



**Canadian
Manufacturers &
Exporters**

**Manufacturiers et
Exportateurs du
Canada**



August 4th, 2011

Mrs. Linda Lizotte-MacPherson
Commissioner - Chief Executive Officer of the CRA
7th Floor
555 MacKenzie Avenue
Ottawa ON
K1A 0L5

Re: Policy on the Eligibility of Work for SR&ED Investment Tax Credits

Dear Commissioner,

On behalf of the members of Canadian Manufacturers & Exporters, Canada's largest trade and business association, I am writing to express the profound concerns of the manufacturing industry with regards to the proposed new CRA policy on the eligibility of work for SR&ED and Investment Tax Credits. As you know, Canada's SR&ED tax credit system is considered as a model among Canada's industrial partners. In its State of the Nation 2010 report, the Science, Technology and Innovation Council reported that Canada invests 0.22% of its GDP in fiscal measures to support private R&D, ranking first among the 23 countries studied. Tax-based incentives are not only the most important mechanism in Canada to help businesses respond to the rapidly evolving environment in which they compete (e.g. by developing the latest and best technologies or by making incremental improvements to process and materials to give them a competitive edge), they also help counteract the impact of the high Canadian dollar, which would otherwise encourage businesses to shift R&D investments and ultimately intellectual property rights offshore.

Given the importance of this program, several former Ministers of National Revenue have committed to maintain the current SR&ED policy. Despite this, a significant number of leading private R&D performers in the aerospace, automotive, aluminum and the information technology and communications sectors among others, report that CRA has been narrowing the definition of eligible SR&ED performed in recent years. Today, many claims that were once accepted by CRA are now being refused by its auditors.

The definition of what an eligible R&D project includes is a significant concern to Canadian manufacturers. One particular issue in this regard is CRA's definition of technological advancement. The definition appears to have changed to focus exclusively on the development of new, core technologies, and to exclude incremental improvements in engineering know-how needed for the applications of key technologies, which are essential for continued process and product innovation and productivity growth. The exclusion of virtual prototyping or evaluation exercises and other similar analyses from the CRA's definition of project scope is a good example on how restrictive CRA's view of R&D has become.

There are also a number of seemingly inconsistent views within the draft policy itself, and also between the legislation and CRA's internal views, that not only cause confusion and uncertainty, but highlight the



complexity of the subject matter and thus the importance of working with industry to develop and roll out practical industry application papers and guidelines that are acceptable to all stakeholders. For example:

1. Under 2.1, the draft policy states that the SR&ED is performed "for the advancement of scientific knowledge, or for the purpose of achieving technological advancement aimed at creating new, or improving existing materials, devices, products, or processes." And yet under 2.1.2, it goes on to state that "in experimental development, the purpose of the work is to achieve technological advancement. This purpose must be distinguished from the purpose of creating new, or improving existing materials, devices, products, or processes" - which seems to suggest that the latter would not qualify.
2. Sections 2.1.1 and 2.1.2 seem to allow for the leveraging or use of existing knowledge, techniques and methods to help analyze and solve the technological uncertainty, which makes sense. After all, how would anyone go about solving the unknown with the unknown? In fact, the definition of SR&ED in 248(1) uses the expression "work undertaken" four times. Literally, this is rather broad and does not specifically dictate the 'how'. And yet, under 3.3 (and this is new), CRA goes beyond the legislation to differentiate between standard and non-standard practice with the goal of disallowing anything that is being viewed by the auditor as "routine". Absent any industry specific guidelines, we see this as one of the biggest areas of contention. Whether a practice or method is routine is highly subjective and frankly is a moving target.

Another major issue companies face is the increasing amount of documentation required by CRA auditors for claims approval. CRA's documentation requirements have been reported by CME members as being progressively more demanding and overly burdensome, from year to year. CRA's approach went from a process-focused, risk-based approach – with an appropriate focus on the processes in place to conduct systematically eligible R&D activities – to a low level transactional focus which we regard as inappropriate, a waste of limited resources, and against general government trends towards risk-management systems.

The Canadian Advanced Technology Alliance (CATA) reported in its submission to the Jenkins Panel that some companies spend up to 25,000 hours a year documenting their SR&ED activities.. At the same time that the federal and provincial governments are introducing initiatives to cut red tape for businesses, especially SMEs, CRA is introducing heavier documentation requirements, especially for experimental development initiatives. Although we understand the importance of proper documentation, CRA has to understand that the time company employees or their consultants spend working on documentation is time they don't spend on their core business. An important part of the monetary benefits association with the SR&ED tax credit is actually washed out in the resources spent for documenting R&D activities.

While industry, government, academia, and politicians across the country are working collectively to find ways to improve productivity, innovation and the private sector's investments in R&D, CRA is putting together a policy review process that actually confirms the trends that manufacturers have witnessed over recent years, based on an extremely narrow view of the nature and importance of R&D conducted by business.



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We believe that CRA should use this current review as an opportunity to support Canadian research, innovation and productivity, and return the program to its original stated and supported intention. Without this, current accumulated tax credits will become of limited use, offshoring of R&D activities by Canadian firms will be accelerated, and it will send a negative signal to multinational companies that are looking at the best business environment in which create jobs, wealth and high value added products through their R&D activities.

Finally, you are certainly aware that the Government of Canada launched a comprehensive review of federal support to R&D last year, led by an expert panel (The Jenkins Panel) and a consultation paper is being currently reviewed by industry. We are strongly concerned that the CRA is moving on this fundamental issue on its own, prior to the comprehensive review of R&D by the expert panel being completed. Coordination between CRA reviews and the panel's consultation is certainly an important factor that will determine the success or the failure of Canada's R&D incentive policies for the next decades.

CME and its members would be grateful for an opportunity to meet with you and with the Minister of National Revenue in order to have a more detailed discussion about the CRA eligibility policy review. We will be calling your office shortly in order to arrange a date and time that is convenient to you.

Respectfully,

Jayson Myers
President & CEO
Canadian Manufacturers & Exporters

CC: The Honourable Gail Shea, Minister of National Revenue
The Honourable James Flaherty, Minister of Finance
The Honourable Christian Paradis, Minister of Industry
The Honourable Maxime Bernier, Minister of State (Small Business and Tourism)
Michael Horgan, Deputy Minister, Finance Canada
Richard Dicter, Deputy Minister, Industry Canada