Federal Court of Appeal | Cour d'appel fédérale

Date: 20220503

Docket: A-231-20

Citation: 2022 FCA 72

CORAM: **RENNIE J.A.**
WOODS J.A.
LASKIN J.A.

BETWEEN:

NATIONAL R&D INC.

Appellant

and

HER MAJESTY THE QUEEN

Respondent

Heard at Toronto, Ontario, on April 6, 2022.

Judgment delivered at Ottawa, Ontario, on May 3, 2022.

REASONS FOR JUDGMENT BY: RENNIE J.A.

CONCURRED IN BY: WOODS J.A.
LASKIN J.A.

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REASONS FOR JUDGMENT

RENNIE J.A.

[1] National R&D Inc. [National] appeals from a judgment of the Tax Court of Canada (2020 TCC 47, *per* Lafleur J. [Decision]). The Tax Court dismissed National's appeal of the Minister of National Revenue's assessment, which denied tax credits claimed by National for scientific research and experimental development [SR&ED] under subsection 248(1) of the *Income Tax Act*, R.S.C., 1985, c. 1 (5th Supp.) [ITA].

[2] The Tax Court judge found that National had not shown on the balance of probabilities that the appellant's project qualified as SR&ED under subsection 248(1) as it did not meet the criteria set out in *Northwest Hydraulic Consultants Ltd. v. The Queen*, [1998] 3 C.T.C. 2520, 1998 CanLII 553 (TCC) [*Northwest Hydraulic*]. Drawing from the decision of this Court in *CW Agencies Inc. v. Canada*, 2001 FCA 393, 284 N.R. 386 at paragraph 17, the judge summarized the criteria as follows:

> 1. Was there a technological risk or uncertainty which could not be removed by routine engineering or standard procedures?
>
> 2. Did the person claiming to be doing SRED formulate hypotheses specifically aimed at reducing or eliminating that technological uncertainty?
>
> 3. Did the procedure adopted accord with the total discipline of the scientific method including the formulation[,] testing and modification of hypotheses?
>
> 4. Did the process result in a technological advancement?
>
> 5. Was a detailed record of the hypotheses tested, and results kept as the work progressed?
>
> (Decision at para. 18)

[3] The judge found that National satisfied the first requirement under *Northwest Hydraulic* but failed to meet the remaining four criteria under the test.

[4] The appellant contends that the judge made legal errors in her understanding of subsection 248(1), made palpable and overriding errors in the assessment of the evidence with respect to the appellant's project, misunderstood the burden of proof on the taxpayer in proceedings before the Tax Court and erred in ruling the expert report tendered by the appellant to be inadmissible.

[5] The facts are fully set forth in the reasons of the Tax Court judge and need not, for the purposes of this appeal, be revisited.

Whether the judge erred in the understanding of section 248(1)

[6] Pursuant to subsection 248(1) of the ITA, SR&ED entails the systemic investigation, by means of experiment or analysis, into scientific or technological innovations:

scientific research and experimental development means systematic investigation or search that is carried out in a field of science or technology by means of experiment or analysis and that is	**activités de recherche scientifique et de développement expérimental** Investigation ou recherche systématique d'ordre scientifique ou technologique, effectuée par voie d'expérimentation ou d'analyse, c'est-à-dire :
…	[…]
(c) experimental development, namely, work undertaken for the purpose of achieving technological advancement for the purpose of creating new, or improving existing, materials, devices, products or processes, including incremental improvements thereto,	**c)** le développement expérimental, à savoir les travaux entrepris dans l'intérêt du progrès technologique en vue de la création de nouveaux matériaux, dispositifs, produits ou procédés ou de l'amélioration, même légère, de ceux qui existent.
and, in applying this definition in respect of a taxpayer, includes	Pour l'application de la présente définition à un contribuable, sont compris parmi les activités de recherche scientifique et de développement expérimental :
(d) work undertaken by or on behalf of the taxpayer with respect to engineering, design, operations research, mathematical analysis, computer programming, data collection, testing or psychological	**d)** les travaux entrepris par le contribuable ou pour son compte relativement aux travaux de génie, à la conception, à la recherche opérationnelle, à l'analyse mathématique, à la

