



SR&ED Newsletter **Edition 2016 –2**

Recent developments to Scientific Research & Experimental Development (SR&ED)
- **project management, patents & tax credit claims.**

Contents

Medical research – CRA focus on APP funds as grants	2
Recent CRA Statements to claimants:	3
Wages not “directly undertaken”	3
All AFP or surgical funding SR&ED assistance	4
Entitlement to Exploit – has the concept been removed?	5
AFP Practice Models – purpose & variations	6
Author’s summary / opinion	7
Need for disclosure of SR&ED portion	7
Status of current CRA position unclear	7
Ontario District initiative?	7
Need for national direction	7

Medical research – CRA focus on APP funds as grants

Facts:

Many physicians in Canada are paid through an alternate payment plan (APP) or funding plan (AFP). This is **common for specialists** at University research hospitals particularly where the **time per patient is not predictable**.¹

The APP is usually a fixed amount payment stipulating **20-40%** of the salary is to be for **administrative, teaching & research** responsibilities.

Generally speaking the **details of how much for each is not described** & hospitals themselves are often unwilling to provide these details to the researchers.

Issues:

Recently the CRA is suggesting APP's could be interpreted as "government assistance" for SR&ED claims. In this example we will assume 25% is to be for **administrative, teaching & research** responsibilities.

Options for treatment – reduce claim by

- full 25% of physician SR&ED wages,
- 0-25%,
- 0%

Legislation & CRA directives:

Income Tax Act

Government assistance

"assistance from a government, municipality, or other public authority whether as a grant, subsidy, forgivable loan, deduction from tax, investment allowance, or any other form of assistance other than the federal investment tax credit (ITC)."²

Assistance receivable

"on or before the filing-due date for a taxation year ... the taxpayer has received, is entitled to receive, or can reasonably expect to receive ... **assistance that can reasonably be considered in respect of SR&ED**."³

CRA - Assistance and Contract Payments Policy⁴

4.3.2 Qualified SR&ED expenditures

Qualified SR&ED expenditures are reduced by any assistance and contract payments **that can reasonably be considered to be in respect of the SR&ED**.

Therefore, assistance and contract payments in respect of **non-qualifying expenditures** relating to the SR&ED **will also reduce** the qualified SR&ED expenditures where the assistance **agreement does not distinguish** payments for eligible activities and costs from payments for non-eligible activities and costs.

Analysis

If the "assistance agreement" does not provide a breakdown the CRA's **approach** would be to **reduce the SR&ED claim by 25%** of the SR&ED wages.

The legislation only requires reasonable allocations to research.

Implications and author's commentary

In the author's experience some **hospitals are able & willing** to provide this information while others are not.

To the extent the researcher (via the research hospital) can provide **details on the reasonableness** of the allocations **to research vs. non-research activities** a lesser allocation would be appropriate.

Notable quote:

"Art is made to disturb, science reassures."

- Georges Braque

¹ Healthforce Ontario, [Specialist Practice Models](#)

² 127(9) Definition of "government assistance"

³ Subsection 127(18)

⁴ Canada Revenue Agency Policy paper December 18, 2012

Recent CRA Statements to claimants:

Table 1: Sources of income for Medical Specialists

Payor	OHIP & AFP/APP	Ontario University
Recipient	Dr. X Medicine Professional Corporation	Dr. X
Type of taxpayer	Ontario Corp. - Dec 31 year end	Individual - Dec 31 year end
Type of income	T2 - corporate (OHIP + AFP payments)	T1 - personal
Nature of work	Testing of hypotheses via medical practice	Academic research
SR&ED claim	Yes	No

Wages not “directly undertaken”

In assessing the claim for wages paid to Dr. X in his MPC the CRA stated,

“We have determined that the specified wages claimed were not incurred for scientific research and experimental development **“directly undertaken by the taxpayer”** nor was it for work **“directly undertaken on behalf of the taxpayer”** as required under Paragraph 37(1) (a) and Subparagraph 37(1) (a) (i) of the Income Tax Act (ITA).

It is our determination that the **work claimed was performed by Dr. X in fulfilment of his employment appointment** with Y University as outlined in his faculty appointment letter and for which he was paid a base salary.

