

Dockets: 2018-677(IT)G
2019-3835(IT)G
2020-1571(IT)G
2020-1574(IT)G

BETWEEN:

CANAFRIC INC.,

Appellant,

and

HIS MAJESTY THE KING,

Respondent.

Appeal heard on September 20, 21, 22, 2022 and December 13, 2022, at
Hamilton, Ontario

Before: The Honourable Eugene P. Rossiter, Chief Justice

Appearances:

Counsel for the Appellant: John P. McLaughlin
Counsel for the Respondent: Devon Peavoy

JUDGMENT

The appeal made under the *Income Tax Act*, R.S.C., 1985, c. 1, for the 2013, 2014, 2015 and 2016 taxation years is allowed. The parties have 60 days from the date of this Order to serve and file their written submissions on costs.

Signed at Ottawa, Canada, this 26th day of July 2023.

“E.P. Rossiter”

Rossiter C.J.

Citation: TCC 2023 108
Date: July 26, 2023
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2019-3835(IT)G
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CANAFRIC INC.,

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Respondent.

REASONS FOR JUDGMENT

Rossiter C.J.

I. OVERVIEW

[1] This is an appeal by Canafric Inc. (“Canafric”) of the Minister of National Revenue’s (“Minister”) Notices of Reassessment disallowing Scientific Research and Experimental Development (“SR&ED”) expenditures and the corresponding Investment Tax Credits (“ITCs”) for the 2013, 2014, 2015 and 2016 taxation years (the “Taxation Years”) under the *Income Tax Act*, R.S.C., 1985, c. 1 (5th Supp.) (the “ITA”).

[2] Canafric operates a food manufacturing business specialized in developing frozen pies mainly for the Canadian and the United States markets. During the Taxation Years, Canafric carried on various projects and activities aimed at developing new or advancing pre-existing products.

[3] For the 2013 taxation year, Canafric claimed SR&ED expenditures and ITCs in respect of the following five projects (the “2013 SR&ED Claim”):

- i.1302: Mortimer’s brand Saffron Garden
- ii.1303: Loblaw’s PC Scotch beef pie

- iii.1304: Metro Irresistible Asian Style dinners
- iv.1306: Costco deli chicken pie fill
- v.1307: Costco crustless quiche

[4] Projects 1304 and 1306 were selected for a joint technical and financial review by the Minister. By Notice of Reassessment dated May 13, 2016, the Minister disallowed SR&ED expenditures in the aggregate amount of \$90,682 and corresponding ITCs in the aggregate amount of \$22,183 in relation to these two projects.

[5] For the 2014 taxation year, Canafvic claimed SR&ED expenditures and ITCs in respect of the following three projects (the “2014 SR&ED Claim”):

- i.1306: Costco deli chicken pie fill
- ii.1401: Costco and Metro Irresistible Shepard’s Pies
- iii.1402: Loblaw’s Free from Chicken & Beef Pot Pies

[6] By Notice of Reassessment dated July 28, 2017, the Minister disallowed the entirety of the claimed SR&ED expenditures and corresponding ITCs in relation to Project 1306, Project 1401 and Project 1402.

[7] For the 2015 taxation year, Canafvic claimed SR&ED expenditures and ITCs in respect of the following seven projects (the “2015 SR&ED Claim”):

- i.1303: Loblaw’s PC Scotch beef pie
- ii.1307: Costco crustless quiche.
- iii.1401: Costco and Metro Irresistible Shepard’s Pies
- iv.1501: Mortimer’s Hand Held Pies “On the Go”
- v.1502: Mortimer’s Halal Kitchen Frozen Entrée
- vi.1503: National Foods Frozen Dinner Entrée
- vii.1504: Swiss Chalet & Cara Foods Frozen Entrée

[8] By Notice of Reassessment dated August 9, 2019, the Minister disallowed SR&ED expenditures totalling \$97,895 and the corresponding ITCs totalling \$15,476 in relation to projects 1401, 1501 and 1502.

[9] For the 2016 taxation year, Canafvic claimed SR&ED expenditures and ITCs in respect of the following six projects (the “2016 SR&ED Claim”):

- i.1501: Mortimer's Hand Held Pies "On the Go"
- ii.1502: Mortimer's Halal Kitchen Frozen Entrée
- iii.1503: National Foods Frozen Dinner Entrée
- iv.1504: Swiss Chalet & Cara Foods Frozen Entrée
- v.1601: Alimentation Couche-tard Chilled Pies
- vi.1602: Longo's Savoury Pies

[10] By Notice of Reassessment dated August 9, 2019 The Minister disallowed SR&ED expenditures totalling \$154,872 and the corresponding ITCs totalling \$23,304 in relation to projects 1501, 1502 and 1602.

II. ISSUE

[11] The issue in these appeals is whether the work Canafriac had undertaken with respect to projects 1304, 1306, 1401, 1402, 1501, 1502 and 1602 constitutes SR&ED within the meaning of subsection 248(1) of the *Act*.

III. FACTS

[12] George Papadopoulos, Azza Hassanein and David Zhou, three Canada Revenue Agency ("CRA") employees involved at various degrees in the reviews of the projects, testified for the Respondent. Suvrut Pandya, the Chief Executive Officer of Canafriac, testified for the Appellant.

(1) Suvrut Pandya

[13] I found Mr. Pandya's testimony to be credible and reliable. He was involved at every stage of the review process for all the Taxation Years and he spoke to the specific technical challenges encountered in every project. He had a good recollection of the various meetings with CRA representatives during the review process as well as the specifics of the technical discussions which took place during those meetings.

