

A comparison of the administration of the Canadian Scientific Research and Experimental Development (SR&ED) tax credit program to the UK R&D tax credit program

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PURPOSE

The purpose of this paper is to compare, review, and comment on the effectiveness of the administration of Canada's Scientific Research and Experimental Development (SR&ED) tax incentive program and the UK's Research & Development (R&D) tax relief scheme.

As this paper will demonstrate both countries' programs have essentially the same criteria as to what constitutes eligible SR&ED/R&D for the purposes of earning a tax credit. In fact, the UK R&D tax relief scheme, which came into effect between 2000 and 2002, was modeled in large part on the SR&ED tax incentive program, implemented in 1985.

While the criteria for a project to qualify under both the Canadian and UK programs are the same from a technological perspective, the manner in which the programs are administered by Canada Revenue Agency (CRA) and Her Majesty's Revenue and Customs (HMRC), respectively, is strikingly different.

We can see the results of these differences come through in the rankings of each country on the R&D/Innovation Ranking. While the UK was able to propel itself from 14th place to 2nd place, Canada has faltered from 12th place to 16th place.

The UK also tracks and regularly reports on the effectiveness of its R&D tax credit program. HMRC publishes these results using econometric studies. For every £1 of R&D tax credit given out, £1.53 to £2.35 of additional expenditure by UK firms is generated (HMRC Evaluation of Research & Development Tax Credit March 2015, **Rigmor Kringelholt Fowkes, João Sousa, and Neil Duncan**).

Unfortunately, CRA does not report these findings. There have been econometric studies in the past by other non-CRA organizations on the SR&ED program but none have been completed in the last 5 years, to our knowledge. This is a significant and inexplicable accountability flaw within the program.

OBJECTIVE OF R&D TAX CREDIT PROGRAMS

Generally the objective of R&D tax credit programs is to stimulate industrial R&D. This means the focus is on new or improved products and processes in respect of for profit corporations (see Note 1). Many countries around the world have R&D tax credit programs, with Canada being one of the first countries to adopt such a program in 1985.

Virtually all of these countries, including Canada and the UK, have adopted a very similar definition of R&D, based on the Frascati Manual. The Frascati Manual was originally written by and for experts in OECD member countries who collect and issue national data on R&D. Over the years, it has become the standard of conduct for R&D surveys and data collection not only in the OECD and the European Union, but also in several non-member economies. The definition is structured to permit and encourage companies to develop new or improved products and processes and in so doing, to advance technology through experimental development. While both Canada and the UK permit basic research and applied research, most R&D tax credit claims in both countries fall under the category of experimental development (rather than pure scientific research). Manufacturing- and tech-based businesses (i.e. software-based businesses) comprise the majority of R&D tax credit claimants.

ELIGIBILITY REQUIREMENTS

For a particular SR&ED/R&D project to qualify for tax credits, in both Canada and the UK, three key criteria need to be met; the presence of technological advancement, systematic investigation and technological uncertainty. As demonstrated in *Appendix A* both these definitions in each country are the same. This is not a surprise as the UK program was modeled after the Canadian program.

Apart from these three key criteria, *Appendix A* reviews and compares all significant criteria set out in these documents.

BENEFITS UNDER THE CANADIAN AND UK PROGRAMS

While, for the purposes of this paper, we are most interested in comparing the effectiveness of each administration in paying out the benefits, it is a worthwhile exercise to review the differences in the calculation of the benefits for each country's program.

Small Medium Enterprises (SME's) in Canada can earn a refundable tax credit of roughly **40%** (Note 2) of eligible SR&ED costs, whereas SME's in the UK earn R&D tax credits of roughly **25%** if in a profitable position and refundable tax credits between **12%** and **32%** if in a tax loss position.

For Large companies, the R&D tax credit rate is **15%** in Canada and **11%** in the UK (under certain circumstances, e.g. funded projects, SMEs in the UK can make a claim under the large scheme).

The costs which qualify for R&D tax credit purposes are very similar in both countries (direct wages, contract fees and materials consumed in R&D), however the UK permits expenditures incurred anywhere in the world as long the costs are charged to the UK entity and the eligible work related to said costs was carried out under the direction of UK personnel. Only costs related to work performed in Canada by Canadian residents are permitted under the SR&ED program.

BALANCING INTEGRITY AND TOLERANCE

There is always a balancing act in administering an R&D tax credit program. On the one hand, the program should be designed to prevent abuse and maintain integrity, consistency, and accountability. On the other hand, the program should incentivize companies to undertake R&D, and should be practical, cost effective, and place a minimum compliance burden on the R&D claimant. Overall the program should contribute to the economic wealth of the country.

