

Minutes of discussions
for Hamilton Region SR&ED Practitioners' meeting (Sept 16/10)

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I) Specific issues addressed in the 2010 MEUK SR&ED newsletters¹ as follows:

A) 2010-1 (10 Minutes)

- i) update on status of CRA's SR&ED Tax Ombudsman
- ii) Discussion of how IP affects market value – using SR&ED info. to identify value

B) 2010—2 (15 Minutes)

- i) Meeting CRA criteria of “Technological Advancement”
 - analysis & discussion of required components +
 - practices to capture this information

C) 2010-3 (20 Minutes)

- i) Release of the CRA guide to conducting a technical review
 - discussion of select items and implications to claimants
- ii) Federal Legislative Proposals Status as of June 30, 2010
- iii) Aggressive tax planning - Federal proposals to require new reporting of “contingent fees”

II) SR&ED Changes not details in newsletters above (40 minutes):

- A) Electronic filing – practitioner experiences to date & related strategies
- B) Update on SR&ED financing sources& factoring agents
- C) Other issues as requested by participants &/or SR&ED blogs.
 - a. Latest version of Cantax will only allow seven projects
 - b. Case selection reasons – CRA internal criteria list
 - c. OMDC – inability to claim on failed SR&ED expenses
 - d. CATA – claims that new review manuals = tighter policy
 - e. Sample size – what's appropriate?

¹ These newsletters are available for download at: http://www.meuk.net/Newsletters_and_Publications.aspx

LIST OF ATTENDEES

Hamilton Region SR&ED Practitioners' Workshop Attendees Sept. 16, 2010

<u>Name</u>	<u>Company</u>
Ajay Sinha	SM Financial SR&ED consultants
Alex Murphy	Murphy & Co.
Alex Schiappa	Deloitte
Allan Gordon	Allan Gordon C.A.
Angus Shuttleworth	Collis & Weitzman
Armondo Valeri	
Arne Luik	RDP Associates
Beth Ye	Roth Mosey, CA's
Brian Hartman	R&D Funding Management In.
Brian Kipp	Impact 360
Chris Chang	The De Factor Group Inc.
Danny Ladouceur	R&D ONE INC.
Christine Gribowski	Gribowski and Associates
Chris Chipman	OME Group Consultants Inc.
Darren Drury	Pinnacle Consultants Inc.
David Bodi	The Emphyrean Group Inc.
David Learmonth	MEUK Corporation
David Milne	SRnED Limited
Don Nagle	Novatron Systems
David Williams	Maxim Strategy Consultants
Dorothy Tapley	Arconas Corporation
Edward A. Collis	Collis & Weitzman
Frank Abrams	ZenPeak
Frank Fiasche	BDO
Frank Naccarato	The Emphyrean Group Inc.
Gerry Gribowski	Gribowski and Associates
George Howie	CTC Group
Gautam Shah	Gautam Shah CA
Gordon Kerr	CPG CA's
Glen Dalzell	TCE Capital Corporation
Greg Farrell	BeneFACT
Greg Garland	Pricewaterhouse Coopers LLP
Harjett Rana	SM Financial SR&ED consultants
Isabel Murphy	Murphy & Co.
Jacques Goyette	R&D ONE INC.
James Perly	Perly Consulting
Janna Kantor	HSP
Jay McLean	Pricewaterhouse Coopers LLP
Jay Wigna	Deloitte
Jim Lycett	Odyssey Scientific group
John Sutherland	Deloitte
Karol Shaw	Karol P. Shaw CA
Kris Unni	SB Partners LLP
Kim Ackerman	Impact 360
Kyle Williams	Maxim Strategy Consultants

Hamilton Region SR&ED Practitioners' Workshop
Attendees Sept. 16, 2010

<u>Name</u>	<u>Company</u>
Laura Martin	Business Improvement Group, Inc.
Lokesh	SM Financial SR&ED consultants
Lowell Hendricks	Arconas Corporation
Mahmood Qasmi	Northbridge Consultants
Mark Klingbaum	Klingbaum Barkin LLP
Masood Mahmood	Accsoft Business Solutions, Inc.
Michael Johnlester	Consultant
Mike Panayi	Pinnacle Consultants Inc.
Narayan Ghimire	FlavorChem International Inc.
Neha Tikn	TSI
Nick Rousopoulos	Debra L. Smith C.A.
Pat Murphy	Murphy & Co.
Paul Goode	Arconas
Paul Zalkey	Century Services Inc.
Peter Allen	Xplornet
Peter Wright	Impact 360
Rick Burdeniuk	BeneFACT
Robert Aceti	Robert Aceti CGA, Business Advisory Services
Ron Dorombozi	Consultant
Roy Bilic	Mountain Cable
Ryan	SM Financial SR&ED consultants
Sapna Santdasani	SGI Lighting
Sarmen Khagerian	Maxim Strategy Consultants
Shabir Gova	SGI Lighting
Shari Stolpmann	Beckett Lowden Read, LLP
Simon Francis	Fuller Landau LLP Chartered Accountants & Business Advisors
Stephan Schweighofer	Business Improvement Group, Inc.
Stephanie Cormack	Murphy & Co.
Sudha Correia	Canadian Research Incentives
Thomas Nagel	Novatron Systems
Tim Robertson	SRED Simple
Vinay Khosla	Bateman MacKay, CA's
Vishal Bhandari	Maxim Strategy Consultants
William Murphy	Murphy & Co.
Zak Siddiqui	ZHS.ca
<u>Moderators</u>	
David Sabina	MEUK Corporation
Domenic Innonni	Canada Revenue Agency
TOTAL number of attendees	32

