Docket: 2016-4984(IT)G

BETWEEN:

CAE INC.,

Appellant,

and

HER MAJESTY THE QUEEN,

Respondent.

[OFFICIAL ENGLISH TRANSLATION]

Appeal heard on June 3 and 4, 2019, and August 24 and 25, 2020, at Montreal, Quebec.

Before: The Honourable Justice Sylvain Ouimet

Appearances:

Counsel for the appellant:	Wilfred Lefebvre Marc-Olivier Plante
Counsel for the respondent:	Dany Leduc Antonia Paraherakis

JUDGMENT

The appeal from the assessments made pursuant to the *Income Tax Act* for the 2012 and 2013 taxation years is dismissed with costs in accordance with the attached reasons for judgment.

Signed at Ottawa, Canada, this 14th day of September 2021.

"Sylvain Ouimet"

Judge Ouimet

Translation certified true
on this 2nd day of October 2023.

François Brunet, Revisor

Citation: 2021 TCC 57
Date: September 13, 2021
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AMENDED REASONS FOR JUDGMENT

Judge Ouimet

I. INTRODUCTION

(1) CAE Inc. (CAE) is appealing against two assessments made by the Minister of National Revenue (the Minister) on December 15 and October 26, 2016. These assessments are for the 2012 and 2013 taxation years. According to these assessments, the Minister found that the amounts received by CAE pursuant to an agreement entered into with the Minister of Industry Canada entitled "- SADI Agreement NO. 780-503924 - Strategic Aerospace and Defence Initiative - Project Falcon" (SADI Agreement) constituted "government assistance" within the meaning of subsection 127(9) of the *Income Tax Act*, R.S.C., 1985, c. 1 (5th Supp.) (ITA). More specifically, the Minister held that the amounts of $57,084,395 and $59,148,888 that CAE received or was entitled to receive under the SADI Agreement during the 2012 and 2013 taxation years respectively, constituted a form of "government assistance."

(2) Having found that the amounts of $57,084,395 and $59,148,888 constituted a form of "government assistance" within the meaning of subsection 127(9) of the ITA, the Minister concluded that the amounts of $41,003,491 and $40,652,951 received by CAE under the SADI Agreement during the 2012 and 2013 taxation

years that were used for scientific research and experimental development ("SR&ED") were to be subtracted from the amount of CAE's deductible SR&ED expenditures pursuant to paragraph 37(1)(d) of the ITA for those taxation years.

(3) In addition, pursuant to subsection 127(18) of the ITA, the Minister held that the amounts that CAE received or was entitled to receive under the SADI Agreement during the 2012 and 2013 taxation years, i.e., $57,084,395 and $59,148,888 respectively, were to be subtracted from the amount of SR&ED expenditures eligible for the purposes of CAE's investment tax credit for those taxation years.

(4) Finally, pursuant to subparagraphs 12(1)(x)(iv) and 12(1)(x)(v) of the ITA, the Minister found that the amount of $14,806,939, i.e., the difference between the amount that CAE received during the 2012 taxation year under the SADI Agreement ($55,810,430) and the amount of CAE's SR&ED expenditures during that same year in connection with the Agreement ($41,003,491), was to be included in the computation of CAE's income for the 2012 taxation year.

(5) The following persons testified on behalf of the respondent at the hearing:

- Jean Lemieux, employee of the Strategic Innovation Fund at the Department of Industry Canada.
- Neil de Gray, expert witness.

(6) The following persons testified on behalf of the appellant at the hearing:

- Constantino Malatesta, Vice-President, Finance, CAE.
- Sylvie Brossard, Vice-President, Taxation Department, CAE.

II. ISSUES

(7) The issues are as follows:

1. Was the Minister correct in finding that the amounts of $57,084,395 and $59,148,888 that CAE received or was entitled to receive under the SADI Agreement during the 2012 and 2013 taxation years respectively, constituted "government assistance" within the meaning of subsection 127(9) of the ITA?

2. Was the Minister correctin finding that the amounts of $57,084,395 and $59,148,888 that CAE received or was entitled to receive under the SADI

Agreement should be subtracted from the amount of SR&ED expenditures eligible for purposes of computing CAE's investment tax credit for the 2012 and 2013 taxation years respectively, pursuant to subsection 127(18) of the ITA?

3. Was the Minister correct in finding that the amounts of $41,003,491 and $40,652,951[1] that CAE received under the SADI Agreement for the 2012 and 2013 taxation years should be subtracted from the amount of SR&ED expenditures deductible from CAE's income for the 2012 and 2013 taxation years, respectively, pursuant to paragraph 37(1)(d) of the ITA?

4. Was the Minister correct in finding that the amount of $14,806,939 was to be included in computing CAE's income for the 2012 taxation year pursuant to subparagraph 12(1)(x)(iv) of the ITA?

(8) In the alternative, if the Court were to conclude that the amounts that CAE received under the SADI Agreement did not constitute a form of "government assistance" within the meaning of subsection 127(9) of the ITA, the Court will have to answer the following question:

Did the amounts that CAE received under the SADI Agreement during the 2012 and 2013 taxation years, respectively, constitute inducements, reimbursements or contributions within the meaning of subparagraphs 12(1)(x)(iii) and (iv) of the ITA?

III. RELEVANT STATUTORY PROVISIONS

(9) The relevant statutory provisions are as follows:

***Income Tax Act*, R.S.C., 1985, c. 1 (5th Supp.)**

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 particular 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

(i) a person or partnership (in this paragraph referred to as the “payer”) who pays the particular amount

[1] The amounts of $41,003,491 and $40,652,951 that CAE received during the 2012 and 2013 taxation years respectively are included in the amounts of $57,084,395 and $59,148,888 mentioned in the second issue.

(A) in the course of earning income from a business or property,

(B) in order to achieve a benefit or advantage for the payer or for persons with whom the payer does not deal at arm's length, or

(C) in circumstances where it is reasonable to conclude that the payer would not have paid the amount but for the receipt by the payer of amounts from a payer, government, municipality or public authority described in this subparagraph or in subparagraph (ii), or

(ii) a government, municipality or other public authority,

where the particular amount can reasonably be considered to have been received

(iii) as an inducement, whether as a grant, subsidy, forgivable loan, deduction from tax, allowance or any other form of inducement, or

(iv) as a refund, reimbursement, contribution or allowance or as assistance, whether as a grant, subsidy, forgivable loan, deduction from tax, allowance or any other form of assistance, in respect of

(A) an amount included in, or deducted as, the cost of property, or

(B) an outlay or expense,

to the extent that the particular amount

(v) was not otherwise included in computing the taxpayer's income, or deducted in computing, for the purposes of this Act, any balance of undeducted outlays, expenses or other amounts, for the year or a preceding taxation year,

(v.1) is not an amount received by the taxpayer in respect of a restrictive covenant, as defined by subsection 56.4(1), that was included, under subsection 56.4(2), in computing the income of a person related to the taxpayer,

(vi) except as provided by subsection 127(11.1), 127(11.5) or 127(11.6), does not reduce, for the purpose of an assessment made or that may be made under this Act, the cost or capital cost of the property or the amount of the outlay or expense, as the case may be,

(vii) does not reduce, under subsection 12(2.2) or 13(7.4) or paragraph 53(2)(s), the cost or capital cost of the property or the amount of the outlay or expense, as the case may be, and

> (viii) may not reasonably be considered to be a payment made in respect of the acquisition by the payer or the public authority of an interest in the taxpayer, an interest in, or for civil law a right in, the taxpayer's business or an interest in, or for civil law a real right in, the taxpayer's property;

37 (1) Where a taxpayer carried on a business in Canada in a taxation year, there may be deducted in computing the taxpayer's income from the business for the year such amount as the taxpayer claims not exceeding the amount, if any, by which the total of

(. . .)

> (c) the total of all amounts each of which is an expenditure made by the taxpayer in the year or in a preceding taxation year ending after 1973 by way of repayment of amounts described in paragraph 37(1)(d),

(. . .)

exceeds the total of

> (d) the total of all amounts each of which is the amount of any government assistance or non-government assistance (as defined in subsection 127(9)) in respect of an expenditure described in paragraph (a) or (b), as paragraph (a) or (b), as the case may be, read in its application in respect of the expenditure, that at the taxpayer's filing-due date for the year the taxpayer has received, is entitled to receive or can reasonably be expected to receive,

67. In computing income, no deduction shall be made in respect of an outlay or expense in respect of which any amount is otherwise deductible under this Act, except to the extent that the outlay or expense was reasonable in the circumstances.

127 (9) In this section

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 127(5) or 127(6); (aide gouvernementale)

non-governmental assistance means an amount that would be included in income under paragraph 12(1)(x) if that paragraph were read without reference to subparagraphs 12(1)(x)(v) to (vii); (aide non gouvernementale)

127 (18) Where on or before the filing-due date for a taxation year of a person or partnership (referred to in this subsection as the "taxpayer") the taxpayer has received, is entitled to receive or can reasonably be expected to receive a particular amount that is government assistance, non-government assistance or a contract payment that can reasonably be considered to be in respect of scientific research and experimental

development, the amount by which the particular amount exceeds all amounts applied for preceding taxation years under this subsection or subsection 127(19) or 127(20) in respect of the particular amount shall be applied to reduce the taxpayer's qualified expenditures otherwise incurred in the year that can reasonably be considered to be in respect of the scientific research and experimental development.

***Interpretation Act*, R.S.C., 1985, c. I-21**

Rules of Construction
Property and Civil Rights
Duality of legal traditions and application of provincial law

8.1 Both the common law and the civil law are equally authoritative and recognized sources of the law of property and civil rights in Canada and, unless otherwise provided by law, if in interpreting an enactment it is necessary to refer to a province's rules, principles or concepts forming part of the law of property and civil rights, reference must be made to the rules, principles and concepts in force in the province at the time the enactment is being applied.

***Civil Code of Québec*, CQLR, c CCQ-1991**

BOOK FOUR – PROPERTY
TITLE TWO – OWNERSHIP
CHAPTER I – NATURE AND EXTENT OF THE RIGHT OF OWNERSHIP

947. Ownership is the right to use, enjoy and dispose of property fully and freely, subject to the limits and conditions for doing so determined by law.

Ownership may be in various modalities and dismemberments.

BOOK FIVE – OBLIGATIONS
TITLE ONE – OBLIGATIONS IN GENERAL
CHAPTER II – CONTRACTS
DIVISION IV – NTERPRETATION OF CONTRACTS

1425. The common intention of the parties rather than adherence to the literal meaning of the words shall be sought in interpreting a contract.

1426. In interpreting a contract, the nature of the contract, the circumstances in which it was formed, the interpretation which has already been given to it by the parties or which it may have received, and usage, are all taken into account.

1427. Each clause of a contract is interpreted in light of the others so that each is given the meaning derived from the contract as a whole.