A government has a number of options to administer a R&D tax credit program. This is where Canada and the UK have taken opposing routes.

In the Canadian government's 2013 Action Plan, the following action items for the SR&ED program were cited:

"The Canada Revenue Agency will also receive new funding of \$15 million over two years to focus more resources on reviews of SR&ED program claims where the risk of non-compliance is perceived to be high and eligibility for the SR&ED program unlikely. The Canada Revenue Agency will also more frequently apply penalties for false statements or omissions, where appropriate. In addition, in order to enable better risk assessment, SR&ED program claim forms will be revised to require more detailed information. To enforce this new requirement, Economic Action Plan 2013 proposes that a new penalty be applied in instances where the new required information is missing, incomplete or inaccurate. These new initiatives will help protect the integrity of the SR&ED tax incentive program."

As a result CRA now undertakes an extensive review to ensure the claimant's SR&ED project qualifies. Based on national statistics, a very high percentage of all SR&ED claims are selected for review; approximately 62% of all SR&ED claims filed are referred by the Taxation Centre to the district offices (Note 10). In our experience, the site reviews on average take 10 months to complete (Note 11) and require substantial hours of additional company personnel time. HMRC reviews are much less frequent and take an average one month to complete a site review, requiring approximately 10 hours of the company's time.

In Canada, CRA employs two representatives, one financial and one technical to review SR&ED tax credit claims filed. Generally the UK only uses one financial HMRC representative to review a claim, however HMRC does have a few technical staff that they can call up on rare circumstances where a determination of project eligibility cannot be made.

These extensive and detailed reviews by CRA have resulted in more SR&ED claims being turned down or drastically reduced. For example, in the Greater Toronto Area (GTA), SR&ED ITC's allowed over ITC's claimed was 57%. This is compared to an average of 78% for the years 2005 to 2009 (Note 10).

Since the changes were enacted under Canada's 2013 Action Plan, businesses which had successfully made SR&ED claims for a number of years (some of which had their SR&ED reviewed by CRA in previous years), find their projects no longer qualify as SR&ED (Note 12). Under a CRA review the prevailing tendency is to review the project in minute detail, which typically results in breaking down the project into individual, low-level activities, where each activity on its own can only be seen as without technological advancement or uncertainty. Furthermore, contemporaneous, SR&ED specific evidence in support of each claimed activity is examined by CRA, and failure of such evidence to explicitly state the link to a specific technological advancement/uncertainty is grounds for denying eligibility.

The HMRC reviewers tend to take a more holistic review approach, and decide if the company's competent professional (Note 3) has reasonably articulated and identified the technological uncertainty and advancement for the project as a whole. It is interesting to note that recent court cases in Canada have sided with the UK approach and have rejected the detailed CRA approach (Note 4).

Under the UK program the policy has been that the competent professional at the company is in the best position to judge if a particular project qualifies under the R&D tax credit program. During an HMRC review of a claim, the claimant's competent professional is questioned and if the responses are reasonable to the HMRC representative, the project is accepted as meeting the R&D tax credit requirements.

The HMRC representative then examines the R&D costs claimed to ensure the costs have been paid and recorded on the company's books; that the costs are reasonably allocated to the R&D project; that the costs are directly related to the R&D project, and the types of costs claimed are permitted under the tax rules. In effect, by examining the costs HMRC meets its obligation to ensure the program has integrity and abuse of the program is kept in check.

WHY IS THERE A DIFFERENCE IN APPROACH BETWEEN THE UK AND CANADA?

The Frascati Manual definition of SR&ED and R&D is a respected definition, and widely used by many other countries; however, the definition is open to subjectivity. In setting the definition, the objective was to include all businesses developing new/improved products/processes in the hard sciences, as the definition was purposely meant to be inclusive. This is also evident in the objectives set out in Note 1 below by the Canadian Department of Finance.

However in doing so, the definition can only provide a general overview of the principles to be followed. Over many years of working in this area we have seen groups of competent professionals such as engineers, and software and hardware specialists argue for and against the eligibility of the same project. This has occurred both within CRA (where we have seen technology advisors and their managers disagree on a project's eligibility) and by competent professionals in the industry.

To address this important issue the UK (HMRC) has stated;

“There may be differences of opinion between competent professionals in a particular field. Where the view taken is a legitimate one, and it has been reached by a competent professional properly exercising his expert judgement then it should normally be accepted.”