I) Specific issues addressed in the 2010 MEUK SR&ED newsletters as follows:

A more complete discussion of these issues is presented in MEUK SR&ED newsletter 2010-1. This and other issues available at http://www.meuk.net/Newsletters_and_Publications.aspx

Status of CRA's SR&ED Tax Ombudsman

I i) CRA's SR&ED Tax Ombudsman queries

- **5 main questions for claimant & preparer feedback: Re. Post Feb. 21/07 SR&ED claims:**
 - Did CRA adequately inform taxpayers about the recent changes to the T661 form?
 - Has the cost of filing and defending an SR&ED claim changed?
 - Did CRA accept your request for a "second opinion"?
 - Did CRA review and audit your claim in a professional and courteous manner?
 - Has any CRA person ever attempted to dissuade you from retaining professional advice?

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Moderator's note:

The group discussed the issues briefly but it was felt that any issues with respect to the items cited were likely pre the 2007 cut-off date.

As a result it was generally concluded that the current system has likely improved with respect to any of the issues stated.

Subsequent event: update issued in Globe and Mail
Report expected January 2011

BARRIE McKENNA — OTTAWA
From Wednesday's Globe and Mail
Published Tuesday, Nov. 09, 2010

The first of several reports was released in November 2010. Next up for the ombudsman is an examination of problems with the Canada Child Tax Benefit, expected to be released in December.

Mr. Dubé said he is also poised to complete a long-awaited report **“in January [2011] at the latest” on widespread problems involving the \$3-billion-a-year federal Scientific Research and Experimental Tax credit program.**

Businesses have long complained about a litany of administrative problems, including a lack of consistent or scientifically-based decisions, increasingly complex requirements and lengthy delays in processing claims.

“We’ve heard a lot of industry complaints,” Mr. Dubé said. “Now we have to put the allegations to the CRA and see what they say.”

How IP affects market value

Market Value Comparative: Technology vs. heavy mfg. : May 2000 (pre- "Dot com" crash) & 2009 (present)

Industry / Company	Stock market listing symbol (NASDAQ)	Market Value \$ Billions		Revenues \$ Billions		Value/ Revenues		Net Income \$ billions		Value/ Income	
		2000	2009	2000	2009	2000	2009	2000	2009	2000	2009
Technology											
Oracle Corporation	ORCL	224.0	107.3	9.3	22.4	24.0	4.78	1.4	5.5	155.3	19.4
Sun Microsystems Inc.	JAVA	139.0	7.2	13.1	13.9	10.6	0.52	1.3	0.4	108.5	17.7
Microsoft Corp.	MSFT	366.0	209.9	22.4	58.4	16.4	3.59	8.7	14.6	41.8	14.4
<i>Average</i>		252.5	108.1	14.9	31.6	13.5	3.0	3.8	6.8	101.9	17.2
Heavy Mfg. - U.S. Auto											
Ford Motor Co.	F	60.0	25.8	162.6	146.0	0.4	0.18	7.2	-14.7	8.3	-1.8
DaimlerChrysler AG	DAI	56.0	34.2	150.4	135.1	0.4	0.25	5.8	2.0	9.7	17.1
General Motors Corp.	GRM(@NYSE)	56.0	0.5	176.6	149.0	0.3	0.003	6.0	-30.9	9.3	-0.01
<i>Average</i>		57.3	30.2	163.2	215.1	0.4	0.1	6.3	-14.5	9.1	5.1

Moderator's note:

The group discussed the examples above with respect to the **value** the market places on **intellectual capital and technology**.

It was further noted that;

- **many companies do not**
- **capital and amortize "development costs"** and
- therefore may be **missing the opportunity** to
- provide users of the financial statements with
- this potentially valuable information.

Overall the group agreed that the **SR&ED related documentation was an excellent starting point for capturing "development costs."**

A brief overview of how this strategy might be enabled was provided on the next page.

Example: Using SR&ED info. to identify value

Step1: Identify costs which meet the 5 criteria for capitalization as “development costs”

Universal Research Corporation

Identification of development vs. research costs for financial statement disclosure

for the fiscal year ended December 31, 2009

Capitalization criteria per CICA handbook section 3450.21 *

Project #:	Name:	start	end	Net costs to date @ Dec. 31, 2009:	1) product defined & costs identified	2) technical feasibility established at year end	3) mgmt. intent to market the product	4) future market clearly defined	5) adequate resources exist to bring to market	Devel. Cost (Y / N)?
901	Widget development	Jan-08	Jun-10	\$315,582	Y	Y	Y	Y	Y	Y
902	Widget improvement	Jan-09	Aug-10	\$24,131	Y	Y	Y	Y	Y	Y

Notes:

* - MUST capitalize & amortize costs if ALL 5 "development cost" capitalization criteria have been met at year end.

