I have made this letter longer than usual, only because I have not had the time to make it shorter.”**

**- Blaise Pascal**

<sup>14</sup> SR&ED Lease Expenditures Policy – draft released Mar 19, 2011

<sup>15</sup> Paragraph 4.3.1

## Questions or feedback

We welcome your questions or feedback on any issues raised in this letter.

We also encourage interested parties to examine:

- past SR&ED newsletters &
- our SR&ED tax guide [the Guide to R&D Base],

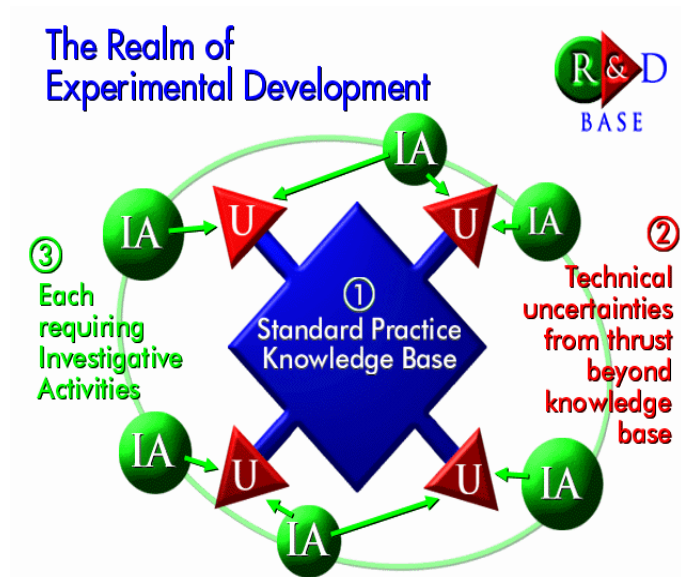
all of which are designed to simplify the SR&ED tax credit claims. These are available from our website at,

## [www.meuk.net](http://www.meuk.net)

- For an overview of our “R&D Base” software &
- additional tutorials defining eligible SR&ED activities,

please go to:

## [www.rdbase.net](http://www.rdbase.net)



## Terms of use

Although we endeavor to ensure accurate and timely information throughout this letter, it is not intended to be a definitive analysis of the legislation, nor a substitute for professional advice. Before implementing decisions based on this information, readers are encouraged to seek professional advice, in order to clarify how any issues discussed herein, may relate to their specific situations.

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