“While due weight will be given to an opinion offered by the company’s competent professional as to whether there is an advance in science or technology being sought, it will not necessarily be conclusive of the issue, and further enquiry may still be needed.”

HMRC has taken the view that the key R&D staff within the company are the ones qualified to make the determination of R&D tax credit eligibility. By asking common sense questions HMRC advisors can assure themselves of the reasonability and eligibility of a R&D tax credit claim.

In our experience, CRA’s approach is to permit very little discussion, which allows the company’s key R&D staff to articulate why their projects qualify as SR&ED. Because CRA uses technical staff (RTA’s) to assess claims, the site review often ends up with the CRA RTA educating the company on the rules without developing a true understanding of the SR&ED carried out.

The UK also takes a reasonable approach to documentation and supporting evidence for an R&D tax credit claim. As it is an incentive program the HMRC look to work with companies to ensure sufficient records are kept. Again, HMRC wants to ensure that the support can allow a reasonable conclusion that the work was done.

In our experience, there appears to be zero tolerance from CRA on the documentation level. When a conflict in opinion arises with a claimant’s key R&D personnel or competent professional, CRA then proceeds to rely on what can be demonstrated via contemporaneous project documentation. As per CRA’s Eligibility of Work for SR&ED Investment Tax Credits Policy, the test for determining whether SR&ED has taken place requires that the claimant keep a record of the hypotheses tested and the results kept as the work progressed. These records must form a sufficiently detailed and organized recording of the work undertaken during experimentation and analysis that the work could be repeated, if necessary. Thus, even in cases where the claimant can provide convincing testimony for why a project should be considered eligible, CRA requires detailed contemporaneous physical evidence to explicitly substantiate this testimony, and where this cannot be readily produced, the CRA will deny the eligibility of the work.

Another area of difference is defining a R&D/SR&ED project. While the UK/CRA definitions are the same, the UK takes a more holistic view of the project. This is evident in their examples of what constitutes a R&D project. For example if a company were improving their DVD player, that would be the R&D project (Note 7). Wherein Canada, CRA would break the development down into subprojects and require that each subproject meet the definition of SR&ED. CRA distills the work down into minute activities that, on their own, cannot possibly meet with criteria. As one CRA RTA told our client, the development of the iPod would not have qualified as SR&ED.

While these differences between the Canadian and UK procedures may appear subtle, in practice it has a dramatic effect. As a firm we have been told by numerous companies that they are now frightened to claim because potential audits come with an onerous process and unpredictable results.

RESULTS OF THE PROGRAMS

As a firm who assists companies in both Canada and the UK to obtain R&D tax credits and government grants, we have been able to compare the perception that our clients have of the program as well as monitor certain results. In addition, we have also been exposed to the business culture in both countries. When we started working in the UK in 2006, we were actually quite surprised to find that the business culture in the UK and Canada are very similar. The tax system, Government incentives, and the way companies do business in terms of innovation, risk and productivity are very similar; much more so than when we compare our clients in Canada and the US.

In 2010 both Canada and the UK found themselves in the same position. Both countries ranked relatively poorly in the Innovation ranking countries (Note 5). In addition, both countries' manufacturing industries were particularly hit hard by the recent economic recession. The UK also suffered from the financial fallout of 2009 more so than Canada. Many SME's in both Canada and the UK struggle to obtain financing to develop new products and both countries financial institutions have a relatively risk averse lending strategy.

By vigorously promoting various policies, of which the R&D tax credit program was one, the UK increased its R&D/Innovation ranking in 2015 to number 2 on the Global Innovation Index, up from a ranking of 14 in 2010. Comparatively, Canada dropped to 16th place in 2015, down from 12th place in 2010 (Note 5).

As mentioned above, the UK tracks and regularly reports on the effectiveness of its R&D tax credit program. For every £1 of R&D tax credit given out, £1.53 to £2.35 of additional expenditure by UK firms is generated (HMRC Evaluation of Research & Development Tax Credit March 2015, **Rigmor Kringelholt Fowkes, João Sousa, and Neil Duncan**).

Unfortunately, there are no similar statistics published by the CRA to compare with. Non-CRA organizations have released econometric studies on the SR&ED program in the past, but to our knowledge none have been completed in the last 5 years.

On a positive note, CRA publishes service standards. An example of CRA's service standards are outlined at Note 6. For SME's CRA generally processes a file within 4 months, assuming the SR&ED claim is filed within 6 months of year end. However by contrast, in our experience HMRC processes a refundable R&D tax credit claim within 30 days, and most non- refundable claims for SME's in our experience are processed in 3-4 weeks.