This is performed EACH taxation year. In this example, project 901 had met the criteria for both the 2008 and 2009 taxation years

Step2: Amortize “development costs” over the expected economic life of the product/process

Project / product	Amount	Total Cost	Year	ITC on expenses*	Total capitalized cost*	Amortization			NBV 2009
						start	rate**	Accumulated Amort'n 2009	
901 Widget development	\$66,000	\$66,000	2008	\$27,390	\$38,610	2008	20.00%	\$7,722	\$315,582
	<u>\$512,000</u>	<u>\$578,000</u>	2009	\$212,480	\$404,130	2009	20.00%	<u>\$80,826</u>	
902 Widget improvement	\$55,000	\$55,000	2009	\$22,825	\$32,175	2009	25.00%	\$8,044	\$24,131
Totals	<u>\$633,000</u>	<u>\$699,000</u>		\$262,695	\$474,915			\$96,592	\$339,713

Notes:

* The capitalized costs should be net of related grants &/or SR&ED investment tax credits on this research

** Amortization rate - straight line over estimated economic life of the technology (5 years) with NO half year provision

Meeting CRA criteria of “Technological Advancement”

Taking your car to the mechanical and claiming, “it doesn’t work!”

- A (Properly trained) mechanic would likely start a conversation like;
 - Mechanic: “What happens when you turn the key in the ignition? Does it start?”
 - Client: “Sure it starts fine.”
 - Mechanic: “Does the engine run?”
 - Client: “Sure it runs fine.”
 - Mechanic: “What happens when you put the transmission in gear? Does it move?”
 - Client: “Sure it moves but it jerks and sometimes backfires.”
 - Mechanic: “Okay. That will be \$500 for not just
» telling me the problem in the first place!”

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Moderator’s note:

Recently the CRA has appeared to increase it’s scrutiny on SR&ED claimants based on one basic challenge claiming that they:

“Do not see the technological advancement.”

To many this situation with the mechanic (above) seems almost foolish since most people would just tell the mechanic the specific problem in the first place.

Ironically when it comes to explaining “technological advancement” some CRA officials appear to provide similar lack of detail in their feedback to SR&ED claimants.

In the group’s opinion a more acceptable and useful answer would be to clarify which of the 5 major components (illustrated next page were lacking in the clients project description.

Recent challenges to “TA”

CRA Definition of “TA”

- Step 1 a): Benchmark “standard practice”
- Step 1 b): Quantified Objectives outside of “standard practice”
- Step 2): Identify “technological uncertainty”
- Step 3 a): Ensure “experimentation” done “systematically”
- Step 3b): Clarifying the “technological conclusions / advancements”

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Moderator’s note:

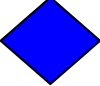
As noted on the prior page, in the group’s opinion a more acceptable and useful answer would be to clarify which of the 5 major components (illustrated above) were lacking in the clients project description.

The group the reviewed some “best practices” to ensure;


- relevant information
- is captured efficiently

a **1 page summary** of the what the group agreed would likely be in the nature of **relevant information** is suggested in the next page.


MEUK - suggested SR&ED project description structure

I 	i) <u>State of Existing technology: Benchmarking methods & sources for citings</u>	<u>Number of</u>	<u>Explanatory notes / results:</u>	
	Internet / Google Searches	_____	internet sites	
	Articles	_____	articles	
	Patent searches	_____	patents	
	Competitive methods	_____	products / processes	
	Similar prior in-house technologies	_____	products / processes	
	Potential components	_____	products	
	Queries to experts	_____	responses	
Other	_____	___ (specify)		

ii) <u>Objective(s)</u>	<u>Performance measures</u>	<u>Existing benchmark</u>	<u>Units of measure</u>	<u>Performance objective</u>
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II)  Technological Uncertainties *Outline top 5 key variables*

III i) *for EACH ACTIVITY* define fiscal year

III 	<u>Experimentation method</u>	<u>Number of</u>	<u>Explanatory notes: justification of sample size</u>	
	i a) Analysis / simulation	_____	alternatives	<i>typically quickest method</i>
	i b) Process trials	_____	runs / samples	<i>typically more time consuming</i>
	i c i) Prototypes	_____	samples	<i>typically most time consuming</i>
	I c ii) prototype revisions	_____	revisions	

ii a) Results - tie to performance objectives in I ii) above

ii b) Conclusions - tie to variable(s) in Uncertainties II)

iii) Documentation - tie to Activities in III i)

iv) a) Costs: labour hours by direct employees - tie to Activities in III i)

iv) b) Costs: labour \$ via contractor - tie to Activities in III i)

v) Costs: materials - consumed or transformed - tie to Activities in III i)

Release of the CRA guides to conducting a technical review

- discussion of select items and implications to claimants

Technical review guides – versions for CRA staff & for claimants

- **i) Claim Review Manual for CRA R&T Advisors**
 - Effective June 1, 2010
 - Replaces Technical Review manual (2000)
 - Highlights: no recordings, timing & T2020/T98 files, treatment of objections

- **ii) SR&ED Technical Review: A Guide for Claimants**
 - summarizes procedural steps
 - Identifies how RTA's will work &
 - Provided BEST practices

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Technical review guides – versions for CRA staff & for claimants

Moderator's note:

The group discussed specific aspects of these manuals including the documentation that should and should not be maintained.

