

Reference: 2022 CCI 94

Date: 20220929

File: 2015-3974(IT)G

BETWEEN:

GESTION ACBK INC. (THE COMPANY WHICH REPLACED

HYDRO LMR INC. FOLLOWING A MERGER),

appellant,

And

HIS MAJESTY THE KING,

respondent.

Appeal heard on November 24 and 25, 2021 and May 3, 2022,  
in Montreal (Quebec)

Front: The Honorable Judge Sylvain Ouimet

**JUDGEMENT**

The appeal from the reassessment under the *Income Tax Act* relating to the appellant's taxation year ending July 31, 2012, is dismissed, with costs, for the reasons attached.

Signed at Ottawa (Canada), this 29<sup>th</sup> day of September 2022.

“Sylvain Ouimet”  
Judge Ouimet

## REASONS FOR JUDGMENT

Judge Ouimet

### I. INTRODUCTION

[1] Gestion ACBK Inc. (“ACBK Management”) is appealing a notice of reassessment issued on June 18, 2013, by the Minister of National Revenue (the “Minister”). This contribution concerns the tax year of the company Hydro LMR Inc. (“Hydro LMR”) ended July 31, 2012 (“the year in question”). In this reassessment, the Minister denied Hydro LMR the deduction of scientific research and experimental development (“SR&ED”) expenditures totalling \$115,267 in its income calculation. Hydro LMR incurred these expenditures during the installation of a hydrodynamic energy-efficient assistance system in a residential building. The Minister concluded that these expenses were not incurred for SR&ED activities and, therefore, were not deductible in calculating Hydro LMR's income for the year in question. The expenses for which Hydro LMR claimed the deduction are as follows:

<b>Salary or Wages</b>	\$4,580
<b>Materials consumed</b>	\$67,425
<b>Subcontractors</b>	\$43,262
<b>Total</b>	<b>\$115,267</b>

[2] For the same reason, the Minister also refused Hydro LMR an SR&ED investment tax credit (“ITC”) of \$37,945. The ITC was claimed for the same expenses.

[3] The following person testified for the Appellant at the hearing:

- André Roy, President and Director of Hydro LMR.

[4] The following people testified for the Respondent at the hearing:

- Philippe Desmarais, Research and Technology Advisor at the Canada Revenue Agency (“CRA”);
- Marie-Claude Giguère, Financial Examiner at the CRA at the time of the assessment.

### II. ISSUES IN DISPUTE

[5] The issues in dispute are as follows:

1. Was the Minister right to refuse Hydro LMR a deduction of \$115,267 in the calculation of its income for SR&ED expenses?

2. Was the minister right to refuse Hydro LMR SR&ED ITCs of \$37,945?

[6] In order to answer these questions, the Court will have to answer the following questions:

1. Were the expenses for which the deduction was refused by the Minister incurred for SR&ED activities within the meaning of [subsection 248\(1\)](#) of the *Income Tax Act* (“*ITA*”)?
2. Were the said expenses deductible in the calculation of Hydro LMR's income under section [37](#) of the *ITA*?

### III. RELEVANT LEGAL PROVISIONS

[7] The relevant legal provisions are as follows:

***Income Tax Act, RSC 1985, c. 1 (5th supplement)***

**37 (1)** Where a taxpayer carried on a business in Canada in a taxation year, there may be deducted in computing the taxpayer's income from the business for the year such amount as the taxpayer claims not exceeding the amount, if any, by which the total of

(a) the total of all amounts each of which is an expenditure of a current nature made by the taxpayer in the year or a preceding taxation year ending after 1973

(i) on scientific research and experimental development related to a business of the taxpayer, carried on in Canada and directly undertaken by the taxpayer,

[...]

(b) the lesser of the following amounts:

(i) the total of the amounts each of which represents a capital expenditure that the taxpayer made during the year or a previous taxation year ending after 1958 in respect of property acquired that would, but for this section, depreciable property of the taxpayer — other than land or leasehold rights therein —, for scientific research and experimental development activities carried out in Canada directly by or on behalf of the taxpayer, in relation to a taxpayer business,

(ii) the undepreciated portion of the capital cost of the property thus acquired, to the taxpayer, at the end of the year (before any deduction, provided for in this paragraph, in computing the taxpayer's income for the year);

[...]