research, where the work is commensurate with the needs, and directly in support, of work described in paragraph (a), (b), or (c) that is undertaken in Canada by or on behalf of the taxpayer,	programmation informatique, à la collecte de données, aux essais et à la recherche psychologique, lorsque ces travaux sont proportionnels aux besoins des travaux visés aux alinéas a), b) ou c) qui sont entrepris au Canada par le contribuable ou pour son compte et servent à les appuyer directement.
but does not include work with respect to	Ne constituent pas des activités de recherche scientifique et de développement expérimental les travaux relatifs aux activités suivantes :
(e) market research or sales promotion, **(f)** quality control or routine testing of materials, devices, products or processes, **(g)** research in the social sciences or the humanities, **(h)** prospecting, exploring or drilling for, or producing, minerals, petroleum or natural gas, **(i)** the commercial production of a new or improved material, device or product or the commercial use of a new or improved process, **(j)** style changes, or **(k)** routine data collection; (*activités de recherche scientifique et de développement expérimental*)	**e)** l'étude du marché et la promotion des ventes; **f)** le contrôle de la qualité ou la mise à l'essai normale des matériaux, dispositifs, produits ou procédés; **g)** la recherche dans les sciences sociales ou humaines; **h)** la prospection, l'exploration et le forage fait en vue de la découverte de minéraux, de pétrole ou de gaz naturel et leur production; **i)** la production commerciale d'un matériau, d'un dispositif ou d'un produit nouveau ou amélioré, et l'utilisation commerciale d'un procédé nouveau ou amélioré; **j)** les modifications de style; **k)** la collecte normale de données. (*scientific research and experimental development*)

[7] National submits that the judge erred in relying on the test from *Northwest Hydraulic*. It contends that the criteria in that case are mere guidance and not mandatory prerequisites for

SR&ED eligibility. National focuses on the third requirement, that the scientific method be followed, and stresses that it is not a requirement for SR&ED eligibility found in section 248. Further, it submits that the scientific method contemplated by *Northwest Hydraulic* and applied by the judge is different from the engineering method and that the judge erred in rejecting National's claim for credits on the basis that it did not follow the scientific method.

[8] This argument fails, for several reasons.

[9] First, in *Kam-Press Metal Products Ltd. v. Canada*, 2021 FCA 88, 2021 D.T.C. 5050 [*Kam-Press*], this Court considered a similar argument to the argument put forward by the appellant in the case at bar. Kam-Press argued that there was no reference to "scientific method" in the text of the ITA and that therefore the third criterion in *Northwest Hydraulic* should not have been applied by the Tax Court judge (para. 6). This Court affirmed that the *Northwest Hydraulic* criteria are the appropriate interpretation of the definition of scientific research and experimental development in subsection 248(1) of the ITA.

[10] Further, National contends that the *Northwest Hydraulic* criteria are inconsistent with the revised Canada Revenue Agency [CRA] guidance on SR&ED eligibility (Eligibility of Work for SR&ED Investment Tax Credits Policy, 24 April 2015 at s. 2.1.3 & Appendix A. 1-4, now, Guidelines on the eligibility of work for scientific research and experimental development (SR&ED) tax incentives, 13 Aug. 2021). National says that the revised guidelines rejected the *Northwest Hydraulic* criteria.

[11] I do not agree. While the new CRA guidance no longer uses the precise language of the "scientific method", the "The 'How' requirement" section of the CRA guidance still speaks to the requirement of an underlying rigour or discipline in the experimental process. In any event, while the CRA guidance is useful context in understanding the purpose and intent of a particular provision, it is not binding on the court. The Court is guided by the rules of statutory interpretation in *Canada Trustco Mortgage Co. v. Canada*, 2005 SCC 54, [2005] 2 S.C.R. 601, and by precedent. The Tax Court judge made no error in relying on the *Northwest Hydraulic* criteria.

