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CCLC Technologies Inc. v. Canada

Between
CCLC Technologies Inc., plaintiff, and
Her Majesty the Queen, defendant

[**1995] F.C.J. No. 1510**

[1995] A.C.F. no 1510

103 F.T.R. 292

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Action No. T-3457-90

Federal Court of Canada - Trial Division
Vancouver, British Columbia

Rouleau J.

Heard: October 10, 1995
Judgment: November 10, 1995

(12 pp.)

Income tax -- Computation of tax, rules for corporations -- Investment tax credits -- What constitutes "assistance" in the nature of a grant or subsidy.

Appeal from a notice of income tax assessment disallowing the plaintiff's claim of a refundable investment tax credit in its 1987 taxation year. During the early 1980's, the plaintiff conceived an elaborate plan to develop a dual process technology for converting coal and heavy oil materials into light crude oil. The province of Alberta was interested in the project and the plaintiff was eager to have it involved, as its participation would lend credibility to the project and as the plaintiff did not have the kind of money required to develop a project of that magnitude. In April 1986, the plaintiff

entered into a Coal Research Agreement with the province. During its 1987 taxation year, the plaintiff incurred substantial expenses on scientific research and experimental development of both a current and capital nature and received approximately $725,500 from the province. By the end of the taxation year, it was entitled to a further $1,564,000 from the province. The plaintiff claimed a deduction of scientific research and development expenditures of $2,300,000 for that taxation year. The defendant disallowed the claim based on its view that the plaintiff was not entitled to the deduction because the payments it received from the province of Alberta were in the nature of an "assistance", "grant" or "subsidy".

HELD: Appeal allowed. The provisions of the Income Tax Act using the phrase "grant, subsidy or other assistance" had no application to ordinary business arrangements between a public authority and a taxpayer. The entire agreement between the plaintiff and the province as well as the conduct of the parties thereto both before and after the agreement was executed left no doubt that the province had a business and commercial interest in the plaintiff's project which interest was the underlying reason for the payments in question. The defendant, therefore, mischaracterized the nature of the relationship between the plaintiff and the province.

Statutes, Regulations and Rules Cited:

Income Tax Act, ss. 12(1), 20(6)(h), 37(1)(a), 37(1)(b), 127(5), 127(9), 127(11.1)(c).

Counsel:

Lorne A. Green and S.M. Cook, for the plaintiff.
Luther P. Chambers Q.C., for the defendant.

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1 **ROULEAU J.**:-- This is an appeal from a Notice of Assessment issued by the Minister of National Revenue disallowing a refundable investment tax credit which the plaintiff claimed in its 1987 taxation year.

2 The plaintiff, CCLC Technologies Inc., is a corporation formed under the Business Corporations Act of the Province of Alberta as a result of an amalgamation of two predecessor corporations, Canadian Coal Liquefaction Corporation and Contar Systems Engineering Ltd. It is in the business of scientific research and experimental development.

3 During the early 1980's, Dr. Fritz Boehm, then President of Contar Systems Engineering Ltd., conceived a plan to develop a dual process of converting coal and heavy oil minerals into light crude oil. He put forth a proposal to a number of significant industry players involving a megaproject for the development of a technological process which would allow for the simultaneous upgrading of coal and heavy oil and the liquefaction of coal. The province of Alberta was interested in the project and Dr. Boehm was eager to have it involved as its participation would lend credibility to the project and neither the plaintiff nor its predecessors had the kind of money necessary to develop a project of this magnitude.

4 On April 1, 1986, after extensive negotiations, the plaintiff entered into an agreement with the province of Alberta, entitled the Coal Research Agreement. It is a hybrid agreement with some of

the hallmarks of a debt instrument with conversion features into equity. There are two factors in the Agreement which make it difficult to define. First, it works towards a commercial facility, namely a process demonstration unit, which alone was going to cost $100 million and which was going to effectively finalize the process technology and show that commercial output could be produced economically before the plant was built. That was to be completed by December 31, 1993, although as of the date of this hearing it had not occurred.

5 If it had occurred, Alberta was entitled under the terms of the Agreement to be repaid out of the gross revenue produced from the commercialization of the technology, its entire investment plus a return on that investment calculated by a formula. The province would then have been required to give up its fifty percent undivided interest in the project technology that had been produced. If commercialization was not achieved, Alberta would hold on to its fifty percent undivided interest in the project technology.

