



TO: Ontario Medical Association  
FROM: Colin Smith\* and Leonard Gilbert  
DATE: August 6, 2021  
SUBJECT: Scientific Research and Experimental Development claims; Resolution of Common Medicine Professional Corporation v. H.M.Q. Court file #2018-1990(IT)G

For several years, with the assistance of both the Ontario Medical Association (“OMA”) and the various AHSC AFP Chairs, Thorsteinssons LLP and Peroff Professional Corporation have sought to clarify a physician’s right to claim scientific research and experimental development (“SR&ED”) expenditures and investment tax credits (“ITCs”). We believe the recent resolution of Common Medicine Professional Corporation’s appeal to the Tax Court of Canada has now clarified the physician’s position.

We are providing this memorandum and enclosed attachments to outline the issue and assist OMA members who may find themselves in a similar situation in the event that the Canada Revenue Agency (“CRA”) continues to deny such SR&ED claims.

### ***Background***

Section 37 of the *Income Tax Act* (Canada) (the “Act”) permits taxpayers carrying on business to deduct certain expenditures made by the taxpayer on SR&ED. Where SR&ED is undertaken by a physician, the physician is often working for a medicine professional corporation (“MPC”). The CRA has challenged numerous SR&ED claims made by MPCs on the basis that eligible SR&ED performed by the physician was not completed on behalf of the MPC, but rather, on behalf of some other party, such as the hospital at which the physician practices medicine. In the CMPC case (discussed below) and in several other cases, the CRA misunderstood the nature of the relationship between the physician, an MPC, and the hospital where the physician practices, by implying that the physician was an *employee* of the hospital, as opposed to an employee of the relevant MPC. Additionally, the CRA also challenged SR&ED claims on the basis that the receipt of funds under an AHSC alternative funding plan (“AFP”) qualified as “government assistance”,<sup>1</sup> which reduces an MPC’s claim for deductions and ITCs in respect of SR&ED work.

The OMA expressed specific concern with the CRA’s misunderstanding of the relationship between physicians, MPCs, and hospitals, and, in particular, the possibility that all physicians be treated as employees of the hospital where they practice. If this position were correct, hospital-based physicians would not be able to carry on their practice through an MPC. In turn, this would restrict hospital-based physicians’ access to the small business deduction and incorporation more generally. The AHSC AFP Chairs also expressed concern with respect to the AFP funding, because that funding is not government

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<sup>1</sup> This generally includes most grants, subsidies, forgivable loans, deductions from tax, investment allowances, or any other form of assistance from a government municipality or other public authority. The amount of government assistance received generally reduces the amount of SR&ED credit eligibility.

assistance, but rather payments for services that are insured by OHIP via contract instead of being paid on a fee-for-service basis.

As a result of the concerns expressed by both the OMA and AHSC AFP Chairs, both groups contributed financially to resolving this matter.

***Common Medicine Professional Corporation v. H.M.Q. (Court file #2018-1990(IT)G)***

Facts

CMPC is a corporation which provided radiology services to patients at St. Michael's Hospital (the "Hospital"). Each of the radiologists working on behalf of CMPC held appointments from the Hospital and the Faculty of Medicine at the University of Toronto (the "University") that entitled them to be members of the Hospital's medical staff, and faculty of the University. Each radiologist also entered into written agreements with CMPC to provide medical services (including medical research) on CMPC's behalf. Accordingly, CMPC claimed SR&ED expenditures for eligible SR&ED that each radiologists' MPC performed on their behalf.

i) *Relationship between Physician and Hospital*

The CRA denied CMPC's claim for SR&ED expenditures initially on the basis that the radiologists did not work for CMPC, but were employees of the Hospital. This position was subsequently abandoned by the CRA. Instead, the CRA claimed that the radiologists acted as independent contractors, such that any eligible SR&ED was carried out on their own behalf, and not on behalf of CMPC. As an alternative, the CRA asserted that the SR&ED was performed by the radiologists pursuant to the terms of their Hospital or University appointment and therefore was performed on behalf of the Hospital or University and not on behalf of CMPC.

The CMPC case was appealed to the Tax Court of Canada. At that point, as part of the litigation process, a significant amount of effort was undertaken to educate the justice lawyer and the CRA litigation officer on the relationship between the Hospital, University, physicians, and MPCs. As a result, the CRA, through settlement based on a partially<sup>2</sup> agreed statement of facts, conceded that:

- The radiologists were not employees of the Hospital or University;
- The radiologists did have contractual obligations to CMPC to undertake SR&ED; and
- The SR&ED undertaken by the radiologists was done on behalf of CMPC.

At the CRA's direction, the Department of Justice, agreed to a Consent to Judgment (the "Judgement") dated December 1, 2020, under which CMPC's entire claim for SR&ED expenditures was allowed in full.

ii) *AFP Funding*

The CMPC case involved a second issue. The CRA asserted that all AFP payments constitute "government assistance" for the purposes of subsection 127(9) of the Act. If correct, the AFP payments

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<sup>2</sup> A "partial" agreed statement of facts means that both parties agreed on certain facts relevant to the litigation, but not all facts relevant to the litigation.

would reduce the eligible SR&ED expenditures that could be claimed by CMPC on a dollar-for-dollar basis and would also reduce the SR&ED expenditures eligible for an investment tax credit. At the direction of the CRA, the Department of Justice settled this issue on the basis that:

- No portion of the AFP payments were “government assistance”; and
- 10%, and no more, of the aggregate AFP payments received (after deducting amounts related to administration and recruitment) were “contract payments” which reduce CMPC’s qualified SR&ED expenditures

***Similar treatment to future cases***

The CMPC Judgment now provides a clear conclusion as to the result that should be reached in similar audits. In that regard, the *Taxpayer’s Bill of Rights* provides that taxpayers have a right to have the law applied consistently. Accordingly, if an audit is commenced in respect of the same or similar issues considered in the CMPC case, reference should be made to the CMPC case, along with the Judgment and partially agreed statement of facts enclosed. Additionally, we are providing a template response that may be followed if an audit is commenced on the same or similar basis as the CMPC case.

We note that on a going-forward basis, it would be prudent for MPCs to file claims in a manner consistent with the Judgement. Specifically, we believe it would be prudent for MPCs to treat 10% of AFP funding as contract payments in subsequent claims.

To the extent your members have any additional questions or require additional assistance in corresponding with the CRA or disputing an assessment, please direct them to contact Colin Smith, or Leonard Gilbert at Thorsteinssons LLP using the contact information listed below:

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Encl.