1428. A clause is given a meaning that gives it some effect rather than one that gives it no effect.

1429. Words susceptible of two meanings shall be given the meaning that best conforms to the subject matter of the contract.

1430. A clause intended to eliminate doubt as to the application of the contract to a specific situation does not restrict the scope of a contract otherwise expressed in general terms.

1431. The clauses of a contract cover only what it appears that the parties intended to include, however general the terms used.

1432. In case of doubt, a contract is interpreted in favour of the person who contracted the obligation and against the person who stipulated it. In all cases, it is interpreted in favour of the adhering party or the consumer.

TITLE TWO – NOMINATE CONTRACTS
CHAPTER XII – LOAN
DIVISION I – NATURE AND KINDS OF LOANS

2312. There are two kinds of loans: loan for use and simple loan.

2314. A simple loan is a contract by which the lender hands over a certain quantity of money or other property that is consumed by use to the borrower, who binds himself to return a like quantity of the same kind and quality to the lender after a certain time.

2315. A simple loan is presumed to be by gratuitous title unless otherwise stipulated or unless it is a loan of money, in which case it is presumed to be by onerous title.

DIVISION III – SIMPLE LOAN

2327. By simple loan, the borrower becomes the owner of the property loaned and he bears the risks of loss of the property from the time it is handed over to him.

IV. FACTS

A. Background

(10) CAE is a Canadian company that was founded in 1947. Its head office is located in Ville Saint-Laurent in the Province of Quebec[2]. CAE is a public corporation listed on the Toronto Stock Exchange[3]. CAE is primarily engaged in the manufacture, sale and maintenance of flight simulators. The company also provides

[2] Partial agreed statement of facts, at paragraph 1.
[3] *Ibid* at paragraph 2.

training sessions in flight simulators for the civil and military aviation industries. The company operates in more than 30 countries and employs approximately 9,000 people worldwide[4].

(11) In 2007, as part of a strategic initiative targeting the aerospace and defence industries, the Minister of Industry Canada created the Strategic Aerospace and Defence Initiative, the "SADI Program"[5].

(12) The SADI Program objectives were as follows:

1. Promote research and strategic development leading to innovation and excellence in products, services and processes;

2. Make Canadian businesses more competitive;

3. Foster collaboration between research institutes, universities, colleges and the private sector[6].

(13) Under the SADI Program, a financial contribution to a research and development project could be granted to a company operating in the aerospace, space or defence sectors[7]. The Department of Industry Canada's Industrial Technologies Office administered this program[8].

B. SADI Agreement

(14) On March 30, 2009, the Minister of Industry Canada and CAE entered into an agreement regarding the SADI Program[9]. This agreement, the SADI Agreement pertained to the CAE's SR&ED "Project Falcon." This project required SR&ED expenditures of $700,000,000 over a five-year period, from 2009 to 2014[10]. It bore on the development of flight simulator and health sector technologies[11]. Under the agreement, the Minister of Industry Canada contributed financially to the project by making "contributions" to CAE between 2009 and 2014 inclusive. These contributions are defined in the agreement as "financial assistance" intended to fund

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[4] *Ibid*.
[5] *Ibid* at paragraph 4.
[6] *Ibid* at paragraph 7.
[7] *Ibid* at paragraph 6.
[8] *Ibid* at paragraph 5.
[9] English translation of the title of the agreement.
[10] Above note 2 at paragraph 8. The original agreement was amended four times between March 2010 and March 2013.
[11] Respondent's expert report, at page 5.

CAE's SR&ED activities in connection with Project Falcon[12]. These contributions constituted 35% of the total "eligible expenses"[13] incurred by CAE in connection with Project Falcon and could not exceed $250,000,000[14]. More specifically, the annual contributions that could be paid to CAE were not to exceed the following amounts[15]:

Government fiscal years	Maximum contributions payable
2009/2010	$31,750,000
2010/2011	$53,250,000
2011/2012	$57,100,000
2012/2013	$63,000,000
2013/2014	$44,900,000
TOTAL	$250,000,000

(15) CAE received $250,000,000, the maximum amount payable to it under the SADI Agreement.

(16) During the 2012 and 2013 taxation years, the amounts CAE received or was entitled to receive under the SADI Agreement were $57,084,395 and $59,148,888 respectively[16]. Only a portion of these amounts was used by CAE to pay for SR&ED expenditures incurred in relation to the Falcon Project, i.e., $41,003,491 in 2012 and $40,652,951 in 2013[17].

(17) Under the SADI Agreement, reimbursement of contributions must be made in 15 annual installments. The total reimbursement is the amount equivalent to the total contributions paid to CAE multiplied by a factor of 1.35. CAE received contributions

[12] Above note 2 at paragraphs 12–13. See also clauses 6.1 and 6.2 of the SADI Agreement as well as the definition of the word "Project" in "Schedule 1" as well as the description set out in "Schedule 2" of the SADI Agreement.
[13] Means the costs incurred and paid by the beneficiary in relation to the project indicated in Schedule 2 and in accordance with Schedule 5, excluding those specifically indicated in the statement of work as not being covered, if applicable, or other charges prohibited elsewhere in this agreement.
[14] Above note 2 at paragraph 10, clause 4.1 of the SADI Agreement.
[15] *Ibid*; Exhibit A-1, clause 4.3; Exhibit A-1, Tab 3, Fourth amendment to the SADI Agreement, clause 3.
[16] *Ibid* at paragraph 26.
[17] *Ibid* at paragraph 28.

totalling $250,000,000, therefore, the total amount to be reimbursed is $337,500,000 ($250,000,000 X 1.35)[18].

(18) According to the SADI Agreement, the reimbursement of contributions is unconditional and not subject to any security[19]. Contributions must be reimbursed according to the schedule and the conditions set out in the agreement. Annual reimbursements must be made no later than July 31 of each year starting in 2015, approximately six years after receipt of the first contributions. The last of the 15 reimbursements is due on July 31, 2029[20]. Under the terms of reimbursement set out in the Agreement, contributions made to CAE implicitly provide the Minister of Industry Canada with an approximate annual rate of return of 2.50%[21].

(19) The amounts to be reimbursed annually by CAE under the SADI Agreement are as follows[22]:

Reimbursements	Payment	Year
1	$11,250,000	2015
2	$11,250,000	2016
3	$11,250,000	2017
4	$11,250,000	2018
5	$22,500,000	2019
6	$22,500,000	2020
7	$22,500,000	2021
8	$22,500,000	2022
9	$22,500,000	2023
10	$22,500,000	2024
11	$33,750,000	2025
12	$33,750,000	2026
13	$33,750,000	2027
14	$33,750,000	2028
15	$33,750,000	2029
TOTAL	$337,500,000	

(20) Under the terms of the SADI Agreement, CAE is subject to certain restrictions. For example, CAE is committed to exclusively manufacturing all

[18] *Ibid* at paragraphs 18, 19; Exhibit A-1, above note 15, Tab 2 "SADI Agreement," Schedule 3, clauses 1, 2.1 and 2.2.
[19] *Ibid* at paragraphs 16, 37; Exhibit A-1, above note 15, Tab 2 "SADI Agreement," Schedule 3, clauses 1, 2.1 and 2.2.
[20] *Ibid* at paragraph 17; Exhibit A-1, above note 15, Tab 2 "SADI Agreement," Schedule 3, clauses 1, 2.1 and 2.2.
[21] *Ibid* at paragraph 21.
[22] *Ibid* at paragraph 20; Exhibit A-1, above note 15, Tab 2 "SADI Agreement," Schedule 3, clauses 1, 2.1 and 2.2.

Project Falcon products in Canada, and certain other restrictions apply to CAE's ability to transfer titles or intellectual property rights relating to the Project[23]. CAE is also required to notify the Minister of Industry Canada of any other government financial assistance requested or received in connection with the Project. If such assistance were to be received, the contributions receivable could be reduced[24]. In addition, in order to be eligible to receive funds under the SADI Program, CAE had to establish a cooperation plan with accredited post-secondary institutions in Canada and allocate them at least 1.0% of the Project's total eligible SR&ED expenditures[25].

(21) The SADI Agreement stipulates that meetings may be organized between the parties to review the results of the SR&ED work undertaken under Project Falcon and to verify whether the SADI Program's performance objectives are being met[26]. Also, CAE must periodically send the Minister of Industry Canada reports on the following subjects[27]:

1. Progress on the Falcon Project's SR&ED work[28];
2. Results achieved[29];
3. SADI Program yields[30].

(22) The SADI Agreement may be terminated by CAE upon early reimbursement of all contributions received and payment of an amount equal to a 2.75% annual return on investment with respect to amounts reimbursed ahead of time[31].

C. Testimony provided by Constantino Malatesta

(23) Mr. Malatesta has been working for CAE since 2006. He was appointed Vice President of Finance and Controller in 2016. During the negotiations leading to the signing of the SADI Agreement, Mr. Malatesta was in charge of CAE's "Complex Accounting Group"[32]. He first noted that, as CAE is a public corporation listed on

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[23] *Ibid* at paragraph 34; Exhibit A-1, above note 5, Tab 2 "SADI Agreement," clause 8.1(e).
[24] *Ibid* at paragraph 35.
[25] *Ibid* at paragraph 36.
[26] *Ibid* at paragraph 32; Exhibit A-1, *supra* note 15, Tab 2 "SADI Agreement," Schedule 6, clause 1.2.
[27] *Ibid* at paragraphs 30–31.
[28] Exhibit A-1, above note 15, Tab 2 "SADI Agreement" Schedule 6, clauses 1.1(a) and 1.2(a).
[29] Above note 2 clauses 1.2(b), 1.3.
[30] *Ibid* clause 1.3.
[31] *Ibid* at paragraph 38; Exhibit A-1, above note 15, Tab 2 "SADI Agreement," clause 8.17.
[32] Transcript of the June 3, 2019, hearing, page 24.

the Toronto and New York Stock Exchanges; its financial statements are audited by independent auditors on a quarterly basis, and an audit report is produced annually[33].

(24) According to Mr. Malatesta, CAE used the SADI Program to fund its SR&ED projects[34]. Mr. Malatesta's role was to provide opinions on the funding and accounting aspects of such projects including when agreements similar to the SADI Agreement were entered into[35].

(25) Mr. Malatesta testified as to the circumstances surrounding the signing of the SADI Agreement. He did not participate directly in the negotiations, but was involved in the CAE negotiating team's discussions[36]. Nathalie Bourque negotiated on behalf of CAE, and Mr. Lemieux negotiated on behalf of the Minister of Industry Canada[37]. The negotiations leading to the signing of the agreement lasted several months.