6 The technology that was involved in the agreement was not simply new process information, design drawings and anything else that was produced as a result of the project. By the time the Agreement was entered into, the plaintiff had already spent over two and half million dollars of its own money working towards the process and Alberta had its own intellectual property and know-how concerning coal liquefaction. These interests, referred to in the Agreement as prior technology, were pooled and cross-licensed into the project. In addition, there was third party technology which, from the plaintiff's perspective, related to an agreement which it had with a German company to use the latter's coal liquefaction process and facilities under a licence arrangement. That technology was cross-licensed into the project as well.

7 During its 1987 taxation year, the plaintiff incurred expenses on scientific research and experimental development in the project of both a current and capital nature and received the amount of $725,569 from Alberta pursuant to the terms of the Agreement. At the end of the taxation year it was entitled to a further $1,564,748 from the province.

8 In its 1987 tax return, the company reported "scientific research and experimental development" expenditures in the amount of $1,102,889 on current account for deduction under paragraph 37(1)(a) of the Income Tax Act and $1,195,470 on capital account for deduction under paragraph 37(1)(b), for a total of $2,298,359. By Notice of Reassessment dated November 10, 1989, the Minister assessed the plaintiff for its 1987 taxation year disallowing the refundable investment tax credit the plaintiff had claimed. The plaintiff objected to the assessment but the Minister confirmed its determination by notice dated December 14, 1980.

9 The relevant provisions of the Income Tax Act are paragraph 12(1)(x), and subsections 127(5), (9) and (11.1). They read as follows:

> 12. (1) There shall be included in computing the income of a taxpayer for a taxation year as income from a business or property such of the following amounts as are applicable:
>
> (x) any amount (other than a prescribed amount) received
> by the taxpayer in the year, in the course of earning
> income from a business or property, from . . .
> (ii) a government, municipality or other public authority

where the amount received can reasonably be considered to have been received . . .
(iv) as a reimbursement, contribution, allowance or as assistance, whether as a grant, subsidy, forgivable loan, deduction from tax, allowance or any other form of assistance, in respect of the cost of property or in respect of an expense

to the extent that the amount

(viii) may not reasonably be considered to be a payment made in respect of the acquisition by the payor or the public authority of an interest in the taxpayer, his business or his property.

127. (5) There may be deducted from the tax otherwise payable by a taxpayer under this Part for a taxation year an amount equal to the aggregate of . . .
(v) an amount not exceeding the lessor of

(i) his investment tax credit at the end of the year in respect of property acquired, or an expenditure made, in a subsequent taxation year and after April 19, 1983, to the extent that the investment tax credit was not deductible under this subsection in the taxation year in which the property was acquired, or the expenditure was made, as the case may be,

(9) In this section and section 127.1,

"government assistance" means assistance from a government, municipality or other public authority whether as a grant, subsidy, forgivable loan, deduction from tax, investment allowance or as any other form of assistance other than as a deduction under subsection (5) or (6);

(11.1) For the purposes of the definition "investment tax credit" in subsection (9),
(c) the amount of a qualified expenditure made by a taxpayer shall be deemed to be the amount of the qualified expenditure, determined without reference to subsections 13(7.1) and (7.4), less the amount of any government assistance, non-government assistance or contract payment in respect of the expenditure that, at the time of the filing of the return of income for the taxation year in which the expenditure was made, the taxpayer has received, is entitled to receive or can reasonably be expected to receive;

10 The question to be answered by the Court in this appeal is whether the amounts received by the plaintiff from Alberta constitute "assistance from a government" whether as a grant, subsidy, forgivable loan, deduction from tax, allowance or any other form of assistance.

11 The Minister takes the position that the money Alberta invested in the project and which it gave to the plaintiff in accordance with the Coal Research Agreement falls within the phrase "other

form of assistance". It is argued there was no partnership or joint venture between the plaintiff and the province for the simple reason that there was no carrying on of a business activity in common with a view to profit, or any assumption of a business risk in the sense of sharing losses. The Coal Research Agreement, according to the defendant, was nothing more than an agreement by Alberta to assist the plaintiff in carrying out the research project, although it had the right to ensure that the work was carried out properly as well as the contingent right to recover the funds.

12 The plaintiff, on the other hand, maintains that the amounts it received from Alberta during its 1987 taxation year are not amounts which should be included in income under the provisions of paragraph 12(1)(x) of the Act. It further argues that the amounts which it actually received or which were receivable at the end of its 1987 taxation year were not "government assistance" as that phrase is used in paragraph 127(11.1). The province, it is argued, was a participant in the project and there was no donative intent on its part when it agreed to become financially involved in the project. According to the plaintiff, the Agreement is indicative that Alberta was driven by commercial animus and was more of a business partner than a party which was giving money away.