It was largely agreed that any increase in communication (whether positive or negative results) early in the process, would be in the interest of all parties.

Federal Legislative Proposals Status as of June 30, 2010

Federal Legislative Proposals Status as of June 30, 2010

Provision	Description
37(8)(a)(ii)(B)(V) "Materials transformed" can now be claimed under the proxy method.	Materials under the proxy method Under the proxy method, the phrase "materials consumed" is changed to "materials consumed or transformed." Also, there reference in the French version of subclause 37(8) (a)(ii)(B)(V) to "materiel" is changed to "matériaux" in the ITA. Effective Date: For costs incurred after February 23, 1998.
127(27)(b),(c),(e),(f) Originally part of the December 20, 2002 Notice of Ways and Means Motion.	ITC can be recaptured on unpaid shared use equipment (SUE) Technical amendments include having an ITC recapture on a property even though the expenditure for the property was unpaid; this include SUE. Also for the purposes of ITC recapture, "cost" was amended to "cost or a portion of costs" and there was clarification for the calculation of ITC recapture on first-term SUE and second-term SUE. Effective Date: For dispositions and conversions that occur after December 20, 2002
New section 143.3 Stock option benefits can no longer be an expenditure.	Stock option benefit denial of expenditure The value of an option granted by a taxpayer is not considered to be an expenditure for income tax purposes. Also, the increase between the option price and the exercised share price is not an expenditure per paragraph 143.3(3)(b). Original release Technical Notes: 2005-08 Effective Date: November 17, 2005
New subsection 220 (2.2) Requests for ministerial discretion to file the prescribed Form T661 or prescribed information past the 18 months can no longer be considered.	Removal of subsection 220(2.1) discretion Under proposed subsection 220(2.2), subsection 220(2.1) does not extend to a prescribed form...or prescribed information filed on or after the day specified in subsection 37(11) or paragraph (m) of the definition of "investment tax credit" in subsection 127(9). The effect of new subsection 220(2.2) is that a person cannot deduct an SR&ED expenditure under section 37, or claim an investment tax credit in respect of an expenditure, if the person takes more than the additional 12 months allowed to make a claim with the Minister. Original release Technical Notes: 2005-080 Effective Date: November 17, 2005
248(1) Definition of Scientific Research and Experimental Development (SR&ED), French version of the ITA	"Engineering" work is among the work listed in paragraph 248(1)(d).The French version of paragraph (d) of the definition is changed to refer to "travaux de génie" instead of "travaux techniques." It was never intended for there to be a difference between the English and French versions of the ITA. Effective Date: Upon Royal Assent
2902(e)	The provisions of paragraph 2902(e), defines a prescribed expenditures to include, among other things, an expenditure for SR&ED where a claimant received or was entitled to receive a reimbursement. The proposed amendments to paragraph 2902(e) are consequential to the amendments to the definition of "contract payment", in subsection 127(9), which renders the provisions of paragraph 2902(e), as redundant for ITC purposes. Effective Date: applicable for amounts that became receivable after December 20, 1991

Moderator's note:

This table tracks the progress of outstanding federal draft legislation amending the Income Tax Act (ITA) that impacts on the Scientific Research and Experimental Development (SR&ED) Program.

Former Bill C-10 ceased to exist with the dissolution of the 39th Parliament on September 7, 2008, and has not presently been reintroduced to the 40th Parliament.

Despite this fact the CRA will administer the proposed amendments as if they are law.

Implications to claimants: The group acknowledged that w most issues seem to be in the clients interest, to follow there are select items in which a claimant may choose not to follow the CRA's direction.

An example might be claims for "stock option benefits" which technically have been ineligible since November 2005 however, as illustrated on the following chart, this legislation is not in force.

Aggressive tax planning - Federal proposals to require new reporting of “contingent fees”

New proposals: Aggressive tax planning - reporting of “contingent fees”

- Reportable transaction bears at least two of the following three hallmarks (page 5):
 - Avoidance Transaction
 - Confidential Protection &/or
 - Contractual protection
- Issue: what do these terms mean and would they apply to “typical SR&ED work done on contingency?”

