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Webcast

May 9, 2019

SR&ED Practitioner Meeting
MEDICAL ISSUES
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SREDStakeholder.CA

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Agenda

- SR&ED – issues for Medical practitioners
- presented 2016 & 2017 - unresolved
  - 1) Directly Engaged / Undertaken - **legislation**
  - 2) AFP/APP funding effects – **legislation**
  - 3) Length of time for objections
  - 4) Consistency of rulings across Canada
- New issues raised during 2018 & 2019
  - 5) Proving involvement with protocols

New SR&ED Director General
May 2018

Jason Charron

Director General of the Scientific Research and Experimental Development Directorate (SR&ED)

Status of medical issues May 9, 2019

- Direction paper in process
- Expected release in near future
- In interim the new SR&ED Director General has provided following CRA positions:

Issue 1 -
CRA Statement :“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).

Guidelines from SR&ED Director General – May 2, 2019

- Directly engaged – what is the CRA's position?

As the legislation allows, "To claim SR&ED tax incentives, the Income Tax Act requires that the SR&ED work must be directly undertaken by the taxpayer or undertaken on behalf of another party and have resulted in expenditures." Physicians and corporations (MPCs, HCEs, etc.) are distinct legal entities for tax purposes.

As you are aware, the medical guidance document key point is that for this community the CRA recognizes that several parties can collaborate to carry out the medical research, and determining the payer and performer can be challenging. We also recognize that we must have reasonable approaches for identifying distinct work. However, performers doing eligible research work can submit a SR&ED claim if they incurred their own eligible expenses and after reducing the qualified SR&ED expenditures for ITC purposes by compensation received or receivable.

Legislation

- Income tax act “SR&ED” (248(1))
  - “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….”

Legislation

- Income tax act “Directly undertaken” (37(1))
  - “…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**, …

CRA SR&ED Salary or Wages Policy – Dec. 18, 2014, section 7.1

Meaning of "directly engaged"

- "Directly engaged in SR&ED – … based on the tasks .. not job title of the employee.
- refers to "hands-on" work,… paragraphs (a) to (d) …definition of SR&ED …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."

Issue & Analysis

- Are doctor's wages "directly undertaken?"
  - term "directly undertaken" not defined ITA or related CRA documents.
  - propose CRA term "directly engaged"
  - 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 wages paid by professional practice have been claimed in the SR&ED claim.

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.

CRA Third-Party Payments Policy Date: December 18, 2014

5.0 Entitlement to exploit the results

To be entitled to exploit the results of the SR&ED, a claimant must have **gained the right to use the results** of the SR&ED in their business **as a direct result of the payment**. Whether a claimant is entitled to exploit the results of the SR&ED is a question of fact and will be determined on a case-by-case basis.

5.1 Two basic situations

5.1.1 Resulting in a product or patent

If the SR&ED results in a product or patent, then this requirement could be satisfied if the claimant has the right to use a resulting patent (even for a royalty), or where the claimant is entitled to **distribute or market any resulting product**. If the claimant cannot use the patent or can only obtain the product through normal commercial channels, this requirement would not be satisfied.

5.1.2 Resulting in a gain of knowledge

If the SR&ED does not result in a product or patent, but results in a gain of knowledge (such as by publication of a scientific paper), then one way this requirement could be satisfied is if the claimant has, as a consequence of the payment, been **granted a preferential right** to use the results of the SR&ED (the knowledge gained) in its business. A preferential right could be access to unpublished results, or early access to results. If results are presented at a conference or published in a journal, this requirement could be met if the sponsor received a prepublication print of the paper. If the results of the SR&ED are in the public domain before the sponsor receives them, then that would not be considered to be a preferential right.

Issue -"All AFP or surgical funding SR&ED assistance"

CRA stated,

- "The doctor being a member of the Department of W AFP Practice Plan is receiving **$X of AFP academic funding** from the Government of Ontario, as well as receiving **$Y of surgical repair funding**.
- These amounts … considered Government Assistance … per subsection 127(18) of the ITA."

Guidelines from SR&ED Director General – May 2, 2019

- Government assistance – whether AFP or any other funding included?

This item is still under review by Rulings/Legal Services. For now, we must continue to apply the contract payment policy.

Legislation

- Income tax act “Reduction of qualified expenditures” (127(18))
  - “Where …taxpayer has received, is entitled to receive or can reasonably be expected to receive a particular amount that is government assistance, non-government assistance or a contract payment that can **reasonably be considered to be in respect of** scientific research and experimental development, …

AFP Practice Models – purpose & variations

Ontario

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.

Author's summary / opinions

1) Need for disclosure of SR&ED portion

- Many uses of funds,
  - Many require breakdown of research / AFP approved by every member however,
  - procedure seldom followed.
- Nature of AFP model
  - strong argument that none, or perhaps only a minimal amount AFP funding
  - directly related to SR&ED
  - More REGULATION than ASSISTANCE

Author's summary / opinions

2) Status of current CRA position unclear

Ontario District initiative?

- As of May 9, 2019 there appears to be no federal detail on this policy & the initiatives appear to be started by CRA district offices

Need for national direction

- For 4 years all SR&ED medical policies delivered to claimants directly instead of usual SR&ED stakeholder process

Recommendations

1) Improve reporting by hospitals

- If hospitals / universities begin to
  - – - report the “research” component
  - – - of any AFP funding
  - – - should resolve “assistance” issue

Recommendations

2) Improve CRA Guidance – federally

- Need for more direction by
  - - CRA SR&ED "policy officers" in Ottawa
  - - via the stakeholder process vs.

  - - SR&ED policy initiatives designed by
  - - field level "compliance" officers.

3) Objection delays
Guidelines from SR&ED Director General – May 2, 2019

- the length of time that objections & appeals are taking to be addressed.

As Appeals is independent of SR&ED, we don't have this information at hand. We are however in discussion with Appeals and they are aware of the direction we are taking.

4) Consistency of Assessments Guidelines from SR&ED Director General – May 2, 2019

- Consistency of the application of these policies across Canada & within regions &/or

The guidance will be shared Nationally and the HQ plans to continue monitoring these claims to help ensure consistency and identify any further guidance or training requirements that may arise. We are also briefing the A/Ds in person shortly on the file.

5) Evidence of protocol design Guidelines from SR&ED Director General – May 2, 2019

- Challenging if the Dr. was involved on protocol designs (e.g. What evidence is relevant)?

Medical guidance document does not specifically address this. It does speak generally to documentation for the work performed and the importance of agreements demonstrating the research relationships and responsibilities.