



Canada Revenue  
Agency

Agence du revenu  
du Canada

# Claiming Scientific Research and Experimental Development

Guide to Form T661

Visually impaired persons can get this publication in braille, large print, or etext (text-to-speech format on computer diskette), or on audio cassette by visiting our Web site at [www.cra.gc.ca/alternate](http://www.cra.gc.ca/alternate) or by calling 1-800-267-1267 weekdays between 8:15 a.m. and 5:00 p.m. (Eastern Time).

If you have difficulty hearing or speaking, you can call our toll-free, bilingual teletypewriter enquiry service to get information. The telephone number is 1-800-665-0354.

In this guide, we use plain language to explain the most common tax situations. If you need help after reading this guide, you can contact us or use our other services (see page 7 or 39).

In this guide, legislative references are to the *Income Tax Act* (the Act) and regulatory references are to the *Income Tax Regulations* (the Regulations).

La version française de cette publication est intitulée *Demande pour la recherche scientifique et le développement expérimental – Guide pour le formulaire T661*.

## What's New?

### Changes to Form T661

**Effective date of revised Form T661:** The new version of Form T661 is effective as of the date of its publication. We encourage you to start using the revised form immediately.

However, if you file an SR&ED claim for a prior year, we will accept the new or the old version of the form, provided you file the amended claim within your SR&ED filing deadline.

**Filing requirements:** The section of this guide called "*How to Complete Form T661*" has been revised to clarify what forms need to be filed and when these forms must be filed in order to access the incentives for SR&ED carried out in Canada.

**Partnerships:** The subsection called "*General filing requirements for partnerships*" in this guide was amended to clarify what forms and documents need to be filed by a partnership and its partners, and when these forms and documents must be filed in order to access the incentives for SR&ED carried out in Canada.

### New or revised application policies

When this guide was printed, the following application policies were issued or revised since the last version of this guide:

SR&ED 2003-01 – *Capital Property Intended to be Used All or Substantially All for SR&ED*

SR&ED 2004-01 – *Retiring Allowance*

SR&ED 2004-02 – *Filing Requirements for Claiming SR&ED Carried out in Canada*

SR&ED 2004-03 – *Prototypes, Pilot Plants/Commercial Plants, Custom Products and Commercial Assets*

Application policies are posted on the CRA's Web site at [www.cra.gc.ca/sred/](http://www.cra.gc.ca/sred/) as soon as they are finalized.

Application policies issued in previous years can also be found on the Web site.

### Upcoming seminars

Consult the CRA's Web site at [www.cra.gc.ca/sred/](http://www.cra.gc.ca/sred/) for upcoming seminars in your area.

### SR&ED co-ordinating offices

A list of the SR&ED co-ordinating tax services offices and the offices they serve is included at the end of this guide.

### Tax centres

At the end of this guide, you will find a list of the CRA's tax centres and the tax services offices for which they process all returns of income filed during the year. You should use this list to determine where to send your SR&ED claim.

### New and revised forms/publications

T661(E) *Claim for Scientific Research and Experimental Development Carried out (SR&ED) in Canada*

## Proposed changes to the legislation

**February 18, 2003 Budget** – The proposed changes received Royal Assent on June 19, 2003.

### **Draft Technical Income Tax Amendments of**

**December 20, 2002** (this draft is expected to be tabled to Parliament in 2004) – The Department of Finance released Draft Technical Income Tax Amendments. The proposed changes are as follows:

- Effective after February 23, 1998, subclause 37(8)(a)(ii)(B)(V) of the Act and related sections are amended to allow costs of “materials transformed” when using the proxy method. However, only claims that are filed within the claimant’s reporting deadline are affected by the proposed changes. Claimants are not permitted to change their elected method when filing their claims.
- Applicable after the announcement date of December 20, 2002, paragraphs 127(27)(b) and (c) and the text after paragraph (d) are amended to recapture an investment tax credit (ITC), where the ITC is claimed for SR&ED on disposition or conversion to commercial property, even though the expenditure for the property is unpaid under subsection 127(26). This includes shared-use equipment.

- **March 23, 2004 Budget** – the budget proposes the following changes to the Income Tax Act:

#### ■ **Small Business Deduction Limit**

That the rules determining the business limit of a Canadian-controlled private corporation (CCPC) be modified for taxation years that end after 2004 such that the small business limit to \$300,000 be accelerated by one year. The small business limit will therefore be \$300,000 in 2005 and subsequent years. However, in determining the expenditure limit for SR&ED, the small business limit to be used is \$300,000.

#### ■ **Refundable SR&ED Investment Tax Credit—Expenditure Limit**

To remove this impediment to small business accessing SR&ED assistance if they also raise funding from common investors, the budget proposes to amend the refundable SR&ED ITC rules. Small CCPCs that have a group of common investors (which group the Minister of National Revenue is satisfied was not formed to gain access to multiple expenditure limits) will not have to share the \$2 million expenditure limit solely because two or more investors collectively have a majority interest in the shares of each corporation. Each small business will, in such a case, have access to its own expenditure limit of \$2 million.

**This change will apply to taxation years that end after March 22, 2004.**

# Contents

	Page		Page
<b>General Information</b> .....	6	Step 3 – Qualified SR&ED expenditures for ITC purposes.....	25
<b>How to Complete Form T661</b> .....	7	Part 4 – Background Information.....	30
Filing requirement.....	7	Schedule A – Third-Party Payments.....	31
How Form T661 is structured .....	9	Schedule B – Special Situations .....	31
<b>Line-by-Line Explanations</b> .....	9	Schedule C – Non-Arm’s Length Transactions.....	33
Part 1 – General Information.....	9	Schedule D – Calculation of Salary Base and Prescribed Proxy Amount.....	35
Part 2 – Scientific or Technological Project Information .....	12	Schedule E – List of all SR&ED projects claimed .....	37
Step 1 – Detailed project description .....	13	<b>Glossary</b> .....	38
Step 2 – Project summary information.....	15	<b>Tax Services Offices</b> .....	39
Part 3 – Summary of SR&ED Expenditures .....	15	<b>Tax Centres</b> .....	40
Step 1 – Allowable SR&ED expenditures for SR&ED carried out in Canada.....	15		
Step 2 – Pool of deductible SR&ED expenditures .....	24		

## General Information

### Legislative references

#### **Income Tax Act**

Sections 37 and 127.1

Subsections 96(2.4), 96(3), 127(5), 127(8), 127(9), 127(10.1), 127(10.3), 127(10.4), 127(11.1) to (11.8), 127(13) to (35), 194(2), and 248(1)

Paragraphs 12(1)(f), 12(1)(v), 12(1)(x), 20(1)(hh), 96(1)(e.1), and 96(1)(g)

See other references in the current version of Interpretation Bulletin IT-151, *Scientific Research and Experimental Development Expenditures*.

#### **Income Tax Regulations**

Sections 2900, 2902, 2903, and 8201

Paragraph 1102(1)(d)

### Internet access

You can find SR&ED Program information, policies, publications, draft papers for comments, and other useful information on our Web site at [www.cra.gc.ca/sred/](http://www.cra.gc.ca/sred/).

### Online help

If you need help completing Form T661, see the “Forms and publications” section of our Web site.

### Our publications

The following publications will help you complete your SR&ED claim. We recommend that you review the current version of these publications.

**T4119**, *Scientific Research and Experimental Development – Economic Development Through SR&ED Tax Incentives* – This leaflet explains the advantages of the SR&ED Program in general terms.

**T4052**, *An Introduction to the Scientific Research and Experimental Development Program* – This brochure describes the scope of the incentive program and explains how to receive benefits.

**Interpretation Bulletin IT-151**, *Scientific Research and Experimental Development Expenditures* – This bulletin discusses the provisions of the Act and the Regulations dealing with SR&ED expenditures and investment tax credits.

**Information Circular 86-4**, *Scientific Research and Experimental Development* – This information circular clarifies what constitutes SR&ED under subsection 248(1) of the Act.

**Information Circular 97-1**, *Scientific Research and Experimental Development – Administrative Guidelines for Software Development* – This information circular helps claimants and our staff interpret how the tax incentives apply to software development.

### Forms related to SR&ED claims

You can obtain a copy of these forms and schedules from our Web site or from your local tax services office:

**Form T661**, *Claim for Scientific Research and Experimental Development (SR&ED) Carried out in Canada*

**Form T1145**, *Agreement to Allocate Assistance Between Persons Not Dealing at Arm’s Length for Scientific Research and Experimental Development (SR&ED) Expenditures Carried Out in Canada*

**Form T1146**, *Agreement to Transfer Qualified Expenditures Incurred in Respect of Scientific Research and Experimental Development (SR&ED) Contracts Carried Out in Canada*

**Form T1174**, *Agreement Between Associated Corporations to Allocate Salaries or Wages of Specified Employees for Scientific Research and Experimental Development (SR&ED) Carried Out in Canada*

**Form T2038(IND)**, *Investment Tax Credit (Individuals)*

**Schedule T2SCH31**, *Investment Tax Credit – Corporations*

**Schedule T2SCH49**, *Agreement Among Canadian-Controlled Private Corporations to Allocate the Expenditure Limit*.

### Provincial and territorial tax incentives

Provincial and territorial incentives may also be available for your SR&ED expenditures. At the time this guide was published, the following provinces and territory offered a tax credit program for R&D: Newfoundland and Labrador, Nova Scotia, New Brunswick, Quebec, Ontario, Manitoba, Saskatchewan, British Columbia, and the Yukon. Contact your provincial or territorial tax authority to determine whether such incentives are available. You will find the telephone numbers in the government section of your telephone book.

### Advisory services

We provide a number of advisory services to enhance awareness of program requirements and to help SR&ED claimants submit successful claims. These services include:

1. **First-time SR&ED claimant service** – This service provides information and assistance to claimants who are new to the program. On request, CRA representatives can call you to answer your questions. If necessary, an SR&ED representative can make a personal visit to explain the program and documentation requirements in more detail.
2. **Public information seminars** – New claimants are invited to attend one of the SR&ED Program’s public information seminars, which are held regularly at locations throughout Canada. Contact your local tax services office if you wish to attend a seminar, or visit our Web site at [www.cra.gc.ca/sred/](http://www.cra.gc.ca/sred/). The first-time claimant service and public information seminars greatly aid new or potential claimants to better understand their entitlements under the SR&ED Program.

3. Preclaim Project Review (PCPR) – The PCPR service provides claimants with an up-front review and a preliminary opinion of the eligibility of their project for SR&ED tax incentives, before they file a claim. A key aspect of the service is direct communication between those who understand the technical issues of the project (the claimant’s personnel) and an SR&ED research and technology advisor. The service helps explain the SR&ED Program, including substantiation requirements, and it addresses concerns before claims are made. See our related brochure, RC4271, *Introducing the SR&ED Program’s Preclaim Project Review Service*.
4. Account Executive Service – This service provides claimants with a designated contact person. You can call your account executive for help with various SR&ED Program areas, including technical or financial issues, and get help accessing other services such as the PCPR. The account executive will make sure that you get the assistance you need and, through ongoing contact, help you better understand the program. See our related brochure, RC4270, *Introducing the SR&ED Program’s Account Executive Service*.

You are encouraged to use these services which are available through most CRA tax services offices across the country.

## Your opinion counts

We review this guide regularly. If you have comments or suggestions that would help us improve it, we would like to hear from you. Send your comments to:

SR&ED Directorate  
 Canada Revenue Agency  
 875 Heron Road  
 Ottawa ON K1A 0L8

## How to Complete Form T661

### Filing requirement

To access the incentive for SR&ED carried out in Canada, you must complete Form T661, and schedule T2SCH31 or Form T2038 (IND), as applicable, and send them with your return of income, along with any related schedules and attachments. You have to file Form T661 whether or not you claim an ITC in the current year.

#### Notes

Form T661 applies only to SR&ED carried out in Canada. Generally, expenditures for SR&ED conducted outside Canada should be claimed with other business expenses on the financial statements.

Expenditures on capital are added to the appropriate capital cost allowance (CCA) class and subject to the normal rules of CCA. Expenditures for SR&ED conducted outside Canada do not qualify for an ITC.

If you want more information on how to treat these expenditures, read the current version of Interpretation Bulletin IT-151. This bulletin is available on the CRA’s Web site.

Technical personnel should complete Part 2 of the form, and financial personnel should complete Part 3 and any applicable schedules. Both financial and technical personnel may need to provide information in Parts 1 and 4.

To meet the filing requirements for claiming incentives for SR&ED carried out in Canada, you have to file an original or amended Form T661 and Schedule T2SCH31, or Form T2038(IND), as applicable, containing all the relevant prescribed information by your reporting deadline.

Prescribed information means all the information requested on Form T661, Schedule T2SCH31, or Form T2038 (IND). For Form T661, prescribed information will also include any attachments or schedules necessary to provide the information requested in Part 2, Step 1 (*Detailed Project Description*) and Step 2 (*Project Summary Information*) in Part 3, on lines 340 and 345 (SR&ED contract costs), and on schedules A, B, C, D and E of Form T661.

A claimant’s reporting deadline is the day that is 12 months after the filing due date of the return of income for the year. A corporation will have 18 months (individuals have 17.5 months) from the end of the tax year in which you incurred the expenditures to report them.

If you do not report an expenditure on Form T661 by the reporting deadline, you will not be able to include these amounts in your SR&ED expenditure pool to be used to reduce your income, and you will not be able to earn an ITC on these expenditures.

This will cause the expenditures to be classified as normal business expenditures in accordance with the Act. For example, an expenditure on equipment, which would have been an SR&ED capital expenditure deductible in the year if the filing conditions had been met, would generally be treated as depreciable property, while an expenditure which would have been an SR&ED current expenditure would generally be deductible as a current expense under section 9 of the Act.

As well, if you do not report your SR&ED expenditures and the required information within the reporting deadline on Schedule T2SCH31 or Form T2038(IND), you will not earn any ITC for the expenditures (see Application Policy SR&ED 2004-02 – *Filing Requirements for Claiming SR&ED Carried out in Canada*).

A corporation exempt from Part I tax under paragraph 149(1)(j) of the Act and incurs SR&ED expenditures has to file Form T661 on or before the due date for filing its return of income for the year or it will be subject to a penalty. The filing due date is 6 months after the end of the corporation’s tax year.

You may use CRA’s preprinted forms and schedules to file your SR&ED claim, or if you use approved commercial software to prepare your return of income, you may use facsimile (ie, computer-printed) forms and schedules produced by the software. The tax preparation software will now generate another format for computer-printed returns called a T2 Return and Schedule Information (RSI). If you use version (04) of Form T661, the RSI 32 format of Form T661 now contains all the prescribed information

requested on Form T661. As a result, you can either file a facsimile copy of Form T661 or the RSI 32 with project descriptions and all the attachments or schedules required by the CRA.

#### Note

If you use version (03) of Form T661 you will continue to be required to file a facsimile copy of Form T661 with project descriptions and all the attachments or schedules required by the CRA, as the RSI 32 does not contain all the prescribed information on Form T661.

Under exceptional circumstances, if you did not file Form T661 and Schedule T2SCH31 or Form T2038 (IND) within your reporting deadline, you may apply to the Director of your tax services office to request that your claim be accepted under subsection 220(2.1) of the Act (Minister's discretionary powers).

In general, this provision could apply when exceptional circumstances beyond the claimant's control have prevented him or her from meeting a legal obligation or paying a specified amount by the required deadline. The claimant must have shown reasonable diligence in his or her efforts to comply with the Act.

### General filing requirements for partnerships

A partnership's SR&ED expenditures must be deducted in the calculation of the partnership's income in the year they are incurred. A partnership will not have an SR&ED expenditure pool balance to carry forward to a later year, and the partners will not be able to include any portion of the partnership's SR&ED expenditures in their SR&ED expenditure pool. As a result, the partners do not include any of the partnership's SR&ED expenditures on their Form T661.

Since the SR&ED expenditures are deducted at the partnership level, the partnership will be required to file Form T661, and the expenditures listed in Part 3 of the form are the total SR&ED expenditures of the partnership, and not just a particular partner's share of those expenditures.

At the end of the fiscal period, a partnership will generally allocate the ITC earned to its partners. To claim the ITC of the partnership, each of the partners will need to file Schedule T2SCH31 or Form T2038(IND). Since the partnership can not claim any ITC for the year, the partnership does not need to file a T2SCH31 or T2038(IND). However, it will be required to provide schedules showing the calculation and allocation of the partnership's ITC.

For claimants who are members of a partnership, each partner's reporting deadline is determined based on the partner's taxation year in relation to the partnership's fiscal year in which the expenditure in question was incurred. A Schedule T2SCH31 or Form T2038(IND) must be filed by each partner within each partner's respective reporting deadline in order to claim a share of the ITC of the partnership.

