



## Scientific Research and Experimental Development (SR&ED) Tax Incentive Program General Overview

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## Objective of this seminar

Provide a better understanding of:

- ☐ The SR&ED tax incentive program and its requirements
- ☐ The types of R&D work that qualifies for SR&ED tax credits
- ☐ The expenditures that may be claimed for SR&ED tax credits
- ☐ The available information sources and advisory services

# SR&ED Tax Incentive Program

Objective: to encourage Canadian businesses of all sizes and in all sectors to conduct research and development (R&D) in Canada

**Quick facts:**

- ❑ SR&ED is the largest (ITCs) 50% or 35% federal government support for industrial R&D in Canada
- ❑ In 2014, the SR&ED program provided close to \$3.1 billion in allowable SR&ED expenditures can be used to reduce taxable investment tax credits (ITCs) to over 20,000 claimants

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## Basic Requirements

- ❑ Claimant must be carrying on a business in Canada in the tax year
- ❑ SR&ED must be related to the claimant's business
- ❑ Expenditures must be incurred
- ❑ SR&ED must be performed in Canada directly by the claimant or on behalf of the claimant
  - Certain expenditures for SR&ED performed outside Canada are permitted (see section 10.0 of the "SR&ED Salary or Wages Policy")
- ❑ Claimant must file a complete claim by the reporting deadline: 12 months after the filing due date of the return of income for the tax year

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## Definition of SR&ED

To be eligible for SR&ED tax incentives, work must meet the legislative definition of “scientific research and experimental development” (in subsection 248(1) of the *Income Tax Act*):

### *How*

“...systematic investigation or search carried out in a field of science or technology by means of experiment or analysis...”

### *Why*

“for the advancement of scientific knowledge (basic or applied research) or technological advancement (experimental development)”

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## Determining Eligibility

Two-step approach

Step 1 – Determine if there is SR&ED

Step 2 – Determine the extent of eligible work  
(only if there is SR&ED)

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# Identifying SR&ED

## *Example Company Project #1*

Start  Finish

No problem was SR&ED countered

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# Identifying SR&ED

## *Example Company Project #1*

Start  Finish

No SR&ED

## *Example Company Project #2*

Start  Finish

No SR&ED

- In ~~Public knowledge~~ ~~technology~~ base
- Public domain information/outside expertise

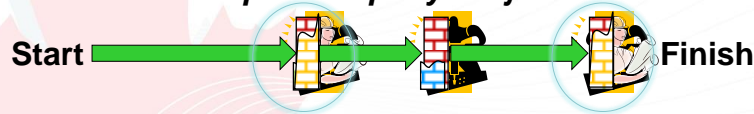
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## Identifying SR&ED

### Example Company Project #2



### Example Company Project #3



Even Problems are documented they have not been  
scientific/technological uncertainty

- Public domain information/outside expertise

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## Step 1 – The 5 Questions

The answer to all five of the following questions must be “yes” for any work in the related project to be considered SR&ED:

1. Was there a scientific or a technological uncertainty?
2. Did the effort involve formulating hypotheses specifically aimed at reducing or eliminating that uncertainty?
3. Was the overall approach adopted consistent with a systematic investigation or search, including formulating and testing the hypotheses by means of experiment or analysis?
4. Was the overall approach undertaken for the purpose of achieving a scientific or a technological advancement?
5. Was a record of the hypotheses tested and the results kept as the work progressed?

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## Step 2 - Support Work

Work that corresponds to the needs and is directly in support of basic research, applied research, or experimental development

Includes *only* these eight specific categories of work:

- |  |   |
|--|---|
| <input type="checkbox"/> Engineering           | <input type="checkbox"/> Computer Programming   |
| <input type="checkbox"/> Design                | <input type="checkbox"/> Data Collection        |
| <input type="checkbox"/> Operations Research   | <input type="checkbox"/> Testing                |
| <input type="checkbox"/> Mathematical Analysis | <input type="checkbox"/> Psychological Research |

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## Step 2 - Excluded Work

Work that is not SR&ED:

- |   |   |
|---|---|
| <input type="checkbox"/> Market research or sales promotion                                 | <input type="checkbox"/> Commercial production or use |
| <input type="checkbox"/> Quality control or routine testing                                 | <input type="checkbox"/> Style changes                |
| <input type="checkbox"/> Research in social sciences or the humanities                      | <input type="checkbox"/> Routine data collection      |
| <input type="checkbox"/> Prospecting, exploring and drilling for petroleum, gas or minerals |   |

