Comité mixte sur la fiscalité
de l'Association du Barreau canadien

et de

Comptables professionnels agréés du Canada
Comptables professionnels agréés du Canada, 277, rue Wellington Ouest, Toronto (Ontario), Canada M5V 3H2
L'Association du Barreau canadien, 66, rue Slater, bureau 1200, Ottawa (Ontario), Canada K1P 5H1

Le 11 août 2023

Monsieur Robert Demeter
Directeur général
Division de la législation de l'impôt
Direction de la politique de l'impôt
Ministère des Finances du Canada
90, rue Elgin
Ottawa (Ontario) K1A 0G5

Courriel : Robert.Demeter@fin.gc.ca

Objet : Incidence de l'arrêt *CAE*

Monsieur,

Dans le présent mémoire, nous souhaitons demander au ministère des Finances d'envisager de donner suite aux récentes décisions de la Cour d'appel fédérale et de la Cour de l'impôt dans le cas *CAE Inc.* c. *Canada*[1] (« **CAE** »). Les fiscalistes sont préoccupés par les incidences de ces décisions. Nous craignons en effet que ces décisions puissent entraîner l'inclusion immédiate de certains montants dans le revenu en vertu de l'alinéa 12(1)x) de la *Loi de l'impôt sur le revenu* (la « Loi »)[2], voire le refus immédiat de crédits d'impôt à l'investissement prévus à l'article 127 de la Loi, dans des circonstances qui sont inappropriées du point de vue de la politique fiscale, comme nous l'expliquons dans le texte qui suit.

Des membres du Comité mixte et d'autres experts en fiscalité ont pris part aux discussions ayant abouti au mémoire et ont contribué à sa rédaction, notamment :

- Michael Ding – WeirFoulds LLP
- John Oakey – CPA Canada
- Anu Nijhawan – Bennett Jones LLP

[1] La Cour d'appel fédérale (2022 CAF 178) a confirmé la décision de la Cour canadienne de l'impôt (2021 CCI 1050). La Cour suprême du Canada a rejeté la demande d'autorisation d'appel le 26 mai 2023.
[2] Sauf indication contraire, tous les renvois législatifs ci-dessous se rapportent à des dispositions de la Loi.

- Carrie Smit – Goodmans LLP

Nous espérons que vous trouverez notre mémoire utile. Nous serons heureux d'en discuter plus avant avec vous au moment qui vous conviendra.

Nous vous prions d'agréer, Monsieur, nos salutations distinguées.

Carmela Pallotto

Carmela Pallotto
Présidente, Comité sur la fiscalité
Comptables professionnels agréés du Canada

Ian Crosbie

Ian Crosbie
Président, Section du droit fiscal
Association du Barreau canadien

CAE Reasons

The taxpayer in CAE received, over a five-year period, "contributions" in the principal amount of $250 million from Industry Canada, pursuant to the Strategic Aerospace and Defence Initiative ("**SADI**") program,[3] including $57 million in 2012 and $59 million in 2013, related to a certain project. The amounts were used by CAE to incur scientific research and experimental development ("**SR&ED**") expenditures (approximately $41 million in each of 2012 and 2013) and other research and development costs in the larger amount of $700 million. Under the agreement with Industry Canada, CAE was required to repay 135% of the amounts (or $337.5 million) beginning after the last advance was made and in escalating specified amounts in annual installments over a 15-year period. CAE claimed investment tax credits ("**ITCs**") in respect of the SR&ED expenditures. The repayment conditions provided Industry Canada with a rate of return of approximately 2.5% on an annual basis.[4] The agreement also imposed various restrictions on CAE, including a requirement that products be manufactured exclusively in Canada, that certain SR&ED work be conducted by post-secondary institutions in Canada, and restrictions on CAE's ability to transfer title or intellectual property rights relating to the project.

The Tax Court concluded that the arrangement was a loan, which CAE had an unconditional obligation to repay. In then considering whether the loan constituted "government assistance", the Tax Court framed the test as follows:

> Having read *Consumers' Gas, CCLC Technologies* and *Immunovacci*ne, I am of the opinion that in order to determine whether payments made under an agreement constitute "government assistance", it is not enough to determine whether payments were made in exactly the same way and for exactly the same reasons as those made by private companies. Rather, I am of the opinion that in order to determine whether the test established by these judgments is met, **the Court must determine whether the payments were made in order to promote the commercial interests of the payer, that is to say whether they were made under an "ordinary commercial arrangement"**. Indeed, I believe that an agreement can be an "ordinary commercial agreement" even if the payments made under it were not made in exactly the same way and for exactly the same reasons as those made by private companies. Given the circumstances, a company may very well determine that it is expedient for it, in the interest of furthering its commercial interests, to enter into an agreement whose terms differ from comparable agreements entered into between private companies during the same period. Finally, I also believe that since payments made under an agreement are made in accordance with its terms, it is appropriate to examine those terms to determine whether they correspond to the terms of an ordinary commercial agreement. **In this regard, it is logical to conclude, unless there is evidence to the contrary, that it is generally contrary to the commercial interests of an enterprise to be party to an agreement whose terms are substantially less advantageous than those of agreements ordinarily concluded under the same circumstances**. (emphasis added)

