

Did the CRA shred its old SR&ED policy on eligibility of work?

AUTHORS



John J. Tobin

The Canada Revenue Agency (CRA) recently replaced its Eligibility of Work for SR&ED Investment Tax Credits Policy¹ with its new Guidelines on the Eligibility of Work for SR&ED Tax Incentives². This has created confusion as to whether this change indicates a substantive development in the law or merely a change in how the program will be administered.

This is no small point. Canada offers some of the most generous and broadly applicable research and development incentives in the world. While the federal government has increased direct funding for research and development initiatives in recent years, the Scientific Research and Experimental Development (SR&ED) tax incentives program is still the largest single support program in Canada—providing over \$3 billion in tax incentives through more than 20,000 claims annually³. This program has attracted the attention of not just Canadian investors but also, increasingly, of foreign investors.

What you need to know

- The CRA has recently replaced its Eligibility of Work for SR&ED Investment Tax Credits Policy with new guidelines on what is considered eligible work for SR&ED tax incentives.
- The new guidelines establish a more concise “why” and “how” framework for determining whether a particular activity can be considered a SR&ED expenditure and, thereby, be eligible for SR&ED incentives.
- The new guidelines do not indicate a departure from the old common law test for determining SR&ED expenditure eligibility (established in *Northwest Hydraulics Consultants v. The Queen*). Rather, they are intended to make it easier for businesses to assess for themselves whether particular expenditures are eligible for the SR&ED program.

Tax incentives for scientific research and experimental development in Canada

Under the Canadian tax system, there are two incentives available to corporations conducting SR&ED:

1. the special deductibility rules available for SR&ED expenditures; and
2. an additional investment tax credit (the ITC).

Both incentives are calculated based on the amount of the expenditures that the corporation incurs for qualifying SR&ED activities. These incentives can be quite significant. The ITC alone, when considering both the federal and provincial SR&ED programs, can potentially produce a refundable tax credit worth nearly 50% of expenditures on qualifying SR&ED activities for Canadian-controlled private corporations (CCPCs). Therefore, it is important to determine what exactly is considered a qualifying SR&ED activity.

The current form of federal SR&ED incentives has been in place since 1985. While the framework of the incentives has largely remained the same, the SR&ED programs, administration and guidelines are continuously changing.

What activities qualify for SR&ED?

The definition of SR&ED can be found in subsection 248(1) of the *Income Tax Act*⁴ (the ITA), and it includes work undertaken by a business for “the purpose of creating new, or improving existing ... products or processes”⁵. While this may sound simple enough, the process of determining which specific business expenditures and activities are eligible for the SR&ED tax incentives has been quite confusing and complex.

To assist with this determination, the Tax Court of Canada laid out the basic common law test for identifying SR&ED activities, in *Northwest Hydraulic Consultants v. The Queen* (“*Northwest Hydraulic*”)⁶. In this case, Chief Justice Bowman set forth the following five questions to determine whether a particular creative venture could constitute SR&ED activity:

1. Is there a technical risk or uncertainty?
2. Did the person claiming to be doing SR&ED formulate hypotheses specifically aimed at reducing or eliminating that technological uncertainty? This involves: (a) observing the subject matter of the problem; (b) formulating a clear objective; (c) identifying and articulating the technological uncertainty; (d) formulating a hypothesis or hypotheses designed to reduce or eliminate the uncertainty; and (e) methodical and systematic testing of the hypotheses.
3. Did the procedures adopted accord with established and objective principles of the scientific method, characterized by trained and systematic observation, measurement and experiment, and the formulation, testing and modification of hypotheses?
4. Did the process result in a technological advancement?
5. Was there a detailed record of the hypotheses, tests, and results as the work progressed⁷?

This test was subsequently reaffirmed by the Federal Court of Appeal (the FCA) in several cases, the most recent of which are *National R&D Inc. v. Canada* (*National R&D*)⁸ and *Kam-Press Metal Products Ltd. V. Canada*⁹.