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Moderator’s note:

With respect to consultants who perform SR&&ED work with fees based on “contingency” it’s was generally felt that SR&ED related services were NOT reportable since;

- 1) Not an Avoidance Transaction since they were specifically provided for by the act

However, **certain “aggressive” positions** within the interpretation of what is SR&ED might be argued as involving,

- 2) Confidential Protection (where the taxpayer is prevented from disclosing method [especially to the CRA] by the consultant) &/or
- 3) Contractual protection (where taxpayer is indemnified by the consultant against any losses).

If these situations exist within the contract consultants may wish to examine these rules further.

II) SR&ED Changes not details in newsletters above:

Electronic filing – practitioner experiences to date & related strategies

II) SR&ED Changes not details in newsletters above

- A) Electronic filing –
Practitioner experiences to date &
Related strategies:**
- keeping online documentation**
 - summarizing # iterations & methods used**
 - methods to transfer data from Science to tax forms?**

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Moderator's note:

Overall the group had mixed feedback regarding the move to e-file but many agrees that the assessment time had been greatly reduced in the case of many claimants.

Update on SR&ED financing sources& factoring agents

Moderator's note:

The group briefly discussed and compared some of the main SR&ED funding agents operating in Ontario using a shortened version of the attached table.

Selected SR&ED funding agents in the Golden Horseshoe area

<u>Comparative Factor</u>	<u>Goldeye</u>	<u>TCE</u>	<u>New Solutions</u>	<u>Century Services</u>	<u>Espresso Capital</u>
Initial Fees:	\$3,000	0.7% of funding + legal (\$2,000)	1-2% of required \$ upon acceptance of Commitment Letter	0.5% @ acceptance of Terms Letter	0% to 7%
Monthly fees:	N/A (Factor fee)	2-2.25%	3%	2%	2%
Minimum fee:	10%	6%	3% / month	1.50%	5%
Minimum funding:	\$100,000	\$250,000	\$100,000	\$200,000	100000
% advanced up to:	70%	70%		80%	
Accrued (from start of yr.)					70%
Submitted Claims			65%		75%
Approved Claims			90%		90%
Repayment if claim fails:	No	Yes	Yes	Yes	Yes
Typical approval time:	7-14 days	5-7 days	3-10 days	3 - 7 days	3-10 days
Established:	2007	1992	1999	1990	2009
Industries served:	All	All	All	All	All
# claims financed to date:	DND	>100	>25	<100	>50
Personal guarantees req'd:	No	Yes	Yes	Yes	No
Restrictions:	No start-ups	None	Trustee required if Initial SR&ED	None	None
Website:	goldeyecapital.com	tcecapital.com	newsolcapital.com	centuryservices.com	espressocapital.com
Contact person:	Dan Gregory dangregory@goldeyecapital.com 416.709.9266	Glen Dalzell gdalzell@tcecapital.com 416-496-7065	Patrick Wieland pwieland@newsolcapital.com 905-279-1355	Paul Zilkey pzilkey@centuryservices.com 416-931-8518	Garron Helman garron@espressocapital.com 647-404-5005

Other issues as requested by participants &/or SR&ED blogs.

II C) Other issues

- a) Latest version of Cantax will only allow seven projects**
 - recommendations on Cantax in general?**

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As per the Sept. 14, 2010 posting reproduced on the following page:

The latest version of Cantax will only allow seven projects

Moderator's note:

The group discussed the fact that there were still significant differences in preparing the T661 claims dependent on the brand of software used.

In the group's experience it appears that the market appears to be dominated by two main programs as follows:

Taxprep (45%)

Profile (45%)

Cantax, DR Tax and other programs. (10%)

As a result the group agreed that extra care should be taken to review completeness particularly when using the "non-main stream" programs.

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We recently learned that the latest version of Cantex will only allow seven projects. If you try to enter an eighth project the entire... - 4 hours ago

Case selection reasons – CRA internal criteria list

**b) Case selection reasons –
CRA internal criteria list:**

- What is this list and how is it used by CRA?
- To be addressed by Dominic Iaonnoni of
CRA

21

As per the July 2010 posting reproduced on the following page:

The CRA has certain codes used to identify review issues – are these available to the public?

Moderator's note:

CRA moderator Dominic Iaonnoni explained that these are just internal codes used to identify review issues.

They are not available to the public.

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CRA Technical Review: "Case Selection Reason"

As of July 2010, I have noticed that a SR&ED Review Report cover sheet, provided by the RTA, has indicated a "Case Selection Reason"

For example, the reason in this case was : 2337 (35% RD)

I can only assume these are the codes for the 'flags' that indicate the SR&ED claim should be reviewed further by the RTA, or financial reviewer, in this case: because the claimant has submitted a percentage of their expenditures to (revenue, or total labor) that exceeds 35%.

Has anyone else seen these reason codes, and could you provide some insight into them?
15 days ago

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1 comment



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Benoit Remillard benoit@amergex.com • In French, it's titled "Genre de demande" (Type of claim) and from what I can see, it just says whether it's a 20% or 35% credit and whether it's an original claim or an amended one.