Where a Form T5013 Summary, *Partnership Information Return*, is required to be filed (more than five partners), the partnership must file the following with the information return: a partnership T661, partnership financial statements, schedules showing the calculation and allocation of the partnership ITC, and T5013 slips, *Statement*

*of Partnership Income*, for all the partners. To claim a share of the partnership ITC, the partners should file their T5013 slip with their Schedule T2SCH31 or Form T2038(IND) on or before their respective reporting deadline. The amount in Box 38 of the T5013 slip should be claimed on line 550 of a corporation's Schedule T2SCH31, or included in the calculation of an ITC on line 6712 of Form T2038(IND) for an individual or trust.

Where a *Partnership Information Return* is not required to be filed (five partners or less), to claim a share of the partnership ITC, the partners should file a T661 for the partnership, financial statements for the partnership, and schedules showing the calculation and allocation of the ITC of the partnership. These should be filed with the partner's Schedule T2SCH31 or Form T2038(IND) on or before their respective reporting deadline. The allocated ITC should be claimed on line 550 of a corporation's Schedule T2SCH31, or included in the calculation of an ITC on line 6712 of Form T2038(IND) for an individual or trust.

For more information on when a *Partnership Information Return* is required to be filed, refer to Information Circular 89-5R, *Partnership Information Return* and 89-5RSR, Special Release: *Partnership Information Return*, as well as the T4068, *Guide for the Partnership Information Return*. These are available on the CRA's Web site or at any tax services office.

For more information on SR&ED expenditures and the ITC of a partnership, read the current version of Interpretation Bulletin IT-151.

### Processing of an SR&ED Claim

In order for the CRA to process an SR&ED claim, a claimant must file with the CRA:

- Form T661 and Schedule T2SCH31 or Form T2038(IND), as applicable, containing all the relevant prescribed information within the reporting deadline, and
- A T2 *Corporation Income Tax Return* or a T1 *Income Tax and Benefit Return*.

### How to speed up the processing of your claim

To help us process your current-year claim as quickly as possible follow these instructions:

- Use the latest version of Form T661 (see the CRA'S Web site).
- File Form T661 and Schedule T2SCH31 or Form T2038(IND) with all the relevant prescribed information within your reporting deadline, and a return of income for the year. Filing a form or schedule with missing information, or using a previous version of Form T661 to file a current-year claim, will delay the processing of your claim.
- Place the completed Form T661 on top of your return of income for quick identification.
- Retain all technical and financial information to support your claim.
- File your SR&ED claim at the appropriate tax centre (filing your claim at your local tax services office may delay the processing of your claim).



- Respond in a timely manner to our requests for more information.
- Check off the appropriate box on the return of income requesting a direct deposit of your refundable ITC.

Even if a claim is complete, the claim must conform to the definition of “scientific research and experimental development” contained in subsection 248(1) of the Act, and also meet the rules under sections 37 and 127 of the Act. All forms and schedules should be filed within the reporting deadline. (See Application SR&ED Policy 2004-02, – *Filing Requirements for Claiming SR&ED Carried Out in Canada.*)

## Classified projects

If a federal agency has designated one or more of your project descriptions as “classified information” for national security reasons, follow these instructions:

- Prepare and keep on file a fully completed Form T661, including all project descriptions in Part 2, Step 2.
- Send a letter to the Research and Technology Section at the following address:  
  
SR&ED Directorate  
Canada Revenue Agency  
875 Heron Road  
Ottawa ON K1A 0L8
- In your letter, explain that certain project descriptions are classified information, and that they are available on request.
- Send a copy of the letter with your return of income, along with the completed Form T661. Do not include the descriptions of the classified projects.

## How Form T661 is structured

We have divided the form into four parts and complemented by schedules:

### Part 1 – General Information

Provide all the information required and sign the “Certification and Election” area on page 1 of the form.

### Part 2 – Scientific or Technological Project Information

#### Step 1 – Detailed project description

Provide project descriptions for the expenditures you claimed in Part 3. Remember to have the individual responsible for technical work complete this part.

#### Step 2 – Project summary information

Provide the number of projects you are claiming in this tax year. Indicate if you received an amount from the Industrial Assistance Program (IRAP) by writing the amount received, if applicable.

## Part 3 – Summary of SR&ED Expenditures

Provide expenditure information on all claims for SR&ED carried out in Canada. This part represents the total cost for all projects. Keep in mind that you also have to provide cost information for individual projects in Part 2 of the form.

You should retain the records of costs and explanations of cost allocations to individual projects. These records should be made available during the claim review.

**Step 1 – Allowable SR&ED expenditures for SR&ED carried out in Canada** – In this section, list your total allowable SR&ED expenditures in the year, both current and capital, for SR&ED carried out in Canada.

**Step 2 – Pool of deductible SR&ED expenditures** – In this section, you calculate the SR&ED expenditure pool deduction that is available in the year, starting with the amount of allowable expenditures for SR&ED carried out in Canada from line 400. Then subtract the deduction claimed in the year. The balance is the amount of SR&ED expenditures left for you to deduct in future years.

**Step 3 – Qualified SR&ED expenditures for ITC purposes** – In this section, you will determine the SR&ED expenditures that qualify for a federal ITC.

## Part 4 – Background Information

We use this information on your business to administer the program and process your SR&ED claim.

**Checklist** – Review the checklist to confirm that you have filed the required information.

### Schedule A – Third-Party Payments

Provide the information requested on this schedule as indicated. Use other copies of this schedule if you are claiming more than one third-party payment.

### Schedule B – Special Situations

This schedule contains adjustments to the deductible SR&ED expenditure pool, and to qualified SR&ED expenditures. Report the amount(s) on Form T661 as required.

### Schedule C – Non-Arm’s Length Transactions

Complete this schedule if you had one or more of the non-arm’s length transactions described in this schedule. Report the amounts on Form T661 as instructed.

### Schedule D – Calculation of Salary Base and the Prescribed Proxy Amount

If you elected to use the proxy method on page 1 of the form, complete this schedule to calculate the salary base and the prescribed proxy amount.

### Schedule E – List of all SR&ED projects claimed in the year

Complete this schedule by providing information for each SR&ED project you claim in the tax year. You have to indicate the total current expenditures for labour, materials, and contracts you claimed for each project.

## Line-by-Line Explanations

The following section explains how to complete each line of Form T661. We recommend that you read the explanations as you fill in the form.

### Part 1 – General Information

#### Name and complete address of claimant

Enter the registered business name, address, Web site address (if you have one), and postal code. If you have to file a *Partnership Information Return* (Form T5013 Summary), enter the name of the partnership.

#### Return for the tax year

Write the dates of the beginning and end of the tax year for which you are submitting the claim.

#### Business identification

Enter the identification number that pertains to your business (i.e., Business Number, social insurance number, or partnership identification number).

#### Lines 100, 105, and 110 – Contact person

Write the name, telephone number, and fax number of the person best suited to provide information about the overall submission.

#### Lines 130 and 132 – Is this the first time you are claiming for SR&ED?

Indicate if this is your first SR&ED claim. If not, indicate the year you filed your last SR&ED claim.

#### Lines 142, 145, and 150 – Partnership information

Answer the questions on lines 142, 145, and 150 if you are entitled to a share of the ITCs for SR&ED earned by a partnership.

#### Line 155 – Name of the person or firm who prepared this claim

Indicate the name of the person who prepared your claim.

### Lines 160 and 162 – Choice of method

Indicate by a checkmark (✓) which method you used to claim SR&ED expenditures. You can choose the traditional method and claim all the SR&ED expenditures you incurred during the year, or you can use the proxy method. The proxy method is an alternative way to determine your SR&ED expenditures and ITC for overhead expenditures.

The proxy method involves calculating a substitute amount for overhead expenditures using a formula, rather than specifically identifying and allocating these expenditures as you would with the traditional method. Table 1 shows how to treat expenditures under each method. You will be required to complete Schedule D if you elect to use the proxy method.

To determine your qualified SR&ED expenditures for ITC purposes, calculate the amount representing the overhead expenditures as a fixed percentage (65%) of the salaries or wages of the employees directly engaged in SR&ED. This amount becomes the prescribed proxy amount (PPA). Special rules apply to restrict the amount of salaries or wages of specified employees you can include in the salary base. For more details, see the explanation for line 502. The PPA may be eligible for the 100% ITC refund.

You do not include the PPA in the SR&ED expenditure pool, and you do not deduct it when calculating income. It represents the amount of overhead expenditures for SR&ED, and is used only to determine your ITC for these overhead expenditures. The PPA is treated as a qualified expenditure for ITC purposes. The actual overhead expenses represented by the PPA are ordinary business expenses and, as such, are not added to the SR&ED expenditure pool.

**Table 1****Treatment of expenditures under the traditional and the proxy methods**

<b>Expenditure</b>	<b>Traditional method</b>	<b>Proxy method</b>
Salaries or wages directly engaged in SR&ED.	<ul style="list-style-type: none"> <li>■ eligible for ITC</li> <li>■ deductible under paragraph 37(1)(a) (see line 300)</li> </ul>	<ul style="list-style-type: none"> <li>■ eligible for ITC and salary base for the PPA (see line 502)</li> <li>■ deductible under paragraph 37(1)(a) (see line 300)</li> </ul>
Overhead expenditures directly related and incremental to SR&ED	<ul style="list-style-type: none"> <li>■ eligible for ITC (see line 360)</li> <li>■ deductible under paragraph 37(1)(a)</li> </ul>	<ul style="list-style-type: none"> <li>■ not specifically identified</li> <li>■ covered in the PPA (see examples below)—PPA is eligible for ITC.</li> <li>■ deductible as regular business expenses only—not deductible under 37(1)(a)</li> </ul>
Other expenditures claimed separately: <ul style="list-style-type: none"> <li>■ materials consumed or transformed (after February 23, 1998) in performing SR&amp;ED</li> <li>■ lease costs of SR&amp;ED equipment</li> <li>■ expenditures for SR&amp;ED directly undertaken on your behalf</li> <li>■ third-party payments</li> </ul>	<ul style="list-style-type: none"> <li>■ eligible for ITC</li> <li>■ deductible under paragraph 37(1)(a)</li> </ul>	<ul style="list-style-type: none"> <li>■ eligible for ITC</li> <li>■ deductible under paragraph 37(1)(a)</li> </ul>
<p>The PPA covers overhead expenditures such as:</p> <ul style="list-style-type: none"> <li>■ office supplies</li> <li>■ general-purpose office equipment</li> <li>■ heat, water, electricity, and telephones</li> <li>■ salaries or wages for support staff</li> <li>■ travel and training</li> <li>■ property taxes</li> <li>■ maintenance and upkeep of SR&amp;ED premises, facilities, or equipment</li> <li>■ any other eligible expenditures directly related to the prosecution of SR&amp;ED that you would not have incurred if the SR&amp;ED had not been carried out</li> </ul>		

You have to elect (choose) to use a method for each tax year for which you want to claim SR&ED expenditures. You have to make your choice of method when you first file Form T661 for the year. Whether you elect to use the proxy method or the traditional method, your choice is irrevocable for the year.

If you are a member of a partnership that elects to use the proxy method to calculate the income from the partnership, the election is only valid if you made it on behalf of all the members of the partnership and you, as an authorized partner, had the authority to act for the partnership.

The following table describes the advantages and disadvantages of each method.

<b>Table 2</b>		
<b>Advantages and disadvantages of the proxy method and the traditional method</b>		
<b>Method</b>	<b>Advantages</b>	<b>Disadvantages</b>
<b>Proxy method</b>	<ul style="list-style-type: none"> <li>■ ITCs are earned on the PPA, which is 65% of directly engaged SR&amp;ED salaries and wages in the salary base</li> <li>■ easier to determine the PPA once you establish the salary base</li> <li>■ no need to track overhead expenditures for SR&amp;ED</li> </ul>	<ul style="list-style-type: none"> <li>■ The PPA may be less than the overhead expenses actually incurred</li> <li>■ must calculate the salary base on which a 65% rate will apply</li> <li>■ may have to calculate an overall cap on the PPA</li> <li>■ cannot include in the SR&amp;ED expenditure pool the expenditures that the PPA represents</li> </ul>
<b>Traditional method</b>	<ul style="list-style-type: none"> <li>■ ITCs calculated on the overhead expenditures actually incurred</li> <li>■ actual overhead expenditures may be greater than the PPA</li> <li>■ no salary base to calculate and no PPA to determine</li> <li>■ no overall cap to calculate</li> <li>■ overhead expenditures are added to the SR&amp;ED expenditure pool</li> </ul>	<ul style="list-style-type: none"> <li>■ demonstrate that the overhead expenditures are directly related and incremental to the SR&amp;ED</li> <li>■ using this method could be a complex exercise, especially when SR&amp;ED and other work are carried out in the same facility (e.g., shop-floor SR&amp;ED)</li> <li>■ specifically identify and allocate which overhead expenditures are for SR&amp;ED work</li> <li>■ explain how you determined the amount, and you have to provide support for the determination</li> <li>■ allocation of overhead must be reasonable</li> </ul>

### Lines 165 and 170 – Authorization and date

The individual, an authorized signing officer of the corporation, or an authorized partner, will certify the information on Form T661, the related schedules, and the attachments. That person also has to indicate the choice of method used to calculate the SR&ED expenditures and related ITCs for the year.

If you are filing your SR&ED claim with the RSI 32 format, you should retain a signed copy in your records.

### Part 2 – Scientific or Technological Project Information

In this part of Form T661, we seek technical information on the work for which you are claiming a tax credit under the SR&ED Program. The following section explains the technical requirements of the SR&ED Program and how the questions on Form T661 are intended to help you provide the technical information we need to process your claim. To avoid preparing information that may not be needed, you should read this entire section before answering any of the questions on Form T661, as some of the questions are interrelated.

When we use the term “project,” we are referring to the work that falls within the definition of scientific research and experimental development (SR&ED) contained in the Act. According to this definition, the work must be a systematic investigation or search that is carried out in a

field of science or technology by means of experiment or analysis. The work can be basic research, applied research, or experimental development. For the purpose of this discussion, we will refer to basic and applied research as “scientific research.” The definition of SR&ED makes a distinction between scientific research and experimental development.

Where the work meets the requirements of the definition of SR&ED, we say that it is “eligible.” For scientific research, the work must be undertaken for the advancement of scientific knowledge; it is normally carried out in a laboratory setting and seeks to discover new scientific knowledge. New scientific knowledge includes the results of unsuccessful work. Whether or not the work achieved its objective is not relevant in determining its eligibility. On the other hand, experimental development requires that the work be undertaken to achieve a technological advancement for creating new, or improving existing, material, devices, products, or processes. Experimental development is normally done in an industrial setting. As with scientific research, there is no requirement that the attempt to achieve technological advancement be successful for the work to be eligible. If your project involves both scientific research and experimental development, answer the questions accordingly.

Projects can be distinct and well defined, with a clear beginning and end. The opposite is also possible, particularly for large, multi-year projects where the objectives may change from year to year. Any project, and

especially large ones, can contain interrelated work of a support nature. This may include routine development, routine engineering, routine programming, routine design, and so on. To be eligible as SR&ED, this interrelated work must be an integral part of an eligible project and commensurate with its needs. The work may not qualify as a stand-alone SR&ED project, but can qualify as support work by virtue of its contribution to the overall SR&ED project—even when it is the only project work done in a particular year. All support work claimed must be related to eligible SR&ED work.

Generally, the work of an R&D program dedicated to advancing a particular technology for creating new or improving existing materials, products, or processes by experimentation or analysis will inherently be SR&ED. A program's technological or scientific objectives are broader and, conceptually, the advancement sought is described at a higher level. In these situations, the eligibility of the work is determined by looking at whether it contributes to the program's technological or scientific objectives. It is therefore important that you establish the relationship of the work claimed as SR&ED to the program's technological or scientific objectives. In addition, you should be able to explain the process you used to differentiate SR&ED from non-eligible work. You are advised to contact the CRA **before** claiming your work at the program level. The CRA will work with you to establish how best to proceed.

The discussion that follows assumes that your claim is being made on a project basis.

### Step 1 – Detailed project description

The questions in Part 2 of Form T661 will help you prepare the specific information we need to process your claim. We recommend that personnel who are familiar with the technical content of the work you are claiming prepare this part of your submission. The project description should be in the technical language and style of those who do the actual work or who understand and are familiar with the work. Answers should concentrate on the technical facts that illustrate the experimental or analytical nature of the work. Although there is no limit to how much information you may provide, most project descriptions are four pages or less.

The questions on Form T661 have been structured to help you present enough information to enable the CRA to do an initial review of the work you are claiming. Thus, your project description must be detailed enough to demonstrate that the work you are claiming meets the SR&ED Program requirements. For both scientific research and experimental development work, the project description should show a systematic investigation or search in a field of science or technology by means of experiment or analysis. In addition, for experimental development work, it is necessary to show that the purpose of the work was to achieve a technological advancement for creating new, or improving existing, materials, devices, products, or processes. For scientific research work, it is necessary to show what advancement in scientific knowledge is being sought or was made.