[14] Mr. Pandya described Canafriac's business as developing new or different products, mainly frozen pies, in accordance with customer demand, evolving taste profile of consumers and regulations regarding fat, salt and sugar contents of products. At all relevant times, his role was to oversee the development work without conducting it himself.

[15] He summarized the product development process for all projects as follows:

- i. A customer requests a product with specific targets in terms of content, shelf life, taste acceptability, texture et cetera;
- ii. Canafric develops and elaborates a recipe that addresses customer targets;
- iii. The product is tested to ensure it meets the client's requirements.

[16] Mr. Pandya explained that plant trials and product development are two distinct stages of the process. While, development work mainly consists of developing, elaborating and testing a recipe that meet the client's requirements, plant trials are conducted to verify that the same success is achievable on a larger scale. Canafric would only proceed with plant trials once the product meets all customer requirements.

[17] In developing new products, Canafric had to balance "health" and "taste" requirements. Higher salt and fat contents generally lead to better tasting but unhealthier products. Throughout the Taxation Years and for every project, Canafric sought to reduce salt and fat contents in its products, while maintaining good taste. According to Mr. Pandya, even if the ultimate goal was the same, the nature of this challenge varied from one product to the other because different ingredients do not interact the same way with fat and salt. This was a major source of disagreement with David Zhou, the CRA's research and technology advisor.

2013 Taxation Year

[18] For the 2013 taxation year, the CRA reviewed projects 1304 and 1306.

(1) Project 1306

[19] Project 1306 was a pie filling developed for Costco, which was meant to follow a specific cooking process. Canafric would boil the filling to 165 degrees Fahrenheit to eliminate all bacteria. Canafric would then freeze the filling and pack it in 10 pound bags which were sent to Costco. Costco would make its own pies using the filling and bake it in the oven before displaying it in its refrigerator.

[20] In addition to the usual fat and salt reduction requirements, Costco wanted a pie filling that could achieve a 10-day shelf life including transportation time without using artificial or chemical preservatives. The challenges were to maintain product integrity and taste after three bakes, one freeze and two filling phases, achieve the targeted shelf life without artificial preservatives and increase protein levels in the filling by 35%.

[21] Canaftric was unable to achieve a 10-day shelf life. Mr. Pandya testified that product samples were sent to an external laboratory for testing. The results established the product became unsafe for human consumption after six days. No plant trials took place for project 1306.

(2) Project 1304

[22] Mr. Pandya testified that “Metro Irresistibles Asian Style dinner” was not a new product. The customer simply wanted improvements to an existing product.

[23] Mr. Pandya described the main challenges as reducing salt and fat contents while preserving the taste profile of the items, maintaining the freeze / thaw credibility as well as maintaining shelf life without using artificial preservatives. According to Mr. Pandya, these improvements made the product “as good as new”.

(3) On-site meetings

[24] An on-site meeting took place on September 14, 2015, at Canaftric’s facility regarding the 2013 SR&ED Claim with CRA representatives David Zhou, George Papadopoulos and Azza Hassanein. Canaftric’s representatives informed David Zhou that the alleged 2013 SR&ED activities did not take place in the facility they visited, but rather at the Burlington plant. Nevertheless, David Zhou insisted on touring the new facility.

[25] Mr. Pandya testified that all the challenges relating to projects 1304 and 1306 were described to David Zhou during the meeting. David Zhou told Canaftric’s representatives, including Mr. Pandya, that reducing fat and salt contents was not a technical challenge since salt and fat reduction techniques are transferrable from one product to another.

[26] During the meeting, Azza Hassanein, the Research and Technology Manager, decided to allow projects 1302, 1303 and 1307 and to postpone the decision for projects 1304 and 1306.

[27] Mr. Pandya stated that Canaftric maintained documents supporting the various amounts claimed for the 2013 Taxation Year, including T4 slips, payroll records and timesheets as well as letters and invoices. Canaftric provided these documents to George Papadopoulos and David Zhou during the meeting and mailed them to Mr. Papadopoulos on October 29, 2015.

[28] At the objection stage, Canafriac sent a letter to Susan Shaw of CRA Appeals which was attached to a 120-page document describing the product development work for projects 1304 and 1306. This document described the various targets and requirements for these two projects as well as the work undertaken by Canafriac in order to accomplish these goals.

2014 Taxation Year

[29] For the 2014 taxation year, the CRA reviewed projects 1306, 1401 and 1402.

[30] Mr. Pandya explained that Project 1306 ran into the 2014 taxation year because of the potentially lucrative contract it could have led to if Canafriac could overcome the challenges.

(1) Project 1401

[31] In project 1401, the main challenges were to replace potato flakes with “real potatoes”, use leaner beef (from 75% muscle and 25% fat to 85% muscle and 15% fat) as well as the usual fat and salt reduction. Project 1401 was successful.

(2) Project 1402

[32] Regarding project 1402, he described the main challenges as using “free from antibiotics” animals and reducing cooking time by 20 to 50%. Mr. Pandya explained that the elimination of antibiotics created challenges with the “quality of the protein”. Since each animal has different immunity levels, chickens and whole cattle beef differed in quality and in texture. As for the cooking time, it led to microbiology concerns since it was not sufficient to reach the usual 165 degrees Fahrenheit, which ensures elimination of bacteria.

2015 and 2016 Taxation Years

[33] The Minister conducted a joint review for the 2015 and 2016 SR&ED Claims.

(1) Project 1501

[34] Project 1501 aimed to develop twelve pocket-sized frozen pies that could be safely consumed after being heated in a microwave or an oven.

[35] The main challenges were to conceive a thicker filling, use a flaky pie crust that is compatible with all the fillings, reduce fat and salt contents and achieve a 21-day shelf life without any artificial preservatives.