(26) In October 2008, CAE considered a reimbursement option whereby it could reimburse government contributions on the basis of a percentage of earned income based on sales growth ("conditional reimbursement")[38]. Ultimately, CAE did not pursue this option. CAE chose the funding option that involved a reimbursement independent of sales growth, i.e., a fixed installment payment program ("unconditional reimbursement"), because it found that this provided CAE with more liquidity and a lower incurred effective interest rate[39]. This aspect of the agreement was the subject of negotiations between the parties[40].

(27) CAE made the reimbursements and, according to Mr. Malatesta, it was always able to make them[41]. According to CAE's consolidated financial statements for 2010 and 2012, revenues and assets were in the billions of dollars, and they were expected to grow from year to year[42]. Although CAE did not provide a surety to guarantee reimbursement of contributions received, it is a public corporation and, therefore,

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[33] *Ibid* at page 23.
[34] *Ibid* at page 24.
[35] *Ibid* at page 25.
[36] *Ibid*.
[37] *Ibid* at page 26.
[38] *Ibid* at pages 9, 31–33.
[39] *Ibid* at page 33.
[40] *Ibid* at page 69.
[41] *Ibid* at pages 34, 36.
[42] *Ibid* at pages 36–38.

financial statements and other public documents could be used to assess its reimbursement capacity[43].

(28) With respect to the accounting treatment of the contributions received from the Minister of Industry Canada, they were generally characterized as long-term obligations in CAE's consolidated financial statements[44]. In order to comply with generally accepted accounting principles (GAAP)[45], certain accounting adjustments had to be made. According to Mr. Malatesta, the contributions received did not really reflect CAE's financial obligation, given the terms of reimbursement[46]. Therefore, the amounts received were adjusted to reflect their real values[47]. The amount of contributions received has been reduced according to the prevailing market interest rate for such funding[48]. These reductions take into account the duration of the agreement, including the reimbursement period.

(29) CAE concluded that the effective interest rate for the SADI Agreement was approximately 2.7%[49]. CAE adjusted this rate to reflect the interest rate that would have been paid in a comparable transaction made at the prevailing market rate of interest, which is its fair market value[50]. The cash value of the difference between the effective interest rate and the interest rate that would have been determined in a transaction at fair market value is added in the computation of income for accounting purposes in accordance with GAAP[51]. This growth component, along with the effective rate, is what it costs CAE to fund the Agreement[52].

(30) Ultimately, the total interest that would have been payable on a fair market value loan, i.e., $210,475,399, was deducted as a funding expense in the financial statements[53]. The amount of $122,975,399 representing the growth component was recorded as income. It constituted a reduction in operating expenses or a reduction in capitalized expenditures[54]. The $210,475,399 financing cost was effectively reduced by the growth component. This reduced the interest expense in the financial

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[43] *Ibid* at page 37.
[44] *Ibid* at page 40.
[45] *Ibid* at page 45.
[46] *Ibid* at page 41.
[47] *Ibid*.
[48] *Ibid*.
[49] *Ibid* at pages 47–48. Mr. Malatesta defined the effective interest rate as the rate incurred even if no reimbursement was payable during the year.
[50] *Ibid* at page 41.
[51] *Ibid* at pages 52–53.
[52] *Ibid* at pages 47, 53.
[53] *Ibid* at page 53.
[54] *Ibid* at page 73.

statements to $87,500,000, the amount of interest actually paid by CAE under the terms of the agreement[55].

(31) In order to determine the fair market value of the interest rate payable in an agreement comparable to the SADI Agreement, CAE examined the interest rate that private corporations agreed upon in such transactions[56]. It looked at the interest rate paid on bonds[57], as well as the rates payable in other transactions where the party that was to receive funds had a credit rating similar to CAE's[58]. It used the highest market rates because its Agreement entailed a greater risk given that it did not provide the government with the same guarantees and protections provided in similar transactions and considering that the amounts receivable would be used for SR&ED activities[59].

(32) According to Mr. Malatesta, the difference between the total amount of interest payable on contributions received under the SADI Agreement and the total amount of interest that should have been paid by CAE if it had had to pay interest on those contributions at the market interest rate, i.e., $122,975,399 ($210,475,399 - $87,500,000), was described as a "government benefit" in CAE's financial statements[60].

D. Testimony provided by Sylvie Brossard

(33) Ms. Brossard has been working for CAE since 2007. At the time of the trial, she was Vice President of CAE's Tax Department. Much of Ms. Brossard's testimony focused on the accounting treatment of contributions that CAE received under the SADI Agreement.

(34) Ms. Brossard testified that CAE did not include in its income the amounts received as contributions under the SADI Agreement, because CAE considered them amounts received from a loan and not received as "government assistance"[61]. For the same reason, CAE did not use these amounts to reduce its eligible SR&ED expenditures[62].

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[55] *Ibid* at pages 53–54.
[56] *Ibid* at page 80.
[57] *Ibid* at pages 73, 77, 84–85.
[58] *Ibid* at page 85.
[59] *Ibid* at pages 83–84.
[60] *Ibid* at pages 93–94.
[61] *Ibid* at pages 112, 118.
[62] *Ibid* at page 112.

(35) CAE included in its 2012 income statements a fictitious profit generated by this loan, which was obtained at a preferential rate. CAE also included in these very 2012 statements a fictitious interest expense equal to the difference between the amounts paid as interest under the SADI Agreement and the amounts that should have been paid as interest if the loan had been granted at the market rate of interest. This amount was "offset" by the addition of a non-deductible expense that cancelled the fictitious profit generated by the preferential interest rate in CAE's financial statements[63].

E. Testimony provided by Jean Lemieux

(36) Mr. Lemieux has been working at the Department of Industry Canada's Strategic Innovation Fund since 2006. He was the Manager and Senior Investment Analyst and, as such, prepared the documents required to enter into the SADI Agreement.

(37) According to Mr. Lemieux, the Industrial Technologies Office implemented the SADI Program in 2007 to promote research and development projects and collaboration with universities, colleges, post-secondary institutions and research institutes within the framework of such projects. The Program also sought to promote the economic development of the aerospace, defence, space and security industries by contributing financially to research and development projects of companies operating in these sectors. Mr. Lemieux also said these industries are important to Canada and have traditionally always been heavily subsidized[64].

(38) The objective of the SADI Program was not to generate a return on contributions, and the program does not have a target rate of return. However, an agreement entered into under the Program could not be limited to providing for the reimbursement of contributions paid to a company. The Agreement was supposed to provide for a reasonable rate of return on "investment" in order to comply with World Trade Organization rules[65].

(39) According to Mr. Lemieux, the amounts received from companies under the SADI Program are, for the most part, transferred to the government's consolidated fund. Only part of these amounts is retained and included in the Program budget.

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[63] Exhibits A-4 and A-5 "Schedule 1 – Net income (net loss) for income tax purposes"; Transcripts of the June 3, 2019, hearing, at page 111.
[64] *Ibid* at pages 122–123.
[65] *Ibid* at pages 154–155.

(40) The SADI Program is a so-called "contribution" program. According to Mr. Lemieux, this is why the SADI Agreement does not characterize the Program as a loan. In addition, the relevant government documents do not stipulate that a loan may be obtained under the Program[66].

(41) The most important criterion that a company must meet in order to benefit from the SADI Program is to demonstrate that Canada will benefit from the project[67]. According to Mr. Lemieux, CAE was able to benefit from the program because it demonstrated that it was a well-established flight simulator company and that the amounts obtained under the Program would allow Canada and the company to maintain its leadership in the flight simulator industry. In addition, the Canadian workforce would benefit from the training that would be provided to them through CAE's participation in the Program, and the Canadian population would benefit as well because using flight simulators for training purposes is beneficial to the environment. Finally, Canadian companies collaborating with CAE would indirectly benefit from CAE's participation in the program[68].

(42) Mr. Lemieux explained that under the SADI Program, a maximum contribution equal to 30% of the total SR&ED expenditures incurred for a project could be paid. During the negotiation of the SADI Agreement, the Minister of Industry Canada offered CAE two options for reimbursement of the contributions to be paid to the Minister, i.e., a conditional reimbursement and an unconditional reimbursement. The option that was originally proposed was an agreement with a conditional reimbursement based on the company's sales. In order to establish the terms of a conditional reimbursement, a mathematical formula was used to calculate a royalty rate that was then applied to the company's sales. The result of this calculation was increased by an adjustment factor that varied according to the company's income. When the company's sales increased, the adjustment factor was increased; therefore, in years when a company's sales were growing, the amounts reimbursements were that much greater. A company could also opt for an unconditional reimbursement. Under that option, a fixed amount determined in advance had to be reimbursed annually[69]. However, it was possible to choose a reimbursement plan according to which the amounts reimbursed gradually increased over the years.

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[66] *Ibid* at page 171.
[67] *Ibid* at page 127.
[68] *Ibid* at pages 143–144.
[69] *Ibid* at page 133.

(43) Mr. Lemieux explained that the process leading to the signing of the SADI Agreement began following a proposal from CAE. Discussions to enter into a contribution agreement were then initiated. In accordance with the *SADI Proposal Preparation Guide*, CAE submitted a first proposal and sent it to the Department of Industry Canada in October 2008. As part of this proposal, CAE asked for a total contribution equal to 35% of the Falcon Project's SR&ED expenditures. The proposed reimbursement plan provided for a conditional reimbursement and a 0.28% royalty rate. Mr. Lemieux performed an audit to determine whether the information that CAE produced in its proposal complied with current standards and began a due diligence process including a risk analysis. After this process was completed, he offered CAE two options, a conditional reimbursement option and an unconditional reimbursement option.

(44) However, the conditions for reimbursement of contributions submitted by CAE as well as the expense-sharing ratio defined in its initial proposal did not meet the standards established by the Department of Industry Canada. In January 2009, CAE submitted a second proposal that complied with existing standards. In this proposal, CAE requested a total contribution equivalent to 30% of the SR&ED expenditures incurred. The total contribution was not to exceed $250,000,000. The contributions were to be reimbursed over a period of 15 years, and the amount reimbursed by CAE was to be equal to the total amount of the contributions received multiplied by a minimum adjustment factor of 1.5. The adjustment factor to be used could increase based on the company's sales or sales growth[70].

(45) Negotiations focused on the total amount of contributions to be paid as well as the period over which reimbursements would be made. The reimbursement ratio was set at 1.35, and the total amount of contributions to be paid was increased to an amount equivalent to 35% of the research and development expenditures incurred[71]. In return, the Department of Industry Canada waived some of the research activities deemed to be riskier. The Department proposed two reimbursement options. Both options included a five-year grace period. The first reimbursement option was conditional and dependent on CAE's sales growth. Contributions were to be reimbursed over an eight-year period[72]. As for the second option, the reimbursement of contributions was unconditional and provided for fixed amounts to be reimbursed over a 15-year period[73]. CAE chose the second option[74]. According to Mr. Lemieux,

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[70] *Ibid* at page 149; Exhibit I-1, "Falcon Project Business Plan."
[71] *Ibid* at page 133.
[72] Exhibit I-2, "Falcon Project Business Plan" at page 12.
[73] *Ibid* at page 13.
[74] Transcriptions, above note 32 at pages 160, 163; Transcripts of the June 4,2019, hearing at page 68.