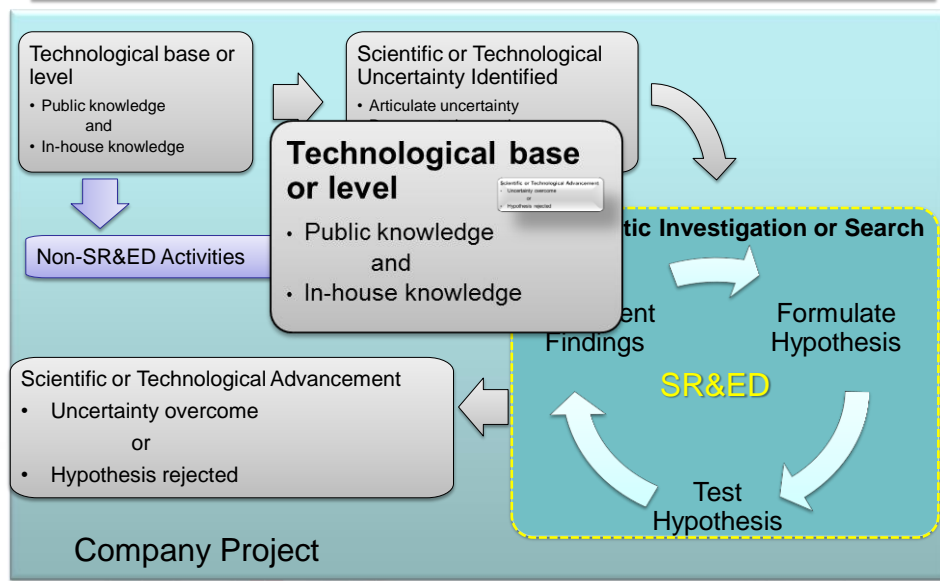
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## Result: The SR&ED “Project”

- ❑ The set of interrelated activities that:
  - Collectively are necessary in trying to achieve the specific scientific or technological advancement defined for the project by overcoming scientific or technological uncertainty, and;
  - Are pursued through a systematic investigation or search in a field of science or technology by means of experiment or analysis performed by qualified individuals.
- ❑ In most cases, not equivalent to the company project
  - Can have multiple SR&ED projects within larger company projects
  - Durations may differ

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## Result: The SR&ED “Project”





## Financial Aspects

 Canada Revenue Agency  
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## Tax Advantages

- ❑ SR&ED expenditure pool does not expire and provides planning opportunities related to the deduction of allowable SR&ED expenditures.
- ❑ ITC earned in a year can be used to reduce the income taxes payable in the year. The unused balance may (sequentially) be:
  - refunded, if ITC earned at 35% rate, or
  - carried back up to three years, or
  - carried forward up to twenty years.



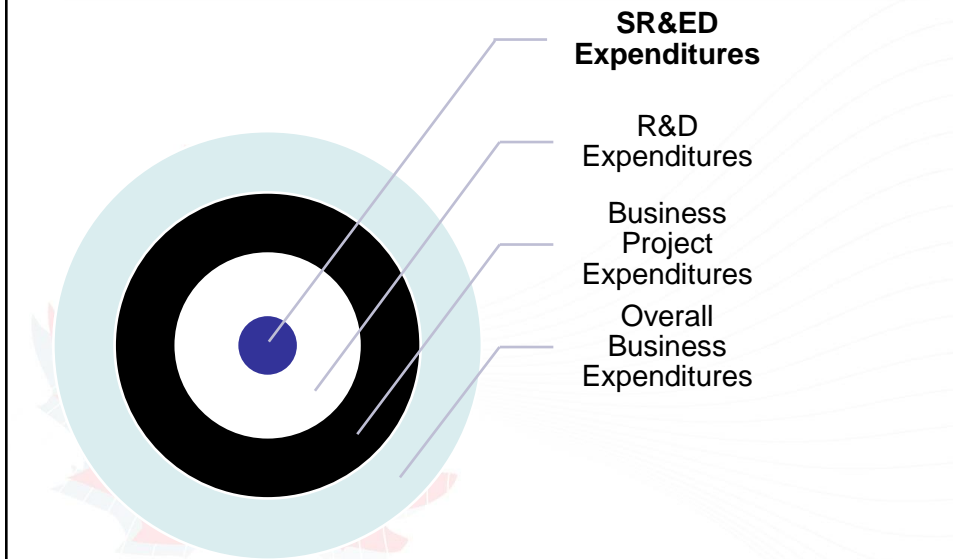
## Types Of SR&ED Claims

- ☐ Refundable corporations – CCPC
- ☐ Other refundable – individuals, members of partnerships, trusts
- ☐ Non-refundable – large or foreign-owned corporations