[36] Mr. Pandya also outlined the challenges relating to the packaging of the product. He explained that CanafriC had to use paper coated with chemicals to ensure the product could be microwaved in a minute. The lamination inside the paper allowed the microwave heat to be transferred 100 times faster than it would have been with normal paper.

[37] Mr. Pandya explained that project 1501 was not successful because the product was not firm enough to be hand-held. This was mainly due to the filling leaking moisture into the pastry. CanafriC was also unable to achieve the required shelf life.

(2) Project 1502

[38] Project 1502 involved the development of a series of halal products. In cross-examination, Mr. Pandya admitted that this was not their first experience with halal products since Project 1501 also involved some halal products. Mr. Pandya explained that the halal requirement created challenges regarding the raw materials which had to be halal-based and the shortenings which could not be animal based.

(3) Project 1602

[39] Project 1602 aimed to develop nine meat and vegetable pies for Longo's. The customer specified the pastry should not contain lard. At least 10% of the shortening had to be made of real butter. The customer also wanted the pies to come in two sizes, which meant CanafriC had to elaborate a different heating process for each pie. Salt and fat content reduction was not a requirement for this project.

[40] Mr. Pandya testified that David Zhou rejected the claim regarding project 1602 saying, "a pie is a pie what is the big deal about it".

On-Site Meeting

[41] The challenges were described to David Zhou during a March 8, 2018, on-site meeting that took place regarding the 2015-2016 SR&ED claims. Mr. Pandya testified that the meeting was originally meant to review two projects (1501 and 1502), but David Zhou chose to focus on project 1501.

[42] During the meeting, David Zhou took the position that only the first product in project 1501 (the butter chicken) created a technical challenge because he was of the view that Canafriac could apply the knowledge it gained during the product development for that product to overcome the similar challenges it encountered for the eleven other products.

[43] After the March 8, 2018, on-site meeting, Reagan Blanchfield, the CRA Financial Reviewer who attended the meeting, came back twice to collect more documents supporting the costs of the 2015-2015 SR&ED Claims.

[44] Canafriac and the CRA planned a conference call regarding the 2015 and 2016 SRED Claims for July 27, 2018, to discuss the projects which had not been reviewed during March 8, 2018, meeting. On July 26, 2018, John Williams sent a letter to David Zhou on behalf of Canafriac asking for the meeting to be postponed because Raj Telkat, their technical consultant, had a medical issue with his eyesight which prevented him from attending the meeting.

(2) George Papadopoulos

[45] George Papadopoulos was the financial reviewer for the 2013 and 2014 SR&ED Claims. He testified as to the CRA's review process of SR&ED Claims.

[46] Mr. Papadopoulos explained that there are three main actors in a SR&ED Review: the Research and Technology Advisor ("RTA"), Research and Technology Manager ("RTM") and Financial Reviewer ("FR").

[47] The FR focuses on the financial aspect of the claim and is not involved with the technical or scientific aspect. Mr. Papadopoulos explained that the FR will usually send the letter accepting or denying the claim even if they did not make the final decision.

[48] RTAs can refer to the CRA's Claim Review Manual (the "Manual") which sets out a set of rules and procedures guiding the review process. After reading section 5.6.6.2 of the Manual, Mr. Papadopoulos acknowledged that paper

documentation is not the only type of information available to support a SR&ED Claim. However, he insisted that anecdotal evidence is not sufficient in and of itself.

[49] According to Mr. Papadopoulos, the CRA does not review every claim. Some claims are accepted without being reviewed. These claims are labelled “Accepted As Filed”. When a claim is accepted as filed, supporting documentation is not necessary.

2013 Taxation Year

[50] The 2013 SR&ED Claim was not completely denied. Some of the projects were accepted as filed. Only projects 1304 and 1306 were selected for a joint technical and financial review. Mr. Papadopoulos admitted that projects 1304 and 1306 had “some potential for SR&ED eligible activities” but they lacked the necessary supporting documentation accounting for the work performed.

[51] Mr. Papadopoulos attended the September 14, 2015, on-site meeting regarding the 2013 SR&ED Claim with David Zhou and Azza Hassanein at CanafriC’s new facility. Mr. Papadopoulos confirmed that this was not the facility where the 2013 SR&ED Claim activities took place.

[52] Mr. Papadopoulos remembered that lengthy technical discussions took place between CanafriC’s representatives, David Zhou and Azza Hassanein. He was not part of those discussions and could not recall what was specifically discussed.

[53] He testified that only “anecdotal” information was provided during the meeting without any “technical or science-related documentation”. However, he eventually received documents containing financial information on October 19, 2015.

[54] He sent out the letter denying the 2013 SR&ED Claim for projects 1304 and 1306 on April 18, 2016.

2014 Taxation Year

[55] The 2014 SR&ED Claim was entirely denied. No on-site meeting took place for the 2014 SR&ED Claim.

[56] Mr. Papadopoulos received a letter dated August 18, 2016, and signed by Suvrut Pandya to schedule a conference call with the RTM, Azza Hassanein,

regarding the 2014 SR&ED claim. Mr. Pandya provided availabilities for the weeks of August 29th to September 2nd or September 6th to September 9th.

[57] Canafric received a letter dated August 24, 2016, from David Zhou. Mr. Zhou agreed to a call on September 9, 2016, but stated that Azza Hassanein would not attend the meeting since the RTM is only required to be present in case of a disagreement between the claimant and the RTA.

[58] Canafric responded with a letter dated September 8, 2016, addressed to Mr. Zhou and Mr. Papadopoulos in which they repeated their demand for Azza Hassanein to attend the call because they did not believe David Zhou to be objective and competent.

