



APPLICATION POLICY

NUMBER: SR&ED 2005-02

SUBJECT: General Rules Concerning the Treatment of Government and Non Government Assistance

DATE: October 28, 2005

Purpose

This application policy outlines the position of the Canada Revenue Agency (CRA) relating to government and non-government assistance and its impact on the expenditures for scientific research and experimental development (SR&ED) carried out in Canada, as well as on the qualified expenditures for the purposes of calculating the SR&ED investment tax credit (ITC). It also replaces and cancels Application Policy 2000-03, *Government Assistance – Treatment of Provincial and Territorial R&D Assistance*.

This application policy should be read in conjunction with the current version of interpretation bulletins IT-273, *Government Assistance – General Comments*, and IT-151, *Scientific Research and Experimental Development Expenditures*.

Legislation

The intent of SR&ED legislation relating to government and non-government assistance is to provide tax incentives to businesses on the net costs of performing SR&ED in Canada.

The SR&ED legislation relating to government and non-government assistance and its impact on the SR&ED deductible expenditure pool and qualified expenditures is contained in paragraphs 37(1)(d) and (d.1), subsections 127(9) definition of “*government assistance*”, and “*non-government assistance*”, and 127(18) to (24) of the *Income Tax Act* (the “Act”).

Paragraph 37(1)(d) and paragraph (h) of the definition of “*qualified expenditure*” in subsection 127(9), and subsections 127(18) to (20) of the Act require that the SR&ED deductible expenditure pool and the qualified expenditures be reduced by any amounts of government or non-government assistance a claimant has received, is entitled to receive, or can reasonably be expected to receive on or before the income tax return filing due date for a tax year. For purposes of subsections 127(18) to (20) of the Act, the assistance has to be in respect of the SR&ED *work* performed in the year. For reducing the SR&ED expenditures under paragraph 37(1)(d) of the Act, the assistance has to be in respect of a current or capital SR&ED expenditure under paragraphs 37(1)(a) or 37(1)(b) of the Act.

“*Government assistance*” is defined in subsection 127(9) of the Act as assistance from a government, municipality, or other public authority whether as a grant, subsidy, forgivable loan, deduction from tax, investment allowance, or any other form of assistance other than

the federal SR&ED ITC. Government assistance also includes assistance provided by foreign governments. For example, we consider to be government assistance certain provincial and territorial tax credits available to claimants performing SR&ED, and which reduce the amount of provincial and territorial taxes payable.

“*Non-government assistance*” is defined in subsection 127(9) of the Act as an amount that would be included in the claimant’s income by virtue of paragraph 12(1)(x) of the Act (read without reference to subparagraphs 12(1)(x)(vi) and (vii)). Essentially, non-government assistance is an amount that is received as an inducement, refund, reimbursement, contribution, allowance, or assistance in the form of a grant, subsidy, forgivable loan, deduction from tax, or any other form of assistance to the extent that it was not otherwise included in income or deducted in calculating the balance of outlays, expenses, or other amounts not deducted for a current or a preceding tax year.

The SR&ED legislation relating to the repayment and deemed repayment of assistance is contained in paragraph 37(1)(c), paragraphs (e.1) and (e.2) of the definition of “*investment tax credit*” in subsection 127(9), and, subsections 127(10.7) and (10.8) of the Act.

Generally, if a claimant repays government or non-government assistance, the SR&ED deductible expenditure pool increases by the same amount by which the original assistance previously reduced the pool. Further, repaying government or non-government assistance will generally increase the amount of the ITC earned in the year based on the ITC rate in the year that the assistance was originally applied. However, repaying assistance does not increase the qualified expenditures in the year. As a result, the ITC earned on the repayment of assistance is not refundable in the year the repayment is made or deemed to be made.