If your company conducted more than 20 projects during the course of your fiscal year, you may provide descriptions for only the 20 largest projects (in dollars). You may,

however, be asked to provide descriptions for any of the remaining projects when we review your claim. Note that you must provide a summary listing of all the projects you are claiming in Step 2 of Part 2 by completing Schedule E, regardless of whether you are claiming on a program basis or whether you have 20 or more projects.

If you prepared a project description for the Preclaim Project Review (PCPR) service, you can submit this information with your claim, as long as it represents the work that was actually done and provides the information outlined in points "A" to "E" below.

If you have an Industrial Research Assistance Program (IRAP) project, you do not need to complete questions "A" to "E." Instead, you may submit a copy of the approved project description of the IRAP proposal, the Statement of Work, and progress reports showing what work was done, as long as these documents provide the equivalent information and readily identify the SR&ED work.

If you continue projects from a previous year, it is sufficient to update your current claim and describe only the work undertaken this year for which you are claiming a tax credit. However, you must provide enough information to enable us to see the project status at the beginning of the current year, as well as the work done during the year in pursuit of the scientific or technological advancement.

Market research, research in the social sciences or the humanities, prospecting, exploring, or drilling for or producing minerals, petroleum, or natural gas are specifically excluded from the SR&ED Program. Activities such as financing, marketing, customer demonstration, quality control testing, patent search and registration, and preparation of submission documents for licensing agencies, certification agencies, or regulatory authorities are also not eligible.

As stated earlier, the eligibility requirement for scientific research work is different from that of experimental development work with respect to the advancement being sought. For the sake of simplicity, the same questions are used on Form T661 for both scientific research and experimental development. Respond to the part of the question that best reflects your work.

**A. Scientific or technological objectives** – For each project, state the overall scientific or technological objectives. For example, if you undertook scientific research, what new scientific knowledge were you attempting to discover? Or, if you undertook experimental development, what technological advancement were you attempting to achieve? What required you to undertake scientific research or experimental development? How does the objective relate to or involve the application of technology, or what was the scientific aspect of your work? Price or cost reduction may be an outcome of product or process development. However, for the work to be eligible, the objectives must relate to the underlying technology, not to any financial or marketing goals. The technological objectives may be expressed in terms of new capabilities incorporated into the product or process being developed. The scientific or technological objectives help put the work claimed into the proper technical perspective in terms of what it will mean for

your business. These objectives also indicate when the project will be complete. The scientific or technological objectives you state must be specific and verifiable.

If possible, give the indicators or measures you will use to determine whether you meet the scientific or technological objectives. If this project continues from the previous year and has not changed in direction, simply restate the scientific or technological objectives. However, if the direction of the project changed at all, you should explain and clarify the new objectives.

**B. Technology or knowledge base or level** – A requirement of experimental development work is that it be undertaken to seek a technological advancement. Seeking a technological advancement means attempting to increase the technology base or level from where it was at the beginning of the systematic investigation or search. The technology base or level includes all the technological resources within your business as well as all the knowledge on the technology that is reasonably available in the public domain. The technological resources within your business comprise the level of technology, the proprietary technological “know-how,” and the experience of the personnel. To establish that this requirement is met, we need to know what your company was able to do with the technology before the SR&ED work was started. Describing the level of technology in your company and available in the industry before the work was started helps us to understand why the work was done and how it will be or could be a technological advancement for your company. It also ensures that a common point is taken when the CRA reviews your claim with respect to the technological advancement you were seeking.

Similarly, for scientific research work, to establish that your work was undertaken to seek a scientific advancement, it is necessary to establish the current scientific knowledge that was reasonably available to you before you started the research. You do not have to provide proof of an exhaustive search and present the actual knowledge available. Rather, you should give a synopsis of your knowledge of the state of the art as the result of a literature search and any first-hand knowledge or experience in the field of science that your work is in. If you are working in a new area, state that this is new ground.

**C. Scientific or technological advancement** – The SR&ED work must be undertaken to achieve an advancement of scientific knowledge or a technological advancement. Even if you were unsuccessful, this requirement will be met in the sense that you gained new technological or scientific knowledge useful for guiding future work. For example, in scientific research, determining that a hypothesis is incorrect represents new scientific knowledge. Similarly, in experimental development, discovering that a certain methodology does not work adds to your technological knowledge base. Generally, work undertaken to remove an element of scientific or technological uncertainty through a process of systematic investigation or search will result in a scientific or technological advancement. Thus, when your work consists of a systematic investigation or search undertaken to resolve a technological

uncertainty by experimentation or analysis, it will meet the program requirements of attempting to achieve a scientific advancement. This approach is particularly useful to show how the technological advancement requirement is met if the advancement sought is only slight or incremental, or if the work is unsuccessful.

Solving technical problems or troubleshooting using generally available scientific or technological knowledge or experience does not meet the requirements of the program. The work must be undertaken with the intention of advancing the underlying technology. The problem must relate to whether or not the objective that you stated in Step 1 “A” can be achieved, and/or how to achieve, is not known and cannot be determined on the basis of your technology or knowledge base level that you stated in Step 1 “B.” What problems were you trying to solve that you could not solve using commonly available experience and knowledge? Were the problems due to design constraints that had to be overcome? Include enough detail to show that these were other than routine problems.

In terms of product or process development, a technological advancement may be achieved if a new capability was incorporated into the product or process to enhance its performance. The new capability must be accomplished through a systematic investigation or search. The product or process may be new, or it may be an improvement of an existing one. If the development was accomplished by purchasing rights or a licence, or by adapting a known principle or knowledge, then it would not represent a technological advancement. To help establish the eligibility of the work, describe the new capability incorporated into the product or process to enhance its performance. Explain why the new capability represents a technological advancement in terms of the underlying technology in the context of the technological resources of your business or the current state of the art. It is not necessary to provide or explain the scientific principle on which the technological advancement is based. You must show how the work undertaken was intended to result in a technological advancement relative to the technology base that your business started from. All the work to produce the product or run the process is not eligible; only the part of the work that is directly involved in achieving the technological advancement will meet the program requirements.

If your work is primarily undertaken to advance scientific knowledge, indicate what field or fields of science the new knowledge is in. Explain why the new knowledge resulting from your work is an advancement relative to the scientific knowledge that is available to your business. How do the results of your experiments or analysis advance scientific knowledge?

To place your work in the proper perspective, it is useful to state in which field or fields of science or technology the work has taken place. This will help establish the business context, so that we can examine the eligibility of your work relative to the fields of science or technology in which your business operates.

- D. **Description of SR&ED work in this taxation year** – Describe the approach you used, project plan, new designs attempted, experiments and/or analysis conducted, interpretation of results, and conclusions. Was the project completed this year? If not, indicate when you expect the project to be completed. What progress was made towards the objectives described in “A” as a result of this work?

If your description includes work that may not be SR&ED work, identify the SR&ED work. Simply listing the new products developed or the results attained is not sufficient; you have to describe the actual SR&ED work done to develop the products or attain the results. If all or part of the work was performed by contractors, a description of the SR&ED work is still required. Include a copy of the statement of work from the contract.

Eligibility is generally determined at the highest possible level to properly recognize all the work required for the technological advancements attempted. For multi-year projects, when the work extends beyond one tax year, eligibility of the work ceases when the specific scientific or technological objectives are met. Therefore, it is important that you describe what work was actually carried out in this tax year. Your description should focus on the pursuit of the scientific or technological advancement. It must also include the results you obtained and the conclusions you made. If the project continued from the previous year, describe the current year’s work and explain how it relates to the scientific or technological advancement stated in “C” above.

- E. **Supporting information** – To substantiate that your work was carried out as described in Step 1 of Part 2, you must have evidence of the work done. Usually, the documents produced in the course of doing SR&ED will be sufficient to support your claim; you should not have to prepare separate documents. List the supporting information that you could use to substantiate the work described in Step 1 of Part 2. Technical records that were created at the time the work was performed provide the most ready form of documentation. Examples of suitable documents are planning documents, documents describing project objectives, descriptions of the problems to be solved, contract work statements, notes of discussions dealing with unexpected obstacles encountered, minutes of meetings, records of trials, observations, project notebooks, lab notebooks, test records, and quantitative measurement data. Even the new products, hardware, genetic material developed, prototypes, pictures of prototypes, or a combination of any of these, or business or employee activity records can be used to substantiate the work done.

## Step 2 – Project summary information

Provide the project descriptions as requested in Step 1 on separate sheets of paper, and submit them with the T661 form.

## Line 200 – List of all SR&ED projects claimed

Provide the total number of projects being claimed in this tax year.

## Line 206 – Industrial Research Assistance Program

**(IRAP)** – Through its IRAP, the National Research Council of Canada offers technical and financial assistance to small and medium-sized Canadian companies (up to 500 employees) that already have technological capabilities but wish to strengthen and enhance them. Indicate the amount of assistance, if any, your corporation received from the IRAP for the project(s) claimed in the year.

Complete Schedule E and attach it to Form T661.

## Part 3 – Summary of SR&ED Expenditures

We have divided Part 3 of this form into three steps. Round all amounts in Part 3 to the nearest dollar.

### Step 1

#### Allowable SR&ED expenditures for SR&ED carried out in Canada (lines 300 to 400)

Usually, SR&ED current expenditures are those that do not result in the acquisition of land, a leasehold interest in land, or property that would otherwise have been your depreciable property.

Current SR&ED expenditures involve three types of expenditures:

1. **Cost for performing SR&ED:** costs you incurred when you directly undertake the SR&ED (in-house SR&ED). These costs are basically wages, materials, and overhead costs.
2. **Cost for SR&ED on your behalf:** costs associated with having SR&ED performed on your behalf (contract payments).
3. **Third-party payment:** payments to certain entities, such as approved associations or approved institutions, to be used for SR&ED undertaken by these third parties. See line 370 for more details.

### Salaries and wages

#### Line 300 – Employees’ salaries and wages

On line 300, include in your pool of deductible SR&ED expenditures the portion of the salaries or wages and taxable benefits you paid to or incurred for your employees who are directly engaged in SR&ED in Canada.

Determine the SR&ED portion of an employee’s salary according to the time that person spends on SR&ED work.

Employees who are directly engaged all or substantially all (ASA) of their time in SR&ED will be considered to spend all of their time in SR&ED. ASA means 90% or more.

### Example

If you incur \$100,000 in wages for an employee who spent 90% of his or her time directly engaged in SR&ED, then \$100,000 is considered to be the directly engaged wages for that employee.

We explain below the meaning of “salary or wages” and “directly engaged in SR&ED.”

### Line 305 – Specified employees’ salaries and wages

Separate the amount of salaries or wages for employees who are **specified employees** (see glossary) and those who are not.

On line 305, enter the amount of salaries or wages you paid to **specified employees**.

For specified employees, do not include bonuses or remuneration based on profits in your pool of SR&ED expenditures.

For SR&ED purposes, the maximum amount of salaries and wages per specified employee is limited to five times the year’s maximum pensionable earnings (YMPE) determined for purposes of the Canada Pension Plan. The YMPE are \$41,100 for 2005 and \$40,500 for 2004. Therefore, the maximum amount of salaries and wages per specified employee that you can include on line 305 is \$205,500 ( $\$41,100 \times 5$ ) for a tax year that ends in 2005, and \$202,500 ( $\$40,500 \times 5$ ) for a tax year that ends in 2004.

The maximum amount is prorated by the number of days in the tax year in which the employee is a specified employee. If a specified employee is also performing SR&ED for an associated corporation, the maximum amount must be allocated between the associated corporations using Form T1174, *Agreement Between Associated Corporations to Allocate Salaries or Wages of Specified Employees for Scientific Research and Experimental Development (SR&ED) Carried Out in Canada*.

### Lines 310 and 315 – Unpaid salaries, wages, and other remuneration

Subsection 78(4) generally applies to accrued salaries, wages, and other remuneration that you still have not paid 180 days after the end of the year in which you incurred the expense. It deems the expense not to have been incurred in that year, but rather in the year the amount is paid.

Enter unpaid subsection 78(4) amounts on line 315 of Form T661, even though the expense is not deductible for the year. Make sure you do not include on line 300 or 305 the amount you entered on line 315. Later, in a following tax year, if you meet the filing requirement, you can deduct such an expense on line 310 of Form T661 for the tax year in which you actually paid the expense.

### Definition of “salary or wages”

“Salary or wages” as defined in subsection 248(1) is income from an office or employment as calculated in sections 5 to 8 of the Act. Therefore, salary or wages of an employee includes vacation pay, statutory holiday pay, sick leave pay, and taxable benefits under section 6. These amounts

were paid to or incurred for the employees in the year. Since you have to incur the expenditure to claim it as SR&ED, do not include benefits for which you have not incurred an expenditure, such as benefits under subsection 6(9) for interest-free loans.

Do not include as salary or wages an expenditure for **related benefits**. Related benefits include the employer’s share of payments to the Canada Pension Plan (CPP) or Quebec Pension Plan (QPP), Employment Insurance (EI), Worker’s Compensation Board (WCB) or the Commission québécoise de la santé et de la sécurité au travail (CSST), an approved employee pension plan, and employee medical, dental, or optical insurance plans.

You may be able to deduct related benefits on line 360 if you use the traditional method.

Do not include as salary or wages an expenditure for extended vacation or extended sick leave. We consider extended leave to be longer than the usual annual leave earned by the employee.

Furthermore, the definition of salary and wages does not include the amounts paid to employees as a retiring allowance (read Application Policy SR&ED 2004-01, *Retiring Allowance*, issued on January 20, 2004, and the comments on line 360).

### Definition of “directly engaged in SR&ED”

Whether an employee is directly engaged in SR&ED is a question of fact based on the duties the employee performs. It is not based on the employee’s job title.

We consider the time employees, including supervisors and managers, spend to carry out the following tasks as time they are directly engaged in SR&ED:

- preparing equipment and materials for experiments, tests, and analyses (this does not include time spent maintaining equipment);
- experimenting, testing, and analyzing;
- collecting data for experimentation and analysis; and
- directing the course of the ongoing SR&ED work being claimed in the year.

We consider time other employees spend to carry out the following tasks to be time during which they are directly engaged in SR&ED (to the extent that the tasks are required as part of an SR&ED project):

- recording measurements, making calculations, and preparing charts and graphs;
- conducting statistical surveys and interviews;
- preparing computer programs; and
- working in engineering or design, operations research, mathematical analysis, computer programming, data collection, testing, or psychological research.

We do not consider employees providing a service to SR&ED staff to be directly engaged in SR&ED. This includes clerks, secretaries, and receptionists engaged in accounting, payroll, finance, legal support, purchasing, sales, human resources, shipping, inventory control, maintenance, word processing, and other such activities.



We consider the time supervisors or managers are directly involved in the technical aspects of ongoing SR&ED work as time spent directly engaged in SR&ED.

We do not consider the time managers and supervisors spend on the non-technological, management aspect of their work to be time during which they are directly engaged in SR&ED. Such non-technological work includes long-term strategic planning, contract administration, and other decision-making functions that do not directly influence the ongoing SR&ED work.

In most cases, work performed beyond the first-line level of supervision does not qualify as directly engaged in SR&ED. If you claim time for employees beyond the first-line level of supervision, you will be asked to provide details of the

duties the employees performed in the time you claimed they were directly engaged in SR&ED. You will also have to demonstrate how these duties are “directly engaged,” as described above.

An employee performs a series of tasks in carrying out his or her duties of employment. You should view these tasks in terms of how they correlate to the primary reason for employment when you determine whether the employee’s salary and wages are directly engaged in SR&ED.

**Note**

The eligibility of the salary and wages is subject to all the relevant conditions set out in sections 37 and 248 of the Act and section 2900 of the Regulations. Eligibility depends on the facts of each case.

We have designed the following table 2.1 to help you determine how to handle the salary and wages for various tasks and duties.