[12] Second, National's argument proceeds on a misunderstanding of the relationship between the courts and legislation. The criteria relied on by the judge are not *ultra vires* subsection 248(1), rather they reflect the court's understanding of what Parliament intended by subsection 248(1) (*Kam-Press* at para. 6; see also Justice Robert Sharpe, *Good Judgment: Making Judicial Decisions*, "The Generality of Law" (Toronto: University of Toronto Press, 2018) at 54). Parliament and the legislatures rely on the courts to give definition, amplitude and precision to statutory language as required by the circumstances of the case. The resulting understanding of legislation as expressed in the jurisprudence is not an improper exercise of judicial legislation, rather it is precisely what courts are required to do: "Generality gives the law its objective, rational, and systematic quality. It is what distinguishes the law from the judicial decision applying it" (Sharpe at 54).

[13] Third, I do not agree that the judge adopted a restrictive approach to what constitutes the scientific method. The Tax Court has found that activities in the applied sciences constituted

SR&ED in the context of technological as opposed to pure scientific development [*i.e.* computer software, algorithms, databases] (*Allegro Wireless Canada Inc. v. The Queen*, 2021 TCC 27, [2022] 1 C.T.C. 2009; *A&D Precision Limited v. The Queen*, 2019 TCC 48, [2019] 6 C.T.C. 2009; *ACSIS EHR (Electronic Health Record) Inc. v. The Queen*, 2015 TCC 263, [2016] 2 C.T.C. 2041 [*ACSIS*]). Although the judge referenced the "scientific method", there is no indication her understanding of the requirements of subsection 248(1) was unsuitable for applied sciences.

[14] Finally, I note that this argument is premised on the assertion that there is a distinction between the scientific method and the engineering method. In support, the appellant relies on an article contained in the book of authorities. This, in my view, is an impermissible attempt to establish, through the back door, a fact that should be a matter of evidence at trial. If there is a critical distinction in the methodology used in the applied as opposed to natural sciences, then the appellant is required to establish that fact in evidence (*Public School Boards' Assn. of Alberta v. Alberta (Attorney General)*, [1999] 3 S.C.R. 845, 180 D.L.R. (4th) 670). What is written in an academic journal cannot be taken on faith. Matters of social, applied and natural sciences must be adduced through experts, and who must be made available for cross-examination, as it is through cross-examination that the credibility of the expert and the reliability of the evidence is tested (*Canada (Citizenship and Immigration) v. Ishaq*, 2015 FCA 151, [2016] 1 F.C.R. 686 at para. 21).

[15] Finally, the judge did not take a narrow or restrictive approach to what evidence might be encompassed by the scientific method. The judge noted that "what is important" is there be the

formulation of hypothesis, testing of those hypotheses and recording of results in a systematic manner (Reasons at paras. 48, 49). The judge acknowledged that she must apply the criteria "within the context of National's business environment" (Reasons at para. 28).

The burden of proof

[16] National contends that the judge did not correctly apply the burden of proof, contending that the judge erred in requiring it to establish, on the balance of probabilities, that the project met the requisite criteria. I note that this is a new argument on appeal.

[17] The judge did not err in requiring National to establish, at trial, that its activities qualified as scientific development under subsection 248(1). The appellant had the burden of proving its case, which meant that it had to disprove the assumptions pleaded by the Minister in reply (*Canada v. Loewen*, 2004 FCA 146, [2004] 4 F.C.R. 3 at paras. 8 and 12). Here, the Minister assumed that the appellant's project did not constitute SR&ED and pleaded to this effect in reply (at paras. 9-11, 15, 36, 41, 46).

The judge's understanding of the evidence

[18] The appellant contends that, without the benefit of the expert report, the judge did not appreciate or understand the evidence and was not in a position to assess whether it conformed to the requirements of subsection 248 (1). I do not agree.