General considerations

Factors used to determine whether an amount is assistance

Determining whether an amount received by an SR&ED claimant from a person is assistance will depend on the particular facts of the case. The following describes some factors that may distinguish assistance from other types of payments:

- The absence of firm terms of repayment on an amount could be an indication that the amount received is not a loan but is assistance. For example, if an amount received is only repayable conditionally upon the claimant meeting certain revenue expectations, then it is most likely assistance and not a loan.
- A review of the facts indicates that the repayments are not mandatory and the amount given is to be used by the claimant in SR&ED. An example would be the case of a grant by a government department to the claimant for the purchase of equipment where it is to be used in SR&ED.

- The absence of a business motive on the part of the payor, may indicate that the claimant is in receipt of assistance. In the CCLC Technologies Inc.¹ decision, the Federal Court of Appeal allowed the Crown’s appeal and ruled that the payments made by the province of Alberta to the claimant constituted both “government assistance” under subsection 127(9) of the Act and “any other form of assistance” under subparagraph 12(1)(x)(iv) of the Act. The terms of the agreement did not establish an ordinary business relationship as the payments were neither made for the purpose of advancing the business interest of the payor nor for acquiring an interest in the property.

Received

Once it has been determined that an amount represents assistance, it is a question of fact whether or not the amount has actually been received. However, some difficulty could arise when trying to determine when a tax credit or a deduction from tax is to be considered “*received*”.

For the purposes of calculating the SR&ED expenditure pool and qualified expenditures, we consider a tax credit or a deduction from tax that is determined to be assistance, to be received at the earliest of:

- when the amount is applied as a reduction of instalment payments to be paid by the claimant, if it is credited to his instalment account by a fiscal authorities; or
- when all the conditions for its receipt are met, at the earliest of:
 - when it reduces the tax payable for a tax year; or
 - when it is paid, if it allows for or increases a tax refund.

Entitled to receive

We consider a claimant to be “*entitled to receive*” assistance in the following circumstances:

- before receiving the assistance, a certain event has to occur and/or the claimant has to fulfill some condition and the event has occurred and/or the condition has been fulfilled, and/or
- the claimant possesses an enforceable right to receive the assistance.

Reasonably be expected to receive

A claimant “*can reasonably be expected to receive*” assistance if, for example:

- the claimant has applied for assistance and, based on the circumstances, it is reasonable to believe that it will be received;
- the claimant has received information advising that assistance will be received, or

¹ 96 DTC 6527

- the claimant has earned the current year's provincial R&D tax credit and added the amount to the provincial R&D tax credit pool to be applied to future years. (This situation would occur where the claimant is in a loss position and does not renounce the provincial or territorial tax credits for research and development (R&D).)

The context of the assistance agreement

Determining whether an amount represents assistance will depend on the substance of the agreement(s) rather than solely on the terminology used in the agreement(s). The terms of the agreement are important in determining whether an amount received is assistance. For example, if an agreement for government assistance includes provisions for repayment only in the event of profits earned and characterizes the repayments as royalties, we consider the amounts to be government assistance and not a *bona fide* business loan. These arrangements are normally referred to as "forgivable loans" as they include conditions that would exempt the borrower from repaying the whole amount or a portion of the amount.

Example

A government department makes financial contributions to the R&D programs of corporations under a government program. The agreements under which the contributions are made contain repayment provisions, but these provisions contain certain conditions:

- the repayments are dependent on future revenues from the developed product and no amount is repayable until such revenues reach a certain level.
- there is a ceiling on the amount of the periodic repayments and the periodic repayments end on a particular date whether or not the entire amount has been repaid.

Unless the facts of a particular case warrant otherwise, generally, we treat these contributions as assistance due to the conditions attached to the repayments and the amount of assistance would reduce the SR&ED expenditure pool and qualified expenditures accordingly.