The number of SME claims processed by HMRC in 2013 were approximately 13,000 and roughly 18,000-20,000 SME claims were processed by CRA in 2013.

OBSERVATIONS

A culture or attitude towards a program by the government officials that implement the program can have a dramatic effect. For a large part of the initial years of the SR&ED tax incentive program up to 2013, the program was truly regarded as an incentive program by CRA. This attitude has now changed. The Action Plan of 2013 has put the taxpayer on the defensive when CRA carries out a site review. This is evidenced by the high review rate by CRA (60% of all SR&ED claims are reviewed; Note 11). These high rates of review are indicative of a program that the government now perceives as abusive, along the lines of offshore tax shelters. In actual fact the rates of abuse under this program are extremely low, much lower than any compliance activity under the Income Tax Act. The program has been in effect for over 30 years and we could find only three reported cases in total of convicted fraudulent claims, where, for most of the past 30 years, over 20,000 claims are filed each year.

We believe the Canadian system has a number of systemic problems and that adopting the UK approach would have a better outcome for the following reasons;

1. Both R&D tax incentive programs have been in existence for at least 15 years. There has been no difference in either country as to reported abuse. Both programs seem to be effective in preventing abuse largely due to the fact that each government carries out a review of the claims. The mere fact that a review may be carried out by HMRC or CRA is a strong preventative measure. The harm caused by fraud is on the financial side, where both countries have detailed reviews in place. An online search of fraud or gross negligence charges in both Canada and the UK reveal very few court cases since the programs began.
2. The current training of the CRA technical advisors in Canada and the detailed review of the technical merits of each SR&ED claim has led to a scrutiny of SR&ED claims at task level and therefore has resulted in improper judgment of SR&ED claims. The results of the training also seem to be quite varied. For example the Toronto area CRA offices deny twice as many SR&ED tax credits as the national average, on a site review (Note 11). This appears to go against the Taxpayer Bill of Rights which states "You have the right to have the law applied consistently."
3. The SR&ED program has been in effect for 30 years, yet in the GTA in 2015 over 65% of claims were adjusted on a CRA site review (Note 11). This figure is much too high for a mature program.
4. The action plan in 2013 and subsequent retraining has created a culture within CRA that a project claimed as SR&ED is guilty until proven innocent. Based on our experience there is zero tolerance with materiality limits when it comes to exercising reasonable judgment. As a firm we have attended many CRA site reviews and our clients have felt under attack and treated as if they were lying.
5. The OECD, which monitors the effectiveness of R&D tax credit programs in countries that have these programs, has recommended that since for *"countries that have experienced a large number of R&D tax policy reversals, the impact of such policies on private R&D expenditure is greatly diminished (Westmore, 2013). It is therefore important that governments do not repeatedly tinker with such policies to minimize policy uncertainty for firms."* We believe the government action item introduced in 2013 has had a detrimental effect on the program.
6. Taxpayers understand that integrity needs to be maintained. Taxpayers easily comprehend that costs claimed that were never paid and claims for non R&D personnel need to be guarded against. However we believe there is much less benefit to the program where a clear consensus on what constitutes SR&ED cannot be achieved. This is evidenced by the fact that a significant percentage of SR&ED claims are adjusted (Note 11).
7. We do not believe there is a strong policy in place, which permits the head office of the SR&ED program to achieve consistency. Technology advisors within CRA have considerable power when reviewing SR&ED claims. Rarely have we seen a technical manager or financial reviewer at CRA overturn a technical advisor's decision. As noted above, there are wide differences in acceptance of SR&ED claims between CRA offices and districts. In addition we suspect this is also true relating to the acceptance rate by individual technology advisors. By contrast there is little recourse for a claimant to argue disagreements with respect to an RTA's determination on technical eligibility. In effect, these are often differences of opinion and while the claimant is provided a means to rebut the RTA's determination per the science report, we have been told by CRA representatives that these are rarely changed unless an error can be proven.
8. The UK program has a practical, quick and effective mediation process. There is no accountability for errors made by CRA technology advisors and financial reviewers. The process to object to inaccurate judgements by these reviewers is handled by a separate division within CRA or in tax court. These take years to be resolved, resulting in frustration, financial hardship and a reduction in future innovation by the companies making these claims.

