

# Canadian SR&ED Stakeholder Meeting

November 24, 2017

# SR&ED cases – FINANCIAL

Presented by David Sabina, CPA

# 1 - Oldcastle – SRED Wages

## Facts:

- Employee \$400K salary + variable amount based on sales
- 72 patents in concrete blocks & architectural masonry
- Does not hold any shares in Oldcastle or parent Co.

## Issue(s):

- Was variable amount commission, bonus or remuneration based on profits?

## Relevant legislation and analysis:

- ITA – 37, 127(9) & Reg. 2900
- Definition of wages – ITA 248(1) & 5-8

# ITA 248(1)

**salary or wages**, except in sections 5 and 63 and the definition *death benefit* in this subsection, means the income of a taxpayer from an office or employment as computed under subdivision a of Division B of Part I and includes all fees received for services not rendered in the course of the taxpayer's business but does not include superannuation or pension benefits or retiring allowances; (*traitement ou salaire*)

Search within this Act:

Search

Acts

Regulations

ites

eal Act: Reports,  
d Repealss Statute Law  
Program

for Legislation

earch

lic Statutes and

## Table of Contents

- [Income Tax Act](#)
  - 1 - [Short Title](#)
  - 2 - [PART I - Income Tax](#)
    - 2 - [DIVISION A - Liability for Tax](#)
    - 3 - [DIVISION B - Computation of Income](#)
      - 3 - [Basic Rules](#)
      - **5 - [SUBDIVISION A - Income or Loss from an Office or Employment](#)**
        - **5 - [Basic Rules](#)**
        - **6 - [Inclusions](#)**
        - **8 - [Deductions](#)**
      - 9 - [SUBDIVISION B - Income or Loss from a Business or Property](#)
        - 9 - [Basic Rules](#)
        - 12 - [Inclusions](#)
        - 18 - [Deductions](#)
        - 22 - [Ceasing to carry on business](#)
        - 26 - [Special Cases](#)
      - 38 - [SUBDIVISION C - Taxable Capital Gains and Allowable Capital Losses](#)
        - 47.1 - [Indexed Security Investment Plans](#)
      - 56 - [SUBDIVISION D - Other Sources of Income](#)

## Basic Rules

### Income from office or employment

**5 (1)** Subject to this Part, a taxpayer's income for a taxation year from an office or employment is the salary, wages and other remuneration, including gratuities, received by the taxpayer in the year.

### Loss from office or employment

**(2)** A taxpayer's loss for a taxation year from an office or employment is the amount of the taxpayer's loss, if any, for the taxation year from that source computed by applying, with such modifications as the circumstances require, the provisions of this Act respecting the computation of income from that source.

NOTE: Application provisions are not included in the consolidated text; see relevant amending Acts. 1970-71-72, c. 63, s. 1"5".

## Inclusions

### Amounts to be included as income from office or employment

**6 (1)** There shall be included in computing the income of a taxpayer for a taxation year as income from an office or employment such of the following amounts as are applicable

#### Value of benefits

**(a)** the value of board, lodging and other benefits of any kind whatever received or enjoyed by the taxpayer, or by a person who does not deal at arm's length with the taxpayer, in the year in respect of, in the course of, or by virtue of the taxpayer's office or employment, except any benefit

**(i)** derived from the contributions of the taxpayer's employer to or under a deferred profit sharing plan, an employee life and health trust, a group sickness or accident insurance plan, a group term life insurance policy, a pooled registered pension plan, a private health services plan, a registered pension plan or a supplementary unemployment benefit plan,

# SR&ED Salary & Wage inclusions

<b>1</b>	<b><u>R&amp;D labour for the:</u></b>	<b><u>Specified employees*</u></b>	<b><u>Non-specified employee</u></b>	<b><u>ITA section</u></b>
	<i>a)</i> R&D expenditure pool (for deduction), &			37(1)
	<i>b)</i> Qualified expenses (for ITC calculation)			127(9)
	<b><u>Type of expense:</u></b>			
	• salary & wages	In	In	(5-8)
	• bonuses or profit based \$	Out	In	37(9) & 5(1)
	• Expenses paid > 180 days	Out	Out	78(4)
	Maximum	5 x [YMPE]	N/A	37(9.1)

## **2 Salary base for proxy amount (for ITC calculation)**

	<b><u>Type of expense:</u></b>			
	• Income from employment	In	In	5 to 7
	• bonuses/profit based \$	Out	Out	5(1) & 37(9)
	• Expenses paid > 180 days	Out	Out	78(4)
	Maximum	2.5x [YMPE]	N/A	Reg. 2900(7)

### **SR&ED wages - annual limits**

<b><u>SR&amp;ED labour:</u></b>	<b><u>YMPE</u></b>	<b><u>Specified employees</u></b>	<b><u>Non-specified</u></b>
		<b><u>Wages</u></b>	<b><u>Proxy Base</u></b>
2016	\$ 54,900	\$ 274,500	137,250
2017	\$ 55,300	\$ 276,500	138,250
			No limit
			No limit

**\*Specified employees own >=10% any class of stock (or related to such shareholders).**

# JUDGE'S RULING - WIN

- [33] There is nothing in the evidence to suggest that the amounts that were paid by Oldcastle to Mr. Castonguay as compensation were for a compensation other than the work done by him as President of the research.



