



# 10 MYTHS TO FILING AN SR&ED CLAIM



*The Canadian government has come a far way since the long gone days of the abused SRTC (Scientific and Research Tax Credit) program. Since 1985, the government has made available the SR&ED (Scientific Research and Exploratory Development) program to effectively motivate an increase in industrial research and exploratory development. This program provides tax credits which are worth up to 68.45% of the incremental SR&ED spending and are refundable for companies that are at a pre-revenue stage. With considerable industry collaboration, the program has been updated and modified over the last 20 years, to improve its effectiveness. It appears that the program is now at a stage where it is working quite well. Nonetheless, given its long history, there are quite a number of misconceptions about the program that may be deterring companies from filing an SR&ED claim.*

*This article will discuss 10 common myths that may be preventing companies from taking advantage of the program. As a prelude, it is important to note the 3 fundamental criteria for eligibility to file an SR&ED claim.*

*They are:*

1. The work done must have been undertaken with the goal of achieving a technological advancement
2. There must be uncertainty in the outcome of the project at the outset
3. The scientific method must have been employed in working through the project

These 3 criteria, in effect, become the 3 immutable laws of filing an SR&ED claim. With this basic understanding, the following are the 10 myths which may steer companies astray.

### **1. You have to reveal your secrets**

Filing an SR&ED claim is about demonstrating to the government that you have a valid claim, i.e. meeting the 3 immutable laws which constitute SR&ED and being able to support your claim. As such, the filing consists of a top down presentation of your efforts. Going down to more detailed discussions is only necessary insofar as it is needed to prove that you indeed meet the 3 fundamental criteria. As such, this means that it is not necessary to explain the fundamental principles of your technology advancement as would be necessary in a patent filing for example. As far as access to your specific information, the government has the strictest security in handling the corporate documents themselves. Once your SR&ED filing has been received by your filing tax office, the documents are transferred with special secure mailing to your CRA review office. Within the CRA office itself, there is authorized and controlled access to the filing room itself. Rest assured, the government program is there to provide real financial assistance to those that qualify under the program. Your technological advancements remain completely private to your company.

### **2. It takes forever to get your claim approved**

In the past it may have taken up to 18 months to get your file processed, but this is certainly not the recent past. The government has made the necessary efforts to ensure that the processing times have come down to a point where companies can make near term plans as to how they will use the money. This includes quite a sizable technical staff who has the ability to fully grasp the essence of what you are presenting. In addition, the technical staff are partnered with financial reviews in a joint approach. This then ensures that the claim review cannot get bogged down in either aspect (i.e. technical or financial), as the reviewers are collaborating to ensure that the review is efficient and timely. As for actual processing times, Canadian controlled private corporations (CCPC) are given the highest priority. The government's goal is to take a completed filing, with no missing or incomplete information and have a cheque issued within 4 months.

### **3. Our work does not qualify because our business is not in science or technology**

The SR&ED program is not for the exclusive domain of science and technology companies. The program is focused on driving technological advancement regardless of what business you are in. Inherently, it means that

you have to take some technical risks in coming up with technological advancements in how you run your operations (i.e. processes) or in your product offering itself. The fact is that many businesses do this type of activity in order to maintain a competitive position within their marketplace. An example of a non-technical business that would qualify is a tomato grower who has experimented with ways to produce larger tomatoes.

#### **4. There is a lot of work in setting-up formalized process in order to file an SR&ED claim**

There are no special company processes that are necessary in order to file a claim. The government is primarily concerned with your ability to support your claim and provide appropriate proof as to its validity. Both the claim filing and claim support information are drawn from the processes that are native to your company. Many supporting documents will stem from normal communication records such as meeting minutes or internal e-mails which report the status of various projects. Ultimately, there does need to be sufficient level of records for the claim to be approved. The work of filing is not in following some prescribed process but in extracting the appropriate information to support qualifying technological advancements.