13 There are a number of cases relating to the interpretation of the words "grant, subsidy or other assistance" in the Income Tax Act. In G.T.E. Sylvania Canada Limited v. the Queen, [1974] DTC 6315, the issue was whether the taxpayer was required to reduce its capital cost for purposes of the Act with respect to its purchases of new equipment. The determination of this issue required the Court to interpret the words "grant, subsidy or other assistance" in paragraph 20(6)(h) of the Income Tax Act.

14 Mr. Justice Cattanach held that there is a common thread throughout the dictionary meanings assigned to those words; that is a "donative intention" on the part of the government or public authority to make a gift or assignment of money out of public funds to a private individual or commercial enterprise deemed to be beneficial to the public interest.

15 The words were also considered by the Exchequer Court of Canada in Ottawa Valley Power Ltd. v. The Minister of National Revenue, [1969] CTC 242. There, Ottawa Valley Power had a long term contract with Ontario Hydro to supply twenty-five cycle electrical power. In the mid-1950's, Ontario Hydro determined it necessary to change its existing twenty-five cycle power to a sixty cycle power system. It undertook a substantial transformation program of its own generating and distribution properties and made consequential arrangements with the suppliers and consumers of its power. As a result of negotiations with Ottawa Valley Power, Ontario Hydro undertook the necessary modifications to the company's plant at its own expense. The Minister refused to allow Ottawa Valley Power capital cost allowance in respect of the additions or improvements made to its plant on the grounds that it had received a grant, subsidy or other assistance from a government or public authority.

16 In rejecting the Minister's position, the Court noted that the words "grant, subsidy or other assistance" have no application to amounts provided by a government in ordinary commercial business arrangements. The decision states at p. 249 as follows:

> I do not think that the rule can have any application to ordinary business arrangements between a public authority and a taxpayer in a situation where the public authority carries on a business and has transactions with a member of the public of the same kind as the transactions of any other person engaged in such a business would have with such a member of the public. I do not think that the

> words in paragraph (h) - "grant, subsidy or other assistance from a . . . public authority" - have any application to an ordinary business contract negotiated by both parties to the contract for business reasons.

(emphasis added)

17 This reasoning was specifically adopted by the Federal Court of Appeal in The Queen v. Consumers Gas Company Ltd., [1987] 1 CTC 79. In that case, the gas company was, on occasion, required by various corporations including governments, municipalities and other public authorities, to relocate portions of its pipelines. The public authorities reimbursed Consumers Gas for these costs. The company treated the payments as capital and offset the amounts against the capital expenditures in respect of which they arose. The Minister argued that the reimbursements received from "governments, municipalities and other public authorities" constituted "assistance" in the nature of a grant or subsidy.

18 The Court of Appeal rejected that argument, adopting the reasoning used in both the G.T.E. Sylvania and Ottawa Valley Power decisions. Mr. Justice Hugessen made the following comments at p. 82:

> The key word in this text as it seems to me, is "assistance" which, in the context, clearly carries with it the colour of a grant or subsidy. Here the evidence is clear that payments made to Consumers Gas by public authorities such as municipalities' Ontario Hydro and the like were made in exactly the same way and for exactly the same reasons as payments made by private businesses, that is, for the purpose of advancing the interests of the payor.

(emphasis added)

19 Clearly therefore, tax provisions using the phrase "grant, subsidy . . . or other assistance" have no application to ordinary business arrangements between a public authority and a taxpayer.

20 I am satisfied based on the evidence before me that the Coal Research Agreement is essentially a technology development arrangement in which the province was an active business participant. The essence of the Agreement is a commercial arrangement negotiated and entered into by both parties for business purposes.

21 There are a number of facts which support this conclusion. To begin, Alberta took an active role in defining the scope of the work and the timing and objectives of the project. It took over eleven months of protracted negotiations between the parties to settle the terms of the Coal Research Agreement. From the commencement of those negotiations, the province acted in its own commercial interest and insisted upon access to both the plaintiff's prior technology and the results that flowed from the project. The drafting process of the Agreement was controlled by Alberta and at the beginning of negotiations it wanted to ultimately control the technology produced, something that Dr. Boehm could not accept. In the end, it settled for a joint ownership interest in the technology produced and in the prior technology and third party technology of the plaintiff brought in under the Agreement.

22 Neither did the province wait passively for progress reports. It negotiated the right to have a representative on the Project Management Committee and took a hands-on approach to how the project was conducted. It participated in the ongoing negotiations with prominent industry members

regarding the ultimate use of the technology should commercialization be achieved and it provided equipment, manpower and its own technology for the project. Indeed, the government continues to actively protect its interest in the project technology as exemplified by the terms of the Summary Agreement (exhibit P-3) which has been negotiated.

