

Canada
Tax

Contacts

National Leader
Albert De Luca
514-393-5322

Global Leader
Natan Aronshtam
416-643-8701

Atlantic
Steven Carr
902-721-5565

Quebec
Martin Vézina
514-393-7139

Louis Boivin
418-696-3951

**Élaine-Nathalie
Lamontagne**
450-618-8112

Julien Lassonde
418-624-5331

Ontario
Brian Harrigan
613-751-5421

Len Lucier
905-315-6730

Cheryl Manuel
519-650-7715

Toronto
Anil Chawla
416-643-8006

Prairies
Ryan Dumonceaux
306-343-4348

Alberta
David Arthur
403-261-8176

British Columbia
Scott Robertson
604-640-3184

Joanne Hausch
604-640-3306

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R&D tax update

Immunovaccine – taxpayer’s appeal dismissed

October 17, 2014 (14-3)

The September 11, 2014 Federal Court of Appeal (FCA) decision in *Immunovaccine Technologies Inc. v. The Queen (Immunovaccine)*, which upheld the characterization of certain loans as “government assistance” for purposes of the scientific research and experimental development (SR&ED) investment tax credit (ITC), may have implications for the funding of innovation in Canada.

In this case, Immunovaccine Technologies Inc. received “contributions” – essentially cash advances which were interest-free and repayable as a percentage of future revenues – from the federal government’s Atlantic Canada Opportunities Agency (ACOA). The Canada Revenue Agency (CRA) assessed the advances as government assistance. Consequently, these amounts were required to be deducted from the taxpayer’s SR&ED and related refundable ITC claims.

The taxpayer argued that the advances constituted an ordinary loan made on reasonable commercial terms in advancement of the business purposes of the federal program. As such, the taxpayer contended, they should not be considered government assistance.

The Tax Court of Canada (TCC) agreed with the CRA and disallowed the taxpayer’s appeal. The court determined that the advances were government assistance which reduced the taxpayer’s SR&ED ITCs for the 2005-2008 taxation years. Although the advances were not subsidies or forgivable loans, they were considered to constitute “any other form of assistance”. Furthermore, according to the TCC, the terms and conditions did not reflect conventional commercial conditions and therefore constituted government assistance.

The FCA upheld the TCC’s decision and dismissed the taxpayer’s argument that under the statutory interpretation principle of *ejusdem generis*, the amounts received from ACOA should not be characterized as “any other form of assistance”. *Ejusdem generis*, which means “of the same kind” in Latin, provides that general words following a list of specific terms should be interpreted as including only items of the same nature as those listed. As a result of this decision, the advances from ACOA were considered government assistance and deducted from the taxpayer’s amount of eligible expenditures for the ITC.

In considering the implications of this decision, it should be noted that when government assistance is repaid, the ITCs are in effect “returned” to the taxpayer. However, the ITCs can only be applied to offset taxes payable as opposed to being

refundable (i.e., paid even if a qualifying taxpayer has no taxes payable). This fact, along with the delay in entitlement to the tax incentive, can have a detrimental effect on investment in innovation. This challenge is exacerbated by the current Canadian financing landscape where public institutions have filled the void of private industrial funding, when compared to other countries. This public funding is available in a variety of forms that generally contain provisions or terms and conditions which do not match perfectly with conventional commercial conditions such as those found in funding from banks or equity investors (e.g., loans at reduced rates or no interest rate or loans with unconventional repayment terms).

As a result of this decision, loans from public institutions may be deemed to be government assistance, reducing SR&ED ITCs. Furthermore, it remains to be seen whether loans will be the only financial instruments impacted, as the decision rests on the premise that the funding in question does not reflect conventional commercial conditions. Based on this premise, other financial instruments, including equity, may perhaps be considered government assistance if the terms and conditions are unconventional. It will also be interesting to know how conditions will be determined as conventional or unconventional especially considering the wide array of financial instruments available in the Canadian landscape.

This subject is quite complex and very relevant in Canada, where government support is needed to promote investments in R&D. It would be unfortunate if Canada were to be placed at a disadvantage compared to other larger economies where private funding is more prevalent, given the relatively small size of our economy, and the limited access to private financial markets.

Deloitte professionals are closely involved in resolving these issues and are available to further discuss the corresponding risks and solutions.

Albert De Luca, National Leader

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2 Queen Street East, Suite 1200
Toronto, ON M5C 3G7 Canada

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