<b>Table 2.1</b>			
<b>Salary and wages for various tasks and duties</b>			
<b>Duty</b>	<b>Directly engaged in SR&amp;ED</b>	<b>Overhead and other expenditures</b>	<b>Non-SR&amp;ED expenditures</b>
Experimentation and analysis	X		
Technical-support work (under paragraph 248(1)(d) of the definition of SR&ED under the Act)	X		
Non-specialized employees: <ul style="list-style-type: none"> <li>■ operating a machine for the purposes of an experiment that requires the use of this machine</li> <li>■ feeding raw materials into a machine</li> </ul> To be eligible, the non-specialized employee's work must be supervised by staff with scientific or technological qualifications.	X		
Direct supervision of employees performing experimentation and analysis (directing the ongoing SR&ED work)	X		
Technological planning for ongoing SR&ED projects you claimed in the year, such as planning for: <ul style="list-style-type: none"> <li>■ assignment of technological personnel</li> <li>■ job priorities</li> <li>■ development of technological strategies</li> <li>■ quality of material used</li> </ul>	X		
Long-term planning for future SR&ED projects, for example: <ul style="list-style-type: none"> <li>■ planning for prototype vs. commercial scale</li> <li>■ project selection</li> </ul>		X	
Human-resource activities such as technological staffing		X	
SR&ED contract administration (technical input only)		X	
Technological training for ongoing SR&ED projects you claimed in the year		X	
Administrative training			X
Technological documentation for internal use	X		
Preparation of user manuals			X
Clerical and other administrative support (e.g., in personnel, accounting, maintenance, and purchasing) if the functions performed are non-technological and aid the ongoing SR&ED you claimed in the year, and if the salaries and wages of the employees providing the support are: <ul style="list-style-type: none"> <li>■ directly related and incremental to the prosecution of SR&amp;ED</li> <li>■ not directly related and not incremental to the prosecution of SR&amp;ED</li> </ul>		X	X
Other support (e.g., equipment maintenance or repairs) if the functions performed are non-technological and aid the ongoing SR&ED work you claimed in the year, and the salaries and wages of the employees providing the support are directly related and incremental to the prosecution of SR&ED		X	
Preparation of Form for SR&ED projects carried out in the current year		X	

### Supporting documents

You must be able to explain how you determined the amount you claimed. You must also be able to provide supporting documentation (e.g., supervisor summaries, Gantt charts, planning documents, documents describing project objectives, resource allocation records, written correspondence, minutes of meetings, project notebooks, lab notebooks, personal notebooks, progress or final reports, time sheets, T4 slips, and job descriptions). For salary and wages, this involves identifying the time you allocated to SR&ED and the work the employee performed

during that time. Keep in mind that the amounts you allocate to SR&ED must be reasonable.

### Line 320 – Cost of materials consumed

Enter the cost of materials consumed in the prosecution of SR&ED. If you incur a liability for materials that you will use later for SR&ED, we consider the cost of these materials to be an SR&ED expenditure in the year in which you will consume the materials. Be sure all costs are the net laid-down price after you deduct trade discounts and add acquisition costs (e.g., transportation costs). Refer to Application Policy SR&ED 2000-01, *Cost of materials for*

SR&ED, issued on March 1, 2000, and its addendum which deals with water and other sources of energy as materials.

The phrase “materials consumed in the prosecution of SR&ED” means that you destroyed the materials or rendered them virtually valueless as a result of the SR&ED. In the following situations, not all materials were consumed in the prosecution of SR&ED (see line 325):

- development of assets to sell (custom products);
- development of assets to use in your commercial operations (commercial assets); and
- sale of experimental production.

#### **Line 325 – Cost of materials transformed into another product**

If the expenditure is ASA or directly attributable to the SR&ED, you can claim the cost of materials transformed into another product. The cost of materials transformed into another product is considered directly attributable to the prosecution of SR&ED if the materials are transformed in the prosecution of eligible SR&ED. For more details, refer to Application Policy 2002-02R – *Experimental Production and Commercial Production with Experimental Development Work – Allowable SR&ED Expenditures*. There will be an ITC recapture when you sell or convert the property to commercial use after February 23, 1998. This amount is added to your tax payable under Part I.

On December 20, 2002, the Finance Minister issued Draft Technical Income Tax Amendments to allow the cost of materials transformed when using the proxy method. The amendments will apply retroactively and be effective from February 23, 1998; however, the proposed change to subclause 37(8)(a)(ii)(B)(V) will apply only to SR&ED claims made within the claimant’s reporting deadline. As the latter is a proposed change to the legislation, the CRA will accept SR&ED claims for materials transformed under the proxy method as if it was law. If the proposed legislation does not pass, the CRA will make an adjustment to your SR&ED claim as required.

#### **Lines 340 and 345 – SR&ED contracts**

Use Table 2.2 to identify arm’s length and non-arm’s length contractors and subcontractors, list the expenditures you incurred (if they are more than \$30,000) and attach it to Form T661. Provide the name of the contractor or subcontractor, the Business Number or GST registration

number, along with the total dollar amount of the contract(s), the contract expenditures incurred in the year, and the project code related to the expenditures. If you used a contractor in more than one project, identify the main project with which the expenditures are associated and give the total of all contracts for each contractor.

It is important that you separate the SR&ED contract expenditures between arm’s length contractors and non-arm’s length contractors carrying out SR&ED on your behalf. See the explanation for line 370 for information about the difference between third-party payments for SR&ED and SR&ED undertaken on your behalf.

When someone performs SR&ED on your behalf and you do not deal with each other at arm’s length, your SR&ED expenditures do not qualify for ITC purposes. In addition, the amount the performer receives will not be considered to be a contract payment. See the explanations for lines 526 (expenditures for non-arm’s length SR&ED contracts), 534 (contract payments), and 508 and 510 (transfer of qualified SR&ED expenditures between non-arm’s length parties).

An amount paid or payable to an arm’s length contractor for SR&ED carried out on your behalf is a contract payment if you are a taxable supplier and are entitled to a deduction under subparagraph 37(1)(a)(i) or (i.1). A contract payment reduces the SR&ED expenditures of the contractor for ITC purposes. The onus is on the claimant to determine whether the contractor performed SR&ED on his or her behalf.

#### **SR&ED performed on behalf of a person**

The key element in determining if an amount is a contract payment is whether the payer requested the contractor to perform SR&ED on his or her behalf under the contract terms. Your decision must be based on the terms of the contract read as a whole, and on the facts surrounding the particular situation.

#### **Meaning of “arm’s length”**

The current version of Interpretation Bulletin IT-419, *Meaning of Arm’s Length*, describes in general terms the criteria we consider when determining whether persons deal with each other at arm’s length.

#### **Note**

When an expenditure relates to a contract for services to be performed after the year-end, it does not qualify as an SR&ED expenditure until the year in which the services are actually performed.

Use this table only if you have contracts greater than \$30,000 and attach it to Form T661.

**Table 2.2**

**Section A –** Number of contractors for whom you have to report and provide details in Section B and C:

Arm's length contractors (Complete section B below)	_____
Non-arm's length contractors (Complete section C below )	_____

**Section B –** Complete this section for each arm's length contractor.

Name of contractor	Contractor's Business No. or GST Registration No.	Number of Contracts One / More	Total dollar amount per contractor greater than \$30,000	Project code for expenditures claimed in the year	Contract expenditures incurred in the year
		<input type="checkbox"/> <input type="checkbox"/>			
		<input type="checkbox"/> <input type="checkbox"/>			
		<input type="checkbox"/> <input type="checkbox"/>			
		<input type="checkbox"/> <input type="checkbox"/>			
		<input type="checkbox"/> <input type="checkbox"/>			
		<input type="checkbox"/> <input type="checkbox"/>			
		<input type="checkbox"/> <input type="checkbox"/>			
		<input type="checkbox"/> <input type="checkbox"/>			
Total contract expenditures in the year					

**Section C –** Complete this section for each non-arm's length contractor.

Name of contractor	Contractor's Business No. or GST Registration No.	Number of Contracts One / More	Total dollar amount per contractor greater than \$30,000	Project code for expenditures claimed in the year	Contract expenditures incurred in the year
		<input type="checkbox"/> <input type="checkbox"/>			
		<input type="checkbox"/> <input type="checkbox"/>			
		<input type="checkbox"/> <input type="checkbox"/>			
		<input type="checkbox"/> <input type="checkbox"/>			
		<input type="checkbox"/> <input type="checkbox"/>			
		<input type="checkbox"/> <input type="checkbox"/>			
		<input type="checkbox"/> <input type="checkbox"/>			
		<input type="checkbox"/> <input type="checkbox"/>			
Total contract expenditures in the year					

**Line 350 – Lease costs of equipment: allowable SR&ED expenditure**

On line 350, enter a lease expense that was ASA attributable to the use of equipment for the prosecution of SR&ED in Canada. You must determine the SR&ED usage as a percentage of the total operating time. Generally, operating time means the time the equipment usually runs or functions.

If you use the proxy method, do not include lease costs for general-purpose office equipment or furniture (see glossary).

**Lease costs for buildings: not an allowable SR&ED expenditure**

An expense you incur for leasing a building does not qualify for SR&ED. A lease cost for a building is any expense you incurred to use a building, or to have the right to use a building.

**Other**

In certain cases, a lease expense that was ASA attributable to using premises or facilities other than a building may be allowable. For example, the lease expense for a structure may be allowable.

### **Line 355 – Lease costs of equipment used primarily for SR&ED**

On line 355, if you use the proxy method, enter 50% of the lease costs of equipment (other than general-purpose office equipment or furniture) that is used primarily for SR&ED. In this case, “primarily” means more than 50%, but less than 90%, of the time.

You should determine the SR&ED usage as a percentage of the total operating time. Generally, operating time means the time the equipment usually runs or functions.

Enter “0” on line 355 if you use the traditional method. Lease costs of equipment you use primarily for SR&ED may be allowable under line 360 as overhead or other expenditures, if you meet certain conditions.

### **Line 360 – Overhead or other expenditures**

On line 360, enter “0” if you use the proxy method. If you use the traditional method, enter overhead and other expenditures you did not list on lines 300 to 355. Usually, “overhead and other expenditures” are expenditures that are:

- directly attributable to the prosecution of SR&ED in Canada; or
- directly attributable to the provision of premises, facilities, or equipment for the prosecution of SR&ED in Canada.

### **Directly attributable to the prosecution of SR&ED in Canada**

You can claim the following types of expenditures:

1. Other salaries and wages of employees who directly undertake, supervise, or support the prosecution of SR&ED. You can only claim an expenditure for an employee on line 360 if you meet all the following conditions:
  - you do not claim the SR&ED portion of the salaries or wages of the employee on line 300, 305, or 310 of Form T661 as “directly engaged salaries or wages;”
  - the employee directly undertakes, supervises, or supports the prosecution of SR&ED (the employee must have a strong technical background); and
  - the employee’s salary or wages can reasonably be considered to be for the prosecution of SR&ED.

Here are some examples of tasks for which you can claim an expenditure for salaries or wages on line 360:

- performing non-technological, management activities or decision-making functions that do not directly influence the course of the SR&ED but that relate to the SR&ED (e.g., long-term planning for future SR&ED projects or contract administration); and
- preparing a technical feasibility study relating to SR&ED projects carried out. (Refer to Application Policy SR&ED 1996-06, *Directly Undertaking, Supervising or Supporting v “Directly Engaged” SR&ED Salary and Wages*).

2. Other expenditures directly attributable to the prosecution of SR&ED in Canada. Include an expenditure, or the part of an expenditure, that is directly related to the prosecution of SR&ED and that would not have been incurred if such prosecution had not occurred (incremental costs).

These expenditures include:

- lease costs of equipment used less than 90% of the time for SR&ED;
- salaries or wages of clerical employees performing non-technological functions that aid the ongoing SR&ED claimed in the year;
- related benefits, such as the employer’s share of payments to the Canada Pension Plan (CPP) or Quebec Pension Plan (QPP), Employment Insurance (EI) Fund, the Worker’s Compensation Board (WCB), or the Commission québécoise de la santé et de la sécurité au travail (CSST), an approved employee pension plan, and employee medical, dental, or optical insurance plans;
- travel and training expenses; and
- other costs (e.g., utilities, long-distance telephone charges, or supplies).
- retiring allowances that meet the criteria outlined in Application Policy SR&ED 2004-01, *Retiring Allowance*.

### **Directly attributable tests**

To meet the requirements under paragraph 2900(2)(c) of the Regulations, an expenditure must satisfy two tests:

- it must be “directly related” to the prosecution of SR&ED; and
- the expenditure would not have been incurred had such prosecution not occurred (the expenditure is incremental to the SR&ED).

By virtue of the words “directly related,” *all* the time spent by administrative staff would not qualify for an SR&ED claim, unlike the time spent by staff hired specifically for the prosecution of SR&ED. However, the words “portion” and “directly related” in paragraph 2900(2)(c) of the Regulations indicate that *some* duties of administrative staff would meet the tests, as determined by a finding of fact.

The work performed by particular employees or departments must connect with (i.e., be “related to”) the:

- SR&ED work;
- SR&ED staff; or
- machinery or equipment used by staff to perform SR&ED.

In addition, the work must be performed without an intervening step or intermediary.

Under subsection 37(1), expenditures for administrative salaries or wages that do not meet the above tests are not expenditures for SR&ED.

For more details, see Application Policy SR&ED 2002-01, *Expenditures incurred for administrative salaries or wages – “directly related” test*.

### **Incremental costs for the prosecution of SR&ED**

Expenditures directly related to the prosecution of SR&ED must also be incremental to the SR&ED. For that purpose, we do not necessarily consider a percentage of an expenditure to be incremental. You must be able to demonstrate that the expenditure would not have been incurred if the prosecution of SR&ED had not occurred. Overhead costs for the prosecution of SR&ED have to be specifically identified and allocated to SR&ED. The method you use to allocate overhead expenditures to SR&ED must be reasonable.

#### **Note**

Costs incurred for work described in paragraph 248(1)(d) of the definition of scientific research and experimental development are not incremental, but could qualify in themselves as SR&ED expenditures.

### **Example**

Corporation A incurs travel costs of \$40,000 in its 2002 tax year. SR&ED employees represent 25% of the total personnel of the corporation. Corporation A cannot claim \$10,000 as an incremental SR&ED expenditure for the prosecution of SR&ED. It must demonstrate that the expenditure is directly related to the prosecution of SR&ED and is incremental. For this purpose, Corporation A would need to identify each trip, have evidence that each is attributable to SR&ED, and allocate the appropriate costs to SR&ED.

### **Directly attributable to the provision of premises, facilities, or equipment for the prosecution of SR&ED in Canada**

1. Costs directly attributable to the provision of premises, facilities, or equipment for the prosecution of SR&ED in Canada include the cost of maintaining premises, facilities, or equipment provided for SR&ED in Canada (e.g., the costs of cleaning, painting, and servicing equipment).
2. Other expenditures, or portions of expenditures, directly related to the provision of premises, facilities, or equipment for the prosecution of SR&ED in Canada, are those that you would not have incurred if the premises, facilities, or equipment had not existed (incremental expenditures). These include, for example, taxes and insurance for a building that you own and that you use for the prosecution of SR&ED.

### **Incremental costs for the provision of premises, facilities, or equipment**

These other expenditures directly related to the provision of premises, facilities, or equipment for the prosecution of SR&ED in Canada must also be incremental to the SR&ED. For that purpose, we consider a reasonable percentage of an expenditure to be incremental.

### **Example**

If you own a building and use it for the prosecution of SR&ED, we consider a reasonable portion of the municipal taxes or the cost of insurance for the building to be directly attributable to the provision of premises, facilities, or equipment for the prosecution of SR&ED.

The method you use to determine the portion that is directly related to the SR&ED has to be reasonable. You can base your allocation, for example, on the area of the building you used for SR&ED over the total area of the building, in square metres. You can use other methods to determine the portion of an expenditure that is directly related to the provision of premises, facilities, or equipment for the prosecution of SR&ED, as long as they are reasonable in the circumstances. In all cases, whichever method you use, you have to be able to provide proof that your allocation is reasonable.

On line 360, do not include capital cost allowance, general administrative expenses, or factory overhead expenses that you would have incurred if you had not conducted the SR&ED.

### **Supporting documents – Overhead expenditures**

You have to identify each overhead expenditure specifically and allocate a reasonable amount to SR&ED. During the financial review, we may ask you to explain how you determined the amount, provide support for this determination, and demonstrate that the overhead expenditures are incremental to the SR&ED.

### **Line 370 – Third-party payments**

Complete one copy of Schedule A for each third-party payment. The payments must be used for SR&ED carried out in Canada that is related to your business, and you must be entitled to exploit the results of the SR&ED.

On line 370, include the total of all third-party payments you made to the organizations listed below:

- a) approved associations that undertake SR&ED;
- b) approved universities, colleges, research institutes, or similar institutions;
- c) non-profit SR&ED corporations resident in Canada and exempt from tax under paragraph 149(1)(j) of the Act;
- d) approved organizations (granting councils) that make payments to an association, institution, or corporation described in a) to c) above; or
- e) corporations resident in Canada, provided the SR&ED was performed.

#### **Note**

To determine whether the Minister of National Revenue has approved a particular institution or association, you can consult the Appendix to the current version of Interpretation Bulletin IT-151, for a partial list of approved entities for SR&ED purposes, or contact the organization in question.

The amounts you report on line 370 are usually referred to as third-party payments for SR&ED. They do not include payments for SR&ED undertaken on your behalf that you report on lines 340 or 345. For example, third-party payments for SR&ED could include payments to participate in arrangements such as industry-wide SR&ED projects undertaken by SR&ED associations, non-profit SR&ED corporations, or universities. In such cases, the payer does not control the actual work performed.

Table 3 shows the usual differences between the two concepts.