RECOMMENDATIONS

1. We recommend that CRA revise its detailed and overly extensive site reviews and carry out reviews that are consistent with the objective of the program. We think the manner in which the UK has administered the program has resulted in superior results in terms of;
 - incentivizing companies to increase their R&D spend
 - maintaining an efficient cost structure to run the program within the government (the UK program requires far fewer personnel than the Canadian program, by virtue of the fact that only a few technical advisors are employed by the UK, whereas Canada has an equal number of technical and financial advisors)
 - overall achieving a higher satisfaction rating by the public
 - maintaining confidence in compliance with the program's requirements
2. There should be more transparency and publishing of results. Again, statistics similar to the statistics published by HMRC should be issued by CRA. This would provide feedback to the public on the results of the program as to how companies and the economy are benefiting under the program. To start, an analysis similar to the UK where statistics are kept as to what every \$1 of SR&ED tax credit generates in terms of incremental R&D spending.
3. CRA needs to revisit the SR&ED policy as to whether the program is to be administered as an incentive program or administered as risk program subject to a high degree of compliance. Currently there is a very high degree of audit/site reviews; disallowed SR&ED claims and notices of objection have escalated; site reviews are lengthy and rarely are any opinions provided by RTA's until a science report is issued. Clearly at this point in time the role of the CRA is not to help the claimant with their SR&ED claim.
4. CRA should review and act upon inconsistencies within the offices across Canada. If certain offices or technology advisors are posting results that are out of line with national averages, investigations and retraining should be carried out. For example, if a district office on average posts downward adjustments to SR&ED claims in the amount of 45%, where the national average is 20%, then this gross inconsistency needs to be investigated and addressed. A strong national centre for CRA/SR&ED should have the authority and accountability to maintain consistency in the program across the country.
5. We believe greater consistency will be achieved if the site review focuses on technological advances and uncertainties at the project level rather than at the activity level. In addition, greater reliance should be placed on understanding the position of the competent professional of the company on eligibility rather than relying solely on what can be directly gleaned from physical project documentation and evidence.
6. We would ask CRA and the government to consider the UK example where only one financial reviewer from HMRC is required. There should be one or two technology advisors per office that are needed on special cases. This would greatly reduce the cost of administering the program.
7. At any point in a HMRC you can ask for mediation, on any issue. We recommend CRA consider this approach.

HMRC has an Advanced Assurance program which allows small companies to have their R&D claims preapproved without further inquiry for the first 3 years. This program should be adopted by CRA (Note 9).

CLOSING COMMENTS

Overall we believe the SR&ED program is a very beneficial and effective program for the Canadian economy as a whole. As opposed to direct business funding, we have found a properly run tax incentive program to be more predictable for business. Companies certainly want to know that if they follow the rules they will receive tax credit funding.

We have the advantage of working with many SME's in Canada, and all of them are building great new products. Our clients are responding to the challenge of making Canada an innovation powerhouse. However, CRA is creating an environment that is very detrimental to the original objective of the program, which is to encourage R&D spending in Canada. Clients who made successful claims in the past count on the SR&ED funding for further development (given they can't get this funding from their financial institution), and when they are turned down based on new, severe criteria along with audits that take 8 months on average to complete the results of which are unpredictable, the impact on their cash flow is very debilitating.

Our clients are very frustrated and we have reason to understand this frustration extends well beyond our client base. We have clients that are world leaders in their technology only to be told their technology is routine and their claim is disallowed. One cannot underestimate the effect of this message being sent by CRA and the government. If this groundswell of SME frustration is not stopped, Canada as a nation will stifle innovation especially with SME's. SME's rely on SR&ED funding to not only to spur additional innovation but to finance part of the R&D costs, where banks will not provide such lending.

The SR&ED program can be a tremendously effective and influential program. If we follow the policies similar to those in the UK, which encourage innovation, we can also rise to be one of the top ranked countries in the world for innovation.

NOTES

1. Excerpt from the Department of Finance Consultation Paper – October 2007

The scientific research and experimental development (SR&ED) tax incentive program is the single largest federal program supporting business research and development (R&D) in Canada, providing over \$3 billion in tax assistance to Canadian businesses in 2006. The SR&ED tax incentive program plays, and will continue to play, a leading role in fostering a competitive and dynamic business environment in Canada. The Government is undertaking a consultation exercise on the SR&ED tax incentive program because it believes that we can build on the program's successes

Both *Advantage Canada* and the S&T Strategy commit the Government to maximize the impact of the Government's investment in R&D. Increasing the impact of federal business R&D assistance programs is an important component of the Government's commitment. One element of achieving this objective, as set out in both Budget 2007 and the S&T Strategy, is to improve the SR&ED program, including its administration, to further encourage R&D within the business sector in Canada.

