



# SR&ED TAX INCENTIVES

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## Documentation system

**Dovico Software**

[www.dovico.com](http://www.dovico.com)

# SR&ED Tax Incentives

## Introduction

To encourage companies to further invest in research and development (R&D), the Canadian government offers some of the world's richest R&D tax incentives. However, most companies are overlooking this source of revenue because of lack of time, resources or expertise needed to identify and manage the work done to document their claims.

The Canadian government has taken a leadership role in supporting research and development through its Scientific Research & Experimental Development program (commonly referred to as SR&ED). SR&ED is now Canada's largest incentive program benefiting businesses of all sizes across all industry sectors in their quest to develop new or improved products and processes, in a lab or on the shop floor.<sup>1</sup>

However, while companies can provide a «guestimate» of the time invested while performing SR&ED activities, they might be underestimating, which results in less refundable tax credits for that company.

<sup>1</sup> Ryan LLC: <http://www.ryan.com/canada/practice-areas/scientific-research-and-experimental-development/>

## STUDY OBJECTIVES

By using Dovico Timesheet to record SR&ED related work done, the applied work environment had two objectives:

1. First, it allowed the company to learn tangibly how new technologies can help in process improvement in replacing a manual system to record time.
2. Second, it provided management with a tool to easily and quickly record and report time spent on relevant SR&ED activities necessary to document their claims.

## THE PROGRAM

The government gives fiscal incentives to companies supporting experimental development, which meet the criteria of the program. These incentives are deductions for R&D expenses in the calculation of taxable revenue and tax credits.

The Canada Revenue Agency (CRA) defines the program as follows:

Scientific research and experimental development (SR&ED) is defined for income tax purposes in subsection 248(1) of the Income Tax Act as follows:

"*Scientific research and experimental development* means systematic investigation or search that is carried out in a field of science or technology by means of experiment or analysis and that is

- (a) basic research, namely, work undertaken for the advancement of scientific knowledge without a specific practical application in view,
- (b) applied research, namely, work undertaken for the advancement of scientific knowledge with a specific practical application in view, or
- (c) experimental development, namely, work undertaken for the purpose of achieving technological advancement for the purpose of creating new, or improving existing, materials, devices, products or processes, including incremental improvements thereto, and, in applying this definition in respect of a taxpayer, includes:
  - (d) work undertaken by or on behalf of the taxpayer with respect to 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 work described in paragraph (a), (b), or (c) that is undertaken in Canada by or on behalf of the taxpayer, but does not include work with respect to:
    - (e) market research or sales promotion,
    - (f) quality control or routine testing of materials, devices, products or processes,
    - (g) research in the social sciences or the humanities,
    - (h) prospecting, exploring or drilling for, or producing, minerals, petroleum or natural gas,

- (i) the commercial production of a new or improved material, device or product or the commercial use of a new or improved process,
- (j) style changes, or
- (k) routine data collection;"

## PROBLEMS

The rules and CRA's administrative position in this area are constantly changing and past leniency has been replaced by stricter assessing policies. One of which includes the need for companies to provide better documentation for time spent on projects and activities to support their SR&ED claims.

While companies can provide a «guestimate» of the time invested while performing SR&ED activities, they might be underestimating. In fact, without proper documentation, CRA can easily contest the percent in time spent performing these activities, which results in less refundable tax credits for that company. Furthermore, without proper documentation to support their claims, companies might have to wait longer for their refund since those claims require a more in-depth examination. In fact, claims can even be refused if the documentation isn't provided in a timely manner. This is reiterated by a Judge as can be read in the case that was settled in September of 2017 *Flavor Net Inc. v. The Queen*, where the following was said:

Furthermore, the Judge examined the last criteria, which was documentation, and concluded that it was very thorough. He also mentioned that while documentation was not compulsory, it assists the taxpayer in establishing that his activities do qualify as SR&ED.

## THE TECHNOLOGY

Not all projects qualify for SR&ED, and it isn't until after the project is underway that a company must look back and determine, based on evidence, which portions of work within their projects is SR&ED. This can prove to be very challenging without a proper time-tracking system in place, and Dovico addresses this issue by accurately capturing all SR&ED eligible activities and costs throughout the year with minimal effort and disruption to employees' regular activities. Time tracking itself does not guarantee meeting CRA's documentation guidelines. The system must also help front line staff by flagging work that could be an SR&ED eligible project, and then gathering information about the obstacles employees are facing, work they are performing, and the supporting documentation they are creating during their developments. But it can accurately capture all SR&ED eligible activities and costs throughout the year with minimal effort and disruption to employees' regular activities.