<b>Characteristics</b>	<b>SR&amp;ED contract</b>	<b>Third-party payment</b>
Control of SR&ED Rights	Payer Exclusive	Performer Non-exclusive (generally published)
Number of funders	Usually limited to one payer	Multiple funders
Type of SR&ED	Commercially focused	Often basic or applied research
Tax treatment	Accrual	Cash basis

You cannot include all payments to organizations such as SR&ED associations and universities as expenditures on line 370, since you could contract with such organizations to perform SR&ED on your behalf. For example, if you need a particular type of expertise, you can contract with an organization to perform specific tasks for you. In this case, the work is performed on your behalf, and you should report the expenditures on line 340 or 345.

For a corporation, include on line 370 any payments you made to a non-profit SR&ED corporation resident in Canada for basic or applied research carried out in Canada. For more details on such payments, see the current version of Interpretation Bulletin IT-151.

The amount of your payment that is eligible for SR&ED may be reduced if the recipient uses the funds to acquire a building or a leasehold interest in a building, or to pay rent for a building.

See the instructions for Schedule A further on in this guide.

**Line 390 – Capital expenditures for SR&ED carried out in Canada**

On line 390, include in the pool of deductible SR&ED expenditures under paragraph 37(1)(b) any capital expenditures for SR&ED carried out in Canada and related to one of your businesses. For purposes of subsection 37(1), expenditures are limited to the acquisition of new or used depreciable property other than buildings and leasehold interests in buildings. You cannot include non-depreciable assets in the pool. We recommend keeping a list of capital items acquired in the year, in case the CRA asks to review it.

**Example**

A claimant acquires land, a building, and equipment to be used ASA for the prosecution of SR&ED. The expenditure pool will only be affected by the equipment expenditure, as land is a non-depreciable asset, and buildings are generally excluded (see below).

The only difference in determining capital expenditures under the traditional method and the proxy method is that you cannot include expenditures for general-purpose office equipment or furniture if you use the proxy method.

An SR&ED capital expenditure is an expenditure you made to acquire property that you intended either to:

- use ASA of the operating time in its expected useful lifetime for the prosecution of SR&ED in Canada; or
- consume ASA of its value in the prosecution of SR&ED in Canada.

You determine a property’s eligibility when you make the expenditure. However, when we determine eligibility, we look beyond the use of the property in the year you make the expenditure, and we consider the intended use over the lifetime of the asset.

We cannot consider that you have made a capital expenditure until the property you acquired becomes available for your use.

**Note**

If you are allowed an SR&ED deduction for the depreciable property, you cannot also claim capital cost allowance on the same property.

When you sell the SR&ED property, the tax treatment of the proceeds may vary. What you do depends on whether you have previously claimed a deduction for the property. For more details, see the explanation for line 440 of Form T661.

**ITC recapture**

There will be an addition to your tax payable under Part I when you sell equipment that was used ASA of the time to carry out SR&ED, or when you convert it to commercial use after February 23, 1998. For more details, see Application Policy SR&ED 2000-04R2, *Recapture of Investment Tax Credit*.

Effective after December 20, 2002, the recapture rules on ITC will also apply to the disposition or conversion of a property where an expenditure would have been a qualified expenditure in a tax year had it not been for the application of the 180-day-unpaid-amount rule in subsection 127(26) of the Act.

**Buildings and land**

Expenditures you incurred to acquire buildings and leasehold interests in buildings (other than prescribed special-purpose buildings) do not qualify as SR&ED expenditures. Expenditures to acquire land and leasehold interests in land are also excluded.

Prescribed special-purpose buildings are defined in section 2903 of the Regulations. They are buildings the Department of Finance approves on a building-by-building basis.

### Line 400 – Allowable SR&ED expenditures

Allowable SR&ED expenditures are the total current and capital expenditures you made in the year. On line 400, enter the total of the amounts on lines 380 and 390.

### Step 2

### Pool of deductible SR&ED expenditures (lines 430 to 470)

Starting with the amount of allowable SR&ED expenditures entered on line 400, calculate the pool of SR&ED expenditures that is available for deduction in the year, the deduction claimed in the year, and any balance of SR&ED expenditures you can deduct in future years.

### Line 430 – Government and non-government assistance

Assistance refers to both government and non-government assistance for SR&ED. Government assistance includes forgivable loans, grants, subsidies, deductions from tax, investment allowances, or any other form of assistance, excluding the federal ITC. It also includes assistance for SR&ED from a provincial government, a municipality, or a public authority, as well as provincial SR&ED tax credits when they apply. Non-government assistance includes inducements and assistance that you obtained from other persons and that you do not include in your taxable income because of some other provision (e.g., the general provisions of section 9).

### Super-allowance benefit amount

For tax years beginning after February 2000 and ending after 2000, paragraph 37(1)(d.1) provides for the reduction of a corporation's pool of deductible SR&ED expenditures for a tax year by its provincial "super-allowance benefit amount" for the year and preceding tax years.

The amount calculated under subsection 127(9) is called the "super-allowance benefit amount" and must be included in the corporation's Part I tax payable in the year. The super-allowance benefit amount will reduce the corporation's pool of deductible SR&ED expenditures for the year and preceding tax years. It will also reduce qualified expenditures for purposes of calculating the ITC.

For more details, refer to Application Policy SR&ED 2000-03, *Government Assistance - Treatment of Provincial and Territorial R&D Assistance*.

If, at the filing due date of your return of income for the tax year, you have received, are entitled to receive, or can reasonably expect to receive assistance, your pool of deductible SR&ED expenditures will be reduced.

If you are using the proxy method, do not deduct the assistance for expenditures that the prescribed proxy amount replaces.

### Line 435 – Previous year's ITC claimed for SR&ED

An ITC for SR&ED expenditures that you claimed in a prior year does not reduce your pool of deductible SR&ED expenditures for the current year. Rather, it will be deducted from the pool of deductible SR&ED expenditures

in the next year. An ITC you claimed in a previous year can include the following:

- ITC used to reduce taxes payable under Part I;
- ITC you carried back to previous years;
- ITC on the prescribed proxy amount;
- ITC on qualified SR&ED expenditures transferred to you from a non-arm's length performer under paragraph 127(13)(e);
- ITC refunds.

However, an ITC on shared-use equipment cannot be included.

When an ITC deducted or refunded may reasonably be considered to relate to a property acquired in a preceding year as shared-use equipment, it will reduce the capital cost of the property acquired.

For partnerships, you have to reduce the balance in the pool of deductible SR&ED expenditures by the amount of ITC in the same year the partnership makes the related SR&ED expenditures.

### Line 440 – Sale of SR&ED assets and other deductions

If you sold an SR&ED asset (capital equipment you purchased for SR&ED) during the year, and the amount on line 450 includes unclaimed expenditures for the asset, include on line 440 the sale proceeds or the amount of unclaimed expenditures for the asset, whichever amount is less.

If the sale proceeds are more than the unclaimed balance of SR&ED expenditures for the asset, include the difference in your income, up to the amount of recapture of CCA. If the sale proceeds are more than the original cost of the asset, the difference is either a capital gain or income, depending on the facts of each case.

### Example

Facts	(1) Unclaimed SR&ED expenditures balance carried forward from the previous year (line 450).....	\$ 500
	(2) Asset you sold during the year:	
	Original cost.....	\$ 1,000
	Proceeds of disposition.....	\$ 100
	Unclaimed expenditures for the asset that are included in the line 450 amount.....	\$ 50
Solution	(1) Determine the line 440 amount, whichever amount is less: the proceeds of disposition.....	\$ 100
	or	
	the amount of unclaimed expenditures for the asset .....	\$ 50
	Line 440 amount .....	\$ 50
	(2) Determine the recaptured CCA, whichever amount is less: cost .....	\$ 1,000
	or	
	proceeds of disposition.....	\$ 100
		\$ 100



Minus the reduction to the line 440 amount ..... \$ 50  
Recapture of CCA (include this amount in your income for the year) ... \$ 50

#### Note

In certain cases, other deductions may have to be made to the SR&ED expenditure pool (e.g., expenditures a corporation renounced for the purposes of Part VIII tax, and amounts deducted under section 61.3).

#### Line 450 – Previous year’s balance

Enter the unclaimed balance in the pool of deductible SR&ED expenditures you are carrying forward from the previous year. For a partnership, enter “0.”

#### Line 453 – Recapture of ITC

Any ITC recaptured under new subsections 127(27), (29), (30), or (34) for the previous tax year will increase the amount of the taxpayer’s subsection 37(1) SR&ED pool for the current year.

Generally, the circumstances that will reduce a claimant’s SR&ED ITCs are disposition of a property or its conversion to commercial use (after February 23, 1998), where the cost of that property was previously claimed as an SR&ED cost for ITC purposes. Refer to Application Policy SR&ED 2000-04R2, *Recapture of Investment Tax Credit-Revision*, for more information on ITC recapture.

Effective after December 20, 2002, the recapture rules on ITC will also apply to the disposition of a property or its conversion to commercial use, where the expenditure for the property would have been a qualified expenditure in a tax year had it not been for the application of the 180-day-unpaid-amount rule in subsection 127(26) of the Act.

#### Line 454 – Adjustments to the pool of deductible SR&ED expenditures incurred in Canada

See the instructions for completing section 1 of Schedule B on page 32.

#### Line 455 – Amount available for deduction

If the amount is negative, enter 0, and include the amount in your income for the year.

#### Line 460 – Deduction claimed in the year

Enter the deduction you claimed in the year from the pool of deductible SR&ED expenditures. You can deduct all or a portion of your expenditures for SR&ED carried out in Canada in the year you make the expenditures, or you can accumulate them and carry them forward to deduct in future years. The deduction is optional, and can be any amount up to the current year’s line 455 amount, subject to the following restrictions:

- If the claimant is a corporation and an acquisition of control has previously occurred, the total amount on line 455 may not be available for deduction in the year or in a later year. You have to use special rules to determine the amount you can deduct. Usually, these rules operate like the non-capital loss restrictions in subsection 111(5)

for an acquisition of control. For more details, see the current version of Interpretation Bulletin IT-151.

- A partnership cannot carry forward SR&ED expenditures to a subsequent year.

#### Line 470 – Balance of deductible expenses

This amount is your unclaimed balance in the pool of deductible SR&ED expenditures at the end of the year. Subject to the restrictions noted at line 460, you can deduct it in future years. For a partnership, enter “0” on line 470.

#### Step 3

#### Qualified SR&ED expenditures for ITC purposes (lines 500 to 570)

In this section, you will determine the SR&ED expenditures that qualify for a federal ITC. Not all expenditures for SR&ED carried out in Canada will earn an ITC.

You should break down your expenditures between current and capital expenditures. This will help you calculate your refundable ITC.

#### Line 500 – Unpaid amounts (other than salaries or wages) from previous years

On line 500, enter unpaid amounts from previous years that you paid in the year and that are deemed to be an expenditure you incurred in the year under subsection 127(26).

Under subsection 127(26), SR&ED current expenditures that you do not pay within 180 days of the end of the tax year in which you incurred them are deemed not to have been incurred in that year for ITC purposes. Instead, you are deemed to have incurred them at the time you paid them. This applies to all unpaid amounts for SR&ED current expenditures except unpaid salaries, wages, or other remuneration that are covered under subsection 78(4). See the explanation for line 310.

The Draft Technical Amendments to the *Income Tax Act*, dated December 20, 2002, propose that, where an expenditure would have been a qualified expenditure in a tax year had it not been for the application of the 180-day-unpaid-amount rule in subsection 127(26), the recapture rules on ITC apply to the disposition or conversion of a property. The proposed amendment would be effective after December 20, 2002.

#### Note

Even if your unpaid amounts under subsection 127(26) do not qualify for ITCs until the time you pay them, they are still allowable SR&ED expenditures and deductible in the year you incurred the expenditures. Make sure to include your unpaid subsection 127(26) amounts in your allowable SR&ED expenditures within the reporting deadline of Form T661. If you do not, they will not be qualified expenditures in the year you pay them.

#### Example

In its tax year ending on December 31, 2001, Corporation A incurs an SR&ED expenditure of \$100,000 for consulting fees payable to Corporation B. Corporation A still has not paid the expenditure 180 days after the end of the 2001 tax year. The expenditure is only paid in November 2002.

- Corporation A must identify the expenditure in the SR&ED expenditure pool on Form T661 within the reporting deadline. It is an allowable SR&ED expenditure and deductible in 2001.
- Corporation A has to enter the unpaid amount on line 520 of Schedule B for the 2001 tax year. For ITC purposes, the expenditure is deemed not to have been incurred in 2001.
- When Corporation A pays the expenditure in the 2002 tax year, it has to enter the amount paid on line 500 of Form T661 for that year.

### Line 502 – Prescribed proxy amount

Enter “0” on line 502 if you use the traditional method.

If you use the proxy method, complete Schedule D to determine the salary base and the PPA and attach it to Form T661. You should read the instruction to Schedule D.

The PPA for a tax year is 65% of the salary base. In certain situations, an overall cap on the PPA may limit the amount you would otherwise determine.

**Salary base** – The salary base for the proxy method is composed of salaries and wages of employees who are directly engaged in SR&ED in Canada. The directly engaged salaries and wages are those you entered on line 300 of Form T661 for non-specified employees, and on line 305 for specified employees. However, special rules apply to restrict the amount of salaries or wages of specified employees that you can include in the salary base.

The salary base does not include taxable benefits under sections 6 and 7 of the Act, bonuses, remuneration based on profits, or an amount deemed incurred in the year under subsection 78(4).

Table 4 illustrates the differences between the expenditures for salaries or wages you include in the SR&ED expenditure pool, and those you include in the salary base you use to calculate the PPA.

<b>Salaries or wages</b>	<b>Salaries or wages expenditure</b>	<b>Salary base</b>
Directly engaged salaries or wages other than taxable benefits under sections 6 and 7, bonuses, remuneration based on profits, an amount deemed incurred under subsection 78(4)		
– for non-specified employees	Yes (included on line 300)	Yes
– for specified employees	Yes (on line 305) amount is restricted *	Yes, amount is restricted **
Taxable benefits (section 6) incurred	Yes (lines 300 and 305)	No
Remuneration based on profits, bonuses	Yes for non-specified employees (line 300)	No
Amount deemed incurred in the year under subsection 78(4)	Yes (line 310)	No
Related benefits (employer’s contributions to certain plans)	No (see explanations for lines 300 to 315)	No
* 5 x year’s maximum pensionable earnings (YMPE) ** 2.5 x YMPE		

### Line 504 – Shared-use equipment (SUE)

Equipment used primarily (more than 50% of its operating time) for the prosecution of SR&ED in Canada may qualify for a partial ITC. One half of the expenditures on equipment used primarily for SR&ED is eligible for an ITC at the rate that would have applied if the expenditures had been all or substantially all for SR&ED.

This shared-use treatment could apply to equipment used for dual purposes in the first and second period, or equipment whose use changes (e.g., when a company performs SR&ED in a shop-floor setting and uses equipment for both SR&ED and production activities).

You earn the partial credit over time. You earn one half of the partial credit at the end of the first tax year after the first 12-month period following your acquisition of the equipment. You earn the other half of the credit at the end of the first tax year after the first 24-month period following your acquisition of the equipment. For that purpose, the equipment is deemed not to have been acquired until it has become available for use.

The test of whether the equipment qualifies for the partial credit begins when you acquire the equipment and it is available for use, and ends in the tax year in which the relevant test period ends. The test is based on how you use the equipment during the entire period up to the end of that tax year. You should be prepared to provide documentation to substantiate the percentage of time you use the equipment for SR&ED.

The shared-use rules are for ITC purposes only. The equipment does not form part of the SR&ED pool, but is depreciated under the regular capital cost allowance rates and rules.

On line 504, enter the expenditures on first term SUE plus the expenditures on second term SUE.

**First term shared-use equipment**

To qualify, the equipment must be:

- depreciable property;
- equipment that does not qualify as a capital expenditure which you entered on line 390 of Form T661 (capital expenditure all or substantially all attributable to SR&ED);
- an asset that is not, according to subsection 2900(11) of the Regulations, a prescribed depreciable property (PDP). PDP prevents equipment in a facility, plant, or line that is going to be used for commercial production or commercial processing from being treated as SUE even if it is used primarily for SR&ED in the first and second term periods. (PDP also includes a building; a leasehold interest in a building; and equipment used in the assembly, construction, or commissioning of a commercial facility, plant, or line);
- equipment other than general-purpose office equipment or furniture (see glossary);
- new (it must not have been used, or acquired for use or lease, for any other purpose before you acquired it); or
- equipment that is used primarily (more than 50%) of its operating time for SR&ED in Canada during the period starting with the time the property was acquired and available for use, and ending at the end of the first tax year ending at least 12 months after that time.

In general, operating time means the time the equipment usually runs or functions. Whether you use the equipment for SR&ED during its operating time is a question of fact that can only be determined on a case-by-case basis. However, we usually consider time you spend to set up equipment for SR&ED work, and time you spend to switch the equipment back to another use, to be operating time in which you used the equipment for the prosecution of SR&ED, as long as this is reasonable in the circumstances.