**127 (5)** There may be deducted from the tax otherwise payable by a taxpayer under this Part for a taxation year an amount not exceeding the lesser of

- **(a)** the total of
    - **(i)** the taxpayer's investment tax credit at the end of the year in respect of property acquired before the end of the year, of the taxpayer's apprenticeship expenditure for the year or a preceding taxation year, of the taxpayer's flow-through mining expenditure for the year or a preceding taxation year, of the taxpayer's flow-through critical mineral mining expenditure for the year or a preceding taxation year, of the taxpayer's pre-production mining expenditure for the year or a preceding taxation year or of the taxpayer's SR&ED qualified expenditure pool at the end of the year or at the end of a preceding taxation year, and
- [...]

**127(9)** The following definitions apply in this section.

[...]

***SR&ED qualified expenditure pool*** of a taxpayer at the end of a taxation year means the amount determined by the formula:

$$A + B - C$$

Where:

**A** is the total of all amounts each of which is a qualified expenditure incurred by the taxpayer in the year,

**B** is the total of all amounts each of which is an amount determined under paragraph 127(13)(e) for the year in respect of the taxpayer, and in respect of which the taxpayer files with the Minister a prescribed form containing prescribed information by the day that is 12 months after the taxpayer's filing-due date for the year, and

**C** is the total of all amounts each of which is an amount determined under paragraph 127(13)(d) for the year in respect of the taxpayer; (*compte de dépenses admissibles de recherche et de développement*)

[...]

***investment tax credit*** of a taxpayer at the end of a taxation year means the amount, if any, by which the total of

- (a)** the total of all amounts each of which is the specified percentage of the capital cost to the taxpayer of qualified property or qualified resource property acquired by the taxpayer in the year,

**(a.1)** 15% of the amount by which the taxpayer's SR&ED qualified expenditure pool at the end of the year exceeds the total of all amounts each of which is the super-allowance benefit amount for the year in respect of the taxpayer in respect of a province,

**(a.2)** where the taxpayer is an individual (other than a trust), 15% of the taxpayer's flow-through mining expenditures for the year,

**(a.21)** where the taxpayer is an individual (other than a trust), 30% of the taxpayer's flow-through critical mineral mining expenditures for the year,

**(a.3)** if the taxpayer is a taxable Canadian corporation, the total of

**(i)** the specified percentage of the portion of the taxpayer's pre-production mining expenditure described in subparagraph (a)(i) of the definition *pre-production mining expenditure*, and

**(ii)** the specified percentage of the portion of the taxpayer's pre-production mining expenditure described in subparagraph (a)(ii) of the definition *pre-production mining expenditure*,

**(a.4)** the total of all amounts each of which is an apprenticeship expenditure of the taxpayer for the taxation year in respect of an eligible apprentice,

**(a.5)** [Repealed, 2017, c. 20, s. 23]

**(b)** the total of amounts required by subsection 127(7) or 127(8) to be added in computing the taxpayer's investment tax credit at the end of the year,

**(c)** the total of all amounts each of which is an amount determined under any of paragraphs (a) to (b) in respect of the taxpayer for any of the 10 taxation years immediately preceding or the 3 taxation years immediately following the year,

**(d)** [Repealed, 2006, c. 4, s. 75]

**(e)** the total of all amounts each of which is an amount required by subsection 127(10.1) to be added in computing the taxpayer's investment tax credit at the end of the year or at the end of any of the 10 taxation years immediately preceding or the 3 taxation years immediately following the year,

**(e.1)** the total of all amounts each of which is the specified percentage of that part of a repayment made by the taxpayer in the year or in any of the 10 taxation years immediately preceding or the 3 taxation years immediately following the year that can reasonably be considered to be a repayment of government assistance, non-government assistance or a contract payment that reduced

**(i)** the capital cost to the taxpayer of a property under paragraph 127(11.1) (b),

**(ii)** the amount of a qualified expenditure incurred by the taxpayer under paragraph 127(11.1) (c) for taxation years that began before 1996,

- (iii) the prescribed proxy amount of the taxpayer under paragraph 127(11.1) (f) for taxation years that began before 1996,
- (iv) a qualified expenditure incurred by the taxpayer under any of subsections 127(18) to 127(20),
- (v) the amount of a pre-production mining expenditure of the taxpayer under paragraph (11.1) (c.3), or
- (vi) the amount of eligible salary and wages payable by the taxpayer to an eligible apprentice under paragraph (11.1) (c.4), to the extent that that reduction had the effect of reducing the amount of an apprenticeship expenditure of the taxpayer, and
- (vii) [Repealed, 2017, c. 20, s. 23]