CAE was not required to provide any guarantees or sureties because the SADI Program does not usually require them.

(46) Mr. Lemieux testified that clause 8.17 of the Agreement, which stipulates that CAE can prematurely terminate the Agreement by reimbursing the contributions received in addition to a 2.75% "annual return on investment," was added at CAE's request. The Minister of Industry Canada did not oppose this request even though the addition of this clause could reduce his yield if CAE were to exercise it[75]. As for Clause 6, it stipulated that CAE was required to report any government assistance that it obtained, it was included in the Agreement because, pursuant to a Treasury Board directive, the total percentage of government assistance that a company may receive as contributions under the SADI Program is 75%[76]. Low interest loans must be factored into this total[77]. According to this directive, contributions must be reimbursable to a for-profit company[78]. The clause prohibiting payment of dividends is a standard clause included in all agreements entered into under the SADI Program. However, such clauses only apply if, after an audit, a company reports that it is unable to make the reimbursements stipulated in the agreement or if the deadlines set out in the agreement are not met[79].

(47) SR&ED projects are monitored on an annual or quarterly basis depending on the level of risk associated with the project. An audit is performed as soon as a claim for reimbursement of SR&ED expenditures is filed because a report must be attached to it.

(48) According to Mr. Lemieux, in the event that CAE had encountered financial difficulties, a new risk analysis would have been performed, and the terms of the SADI Agreement would have been renegotiated[80]. It was only as a last resort that the Minister of Industry Canada would have put CAE into default[81]. In some cases, the debt can be written off[82]. If any renegotiations had taken place, they would have sought to ensure that Canada would still benefit from the deal[83]. During his cross-

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[75] *Ibid* at pages 166–167.
[76] Exhibit A-1, above note 15, Tab 1A "Industry Canada's SADI Program Guide," at page 5; Transcripts, above note 32 at page 167; Exhibit I-4, "Directive on Transfer Payments."
[77] Exhibit I-4 "Directive on Transfer Payments," Schedule C, No. 2.
[78] Exhibit I-4, above note 77, Schedule E, at page 25.
[79] *Ibid* at pages 69–72.
[80] *Ibid* at page 57.
[81] *Ibid* at pages 174–177.
[82] *Ibid* at page 175.
[83] *Ibid* at page 81.

examination, Mr. Lemieux said the government was doing this in order to protect its rights[84].

F. Neil de Gray's testimony

1. Mr. de Gray's mandate

(49) Mr. de Gray is the Director of Disputes and Investigations at Duff & Phelps. Since 2010, his firm has specialized in corporate and securities valuation, damage quantification and corporate finance advisory services[85]. The respondent retained his services as an expert in corporate finance and the valuation of debt instruments and securities. Mr. de Gray's services were retained to assist the Court. Mr. de Gray was asked to say whether, in his opinion, the SADI Agreement has the attributes of a "business" and constitutes an "ordinary business arrangement." More specifically, the respondent asked him whether, in his opinion, the payments made pursuant to the SADI Agreement were made "in exactly the same manner and for exactly the same reasons as the payments made by private companies, that is to say in order to promote the interests of the payer"[86]. Mr. de Gray was aware that the parties disagreed as to whether the agreement constituted a loan agreement or some other type of agreement. He was not asked for his opinion on this matter[87].

2. Mr. de Gray's analysis

(50) In assessing the "nature" of the SADI Agreement and determining whether this Agreement has the attributes of a "business enterprise" and constitutes an "ordinary business agreement," Mr. de Gray considered the main conditions of the Agreement which, according to him, are as follows:

a) reimbursement;
b) the SADI Agreement's internal rate of return;
c) clauses and restrictions;
d) other conditions[88].

(51) Mr. de Gray analyzed the terms of the SADI Agreement and concluded that, in general, those terms were based on a higher risk profile and therefore a return at

[84] *Ibid* at page 60.
[85] Respondent's Expert Report at paragraph 1.10.
[86] *Ibid* at paragraph 1.4.
[87] *Ibid* at paragraph 7.1.1.b.
[88] *Ibid* at paragraph 7.1.1.1.

the higher end of the spectrum of returns available with comparable "instruments" on the market[89]. Below, this Court provides a summary of Mr. de Gray's conclusions regarding each of those terms.

(a) Reimbursement

(52) Schedule 3 of the SADI Agreement sets out the terms for reimbursing contributions. They require full unconditional reimbursement of all contributions received by CAE. Reimbursements must be made within a period of 15 years starting in 2015. Overdue amounts earn interest at the "bank rate" plus 3%, compounded monthly[90]. Mr. de Gray found that the requirement to reimburse all contributions received under the Agreement and interest accrued on overdue amounts is generally consistent with the terms of a "business agreement"[91].

(53) Mr. de Gray believed that the deferral of interest and principal payments during the first five years of the SADI Agreement and the 15-year reimbursement period increase the lender's risk associated with the loan agreement. According to Mr. de Gray, it is unusual for a business loan agreement to provide for a five-year deferral of interest and principal. Mr. de Gray said a business loan agreement usually requires some form of reimbursement over the life of the agreement, and deferral periods are usually less than five years[92].

(b) SADI Agreement's implied internal rate of return

(54) Mr. de Gray noted that the SADI Agreement provides the Minister of Industry Canada with a rate of return on funds advanced to CAE. Under the Agreement, CAE must reimburse the full face value of the total amount of contributions received, plus an amount equal to the total amount multiplied by a maximum factor of 0.35 over a period of 15 years[93].

(55) To determine whether the SADI Agreement has the attributes of a "business enterprise" and constitutes an "ordinary business agreement," Mr. de Gray examined whether the "implied" rate of return of the Agreement was a fair market rate of return

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[89] *Ibid* at paragraph 7.3.5.
[90] *Ibid* at paragraph 7.2.1.
[91] *Ibid* at paragraph 7.2.2.
[92] *Ibid* at paragraph 7.2.3.
[93] *Ibid* at paragraph 6.1.

taking into account the risk profile of the "investment." It is an "implied" rate of return because the Agreement does not make any reference to a rate of return.

(56) Based on the total contributions that CAE received ($250,000,000) and the total reimbursements to be made ($337,500,000), Mr. de Gray found that the SADI Agreement provided an $87,500,000 return ($337,500,000 – $250,000,000)[94]. Mr. de Gray determined what this dollar return meant in terms of the annual rate of return. He calculated the implied rate of return based on the cash flow projections in the Agreement and subsequent amendments to the Agreement. He found that the implied internal rate of return under the Agreement was approximately 2.5%[95].

(57) In order to determine whether this rate was a fair market rate for such an "investment," Mr. de Gray considered the following:

1. The terms of the Agreement and their impact on a fair market rate of return;
2. The risk-free benchmark rates of return in effect on the market on the date the parties entered into the Agreement;
3. Yield on investment grade corporate bonds in Canada and the United States during the period in question;
4. Implied rates of return associated with corporate bonds issued by firms in the aerospace and defence industries during the period in question;
5. Implied rates of return associated with CAE's existing trade receivables from arm's length third parties;
6. Implied market rate of return on the SADI Agreement identify by CAE that was reported in its financial reports[96].

Terms of the SADI Agreement

(58) Mr. de Gray examined the terms that, he believed, affected the risk profile of the SADI Agreement. These terms are as follows:

(a) average duration to expiry date;
(b) security;

[94] *Ibid* at paragraph 6.2.
[95] *Ibid* at paragraph 6.5.
[96] *Ibid* at paragraph 7.3.2

(c) clauses and restrictions;
(d) ranking;
(e) terms of reimbursement;
(f) early reimbursement;
(g) fixed rate of return and interest rate.

(a) Average duration to expiry date

(59) Mr. de Gray considered the SADI Agreement had a 20-year term, i.e. a five-year contribution period followed by the 15-year reimbursement period. He said that when the deadline for an agreement is extended, the inherent risk and the rate of return increase accordingly[97].

(b) Securities

(60) "Contributions" under the SADI Agreement are not secured. Since unsecured instruments present a higher inherent risk to the contributor, the rate of return for these instruments is higher.

(c) Clauses and restrictions

(61) The clauses are intended to provide the lender with protections; the risk for the lender is therefore increased if an agreement contains few protective clauses. After examining the SADI Agreement, Mr. de Gray found that few protections were provided. As a result, the risk profile of the Agreement is higher and so is the required return[98].

(d) Ranking

(62) According to Mr. de Gray, the SADI Agreement does not specifically address the "instrument's" ranking with respect to CAE's other issued and outstanding debt "instruments." Mr. de Gray stated that a debt "instrument" is ranked in the order of the "instrument's" eligibility or its priority over the assets of the corporate borrower with respect to other lenders to the corporation. A senior debt "instrument" has a lower risk profile because the lender is more likely to receive the funds owed than a lender holding a junior debt instrument. Mr. de Gray found that because the

[97] *Ibid* at paragraph 7.3.4.
[98] Transcripts of the August 24, 2020, hearing, at pages 75–76.

Agreement is silent on the issue of ranking, this increases the risk exposure for the Minister of Industry Canada[99].

(e) Reimbursement

(63) Mr. de Gray stated that the Minister of Industry Canada's risk exposure was increased because the SADI Agreement does not provide for any reimbursements during the first five years of contribution payments and reimbursement gradually increases during the 15 years following this period. He stated that, normally, lenders require that borrowers at least make interest payments[100]. It follows that the Agreement should provide a higher rate of return.

(f) Early reimbursement

(64) Under the SADI Agreement, CAE is entitled to terminate the agreement prematurely and prepay all amounts due, along with a 2.75% premium. According to Mr. de Gray, this option is generally advantageous for the beneficiary of the capital. Furthermore, the option is detrimental to the funding party because it reduces the funder's ability to forecast the level of its future liquidity. Financial instruments with prepayment options therefore have higher rates of return[101].

(g) Fixed rate of return and interest rate.

(65) The SADI Agreement provides for a fixed rate of return. It remains the same throughout the term of the Agreement, regardless of the market interest rate. Therefore, fixed rates are higher than variable or floating rates because, under a fixed agreement, the lender is exposed to fluctuations in market rates throughout the term of the agreement[102].

<u>The risk-free benchmark rates of return in effect on the market on the date the parties entered into the Agreement</u>

(66) According to Mr. de Gray, a risk-free rate is the theoretical rate of return an investor would expect from a risk-free investment over a given period. A risk-free rate is equal to a base rate or a guaranteed base rate. Therefore, the rate of return on a given instrument must include a premium to offset the increased risk profile. In

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[99] *Ibid* at pages 76–77.
[100] *Ibid.*
[101] *Ibid.*
[102] *Ibid.*

practice, many view the yield on Canadian and US government bonds as an indication of a risk-free rate in Canada and the United States, respectively[103].