You can claim 1/4 of the capital cost of the equipment after certain adjustments. You may need to make adjustments to the capital cost if you purchased the equipment from a non-arm's length supplier (see the explanations for lines 522 and 524). However, the capital cost of the equipment is not reduced by the amount of any related assistance or contract payments; rather, such assistance and contract payments reduce the qualified expenditures on lines 534 and 536 of Form T661.

**Second term shared-use equipment**

Second term SUE is a property, which was first term SUE, that you used primarily (more than 50%) of its operating time for SR&ED in Canada during the period starting with the time you acquired the property and it was available for use, and ending with the first tax year that ends at least 24 months after that time.

**Example**

On November 30, 1998, Company A purchased a new milling machine for \$100,000, to be used in SR&ED and in manufacturing and processing (M&P) over its expected useful life. The expenditure does not pass the "ASA" test. The company has a June 30 year-end. The machine ran 8 hours a day, 5 days a week. The operating time of the machine for SR&ED and M&P is as follows:

Time period	Total machine hours	SR&ED	M&P
December 1, 1998, to June 30, 1999	1,200	1,000	200
July 1, 1999, to November 30, 1999	800	600	200
December 1, 1999, to June 30, 2000 <b>(end of first period)</b>	1,200	800	400
July 1, 2000, to November 30, 2000	800	200	600
December 1, 2000, to June 30, 2001 <b>(end of second period)</b>	1,200	400	800
<b>Total</b>	<b>5,200</b>	<b>3,000</b>	<b>2,200</b>

**For the tax year ending June 30, 1999** – You should capitalize the asset's cost in the regular CCA class.

**For the tax year ending June 30, 2000** – The machine was used primarily in SR&ED (2,400/3,200 hours or 75% of the time) for the period from the time the machine was available for use (December 1, 1998) to the end of the first tax year ending at least 12 months after that time (June 30, 2000). Therefore, it is first term SUE, and you can include 25% of \$100,000 (\$25,000) as a qualified expenditure.

**For the tax year ending June 30, 2001** – The machine was used primarily in SR&ED (3,000/5,200 hours or 58% of the time) for the period from the time the machine was available for use (December 1, 1998) to the end of the first tax year ending at least 24 months after that time (June 30, 2001). Therefore, it is second term SUE, and you can include 25% of \$100,000 (\$25,000) as a qualified expenditure.

**Notes**

1. To qualify for SUE, the property must not have been used, or acquired for use or lease, for any other purpose before it was acquired by the claimant.
2. Any ITC you earned and claimed for SUE reduces the CCA class in the year after the claim.

Table 5 below compares equipment that is ASA for SR&ED (line 390 of Form T661) and shared-use equipment.

<b>Table 5</b>	
<b>ASA equipment used for SR&amp;ED</b>	<b>Shared-use equipment</b>
<ul style="list-style-type: none"> <li>■ relates to equipment intended to be used in SR&amp;ED throughout its useful life</li> <li>■ included in the subsection 37(1) expenditure pool and earns ITC</li> <li>■ ITC is earned on capital expenditure</li> <li>■ ITC is earned on the full cost</li> <li>■ includes general-purpose office equipment or furniture under the traditional method only</li> <li>■ eligibility is based on intent</li> </ul>	<ul style="list-style-type: none"> <li>■ relates to equipment you use for SR&amp;ED and some other purpose</li> <li>■ only earns ITC (capital cost is included in CCA schedule in the usual manner)</li> <li>■ you earn the partial ITC over the first and second period</li> <li>■ you earn ITC on one-half of the cost</li> <li>■ excludes general-purpose office equipment or furniture under both the traditional and proxy methods</li> <li>■ eligibility is based on actual use</li> </ul>

**Lines 508 and 510 – Transfer of eligible expenditures**

If someone carries out SR&ED on your behalf and you and the other party are not dealing at arm’s length, your expenditures for the contract do not qualify for ITC purposes. In addition, the amount received or receivable by the performer of the SR&ED is not considered to be a contract payment. However, the performer can transfer qualified expenditures to you up to a maximum of the contract amount.

Subsection 127(13) provides for the transfer of qualified expenditures between non-arm’s length claimants. A partnership cannot be a party to such a transfer, since it is not considered to be a person for the purpose of this paragraph.

To effect such a transfer, the two parties (the payer and the performer) must file a joint agreement on Form T1146, *Agreement to Transfer Qualified Expenditures Incurred in Respect of Scientific Research and Experimental Development (SR&ED) Contracts Carried Out in Canada*.

The amount that the performer can transfer for a tax year is the least of the following three amounts:

- the amount specified by the parties in their agreement;
- the performer’s SR&ED qualified expenditure pool at the end of the year before deducting the transfer of qualified expenditures to the payer; or
- the total of all amounts that would be contract payments if the two parties were dealing at arm’s length (notional contract payments) that are:
  - for performing SR&ED for or on behalf of the payer;

- paid by the payer to the performer on or before the day that is 180 days after the end of the particular year; and
- for a qualified expenditure the performer incurred in the particular year (not considering subsections 78(4) and 127(26)) for that portion of the SR&ED that was performed when the performer did not deal at arm’s length with the payer, and that is paid by the performer on or before the day that is 180 days after the end of the particular year, or for an amount transferred to the performer in respect of the SR&ED.

The least of the three amounts may be transferred out of the performer’s SR&ED qualified expenditure pool for the year (enter amounts you transferred on lines 544 and 546) and into the payer’s SR&ED qualified expenditure pool for its first tax year ending at the same time as, or after, the end of the performer’s tax year in which the transfer is made (enter amounts transferred to you on lines 508 and 510).

**Example**

Corporation C performs SR&ED for a related corporation (Corporation D) according to a contract for services. Both corporations have the same December 31 tax year-end. The contract price is \$1,000, which Corporation D paid in full in 2000.

Corporation C performed 80% of the SR&ED in 2000 and incurred \$784 of qualified expenditures in 2000. However, Corporation C paid only \$392 of the qualified expenditures by the 180th day after December 31, 2000. Corporation C paid the remaining \$392 in 2001. Corporation C completed the SR&ED in 2001 and incurred an additional \$196 of qualified expenditures in that year. Corporation C paid that amount at the end of that year. Corporation C also incurred and paid qualified expenditures of \$100 in 2000 and \$100 in 2001 for other SR&ED projects.

Corporation C and Corporation D want to file an agreement to transfer qualified expenditures from Corporation C to Corporation D for 2000 and 2001. They have to use Form T1146.

<b>Calculation</b>	<b>2000</b>	<b>2001</b>
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**Line 100 of Form T1146**

Corporation C’s SR&ED qualified expenditure pool at the end of the year, before reducing it by transferring qualified expenditures to Corporation D	\$492	\$688
\$392 + \$100 = \$492		
\$588 + \$100 = \$688		

**Line 102 of Form T1146**

Calculation of line 102 amount	\$400	\$200
\$392 ÷ \$784 × \$800* = \$400		
\$196 ÷ \$196 × \$200* = \$200		

**\*Notional contract payment for**

**2000:** \$800 (\$1,000 less \$200 under paragraph 18(9)(a)—that is 20% of \$1,000)

**2001:** \$200 (the paragraph 18(9)(a) amount of \$200 in 2000, is deemed incurred in 2001)

### Line 104 of Form T1146

Maximum amount that can be transferred: the amount on line 100 or 102, whichever amount is less \$400 \$200

Corporation C can transfer to Corporation D an amount up to the amount on line 104.

### Lines 534 and 536 – Government or non-government assistance and contract payments

Assistance and contract payments will only reduce the SR&ED expenditures for the project to which they relate. We illustrate this with the following example:

#### Example

	Project 1	Project 2	Project 3
Allowable SR&ED expenditures	\$125	\$250	\$125
<b>minus:</b>			
Contract payments	(\$50)	0	(\$100)
Government assistance	(\$100)	0	(\$50)
Non-government assistance	0	(\$50)	0
Qualified expenditures	0*	\$200	0*

\* The excess funding received for Projects 1 and 3 (\$25 each) does not reduce the Project 2 expenditures that are eligible for an ITC.

The amount of qualified expenditures is reduced by any government assistance, non-government assistance, or contract payment that the claimant, or a person or partnership not dealing at arm's length with the claimant, has received, is entitled to receive, or can reasonably expect to receive.

For a brief overview of what constitutes **government and non-government assistance**, see the explanation for line 430. However, for ITC purposes, assistance for expenditures that the PPA replaces is also included on lines 534 and 536.

Usually, an amount a claimant received or will receive is considered to be a **contract payment** if:

- the amount is from a taxable supplier;
- the amount is for SR&ED;
- the SR&ED is performed for, or on behalf of, a person or partnership entitled to deduct the amount because of subparagraph 37(1)(a)(i) or (i.1); and
- the claimant and that person or partnership are dealing at arm's length when the SR&ED is performed.

#### Note

When an amount received is not for SR&ED done on behalf of the payer, it will not reduce the qualified expenditures of the performer.

For more details on contract payments, see the current version of Interpretation Bulletin IT-151.

### Non-arm's length SR&ED contract

For a non-arm's length SR&ED contract, the payer does not have any qualified expenditures in respect of the contract amount for SR&ED. Also, the contract amount is not a contract payment to the payee.

### Rules for reducing qualified expenditures

Subsection 127(18) reduces the qualified expenditures of a claimant (including a partnership) by any government assistance, non-government assistance, or contract payments (assistance) the claimant received, is entitled to receive, or can reasonably expect to receive for SR&ED on or before the filing due date for a tax year. Provincial tax credits related only to an R&D program will reduce the qualified expenditures for SR&ED for the year.

The qualified expenditures you incurred in the year that relate to SR&ED are reduced by the assistance that relates to SR&ED, minus all amounts applied for preceding tax years to reduce your qualified expenditures or the qualified expenditures of some other claimant that does not deal at arm's length with you (see below).

#### Example 1

Company A receives \$30,000 of assistance for SR&ED in its 2001 tax year. It incurs \$50,000 of qualified expenditures before any reduction under subsection 127(18) for that year.

Subsection 127(18) requires that Company A's qualified expenditures be reduced by the \$30,000 of assistance it received. As a result, Company A can only claim an ITC based on the remainder of \$20,000.

#### Example 2

Company A spends \$20,000 on SUE. This is the only SR&ED expenditure the company incurred. Company A receives \$6,000 of assistance for SR&ED to acquire the SUE. The qualified expenditure determined before the reduction for the assistance received is \$5,000 in 2000 (the first term SUE, 1/4 of \$20,000) and \$5,000 in 2001 (the second term SUE).

Subsection 127(18) states that the portion of the assistance that is for the SR&ED (\$6,000) must reduce qualified expenditures incurred in the year for the SR&ED. In 2000, the assistance of \$6,000 will fully offset the qualified expenditures of \$5,000 for first term SUE. Since Company A did not incur other qualified SR&ED expenditures in that year, it has to apply the remaining \$1,000 to reduce the qualified expenditures for second term SUE to \$4,000 in 2001.

In certain cases, assistance received or receivable by a non-arm's length party may also reduce your qualified expenditures under subsection 127(19). This subsection applies when the assistance is **greater** than the total qualified expenditures that the recipient and the non-arm's length party incurred in the year for the SR&ED. Bear in mind that from the assistance received, you must subtract all amounts relating to it that applied for a preceding year to reduce the qualified expenditures of the recipient and the

non-arm's length party. When the assistance is greater than the expenditures, your qualified expenditures with respect to the SR&ED will be eliminated.

### Example 3

Company D receives a contract payment of \$120,000 for SR&ED from an arm's length party in its 2000 tax year. Company D contracts out part of this SR&ED to its subsidiary, Company E, which has the same December 31 year-end.

Company E completes its portion of the SR&ED in its 2000 tax year. It incurs \$48,000 of qualified expenditures relating to the SR&ED before any reduction because of assistance. Company D incurs qualified expenditures of \$20,000 for the SR&ED in its 2000 tax year, and \$40,000 for the SR&ED in its 2001 tax year before any reduction for assistance. All of the SR&ED is completed by the end of year 2001.

Under subsection 127(18), the qualified expenditures Company D otherwise incurred in its 2000 tax year, \$20,000, are reduced to nil. Under subsection 127(19), the \$48,000 of qualified expenditures Company E otherwise incurred in 2000 are also reduced to nil, because of the contract payment received by Company D.

In 2001, subsection 127(18) requires that the difference between \$120,000 and \$68,000 (the sum of \$20,000 and \$48,000 that reduced the qualified expenditures of Company D and Company E for their 2000 tax year) be applied to reduce to nil the qualified expenditures that Company D incurred in 2001 for the SR&ED.

Since Company D incurs only \$40,000 more of qualified expenditures in 2001 before completing the SR&ED, it would have no qualified expenditures for the SR&ED in 2001. The unapplied amount of the contract payment, \$12,000 (\$120,000 – \$68,000 – \$40,000), would not affect the amount of qualified expenditures that Company D or Company E incurred for other SR&ED.

If there is an amount of unapplied assistance, it will reduce the qualified expenditures **each** non-arm's length person incurred for the SR&ED, as long as the following conditions apply:

- each member of a non-arm's length group performs the SR&ED;
- each member is not dealing at arm's length with the recipient of the assistance; and
- section 127(19) does not apply to the assistance in respect of a particular year.

However, to avoid the multiple reduction of qualified expenditures, the recipient can allocate the remaining assistance under subsection 127(20) by completing and filing Form T1145 by the filing-due date.

### Lines 552 and 554 – Adjustments to qualified expenditures

See the instructions for completing section 2 of Schedule B on page 32.

### Lines 555 and 556 – Non-arm's length adjustments

See the instructions for completing Schedule C on pages 33 to 35.

### Line 559 – SR&ED qualified expenditure pool

You use the amount in this pool at the end of a tax year to calculate the ITC for that year.

In general, the amount in the SR&ED qualified expenditure pool at the end of a tax year is equal to the qualified expenditures you incur in the year, plus any amount transferred to you under paragraph 127(13)(e) (i.e., amounts on lines 508 and 510), and minus any amount you transferred to another person under paragraph 127(13)(d) (i.e., amounts on lines 544 and 546).

### Line 560 – Repayments made in the year

Amounts that can reasonably be considered repayments of government assistance, non-government assistance, or contract payments that previously reduced qualified SR&ED expenditures also qualify to earn an ITC.

On line 560, enter any repayments that you made during the year for assistance or contract payments for SR&ED. Include on this line amounts that are considered to be assistance you repaid in the year (e.g., the amount of assistance that reduced a qualified expenditure, if you did not receive the assistance and reasonably cannot expect to receive it).

Also include on line 560 any repayments of assistance for first and second term SUE.

### Line 570 – Total SR&ED qualified expenditures

This is the total of the SR&ED qualified expenditure pool and the repayments of assistance and contract payments. Add the amounts from lines 559 and 560, and enter the total on line 570. To claim an ITC on this amount, use Schedule T2SCH31, *Investment Tax Credit – Corporations*, or Form T2038(IND), *Investment Tax Credit – Individuals*, whichever applies to you.

## Part 4 – Background Information

We need this information to process your SR&ED claim.

### A. Sources of funds for SR&ED (lines 600 to 618)

Estimate the percentage distribution of the sources of funds for SR&ED performed within your organization. Use the total SR&ED expenditures you entered on line 605 (make sure that the total of lines 600 to 618 equals 100%).

#### Line 600 – Internal funding

Internal sources include funds that originate from internal company funding, loans, and income tax refunds used for SR&ED you performed in this fiscal period.

#### Lines 602 and 604 – Funding from parent companies, subsidiaries, and affiliated companies

Enter funding from parent companies, subsidiaries, and affiliated companies. Identify both Canadian and foreign funding.

**Line 605 – Expenditures for SR&ED performed within your business**

Line 605 is the total allowable expenditures for SR&ED performed within the company.

**Line 606 – Federal grants**

Enter federal grants for SR&ED, and the SR&ED portion of any other federal grants. Exclude funds or tax credits from SR&ED tax incentives.

**Line 608 – Federal contracts**

Enter federal contracts for SR&ED, and the SR&ED portion of any other federal contracts.

**Line 610 – Provincial funding**

Include provincial funding for SR&ED, as well as SR&ED contracts and the SR&ED portion of any other provincial grants or contracts. Exclude funds or tax credits from SR&ED tax incentives.

**Lines 612 and 614 – Contracts for other companies**

Exclude funds from companies reported on lines 602 and 604. Identify both Canadian and foreign funding.

**Lines 616 and 618 – Other funding**

Include funds from universities, other levels of government, private non-profit organizations, individuals, and foreign governments. Identify both Canadian and foreign funding.

**B. Business personnel (lines 630 to 638)****Line 630 – Number of employees**

Enter the average number of employees on your organization's payroll that year.