(e.2) the total of all amounts each of which is the specified percentage of 1/4 of that part of a repayment made by the taxpayer in the year or in any of the 10 taxation years immediately preceding or the 3 taxation years immediately following the year that can reasonably be considered to be a repayment of government assistance, non-government assistance or a contract payment that reduced

- (i) the amount of a qualified expenditure incurred by the taxpayer under paragraph 127(11.1) (e) for taxation years that began before 1996, or
- (ii) a qualified expenditure incurred by the taxpayer under any of subsections 127(18) to 127(20),

in respect of first-term shared-use-equipment or second-term shared-use-equipment, and, for that purpose, a repayment made by the taxpayer in any taxation year preceding the first taxation year that ends coincidentally with the first period or the second period in respect of first-term shared-use-equipment or second term shared-use-equipment, respectively, is deemed to have been incurred by the taxpayer in that first taxation year,

exceeds the total of

- (f) the total of all amounts each of which is an amount deducted under subsection 127(5) from the tax otherwise payable under this Part by the taxpayer for a preceding taxation year in respect of property acquired, or an expenditure incurred, in the year or in any of the 10 taxation years immediately preceding or the 2 taxation years immediately following the year, or in respect of the taxpayer's SR&ED qualified expenditure pool at the end of such a year,
- (g) the total of all amounts each of which is an amount required by subsection 127(6) to be deducted in computing the taxpayer's investment tax credit
  - (i) at the end of the year, or
  - (ii) [Repealed, 1996, c. 21, s. 30]

(iii) at the end of any of the 9 taxation years immediately preceding or the 3 taxation years immediately following the year,

(h) the total of all amounts each of which is an amount required by subsection 127(7) to be deducted in computing the taxpayer's investment tax credit

(i) at the end of the year, or

(ii) [Repealed, 1996, c. 21, s. 30]

(iii) at the end of any of the 10 taxation years immediately preceding or the 3 taxation years immediately following the year,

(i) the total of all amounts each of which is an amount claimed under subparagraph 192(2)(a)(ii) by the taxpayer for the year or a preceding taxation year in respect of property acquired, or an expenditure made, in the year or the 10 taxation years immediately preceding the year,

(j) if the taxpayer is subject to a loss restriction event at any time before the end of the year, the amount determined under subsection (9.1) in respect of the taxpayer, and

(k) if the taxpayer is subject to a loss restriction event at any time after the end of the year, the amount determined under subsection (9.2) in respect of the taxpayer,

except that no amount shall be included in the total determined under any of paragraphs (a) to (e.2) in respect of an outlay, expense or expenditure that would, if this Act were read without reference to subsections 127(26) and 78(4), be made or incurred by the taxpayer in the course of earning income in a particular taxation year, and no amount shall be added under paragraph (b) in computing the taxpayer's investment tax credit at the end of a particular taxation year in respect of an outlay, expense or expenditure made or incurred by a trust or a partnership in the course of earning income, if

- (l) any of the income is exempt income or is exempt from tax under this Part,
- (m) the taxpayer does not file with the Minister a prescribed form containing prescribed information in respect of the amount on or before the day that is one year after the taxpayer's filing-due date for the particular year; (*crédit d'impôt à l'investissement*)

**qualified expenditure** incurred by a taxpayer in a taxation year means:

- (a) an amount that is an expenditure incurred in the year by the taxpayer in respect of scientific research and experimental development and is
  - (i) an expenditure described in subparagraph 37(1)(a)(i), or
  - (ii) 80% of an expenditure described in any of subparagraphs 37(1)(a) (i.01) to (iii), or
  - (iii) and (iv) [Repealed, 2012, c. 31, s. 27]
- (b) a prescribed proxy amount of the taxpayer for the year,

[...]

**248(1)** The following definitions apply in this Act.

[...]

