

Government Proposes Remedy for Loans-as-Income Debacle (CAE Inc.)

- Pending New Legislative Amendment on “Concessional Loans” Addresses TCC and FCA Decisions on CAE Inc.

In its fall economic statement issued 21-Nov-2023, the Canadian Federal Government proposed a remedy for the recent court decisions (TCC Sep 2021 and FCA Oct 2022 CAE Inc.) that created an unusual / unintended situation that caused certain “incentivizing” loans made to corporations by Canadian governments to be counted as income and hence subject to income tax.

The subject of these decisions was the Canadian aerospace company CAE Inc. which had received \$81.6M from the Canadian Federal Government in the form of an un-secured, non-forgivable loan under the Strategic Aerospace and Defense Initiative (“SADI”) program. The courts ruled that:

1. The funds from the loans acted to reduce CAE's SR&ED ITCs (not surprising, intended and very well precedented).
2. Although the loans were repayable, since the terms were not “strictly commercial” some of the loaned funds were taxable as income (very surprising, unintended and unprecedented).

In May 2022 the Supreme Court of Canada denied CAE's application to appeal the FCA and TCC decisions.

In August 2023, CPA Canada and the Canadian Bar Association made a joint submission to the Canadian Department of Finance outlining the need for some legislative measure to correct the situation and prevent a landslide of unintended consequences.

The fall economic statement included the following text on page 124:

Concessional Loans

Under the Income Tax Act, if a taxpayer receives government assistance in the course of earning income from a business or property, the amount of that assistance may reduce the amount of a related expense or the cost or capital cost of a related property, or may be included in the taxpayer's income. The amount of assistance may also reduce the amount of an expenditure on which an associated investment tax credit is based.

Historically, non-forgivable loans from public authorities were generally not considered government assistance. This position extended to concessional loans (meaning loans that do not bear interest or that bear interest at below-market rates) from public authorities. However, in a 2021 decision, the Tax Court of Canada determined that the full principal amount of a concessional loan was government assistance. This decision was affirmed by the Federal Court of Appeal in 2022.

The 2023 Fall Economic Statement proposes to amend the Income Tax Act to provide that bona fide concessional loans with reasonable repayment terms from public authorities will generally not be considered government assistance.

This amendment would come into force on the date of the 2023 Fall Economic Statement.

It is important to note:

It is unclear if the resulting legislation will affect SR&ED ITCs or not. The wording of the last sentence in the statement *"The amount of assistance may also reduce the amount of an expenditure on which an associated investment tax credit is based."* suggests it might. However, this is tempered by the final sentence, *"... bona fide concessional loans with reasonable repayment terms from public authorities will generally not be considered government assistance"*. Furthermore, the letter sent jointly by the Canadian Bar Association / CPA Canada to the department of finance explicitly mentions only "income inclusions".

It won't likely help / relieve CAE Inc. on the tax years covered by the extant TCC and FCA decisions. The only relief available to CAE Inc. is likely to be reclaiming the lost SR&ED ITCs at line 445 Form T661 if – in the future – any portion of the loan is repaid, or if funds that were available but not received are no longer available.

Learn More

Full text of 2023 Fall Economic Statement Canadian Federal Government (see page 124)

<https://www.budget.canada.ca/fes-eea/2023/report-rapport/FES-EEA-2023-en.pdf>

Letter from CPA Canada and the Canadian Bar Association to the Canadian Department of Finance

<https://www.scitax.com/pdf/01119-TX-August-2023-JCT-Submission-CAE.pdf>

Full text of the Tax Court Canada decision on CAE (14-Sep-2021)

https://www.scitax.com/pdf/Dckt_2016-4984-IT-G_14-Sep-2021.pdf

Full text of the Federal Court of Appeal decision on CAE (19-Oct-2022)

https://www.scitax.com/pdf/Dckt_A-264-21_19-Oct-2022.pdf

Scitax Bulletin #59 Supreme Court Declines Immunovaccine SR&ED Case (27-Mar-2015)

<https://www.scitax.com/pdf/Bulletin.59.Supreme.Court.Declines.Immunovaccine.SRED.Case.27-Mar-2015.pdf>

Canadian Government publication "Strategic Aerospace and Defence Initiative (SADI) - Program Guide"

https://www.ic.gc.ca/eic/site/ito-oti.nsf/eng/h_00022.html

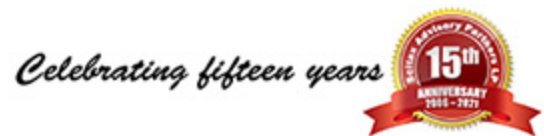
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