[59] Mr. Papadopoulos stated that the RTM is usually not present at the first meeting. According to Mr. Papadopoulos, the RTM will only attend meetings in case of a disagreement between the RTA and the claimant.

[60] On September 9, 2016, Mr. Papadopoulos received a call from David Zhou informing him that the conference call regarding the 2014 SR&ED Claim never took place and that “he must now close out the file since claimant is not providing any information”.

[61] Shortly after this call, Mr. Papadopoulos received an email from David Zhou formalizing decision to reject 2014 SRED Claim based on section 5.11.0 of the Manual because Canafric refused to allow an interview in a reasonable time or under reasonable conditions.

(3) Azza Hassanein

[62] Azza Hassanein was the RTM for the 2013 and 2014 SR&ED Claims.

[63] Ms. Hassanein explained that the decision to allow or deny a SR&ED claim is part of the RTA’s responsibility. She stated that she did not have the power to overrule the decision. She described her role regarding the RTAs decision as ensuring the RTA followed the Manual, conducted the review per CRA policies, gave the claimant the due process, and that the decision is supported by the report.

2013 SR&ED Claim

[64] Ms. Hassanein attended the September 14, 2015, on-site meeting but she did not recall the lengthy technical discussion with Canafriac's representatives. She could only remember that projects 1304 and 1306 were discussed during the meeting.

2014 SR&ED Claim

[65] Ms. Hassanein stated that she contacted Mr. Pandya and agreed to conduct the review through a conference call, instead of a site visit since an on-site visit had already taken place.

[66] She confirmed Mr. Papadopoulos' testimony regarding the exchange of letters between August 18, 2016, and September 8, 2016 discussing whether she would attend the conference call. She agreed with David Zhou's August 24, 2016, stating that she did not have to be present because he was the decision maker.

(4) David Zhou

[67] David Zhou was RTA in charge of the technical review of the projects for the Taxation Years.

[68] Mr. Zhou holds a bachelor degree in Food Engineering in China and a Master's degree in Food Science at Memorial University of Newfoundland, with a specialization in "starch functionality". Prior to joining the CRA, he worked in the food manufacturing industry for 20 years. His previous employers include Cadbury and Mars who mainly manufacture candies, chocolate bars and sweets.

[69] Mr. Zhou was hired as an RTA at the CRA in early 2015.

[70] Mr. Zhou acknowledged that Canafriac's products differed from the ones he had previously worked on in that they were not high sugar products.

[71] While referring to the SR&ED Claim Review Manual, Mr. Zhou explained that claimants have to provide independent objective evidence corroborating their claim in addition to oral evidence.

2013 Taxation Year

[72] Mr. Zhou took part in the September 14, 2015, on-site meeting regarding the 2013 SR&ED Claim. It started with the CRA's presentation of the SR&ED program.

[73] After discussing project 1306 with CanafriC's representatives, Mr. Zhou agreed there was a technological uncertainty but he did not consider there was enough documentation to support the work undertaken to overcome the uncertainty.

[74] Mr. Zhou reached the same conclusion regarding project 1304. There was a technological uncertainty, but he did not have enough documentation to conclude there was technological advancement.

2014 Taxation Year

[75] Mr. Zhou testified that none of the projects were examined with relation to the 2014 SR&ED Claim because no meetings took place with CanafriC and no evidence or documentation whatsoever was provided.

2015-2016 Taxation Years

[76] Mr. Zhou attended the March 8, 2018, meeting. He acknowledged that he was presented with more "technical" information than he had been in the 2015 meeting, which allowed him to gain a better understanding of the projects.

[77] During the meeting, Mr. Zhou focused his review on project 1501. CanafriC's representatives explained some of the technical challenges relating to the projects, but he could not recall the specifics of the discussion.

[78] As for project 1501, Mr. Zhou explained that the twelve products all consisted of a filling, pastry and crust with the filling being the only component that varied from one product to another. Mr. Zhou believed the first product posed a technological uncertainty, but not the eleven other products since the same technology was transferrable from one product to the other to resolve the uncertainty.

[79] His SR&ED report outlines the documents or information provided prior to and during the March 8, 2018, meeting. These included the project summary for project 1501, examples of the recipes for the various products, the product sensory evaluation form as well as Internal and external correspondence about the carton design and the glue issues.

[80] No other projects were reviewed with regard to the 2015-2016 SR&ED Claims because the July 27, 2018, conference call never took place. Mr. Zhou admitted that the CRA received a fax of CanafriC's letter requesting the meeting to

be postponed on July 26, 2018, at 3PM. Mr. Zhou explained that he still expected the call to proceed on July 27, 2018, he did not see the letter on time.

IV. DISCUSSION

[81] Section 37 of the ITA allows taxpayers to deduct scientific research and experimental development expenditures related to a business of the taxpayer carried on in Canada. These expenditures might not otherwise be deductible under the general rules found at section 18 of the ITA. Moreover, taxpayers may claim investments tax credits pursuant to section 127 of the ITA. To be eligible for the deduction and investment tax credit, the claimant must have carried SR&ED activities during the relevant taxation year.

[82] The definition of scientific research and experimental development is found at subsection 248(1) of the ITA:

248 (1) 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.

[83] The SR&ED definition relies on a “catch and release” mechanism which includes a broad category of activities under paragraphs 248(1)(a) to (c) ITA and excludes specific items under paragraphs 248(1)(e) to (k) ITA¹. The three activities included under paragraphs 248(1)(a) to (c) are basic research, applied research and experimental development. Most SR&ED cases, including these appeals, will turn on experimental development².