The federal income tax incentives for SR&ED are intended to provide broad-based support for SR&ED performed in every industrial sector in Canada, and to support small businesses in the performance of SR&ED. The rationale for this tax support is that the benefits of SR&ED extend beyond the performers themselves to other firms and sectors of the economy. The existence of these spillovers, or externalities, means that, in the absence of government support, firms would perform less SR&ED than is optimal for the economy.

2. Tax Rates

a. SR&ED tax rates in Canada

Type of Entity	Nature of Expenditure ¹	ITC rate on total expenditures up to the expenditure limit ²	Refund Rate	ITC rate on total expenditures in excess of expenditure limit ²	Refund Rate
Qualifying CCPCs ³	Current	35%	100%	15% ⁴	40%
	Capital	0	0	0	0
Other Corporations	Current	15%		15%	
	Capital	0		0	

(1) Starting January 1, 2014, expenditures for R&D capital property are excluded for ITC purposes.

(2) The expenditure limit is \$3 million.

(3) **Qualifying Corporation** – A CCPC whose prior year taxable income of the associated group (before any loss carrybacks) is below the "qualifying income limit."

Qualifying Income Limit – A CCPS's Qualifying Income limit is \$500,000. However this amount is reduced by \$0.0125 for every \$1 of the prior year's taxable capital of the associated group employed in Canada is above \$10 million, up to a maximum of \$50 million.

- (4) A CCPC also has an expenditure limit for their maximum amount of SR&ED costs it can claim to ear the 35% refundable ITC. Generally, a CCPC's \$3 million expenditure limit in respect of the 35% credit is reduced by \$10 for every \$1 by which the previous year's taxable income of the associated group exceeded \$500,000, up to \$800,000.
- (5) Starting January 1, 2014, the ITC rate was reduced to 15% from 20%.

b. R&D tax rates in the UK

SME Scheme

Date	Enhanced expenditure (cost plus 130% uplift)	Tax saving (profitable)*	Tax credits (loss making)
4/1/15 onwards	230%	26%	33.35%

* in addition to existing saving of 20%

Large Company Scheme

Date	ATL Credit
1/4/16 onwards	11% (subject to tax)

3. Competent Professional

The expression 'competent professional working in the field' has not been defined as the natural meaning is considered to be self-explanatory. In respect of their field of expertise one would expect such a person to:

- i) Be knowledgeable about the relevant scientific and technological principles involved,
- ii) Be aware of the current state of knowledge, and
- iii) Have accumulated experience and be recognised as having a successful track record.
- iv) Simply having worked in a field or having an intelligent interest in it does not, by itself, make a person a competent professional.
- v) There may be differences of opinion between competent professionals in a particular field. Where the view taken is a legitimate one, and it has been reached by a competent professional properly exercising his expert judgement then it should normally be accepted.

4. Court Cases Refuting CRA's Position on Project Eligibility

- a. Les Abeilles Service de Conditionnement Inc (Tax Court Canada October 2014)

The courts awarded judgment to Les Abeilles and concluded that;

- (i) To evaluate a SR&ED project the entire project must be considered not lower level activities in isolation.

- (ii) There is no statutory requirement to keep and provide the level of supporting documentation sought by CRA. However, sufficient evidence should be in place to support the work done in the timeframe of the claim period.

5. Innovation Statistics Taken from Global Innovation Index

As an example see for 2015 country rankings,

<https://www.globalinnovationindex.org/userfiles/file/reportpdf/GII-2015-v5.pdf>

6. CRA Service Standards Taken from Service Standards Report

Our service standards

The SR&ED Program has the following service standards for processing SR&ED claims:

- refundable claims – 120 calendar days from receipt of a complete claim
- non-refundable claims – 365 calendar days from receipt of a complete claim
- claimant-requested adjustments to refundable claims – 240 calendar days from receipt of a complete claim
- claimant-requested adjustments to non-refundable claims – 365 calendar days from receipt of a complete claim

The SR&ED Program is committed to meeting these service standards at least 90% of the time.

Success rate

Our annual results are published in the Canada Revenue Agency's (CRA) Annual Report to Parliament. Our success in meeting these standards is measured by the percentage of files processed within the standard. CRA processing time is the number of calendar days it takes for the CRA to process claims from the time a complete claim is filed to the time the review is complete, excluding delays outside of the CRA's control.