(67) Because the term of the SADI Agreement is approximately 20 years, Mr. de Gray examined the risk-free rate of return on 20-year bonds as measured by the Canadian government and the US Treasury[104]. Mr. de Gray compared the implied rate of return of the SADI Agreement to the risk-free rates of return for the period March 31, 2007, to March 31, 2014. He found that the implied rate of return on the Agreement (2.50%) was approximately 1.15% lower than the risk-free rate of return (3.65%) in Canada as at March 30, 2009. Based on this finding, he concluded that because the SADI Agreement had a higher risk profile than risk-free government bonds did, the SADI Agreement should have produced a greater rate of return than the rate for a risk-free investment[105].

Yield on investment grade corporate bonds in Canada and the United States

(68) Mr. de Gray examined the rate of return on Canadian BBB-rated corporate bonds with terms to maturity similar to those of the SADI Agreement, during the period from 2008 to 2014. According to M. de Gray, corporate bonds rated BBB or higher are generally considered investment grade, which means they have a high-quality credit rating.

(69) On March 30, 2009, he found that the approximate rate of return on Canadian corporate bonds with a 20-year maturity and a level of risk comparable to CAE's was 8.54%. Given CAE's risk profile, this led Mr. de Gray to conclude that he expected the rate of return on the SADI Agreement to exceed 8.54%[106].

The implied rates of return associated with corporate bonds issued by firms in the aerospace and defence industries during the period in question

(70) Mr. de Gray pointed out that from 2007 to 2014, several companies within the aerospace and defence industries issued unsecured corporate bonds with 10- to 30-year maturities. Bonds rated A to BB+ during the period provided rates of return ranging from 2.5% to 7.75%. The average rate was 5.13%.

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[103] Above note 85 at paragraph 7.3.7.
[104] *Ibid* at paragraph 7.3.7.
[105] *Ibid* at paragraph 7.3.10.
[106] *Ibid* at paragraph 7.3.13.

(71) After examining, in particular, CAE's internal credit benchmarking, Mr. de Gray found that the rate of return on the SADI Agreement was lower than the rate of return on the aerospace and defence bond market. He found that the Agreement's rate of return was significantly lower than the market rate of return[107].

The implied rates of return associated with CAE's existing trade receivables from arm's length third parties

(72) Mr. de Gray said the implied interest rate under CAE's existing commercial debt agreements with arm's length third parties was a market rate of return indicator for the SADI Agreement. In the notes included in CAE's annual reports, Mr. de Gray saw that CAE was party to several loan agreements during the period 2008 to 2014. Mr. de Gray thought the US$120,000,000 that CAE obtained in 2010 through a private investment was particularly attractive. It was an unsecured investment with an average 8.5-year term to maturity and a combined interest rate of 7.15% with interest payable semi-annually. Considering the proximity of the private placement's issue date and the date on which the SADI Agreement was signed, the amount of the loan and the fact that it was unsecured, Mr. de Gray found that this private placement was a reasonable indicator of a fair market rate of return for the Agreement.

(73) According to Mr. de Gray, the rate of return under the SADI Agreement should have been higher than the 7.15% rate for the private placement, given the following:

1. The term for the Agreement was longer than the term for the private placement: 15 to 20 years versus eight years;

2. The private placement had a higher ranking (senior debt);

3. The Agreement included minimum provisions. The private placement did not;

4. The Agreement included deferred reimbursement terms.

Implied market rate of return associated with CAE's financial reports on the SADI Agreement

(74) According to Mr. de Gray, CAE's consolidated and audited annual financial statements, as well as the information presented in the appendices, provide a better

[107] *Ibid* at paragraph 7.3.18.

understanding of CAE management's assessment of a fair market rate of return for the SADI Agreement.

(75) For the purposes of financial statements, CAE adjusted the par value of contributions received under the SADI Agreement based on their fair market value. CAE used a fair market rate of return for SADI Agreement obligations ranging from 6% for contributions received in 2014 to 13% for contributions received in 2010. Mr. de Gray calculated a 10.1% implied weighted cumulative market rate of return at the end of fiscal 2014[108]. According to CAE's records, the Agreement's liabilities (contributions to be reimbursed) were in line with the upper range of market benchmarks[109].

(76) For example, contributions received by CAE, totalling $33,805,358 for fiscal 2010, were discounted to reflect a $9,125,957 liability on CAE's financial statements. CAE then used a 13% fair market rate of return for contributions made in the fiscal year 2010. Throughout the period during which contributions were made, CAE discounted its total liability from $250,000,000 to $139,095,006.

(c) Clauses and restrictions

(77) Mr. de Gray stated that business agreements are generally subject to several protective clauses and restrictions that protect the funder's interests[110]. These include financial clauses that are specific operating performance measures or ratios used to monitor the borrower's business and assess its reimbursement capacity[111]. They also include positive covenants that require the company to perform certain activities or continue to comply with certain regulations and restrictive covenants that limit the borrower's activities and set limits for the company[112].

(78) Mr. de Gray found that the SADI Agreement contained some protective clauses and restrictions, but fewer than standard business agreements do. In addition, the Agreement does not contain specific financial clauses. As a result, he believed that the Minister of Industry Canada was assuming greater risk with the Agreement than a typical commercial lender would[113].

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[108] *Ibid* at paragraph 7.3.26.
[109] *Ibid* at paragraph 7.3.28.
[110] *Ibid* at paragraph 7.4.1.
[111] *Ibid* at paragraph 7.4.1 a.
[112] *Ibid* at paragraph 7.4.1 b.
[113] *Ibid* at paragraph 7.4.4.

(d) Other conditions

(79) According to Mr. de Gray, the SADI Agreement contains a number of restrictions limiting CAE's ability to dispose of any intellectual property or equipment designed using funds obtained under the Agreement. The Agreement also limits the amount of work that can be performed and the costs that can be incurred outside of Canada. According to Mr. de Gray, these restrictions reflect the Government of Canada's political and national objectives, and they are unusual in an ordinary business agreement[114]. Mr. de Gray added that there are also political reasons for the public communications responsibilities that are set out in Schedule 4 of the Agreement that cover the publication of information and marketing materials. These responsibilities are not common in standard business agreements[115]. Finally, Mr. de Gray said standard business agreements do not usually require the recipient (in this case, CAE) to partner with certain arm's length parties and non-profit organizations in order to be eligible for funding under an agreement[116].

3. Mr. de Gray's findings

(80) Mr. de Gray found that the SADI Agreement does not possess the attributes of a "business enterprise" and does not constitute a "standard business agreement." As a result, he also found that the payments made to CAE under the Agreement were not made exactly the same way and for exactly the same reasons as payments made by private companies, i.e., in order to promote the payer's interests[117].

(81) Mr. de Gray made this finding after having determined that, because of its risk profile, the rate of return on a "financial instrument" such as the SADI Agreement was lower than the rate a "normal investor" would expect to receive from this type of "investment"[118]. More specifically, he drew the following three conclusions:

1. The approximately 2.5% rate of return assumed by the Agreement was significantly lower than the fair market rate of return for a financial instrument with a risk profile comparable to that of the Agreement[119].

[114] *Ibid* at paragraph 7.5.7.
[115] *Ibid* at paragraph 7.5.9.
[116] *Ibid* at page 30.
[117] *Ibid* at page 3.
[118] *Ibid*.
[119] *Ibid* at paragraph 3.1a; Transcripts, above note 98 at pages 57–58.

2. The Agreement is subject to minimum positive and restrictive covenants and does not contain any of the financial clauses that would be characteristic of this type of ordinary business agreement[120].

3. The Agreement contains several other conditions that are not usually found in an ordinary business agreement. These conditions are primarily motivated by political considerations or government action, rather than business reasons[121].

V. POSITIONS OF THE PARTIES

A. Position of the appellant

(82) The appellant submits that the amounts of $57,084,395 and $59,148,888 that CAE received under the SADI Agreement during the 2012 and 2013 taxation years respectively do not constitute "government assistance" within the meaning of subsection 127(9) of the ITA[122].

(83) According to the appellant, paragraph 12(1)(x) and subsection 127(18) of the ITA apply when a taxpayer obtains "government assistance" within the meaning of subsection 127(9) of the ITA. However, as these provisions refer to the phrase "amount received," they can only be applied if an amount has been "received" as "government assistance."

(84) The appellant argues that the amount that CAE "received" was $250,000,000. According to the appellant, in order to determine whether an amount of "government assistance" has been "received," it is necessary to characterize the Agreement. The appellant argued that the SADI Agreement constituted a simple loan because, under the Agreement, the Department of Industry Canada loaned CAE an amount of $250,000,000 over a five-year period, and CAE undertook to reimburse this amount unconditionally[123].

(85) The appellant submits that article 2314 of the C.C.Q. provides a definition of a simple loan according to which a loan is a contract by which the lender hands over a certain quantity of money or other property that is consumed by use to the borrower. The borrower undertakes to return a like quantity of the same kind and

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[120] *Ibid* at paragraph 3.1 b.
[121] *Ibid* at paragraph 3.1 c.
[122] Transcripts, above note 3 at page 3, at paragraphs 7–16.
[123] Above note 2 at paragraph 16.

quality to the lender after a certain time. According to the appellant, the SADI Agreement clearly establishes a "lender-borrower" relationship between the Minister of Industry Canada and CAE, and the Agreement was entered into in accordance with standard business practices for commercial loans. More specifically, the agreement contains late reimbursement and loan default clauses.

(86) The appellant submits that the definition of "government assistance" in subsection 127(9) of the ITA as well as the language of subsection 127(18) of the ITA impose a condition if a payment made under an agreement is to be characterized as "government assistance": the taxpayer must have received the amount. According to the appellant, that is the case here because the term "assistance from a government" is found in subsection 127(9) and the term "amount received" appears in subsection 127(18). Finally, the appellant argues that, because Parliament used the verb "receive", there must be a transfer of ownership for an amount to have been "received" within the meaning of these provisions.

(87) The appellant submits that, in the context of the application of the ITA, the lender does not transfer ownership of the amount loaned to the borrower. The appellant cited the following case law in support of its position: *Dunkelman v. M.N.R.*[124] and *Fonthill Lumber Ltd. v. the Queen*[125]. According to the appellant, property is not transferred when a loan is made because the lender will eventually be reimbursed. For these reasons, the amounts paid to CAE under the SADI Agreement were not received as "government assistance."

(88) Finally, the appellant submits that the dollar value of the difference between the implied interest rate under the SADI Agreement and the market interest rate for a similar loan could not constitute "government assistance" because CAE did not receive any amount as a result. The appellant submits that this issue was not referred to this Court and therefore declined to provide further comments on this point, although the Court gave the appellant the opportunity to do so.