Our position is that **he/she is an employee of Y University** because they are treating him as such by remitting payroll deductions on his behalf and issuing a T4 for salary.

In addition, the university provides other means of support such as research funding and grants in support of the doctor in his academic position.”

Legislation & CRA directives

Income tax act

SR&ED

“Scientific research and experimental development... includes ... d) engineering, design, operations research, mathematical analysis, computer programming, data collection, testing or psychological research, where the work is commensurate with the needs, and directly in support, of...”⁵

Directly undertaken

“...there may be deducted ... all amounts each of which is an expenditure .. on scientific research and experimental development related to a business of the taxpayer, carried on in Canada and **directly undertaken by the taxpayer, ...**”⁶

⁵ ITA 248(1)

⁶ ITA 37(1)

All AFP or surgical funding SR&ED assistance

CRA SR&ED Policy Papers

Meaning of "directly engaged"

“Directly engaged in SR&ED – Whether an employee is directly engaged in SR&ED is based on the tasks that they perform and not on the job title of the employee. Directly engaged refers to **"hands-on" work**, which would be included in **paragraphs (a) to (d)** of the definition of SR&ED in paragraph 248(1) of the Income Tax Act.

Generally, employees, including managers and supervisors, **conducting experimentation and analysis** in the performance of basic research, applied research, or experimental development are considered to be directly engaged in SR&ED.”⁷

Issue & Analysis

Are wages of researcher for work “directly undertaken?”

We are not aware of the term **“directly undertaken”** being defined in the income tax act or related CRA documents. In this instance we propose the CRA’s term “directly engaged” would be relevant.

Dr. X was one of the principal investigators both with the university and in clinical testing in his professional practice.

As such he was “directly engaged” in both **design & related testing**.

Only the wages paid by the professional practice have been claimed in the SR&ED claim.

Conclusions

As illustrated in table 1 there are often 2 sources of income for Medical Specialists. The **CRA’s position** is in fact

- **applying the income of another legal entity (the Doctor as a person)**
- **to the work performed by the corporation.**

The CRA also stated,

“The doctor being a member of the Department of W AFP Practice Plan is receiving \$X of **AFP Academic** Funding from the Government of Ontario, as well as receiving \$X of **surgical repair** funding.

These amounts would be considered Government Assistance and netted against qualified expenditures for SR&ED as per the requirement of Subsection 127(18) of the ITA.”

Legislation & CRA directives

Income tax act

Government assistance

“..the total of all amounts each of which is the amount of any government assistance or non-government assistance (as defined in subsection 127(9)) **in respect of an [SR&ED] expenditure** described in paragraph (a) or (b).

Analysis

In many cases the doctors do not believe any SR&ED related funds were received in respect of the SR&ED projects claimed.

It certainly seems odd that surgical repair funding could be considered SR&ED related.

Recommendations

To the extent the researcher (via the research hospital) can provide details on the reasonableness of the allocations to research vs. non-research activities a lesser allocation would be appropriate.

⁷ SR&ED Salary or Wages Policy - December 18, 2014, section 7.1

Entitlement to Exploit – has the concept been removed?



Canada Customs
and Revenue Agency

Agence des douanes
et du revenu du Canada

NO.: IT-151R5 DATE: October 17, 2000
SUBJECT: INCOME TAX ACT
Scientific Research and Experimental Development Expenditures

Entitlement to Exploit the Results

¶ 37. The determination of whether a taxpayer is "entitled to exploit the results" of SR&ED is a question of fact that can only be determined on a case-by-case basis. For example, this requirement is **considered to be met in cases where the taxpayer has the right to use a patent that results from the SR&ED project even if the taxpayer is charged a royalty or similar fee for the use of the patent. This requirement is also considered to be met in cases where the taxpayer is entitled to distribute and market any product that results from the SR&ED project.**

In addition, when a taxpayer makes a payment for SR&ED to a corporation described in subparagraph 37(1)(a)(i.1) or to an approved university or other entity described in subparagraph 37(1)(a)(ii) and it is likely that the SR&ED project will not result in a product or patent, the taxpayer will be considered to have **met this requirement if** it can be established that the taxpayer has, as a consequence of the payment, been granted a **preferential right to use the results** of the SR&ED in its business.