The table below shows our results for the current fiscal year up to the end of the last completed quarter. The first column indicates the type of claim. The second column indicates the percentage of claims where the service standards are met in relation to CRA processing time. The third column indicates the CRA's average claim processing time in days. The fourth column indicates the average number of days associated with delays outside of the CRA's control. The fifth column indicates the total claim processing time.

Situations that may lead to delays outside of the CRA's control include:

- Filing an incomplete claim
- Filing an SR&ED claim without filing the associated income tax return
- Not filing a claim at the appropriate tax centre or filing a claim at a tax services office
- Being unable to respond to CRA's requests for information in a timely manner

- Postponement or inability to schedule meetings with the CRA
- Being unable to respond in a timely manner to a proposal letter sent by the CRA
- Reviews of prior year SR&ED claims impacting the review of the current year claim
- Modification to a claim during the course of a review
- Requests by claimants that the review of their claim be delayed

Success Rate and Average Processing Times

April 1, 2015 to March 31, 2016

This table show the success rate and the average processing times of the different type of claims.

Type of Claim	CRA Success Rate	Average Days (within CRA's control)	Average Days (outside CRA's control)	Total Average Time (days)
Refundable claims 120 days	95%	39	28	67
Refundable claimant-adjusted claims 240 days	95%	103	56	159
Non-Refundable claims 365 days	97%	90	72	161
Non-Refundable claimant-adjusted claims 365 days	93%	157	108	265
All claims	95%	65	45	110

7. Example of An R&D Project (Excerpt from HMRC CIRD 81900)

A1. A company conducts extensive market research to learn what technical and design characteristics a new DVD player should have in order to be an appealing product. This work is not R&D (paragraph 37). However, it does identify a potential project to create a DVD player incorporating a number of technological improvements that the company's R&D staff (who are competent professionals) regards as genuine and non-trivial. This project would be seeking to develop an appreciably improved DVD player (paragraphs 23 - 25) and would therefore be seeking to achieve an advance in science or technology (paragraph 9 (c)).

A2. The company then decides on a detailed specification for the desired new product, and devises a plan for developing it. Some elements of this plan involve planning of activities that directly contribute to resolving the project's scientific or technological uncertainties (such as the system uncertainty associated with an improved control mechanism for the laser that 'reads' the DVD). This element of planning is R&D (paragraph 36), as are the activities themselves (paragraph 4). Other elements of the plan focus on obtaining intellectual property protection or cosmetic design decisions, for example, which do not directly contribute to resolving the project's scientific or technological uncertainties and are not qualifying indirect

activities (paragraph 31) and are therefore not R&D. Neither this planning (paragraph 37) nor these activities (paragraph 28) are R&D.

A3. The scientific or technological work culminates in the creation of a series of prototype DVD players, and ultimately a 'final' prototype is produced and tested which possesses the essential characteristics of the intended product (circuit board design, performance characteristics, etc.). All the activities that directly contributed to resolving the scientific or technological uncertainty of creating the DVD player up to this point (such as the testing of successive prototypes) are R&D (paragraphs 34 and 39).

A4. Several copies of this prototype are made (not R&D; paragraphs 4-5 and 26-28) and distributed to a group of consumers to test their reactions (not R&D; paragraph 28 (a)). Some of these consumers report concerns about the noise level of the DVD player in operation. Additional work is done to resolve this problem. If this involves a routine adjustment of the existing prototype (i.e. no scientific or technological uncertainty) then it will not be R&D (paragraph 14); if it involves more substantial changes (i.e. there is scientific or technological uncertainty to resolve) then it will be R&D.

8. Records Requirement (Excerpt from HMRC CIRD 80550)

There is no record keeping requirement specifically for the purposes of claiming R&D relief, but the general CTSA requirement to keep sufficient records applies. Therefore, HMRC officers should be flexible in considering what records will be of assistance. They may well find that discussing the claim with the company, or agent, in advance of the making of detailed evidence requests will provide a better appreciation of what records are available, and enable them to focus their enquiries in a more cost-effective way for both them and the company.

9. Advanced Assurance HMRC

Overview

HM Revenue and Customs (HMRC) introduced Advance Assurance for companies that claim Research and Development (R&D) tax relief in November 2015.

If your company carries out R&D for itself or other companies, it could qualify for Advance Assurance. This means that for the first 3 accounting periods of claiming for R&D tax relief, HMRC will allow the claim without further enquiries.

Applying for Advance Assurance is voluntary and you can do this at any time before the first claim for R&D tax relief.

Your company can still apply for R&D tax relief without Advance Assurance.

There is a [pre-recorded webinar](#) giving an overview on Advance Assurance.