***scientific research and experimental development*** means systematic investigation or search that is carried out in a field of science or technology by means of experiment or analysis and that is:

- (a) basic research, namely, work undertaken for the advancement of scientific knowledge without a specific practical application in view,
- (b) applied research, namely, work undertaken for the advancement of scientific knowledge with a specific practical application in view, or
- (c) experimental development, namely, work undertaken for the purpose of achieving technological advancement for the purpose of creating new, or improving existing, materials, devices, products or processes, including incremental improvements thereto,

and, in applying this definition in respect of a taxpayer, includes:

- (d) work undertaken by or on behalf of the taxpayer with respect to engineering, design, operations research, mathematical analysis, computer programming, data collection, testing or psychological research, where the work is commensurate with the needs, and directly in support, of work described in paragraph (a), (b), or (c) that is undertaken in Canada by or on behalf of the taxpayer,

but does not include work with respect to

- (e) market research or sales promotion,
- (f) quality control or routine testing of materials, devices, products or processes,
- (g) research in the social sciences or the humanities,
- (h) prospecting, exploring or drilling for, or producing, minerals, petroleum or natural gas,
- (i) the commercial production of a new or improved material, device or product or the commercial use of a new or improved process,
- (j) style changes, or
- (k) routine data collection; (*activités de recherche scientifique et de développement expérimental*)

**Income Tax Regulations, CRC, c. 945**

**2900 (4)** For the purposes of the definition ***qualified expenditure*** in subsection 127(9) of the Act, the prescribed proxy amount of a taxpayer for a taxation year, in respect of a business, in respect of which the taxpayer elects under clause 37(8)(a)(ii)(B) of the Act is



55% of the total of all amounts each of which is that portion of the amount incurred in the year by the taxpayer in respect of salary or wages of an employee of the taxpayer who is directly engaged in scientific research and experimental development carried on in Canada that can reasonably be considered to relate to the scientific research and experimental development having regard to the time spent by the employee on the scientific research and experimental development.

#### IV. FACTS

[8] André Roy (“Mr. Roy”) was the president and sole director of Hydro LMR during the period in question. He is an electromechanic by training and specializes in automation<sup>[1]</sup>. During this period, Mr. Roy's work mainly consisted of designing, installing, and programming automated systems in the agri-food industry.

[9] On an unspecified date before the year in question, Dominic Laperle (“Mr. Laperle”) had installed a system named “hydrodynamic system for the energy-efficient assistance of a building, construction processes and corresponding uses” in a residence in Saint-Césaire, in the province of Quebec. Mr. Laperle obtained a patent for this system. According to Mr. Roy's testimony, Mr. Laperle's system makes it possible to reduce the effect of a building on the environment by making it energy-autonomous.

[10] After the completion of the construction of the residence and the installation of the hydrodynamic system, Marc Brunet (“Mr. Brunet”), from the Quebec Industrial Research Center (“CRIQ”), contacted Mr. Roy to ask him if he was able to improve Mr. Laperle's system. Mr. Brunet asked him to accompany him on a visit to the residence in Saint-Césaire. Following the visit, Mr. Roy became interested in Mr. Laperle, and he decided, through Hydro LMR, to buy land in Saint-Alphonse de Granby, in the province of Quebec, in order to build a triplex and install an improved version of Mr. Laperle's system.

[11] To this end, Hydro LMR created a project called “Study and analysis of a thermal storage system”, for which it claimed the deduction of expenses for SR&ED activities and an ITC for the year in question<sup>[4]</sup>. Hydro LMR has chosen the proxy method for calculating SR&ED expenditures<sup>[5]</sup>.

[12] The expenses for which the Minister refused to deduct were incurred by Hydro LMR during the construction and installation of an improved version of Mr. Laperle's system at the triplex.

#### V. DISCUSSION

##### A. Preliminary question

[13] On October 1, 2017, Hydro LMR merged with three other companies under the *Business Corporations Act*<sup>[6]</sup> (“BCSA”). At the end of this merger, Gestion ACBK was incorporated, and Hydro LMR was automatically deregistered on October 1, 2017. The respondent submits that pursuant to subsection 286(2) of the *LSA*, Gestion ACBK retains the rights to Hydro LMR and

that, therefore, it can be a party to legal proceedings to which Hydro LMR was a party<sup>[7]</sup>. Article 286 of the *LSA* is worded as follows:

The merger certificate, issued by the company registrar in accordance with the provisions of Chapter XVIII, certifies the merger of the companies on the date and, where applicable, at the time appearing on this certificate.

From that moment on, the merging companies continue their existence in the company resulting from the merger and their assets then form only one, which is that of the company resulting from the merger. The rights and obligations of the merging companies become those of the company resulting from the merger and the latter becomes a party to any judicial or administrative procedure to which the merging companies were parties.