[84] Paragraph 248(1)(c) ITA defines experimental development as work undertaken for the purpose of achieving technological advancement. This Court and the Federal Court of Appeal have rendered many decisions interpreting this paragraph of the ITA most of which turned on the specific facts of the case. Despite the factual nature of the issue, courts have consistently adopted the framework developed by Bowman J. (as he then was) in *Northwest Hydraulic Consultants Ltd. v The Queen*³ (“Northwest Hydraulic”). Before outlining the appropriate approach to address this issue, Justice Bowman discussed the intent of Parliament in enacting the SR&ED program:

[11] The tax incentives given for doing SRED are intended to encourage scientific research in Canada (*Consoltex Inc. v. R.* (1997), 97 D.T.C. 724 (T.C.C.)). As such the legislation dealing with such incentives must be given “such fair, large and liberal construction and interpretation as best ensures the attainment of its objects” (Interpretation Act, section 12).

¹ 1726437 *Ontario Inc. (AirMax Technologies) v The Queen*, 2012 TCC 376, at para 13.

² *Béton Mobile du Québec Inc. v The Queen*, 2019 TCC 278, at para 40.

³ [1998] 3 CTC 2520.

[85] The Federal Court of Appeal summarized the five criteria in *CW Agencies Inc. v Canada*, 2001 CAF 393 as follows:

[17] Both sides in front of us relied on the test outlined in *Northwest Hydraulic Consultants Ltd. v. R.* (1998), 98 D.T.C. 1839 (T.C.C.). In that case, Judge Bowman of the Tax Court outlined five criteria which are useful in determining whether a particular activity constitutes SRED. Those criteria have been approved by this Court in *RIS-Christie Ltd. v. R.* (1998), 99 D.T.C. 5087 (Fed. C.A.) at page 5089. The criteria 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?

[86] The Federal Court of Appeal has remained consistent in its adoption of the five criteria set out in *Northwest Hydraulic*⁴. Recently, some claimants have attempted to convince the Court to stray away from these criteria on the basis that they are not mandatory prerequisites for SR&ED eligibility since they are not found in the words of subsection 248(1) ITA. In *Kam-Press Metal Products Ltd. v Canada*⁵, the Federal Court of Appeal rejected this argument stating that the role of a Court is not merely to recite but to interpret legislation in accordance with interpretation principles. The Court maintained this position in *National R&D Inc. v Canada*⁶:

[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

⁴ *Jentel Manufacturing Ltd. v. R.*, 2011 FCA 355 at para 6; *R&D Pro-Innovation Inc. v. R.*, 2016 FCA 152 at para 4.

⁵ 2021 CAF 88.

⁶ 2022 CAF 72.

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). [Emphasis added]

[87] The first criteria, whether there is a technological risk or uncertainty, stems from the words of paragraph 248(1) ITA, namely the requirement for a technological advancement. A technological advancement is needed when it is unknown or uncertain whether a certain objective can be accomplished, due to a lack of scientific knowledge⁷. This was discussed by this Court in *Abeilles Service de Conditionnement Inc. v The Queen*⁸:

[142] It must be borne in mind that these criteria are used to help determine whether or not a technological advancement has occurred. The first criterion, technological uncertainty, is one way of dealing with the technological advancement criteria; there can hardly be a technological advancement if one already knows how to achieve the end result; [...] [Emphasis added]

[88] Not only must the claimant identify a technological uncertainty, they must also establish that it could not be removed by routine engineering or standard procedures⁹:

[16] [...] 1. Is there a technical risk or uncertainty?

(a) Implicit in the term “technological 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,

⁷ CANADA REVENUE AGENCY, *Guidelines on the eligibility of work for scientific research and experimental development (SR&ED) tax incentives dated August 13, 2021*, August 13, 2021.

⁸ 2014 TCC 313.

⁹ *Northwest Hydraulic*, *supra*, note 3 at para 3.

procedures and data that are generally accessible to competent professionals in the field. [Emphasis added]

[89] The technological uncertainty criterion is also known as the “why requirement”. The recognition that scientific or technological uncertainty exists marks the starting point for the SR&ED work, while the advancement is the targeted outcome of the work. Therefore, an attempt to resolve scientific or technological uncertainty is an attempt to achieve scientific or technological advancement¹⁰. It should be noted that the lacking knowledge must really not exist in the base of scientific or technological knowledge, not simply be unknown to the claimant¹¹. In determining the existence of a technological uncertainty, courts must not look at each manoeuvre or test individually, but rather they should consider each project globally¹².

[90] The fourth criterion, whether the process resulted in technological advancement, is the second part of the “why requirement”. It is important to remember that this criterion does not require the claimant to demonstrate they were successful in meeting their objectives. If the work was unsuccessful but undertaken for the purpose of achieving technological advancement, it may still qualify¹³. To satisfy this requirement, the project must result in a technological advancement or an advancement in the general understanding, meaning that which is known or available to persons knowledgeable in the field¹⁴. This includes the rejection of a hypothesis. In *Formadrain Inc.*, this Court found that a project constituted experimental development even if it was not successful:

[113] Although the appellant's project relative to the mandrel did not lead to a technology that was usable in 2013, the fact still remains that the research enabled the appellant to advance its scientific and technological knowledge.

[114] In the 2015 Policy, it is indicated:

By showing why a possible solution will not succeed or will not meet the desired objectives, advancement in science or technology is still possible. In some instances, the project's objectives might not have been achieved but, in the process, SR&ED was carried out to understand the reasons for the failure. Hence, scientific or

¹⁰ CANADA REVENUE AGENCY, *Guidelines on the eligibility of work for scientific research and experimental development (SR&ED) tax incentives dated August 13, 2021*, August 13, 2021.

¹¹ *Formadrain Inc. v The Queen*, 2017 CCI 42 at para 93.