**Lines 632 to 638 – SR&ED Personnel**

Include the number of people who work solely on SR&ED projects, plus a full-time equivalent (FTE) for people who work only part time on SR&ED.

**Example**

If, out of five scientists engaged in SR&ED, one works solely on SR&ED projects and the remaining four devote only one-quarter of their working time to SR&ED, then:  
 $FTE = 1 + \frac{1}{4} + \frac{1}{4} + \frac{1}{4} + \frac{1}{4} = 2$  scientists.

**C. Nature of SR&ED work (lines 650 to 664)**

**Lines 650 to 664 – Basic research; applied research; development of new products, processes, and technical services; improvement of existing products, processes, and technical services**

In this section, estimate the approximate distribution of your SR&ED performed within your business, using the total SR&ED expenditures you entered on line 605 (make sure that the total of lines 650 to 664 equals 100%).

**Lines 658 and 664 – Technical services**

Technical services are new or existing services that either support or complement the production or use of the technology.

**D. Specialized field of research (lines 670 to 674)****Line 670 – Software development**

Indicate the percentage of the amount on line 605 attributed to software development. Software development is defined as work relating to programming the encoded instructions executed by electronic devices, including computers, for performing operations and functions. See Information Circular 97-1, *Scientific Research and Experimental Development – Administrative Guidelines for Software Development*, for the identification of SR&ED in software development.

**Line 672 – Biotechnology**

Indicate the percentage of the amount on line 605 attributed to biotechnology. Biotechnology is defined as work using biological agents. "Biotechnology's multidisciplinary nature encompasses a range of techniques dealing with recombinant DNA (Deoxyribonucleic Acid), cell fusion, plant and animal cell cloning, monoclonal antibodies, tissue culture, and bioprocess engineering. What distinguishes the new biotechnology from the one used to make bread, beer or cheese is the enormous expansion of our power to manipulate biological agents through the transfer, modification, and control of genetic material." (Science Council of Canada, *Enabling Technologies*)

**Line 674 – Environmental protection**

Indicate the percentage of the amount on line 605 attributed to environmental protection. Environmental protection is defined as the field of work devoted to the reduction or elimination of pollutants and wastes (including the prevention, treatment, and reuse of pollutants and wastes). SR&ED performed in order to improve employee health and workplace safety are excluded.

**Schedule A – Third-Party Payments**

Provide the required information for each entity to which you made payments for SR&ED carried out in Canada, and that you reported on line 370. Read the preamble of Schedule A for an explanation of third-party payments.

Use a separate copy of Schedule A for each payment, and attach them to Form T661 or the RSI 32.

**1. Identification**

**Line 701** – Indicate the name of the third-party who received the payment.

**Line 702** – Indicate the mailing address of the third-party.

**Line 704** – Show the amount paid to the third-party.

**Line 706** – Provide a list of the research projects which relate to the third-party. Use separate sheets if needed.

**Lines 711 to 718** – Check the appropriate category to indicate the type of entity.

**Line 721** – State if you are dealing at arm's length with the third-party.

## 2. Nature of payment

**Line 731 to 734** – Check the appropriate category to indicate the type of work.

**Line 736** – Explain briefly what the payment is for.

**Line 738** – Explain briefly how the SR&ED is related to a business that you carry on.

**Line 740** – Explain briefly how you are entitled to exploit the results of the SR&ED.

## Schedule B – Special Situations

This schedule lists adjustments to the deductible expenditure pool, and to the qualified expenditures for ITC purposes. Report these on Form T661 as indicated.

### Section 1 – Adjustments to the pool of deductible SR&ED expenditures incurred in Canada

#### Line 445 – Repayments of assistance

If an amount of assistance has reduced your balance in the pool of deductible SR&ED expenditures (see line 430), add any repayments of that assistance to the pool on line 445. Also, if an amount of assistance receivable has reduced your expenditure pool balance and you did not receive the amount, nor do you expect to, the amount is considered to be a repayment of assistance that you can add to the pool on line 445.

#### Line 452 – Amalgamation and wind-up

For information on how an amalgamation or wind-up affects the pool of deductible SR&ED expenditures, read the current version of Interpretation Bulletin IT-151.

**Line 454** – Calculate the total of lines 445 and 452, and report this amount on line 454 of Form T661.

### Section 2 – Adjustments to qualified expenditures for ITC purposes

#### Line 520 – Unpaid amounts

On line 520, deduct unpaid amounts deemed not to be an expenditure incurred in the year under subsection 127(26).

##### Note

Even if your unpaid amounts under subsection 127(26) do not qualify for ITCs until the time you pay them, they are still allowable SR&ED expenditures that are deductible in the year you incurred them. Make sure to include your unpaid subsection 127(26) amounts in your allowable SR&ED expenditures within the reporting deadline for filing Form T661. If you do not, they will not be qualified expenditures in the year you pay them.

#### Example

In its tax year ending on December 31, 2001, Corporation A incurs SR&ED expenditures of \$100,000 for consulting fees payable to Corporation B. Corporation A still has not paid the expenditure 180 days after the end of the 2001 tax year. The expenditure is only paid in November 2002.

- Corporation A must identify the expenditure in the SR&ED expenditure pool on Form T661 within the reporting deadline. It is an allowable SR&ED expenditure deductible in 2001.
- Corporation A has to enter the unpaid amount on line 520 of Schedule B of Form T661 for the 2001 tax year. For ITC purposes, the expenditure is deemed not to have been incurred in 2001.
- When Corporation A pays the expenditure in the 2002 tax year, it should enter the amount paid on line 500 of Form T661 for that year.

#### Line 528 – Expenses paid to a non-taxable supplier

You cannot earn an ITC on any allowable SR&ED current expenditure, claimed on lines 300 to 370, that is paid or payable to or for the benefit of a person or partnership that is not a taxable supplier in respect of the expense. **Taxable supplier** usually means a resident of Canada, a Canadian partnership, or a person or partnership that pays or receives the amount in the course of carrying on a business through a permanent establishment in Canada.

This rule does not apply to an expenditure on SR&ED that you directly undertake. It usually applies in situations where a payer contracts out its SR&ED to an arm's length performer. If the SR&ED contract expenditure is paid or payable to or for the benefit of a non-taxable supplier, it is not a qualified expenditure for ITC purposes. See Application Policy SR&ED 2002-03, *Taxable Supplier Rules*.

#### Example

Company A, a Canadian corporation, contracts out its SR&ED to Company B, another Canadian corporation, for \$100,000. Company A and Company B deal with each other at arm's length throughout the period in which the SR&ED is performed. However, Company B does not actually perform the SR&ED. Instead it contracts out the SR&ED to a foreign company, Forco, for a contract price of \$95,000. Forco, in turn contracts it to a third Canadian company, Company C, for \$90,000.

Because \$95,000 of the \$100,000 paid or payable by Company A to Company B was, in turn, paid or payable to Forco, which is not a taxable supplier in respect of the amount, \$95,000 of the \$100,000 is considered to be paid or payable to, or for the benefit of, a corporation that is not a taxable supplier in respect of the amount. Enter \$95,000 on line 528 of Appendix B. Company A may still be able to claim \$5,000 of qualified expenditures, since the SR&ED is performed in Canada.



Company B, on the other hand, does not have any qualified expenditures for two reasons. First, the \$95,000 paid or payable to Forco is also considered to be paid or payable to, or for the benefit of, a corporation that is not a taxable supplier in respect of the \$95,000. Second, there is a contract payment of \$100,000 paid or payable to Company B.

### Lines 530 and 532 – Prescribed expenditures

Enter the total prescribed expenditures that Section 2902 of the Regulations does not allow for ITC purposes. The most common prescribed expenditures are:

- interest and other financing costs;
- legal or accounting fees; and
- expenditures for the acquisition of used equipment.

Read the current version of Interpretation Bulletin IT-151, for more details.

### Lines 548 and 550 – Other deductions

On lines 548 and 550, enter any qualified expenditures incurred in the course of earning income that will not be subject to Part I tax. Subsection 127(9), which defines the term **investment tax credit**, ensures that an ITC will be generated only when the income from the business to which a particular expenditure relates is subject to Part I tax.

Also enter expenditures renounced for the purposes of Part VIII tax. For more details, read the current version of Interpretation Bulletin IT-151.

**Line 552** – Add lines 520, 528, 530, and 548. Report the total amount on line 552 of Form T661.

**Line 554** – Add lines 532 and 550. Report the total amount on line 554 of Form T661.

## Schedule C – Non-Arm’s Length Transactions

Complete this schedule if you have any of the non-arm’s length transactions described in this schedule. Report the amounts as indicated on lines 555 and 556 of Form T661.

### Lines 522 and 524 – Purchase of goods and services from non-arm’s length suppliers

Special rules apply to expenditures for purchases of goods and services from non-arm’s length parties.

In general, if an SR&ED performer purchases goods or services for SR&ED from a person with whom the performer does not deal at arm’s length, the amount eligible for an investment tax credit to the performer is limited to the cost to the non-arm’s length person who provides the goods or services.

Under subsection 127(11.6), the amount of an expenditure you incur for the service or property and the capital cost of the property is deemed to be:

1. in the case of a service rendered to you, either the expenditure you actually incurred or the **adjusted service cost**, whichever amount is less; and

2. in the case of a property sold to you, either the capital cost to you otherwise determined or the **adjusted selling cost** to the supplier of the property, whichever amount is less.

The definitions of **adjusted service cost** and **adjusted selling cost** are found in subsection 127(11.7).

Subsection 127(11.8) provides additional rules for non-arm’s length purchases of goods and services. One of these rules is that any cost to a supplier cannot include any amount that would not be a qualified expenditure if the ultimate purchaser or user of the goods or services incurred the amount directly. Under another rule, leasing a property is deemed to be rendering a service.

On lines 522 and 524, enter the difference between the amount you included in your pool of deductible SR&ED expenditures for the purchases of goods and services from non-arm’s length suppliers and the deemed amount of the expenditure under subsection 127(11.6).

If the property is SUE, the amount of the expenditure for SUE entered on line 504 of Form T661 is based on the **adjusted selling cost** of the property.

The current version of Interpretation Bulletin IT-419, *Meaning of Arm’s Length*, describes in general terms the criteria for determining whether persons deal with each other at arm’s length.

### Line 526 – Non-arm’s length SR&ED contracts

Expenditures for SR&ED performed on your behalf by a person or a partnership at a time when you and the performer do not deal with each other at arm’s length do not qualify for ITC purposes. On line 526, deduct the amount you entered on line 345 for non-arm’s length SR&ED contracts.

#### Note

Expenditures you incurred for non-arm’s length SR&ED contracts are not considered to be either qualified expenditures or a contract payment to the performer for ITC purposes. However, you and the non-arm’s length performer can file Form T1146 so that all or a part of the performer’s qualified expenditures for SR&ED, up to a maximum of the contract amount, can be transferred to you (the payer) for ITC purposes. For more details, see the explanations for lines 508 and 510, and lines 534 and 536.

#### Example

A Canadian corporation, Parentco, contracts with its wholly owned Canadian subsidiary, Subco, for Subco to perform SR&ED on Parentco’s behalf. An amount of \$100,000 is payable by Parentco under the contract. This SR&ED is subcontracted out by Subco to an arm’s length party, Performco, for \$95,000. Performco completes the work in 2001 and all contract amounts are paid in full in 2001.

Since the work is performed at a time when Subco is not dealing at arm’s length with Parentco, Parentco’s \$100,000 expenditure is not a qualified expenditure. Under the definition of **contract payment**, the \$100,000 is not a contract payment paid or payable to Subco. As a result, Subco has a qualified expenditure of \$95,000, which it can transfer back to Parentco by filing Form T1146. Performco,

however, has to reduce the qualified expenditures it incurred for the SR&ED by the \$95,000 contract payment from Subco.

### Lines 538 and 540 – Allocation of assistance

Subsection 127(20) provides a way to allocate assistance for SR&ED that was not applied to the recipient's qualified expenditures. The assistance can be allocated among the members of a non-arm's length group in situations where:

- each member of the group performs the SR&ED when the member is not dealing at arm's length with the recipient of the assistance; and
- subsection 127(19) does not apply to the assistance for the tax year in which the allocation can be made (i.e., the amount of the government assistance, net of the amount applied against qualified expenditures in previous years, is less than the total qualified SR&ED expenditures incurred in the year by the recipient and by the non-arm's length persons).

### Example

Company A, Company B, and Company C are related corporations that have the same December 31 year-end. Company A contracts out its SR&ED to Company B and Company C. Company B and Company C will each perform half of the SR&ED for \$50,000.

In June 2000, Company A receives government assistance of \$40,000 for the SR&ED. Company B and Company C each incur \$15,000 of qualified expenditures for the SR&ED in 2000 and \$33,000 in 2001. They pay for all their qualified expenditures by the end of each year to which the expenditures relate.

In 2000, subsection 127(19) applies to the government assistance in respect of Company A's 2000 tax year. As a result, Company B and Company C's qualified expenditures of \$15,000 each that they incurred in 2000 is reduced to nil. Since there remains \$10,000 of government assistance that has not been applied to reduce qualified expenditures for the SR&ED, that amount reduces qualified expenditures that Company B and Company C incurred for the SR&ED in 2001.

In 2001, subsection 127(19) does not apply for Company A's 2001 tax year, since the amount of government assistance (i.e., \$40,000) is less than the sum of the total amounts previously applied under subsection 127(19) (i.e., \$30,000) and the total qualified expenditures (i.e., \$66,000) that Company B and Company C otherwise incurred in their tax years that end in Company A's 2001 tax year.

Under such a scenario, the companies should allocate the remaining assistance among themselves. Subsection 127(20) permits the three companies to allocate the remaining \$10,000 of assistance to reduce the qualified expenditures of Company B, Company C, or both, which they incurred in 2001. If they do not allocate the remaining \$10,000 of assistance under subsection 127(20), subsection 127(21) will operate to reduce both B and C's qualified expenditures.

Company A and Company B can file an agreement (Form T1145) with the CRA specifying that the \$10,000 remaining assistance should be applied to reduce Company B's \$33,000 of qualified expenditures to \$23,000. Consequently, the amount of qualified expenditures that Company C incurred in 2001 would still be \$33,000.

To make the allocation, use Form T1145, *Agreement to Allocate Assistance Between Persons Not Dealing at Arm's Length for Scientific Research and Experimental Development Expenditures (SR&ED) Carried On in Canada*.

### Lines 544 and 546 – Transfer of qualified expenditures

If someone carries out SR&ED on your behalf and you and this other party are not dealing at arm's length, your expenditures for the contract do not qualify for ITC purposes. In addition, the amount received or receivable by the performer of the SR&ED is not considered to be a contract payment. However, the performer can transfer qualified expenditures to you, up to a maximum of the contract amount.

Subsection 127(13) provides for the transfer of qualified expenditures between non-arm's length persons. A partnership cannot be a party to such a transfer, since it is not considered to be a person for this purpose.

To make such a transfer, the two parties (the payer and the performer) must file a joint agreement on Form T1146, *Agreement to Transfer Qualified Expenditures Incurred in Respect of Scientific Research and Experimental Development (SR&ED) Contracts Carried Out in Canada*.

The amount that the performer can transfer for a tax year is the least of the following three amounts:

- the amount specified by the parties in their agreement;
- the performer's SR&ED qualified expenditure pool at the end of the year before deducting the amount of qualified expenditures transferred to the payer; and
- the total of all amounts that would be contract payments if the two parties were dealing at arm's length (notional contract payments) that are:
  - for performing SR&ED for or on behalf of the payer;
  - paid by the payer to the performer on or before the day that is 180 days after the end of the particular year; and
  - for a qualified expenditure the performer incurred in the particular year (not considering subsections 78(4) and 127(26)) for that portion of the SR&ED that was performed when the performer did not deal at arm's length with the payer, and is paid by the performer on or before the day that is 180 days after the end of the particular year, or for an amount transferred to the performer in respect of the SR&ED.

The least of the three amounts is transferred out of the performer's SR&ED qualified expenditure pool for the year (enter amounts you transferred on lines 544 and 546) and into the payer's SR&ED qualified expenditure pool for its first tax year ending at the same time, or after, the end of the performer's tax year in which the transfer is made (enter amounts transferred to you on lines 508 and 510).

### Example

Corporation C performs SR&ED for a related corporation, Corporation D, according to a contract for services. Both corporations have the same December 31 tax year-end. The contract price is \$1,000, which Corporation D paid fully in 2000.

Corporation C performed 80% of the SR&ED in 2000 and incurred \$784 of qualified expenditures in 1999. However, Corporation C only paid \$392 of the qualified expenditures by the 180th day after December 31, 2000. Corporation C paid the remaining \$392 in 2001. Corporation C completed the SR&ED in 2001 and incurred an additional \$196 of qualified expenditures in that year. Corporation C paid that amount at the end of that year. Corporation C also incurred and paid qualified expenditures of \$100 in 2000 and \$100 in 2001 for other SR&ED projects.