B. Position of the respondent

(89) The respondent submits that the amount of $250,000,000 that CAE received under the SADI Agreement constituted "government assistance" within the meaning of subsection 127(9) of the ITA. Therefore, in computing its deductible SR&ED expenditures, CAE had to subtract the amounts of $41,003,491 and $40,652,951

[124] *Dunkelman v. MNR*, 59 DTC 1242 (Exchequer Court of Canada).
[125] *Fonthill Lumber Ltd v. the Queen*, 81 DTC 5333 (Trial Court).

during its 2012 and 2013 taxation years respectively, pursuant to paragraph 37(1)(d) of the ITA.

(90) For the same reason, but according to subsection 127(18) of the ITA, in computing its eligible SR&ED expenditures CAE had to subtract the amounts of $57,084,395 and of $59,148,888 for the purposes of computing the investment tax credit, because they were received or were receivable under the Agreement during said taxation years.

(91) Finally, the respondent argues that the amount of $14,806,945, i.e., the difference between the amount received or receivable by CAE during its 2012 taxation year ($55,810,430) and the amount actually received in 2012 ($41,003,491) was to be included in CAE's income pursuant to subparagraph 12(1)(x)(iv) of the ITA.

(92) According to the respondent, the provisions of the ITA are intended to provide tax incentives to businesses on the net costs relating to the performance of SR&ED work in Canada. The provisions at issue restrict access to tax breaks for SR&ED expenditures and to investment tax credits. On this point, the respondent's position is essentially the same as the position defended by the Attorney General of Canada in *Immunovaccine*[126]. Subsection 37(1) of the ITA lists deductible SR&ED expenditures. The items in paragraphs 37(1)(a) to 37(1)(c.3) of the ITA increase the expenditure pool and those in paragraphs 37(1)(d) to 37(1)(h) decrease the pool. Government assistance under paragraph 37(1)(d) of the ITA reduces the SR&ED qualified expenditure pool if it is related to an SR&ED expenditure where a taxpayer carried on a business in Canada in a taxation year. When amounts received as government assistance that are used for the purposes of SR&ED must be reimbursed, these amounts may be deducted from the taxpayer's income, once they have been repaid pursuant to paragraph 37(1)(c) of the ITA.

(93) With respect to the investment tax credit, according to subsection 127(18) of the ITA, government assistance received or receivable by the taxpayer in respect of SR&ED activities shall be applied to reduce the taxpayer's qualified SR&ED expenditures in computing its investment tax credit. As for subsection 127(10.7) of the ITA, it specifies that the amount of assistance that is repaid can be added to the investment tax credit in the year it is repaid. In the event that the amount of assistance exceeds the amount of SR&ED expenditures incurred for a particular project, the

[126] *Immunovaccine Technologies Inc. v. The Queen*, 2013 TCC 103.

excess amount shall be included in computing the income for a taxation year pursuant to paragraph 12(1)(x) of the ITA.

(94) The respondent is of the view that, given the legislative framework within which these provisions are found, it is clear that repayable government contributions can still constitute "government assistance." The respondent submits that it is not necessary to characterize the Agreement. According to the definition of "government assistance," the legal classification of the Agreement under which the payments are made does not have to be determined. That definition does not exclude any type of contract and provides a non-exhaustive list of various kinds of assistance.

(95) According to the respondent, in *Immunovaccine*[127], the Federal Court of Appeal specified that the phrase "government assistance" should be given a broad meaning. Citing paragraph 15 of that judgment, the respondent argued that "government assistance" can arise from agreements in which the amounts paid must be repaid, and the repayment includes a performance component.

(96) The respondent contends that, according to the test propounded in *CCLC Technologies*[128], the following question must be answered in order to determine whether a payment made by a government agency constitutes "government assistance": was the agreement entered into "in exactly the same way for exactly the same reasons as payments made by private business", that is, for the purpose of advancing the interests of the payor? According to the respondent, agreements of this type characterized by the case law as "ordinary business agreements" involve payments made by a public authority under agreements entered into in the course of operating a business. They also apply to payments made under agreements entered into to acquire goods and services that are incidental to the activities of a public authority. These categories of payments are therefore excluded from the meaning of the word "assistance."

(97) According to the respondent, since Mr. de Gray found that the SADI Agreement was not an ordinary business agreement, the Minister of Industry Canada did not act "in exactly the same way for exactly the same reasons as private businesses," that is, to protect its business interests. Rather, he was seeking to promote the interests of businesses operating in an important sector of Canadian

[127] *Immunovaccine Technologies Inc. v. Canada*, 2014 FCA 196.
[128] *Canada v. CCLC Technologies Inc.*, 96 DTC 6527 (Appeal Division).

industry, including the interest of CAE. Therefore, contributions made under the Agreement can be characterized as "government assistance."

(98) The respondent contends that several elements demonstrate that the purpose of the SADI Agreement was to promote an area of activity that is important to Canada and not to advance the business interests of the Minister of Industry Canada. The objectives of the SADI Program show that it was designed to encourage strategic SR&ED and encourage innovation and excellence in aerospace and defence companies operating in Canada; encourage strategic SR&ED work leading to innovation and excellence; increase the competitiveness of Canadian businesses; foster collaboration between research institutes, universities, colleges and the private sector. Also, advancing government business interests and potential returns on investment are not criteria for evaluating contribution requests[129]. The Minister of Industry Canada examines the proposals based on the benefits that they can provide for Canada[130], including technological, social and economic benefits, in particular job creation in Canada, workforce training, working with universities, colleges and research institutes; performing work exclusively or almost exclusively in Canada and at Canadian facilities. According to the respondent, these objectives clearly reflect the government's desire to promote government social and economic policy rather than its own financial interests.

(99) As for the SADI Agreement's internal rates of return, they can be explained as follows: on the one hand, the program requires that the recipient of the contributions repay an amount greater than the contribution paid; on the other hand, the government is asking for a return on investment in order to reduce the risk that assistance given to businesses will be deemed non-compliant with World Trade Organization rules.

(100) If the Court were to hold that the amounts paid to CAE under the SADI Agreement could not be characterized as "government assistance," these amounts (all the contributions) would still have to be taxed under paragraph 12(1)(x) of the ITA by way of reimbursements or contributions[131]. On the one hand, the amounts paid are clearly defined as contributions. In addition, these contributions are paid as reimbursements of expenses incurred by CAE in connection with the Falcon project. All contributions that the appellant received during its taxation years ended March 31, 2012, and 2013 must therefore be included in the computation of its

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[129] Exhibit A-1, above note 15, Tab 1A), "Industry Canada's SADI Program Guide" at page 7.
[130] Exhibit A-1, above note 15, Tab 1B), "Program Information" at page 10; Exhibit I-3, "SADI Proposal Preparation Guide," at page 22.
[131] Transcript of the hearing held on August 25, 2020, at page 156.

income for each of those years under section 12 of the ITA, insofar as the inclusion of an amount does not increase the tax currently at issue.

(101) Finally, like the appellant, the respondent submits that the issue of whether the dollar value of the difference between the implied interest rate under the SADI Agreement and the market interest rate for a similar loan can constitute "government assistance" had not been raised before the court. The respondent also said she did not wish to comment further on this point, although the Court gave her the opportunity to address it.

VI. DISCUSSION

(102) In order to deal with the issues, the Court must determine whether payments made to CAE under the SADI Agreement constitute "government assistance" pursuant to subsection 127(9) of the ITA.

(103) It is first appropriate to examine the various forms that "government assistance" may take under subsection 127(9) of the ITA in order to determine whether payments made to CAE under the SADI Agreement constitute a form of "government assistance." Next, the Court will consider the test recognized by the case law to determine whether payments made by a government, municipality or other public authority constitute "government assistance" under subsection 127(9) of the ITA. Finally, the Court will determine whether payments totalling $250,000,000 made to CAE under the SADI Agreement constitute "government assistance" under that provision.

A. The various forms that assistance received from a government, municipality or other public authority may take under subsection 127(9) of the ITA.

(104) The phrase "government assistance" is defined as follows in subsection 127(9) of the ITA:

> 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 127(5) or 127(6).
>
> [Emphasis added.]

(105) This definition is clear. According to that definition and given the use of the phrase "as any other form," assistance received from a government, municipality or

other public authority may take any form, except for the deductions provided for in subsections 127(5) and (6) of the ITA. The list of forms of assistance in subsection 127(9) of the ITA is therefore not exhaustive and the forms of assistance listed are merelyexamples. In *Immunovaccine Technologies Inc. v. The Queen*[132], this Court decided that a repayable contribution to enable research projects made by a government agency could constitute "government assistance" under subsection 127(9) of the ITA, although this form of assistance is not specifically mentioned in this provision[133].

(106) This interpretation, which provided a broad meaning to the phrase "government assistance," was approved by the Federal Court of Appeal of Canada (Federal Court of Appeal) when *Immunovaccine Technologies Inc. v. the Queen*[134] was appealed against. In its judgment, the Federal Court of Appeal said the following regarding this matter:

> It is worthy of note that the phrase "assistance from a government" precedes an enumeration: grant, subsidy, forgivable loan, deduction from tax, investment allowance. However, the words "or as any other form of assistance" immediately follow this enumeration. Contrary to the appellant's contention – and as the Judge found at paragraph 45 of her reasons – such phrasing does not restrict the form of assistance included in subsection 127(9). Instead, it provides a broad meaning to the word "assistance," capable of encompassing a variety of forms of government assistance not necessarily limited to the said enumeration. Accordingly, this definition can include agreements which are not purely gratuitous and unilateral[135].
>
> [Emphasis added.]

(107) Therefore, pursuant to subsection 127(9) of the ITA, it is possible that payments made to CAE under the SADI Agreement can constitute "government assistance."

B. The test recognized by the case law to determine whether a payment made by a government, municipality or other public authority constitutes "government assistance" under subsection 127(9) of the ITA.

(108) In order to determine whether a payment constitutes "government assistance" under subsection 127(9) of the ITA, the Court must apply the test propounded by the

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[132] Above note 126.
[133] *Ibid* at paragraph 45.
[134] Above note 126.
[135] Above note 127 at paragraph 15.

Appeal Division of the Federal Court in *Canada v. Consumers' Gas Co.*[136] (Consumers' Gas), which was followed by the Federal Court of Appeal in *Canada v. CCLC Technologies Inc.*[137](CCLC Technologies) and *Immunovaccine Technologies Inc. v. Canada*[138] (Immunovaccine). Those cases stand for the following test: if payments have been made in exactly the same way for exactly the same reasons as payment made by private business, that is, for the purpose of advancing the interests of the payor, they do not constitute "government assistance" under subsection 127(9) of the ITA.

(109) However, it is appropriate to examine these cases in greater detail to ascertain how this test has been applied.