¹² *Id.*, at paras 98-100.

¹³ *Abeilles Service de Conditionnement Inc. v The Queen*, *supra*, note 8 at para 143.

¹⁴ *Joel Theatrical Rigging Contractors (1980) Ltd. v The Queen*, 2017 TCC 6 at para 43.

technological advancement can be achieved even if the project's objectives are not met.

The rejection of a hypothesis is advancement because it eliminates a possible solution. [Emphasis added]

[91] The 2013 SR&ED Claim included five projects, two of which, projects 1304 and 1306, were selected for a joint technical and financial review. These two projects were discussed at length during the September 14, 2015, on-site meeting. Canafrić's customers outlined specific targets which included a higher shelf life without artificial preservatives, reducing salt and fat contents, increasing protein levels, maintaining product integrity during the freeze / thaw process. These targets were to be achieved without affecting the taste of the product. During his examination in chief, Mr. Zhou acknowledged that projects 1304 and 1306 posed a technological uncertainty.

[92] The 2014 SR&ED Claim included projects 1306, 1401 and 1402. Projects 1401 and 1402 were new products with specific requirements including salt and fat reduction, the replacement of potato flakes with "real potatoes", using free from antibiotics meat, reducing cooking time. Mr. Zhou did not specify whether he believed projects 1401 and 1402 posed a technological uncertainty since no meeting took place regarding the 2014 SR&ED Claim.

[93] The 2015-2016 SR&ED Claim included seven projects, two of which, projects 1501 and 1502, were discussed during the March 8, 2018, meeting. The main challenges were to conceive a thicker filling, use a flaky pie crust that is compatible with all the fillings, reduce fat and salt contents, achieve a 21-day shelf life without any artificial preservatives and use halal products while preserving the taste profile of the products.

[94] Based on the challenges described by Mr. Pandya, projects 1304, 1306, 1401, 1402, 1501 and 1502 posed a technological uncertainty which could not be resolved by routine engineering or standard procedures. Canafrić attempted to create recipes in order to meet client objectives for their products. Each project consisted of a new or improved product which meant there was no information available on how to achieve these goals. A major source of disagreement for all SR&ED Claims was David Zhou's position that each breakthrough was transferrable from one product to the other. For example, Mr. Zhou said that salt and fat reduction techniques could be replicated in different products. Mr. Pandya clearly demonstrated that this was not the case because the ingredients will react differently when used in different products. Canafrić was unable to achieve all of its targets. Nonetheless, the

elimination of certain recipes which did not work constituted a technological advancement.

[95] I found Mr. Pandya to be a very impressive witness. He demonstrated a deep knowledge of the area under research and had excellent communication skills. He was very well spoken and factual in his evidence and was obviously very experienced in the area of the research being conducted. Mr. Zhou on the other hand, although factual, was very much a generalist without support or backups. He was rigid in his evidence and his approach lacked the understanding necessary to properly evaluate the operations in question. This is not surprising given his lack of knowledge in the area under research and his newness to the position he occupied.

[96] The second and third criteria are part of the “how requirement”. These two criteria relate to the preamble of the definition which states that work must be a systematic investigation or search that is carried out in a field of science or technology by means of an experiment or analysis. This is to ensure the work was undertaken for the purposes contemplated in subsection 248(1) ITA¹⁵:

[142] [...] the second and third criteria are, inter alia, one way of ensuring that the work was undertaken for the purpose of achieving technological advancement and that it was not, for example, an advancement achieved by accident rather than work undertaken for the purpose of achieving technological advancement.

[97] In *Northwest Hydraulics*, Bowman J. outlined the second criterion, whether the person claiming to be doing SRED formulated hypotheses specifically aimed at reducing or eliminating that technological uncertainty, in a five-stage process:

[16] [...]

- (a) The observation of the subject matter of the problem;
- (b) The formulation of a clear objective;
- (c) The identification and articulation of the technological uncertainty;
- (d) The formulation of a hypothesis or hypotheses designed to reduce or eliminate the uncertainty;
- (e) The methodical and systematic testing of the hypotheses.

¹⁵ *Abeilles Service de Conditionnement Inc. v The Queen*, *supra*, note 8.

[98] The second criterion is linked to the first criterion since technological uncertainty is necessary to formulate a hypothesis¹⁶. Sommerfeldt J. conducted a textual analysis of “hypothesis” and found that it “is a statement to be tested by an experiment or a trial”¹⁷.

[99] Regarding the third criterion, whether the procedures adopted accord with established and objective principles of scientific method, Bowman J. stated the following:

[16] [...]

(a) It is important to recognize that although the above methodology describes the essential aspects of SRED, intuitive creativity and even genius may play a crucial role in the process for the purposes of the definition of SRED. These elements must, however, operate within the total discipline of the scientific method.

(b) What may appear routine and obvious after the event may not have been before the work was undertaken. What distinguishes routine activity from the methods required by the definition of SRED in section 2900 of the Regulations is not solely the adherence to systematic routines, but the adoption of the entire scientific method described above, with a view to removing a technological uncertainty through the formulation and testing of innovative and untested hypotheses.

[100] Sommerfeldt J. reiterated the elements characterizing the systematic approach in *Joel Theatrical*:

[33] [...] The third requirement indicates that the procedures used should accord with established and objective principles of the scientific method, which is characterized by:

- trained and systematic observation,
- measurement and experiment, and
- the formulation, testing and modification of hypotheses (it is this third characteristic of the third requirement that overlaps with the fourth and fifth stages of the second requirement).

¹⁶ *Formadrain Inc. v The Queen*, *supra*, note 12 at para 103.