[Emphasis added.]

[14] Consequently, the Respondent submits that the title should be amended in order to replace Hydro MRL with "Gestion ACBK Inc. (the company that replaced Hydro LMR Inc. as a result of a merger)". The Respondent argues that the Court should follow the approach taken in *Imperial Tobacco Canada Limited v. The Queen*<sup>[8]</sup> and *Canwest Mediaworks Inc. v. The Queen*<sup>[9]</sup>. In these decisions, such a heading was used in similar circumstances. The appellant does not object to the amendment of the title proposed by the respondent<sup>[10]</sup>.

[15] Having regard to the observations of the parties, the Court accepts the respondent's request. The initial title will therefore be replaced by the following: *Gestion ACBK Inc. (the company that replaced Hydro LMR Inc. as a result of a merger) v. His Majesty the King*.

#### B. Total amount of SR&ED expenditures under dispute

[16] During the hearing, Mr. Roy acknowledged that certain expenses incurred by Hydro LMR during the construction and installation of the system did not qualify as eligible SR&ED (Scientific Research and Experimental Development) expenses. Specifically, Mr. Roy chose not to dispute the rejection of deductions totalling \$667 and \$59, which were initially claimed for materials consumed<sup>[11]</sup>. Furthermore, Mr. Roy also decided not to contest the disallowance of an \$8,490 deduction related to the purchase of Mr. Laperle's intellectual property<sup>[12]</sup>. Consequently, the appellant has declared a total of \$106,051 as SR&ED expenses. These expenses are as follows:

<b>Wages</b>	\$4,580
<b>Materials consumed</b>	\$66,699
<b>Entrepreneurs</b>	\$34,772
<b>Total</b>	<b>\$106,051</b>

C. Was the Minister right to refuse Hydro LMR a deduction of \$106,051 in the calculation of its income for SR&ED expenses?

[17] In order for expenses to be deductible from a company's income as expenses for an SR&ED activity, the following two conditions must be met:

- the taxpayer must demonstrate that the expenses were incurred for SR&ED activities within the meaning of subsection 248(1) of the ITA;
- the taxpayer must demonstrate that the expenses are deductible under article 37 of the ITA.

(1) Is it reasonable that the Minister has determined that the expenses of \$106,051 were not incurred for SR&ED activities within the meaning of subsection 248(1) of the ITA?

[18] The term "scientific research and experimental development activities" is defined in subsection 248(1) of the ITA. According to this definition, an SR&ED activity is a systematic scientific or technological investigation or research carried out by way of experimentation or analysis. It must be pure research, applied research or experimental development. The relevant part of subsection 248(1) reads as follows:

***scientific research and experimental development*** means systematic investigation or search that is carried out in a field of science or technology by means of experiment or analysis and that is:

- (a) basic research, namely, work undertaken for the advancement of scientific knowledge without a specific practical application in view,
- (b) applied research, namely, work undertaken for the advancement of scientific knowledge with a specific practical application in view, or
- (c) experimental development, namely, work undertaken for the purpose of achieving technological advancement for the purpose of creating new, or improving existing, materials, devices, products or processes, including incremental improvements thereto,

[...]

[19] For the purposes of this definition, SR&ED activities include work undertaken by or on behalf of the taxpayer with respect to engineering, design, operations research, mathematical analysis, computer programming, data collection, testing or psychological research, where the work is commensurate with the needs of the work described in paragraph 248(1)(a), (b) or (c) of the ITA that is undertaken in *Canada* by or on behalf of the taxpayer.

[20] Work relating to certain activities does not constitute SR&ED activities for the purposes of this definition. These activities are as follows:

- (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*)

[21] In this case, the Court must determine whether the activities carried out by Hydro LMR constitute SR&ED activities. More specifically, the Court must determine whether Hydro LMR has carried out "experimental development" within the meaning of paragraph (c) of subsection 248(1) of the ITA. Therefore, the Court must determine whether the work undertaken by Hydro LMR to design and install an improved version of Mr. Laperle's system at the triplex constitutes "experimental development" within the meaning of this paragraph.

[22] In *Northwest Hydraulic Consultants Ltd. v. The Queen*<sup>[15]</sup>, the Court set out the criteria that must be used to determine whether a taxpayer has done "experimental development" within the meaning of the ITA. These criteria, taken up and confirmed by the Federal Court of Appeal in *C.W. Agencies Inc. c. The Queen*<sup>[16]</sup>, are 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?<sup>[17]</sup>

[23] These five criteria must all be fulfilled for the Court to conclude that the activities carried out by the taxpayer constitute "experimental development"<sup>[18]</sup>.