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[3] The SADI program is, as we understand it, intended to support research and development projects in the aerospace, space, defence and security sectors: https://ised-isde.canada.ca/site/industrial-technologies-office/en/strategic-aerospace-and-defence-initiative-sadi

4 Early termination was also permitted upon the payment by CAE of an amount representing a return on investment of 2.75% on an annual basis. [5] Notably, the decision in CAE is a departure from the Canada Revenue Agency's historical position. See, for example, Interpretation bulletin IT-273R2 (September 13, 2000), paragraph 16 [now archived], whereunder the CRA had previously stated that:

The Tax Court concluded that the loan agreement was not an "ordinary commercial agreement" and therefore constituted government assistance, within the meaning of subsections 127(9) and 12(1)(x), since:5 (1) the implicit interest rate of 2.5% was significantly less than the typical market rate for a comparable loan, (2) there was a lack of commercial covenants and (3) several conditions in the agreement were motivated by political considerations rather than commercial reasons. Focusing on the first point, the Federal Court of Appeal upheld the Tax Court's decision, affirming that the test for determining whether a payment constitutes "government assistance" turns on the underlying mechanism and purpose of the payment. On May 26, 2023, the Supreme Court of Canada dismissed CAE Inc.'s application for leave to appeal.

Principles and Concerns Emerging from CAE

The CAE decision stands for the proposition that a government loan lacking sufficient "ordinary commercial terms" – including one that is made other than to promote the commercial interests of the government or one that has a lower-than-market interest rate – will be considered "government assistance" within the meaning of paragraph 12(1)(x)6 and subsection 127(9).

A finding that an amount is "government assistance" can result in one or more of the following:

- the amounts received or receivable in each year in respect of SR&ED expenditures are excluded from qualified SR&ED expenditures for ITC purposes by subsection 127(18),
- the amounts received in relation to the SR&ED activities are not deductible in computing income from the taxpayer's business by virtue of paragraph 37(1)(d),
- the amounts received are includible in income under paragraph 12(1)(x),7 or
- the amounts received or receivable, in respect of, or for the acquisition of, property will reduce the capital cost of the property under paragraph 127(11.1)(b) for purposes of calculating ITC's under subsection 127(9).

The Courts' reasoning, coupled with the broad language used in paragraph 12(1)(x) and subsection 127(9) may cause various loan amounts to be captured as government assistance. The reasoning appears to apply to loans that don't meet normal commercial terms including low-interest loans which are made directly by the government, by a Crown corporation, or by other public authority. The treatment of unconditionally repayable loans as government assistance appears to be inconsistent with the tax policy objectives of the Act.

For example, we understand that the mandates of each of the Business Development Bank of Canada, Canada Infrastructure Bank, Export Development Canada, and Farm Credit Canada, each of which could

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[5] Notably, the decision in CAE is a departure from the Canada Revenue Agency's historical position. See, for example, Interpretation bulletin IT-273R2 (September 13, 2000), paragraph 16 [now archived], whereunder the CRA had previously stated that:

> The fact that a loan is interest-free or that the rate of interest on the loan is less than the existing commercial rate of interest will not normally cause a loan to be considered as assistance for the purpose of paragraph 12(1)(x).

6 Although paragraph 12(1)(x) of the Act does not specifically define government assistance, the wording of the paragraph produces a similar result as the defined term government assistance in subsection 127(9)

7 Subject to certain elections which, if made, reduce the quantum of other tax attributes.

be viewed as a government entity, include acting as lenders (complementary to the private sector) providing financing to projects which are desirable for socio-political reasons (*e.g.,* to promote the long-term success of particular industries or projects where returns are measured by more than dollars and cents) but might not be able to be fully financed from the private sector. Given the broader policy reasons for financing by these entities, such loans could, in some circumstances, not have fully commercial terms. It does not appear, however, that from a policy perspective, such amounts should be treated as government assistance under paragraph 12(1)(x) or subsection 127(9), as such treatment might result in the desired projects not being economically viable because of the increased tax burden.

Further, treatment of government loans as "government assistance" seems contrary to the policy considerations underlying the Budget 2023 announcements relating to measures, including a number of new ITCs, in pursuit of advancing Canada's "clean" economy. Where government financing is involved in such ventures, the potential for immediately denied ITCs or immediate income inclusions may make such projects undesirable.

Furthermore, the CAE decision gives rise to added, and we believe, inappropriate uncertainty as to the scope of paragraph 12(1)(x) and subsection 127(9), which we believe should be clarified.

Recommendation

We recommend that the Act be amended to exclude loans which are unconditionally repayable from being "government assistance" for the purposes of paragraph 12(1)(x) and subsection 127(9). In the interim, we would urge Finance to issue a comfort letter on this issue.