¹⁷ *Joel Theatrical Rigging Contractors (1980) Ltd. v The Queen*, *supra*, note 15 at para. 26.

[101] This Court has consistently held that trial and error does not come within the scientific method if used alone. Trial and error aim to solve a functional problem using different options. Unlike the systematic investigation required under subsection 248(1) ITA, trial and error does not attempt to understand why a particular option did not work and simply moves on to the next option¹⁸. This was explained in *Joel Theatrical*:

[40] I am not aware of any jurisprudence that has established that trial and error does not come within the scientific method and does not qualify as SR&ED; however, there are several cases which, while not saying so explicitly, suggest that trial and error may well fall outside the scientific method. For instance, in R&D Pro-Innovation Inc., a research and technology adviser for the CRA indicated that the activities undertaken by the appellant in that case were performed unsystematically and by trial and error. Masse J disagreed and found that the appellant's experimental program was methodical and systematic; however, he dismissed the appeal on other grounds.²⁴ In ACSIS EHR (Electronic Health Record) Inc., representatives of the appellant (whose appeal was successful) testified that its researchers, in conducting their experiments, applied a systematic approach, rather than a haphazard approach or trial and error.²⁵ In Puissance de Recherches Générales Novalia Inc., the CRA was of the view that the appellant (whose appeal was unsuccessful) had used a trial and error system, rather than systematic investigation. [Emphasis added]

[102] It was later confirmed in *Flavor Net Inc. v The Queen*¹⁹:

[53] With respect to the adequacy of the experimentation undertaken by the appellant, this was not as obvious. Parts of the testimony and documentary evidence suggested that the testing was by and large done using the trial and error method. For example, I found that the testimony of Mr. Schmalz and the documentary evidence did not provide any clear rationale for the selection of certain nutraceuticals, other than the fact that they were widely known to have various health benefits. This is particularly striking given that Mr. Schmalz testified that nutraceuticals were incorporated partly to test whether they aided in the dispersion of the sterols in water. In Joel Theatrical Rigging Contractors (1980) Ltd.,²⁹ Justice Sommerfeldt suggested that experimentation by trial and error alone does not meet the requirements of testing in accordance with the principles of the scientific method.

[...]

¹⁸ CANADA REVENUE AGENCY, *Eligibility of Work for SR&ED Investment Tax Credits Policy*, April 24, 2015.

¹⁹ 2017 TCC 179; see also *Béton Mobile du Québec Inc. V The Queen*, *supra*, note 2 at para 50.

[55] Therefore, I am of the view that the third requirement was not met by the appellant. [Emphasis added]

[103] Mr. Pandya described Canafric's development process as follows:

- i. The client requests a product with specific features.
- ii. Canafric elaborates a recipe designed to meet the client's requirements.
- iii. The recipe is tested to ensure it meets the requirements.
- iv. The product is sent to a "taste panel" to evaluate its taste.

[104] This process meets the second criterion. Canafric formulated hypothesis specifically aimed at achieving its various goals. As for the third criterion, whether the process accorded with the scientific method, the CRA's position was that Canafric relied on a "trial and error" approach by trying various recipes to reach its targets and without attempting to explain or analyze the reason why each recipe did not work. I disagree with this position. When it found a recipe could not meet client requirements, Canafric's main takeaway was not simply that it did not work. Canafric conducted analyses in order to understand which requirement was not met and modified specific parts of the recipe in order to address the issue. In doing so, Canafric was limited by its clients' demands regarding which ingredients to use.

[105] The fifth criterion, whether the claimant kept a detailed record of the hypotheses tested and results as the work progressed, is the only criterion which cannot be inferred directly from the language used in subsection 248(1) ITA:

[16]

5. Although the Income Tax Act and the Regulations do not say so explicitly, it seems self-evident that a detailed record of the hypotheses, tests and results be kept, and that it be kept as the work progresses.

[106] The Federal Court of Appeal discussed this criterion in *RIS-Christie Ltd v The Queen*²⁰ ("*RIS-Christie Ltd*"). The Tax Court found that research involving experimentation and testing had been undertaken, but held the claimant was obligated to adduce documentary evidence of test results in order to claim tax benefits under section 37 ITA. Robertson J.A. tempered the requirement to provide documentary evidence:

²⁰ [1999] 1 CTC 132 (FCA).

[14] In addition to developing new products or processes, scientific research connotes the existence of controlled experiments involving the testing of models or prototypes. Thus, evidence of scientific research must be adduced by the taxpayer in order to demonstrate that such research (including testing) was undertaken and that it is eligible for favourable tax treatment: see, for example, Progressive Solutions Inc. v. R. (1995), 96 D.T.C. 1232 (T.C.C.). Not only must taxpayers establish that tests were performed, they must also demonstrate that they were conducted in a systematic fashion. In my view, the requirement that research efforts be “systematic” is a higher threshold than simply requiring that research, including testing, be conducted. Although both documentary and viva voce evidence are admissible, the only sure-fire way of establishing that scientific research was undertaken in a systematic fashion is to adduce documentary evidence which reveals the logical progression between each test and preceding or subsequent tests.

[15] Thus, it is reasonable to expect a taxpayer to adduce documentary evidence of systematic research, including testing. If, however, a taxpayer has a plausible explanation for the failure to adduce such evidence, it is still open to the court to hold that, on a balance of probabilities, systematic research was undertaken. For example, where research notes are accidentally destroyed, it should be permissible for the trial judge to infer that systematic research was conducted, having regard to the totality of the evidence. During oral argument, counsel for the Minister accepted this proposition, if only because that scenario was inapplicable in the present case. However, in my view, it should also be permissible to infer that a taxpayer had conducted systematic research where it is established that such research led to a technological advancement. I say this because the whole foundation of the scientific research provisions of the Act and Regulations should not rest solely on the repeatability criterion. Otherwise, repeatability would negate the validity of all other evidence pertaining to scientific research. [Emphasis added]

[107] The Federal Court of Appeal allowed the taxpayer’s appeal on the basis that once the Tax Court found testing had been conducted and led to a technological advancement, a “rebuttable inference was raised that the testing conducted by the taxpayer was carried out in accordance with the SR&ED definition”. At that point, it was no longer necessary for the claimant to provide documentary evidence relating to the repeatability of testing data²¹.