Assistance versus contract payment

Here are some essential features that distinguish an assistance from a contract payment

- Assistance involves predominantly a donative intent rather than a business motive. An assistance agreement between the grantor and the recipient of the amount will show that the main purpose of the agreement from the grantor's point of view was other than profit. Contract payments on the other hand are payments for SR&ED that is performed on behalf of the payor.
- The repayment provisions if any in an assistance agreement are not strictly enforceable. A contract is a commercial arrangement between two or more parties subject to the legal liabilities and enforceable in the case of default.
- A contract arrangement implies authority of the payor over the deliverables and sometimes over the whole work process. Assistance by its very nature does not generally

extend any such implications although some assistance agreements could include restrictions in respect of how the work is to be done or where the product could be sold, etc.

Application of the rules

SR&ED deductible expenditure pool

Subsection 37(1) of the Act provides for the calculation of the claimant's pool of deductible SR&ED expenditures. Paragraph 37(1)(d) of the Act reduces the SR&ED expenditure pool by any amounts of government or non-government assistance a claimant has received, is entitled to receive, or can reasonably be expected to receive on or before the income tax return filing due date for a tax year for current or capital SR&ED expenditures.

Government or non-government assistance reduces SR&ED expenditures on a project-by-project basis. This means that the assistance relating to a particular project cannot reduce the SR&ED expenditures of another project. Further, government or non-government assistance can only reduce the SR&ED expenditures of a particular project to nil. In no case would the reduction result in an SR&ED project having a negative amount for SR&ED expenditures.

In cases where the amount of assistance is more than the SR&ED expenditures of a particular project, the excess amount will be included as income under paragraph 12(1)(x) of the Act. This will also apply to cases where part of the assistance related to a particular project is not applied in the current year and the project will be discontinued in the following tax year.

It should be noted that the amount of assistance deducted in calculating the SR&ED expenditure pool is the amount in respect of the expenditure described in paragraph 37(1)(a) or (b). As a result, the assistance only reduces the pool to the extent that the expenditures for which the assistance was given have been included in the pool. Therefore, if a claimant has elected to use the proxy method and does not claim any amount for overhead expenditures in the pool, no amount of assistance related to overhead will reduce the pool.

For each project, the amount of assistance that reduces the project's SR&ED expenditures is the lesser of the following:

- the total of all amounts of assistance for current and capital expenditures that, at the claimant's filing-due date for the year, the claimant has received, is entitled to receive, or can reasonably be expected to receive and
- the total amount of current and capital expenditures related to that project.

The amount of government or non-government assistance that relates to the prescribed proxy amount (PPA) would not reduce the SR&ED expenditure pool because the PPA is not an expenditure under paragraph 37(1)(a) or (b) of the Act. It is a notional amount that is used in

lieu of the actual overhead expenditures in calculating qualified expenditures when using the proxy method. The portion of assistance that relates to the PPA should be included in income under paragraph 12(1)(x) of the Act in the year that it is received (see Example A in the Appendix).

To calculate the SR&ED deductible expenditure pool, assistance should be reflected in the SR&ED claim in the tax year in which the current or capital expenditures are incurred. Assistance received or that can reasonably be expected to be received for an SR&ED expenditure incurred in a particular year will reduce the SR&ED deductible expenditure pool in that particular year.

SR&ED qualified expenditures

The definition of an “*investment tax credit*” in subsection 127(9) of the Act provides for calculating the amount of ITC that is available to a claimant at the end of a particular tax year. Paragraph (h) of the definition of qualified expenditure in subsection 127(9) and subsections 127(18) to (20) of the Act require that qualified expenditures be reduced by any amounts of government assistance, or non-government assistance, that the claimant has received, is entitled to receive, or can reasonably be expected to receive in respect of SR&ED performed in the tax year, on or before the income tax return filing due date for a tax year. (See Example C).

Subsection 127(18) requires a reduction of the expenditures *in respect of the SR&ED*. Therefore, assistance in respect of non-qualifying expenditures relating to the SR&ED will also reduce the qualified expenditures provided that the assistance agreement does not clearly distinguish payments for eligible activities and costs from payments for non-eligible activities and costs.