14 days ago • [Reply privately](#) • [Flag as inappropriate](#)



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OMDC – inability to claim on failed SR&ED expenses

c) OMDC – inability to claim on failed SR&ED expenses

Per discussion with Mark Sonnenberg (OMDC)

- Amounts claimed for SR&ED are ineligible for OMDC credits**
- This is being applied even if/when SR&ED expenses are denied by CRA**

22

As per the Sept. 15, 2010 email reproduced on the following page:

Per discussion with Mark Sonnenberg (OMDC)

- Amounts claimed for SR&ED are ineligible for OMDC credits
- This is being applied even if/when SR&ED expenses are denied by CRA

Moderator's note:

The group noted that this was due to the use of the word “claimed” in the legislation.

This underlines the importance of correctly choosing whether to claim SR&ED vs. Ontario Interactive Media credits for any projects which may qualify for both.

David Sabina

From: Mark Sonnenberg (OMDC) [Msonnenberg@omdc.on.ca]
Sent: Wednesday, September 15, 2010 10:56 AM
To: David Sabina
Subject: RE: SR&ED practitioner meeting - quick question on "double dipping" costs
Follow Up Flag: Follow up
Flag Status: Red

On page 22 of our June 2010 guidelines:

Expenditures for which the qualifying corporation or qualifying predecessor corporation makes a claim under section 90, 91 or 92 of the Act or section 43.5, 43.8 or 43.10 of the *Corporations Tax Act*, or incurred by the corporation in carrying out activities that constitute scientific research and experimental development for the purposes of paragraph 37(1)(a) of the Income Tax Act (Canada) or subparagraph 37(1)(b)(i) of that Act do not constitute Ontario Labour Expenditures under the OI DMTC.

So, the client needs to decide where they are going to claim certain expenditures. IF the client decides to make the claim under SR&ED, then these are specifically excluded as per the above. Although it may not be "fair" as you say, it's the law. I have no discretionary powers on this point.

From: David Sabina [mailto:dsabina@meuk.net]
Sent: Wednesday, September 15, 2010 10:45 AM
To: Mark Sonnenberg (OMDC)
Subject: RE: SR&ED practitioner meeting - quick question on "double dipping" costs

Really? So even if the costs are not accepted by the CRA they are still being rejected by the Ontario Ministry for the OMDC?

I agree that this seems unfair and will mention it during tomorrow's meeting.

In your opinion is the change required on the OMDC side or with the CRA?

Regards, Dave Sabina

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From: Mark Sonnenberg (OMDC) [mailto:Msonnenberg@omdc.on.ca]
Sent: Wednesday, September 15, 2010 10:44 AM
To: David Sabina
Subject: RE: SR&ED practitioner meeting - quick question on "double dipping" costs

Nope. Rejected.

From: David Sabina [mailto:dsabina@meuk.net]

9/15/2010

CATA – claims that new review manuals = tighter policy

d) CATA – claims
New review manuals =
tighter policy

August 2010 Article by Russ Roberts claims:

- More challenges to “Technological Advancement” criteria
- Less “latitude” experienced by previously successful claimants
- Higher focus on documentation especially in “commercial” settings (i.e. cut-off of SR&ED)

23


As per the Aug. 2010 CATA posting reproduced on the following page:

- The CRA is becoming more stringent in certain areas.

Moderator’s note:

This fact has been noted by several practitioners.

The group again discussed and reiterated the importance of being able to document the “technological advancement” criteria discussed earlier in this meeting.



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Scientific Research and Experimental Development (SR&ED) Tax Incentive Program Alert and Call to Action August 2010

Russ Roberts, CATAAlliance, Sr. VP, Tax & Finance

Note: Please circulate the CATA SR&ED Alert broadly. Items are linked to more detailed exp We welcome your views and participation in advancing Canada's high tech business growth.

Alert: CRA has issued new, stringent review protocols for SR&ED claims.

If you have claims currently under review or coming up for review, or if you are fil claims, you should understand the implications of these changes. You cannot assu you can rely on past experience as a predictor of how to support your claims or of outcome of your claims, going forward.

Specifically, the CRA has released two new documents, both effective June 1, 2010:

- an internal procedural manual for its Research and Technology Advisors (RTAs), the *Review Manual for Research and Technology Advisors*. The CRA has posted a public version of this manual on its website <http://www.cra-arc.gc.ca/txcrdt/sred-rsde/objctns/ntr-tchrvw-eng.html>
- a guide that provides an overview of the claim review process for claimants to help t prepare for technical reviews of their claims, The SR&ED Technical Review: A Guide i Claimants (draft). To see the guide, go to the CRA website at <http://www.cra-arc.gc.ca/txcrdt/sred-rsde/objctns/tchrvw-cmmnt-eng.html>. The CRA indicates that t a concise version of the new, internal Claim Review Manual for RTAs.