AFP Practice Models – purpose & variations⁸



HealthForceOntario

Specialist Practice Models

Compensation Options

Specialists in Ontario may be compensated through a fee for service system or through an Alternative Funding Plan (AFP) or Alternative Payment Plan (APP). AFPs/APPs are contractual arrangements between the Ministry of Health and Long-Term Care and a group of physicians, and may include other organizations such as hospitals and universities. Some AFPs/APPs also include funding for teaching and research.

These agreements provide flexibility in practice, encourage coordination and integration of medical services, and stabilize compensation for highly specialized groups, specialists and sub-specialists. AFPs/APPs have become more attractive and desirable to many physicians seeking a more balanced working life, regular hours, and acknowledgement of patient acuity, geographical challenges and financial security.

Over the years, a variety of compensation models have been developed and used by AFPs/APPs. Presently, most agreements are blended models that combine a base rate, incentive/premium payments and possibly a fee-for-service component payment. There are several remuneration methods:

- Global/block funding based on specific services or locations
- Blended funding models that include a base payment for clinical services, teaching, research, administration or indirect services plus a premium payments, which could be based on a percentage of the value of Fee-for-Service billings
- Bed utilization rate
- Sessional payment plus fee-for-service billings

AFP/APP Models

There are a variety of models used to cover:

- Specific communities and under-serviced specialties
- Individual departments in a single hospital
- Entire services of all physicians at a single hospital
- Services of all full-time specialists at an academic health science centre
- Province-wide gynaecology oncology, radiation oncology and medical oncology services
- Emergency services in hospitals, specialist services in the north and agreements with specialists and subspecialists associated with academic health science centres
- Regional trauma hospitals to ensure the 24-hour availability of high-level care for patients with serious trauma (Trauma Team Leader global funding agreements)
- Academic Health Science Centres, for clinical services, education and research
- Services such as psychiatry, the Regional Surgical Network, neurosurgery/neurology and anaesthesia in northern regions

For more information, read the **Ministry's Resource Manual for Physicians**.

⁸http://www.healthforceontario.ca/en/Home/Physicians/Training_%7C_Pra ctising_in_Ontario/Physician_Roles/Specialist_Practice_Models

Author's summary / opinion

Need for disclosure of SR&ED portion

Having reviewed **AFP agreements** the author has found

- Very little consistency between them however,
- **Many require a breakdown of the research / AFP funds to be approved by every member** of the medical team however,
- This **procedure is seldom followed.**

Reviewing the nature of activities the AFP model is intended to fund there also seems to be a

- strong argument that **none, or** perhaps only a **minimal amount** of the **AFP funding**
- would be directly related to **SR&ED.**

Status of current CRA position unclear

Ontario District initiative?

As of October 7, 2016 there appears to be no federal detail on this policy & the initiative appear to be started by one of more CRA district offices in the Greater Toronto area.

Need for national direction

It is disconcerting that these changes are being announced to the claimants directly instead of the via the usual stakeholder process.

SR&ED practitioners are expected to comment on laws that are not published & which are being created then enforced by people who have no authority to do so.

More worrisome is the fact that these new "local CRA initiatives" are becoming commonplace so consistency on policies continues to differ between different CRA offices.

Recommendations

Improve reporting by hospitals

If the hospitals begin to

- **report the "research" component**
- **of any AFP funding**
- this situation should resolve itself.

This indicates a **major step for our research hospitals to either**

- a) **Provide details** of the SR&ED components of any AFP funding or
- b) **Risk** the chance that their medical specialists will be **unfairly denied** credits they would otherwise have qualified for.

Improve CRA Guidance on new policies – federally

This also illustrates the

- need for direction by
- **CRA SR&ED "policy officers"** in Ottawa
- via the **stakeholder process** vs.
- having **SR&ED policy initiatives**
- designed by field level **"compliance" officers.**

Notable quote:

"It isn't the mountains ahead to climb that wear you out; it's the pebble in your shoe."

- Muhammad Ali

Questions or feedback

We welcome your questions or feedback on any issues raised in this letter.

We also encourage interested parties to examine:

- past newsletters
- RDBASE.NE online R&D software &
- additional tutorials on managing R&D at

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