Similar to paragraph 37(1)(d), the reduction under 127(18) will reduce the qualified expenditures on a project-by-project basis. This means that the assistance from one project will not reduce the expenditures of another project.

For each project, the amount of assistance that reduces the pool is the lesser of the following:

- the total of all amounts of assistance in respect of the SR&ED that, at the claimant’s filing due date for the year, the claimant has received, is entitled to receive, or can reasonably be expected to receive less any amounts of assistance applied in preceding tax years; and
- the total project costs related to that project for the year.

The excess assistance that is not applied to the particular project in the current year will be carried forward to reduce qualified expenditures of that project in a subsequent year.

For purposes of determining the qualified expenditures, assistance should be reflected in the SR&ED claim in the tax year in which the SR&ED is undertaken. Assistance that a claimant

has received, is entitled to receive, or can reasonably be expected to be received for SR&ED undertaken in a particular year, will reduce the qualified expenditures in that particular year or a subsequent year.

The portion of the government or non-government assistance that relates to the PPA will reduce the qualified expenditures under subsection 127(18) in the year or subsequent year it is earned, since it is assistance that is reasonably expected to be received for SR&ED.

Provincial and territorial R&D tax credits

Many provinces as well as a territory offer an R&D tax credit program to claimants who have a permanent establishment in the province or territory where they carry out the R&D.

At the time of the publication of this paper, R&D assistance programs were being offered by the provinces of Newfoundland and Labrador, Nova Scotia, New Brunswick, Québec, Ontario, Manitoba, Saskatchewan, British Columbia, as well as by the Yukon Territory.

The provincial and territorial R&D programs, except for the Quebec R&D program, generally follow the same expenditure rules used under the federal SR&ED program and the tax credits are calculated as a percentage of the federal SR&ED qualified expenditures incurred in the year. The Québec R&D Salaries Tax Credit is calculated on salary and subcontract expenditures incurred in the year for R&D work performed in the Province of Québec.

It is important for claimants to carefully review the R&D program that applies in their province or territory to determine the impact of claiming these credits may have on their SR&ED claim under the federal program.

In certain circumstances, the claimant may renounce the provincial R&D tax credits. In these cases, the SR&ED expenditure pool and qualified expenditures would not be reduced by the provincial or territorial R&D tax credit.

The amount of provincial or territorial tax credit that relates to the PPA would not be included in determining the amount of assistance to be applied against the SR&ED deductible expenditure pool. This is because PPA is not an expenditure under paragraph 37(1)(a) or subparagraph 37(1)(b)(i) of the Act but is a notional amount that is used in place of the actual overhead expenditures in calculating the ITC.

Under the proxy method, the portion of the provincial or territorial tax credits that relates to the PPA should be included in income under paragraph 12(1)(x) of the Act in the year it is received. (see Example A in the Appendix).

In determining the amount of qualified expenditures for the year, the treatment of provincial and territorial assistance is identical under the proxy and the traditional methods (see Example A in the Appendix). Under the proxy method, the portion of the provincial or

territorial tax credit that relates to the PPA reduces the qualified expenditures under subsection 127(18) of the Act since it is assistance in respect of SR&ED regardless of whether the credit is refundable or non-refundable.

The Quebec R&D salaries tax credit program allows salaries and subcontracts as support for R&D in the calculation, that may not qualify as SR&ED expenditures under the federal SR&ED program if the claimant has elected to use the proxy method. The portion of the provincial tax credit earned on these support salaries and subcontracts is not assistance under paragraph 37(1)(d) of the Act but should be included in income under paragraph 12(1)(x) of the Act in the year it is received.

The Ontario Innovation Tax Credit (OITC) can only be earned on a maximum amount of \$2,000,000 in R&D expenditures. For the purposes of calculating the federal SR&ED expenditure pool and the qualified expenditures, if the expenditures are greater than \$2,000,000, the OITC is calculated in the following pecking order - by type of expenditure: first to current expenditures, then to the PPA, and finally to capital expenditures.