[24] In the *Northwest Hydraulic* decision, this Court explained the meaning of the expression "technological uncertainty" when applying the relevant provisions of the *ITA* as follows:

- (a) Implicit in the term "technical risk or uncertainty" in this context is the requirement that it be a type of uncertainty that cannot be removed by routine engineering or standard procedures. I am not talking about the fact that whenever a problem is identified there may be some doubt concerning the way in which it will be solved. If the resolution of the problem is reasonably predictable using standard procedure or routine engineering, there is no technological uncertainty as used in this context.

(b) What is "routine engineering"? It is this question, (as well as that relating to technological advancement) that appears to have divided the experts more than any other. Briefly, it describes techniques, procedures and data that are generally accessible to competent professionals in the field <sup>[19]</sup>.

[Emphasis Added.]

[25] Therefore, in order to demonstrate that Hydro LMR's expenses relate to SR&ED activities within the meaning of the ITA, the appellant must demonstrate, on the preponderance of the evidence, that there was a technological risk or uncertainty that could not be eliminated by current techniques or usual procedures<sup>[20]</sup>.

[26] In this particular case, Mr. Roy took the necessary steps to install an upgraded version of Mr. Laperle's hydrodynamic system in the triplex. Initially, he acquired Mr. Laperle's patent for the system. Additionally, he utilized Mr. Laperle's handwritten notes as a reference to design and implement the second prototype of the hydrodynamic system at the triplex. Prior to commencing the construction of the triplex, Mr. Roy met with Daniel Rousse (referred to as "Mr. Rousse"), a researcher holding the Industrial Research Chair in energy and efficiency at the École de technologie supérieure ("ÉTS"). This meeting aimed to conduct a digital simulation of the system. Following the meeting, Mr. Roy received the simulation results report from ÉTS. Subsequently, he made the decision to construct a full-scale prototype of his system, which was then integrated into the triplex.

[27] The system designed by Mr. Roy included, among other things, solar panels installed on the roof of the building, concrete water tanks filled with gravel buried under the concrete floor of the building's basement, a heat pump, a radiant floor system, a control panel (computer) and probes to measure the water temperature in the tanks.

[28] Mr. Roy reported that when creating his full-scale prototype, he relied on Mr. Laperle's notes and patent as reference materials. However, during this process, he identified a significant design issue in Mr. Laperle's system. According to Mr. Roy, the water temperature within the tanks was insufficient, reaching extremely cold temperatures that caused freezing. This, in turn, hindered the proper operation of the water pump responsible for conveying water to the solar panels installed on the building's roof. Mr. Roy attributed the problem to several factors, including the tank size, the absence of a temperature measurement probe, and issues with the control panel programming.

[29] Mr. Roy testified that when designing his system, he faced two technological uncertainties, specifically related to the size of the water tanks and the temperature of the water within them<sup>[21]</sup>. To resolve these problems, Mr. Roy utilized the data contained in the ÉTS report as a basis for making modifications. He modified the size of the basins and installed probes to measure the temperature as well as additional valves. This involved altering the size of the basins originally used by Mr. Laperle, with the smaller basin placed inside the larger one. Additionally, he installed a third basin (a conventional water heater) outside the building and connected it to the system. Finally, he also proceeded to install and program the control panel which controls the water pump. According to Mr. Roy, these uncertainties could not be eliminated using usual procedures or current techniques.

[30] The evidence shows that Mr. Roy used common techniques to try to resolve the two technological uncertainties he faced. During his testimony, Mr. Roy did not describe precisely the techniques that he used in order to try to overcome these uncertainties, neither during the design nor the construction of his system. The evidence does not demonstrate that the modification of the sizes of the basins, the installation of probes to measure the temperature, the installation of valves and the design and installation of the control panel required the use of practices that were not commonly used at the time.

[31] Furthermore, according to the testimony of Mr. Desmarais, Mr. Roy used known thermodynamic principles to measure energy exchanges in a system. Mr. Desmarais also testified that it was possible to measure the thermal exchanges between the basins and to model the envisaged system using mathematical equations and concepts known at the time in order to estimate the appropriate dimensions of the basins. A scale model could also have been used to test it.