(110) In *Consumers' Gas*, the Court was called upon to rule on the application of subsection 13(7.1) of a previous version of the *Income Tax Act*. The taxpayer was a public natural gas distribution company in the province of Ontario that distributed natural gas through pipelines that ran beneath the surface of streets and roads. Various organizations, including public authorities, from time to time required that the company relocate portions of its pipeline network in order to do construction work. In these cases, the company sought to recover the full cost of relocating the pipelines from the agency that requested it, especially in the case of public authorities[139].

(111) In that case, it was clear that reimbursements made to Consumers' Gas did not constitute a form of government assistance, because these payments had been 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. These payments had been made under an ordinary business agreement. The relevant passage reads as follows:

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[136] *Canada v. Consumers' Gas Co.,* [1987] 2 FC 60, 1986 CarswellNat 496.

[137] *Canada v. CCLC Technologies Inc.,* (1996) FCJ No. 1226 (QL), 1996 CanLII 11571.

[138] Above note 127.

[139] Above note 136 at paragraph 4. In this case, the Court was called upon to rule on the application of subsection 13(7.1) of the former *Income Tax Act*. More specifically, it had to determine the meaning of the expression "assistance from a government, municipality or other public authority." The Court held that the key word for this expression was the word "assistance." According to the Court, the word "assistance" clearly carried with it the colour of a grant or subsidy and it held that, in that case, the reimbursements of the costs of relocating pipelines made by public authorities were made in exactly the same way and for exactly the same reasons as the reimbursements made by private businesses that submitted similar requests. Therefore, the reimbursements made by the public authorities did not constitute "assistance from a government, municipality or any other public authority."

> 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…[140]
>
> [Emphasis added.]

(112) In the same case, the Court also cited certain comments made in *Ottawa Valley Power Co. v. Minister of National Revenue*[141] (Ottawa Valley) to hold that payments made under an ordinary business arrangement for business reasons could not be characterized as "government assistance." These comments are as follows:

> What this rule appears to contemplate is the case where a taxpayer has acquired property at a capital cost to him and has also received a grant, subsidy or other assistance from a public authority" in respect of or for the acquisition of property" in which case the capital cost is deemed to be "the capital cost thereof to the taxpayer minus ... the grant, subsidy or other assistance." That rule would not seem to have any application to a case where a public authority actually granted to a taxpayer capital property to use in his business at no cost to him. Quite apart from the fact that the rule so understood would have no application here, 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 that 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. If Ontario Hydro were used by the legislature to carry out some legislative scheme of distributing grants to encourage those engaged in business to embark on certain classes of enterprise, then I would have no difficulty in applying the words of paragraph (h) to grants so made. Here, however, as it seems to me, the legislature merely authorized Ontario Hydro to do certain things deemed expedient to carry out successfully certain changes in its method of carrying on its business and the things that it was so authorized to do were of the same character as those that any other person carrying on such a business and faced with the necessity of making similar changes might find it expedient to do. I cannot regard what is done in such circumstances as being "assistance" given by a public authority *as a public authority*.[142]

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[140] *Ibid* at paragraph 11.

[141] *Ottawa Valley Power Co. v. Minister of National Revenue*, [1969] 2 Ex. C.R. 64, 1969 CarswellNat 283.

[142] *Ibid* at paragraph 72.

[Emphasis added.]

(113) In *CCLC Technologies* and *Immunovaccine*, the Federal Court of Appeal ruled on the meaning to be given to the phrase "government assistance" found in subsection 127(9) of the ITA. In *Immunovaccine,* the Court adopted the following test: a payment constitutes "government assistance" if it has not been 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.

(114) The relevant passage in *CCLC Technologies* reads as follows:

> The appeal raises two questions.
>
> (1) Were the amounts provided by the Government of Alberta to the respondent "assistance" as a grant, subsidy, forgiveable loan, deduction from tax, investment allowance or as any other form of assistance. . . within the language of both subparagraph 12(1)(x)(iv) of the *Income Tax Act*, defining income, and of subsections 127(11.1) and 127(9) defining investment tax credits?
>
> (2) If the answer to the first question is in the affirmative, should such amounts nevertheless be excluded from income pursuant to subparagraph 12(1)(x)(viii) as a payment made in respect of the acquisition by the payor . . . of an interest in the taxpayer, his business or his property . . .? With respect to the first question, we are of the view that the sums provided to the respondent amounted to government assistance. This Court in *The Queen v. Consumers Gas Company Ltd.* contrasted "government assistance" to payments made by public authorities
>
> > in exactly the same way for exactly the same reasons as payments made by private business, that is, for the purpose of advancing the interests of the payor.
>
> In this context it is clear that the Court was speaking of payments made for advancing the business interests of the payor.
>
> 3 The agreement does not in our opinion establish an ordinary business arrangement between the parties. For its part the Government of Alberta undertook to provide technology and to pay money to the respondent. While in the short term the government obtained an equity interest, if the project were to prove commercially successful the Government would be obliged to sell its interest to the respondent, the price being simply the return of its money contribution plus its interest costs in having made that contribution. If the project did not prove to have commercial value, as in fact it did not during the period in question, the Government was entitled to nothing except an equity interest in a technology demonstrated not to have present commercial value. We find it impossible to characterize this as an ordinary business arrangement. Whatever public policy

> merits the agreement may have had from the standpoint of Alberta, it does not amount to an arrangement that a business would enter into to advance its business interests. A business which invested money in ventures on the basis that it could not receive any net profit if the venture succeeded and would gain an equity interest only if the venture proved uncommercial, would not long survive[143].
>
> [Emphasis added.]

(115) The relevant passage in *Immunovaccine* reads as follows:

> [10] In *Canada v. CCLC Technologies Inc.*, 139 D.L.R. (4th) 765, 96 D.T.C. 6527 [*CCLC Technologies*], this Court adopted a test which determines whether payments made by a public authority, akin to ACOA and pursuant to an agreement, have the attributes of a commercial venture. In other words, the key question becomes: is the public authority in question acting in a business rather than a governance capacity?
>
> [11] The Judge made reference to and applied the test developed in *CCLC Technologies* as to whether the government body acted "in exactly the same way for exactly the same reasons as payments made by private business, that is, for the purpose of advancing the [business] interests of the payor" (Judge's reasons at para. 46)[144].
>
> [Emphasis added.]

(116) Having read *Consumers' Gas*, *CCLC Technologies* and *Immunovaccine*, I am of the view that in order to determine whether payments made under an agreement constitute "government assistance," it is not sufficient to determine whether payments were made in exactly the same way for exactly the same reasons as payments made by private businesses. Rather, I am of the opinion that in order to determine whether the test propounded in those cases is met, the Court must determine whether the payments were made in order to promote the business interests of the payer, that is, whether they were made pursuant to an "ordinary business agreement"[145]. Indeed, I believe that an agreement may be an "ordinary business agreement" even though the payments made under the agreement have not been made in exactly the same way for exactly the same reasons as payments made by private businesses. According to the circumstances, a business may well determine that, in order to promote its business interests, it is appropriate for it to enter into an agreement whose terms differ from comparable agreements entered into between private businesses during the same period. Finally, I also believe that, since

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[143] Above note 137 at paragraphs 1–3.
[144] Above note 127 at paragraph 10–11.
[145] *Ibid* at paragraph 16; above note 137 at paragraph 3.

payments made under an agreement are made in accordance with its terms, it is appropriate to examine those terms in order to determine whether they are consistent with the terms of an ordinary business agreement and, if necessary, perform a comparative analysis[146]. Regarding this matter, unless there is evidence to the contrary, it is logical to conclude that it is generally not in a company's interest to be party to an agreement whose terms are substantially less attractive than those stipulated in ordinary agreements entered into under the same circumstances.

C. Is the SADI Agreement an "ordinary business agreement"?

(117) After having read the SADI Agreement and given the circumstances, it is not possible to determine whether or not this is a "ordinary business agreement." The facts show that the Government of Canada entered into the SADI Agreement to assist an industry that was important to Canada, not to advance its own business interests. This is not sufficient for the Court to find that the SADI Agreement is not an ordinary business agreement. As mentioned above, in order to make this determination, I am of the view that the Court must compare the terms of the SADI Agreement with the terms of business agreements that were entered into by private businesses at the same time in order to obtain $250,000,000 of funding. To this end, it is necessary to characterize the agreement. Once the agreement has been characterized, the Court will be able to identify the main terms of this type of agreement in order to compare them and determine whether it is an "ordinary business agreement." It is therefore necessary to perform a comparative analysis.

1. Characterization of the SADI Agreement

(118) The parties did not expressly characterize the SADI Agreement. The respondent submits that it is a contribution agreement to provide financial assistance for a research and development project. The appellant submits that it is a simple loan within the meaning of section 2314 of the C.C.Q. The agreement does refer to "contributions," but that is not in itself determinative. During his testimony, Mr. Lemieux characterized these contributions as an "investment," but again, this is not decisive. As with business investments, there are various kinds of "contributions" to research and development.

(119) In this case, it is necessary to refer to the civil law in force in Quebec in order to characterize the SADI Agreement. Pursuant to subsection 8.1 of the *Interpretation*

[146] Above note 127 at paragraph 16.

Act[147], in order to apply the ITA in the province of Quebec, if in interpreting an enactment it is necessary to refer to rules, principles or concepts forming part of the law of property and civil rights, reference must be made to the rules, principles and concepts in force in Quebec[148].

(120) Can the SADI Agreement be characterized as a loan as the appellant argues? Section 2314 of the *Civil Code of Québec* defines a simple loan as follows:

> 2314. A simple loan is a contract by which the lender hands over a certain quantity of money or other property that is consumed by use to the borrower, who binds himself to return a like quantity of the same kind and quality to the lender after a certain time.

(121) According to the civil law, when the judge must characterize an agreement, he must investigate the legal transaction contemplated by the parties. This can be done by identifying the parties' objective when they entered into the agreement or, more often, the essential promise that is central to the agreement[149]. In order to characterize the agreement, it may also be useful or necessary to examine the obligations and other effects of the agreement[150]. In characterizing the agreement, extrinsic evidence, such as the circumstances surrounding the formation of the agreement and its application by the parties, are facts to which the judge may refer, but only when the agreement is ambiguous[151]. It should be noted that a court is never bound by the parties' characterization of the agreement[152].

(122) The essential promises of the parties to the SADI Agreement can easily be identified. According to the Minister of Industry Canada, this means paying CAE a maximum total contribution of $250,000,000 over a five-year period, from 2009 to 2015, under the terms of the agreement. CAE's essential promise involves repaying the contributions received in accordance with the terms and schedule stipulated in the agreement.

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[147] *Interpretation Act*, RSC 1985, c I-21.

[148] It should be noted that according to clause 21 of the SADI Agreement, the Agreement must be interpreted in accordance with the laws in force in Canada in the Canadian province where CAE has its head office. CAE headquarters are located in Ville Saint-Laurent in the Province of Quebec.