Examples B-1 and B-2 in the Appendix illustrate the application of the pecking order in two situations, i.e. when the total expenditures are lesser or greater than the \$2,000,000 expenditure limit respectively. Basically, when the expenditures exceed \$2,000,000, using the pecking order will result in different amounts of SR&ED deductible expenditure pool balances and qualified expenditures than if they were calculated under the prorated method.

Please note that in cases where the SR&ED expenditure limit is reduced under subsection 127(10.2) of the Act, that is where prior year taxable income exceeds \$200,000 (prior to 2003) or the new \$300,000 limit (for year 2003 and subsequent years), the reduced limit replaces the \$2,000,000 expenditure limit for the purposes of calculating OITC. The reduced limit amount should be allocated to various types of expenditures, i.e., current, PPA, and capital, in the same pecking order as discussed above, for calculation of the OITC.

Super-Allowance Benefit Amount

Under paragraph 37(1)(d.1) of the Act, for tax years **commencing** after February 2000, any “super-allowance benefit amount” (within the meaning assigned by subsection 127(9)) provided by a province for R&D is also to be treated as government assistance. The legislation is applicable to tax years that begin after February 2000 except that if a claimant’s first tax year begins after February 2000 and ends before 2001, the legislation applies to tax years that begin after 2000.

Before March 2000, this type of advantage was not considered government assistance.

ORIGINAL SIGNED BY /

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Example A – Traditional method and proxy method

Given:

- Canadian-controlled private corporation throughout the year with a permanent establishment in the province.
- Expenditures incurred for SR&ED performed in Canada.
- Prior year's taxable income is less than \$300,000 (\$200,000 for tax years prior to 2003)
- Assumed provincial or territorial tax credit rate at 10%
- Provincial or territorial tax credit for SR&ED per subsection 127(18) is \$15,000 (\$150,000 X 10%).
- Federal and provincial SR&ED expenditures are the same.

Federal SR&ED expenditures:

Type of expenditure	Traditional method	Proxy method
Salaries	\$100,000	\$100,000
Overhead	(actual) <u>50,000</u>	<u>0</u>
Total federal SR&ED expenditures	\$150,000	\$100,000

Provincial or territorial R&D tax credit calculation:

A) Assistance for SR&ED per subsection 127(18) : Provincial or territorial Tax credit <ul style="list-style-type: none"> • 10% of actual federal expenditures • 10% of expenditures and PPA(100,000 x 65%) (((\$100,000 + 65,000) x 10%) 	* \$15,000	* \$ 16,500
B) Federal SR&ED expenditures per 37(1):		
- salaries	\$100,000	\$100,000
- overhead	<u>50,000</u>	<u>0</u>
Total expenditures (line 380)	\$150,000	\$100,000
Provincial or territorial ITC –10 % of line 380	** 15,000	** 10,000
Portion of provincial and territorial tax credit relating to the prescribed proxy amount (PPA)	n/a	*** \$6,500

**This amount will reduce the SR&ED qualified expenditures per subsection 127(18) of the Act.*

*** This amount will reduce the pool of deductible SR&ED expenditures per paragraph 37(1)(d) of the Act.*

**** This portion (\$6,500) of the provincial or territorial ITC relates to the PPA and does not reduce the pool of SR&ED expenditure per 37(1)(d) and should be included in income per subsection 12(1)(x) of the Act in the year it is received.*

Application Policy SR&ED 2005-02

Federal SR&ED expenditure pool:

Current year's expenditures	\$150,000	\$100,000
Less: government assistance	(15,000)	(10,000)
Add: Prior-year expenditure pool balance	<u>0</u>	<u>0</u>
SR&ED expenditure pool available for deduction (see note below)	\$135,000	\$ 90,000

Note: The actual overhead expenses represented by the PPA are ordinary business expenses.