[108] Citing the *RIS-Christie Ltd.* decision, this Court, in *Formadrin Inc.*, held that “it is not mandatory that the evidence be documentary and that testimonial evidence may be presented”. However, the Court highlighted that not adequately documenting an SR&ED project is a riskier approach for claimants²². This Court took an identical position in *Béton Mobile du Québec Inc.* where Lafleur J. held that documentary

²¹ *Id.* At para 15.

²² *Formadrin Inc. v The Queen*, *supra*, note 12 at para 118.

evidence is not mandatory even if the scientific method usually requires the preparation of a detailed record or notes throughout the testing process²³.

[109] The preferred approach to the documentation requirement was described by this Court in *Flavor Net Inc.*:

[60] Although, it has been held that meeting this criterion is not compulsory, doing so will assist a taxpayer in establishing that its activities qualify as SR&ED. Therefore, it is to the taxpayer's benefit to keep detailed records of the hypotheses, tests and results as the work progresses. This criterion is closely related to parts of the third requirement, which is that the taxpayer conduct its testing in accordance with established and objectives and principles of the scientific method, including systematic observation, measurement and experimentation. [Emphasis added]

[110] The documentation requirement was another source of disagreement in these appeals. For example, David Zhou testified that projects 1304 and 1306 had elements of technological uncertainty but did not have sufficient supporting documentation. Documentary evidence is not mandatory. Testimonial evidence may be presented in support of a claim. In this case, Canafriac provided both documentary and testimonial evidence in support of its various claims.

[111] On September 14, 2015, an on-site meeting took place regarding the 2013 SR&ED Claim and specifically projects 1304 and 1306. Mr. Pandya testified that all the technical information regarding these projects was explained orally to Mr. Zhou during the meeting. This was corroborated by Mr. Zhou himself. Mr. Papadopoulos and Mrs. Hassanein, while they could not speak to the specifics of the discussion, confirmed that a “lengthy technical discussion” took place between Canafriac’s representatives and Mr. Zhou. After the meeting, Canafriac sent documentation supporting the various costs of the projects to Mr. Papadopoulos on October 29, 2015. At the Appeal stage, Canafriac communicated a 120-page document to the CRA which included a detailed description of the projects and the development process on July 27, 2018.

[112] As for the 2014 SR&ED Claim, the meeting which was initially scheduled for September 9, 2016, never took place. Consequently, no information, whether oral or documentary, was communicated at the audit stage. However, documents supporting

²³ *Béton Mobile du Québec Inc. v The Queen*, supra, note 2 at para 54; See also *Abeilles Service de Conditionnement Inc. v The Queen*, supra, note 14 at para 94.

the 2014 SR&ED Claim were produced at the appeal stage as part of the 120-page document sent to CRA appeals on July 27, 2017.

[113] An on-site meeting took place on March 8, 2018, regarding projects 1501 and 1502. Similar to the 2015 meeting, Canafriac's representatives explained the work relating to these projects to Mr. Zhou who was accompanied by Kevin Kells (RTM) and Reagan Blanchfield (FR). Mr. Zhou acknowledged that Canafriac provided sufficient information about project 1501 to make a determination. A conference call scheduled to take place on July 27, 2018, regarding the other projects never took place because Canafriac's technical consultant had a medical issue. Once again, documentation was provided to Reagan Blanchfield after the meeting which included a project summary and a description of the project costs.

V. CONCLUSION

[114] Based upon the evidence, Appellant's evidence was most compelling and met the burden put forth upon them by the pleadings. The Respondent failed to address the Appellant's evidence in a forthright manner, especially the documentation provided to the CRA and the detailed technical discussions, which took place during the on-site meetings. This was never addressed by the Respondent other than by denying the claim.

[115] The Appellant successfully established that the 2013, 2015, 2015 and 2016 SR&ED Claims met all five criteria established in *Northwest Hydraulics*:

- i. There was a technological risk or uncertainty, which could not be removed by routine engineering or standard procedures.
- ii. Canafriac formulated hypotheses specifically aimed at reducing or eliminating that technological uncertainty.
- iii. The procedure adopted accord with the total discipline of the scientific method including the formulation testing and modification of hypotheses.
- iv. The process resulted in a technological advancement.
- v. A detailed record of the hypotheses tested, and results were kept as the work progressed.

[116] I am more than satisfied the Appellant discharged its burden. The appeal is allowed.

[117] Each party is requested to make written submissions on costs within 60 days as to:

- a) Entitlement of costs; and
- b) Quantum of costs, if any.

Signed at Ottawa, Canada, this 26th day of July 2023.

“E.P. Rossiter”

Rossiter C.J.

CITATION: TCC 2023 108

COURT FILE NOs.: 2018-677(IT)G
2019-3835(IT)G
2020-1571(IT)G
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STYLE OF CAUSE: CANAFRIC INC. AND HIS MAJESTY
THE KING

PLACE OF HEARING: Hamilton, Ontario

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13, 2022

REASONS FOR JUDGMENT BY: The Honourable Eugene P. Rossiter, Chief
Justice

DATE OF JUDGMENT: July 26, 2023

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