



ESSENTIAL GUIDE TO USING
SR&ED
TO FUEL GROWTH



TABLE OF CONTENTS

Introduction	1
Financial Overview	2
Technical Overview	3
Simulating SR&ED	4
Best Practices	5
Conclusion	6
About R&D Partners	7

Introduction

The Scientific Research and Experimental Development Program, also known as “SR&ED” (colloquially known as “shred”), is a federal tax incentive program for businesses carrying out eligible research and development activities. It is an incentive to encourage innovation and leadership in Canada by subsidizing eligible R&D expenditures. It is managed by an independent group within Canada Revenue Agency (CRA).

From a small business perspective, SR&ED can play an essential role in a company's financing by extending runway until products can be monetized through sales. In some cases, it can be the single source of cash flow for quite some time.

On the other hand, larger companies, such as multinationals, rely on SR&ED to develop new innovative product lines on a yearly basis.

Nevertheless, large businesses and small businesses have equal access to the program. In fact, 75% of all claimants are small businesses with less than \$500 000 in revenue.

In this guide, we will demystify the tax credit program and explain when to apply so your credits have meaningful impact on growth. We will also highlight key technical, financial, and legal considerations when pursuing SR&ED.

Financial Overview of the Program

Every Canadian jurisdiction has its own SR&ED program managed by their respective provincial tax authorities. From province to province, the eligibility criteria is the same, but the rates differ based on factors such as total expenditures, company profitability, or some ratio thereof. Furthermore, some provinces treat the refundable and non-refundable portions of the tax credit differently based on legal status of the claimant (Canadian-controlled private corporation or foreign-controlled corporation).

When trying to estimate the size of your claim, it is important to look at your eligible pool of expenditures. The eligible expenditure pool is an amalgamation of three types of expenditures:

1. Employee salaries or wages
2. Subcontractor fees
3. Materials consumed or transformed

From there, you can apply an additional amount to account for overhead.

It is important to note that the CRA favors expenditures related to employee salaries and wages. This type of expenditure always carries the highest refund percentage compared to subcontractor fees or materials consumed. Hence, if it is financially feasible to hire internally, it is best practice to do so.

Technical Overview of the Program

Unlike other programs, a company's eligibility to the SR&ED program is anchored in the projects they worked on in a given fiscal year, as well as the expenditures associated to those projects. The CRA will ultimately rely on the completeness and accuracy of the technical and financial information associated to a project when assessing a claim.

From a technical perspective, the CRA uses the following framework to determine project eligibility:

- 1) Was there a scientific or technological uncertainty?**
- 2) Did the effort involve formulating assumptions or hypotheses aimed at reducing that uncertainty?**
- 3) Did you have a systematic approach when investigating the assumptions / hypotheses?**

In other words, an eligible project needs to have established goals (formulated assumptions), foreseeable obstacles (technological uncertainty), documented work to overcome those obstacles (a systematic approach), and results (technological advancement).

It is important to note that the results do not need to be positive to be eligible for SR&ED credits (i.e. the project could fail).

SR&ED Simulation*

We will use a fictional Canadian-controlled private corporation (CCPC) to simulate a SR&ED claim. We will also compare the claim in Quebec and Ontario.

For the sake of simplicity, we will assume all expenditures are eligible R&D. The company spent \$500,000 in salaries, \$40,000 in subcontracting fees, and \$5,000 in materials consumed. No other government assistance like grants were received.

Expenditures	Quebec	Ontario
Total Salaries	\$ 500,000	\$ 500,000
Total Subcontractor fees	\$ 40,000	\$ 40,000
Total Materials	\$ 5,000	\$ 5,000
	<u>\$ 545,000</u>	<u>\$ 545,000</u>
Refundable Tax Credits		
SR&ED (Provincial and Federal)	\$ (379,750)	\$ (317,273)
	<u>\$ 165,250</u>	<u>\$ 227,727</u>
Cost before non-refundable credits		
Non-Refundable Tax Credits		
SR&ED (Provincial and Federal)	\$ 0	\$ (26,146)
	<u>\$ 165,250</u>	<u>\$ 201,581</u>
Net Cost		
Effective Refund (%)	69.68%	63.01%

*This is based on a best case scenario analysis, rates may decrease with additional information.

Best Practices When Claiming SR&ED

Whether you are developing brain-computer interfaces or you manufacture advanced materials for clean energy, no project is automatically accepted by the CRA. Your work must be documented and defended appropriately. Thus, the importance of contemporaneous documentation. Contemporaneous refers to documentation that is created at the time the SR&ED activity is performed, identifies who did the work and what was done. Ideally, the documentation should exemplify the technological uncertainties and the systematic investigation that was performed.

Recurring SR&ED audits (monthly or quarterly) with your lead engineers ensures your team does not forget what was worked on. There are a plethora of time tracking tools on the market to help you with this, but more importantly, you need to instill a culture of documenting SR&ED among your engineering team.

Within the context of software development, a CTO and Product Owners should tirelessly reinforce the following good behaviors:

- Logging projects & tasks with Asana, Trello, or any team favorite task management tool
 - Tracking revision history with git & Github
 - Writing commit messages with a standard format
 - Keeping written code (& feature) reviews via Github pull requests
 - Tracking time associated to each activity in a given project
-




Conclusion

Canadian companies that experience significant growth year-over-year know how instrumental SR&ED can be. Our simplified case study on page 4 illustrated this quite easily - a company with \$545,000 of eligible expenses in Quebec and Ontario respectively save ~70% and ~63% on engineering costs.

Companies can even forecast their SR&ED at the beginning of the fiscal year and periodically review how they are trending toward their goal.

More importantly, in an era of agile development, product leaders need to find a way of documenting SR&ED with minimal overhead and without sacrificing speed.

To recap...

-  Track your projects contemporaneously
-  Don't assume your projects are eligible
-  Build a culture of tracking SR&ED

How R&D Partners Can Help

For over 15 years, we have successfully claimed over \$200 million in R&D tax credits and other government funding for our clients. Our client list proudly includes startups, leading high-growth firms, and some of the most recognizable global technology firms. We have some of the most sought-after team members, an impressive track record, a proven approach, and numerous awards recognizing our work.

Our team is adept at dealing with the technical R&D admissibility issues as well as navigating the complex R&D taxation rules across multiple jurisdictions. We work with clients from the start to systematically claim government funding, but we have also been very successful in taking over previously rejected claims.

Our team of professional engineers, scientists, and tax professionals strive to maximize government funding and simplify your life.

[book a free meeting now](#)

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