Federal SR&ED qualified expenditures for ITC purposes:

SR&ED current expenditures	\$150,000	\$100,000
Add: PPA	0	65,000
Less: Government assistance (per calculations above)	<u>(15,000)</u>	<u>(16,500)</u>
SR&ED qualified expenditures for ITC purposes	\$135,000	\$148,500

Example B-1 – Ontario Innovation Tax Credit (OITC)

Given:

Same conditions as in example A, with the following variations:

- Expenditures **less than** \$2,000,000
- Federal ITC rate of 35%
- OITC rate – 10%
- The claimant is using the proxy method
 - Current SR&ED expenditures
 - Salaries \$800,000
 - Proxy amount (\$800,000 x 65%) 520,000
 - ASA Capital SR&ED expenditures 350,000
 - Total project cost \$1,670,000

Calculation of the OITC:

Current expenditures	\$800,000 x 100% x 10%	\$80,000	(A)
PPA	520,000 x 100% x 10%	52,000	*
Capital SR&ED expenditures	350,000 x 40% x 10%	<u>14,000</u>	(B)
Total OITC		\$146,000	

OITC is applied in a pecking order by type of expenditures (current, PPA, then capital).

* *The OITC amount (\$52,000) related to the PPA should be added to income under paragraph 12(1)(x) of the Act on Schedule 1 of the federal corporate income tax return in the year it is received.*

Federal SR&ED expenditure pool:

Current year's expenditures (current and capital)	\$1,150,000
Less: government assistance (OITC) (A+B)	(94,000)
Add: Prior-year expenditure pool	<u>0</u>
Amount available for deduction	\$1,056,000

Federal SR&ED qualified expenditures for the ITC calculation:

The provincial tax credits are applied in the same pecking order; no prorata allocation used.

Current expenses	(\$800,000 – \$80,000)	\$720,000
Prescribed Proxy Amount	(\$520,000 – \$52,000)	468,000
Capital expenditures	(\$350,000 – \$14,000)	<u>336,000</u>
Net qualified expenditures		\$1,524,000

Federal ITC: \$1,524,000 x 35% = \$533,400

Example B-2 - Ontario Innovation Tax Credit (OITC)

Given:

Same conditions as in example B-1, with the following variations:

- Expenditures **greater than** \$2,000,000
- Federal ITC rates: 35% on the first \$2M expenditures and 20% on the excess of \$2M
- OITC rate at 10%
- Claimant uses the proxy method
 - Current SR&ED expenses
 - Salaries \$2,000,000
 - Proxy amount (\$2,000,000 x 65%) 1,300,000
 - ASA Capital SR&ED expenditure 1,500,000
 - Total project costs \$4,800,000

Calculation of the OITC:

Current SR&ED expenses (\$3,300,000) or maximum limit (\$2,000,000), the lesser of the two x 10%	\$200,000
Capital SR&ED expenditures (1,500,000 x 40%) x 10% (nil since maximum limit taken above)	<u>0</u>
Total OITC	\$200,000

Federal SR&ED expenditure pool

Current year expenditures (proxy not included)	\$3,500,000
Less: government assistance (OITC)	(200,000)
Add: Prior-year expenditure pool	<u>0</u>
Amount of deductible SR&ED expenditures available	\$3,300,000

Federal SR&ED qualified expenditures for the ITC calculation

As the expenditures exceed the maximum allowed (\$2,000,000), the provincial ITC is applied in the following order:

Salaries (\$2,000,000 - 200,000 (OITC))	\$1,800,000
PPA	\$1,300,000
Capital expenditures	<u>\$1,500,000</u>
Net qualified expenditures	\$4,600,000

Federal ITC

Current expenditures	\$1,800,000 x 35%	\$630,000
Prescribed Proxy Amount (portion)	200,000 x 35%	70,000
Prescribed Proxy Amount (balance)	1,100,000 x 20%	220,000
Capital expenditures	1,500,000 x 20%	<u>300,000</u>
Total ITC		\$1,220,000