The CRA's website states that the Claim Review Manual for RTAs and the Technical Review (claimants "cancel and replace the *Guide to Conducting a Scientific Research and Experiment Development Review Part 1: The Technical Review dated January 14, 2000.*"

Both the Claim Review Manual for RTAs and the Technical Review Guide for claimants are of effective June 1, 2010. However, from what we understand, the CRA has been applying Clai Manual procedures even to some reviews that were started before June 1, 2010. Also, the T Review Guide for claimants has been posted as a "draft" for limited comment by August 1, ;

Impact

Those experiencing reviews under this new regime are finding:

- the reviews much more rigid; and
- the positions being taken and the information requirements more oriented to dedicat projects as opposed to projects where the R&D is highly integrated within the contex need to develop advanced technologies required for improved commercial products, and services.

We are hearing of companies that thought they knew what was expected and that had good experiences now not being able to support their current claims to the satisfaction of reviewe their claims are reviewed under these new protocols.

Senior SR&ED practitioners are emphasizing similar concerns to us. Specifically, they are sa

Sample size – what’s appropriate?

e) Sample size – what’s appropriate?

- **This is an ongoing issue**
Example provided by Harvey Cantor, C.A.:
- **200 test sample devices required per initial estimate**
- **DOE worked down to 83 samples**
- **70 tested in field, 10 in house, 3 extra**
- **CRA disallowed all materials but allowed 97% of labour**

24

As per the Sept. 2010 email reproduced on the following page:

One of the group members had an issue (outlined above) regarding appropriate sample sizes.

Moderator’s note:

The group discussed the concept of determining and appropriate sample size for an experiment and agreed that ;

- while there were base principles to estimate these sizes
- these in turn required assumptions which were ultimately subjective &
- as a result “professional judgment” (or opinion) will always play a portion.

To provide an overview of some “best practices” for supporting a minimum sample sizes have also been provided.

- **Appropriate sample size? Issue submitted by Harvey Cantor, C.A.**

Claimant is in extremely highly regulated industry. Claimant works with both the creation of prototype devices and management of data initiated from a number of devices both from itself and 5 other manufacturers, each of which have their own proprietary ways of managing and handling data.

Claimant's goal is to create, capture and process data in a way that ensured confidentiality for the manufacturer's, operator's or regulator's knowledge. Claimant was simultaneously involved in an experimental network as the operators' used a number of different varieties of communication approaches including 19,200 baud serial, to 10 base T 10-1000, fibre, and frame relay radio. Estimated population of data initiated devices approximate 10,000.

The claimant could only test its prototype devices on its own proprietary machines in house as due to highly restricted environment it was not even allowed access to samples of machines. In order to complete its tests of prototypes it had to come to agreements with both the local operator and the regulator in respect to where it could test its devices and the number of units to be tested. As part of its agreement the claimant was also required to provide a limited amount of data to the regulator and operator and accept their requirements and specifications as to trial size.

Key issues in the data collection were effecting efficient and accurate near real time collection of data over distributed networks. The claimant's engineers felt that in order to test its devices and because of the combination of data from machines of 6 manufacturers and the different communications they would require about 200 test devices. The operator initially offered to make available 160 devices from other manufacturers but later restricted it to 70.

The test did not fully resolve all the uncertainties. At the end of the year there were still problems with data collisions and control of duplicated data

Claimant's labour was 97% allowed

Claimant purchased materials for 200 test prototype devices because purchased components had to be custom built and long lead times were required

Claimant only built 83 devices, deployed 70 in the field, 10 were used in the in house tests and 3 were for quick replacement if a unit failed.

CRA has disallowed materials for 190 test prototype devices

What is the appropriate sample size?

SR&ED planning - Determining an Appropriate Sample Size

The SR&ED legislation clarifies that [any] “testing” which is “commensurate with the needs and directly in support of the project” is eligible for ITC’s.

Many SR&ED eligible projects involve testing or sampling of a product or a production process. Inevitably, when the repetitive measurement of any parameter is involved, the question will always arise;

“What is an appropriate number of test runs or samples required for my project?”

CRA often challenges this aspect of SR&ED claims, leaving it to the claimant to justify the original number of test runs/samples put forward. This is particularly likely in situations where the “experimental production” is being sold in what might be considered a “commercial” operation.

When does the SR&ED testing end?

If the technical rationale for determining the number of test runs/samples required is weak (or non-existent), the claimant may have a large portion of their claim rejected.

At this point, most people (even the engineers in the crowd) start to grow a little nervous, because setting that significant “number” involves dealing with statistics from a varying degree of sources including

- Statistical and engineering texts
- Industrial standards: eg. ISO, Six Sigma
- Industry specific: Pharmaceuticals, etc.

Although the process of determining sample size can be a bit confusing for most people, determining an acceptable answer can be done knowing what it is you want to prove!

The following is provided as a generic guide to help find your way through the basic principles.

Define Project Objectives First

Clearly defining your ultimate goal will frame the prescribed scope of work for the research project and ultimately the number of samples required.

In short, the number of specific objectives is directly proportional to the statistically significant sampling/testing requirements. This “scoping” exercise involves consideration of several components that are inextricably linked:

- 1) **the types of tests required** – consideration must be given to the:
 - complexity of the test itself,
 - time and cost required to conduct the test
 - analysis of results to support the objectives.