# Implications – wage agreements

- Courts willing to entertain
  - no limits on employee SR&ED wages
  - as long as “reasonable.”
- Specified employees caught by annual limits.

## 2 – AG Shield – definition SR&ED wages

### Facts:

- Tom & Gary McCrea, each own 50% of shares
- Spent 23% of time in SR&ED
- Allocated 100% of salary to SR&ED

### Issue(s):

- Is allocation reasonable?

### Relevant legislation and analysis:

- ITA 37(1)

# Actual time spent on SR&ED

	<u>SR&amp;ED</u>	<u>Non</u>	<u>Total</u>
Tom	1094.5	1905.5	3000
Gary	<u>291.5</u>	<u>2708.5</u>	<u>3000</u>
	1386	4614	6000
	<b>23%</b>	<b>77%</b>	<b>100%</b>

[14] Mr. Kowal explained his advice as follows:

The advice that I gave them was that pursuant to the *Income Tax Act*, the *Income Tax Act* says that specified shareholder -- specified employees, which they are as shareholders, could be paid for SR&ED work and as such if they were paid for SR&ED work, that constituted a valid input tax credit pursuant to the *Tax Act*. That's what I advised.

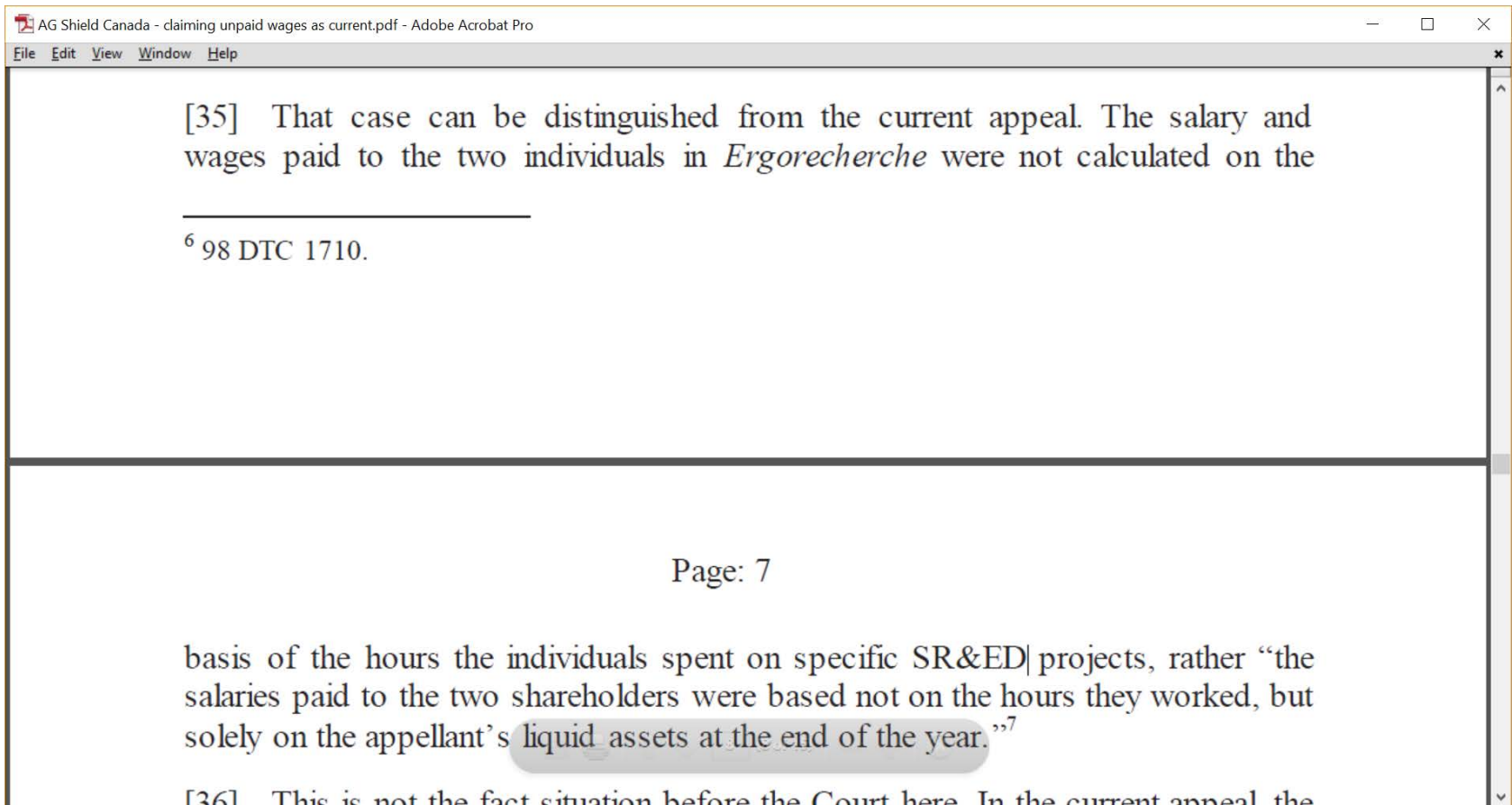
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... the only wages that we accrued for them were for those hours that pertain to SR&ED work. They were not compensated for any other work that they performed for the company because essentially they were -- they -- they took a draw from the company, if I can get into that? They took a draw from the company and that draw was simply something they needed for their own livelihood.