#### **5. It is not worth the bother**

Filing an SR&ED claim is well worth the bother for 2 reasons: (1) The tax credits are very significant and (2) The tax credits are refundable for small companies. Without going through a detailed calculation, if we consider a company that spends \$100k on salaries to perform the SR&ED, the tax credit refund which a Canadian controlled private corporation (CCPC) would receive is \$68.48k (assuming a typical provincial participation). If the CCPC had no taxable income or was at a pre-revenue stage, they would receive a refund in the full amount. Larger corporations would receive amounts that are somewhat reduced from this but they are still quite significant. Now you can think about this in many ways: you can do more SR&ED, you can hire better, you can expedite your projects. No matter how you look at it, the SR&ED program has the ability to be a regular on-going source of financing for you.

#### **6. We don't do research here and standard engineering and development does not qualify**

It is a common misconception that engineering and development are just part of what a company needs to do and would not qualify for an SR&ED tax credit. While this statement is technically correct, you must look at your work from an SR&ED orientation. That is, you must first determine whether you have an advancement that meets the 3 criteria as set down by the SR&ED program. If there is such an advancement, then supporting activities to the SR&ED work would also qualify as valid SR&ED expenditures. Among other things, supporting activities include standard engineering and development work if those activities are a necessary part of the SR&ED and they would not otherwise have been incurred. An example of this would be the building of a custom test jig that is necessary to test a prototype; alternately, the programming of a custom user-interface to test software that is SR&ED.

#### **7. Our claim was rejected so there is no point in continuing**

While this might be true, as long as you are not beyond the time limit (18 months after fiscal year end), it is important to review the reasons why it did not get approved. If at the heart of the matter you have achieved a technological advancement, then it is a matter of ensuring that the claim is adequately prepared from both the technical aspects and the financial aspects. Even though the government has a highly skilled technical staff in order to understand what you have done, they are not experts in all of the various fields. Hence, at times their judgment may be off. If you believe that you could prove your technological advancement in front of a group of peers, then it is worth defending your claim, even if you have to provide what effectively amounts to "expert witness testimony". On the financial side of things, it is conceivable that you could be claiming costs in a different way than has been done before, and that are justifiable for your project. If you can explain and prove why it needs to be so, then do so. Remember, especially with your first claim, you are establishing a precedent for how your future claims will be treated.

## **8. We contract out so we don't have anything to claim**

Whether you contract out or not, a claim for SR&ED is valid if it meets the 3 fundamental criteria for the overall project. What is important to note is that the SR&ED cannot be claimed by both you and the contractor. It is therefore important to make it clear in the contract agreement that the contractor will not own the SR&ED rights to the work. In the case where the overall project produces a technological advancement and the parts of it that are contracted out represent routine development work, it is still possible to claim these as they may form an essential part of the overall SR&ED project. An example would be if you have a project which makes a technological advance in a manufacturing process and the software portion of the work is contracted out. As long as the software is integral and essential to the overall project, it can be claimed.

## **9. We already receive government assistance and are not able to claim SR&ED**

It is correct to say that you will have to deduct the government assistance from the SR&ED claim which you are submitting. This does not mean that you are not able to make the SR&ED claim at all. If there are projects that meet the 3 fundamental SR&ED criteria, you are able to file a claim within the filing deadline, and there are still benefits to doing so. If the SR&ED credits add up to an amount that exceeds the level of government assistance, then you have a credit or refund that you obtain. Secondly, if at some point in the future, you are obliged to make repayments to the government for the assistance, you can then begin to take back the SR&ED credits that were previously held back. If you had not made an SR&ED within the filing deadline when the opportunity existed, then you would lose out on this option.

## **10. Our project failed and therefore we would not qualify for SR&ED**

Failure of the project is not part of the criteria for assessing whether a claim is valid. Your project must meet the 3 fundamental criteria to qualify and that is all. If anything, failure of your efforts clearly highlights the fact that there was technical risk and that the outcome was uncertain. Failures and set-backs are in fact common on the road to achieving technological advancement. In fact, it is the aversion to risk-bearing and failures that the government is trying to alleviate. So, failure is perfectly alright and understood when it comes to making an SR&ED claim.

So there you have it. By providing such strong incentives to those that are willing to undertake efforts to achieve technological advancement, it eases the financial burden of progress. Furthermore, it entices more companies to look for ways to strive for technological advancement. This in turn has great benefits for our overall knowledge base and for the overall health and growth of our economy. Exactly what the government is after. So don't hesitate, put the myths behind you and look for ways in which you can take advantage of this excellent government program today.

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