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SR & ED Update – Iwasan's Newsletter

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CCRA – A New Attitude Toward the SR&ED Program

Recently, Canada Customs and Revenue Agency invited the principals of Iwasan, Chris Stevens and Peggy Mooney, to two informative meetings:

- An "Outreach" seminar presented by the Financial Legislative Application Section with regard to the recent changes in legislation affecting "materials consumed" and "materials transformed".
- A SR&ED "Claim Process Review" strategy meeting.

It was evident in both meetings that CCRA is committed to changing the administration of the program including internal and external attitudes towards the SR&ED program.

A significant step forward is that CCRA is making some language changes to reflect their commitment to providing SR&ED tax credits as an "incentive" program and getting away from the idea that they are program enforcers. They are no longer referring to visits from CCRA financial and science people as "audits" rather they are referred to as "reviews". Applicants are now referred to as "claimants" and not "taxpayers". Divorcing the SR&ED incentives program from the tax collection mentality of CCRA is a positive step forward and hopefully will be reflected in the way claims are reviewed.

CCRA Recognizes Small Companies Not Claiming When Entitled

CCRA has acknowledged that the SR&ED program is not being effectively delivered to small and medium size companies. Several things deter companies from claiming: they made an attempt to claim in the mid 1990's and were scared away from the program by the enforcement attitude encountered; or they conscientiously made the decision not to claim because of the uncertainty of receiving the refund; or do not claim due to the amount of effort it takes to compile a claim.

CCRA is inviting companies back to the program or if they have never claimed, they are encouraged to claim now. CCRA is citing 50% of claims filed are approved with only a desk review and 70-80% of all dollar amounts claimed is being approved.

Materials Consumed vs Materials Transformed

The treatment of materials for SR&ED claims is the subject of a new Application Policy put out by CCRA. A subtle change in the wording of the legislation has caused a significant change to the treatment of materials for SR&ED projects.

• **MATERIALS CONSUMED**

The cost of materials consumed in the prosecution of SR&ED is an allowable expenditure under both the proxy method and the traditional method. Consumed in the prosecution of SR&ED basically means that the materials must be destroyed or rendered virtually valueless as a result of the SR&ED.

- ***MATERIALS TRANSFORMED***

Materials that are transformed into a product are not materials that are consumed in SR&ED. This means that the cost of materials transformed is an allowable expenditure, but only if the corporation uses the traditional method. Another new twist is that if the product of the SR&ED is sold or converted to commercial use after Feb 23, 1998, there will be a recapture of the ITC on the materials, as an addition to the taxable income of the corporation in that year.

Where the claimant uses the proxy, the materials transformed are not allowable, they are covered by the 65% proxy.

This means that in projects where materials are a significant part of the claim a comparison will need to be made to determine which methodology is most advantageous in that year. So much for the simplicity of the proxy method!

Claim Process Review Strategy

CCRA is presently having consultative sessions across the country with their own employees, industry, tax professionals, and consultants with the goal to developing a system to review a company's system for determining what work does or does not qualify for SR&ED, and how the related expenditures are captured. This concept is in its infancy and appears at the outset to be well suited to very large, organized corporations. In fact, it was stated by CCRA at the session that it would have little benefit to smaller corporations that spend a few days compiling their claim and with 1 or 2 day reviews by CCRA.

However, the good news for companies of all sizes is that CCRA intends to recognize the documentation/evidence already in existence in corporations (outside what is produced for the SR&ED application), such as prototypes, current state of technology vs. state of technology at outset of the project, etc. when reviewing the science eligibility.

Iwasan Consulting acts as consultants in the area of SR&ED applications, Provincial Incentives & IRAP programs. Call us today for a complimentary review of your claim potential.