## Two Calculation Methods

- ☐ **Traditional method**
  - Overhead and other expenditures – identify specifically
- ☐ **Proxy method**
  - Overhead and other expenses are replaced by an amount equal to 55% of directly engaged salaries
  - Simpler alternative to the traditional method
- ☐ Must choose one of the methods with the first filing of claim Form T661 for a particular tax year
- ☐ Method cannot be changed *for that tax year* for amended SR&ED claim

## SR&ED Expenses



## SR&ED Expenses

### The allowable SR&ED expenditures for SR&ED carried on in Canada include:

- Salaries or wages of directly engaged employees
- Materials consumed and/or transformed in performing SR&ED
- Contract expenditures for SR&ED performed for you
- Third-party payments
- Overhead and other expenditures, if traditional method elected

**Note:** Some SR&ED salaries may be allowable for SR&ED performed outside of Canada if specific conditions are met.

## Salaries Or Wages

- ❑ Employees directly engaged in SR&ED activities in Canada, including a provision for limited salaries and wages outside of Canada
- ❑ Cost claimed is based on the time spent on SR&ED and may include an allocation for paid vacation; public holidays; sick leave; and some bonuses and taxable benefits
  - Salary and bonuses must be paid within 180 days of the end of the tax year

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## Materials

- ❑ **Materials consumed**
  - Absorbed, used up, or broken down into small pieces
  - Material that was destroyed or rendered virtually valueless as a result of the SR&ED (value is reduced to less than 10% of the original value)
- ❑ **Materials transformed**
  - Materials for SR&ED that are changed or incorporated into a product that has some value to the taxpayer or to another party
  - Claimant must recapture the ITC if the items are sold or converted to commercial use

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## Contract Expenses

- ❑ Expenditures to contractors to perform SR&ED **for the claimant**
- ❑ SR&ED must be carried out in Canada
- ❑ SR&ED must be related to your business
- ❑ Must identify expenditures to arm's length and non-arm's length contractors separately
- ❑ Only the cost of the SR&ED performed during the tax year of the claimant can be claimed
- ❑ Contractors must be taxable suppliers for the expenditures to qualify for the ITC

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## Third-Party Payments

Payment made to a corporation resident in Canada or other approved entity (ex: university, college, association, research institute)

- For SR&ED carried out in Canada
- Related to payer's business
- Where the payer is entitled to exploit the results but does not control the work performed
- All of the payment has to be for performing SR&ED

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## Overhead And Other Expenses

### **Applies to the traditional method only:**

Other expenditures directly attributable to SR&ED activities carried out in Canada that would not have been incurred if the SR&ED activities did not occur

#### □ Examples:

- Other salaries attributable to SR&ED but not of directly engaged employees
- Employer share of deductions at source related to salaries of employees directly engaged
- Energy sources
- Supplies, including office supplies
- Maintenance of SR&ED equipment

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## Deductible SR&ED Expenses

The pool of deductible expenditures must be reduced by the following amounts:

- Government and non-government assistance, received, receivable, or reasonably expected to be received
- Prior-year ITC applied and/or carried back to previous years, and/or ITC refunded
- Proceeds of the sale of SR&ED assets

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## Qualified SR&ED Expenses

Begin with allowable current expenditures

Add:

- Shared-use equipment, if any
- Proxy amount (if proxy method elected)

Subtract:

- Non Arm's length contract payments
- Government/non-government assistance
- 20% of expenditures included on lines 340 and 370 that were incurred after December 31, 2012
- Prescribed expenditures

Result

- Qualified SR&ED expenditures

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## Advisory Services and Tools

❑ The SR&ED program offers several free services:

- First-time claimant advisory service (FTCAS)
- Pre-claim project review (PCPR) service
- Account executive (AE) service
- Public information and industry-specific seminars
- Self-Assessment and Learning Tool (SALT)

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## How To Reach Us

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