The CRA’s previous Eligibility of Work for SR&ED Investment Tax Credits Policy (now archived) mirrored the common law test established in *Northwest Hydraulic*. The five questions detailed by that case were listed on the CRA website as the criteria that corporations should consider when assessing their expenses as eligible or not for SR&ED.

New guidelines for SR&ED eligibility

The CRA’s new guidelines require a SR&ED applicant to answer just two critical questions to determine their SR&ED incentive eligibility: “why” and “how”.

1. Why is the work being conducted in order to advance scientific knowledge, or for the purpose of achieving technological advancement?
2. How is the work being conducted by means of a systematic investigation or search that is carried out in a field of science or technology by means of experiment or analysis?

If the answer to these questions is yes, the work should qualify as an eligible SR&ED activity.

Additionally, it is important to note that, for the “how” requirement, the CRA further explains what it considers to be necessary elements of a “systematic investigation or search”:

- the generation of a hypothesis. This is an idea consistent with known facts, which serves as a starting point for further investigation towards achieving an objective or resolving a problem. The idea may be expressed as a possible solution to a problem, a proposed method, or an approach.
- the testing of this idea or hypothesis by means of experiment or analysis (the idea can evolve and change as a result of testing).
- the development of logical conclusions based on the results or findings of the experiment or analysis; and
- the keeping of evidence that is generated as the work progresses.

How different are the new SR&ED guidelines?

While it may seem like the new guidelines are a departure from the common law test established in *Northwest Hydraulic*, a closer look shows that this is not actually the case. The CRA is still applying the five-element test for determining SR&ED. The purpose of the new guidelines is to provide clearer and simpler information about how SR&ED work is defined under the ITA and to make it easier for businesses to assess whether their work is eligible for SR&ED tax incentives at the outset, before they apply¹⁰.

Further, the CRA explicitly acknowledges in the new guidelines that the definition of SR&ED given in subsection 248(1) of the ITA has not changed¹¹. A careful reading of the “why” and “how” requirements set out by the CRA in the new guidelines reveals that this is just a re-wording of the *Northwest Hydraulic* test, with the first element of the test— is there technical risk or uncertainty?—being contained within the “why” requirement and the last four elements being re-written and summarized to fit within the “how” requirement and the definition of a “systematic investigation or search” encompassed therein.

The five-element test remains ingrained in the jurisprudence. In the recent FCA decision in *National R&D*, the taxpayer argued that: (i) the third criterion of the *Northwest Hydraulic* test has no textual foundation in the statutory definition of SR&ED; and (ii) regardless, the CRA’s new policy was inconsistent with the test. The FCA reminds us that CRA commentary is not binding on the Court, although it can provide helpful guidance to understand a provision’s context and purpose. It further commented: “While the new CRA guidance no longer uses the precise language of the ‘scientific method’, the ‘The “How” requirement’ section of the CRA guidance still speaks to the requirement of an underlying rigour or discipline in the experimental process”¹². The FCA also confirmed that the proper interpretation of the SR&ED definitions remains as set out in *Northwest Hydraulic*.

The future of SR&ED

It is possible that the CRA’s new guidelines indicate that it views the eligibility test, as formulated, as placing an undue emphasis on technical risk or uncertainty and not enough emphasis on why the research is being done and how it advances Canadian competitiveness. Canada’s Budget 2022 announced the government’s commitment to undertake a review of the SR&ED program—first to ensure its effectiveness in encouraging R&D that benefits Canada and second to explore opportunities to modernize and simplify it. Until then, the current case law and past guidance from CRA is still relevant and useful. Also, bear in mind that there are many other factors that determine the scope and type of SR&ED incentives that are available to an applicant. As Canada’s reputation as an innovative economy grows and continues to attract more research dollars from both domestic and foreign investors, understanding these factors will only grow in importance.

FOOTNOTES

To discuss these issues, please contact the author(s).

This publication is a general discussion of certain legal and related developments and should not be relied upon as legal advice. If you require legal advice, we would be pleased to discuss the issues in this publication with you, in the context of your particular circumstances.

For permission to republish this or any other publication, contact [Janelle Weed](#).

© 2025 by Torys LLP.

All rights reserved.