[19] The judge's reasons demonstrate a careful regard to the evidence. The judge found on the evidence that the appellant did not conduct its work in a methodical manner and did not keep adequate records. To the extent that the appellant kept records, she found them "vague", "unclear", and not reflecting a logical progression between the premise of an experiment and the result. The recorded entries were conclusionary and there was no indication that any of the hypotheses advanced were modified as a result of any analysis or testing (Reasons at paras. 52-55). The *viva voce* testimony of the one witness called by National did not make up for the inadequacy of the documentary evidence (Reasons at para. 73).

[20] I do not see a palpable and overriding error in the judge's findings with respect to the evidence.

The decision to exclude expert testimony

[21] In assessing whether or not to admit the expert report and testimony of the appellant's proposed expert witness, the judge relied on the criteria from *White Burgess Langille Inman v. Abbott and Haliburton Co.,* 2015 SCC 23, [2015] 2 S.C.R. 182. With respect to the procedural requirements governing the admission of expert reports, she was guided by section 145 of the *Tax Court of Canada Rules (General Procedure)*, S.O.R./90-688a.

[22] The judge found that the report did not comply with section 145(2) of the *Tax Court Rules* nor paragraphs 3(*d*),(*e*), (*g*) and (*h*) of the Code of Conduct for Experts. The proposed report did not set out the proposed evidence in full, did not identify the source of the facts and assumptions and did not include the source material.

[23] Turning to the substance of the report, the judge assessed the report against the well-known criteria – expert opinion evidence must meet the threshold requirements of admissibility: relevance, necessity, the absence of an exclusionary rule and a properly qualified expert. If this threshold is crossed, there is a second, discretionary gatekeeping step. The trial judge must decide whether the expert evidence is sufficiently beneficial to the trial process to warrant its admission despite the potential harm to the trial process.

[24] The judge held the report did not satisfy the threshold criteria for admissibility and I see no error in that conclusion. The judge found that the expert did not satisfy the requirements of impartiality and independence. There was ample evidence to support this conclusion, including the fact that the appellant wrote 65% of the report and that in tone the report was an exercise in advocacy. The judge also determined because the expert report was an opinion on the application of the law to the facts, it failed to meet the requirement of necessity. The judge held the case law was clear that such an opinion was not the proper subject matter for opinion evidence. I agree. With the exception of foreign law, a court does not need an expert opinion on how to apply the law.

[25] The judge also determined that the report failed at the second, or gate-keeping stage, of the inquiry into whether or not to admit an expert report. This stage requires that a court balance the probative value of the evidence with any potential prejudicial effects. As the expert witness was not impartial and the report proffered an opinion on a question of law, the judge decided, on balance, not to admit the report. There are no bright lines in this exercise, and absent an error in principle, a material apprehension of evidence or an unreasonable conclusion, a decision of a

trial judge not to admit expert evidence will not be reversed on appeal (*Roher v. Canada*, 2019 FCA 313, [2020] 5 C.T.C. 148 at para. 30; *R. v. Oppong*, 2021 ONCA 352, 156 O.R. (3d) 401).

[26] The appeal is therefore dismissed with costs.

"Donald J. Rennie"
J.A.

"I agree.
Judith Woods J.A."

"I agree.
J.B. Laskin J.A."

FEDERAL COURT OF APPEAL

NAMES OF COUNSEL AND SOLICITORS OF RECORD

DOCKET:	A-231-20
STYLE OF CAUSE:	NATIONAL R&D INC. v. HER MAJESTY THE QUEEN
PLACE OF HEARING:	TORONTO, ONTARIO
DATE OF HEARING:	APRIL 6, 2022
REASONS FOR JUDGMENT BY:	RENNIE J.A.
CONCURRED IN BY:	WOODS J.A. LASKIN J.A.
DATED:	MAY 3, 2022

APPEARANCES:

Jonathan N. Garbutt Michael Harker	FOR THE APPELLANT
Angelica Buggie H. Annette Evans	FOR THE RESPONDENT

SOLICITORS OF RECORD:

Dominion Tax Law - Cambridge Office Cambridge, Ontario	FOR THE APPELLANT
A. François Daigle Deputy Attorney General of Canada	FOR THE RESPONDENT