Effects of environment

Sampling or testing the performance of a machine or production line will typically require much different baseline considerations than say testing a new consumer product or computer program;

- 2) **number of variables to include in the test matrix** – consideration must be given to
 - a ceiling on what can be achieved within
 - practical performance and budget limitations;

Typically the **number of inter-dependent variables** will affect the overall **number of tests required on an exponential basis**.

- 3) **evaluation criteria used to support decision making**
As the precision becomes finer and confidence levels increase, so does the requirement for sampling/testing.
 - While acceptable confidence limits for many scientific projects are between 90 – 95%, the precision may be acceptable at $\pm 20\%$, whereas confidence levels may be as high as 99 – 99.9% with high precision ($\pm 5\%$ or smaller) for some industrial or pharmaceutical applications.

Although Items 1, 2, and 3 are mutually dependent, there is flexibility in setting the level of precision and confidence you wish to attain with respect to significant data, i.e., do you want to be within $\pm 10\%$ precision of a 90% confidence interval, or do you want to be within $\pm 5\%$ of a 99% confidence interval?

In short, the number of test runs or samples required for any given project is driven by the precision and level of confidence demanded by your defined objectives.

Rules of thumb / industry standards

Although there are some general rules of thumb, there is no way to avoid the fact that some calculations need to be performed to develop a justifiable sample size number.

Sample Size calculation example

Determining a sample size can quickly become very complicated conceptually.

Say you have a factory that produces widgets, and your competitor claims that 'half your widgets' come off the assembly line defective.

How many widgets should you randomly select (as a sample) to find out the percentage of widgets that tend to be defective during normal production?

If your normal production is 5,000 widgets per month, and you want to be 95% confident in your results, within a range of 10 percentage points of the mean, your sample size should be as calculated below¹²:

Determine Sample Size

Confidence Level: 95% 99%

Confidence Interval:

Population:

sample size needed:

Let's say within your sample of 94 widgets the mean defective rate was 30%.

This means that;

- 95% of the time your normal production
- will have defect rates between 20% and 40%,
- meaning between 1,000 - 2,000 defective widgets
- for every 5,000 produced.

Glossary of Terms

When choosing a correct sample size for a survey or study, you can use a "sample calculator", as shown above in the widgets example. You need to specify the following items:

- Confidence level – the percent of the time the mean of your results will lie within the confidence interval.

- Confidence interval – the precision applied to the specific mean quantity (i.e. the range that the mean lies within, mean \pm value)
- Population – the total number of individuals (the group size) about which you wish to determine some average result / property; the lot size or expected production; the number of people who are purchasing a product as a way to estimate the population size.

Also, from a population, a sample size is chosen to magnify the characteristics of that population. The sample calculator takes into account the population and confidence requirements. It computes an appropriate sample size to ensure the results are accurately representing the population.

Limitations:

The sample calculator does not take into account many specifics when attempting to apply it to certain industries or cases. Certain industry standards and practices will alter the recommended sample size due to unaccountable demands at the time. It is meant to be used as a guideline when choosing a sample size.

On the next page we illustrate a generic chart¹³ giving standard sample sizes based on the level of confidence chosen, population size, and confidence intervals.

Notable quotes:

*"If everything seems to be going well,
you have obviously overlooked
something."*

*"When everything is coming your way,
you're in the wrong lane."*

- Steven Wright, scientist and comic

¹² The calculator is from the website of Creative Research Systems – The Survey System found at: <http://www.surveysystem.com/sscalc.htm>

¹³ taken from the IEEE website at <http://www.ieee.org/portal/pages/corporate/research/sample sizes.html>

Sample Sizes

Population Size (N)	95% Level of Confidence			99% Level of Confidence		
	±3%	±5%	±10%	±3%	±5%	±10%
500	250 _a	218	81	250 _a	250 _a	125
1,000	500 _a	278	88	500 _a	399	143
1,500	624	306	91	750 _a	460	150
2,000	696	323	92	959	498	154
4,000	788	341	94	1,142	544	158
5,000	880	357	95	1,347	586	161
10,000	965	370	96	1,556	622	164
20,000	1,014	377	96	1,687	642	165
50,000	1,045	382	96	1,777	655	166
100,000	1,058	383	96	1,809	659	168

Note: The choice of +/- 3 percent, +/- 5 percent, and +/- 10% for confidence intervals is based on the tendency of researchers to use these intervals or a similar range of intervals in the design of their surveys.

* Population sizes for which the assumption of normality does not apply; in such cases, the appropriate sample size is 50 percent of the population size.

Source: Rea, Louis., and Richard A. Parker. *Designing and Conducting Survey Research: A Comprehensive Guide*. 2nd ed. San Francisco, CA: Jossey-Bass, 1997, page 121.

LINKS TO OTHER SUPPORTING DOCUMENTS:

A more complete discussion of these issues is presented in;

- MEUK SR&ED newsletters
- 2010-1 through 2010-3.

These and other issues available at http://www.meuk.net/Newsletters_and_Publications.aspx