[149] Didier Lluelles et Benoît Moore, *Droit des obligations*, 3e éd, Montréal, Éditions Thémis, 2018, at paragraphs 1733-1734.

[150] *Ibid*. See also: *Uniprix Inc. v Gestion Gosselin et Bérubé Inc.*, 2017 SCC 43, at paragraph 38.

[151] *Eli Lilly and Co. v. Novopharm Ltd*, [1998] 2 SCR 129, at paragraphs 54–55.

[152] Jean-Louis Baudouin, Pierre-Gabriel Jobin et Nathalie Vézina., *Les obligations*, 7e éd, Cowansville, Yvon Blais, 2013, at page 85, No. 56.

(123) It appears that the essential promises of the parties to the SADI Agreement correspond to the two conditions that must be met in order for an agreement to be characterized as a loan. According to article 2314 of the CCQ, that is, one party must hand over of a certain quantity of money to the other party, and party that received the money must return a like quantity of the same kind and quality to the lender. Under the agreement, the Minister of Industry Canada loaned CAE $250,000,000. As a result, the first condition is met. Also under the agreement, CAE was to remit to $337,500,000 to the Minister of Industry Canada. Thus, the second condition is met. Since the two conditions provided for in article 2314 of the CCQ were met, the Court concludes that the agreement is a loan.

2. Mr. de Gray's expert report

(124) In order to demonstrate to the Court that the SADI Agreement does not constitute an "ordinary business agreement," the respondent called Mr. de Gray to testify. Most of the respondent's arguments on this point were based on the contents of his expert report. This expert report was entered into evidence during the trial. For its part, the appellant did not produce an expert report or an expert rebuttal report.

1. Mr. de Gray's qualifications as an expert

(125) The respondent asked the Court to recognize Mr. de Gray as an expert in corporate finance. In particular, the respondent asked that Mr. de Gray be recognized as an expert in the valuation of debt instruments and investments. The Court agreed. This decision was based on the following facts submitted for the Court's appraisal:

- Throughout his career, Mr. de Gray has authored or co-authored articles on the principles of business valuation. He has been making expert reports for over 10 years, many of which have been submitted to the courts.

- Mr. de Gray attended the Rotman School of Management at the University of Toronto, where he received his Bachelor of Commerce degree.

- He obtained his Chartered Accountant designation after a three-year internship with Ernst & Young.

- He obtained his Chartered Business Valuator designation in 2012.

- He obtained a Forensic Accounting Certificate from the American Institute of CPAs in 2017.

- He is currently the Director of Disputes and Investigations at Duff & Phelps. This department is responsible for valuation analysis, expert reports, damage quantification analysis as well as financial loss reports.

(126) The appellant did not object to Mr. de Gray's recognition as an expert.

2. Mr. de Gray's mandate and the issue before the Court

(127) The respondent asked Mr. de Gray the following question: Were payments issued under the SADI Agreement 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 [business] interests of the payor? Mr. de Gray's report bears on this issue. In order to answer this question, Mr. de Gray first determined whether the agreement constituted an "ordinary business agreement." It is therefore appropriate that the Court consider the analysis that Mr. de Gray performed to make this determination.

(128) After reviewing the main terms of the SADI Agreement, Mr. de Gray found that it was not an "ordinary business agreement." That finding was based on the following three conclusions:

1. The approximate implicit 2.5% rate of return under the Agreement was significantly lower than the fair market rate of return for a financial instrument with a risk profile comparable to that of the Agreement.

2. The agreement is subject to minimum clauses and does not contain any of the financial clauses typically included in this type of business agreement.

3. The Agreement contains several other conditions that are not usually found in this type of business agreement. These conditions are primarily motivated by political considerations or government action, rather than business reasons.

(129) It is therefore necessary to examine each of these conclusions in greater detail.

(130) Mr. de Gray found that the rate of return is one of the main conditions typically included in agreements similar to the SADI Agreement. Based on Mr. de Gray's testimony and in the absence of other evidence, the Court finds that the rate of return of an agreement with the same object as the SADI Agreement is one of the main conditions of such an agreement. For the same reasons, the Court

also finds that the approximate implicit 2.5% rate of return under the SADI Agreement is substantially lower than the rate of return for financial instruments with a similar risk profile. In addition, the appellant did not submit evidence to establish that, in order to promote its business interests, a lender would have entered into an agreement such as the SADI Agreement at a 2.5% interest rate. In view of this and the fact that the Court has already concluded that the rate of return under the SADI Agreement is one of its main conditions, the Court concluded that the SADI Agreement is not an "ordinary business agreement."

(131) That said, the Court nevertheless considered the facts on which Mr. de Gray based his conclusion that the rate of return under the SADI Agreement was substantially lower than the rate of return for financial instruments with a similar risk profile.

(132) For the period 2008 to 2014, Mr. de Gray examined the interest rates for Government of Canada bonds, United States treasury bills, bonds issued by Canadian companies and those issued by companies operating specifically in the aerospace and defence sectors. Mr. de Gray also examined the business loans that CAE obtained during the same period. Finally, he examined the manner in which CAE treated the SADI Agreement in its financial reports.

(133) The interest rate for a financial instrument considered to be risk-free is useful for the analysis to be performed by the Court. However, the Court used only the Government of Canada bond rate because Mr. de Gray did not explain why the Court should consider the risk-free rate in effect in the US market. When the SADI Agreement was entered into on March 30, 2009, this rate was 3.65% on average. During the period from 2008 to 2014, the average rate fluctuated from 2.88% to 4.33%.

(134) In this case, it is not necessary to examine the interest rates on bonds issued by companies in the Canadian market. A bond issue is not a loan; they are completely different transactions. The Court understands that different "financial instruments" can be compared depending on the risk associated with each instrument. However, it is not necessary to compare them in this case because Mr. de Gray had access to information regarding business loans obtained by CAE. The Court accepts Mr. de Gray's finding that the interest rate on business loans is indicative of the market interest rate applicable to an agreement comparable to the SADI Agreement. Business loans obtained by CAE are indeed transactions with a higher degree of comparability than bond issues.

(135) With respect to business loans obtained by CAE, Mr. de Gray noted that CAE entered into a number of loan agreements during the period 2008 to 2014. He noted that CAE obtained an amount of $120,000,000 in 2010 through a private placement. This was particularly relevant because it was not secured, it had an average 8.5-year term to maturity and a combined interest rate of 7.15% with interest payable semi-annually. Considering the proximity of the date on which this agreement was entered into and the date on which the SADI Agreement was signed, the amount of the loan and the fact that it was unsecured, Mr. de Gray found that this agreement provided him with a reasonable approximation of a prevailing market interest rate for an agreement comparable to the SADI Agreement. In fact, he was of the opinion that the interest rate under the SADI Agreement should have been higher than 7.15% for the following reasons: the term of the agreement was longer than the term of the private placement, i.e., 15 to 20-years; it had a preferential rating; last but not least, it did not include the standard restrictive covenants.

(136) Finally, Mr. de Gray noted that, in its financial reports, CAE acknowledged that the interest rate obtained on the "lender's" contributions under the SADI Agreement were lower than the prevailing market interest rate.

(137) In view of this and as mentioned above, the Court finds that the SADI Agreement does not constitute an "ordinary business agreement." The appellant has not shown that a private company would have entered into this agreement in order to promote its business interests. Rather, the evidence shows that the implicit rate of return under the Agreement was significantly lower than the market rate of return for a comparable loan. In addition, it is established that the risk-free market interest rate for the period in this case was 3.65%. The Court therefore finds that, in this case, the loan was granted at a rate substantially below the market rate and that it would have been contrary to the business interests of a private lender to grant a loan at that rate.

D. Was the amount of $250,000,000 paid to CAE under the SADI Agreement "received" by CAE within the meaning of subsections 12(1), 127(9) and 127(18) of the ITA?

(138) The appellant argues that subsections 12(1), 127(9) and 127(18) of the ITA can only be applied if the taxpayer has "received" an amount as "government assistance." The appellant submits that CAE did not "receive" an amount of money under the SADI Agreement because it is a loan, and a taxpayer cannot have "received" an amount unless the ownership of the amount in question was transferred.

(139) The verb "to receive" is not defined in the ITA. It is defined in the Le Robert dictionary as follows:

> "Être mis en possession de (qqch.) par suite d'un envoi, d'un don, d'un paiement, d'une communication, etc."

(140) This definition does not make any reference to a transfer of ownership. It is therefore sufficient to be in possession of a good to have "received" it, regardless of whether there has been a transfer of ownership. The same applies to the English language version of these provisions in which the verb "received" appears. The Merriam-Webster dictionary defines the word "Receive" as follows:

> "To come into possession".

(141) There is no indication or evidence showing that Parliament intended to add this condition, i.e., the transfer of ownership of the property received, so that subsections 12(1), 127(9) and 127(18) of the ITA can apply. Accordingly, the Court concludes that the contributions made to CAE under the SADI Agreement were indeed "received" within the meaning of subsections 12(1), 127(9) and 127(18) of the ITA.

(142) With respect to the appellant's argument, which was based on *Dunkelman*, the Court notes that the case involved the interpretation of the phrase "transferred property" as it appeared in subsection 22(1) of an earlier version of the ITA. However, since the definition of "government assistance" does not refer to that phrase, this Court is of the view that it is not appropriate to consider this case law in the case at bar.

VII. CONCLUSION

(143) The Court finds that the SADI Agreement does not constitute an ordinary business agreement. Accordingly, amounts paid to CAE under the Agreement in the 2012 and 2013 taxation years respectively constitute amounts received as "government assistance" within the meaning of subsection 127(9) of the ITA. For the same reason, the amounts that CAE was entitled to receive under the terms of the Agreement during said taxation years constitute "government assistance" within the meaning of subsection 127(18) of the ITA.

(144) As this Court can decide this appeal on the basis of the conclusions set out above, it will not consider the alternative issue set out at paragraph 8 of this judgment.

(145) For these reasons, the appeal is dismissed with costs.

These Amended Reasons for Judgment are issued in substitution for the Reasons for Judgment dated September 8, 2021.

Signed at Ottawa, Canada, this 8th day of November 2021.

"Sylvain Ouimet"

Ouimet, J.

Translation certified true
on this 2nd day of October 2022.

François Brunet, Revisor

CITATION:	2021 TCC 57
DOCKET:	2016-4984(IT)G
STYLE OF CAUSE:	CAE INC. AND HER MAJESTY THE QUEEN
PLACE OF HEARING:	Montreal, Quebec
DATE OF HEARING:	June 3 and 4, 2019, and August 24 and 25, 2020
REASONS FOR JUDGMENT BY:	The Honourable Justice Sylvain Ouimet
DATE OF JUDGMENT:	September 14, 2021

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