Advantages of Advance Assurance

When you apply for Advance Assurance you'll have an HMRC specialist to help you understand and comply with the [R&D tax relief conditions](#).

If you are given Advance Assurance, you can spend time concentrating on your business, rather than focussing on your R&D tax claims.

Advance Assurance gives proof that your company will get R&D tax relief. This may help you get funding.

Who can apply for Advance Assurance

Your company can apply for Advance Assurance if it's planning to carry out, or has previously carried out R&D. It has to meet certain conditions which are that:

- it hasn't claimed R&D tax relief before
- its annual turnover is £2 million or less
- it has less than 50 employees

Use information from your accounts to see if your company meets these conditions at the date of application.

If your company is new, you can still apply, as long as you haven't claimed R&D tax relief before.

These conditions may also apply if your company is part of a group, but see [who can't apply for Advance Assurance](#) to be certain.

If you're planning to carry out future R&D, HMRC may contact you after you've submitted your first claim. This is to check that your R&D matches the details you gave in the Advance Assurance application form.

Agents

Agents can apply for Advance Assurance on your behalf.

When [HMRC contacts you to discuss your application](#), they'll need to talk to a company director or an employee (for example, research manager), however your agent will be able to contribute.

Who can't apply for Advance Assurance

If your company is part of a group and another company within that group has made a claim for R&D, HMRC won't accept the application for Advance Assurance.

HMRC won't offer Advance Assurance if your company:

- entered into a Disclosable Tax Avoidance Scheme (DOTAS)
- is a corporate serious defaulter

Information needed to apply

To apply for Advance Assurance you'll need:

- your company accounts
- your company registration documents (from Companies House)
- HMRC correspondence
- previous company tax returns (not needed for new companies)
- the name of a main contact - someone with a direct knowledge of your company R&D (for example, research manager or company director) and who may need to discuss the application with HMRC

You'll need to give some basic information about your company and detailed information about your company's R&D activities.

Apply for Advance Assurance

If your company qualifies for Advance Assurance and you want to apply, fill in [form CT R&D \(AA\)](#).

What happens next

When HMRC receives the form they'll contact you to talk about your company's activities in more detail.

Most applications are dealt with by a short telephone call. More complex cases could take longer and HMRC may need to visit your company.

Dealing with HMRC

You'll need to appoint a main contact. This must be someone with a direct knowledge of your company's R&D (research manager or company director), and who may need to discuss the application with HMRC.

Notice of HMRC's decision

Once HMRC is satisfied that your company activities are within the rules of the scheme and you understand how the rules apply to your company, they'll send you a letter telling you their decision.

If your company is granted Advance Assurance for 3 accounting periods HMRC will send you an agreement letter. This letter will explain your company responsibilities.

If your company is not given Advance Assurance you will receive a letter giving you the reasons why.

10. Statistics

Statistics for GTA audit adjustment rates taken from Red Book + Report Card Part III for 2015 and the Muller report, dated November 30, 2009, for earlier years.

Statistics for overall reviews is taken from the Red Book + Report Card Part III.

11. Sample

This is based on a sample of 68 SR&ED tax credit claims processed under a site review since 2013.

12. Sample

This is based on a small sample of 7 companies who had a site review, and which companies are no longer making SR&ED claims do the site review.

APPENDIX A

Definition of Research and Development for Tax Credit Purposes

	UK		CANADA	
	Yes/No	Ref. (CIRD)	Yes/No	Ref. (CRA-EOW)
Main Criteria				
Advance in Science or Technology	Yes	81900	Yes	2.1.4
Scientific or Technological Uncertainty	Yes	81900	Yes	2.1.1
Systematic Investigation	Yes	81900	Yes	2.1.3
Appreciable Improvement	Yes	81900	N/A	
Other Criteria				
Competent Professional	Yes	81300	Yes	2.1.3
Science and Technology; Hard vs Social Science	Yes	81900	Yes	1.0
Abortive Projects	Yes	81900	Yes	2.1.4
Directly Engaged Activities	Yes	81900	Yes	2.2
System Uncertainty	Yes	81900	Yes	2.1.1
Qualifying Indirect Activities	Yes	81900	N/A	
Project Timeline; Start and Finish	Yes	81900	Yes	3.3
Ineligible Activities; Cosmetic, Routine	Yes	81900	Yes	1.0

- 1) CRA Eligibility of Work for SR&ED Investment Tax Credit Policy (CRA-EOW)
- 2) BIS Guidelines CIRD81300 and 81900