## APPLYING THE TOOL

In a case where approved SR&ED projects and activities as well as administrative and support tasks were entered by the appropriate manager in Dovico Timesheet, and assigned to each employee, the tool was used in a real-time environment where time relating to SR&ED activities was recorded by each staff member during a one-year period, the company's fiscal year. At the end of the year, the Chief Financial Officer printed a report showing the number of hours worked, the percent of time spent, and the costs associated with each project and task for each employee. The report took approximately 3 minutes to prepare and the information was based on accurate information entered daily by each employee and approved by each manager on a weekly basis.

Separate eligible SR&ED costing from the overall business project costing. In most cases, the eligible SR&ED activities will form a subset of the overall commercial project activities. It is critical to be able to show how the SR&ED eligible activities were separated from the non-eligible activities. Note, however, that in practice CRA will want to see ALL costs of the project — claimed and unclaimed — to verify for themselves that this has been correctly done.<sup>2</sup>

<sup>2</sup> <https://www.bdo.ca/global-search?searchtext=SR>

## RESULTS

In a separate case:

“Because of Dovico functionality we have reduced our time reporting tasks from four days down to four hours. From a user perspective as well as an administrative perspective, the product is extremely straight forward and user friendly. We use several reports monthly, quarterly and annually to capture time spent on project and operational cost, it makes it easy to identify and defend where resources are needed in quick and easy reports. When we have issues with the product, which is rare, Dovico Support is responsive, professional, and extremely knowledgeable.

Thanks for a great product.”

Molly Schreiner,  
Operations Manager  
TC3 Health

Feedback regarding the tool used in this context was obtained by using it in a real-time environment and creating reports. The reports were used during an official company audit by the CRA. While the initial technical assessment report would have resulted in the claim being reduced by 50% or more, the reports generated by the tool provided enough foundation for the auditor to amend the technical assessment hence reducing the claim by less than 4% instead. As a result, the company was able to receive its claimed value for the SR&ED activities performed of \$89,682. Would the company not have used the tool for time entry of the qualified SR&ED projects and activities, the company would have lost \$44,841.

All commented on the greater capacities and ease of use of the timesheet entry tools. Interestingly, staff members noted their tendency to reduce the accuracy of their time recordings when manual recording was involved, underlining the value-added of this technology.

## REFERENCES

- Dovico Software is a software development company that provides proven project time and cost saving solutions. Established in 1993 in response to the emerging global demand for improved operating efficiency, their timesheet software products have been embraced by thousands of the world's best-known and most successful companies. Dovico has spent the last 30 years creating and continually refining their time management software tools that let companies stay focused on what they do best [timesheet.dovico.com](https://timesheet.dovico.com)
- Ryan LLC, an award-winning global tax services and software provider, is the largest Firm in the world dedicated exclusively to business taxes. With global headquarters in Dallas, Texas, the Firm provides an integrated suite of federal, state, local, and international tax services on a multi-jurisdictional basis, including tax recovery, consulting, advocacy, compliance, and technology services. Ryan is a five-time recipient of the International Service Excellence Award from the Customer Service Institute of America (CSIA) for its commitment to world-class client service. Empowered by the dynamic *myRyan* work environment, which is widely recognized as the most innovative in the tax services industry, Ryan's multi-disciplinary team of more than 2,200 professionals and associates serves over 14,000 clients in more than 45 countries, including many of the world's most prominent Global 5000 companies. More information about Ryan can be found at [Ryan.com](https://Ryan.com)

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- Canadian Advanced Technology Alliance (CATA Alliance) is Canada's leading, most influential and entrepreneurial technology alliance
- Canada Revenue Agency <https://www.canada.ca/en/revenue-agency/services/scientific-research-experimental-development-tax-incentive-program.html>
- Grant Thornton LLP is a leading firm of chartered accountants, management consultants and other professional advisers serving entrepreneurial people and organizations <https://www.rcgt.com/en/insights/another-sred-caselaw-analysis-the-flavor-net-case/>
- BDO Canada <https://www.bdo.ca/global-search?searchtext=SR>