And at the end of the year, those drawings were then put through as dividend income. No different than any other shareholder of a corporation would receive to offset his drawings.<sup>3</sup>

[15] Tom McCrea testified that he and his brother determined that the Appellant

# JUDGE'S RULING - WIN



# Implications

- Contrary to other precedence
  - *Ergorecherche & Conseils Inc. 98 DTC 1710*
  - *Synchrosat Limited v. The Queen (2003TCC380)*

# 3 - Birchcliff - loss co & acquisition of control

## Facts:

- Purchased R&D loss Co. (Veracel)
- Goal to use as real estate income shelter
- Attempted to avoid acquisition of control rules

## Issue(s):

- Should losses be available?

## Relevant legislation and analysis:

ITA 111 & 256

# JUDGE'S RULING - LOSS

- [112] Subsection 245(2) empowers the Minister to determine the tax consequences that are reasonable in the circumstances in order to deny a tax benefit. As noted, the Veracel Transactions were planned so as to fit within the exception provided for in clause 256(7)(b)(iii)(B).
- Loss Streaming Restrictions apply to prevent the Appellant from using Veracel's Tax Attributes



# Implications

- Interesting use of “Avoidance Rule”
- Many complicated schemes on “control”

# 4 - Aeronautic Development Corporation CCPC status & Defacto Control

## Facts:

- non-resident corporate shareholder
  - 46% owner
  - sole client

## Issue(s):

- Control for CCPC status?

## Relevant legislation and analysis:

125(7) & 256

# JUDGE'S RULING - LOSS

- “controlled directly or indirectly in any manner” for the de facto control test
- **the controller has any direct or indirect influence that, if exercised, would result in control in fact of the corporation, ..”**

# Implications – Proper structure of CCPC

- Avoid Defacto control issues
- Consider NO cross ownership?

# 5 - Westsource Group – 18 month deadline

## Facts:

- information for 1 of 2 projects (boxes 240, 242 and 244 of Schedule 60) missing

## Issue(s):

- Is information “prescribed information”.

## Relevant legislation and analysis:

ITA 37 & 127(9)

# JUDGE'S RULING - LOSS

- 37(11)
  - no amount in respect of an expenditure ... may be deducted under subsection 37(1) unless the taxpayer files with the Minister a prescribed form containing prescribed information in respect of the expenditure on or before the day that is 12 months after the taxpayer's filing-due date for the year.

# Implications

- Consistency in rulings
- Benefit of electronic filing & diagnostics
- Claimants should aim for 6 vs. 18 month deadline

# 6 - Rio Tinto Alcan – reassessment

## Facts:

- Inc. 1989 to manage production aluminum in Sept-Îles, Quebec.
- undertakes SR & ED work on behalf of 5 partners.
- July 2011 started review fiscal years 2006-2009 SR & ED work
- Assessments: 2013 for tax years 2006 & 2007.

## Issue(s):

Tax Act authorize the Minister to reassess outside the normal reassessment period? s

## Relevant legislation and analysis:

ITA 152 – 4 years from date of original assessment



# JUDGE'S RULING - LOSS

- Client file a waiver for FAPI
- Applied to SR&ED or other issues

# Implications – Risk to large companies

- Reassessment period is 4 years for non-CCPC's
- CRA could reassess
- Large liability on Balance Sheet
- Could affect client accounting policies