

1726437 Ontario Inc v The Queen, 2012 TCC 376 (informal procedure)

SR&ED expenses - What counts?

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The issue was whether expenses incurred to improve and test HVAC systems to develop one appropriate for the specific use qualified as SR&ED credits as defined in subsection 248(1) of the ITA.

The Court held that the factors were met and that the expenses qualified. However, since the taxpayer elected to proceed under the informal procedure, recovery was limited to \$12,000 despite the \$300,000+ expenditure.

FACTS

The taxpayer had determined that existing HVAC systems were not suitable for installation in multi-level townhomes and spent significant amount of money developing and testing HVAC systems that were suitable. It claimed that these expenses were SR&ED expenses and eligible for ITCs.

The MNR reassessed and denied most of the amounts claimed on the basis that they were routine engineering expenses.

ANALYSIS

The FCA reviewed the definition in subsection 248(1), which reads:

“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 in 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;

[Emphasis original to judgment.]

The Court stated that this definition works on a "catch" (a wide initial definition) and "release" (subsequent exclusions) concept. Relevant concepts in determining whether the definition of SR&ED is met was found in *Northwest Hydraulic Consultants Limited v. The Queen*, 98 DTC 1839, which asks:

- (1) Was there a technological risk or uncertainty which could not be removed by routine engineering or standard procedures?
- (2) Did the person claiming to be doing SR&ED formulate hypotheses specifically aimed at reducing or eliminating that technological uncertainty?
- (3) Did the procedures adopted accord with the established and objective principles of the scientific method, including the formulation, testing and modification of hypotheses?
- (4) Did the process result in a technological advancement?
- (5) Was a detailed record of the hypotheses, tests and results kept as the work progressed?