Example C

Application Policy SR&ED 2005-02

Given:

ABC Corporation has a taxation year end of December 31, 2002. The filing due date of their tax return is June 30, 2003. A government department approves an assistance grant in the aggregate amount of \$375,000 to ABC Corporation. The agreement is signed on Oct 1, 2002. The provisions of the agreement were effective on October 1, 2002, and will terminate on September 30, 2003. For the 2002 tax year, the corporation had a net loss. The grant agreement provides that assistance will be paid after the R&D is performed and a claim outlining the expenses incurred are submitted to the government department.

The expenses incurred and the amounts received as per the grant agreement are as follows:

Claim #	Period	Expenditures Incurred	Grant Amounts Received	Date Received
1	Oct 1, 2002 - Oct 31, 2002	\$40,000	\$40,000	Nov 30, 2002
2	Nov 1, 2002 – Dec 31, 2002	\$77,500	\$77,500	Feb 10, 2003
3	Jan 1, 2003 - Mar 31, 2003	\$100,800	\$100,800	Apr 2, 2003
4	Apr 1, 2003 - Jul 31, 2003 <i>* The claim was filed with the granting government department on Aug 1, 2003.</i>	\$50,000	\$50,000	Nov 2, 2003 *

The last claim for the remaining expenses has not been filed to date.

We will show the calculation of assistance under 37(1)(d) and 127(18), the SR&ED expenditures pool and qualified expenditures for both methods below. For the purposes of the 2002 tax year only claims #1 and #2 will be used as the amount is received in claim # 1 and the amount can reasonably be expected to be received in claim # 2. The other claims would become part of the 2003 tax year.

Application Policy SR&ED 2005-02

Federal SR&ED expenditures for year 2002:

Type of expenditure	Traditional method	Proxy method
Salaries (\$10,000 + \$40,000)	\$50,000	\$50,000
Materials (\$10,000 + \$25,000)	35,000	35,000
Overhead (\$20,000 + \$12,500)	(actual) 32,500	0
Total federal SR&ED expenditures	\$117,500	\$85,000

Calculation of assistance for paragraph 37(1)(d):

Relating to:		
Salaries	\$50,000	\$50,000
Materials	35,000	35,000
Overhead	* 32,000	
Total assistance for paragraph 37(1)(d)	\$117,500	\$85,000
Total assistance per subsection 127(18)	**\$117,500	**\$117,500

* Under the proxy method, this portion (\$32,500) of the assistance relates to the PPA and does not reduce the pool of SR&ED expenditure per paragraph 37(1)(d). It should be included in income per paragraph 12(1)(x) of the Act in the year it is received (\$20,000 in 2002 and \$12,500 in 2003). However, for a claimant using the traditional method, this will be included in the total amount of assistance that will reduce the SR&ED expenditure pool under paragraph 37(1)(d).

** Pursuant to subsection 127(18) of the Act, this amount will reduce the SR&ED qualified expenditures. The assistance of \$32,500 relating to the PPA is considered to be assistance for paragraph 127(18) purposes.

Federal SR&ED expenditure pool:

Current year's SR&ED expenditures	\$117,500	\$85,000
Less: Government assistance (per 37(1)(d)) (\$40,000 + \$117,500)	117,500	85,000
Add: Prior-year expenditure pool balance	0	0
SR&ED expenditure pool available for deduction	0	0

Note: When using the proxy method, the actual overhead expenses represented by the PPA are deducted as regular business expenses on the financial statements by the claimant using the proxy method.

Federal SR&ED qualified expenditures for ITC purposes:

SR&ED expenditures	\$117,500	\$85,000
Add: PPA	0	32,500
Less: Government assistance (per 127(18))	(117,500)	(117,500)
SR&ED qualified expenditures for ITC purposes	0	0