[32] Finally, Mr. Desmarais also indicated that Mr. Laperle's patent made reference to other previous patents relating to thermal storage, which allowed him to conclude that there were systems similar to that designed by Hydro LMR since the 1980s.

[33] As we mentioned previously, in this case, the Court must determine whether the work undertaken by Hydro LMR to design and install the second improved prototype of Mr. Laperle's hydrodynamic system at the triplex constitutes “experimental development” within the meaning of subsection 248(1) of the *ITA*. The appellant has not demonstrated that the technological uncertainties faced by Hydro LMR during the design and installation of its hydrodynamic system could not be eliminated by current techniques or routine procedures. The Court concludes that Mr. Roy used common techniques to try to resolve the two uncertainties he faced.

[34] Consequently, the Court concluded that the activities of Hydro LMR during the design and installation of the hydrodynamic system at the triplex do not constitute SR&ED activities within the meaning of the *ITA*.

(2) Are the expenses deductible under section 37 of the *ITA*?

[35] Under paragraph 37(1)(a) of the *ITA*, a taxpayer who carries on a business in Canada and who has engaged in SR&ED activities within the meaning of subsection 248(1) of the *ITA* may deduct certain expenses in calculating the income of this business.

[36] The expenses that can be deducted result from an election to be made by the taxpayer for each of his tax years. For each of them, the taxpayer can choose between the “traditional method” and the “proxy method”. In this case, Hydro LMR elected to use the “proxy method” for the year in question, pursuant to division 37(8)(a)(ii)(B) of the *ITA*. Under this provision, the following expenses are expenses relating to SR&ED activities:

**(B)** where a taxpayer has elected in the prescribed form and in accordance with subsection 37(10) for a taxation year, expenditures incurred by the taxpayer in the year each of which is

**(I)** [Repealed, 2012, c. 31, s. 9]

**(II)** an expenditure of a current nature for the prosecution of scientific research and experimental development in Canada directly undertaken on behalf of the taxpayer,

**(III)** [Repealed, 2012, c. 31, s. 9]

**(IV)** that portion of an expenditure made in respect of an expense incurred in the year for salary or wages of an employee who is directly engaged in scientific research and experimental development in Canada that can reasonably be considered to relate to such work having regard to the time spent by the employee thereon, and, for this purpose, where that portion is all or substantially all of the expenditure, that portion shall be deemed to be the amount of the expenditure, or

**(V)** the cost of materials consumed or transformed in the prosecution of scientific research and experimental development in Canada, or

**(VI)** [Repealed, 2012, c. 31, s. 9]

[37] As the Court determined that the activities associated with the design and installation of the hydrodynamic system at the triplex did not qualify as SR&ED activities, the initial requirement for Hydro LMR's expenses to be deductible in income calculations remains unmet. Consequently, there is no need for the Court to address the matter of expense deduction under section 37 of the ITA (Income Tax Act). These expenses were not incurred by Hydro LMR for SR&ED activities, and therefore, they do not qualify as eligible SR&ED expenses.

D. Was the Minister right to refuse Hydro LMR an ITC of \$37,945?

[38] In addition to being deductible in calculating a taxpayer's income, certain SR&ED expenses incurred by the taxpayer also entitle the taxpayer to an ITC calculated in accordance with subsection 127(5) of the ITA. To apply this subsection, it is first necessary to determine the taxpayer's ITC is in accordance with subsection 127(9) of the ITA. The amount of the ITC depends on the "eligible research and development expenses account", which includes any "eligible expenses" incurred by the taxpayer during the year.

[39] Eligible expenditures, as defined in subsection 127(9) of the ITA, include expenditures related to SR&ED activities that are assigned to first-period or second-period multi-purpose equipment, current expenses referred to in paragraph 37(1)(a) of the ITA, and capital expenditures referred to in subparagraph 37(1)(b)(i) of the ITA. In addition, when the taxpayer chooses the "proxy method", as was the case here, the eligible expenses also include a prescribed replacement amount. The replacement amount is provided for in subsection 2900(4) of the Income Tax Regulations. During the period in question, this amount was equivalent to 65% of the amounts incurred by the taxpayer during the year for the salary or wages of his employee who is directly involved in SR&ED activities carried out in Canada and which can reasonably be considered to relate to these

activities.<sup>[40]</sup> Consequently, when the Court concludes that a taxpayer's expenses were not incurred for an SR&ED activity, the taxpayer is not entitled to an ITC for these expenses. Since the Court concluded that the expenses for which Hydro LMR claimed the deduction were not incurred for such activities, it is not entitled to an ITC of \$37,945.

