



Funding for Innovation and Growth

Part I: Outlining Changes in SR&ED Eligibility

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Editor's Note: This article is the first in a series that will outline how recent policy changes impact eligibility criteria for Scientific Research and Economic Development (SR&ED) projects; how project tracking can be used to strengthen an SR&ED claim; and how companies can leverage different direct sources of government funding along with SR&ED to achieve their business goals.

Each year more than \$20 billion is allocated to Canadian companies through indirect government funding initiatives, such as the Scientific Research and Experimental Development (SR&ED) program, and direct government funding initiatives, such as grant and loan programs. Recently government funding policies have undergone many changes that can affect companies looking to invest in innovation, business growth, and workforce development.

Recent revisions to the SR&ED program that redefine eligible work and increased emphasis on ongoing supporting documentation make careful tracking of SR&ED activities essential to optimizing claim value.

Furthermore, more governmental focus on supporting direct funding programs, which provide financing and resources for innovation, business growth, and workforce development, has contributed to a growing trend of leveraging multiple government funding programs with SR&ED to optimize returns and meet various company business needs and goals.

What Are the Benefits of SR&ED?

SR&ED is a roughly \$3 billion federal tax incentive program created in the mid-1980s to encourage technological development and business R&D in Canada. While many other countries have similar programs, Canada's SR&ED program is one of the most lucrative tax incentive programs in the world.

If your company is a qualified Canadian-controlled private corporation (CCPC) that is developing a new technology or improving existing technology, products, or processes, it may be able to receive federal SR&ED tax credits (both refundable or nonrefundable) of up to 35 percent on eligible expenditures (including labor, subcontract costs, materials, and overhead).

Similarly, foreign-owned or public corporations can qualify for a 15 percent federal tax credit on eligible expenditures.

Additional provincial or territorial tax credits on qualified SR&ED expenditures are applied in conjunction with federal SR&ED tax credits. These provincial and territorial SR&ED rates vary from province to province. Any provincial or territorial tax credit is calculated and deducted from the pool of eligible expenditures first, with the federal SR&ED credit then calculated on the remainder of the pool.

The funds your company receives from the SR&ED program can then be invested back into the business in the form of purchasing new equipment, hiring new staff, expanding your facilities, taking on more challenging projects, or paying down debts.

Determining SR&ED Eligibility

One of the main challenges that companies are confronted with when applying for the SR&ED program is identifying what work qualifies as SR&ED in accordance with CRA guidelines.

Not all R&D a business conducts will be SR&ED-eligible, especially if this work is performed as due diligence or as a natural course of operations. The first step in identifying which activities are eligible involves determining whether the method and objective of the work performed meet the three main criteria for SR&ED.

In 2012 the CRA outlined five qualifying questions in three categories to increase specificity when defining SR&ED criteria. They are:

Scientific or Technological Uncertainty

1. Was there a scientific or technological uncertainty that could not be overcome by standard practice?

This means that due diligence and background research were performed to establish that no easily available, off-the-shelf solution already existed to solve the particular issue and, therefore, that further research and experimentation were necessary.

2. Did the effort involve formulating hypotheses specifically aimed at reducing or eliminating that uncertainty?

Standard business R&D projects are characterized by general business objectives for increased profitability. SR&ED projects, on the other hand, are distinguished by very explicit objectives or hypotheses to overcome specific uncertainties or address gaps in industry knowledge. In addition, SR&ED projects are supported by contemporaneous documentation showing that the relevant systematic investigation or search was directed toward meeting the main objective (the project does not have to succeed to be eligible).

Scientific and Technological Content

3. Was the procedure of the work performed consistent with the total discipline of the scientific method, including formulating, testing, and modifying the hypotheses?

SR&ED-eligible projects demonstrate scientific rigor and reliability in terms of methodology and analysis, such that testing can be replicated by others to achieve similar results. By contrast, standard business R&D experimentation often involves trial and error or adopting existing, readily available solutions without specific hypotheses in mind.

Furthermore, SR&ED-eligible work must be performed or directed by qualified and experienced individuals with knowledge in the field and with relevant skill gained through formal training and experience, whereas standard business R&D does not always meet this criterion.

4. Was a record of the hypotheses tested and the results kept as the work progressed?

This is one of the most important questions to ask when determining whether the work performed is SR&ED-eligible. The ability to support the work claimed in your application with relevant documentation will significantly affect the strength of your claim and the value of the refund you receive, as well as improve the likelihood of a successful audit defense, if necessary.

Many different kinds of supporting documentation are naturally generated throughout a project, including financial and labor records, project planning documents, testing records and notes, and records of electronic communication. Although some forms of documentation provide stronger evidence for your claim and address the main hypotheses directly, all documentation that may be relevant to your SR&ED projects should be dated and kept, ideally, in a designated location.

Scientific or Technological Advancement

5. Did the process result in a scientific or technological advancement?

This does not mean that only experimentation that was successful in achieving its main objective is eligible. Unsuccessful projects can significantly increase a company's knowledge base and reveal important industry-specific information and results that were not previously available. This material can then be used in subsequent tests to continue R&D work.

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