Corporation C and Corporation D want to file an agreement to transfer qualified expenditures from Corporation C to Corporation D for 2000 and 2001. They have to use Form T1146.

Calculation	2000	2001
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#### Line 100 of Form T1146

Corporation C's SR&ED qualified expenditure pool at the end of the year, before reducing for the transfer of qualified expenditures to Corporation D	\$492	\$688
$\$392 + \$100 = \$492$		
$\$588 + \$100 = \$688$		

Line 102 of Form T1146	\$400	\$200
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Calculation of line 102 amount

$\$392 \div \$784 \times \$800^* = \$400$

$\$196 \div \$196 \times \$200^* = \$200$

#### \*Notional contract payment for

**2000:** \$800 (\$1,000 less \$200 under paragraph 18(9)(a)—that is 20% of \$1,000)

**2001:** \$200 (the paragraph 18(9)(a) amount of \$200 in 2000, is deemed incurred in 2001)

#### Line 104 of Form T1146

Maximum amount that can be transferred: the amount on line 100 or 102, whichever amount is less	\$400	\$200
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Corporation C can transfer to Corporation D an amount up to the amount on line 104.

### Total non-arm's length transactions

**Line 555** – Add lines 522, 526, 538, and 544. Report the total amount on line 555 of Form T661.

**Line 556** – Add lines 524, 540, and 546. Report the total amount on line 556 of Form T661.

## Schedule D – Calculation of Salary Base and Prescribed Proxy Amount

If you have elected to use the prescribed proxy method on page 1 of Form T661, complete this schedule to calculate the salary base and the prescribed proxy amount. Attach the schedule to Form T661. If there are more than four specified employees, use separate sheets.

### Section A – Salary Base

**Line 810** – Enter the amount from line 300 of Form T661. This amount is the total salaries or wages of employees directly engaged in SR&ED, other than specified employees.

**Line 812** – Enter the bonuses, remuneration based on profits, and taxable benefits under sections 6 and 7 of the Act that you included on line 300.

**Line 814** – Add line 810 and line 812.

**Line 816** – Enter the amount of salaries or wages of specified employees directly engaged in SR&ED that qualify to be included in the salary base. Calculate this amount in Section C.

The amount of salaries or wages for a specified employee that you can include in the salary base for the prescribed proxy amount is subject to certain restrictions. These are outlined in subsection 2900(9) of the Regulations.

**Line 818** – Add lines 814 and 816 to arrive at the salary base.

### Section B – Prescribed proxy amount

**Line 820** – Calculate the PPA, which is 65% of the amount on line 818 in section A. Report it on line 502 of Form T661.

### Section C – Salaries and wages of specified employees

In this section, you determine the salaries and wages of specified employees that can be included in the salary base. Table 6 illustrates the rules for specified employees.

In column 1, write the name of each specified employee.

In column 2, enter the total amount you incurred in the year for salaries or wages of the specified employee. This amount is 100% of the expenditure for salaries or wages of the employee, not only the SR&ED portion. Do not include taxable benefits under sections 6 and 7, bonuses, remuneration based on profits, or an amount deemed incurred in the year under subsection 78(4).

In column 3, enter the percentage of time the employee was directly engaged in SR&ED in Canada, up to a maximum of 75%.

In column 4, enter the results of the amount in column 2 multiplied by the percentage in column 3.

In column 5, enter the maximum amount allowed for the year. To determine the maximum amount allowed for the year, use the formula  $2.5 \times A \times B \div 365$ . In this formula, **A** is the year's maximum pensionable earnings (section 18 of the *Canada Pension Plan*) for the calendar year in which your tax year ends. The maximum pensionable earnings are \$40,500 for 2004 and \$39,900 for 2003. **B** is the number of days in the tax year that you employ the individual.

If the specified employee is also employed by a corporation with which you are associated, the maximum amount

allowed cannot be more than  $2.5 \times A$ , minus the amount the associated corporation has included in its salary base for its tax year ending in the same calendar year. Use Form T1174 to allocate salaries or wages of specified employees of SR&ED between associated corporations.

In column 6, enter the salary allocated to SR&ED for each specified employee and carry the total to line 816 of Section A. The salary allocated to SR&ED is the amount in column 4 or the amount in column 5, whichever amount is less.

Table 6 below illustrates the rules applicable to salaries and wages of specified employees:

Column 1	Column 2	Column 3	Column 4	Column 5	Column 6
Name of specified employee	Total salaries or wages for the year (SR&ED and non-SR&ED). Do not include taxable benefits under sections 6 and 7, bonuses, remuneration based on profits, or an amount deemed incurred in the year under subsection 78(4).	% of time spent in SR&ED in Canada (maximum 75%)	Amount in column 2 multiplied by % in column 3	$2.5 \times A \times B / 365$ A= \$40,500 B= no. days	Amount in column 4 or 5, whichever amount is less
Employee 1	\$ 50,000	50%	\$25,000	\$101,250**	\$25,000
Employee 2	\$ 50,000	75% *	\$37,500	\$101,250	\$37,500
Employee 3	\$100,000	60%	\$60,000	\$101,250	\$60,000
Employee 4	\$100,000	75% *	\$75,000	\$101,250	\$75,000
Employee 5	\$150,000	70%	\$105,000	\$101,250	\$101,250
<b>Carry the total amount of column 6 to line 4 of Section A of Schedule D</b>					\$298,750
* Although 80% of actual time was directly engaged in SR&ED in Canada, enter only 75% in column 3 (maximum % allowed).					
** This is the maximum allowed for the 2004 year (as determined by the formula $2.5 \times \$40,500$ (in 2004) $\times 365/365$ , if you employed the employee for the whole year).					

On line 6, enter 65% of line 5 and report this amount to line 502 of Form T661.

In certain situations, an overall cap on the PPA may limit the amount otherwise determined.

**Overall cap on PPA** – For most claimants, the PPA is 65% of the total of the SR&ED portion of salaries of employees directly engaged in SR&ED in Canada. However, in certain situations, an overall cap on the prescribed proxy amount may limit the PPA you have otherwise determined. Usually, the overall cap will not restrict the PPA if you have deducted more than \$65 of non-SR&ED expenses (other than rent for a building, capital cost allowance, interest and financing costs, allowance for doubtful accounts, and all other amounts deductible under section 20) for each \$100 of eligible salary you included in the salary base.

Use Table 7 to help you calculate this amount.

Enter the total amounts you deducted when calculating your net income for tax purposes from your business for the year (include the cost of goods sold in the total amounts you deduct).....	6) _____
Enter the deductions you claimed in the year under sections 20 (e.g., capital cost allowance, interest, bad debts), 24 (if you cease to carry on a business), 26 (for a bank), 30 (improving land for farming), 32 (if your business is that of an insurance agent or broker), 37 (for SR&ED expenditures), 66 to 66.8 (e.g., exploration and development expenditures), and 104 (for a trust).....	7) _____
Enter the amount of expenditures you incurred for the use of, or the right to use, a building (other than a prescribed special-purpose building).....	8) _____
Enter the amount from line 6, minus the amounts on line 7 and line 8 .....	9) _____

The PPA to enter on line 502 is either 65% of the amount on line 5 in section A of Schedule D of Form T661, or the amount on line 9 of Table 7, whichever amount is less.

## Schedule E – List of all SR&ED projects claimed

Use Schedule E provided with Form T661 and attach it to Form T661. For each project you are claiming, provide the following information using the table below. Expenditures should be recorded and allocated on a project basis. If you have more than 50 projects, use separate copies of Schedule E.

### Line 210 – Project identification: code or name

List all the SR&ED projects claimed. The internal reference code is the code you use to track the project and its costs. If you do not use such a code, then give an equivalent identifier. The project name is the internal name or title you have given the project.

#### Note

If you do not have an established system of project coding, number the projects in sequence and use these numbers throughout your claim.

### Line 212 – Start date

The date when you started work on the SR&ED project.

### Line 214 – Finish date

The date when the SR&ED project's initial scientific or technological objectives were achieved. If the project is not finished in this tax year, give the expected finish date.

### Line 216 – Total labour expenditures in current tax year

This may be an actual amount or a reasonable allocation. It relates to the amount to be reported on line 300 to 310.

### Line 218 – Total cost of materials in current tax year

These may be actual amounts, or reasonable allocations if the expenditures are not specific to the project.

### Line 220 – Total contract expenditures in current tax year

If some of the project work was contracted out, provide the actual contract amounts. Do not include the subcontract costs (see lines 340 and 345).

Whenever you allocate or estimate costs, keep a copy of your calculations and the rationale on which they are based, in case we need to verify the amounts at a later date.

Keep a copy of the terms and conditions of a contract, as well as a statement of work expected of the contractor, as you may need to provide these on request.

Other information, such as the names of the qualified personnel, must also be kept and provided on request.

For multi-year projects, claim the expenditures in each year to meet the deadline for filing. Claiming all the expenditures at the end of the project will result in expenditures being denied.

## Glossary

**Directly engaged in SR&ED** – Whether an employee is directly engaged in SR&ED is based on the tasks he or she performs, not a job title. For a list of tasks, see the section called “Definition of directly engaged in SR&ED,” which follows the explanations for lines 300 to 315 in the guide.

**General-purpose office equipment or furniture** – General-purpose office equipment or furniture includes all furniture, such as desks, chairs, lamps, filing cabinets, and bookshelves. It also includes photocopiers, fax machines, telephones, pagers, typewriters, word processors, teletypewriters, and calculators.

Computers, including hardware, software, and ancillary equipment, are not considered to be general-purpose office equipment or furniture.

**Pool of deductible SR&ED expenditures** – You can pool expenditures of a current and capital nature on SR&ED you carried out in Canada, and deduct them when you calculate the income from a business you carried on in the year you made the expenditure or in any later year. For more details, see the current version of Interpretation Bulletin IT-151.

**Prescribed proxy amount (PPA)** – If you elect to use the prescribed proxy method under clause 37(8)(a)(ii)(B), you can calculate a PPA under subsection 2900(4) of the Regulations. Your PPA is a notional amount. You do not include this amount in the pool of SR&ED expenditures, and you do not deduct it when calculating your income. It represents the amount of overhead expenditures related to SR&ED and is used to determine a claimant’s ITCs for these overhead expenditures. The PPA is treated as a qualified expenditure for ITC purposes. The actual overhead expenses the PPA represents are ordinary business expenses. Although you do not include the PPA in the pool of SR&ED expenditures, any ITC you claimed in a previous year that can reasonably be considered to be for a PPA of a previous year will reduce the pool of SR&ED expenditures.

For most claimants, the PPA for a tax year is 65% of the salary base.

**Salary base** – The salary base is the portion of salaries and wages of employees who are directly engaged in SR&ED carried out in Canada that can reasonably be considered to relate to such work. It is based on the time these employees spent on SR&ED. However, the amount of an employee’s salaries and wages that you can use to determine the salary base cannot include an amount described in sections 6 or 7 of the Act, an amount deemed incurred under subsection 78(4), remuneration based on profits, or bonuses. In addition, the amount of salaries and wages that you can take into account may be further restricted for a specified employee.

**Scientific research and experimental development (SR&ED)** – See the current version of Information Circular 86-4, *Scientific Research and Experimental Development*, for technical guidelines. This circular clarifies what constitutes SR&ED according to subsection 248(1) of the Act.

**Shared-use equipment** – You can earn ITCs on a portion of the cost of equipment you used primarily (more than 50% of the time) for the prosecution of SR&ED. For more details, see the explanations for line 504 in the guide.

**Specified employee** – A specified employee is defined under subsection 248(1) of the Act. The definition includes an employee who does not deal at arm’s length with the employer in a particular year or who owns directly or indirectly, at any time during the year, 10% or more of the issued shares of any class of the capital stock of the employer or of any corporation related to the employer. For this purpose, shares owned by a person with whom the employee does not deal at arm’s length are included.

## Tax Services Offices

The CRA delivers the SR&ED Program through 10 co-ordinating tax services offices.

### Co-ordinating tax services offices

<b>Calgary</b>	130, 220-4th Avenue South East Calgary AB T2G 0L1 Telephone: (403) 691-5890 Fax: (403) 691-6625
<b>Halifax</b>	10 <sup>th</sup> Floor – 1557 Hollis Street P.O. Box 638 Halifax NS B3J 2T5 Telephone: (866) 433-5986 Fax: (902) 426-4727
<b>Hamilton</b>	50 Bay Street West P.O. Box 2220 Hamilton ON L8N 3E1 Telephone: (905) 572-2650 Fax: (905) 570-8247
<b>Laval</b>	3400 Jean-Béraud Avenue Laval QC H7T 2Z2 Telephone: (514) 338-4198 1-888-784-8709 Fax: (514) 338-4564
<b>Montréal</b>	305 René-Lévesque Boulevard West Montréal QC H2Z 1A6 Telephone: (514) 496-1317 Fax: (514) 496-6607
<b>Ottawa</b>	333 Laurier Avenue West Ottawa ON K1A 0L9 Telephone: (613) 598-2106 Fax: (613) 952-1856
<b>Québec</b>	94 Dalhousie Street Québec QC G1K 4B8 Telephone: 1-866-204-0101 (418) 648-7151 Fax: (418) 648-5663
<b>Toronto Centre</b>	1 Front Street West Toronto ON M5J 2X6 Telephone: (416) 973-2249 Fax: (416) 952-8334
<b>Toronto West</b>	3rd floor 5800 Hurontario Street P.O. Box 6000 Mississauga ON L5A 4E9 Telephone: (905) 566-6010 Fax: (905) 566-6754
<b>Vancouver</b>	1166 West Pender Street Vancouver BC V6E 3H8 Telephone: (866) 317-0473 Fax: (604) 666-0222

### For tax services offices in:

Calgary, Edmonton, Northwest Territories, Regina, Saskatoon, Winnipeg
Bathurst, Charlottetown, Halifax, Moncton, Saint John, Newfoundland and Labrador, Sydney
Hamilton, Kitchener/Waterloo, London, St. Catharines, Windsor
Laval, Abitibi-Outaouais
Montréal, Montérégie/Rive-Sud
Belleville, Kingston, Nunavut, Ottawa, Peterborough, Sudbury, Thunder Bay
Chicoutimi, Québec, Rimouski, Sherbrooke, Trois-Rivières
Toronto Centre, Toronto East, Toronto North
Toronto West
Burnaby, Northern B.C. and Yukon, Southern Interior, Vancouver, Vancouver Island

## Tax Centres

File your SR&ED claim with your return of income at one of the following seven tax centres:

Tax centre	Address, postal code, and fax number	Corporations served by tax services offices in:	Individuals served by tax services offices in:
St. John's	290 Empire Avenue St. John's NL A1B 3Z1 Telephone : 1-888-832-1728 Fax : (709) 754-3416	New Brunswick, Newfoundland and Labrador, Nova Scotia, Kingston, Peterborough, St. Catharines	New Brunswick, Newfoundland and Labrador, Nova Scotia, Kingston, Peterborough, St. Catharines
Summerside	275 Pope Road Summerside PE C1N 5Z7 Telephone : 1-877-427-1321 Fax: (902) 432-6287	Prince Edward Island, Hamilton, Belleville, Kitchener/Waterloo	Prince Edward Island, Hamilton, Belleville, Kitchener/Waterloo
Jonquière	2251 René Lévesque Blvd. Jonquière QC G7S 5J1 Telephone : 1-888-699-0735 Fax : (418) 548-0846	Québec, Chicoutimi, Rimouski, Trois-Rivières, Outaouais, Montérégie-Rive-Sud	Québec, Chicoutimi, Rimouski, Trois-Rivières, Outaouais, Montérégie-Rive-Sud
Shawinigan	4695 – 12th Avenue Shawinigan-Sud QC G9N 7S6 Telephone : 1-800-959-7405 Fax: (819) 536-7078	Montréal, Laval, Sherbrooke, Rouyn-Noranda, Nunavut, Ottawa, Sudbury (North-eastern Ontario served by Sudbury TSO)	Montréal, Laval, Sherbrooke, Rouyn-Noranda, Nunavut, Ottawa, Sudbury (other than Sudbury/Nickel Belt)
Sudbury	1050 Notre-Dame Avenue Sudbury ON P3A 5C1 Telephone : 1-800-998-7739 Fax: (705) 671-3994	Toronto, Sudbury (Nickel Belt)	Toronto, Sudbury (Nickel Belt)
Winnipeg	66 Stapon Road Winnipeg MB R3C 3M2 Telephone : 1-800-724-0790 Fax: (204) 984-5164	Alberta, Manitoba, Northwest Territories, Saskatoon, Thunder Bay, Windsor, London	Alberta, Manitoba, Northwest Territories, Saskatoon, Thunder Bay, Windsor, London
Surrey	9755 King George Highway Surrey BC V3T 5E1 Telephone : 1-888-738-7718 Fax: (604) 585-5769	British Columbia, Yukon Territory, Regina	British Columbia, Yukon Territory, Regina