Fix announced for “government assistance" tax problem regarding low-interest loans

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Overview

In Canada’s Fall Economic Statement, the federal government announced a fix for tax problems related to government assistance in the form of low-or-no-interest loans. Read on to learn more about this latest development.

Background

The *Income Tax Act* (Canada) (ITA) has various adverse rules dealing with “government assistance” received, receivable or expected to be received by a taxpayer. In some cases, these rules reduce the amount of a taxpayer’s expenditures by the amount of government assistance obtained that relates to such expenditures. This has the impact of reducing deductible expenses, increasing profit and thereby increasing income tax payable. In other cases, these rules reduce the taxpayer’s cost basis in property it has acquired by the amount of related government assistance. This also has the effect of reducing deductible expenses (*i.e.*, where the property is depreciated such that its cost is deducted in computing income for tax purposes over a series of annual deductions), and may also reduce the amount of investment tax credits (ITCs) the taxpayer may claim that are computed as a percentage of the cost of qualifying property or expenditures. Finally, in other cases the amount of government assistance is simply added to the taxpayer’s income for tax purposes. Under all of these provisions (collectively the “government assistance rules”), understanding what constitutes “government assistance” and the impact of obtaining it is key.

In May 2023, the Supreme Court of Canada refused to hear a taxpayer’s appeal from a Federal Court of Appeal decision holding that certain low-interest loans it had received from the government were “government assistance”, establishing an alarming precedent.[1] The dollars involved were quite substantial, and the result was problematic for a number of reasons, as we have previously observed. First of all, the courts determined that the quantum of “government assistance” that the taxpayer had obtained was the **entire principal amount** of the low-interest loans in question, not the economic value of whatever benefit the below-market interest rate created. For example, one would not have expected that the amount of “government assistance” recognized by the

tax system on a $100 loan borrowed at, say, 2 per cent interest rather than a market rate of 10 per cent interest would be the entire $100.

Moreover, the Canada Revenue Agency's (CRA) decision to pursue the taxpayer flew in the face of a publicly-stated CRA general policy *not* to apply the government assistance rules to low-interest (or even interest-free) loans that are unconditionally repayable.[2] While CRA administrative policies (even published ones) are not the law, the effective functioning of the tax system requires that taxpayers be able to reasonably rely on the CRA's public statements as to various technical and policy issues. As a result, the business community was quite surprised by the results of this decision.

What made the timing of this decision particularly unfortunate is the government's announcement of five new "clean economy" ITCs over the past 18 months. Draft legislation enacting the carbon capture, utilization and storage (CCUS) ITC and clean technology ITC was released in August 2023, with revised versions expected to come before Parliament by the end of 2023. The other three ITCs (clean technology manufacturing, clean electricity and clean hydrogen) are still in the consultation stage, with legislation to be released in 2024.[3] These ITCs, together with $20 billion of funding from Canada Infrastructure Bank (CIB) earmarked for clean economy projects, form the central pillars of the government's "clean economy" initiative contained in the federal budget of March 28, 2023.[4]

The problem is that many of the types of projects targeted by this initiative are very difficult to finance from the private sector, given their sheer size and the related technical and other challenges they entail. CIB financing on advantageous terms was intended to address this very concern. However, the court's decision that loans on off-market terms (*i.e.*, not ordinary commercial agreements) constitute "government assistance" meant that from a practical perspective, clean economy projects could effectively claim the new ITCs or get favourable financing from CIB (a quasi-governmental entity) but not both. Left unchecked, this problem would have severely reduced the impact of the government incentives in this sector and made many desirable clean economy projects uneconomic to build in Canada. These concerns were raised with the government by many interested stakeholders, including The Canadian Chamber of Commerce, The Canadian Bar Association – CPA Canada Joint Committee on Taxation and a variety of industry associations particularly impacted by this situation.

ITA amendments

Happily, the government's Fall Economic Statement (FES) of Nov. 21, 2023 contained an announcement that it intends to fix this issue[5] (Read our 2023 FES commentary). Specifically, the FES states that the ITA will be amended "to provide that *bona fide* concessional loans[6] with reasonable repayment terms from public authorities will generally not be considered government assistance." While draft legislation to this effect was not included with the FES, the government states that this amendment will come into force on Nov. 21, 2023. This relief is very much welcome in the tax and business communities (particularly in affected sectors such as energy, mining and scientific research) and the government should be commended for it.

Footnotes

[1] See *CAE Inc. v. His Majesty the King*

[2] See Archived CRA Interpretation Bulletin IT 273R2, para. 16.

[3] See Delivery Timeline for Clean Economy Investment Tax Credits.

[4] See Supporting Clean Electricity Projects section.

[5] See the Business Income Tax Measures section. For a discussion of the various tax measures contained in the FES, read our previous article.

[6] Defined in the FES as “loans that do not bear interest or that bear interest at below-market rates”.

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