[40] Consequently, when the Court determines that a taxpayer's expenses were not expended on SR&ED activities, the taxpayer is not eligible for an Investment Tax Credit (ITC) for those expenses. In light of the Court's ruling that the expenses claimed by Hydro LMR were not associated with such activities, the company is not eligible for an ITC amounting to \$37,945.

## VI. CONCLUSION

[41] Since the Court concluded that, on the preponderance of the evidence, the expenses of \$115,267 were not incurred for SR&ED activities within the meaning of subsection 248(1) of the ITA, *it is correct* that the Minister refused the deduction of these expenses in the calculation of the appellant's income. Consequently, and for the same reason, the Minister was right to refuse Hydro LMR SR&ED ITCs of \$37,945.

[42] For these reasons, the appeal is dismissed with costs.

Signed at Ottawa (Canada), this 29th<sup>day</sup> of September 2022.

“Sylvain Ouimet”  
Judge Ouimet

REFERENCE:	2022 CCI 94
COURT FILE NO.:	2015-3974(IT)G
TITLE OF THE CAUSE:	GESTION ACBK INC. (COMPANY WHICH REPLACED HYDRO LMR INC. FOLLOWING A MERGER) AND HIS MAJESTY THE KING
LOCATION OF THE HEARING:	Montreal, Quebec)
HEARING DATES:	November 24 and 25, 2021 and May 3, 2022
REASONS FOR JUDGMENT BY:	The Honorable Justice Sylvain Ouimet
DATE OF JUDGMENT:	September 29, 2022
APPEARANCES:	



For the appellant: André Roy  
Counsel for the respondent: M<sup>e</sup> Christina Ham

LAWYERS ON FILE:

For the appellant:

Name:

Office:

For the respondent: Francois Daigle  
Deputy Attorney General of Canada  
Ottawa (Canada)

- 
- [1] Transcript of the hearing of November 24, 2021, at p. 57 and 59.
- [2] Ibid., at p. 59.
- [3] Ibid., to the P. 55, Exhibit A-2, and Respondent's collection, Exhibit I-1, at tab 3.
- [4] Response to the Notice of Appeal, paragraph 8(b).
- [5] Ibid., in paragraph 8(d).
- [6] Business Corporations Act, CQLR Ch. S-31.1(LSA).
- [7] See *Ville de Sainte-Marthe-sur-le-Lac c. Experts-conseils RB inc.*, 2017 QCCA 381, at paras 32 and 33.
- [8] *Imperial Tobacco Canada Limited v. The Queen*, 2007 CCI 636.
- [9] *Canwest Mediaworks Inc. vs. The Queen*, 2006 CCI 579.
- [10] Transcript of November 24, 2022, supra (note 1), at p. 9.
- [11] Ibid. to the P. 26.
- [12] Transcript of the hearing of May 3, 2022, at p. 83 to 87.
- [13] Subsection 248(1) of the ITA, definition of “scientific research and experimental development activities”, paragraph (d).
- [14] Subsection 248(1), “scientific research and experimental development activities”, paragraphs (e) to (k).
- [15] *Northwest Hydraulic Consultants Ltd. vs. The Queen*, [1998] ACI No.340(QL), at para 16 (Northwest Hydraulic).
- [16] *CW Agencies Inc. vs. The Queen*, 2001 FCA 393, at para 17 (CW Agencies Inc.). See also the decision of the Federal Court of Appeal *RIS-Christie Ltd. vs. Canada*, 1998 CanLII 8876, [1999] 2 FC F 30 (RIS-Christie).
- [17] *CW Agencies Inc.*, supra (note 16), at para 17.
- [18] *Béton Mobile du Québec Inc. vs. The Queen*, 2019 CCI 278, at para 39.

[19] Northwest Hydraulic, *supra* (note 15), at para 16.

[20] Tacto Neuro Sensory Devices Inc. / Tacto neurosensory devices inc. vs. The Queen, 2004 CCI 341, at para 11.

[21] Transcript dated November 25, 2021, at p. 162 and 163.

[22] Division 37(8)(a)(ii)(B) of the ITA (as applicable).

Unofficial Translation - Not to be used for legal purposes