23 It is indisputable that Alberta acquired some interest in the property of the plaintiff as the company's prior technology was rolled into and became part of the project technology co-owned by the province. This conclusion is supported by the course of conduct presently being followed by Alberta as set forth in the evidence of Ms. Wood who testified that the province is presently negotiating a sale of its interest in the project property to the plaintiff. This event clearly could not occur if the province did not hold some beneficial interest in the project property.

24 Finally, the terms of the Agreement itself unequivocally demonstrate that the payments made by the province were not a grant, subsidy or some other form of assistance. For example, paragraph 7 of the preamble to the agreement states:

> Both parties are interested in the know-how and patents related to the area of coal/heavy oil hydrogenation and plan to advance the technology in the Province of Alberta based on this know-how, starting with construction of operation of bench scale and pilot plants;

25 Paragraph 4 provides for the formation and operation of the Management Committee, the existence of which is consistent with a joint development effort and not the hallmark of a grant. Paragraph 5(6) of the Agreement provides:

> The Minister may . . . withhold payment until . . . (ii) the Company has furnished a statutory declaration to the Minister certifying all debts, claims, liabilities or other obligations of the Company arising from or relating to the performance of the Project have been paid in full,

26 This type of provision would not be necessary unless the Alberta government had the same interest in the project as the plaintiff, that is a business and commercial interest. Paragraph 8 gives Alberta access to the project technology and requires the plaintiff to make all prior technology, and to the extent possible third party technology, available to the province in sufficient detail to allow Alberta to practice the project technology.

27 However, it is paragraphs 10, 11 and 12 which, when read as a whole, best illustrate the essence of the commercial arrangement struck between the parties. That arrangement is most accurately described as a type of mutual endeavour which is dependent upon the outcome of future events. In accordance with paragraph 10, Alberta and the plaintiff co-owned the technology as to an undivided fifty percent interest pending commercialization of the technology. The province agreed to restrict its use of the technology during the evaluation period. The purpose of this paragraph was to ensure that both parties were working toward the same objective, namely commercialization. Paragraphs 11 and 12 provided that if commercialization of the project technology was achieved, Alberta was to sell its interest in the project technology to the plaintiff for an amount equal to its contributions plus a return on those contributions. Payment of the purchase price was to be made out of the gross revenue earned from the use of the project technology. If commercialization was not achieved, and neither party had been required to forfeit its interest under the terms of the agree-

ment, then the parties continued to own the technology together and any revenue from a sale or licensing arrangement would be split equally.

28 Based on this evidence it is my view that the defendant has mischaracterized the nature of the relationship between the plaintiff and the Alberta government and that its position simply has no merit and is not supported by either the jurisprudence or the facts. Indeed, the entire premise of the Crown's precarious argument is based on paragraph 18 of the Coal Research Agreement which reads as follows:

> Nothing in this Agreement is to be construed as making the Company an agent of the Minister or as creating a partnership or joint venture relationship, either generally or for any specific purpose, between the Company and the Minister or an employer/employee or master/servant relationship between the Minister and the Company's employees. The parties are acting independently of each other in the performance of their respective duties and responsibilities under this Agreement.

29 Clearly, this paragraph was an attempt by the province to limit its commercial exposure and liability. It is not in and of itself, however, determinative of the nature of the relationship between the parties. Nor can it be relied on, as suggested by the defendant, to conclude that the amounts in question were paid by the province as some form of government grant, subsidy or assistance. That approach is far too simplistic. It is a long established principle of law that the parties to an agreement cannot characterize their relationship simply by labelling it or describing it as something which it is not. In Weiner v. Harris, [1910] 1 K.B. 285 the Court stated at p. 290:

> Perhaps the commonest instance of all, which has come before the Courts in may phases, is this: Two parties enter into a transaction and say "It is hereby declared there is no partnership between us." The Court pays no regard to that. The Court looks at the transaction and says "Is this, in point of law, really a partnership? It is not in the least conclusive that the parties have used a term or language intended to indicate that the transaction is not that which in law it is."

(emphasis added)

30 Accordingly, the mere fact that the agreement states there is no partnership or joint venture between the plaintiff and the provincial government is not conclusive. The agreement as a whole and the conduct of the parties, both before and after the agreement was executed, leave no doubt that the province of Alberta had a business and commercial interest in the plaintiff's project and this was the underlying reason for the payments in question. The amounts in question do not constitute some form of government assistance.

31 The plaintiff's appeal is therefore allowed. The matter is to be referred back to the Minister for reassessment in accordance with these reasons. Costs to the plaintiff.

qp/d/hbb/DRS/DRS