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Tax Alert — Canada

Amendments to treatment of concessional loans impact SR&ED claims

EY Tax Alerts cover significant tax news, developments and changes in legislation that affect Canadian businesses. They act as technical summaries to keep you on top of the latest tax issues. For more information, please contact your EY advisor or EY Law advisor.

Important legislative amendments to the *Income Tax Act* (ITA) contained in Bill C-69, *Budget Implementation Act, 2024, No. 1*,[1] have a direct impact on the scientific research and experimental development (SR&ED) tax incentive program. These amendments provide clarity on the treatment of concessional loans with respect to the legislation governing government assistance for SR&ED purposes, which has implications for the computation of SR&ED investment tax credits (ITCs).

Background

In the 2023 Fall Economic Statement, the government proposed a relieving rule to counteract the effect of a court decision on the treatment of "concessional loans," which are loans from public authorities that are either non-interest bearing or are granted at below-market interest rates. The court decision determined that the principal amount of a concessional loan constituted government assistance for purposes of the ITA. The amendments proposed that, effective 21 November 2023, a bona fide concessional loan with reasonable repayment terms from a public authority in Canada would generally not be treated as government assistance.

The proposal was subsequently included in Bill C-69, which also provided that the relieving rule would be effective 1 January 2020 (instead of 21 November 2023, as originally proposed) and applies to loans made after 2019. Bill C-69 was enacted on 20 June 2024.

[1] For more information on the tax measures contained in Bill C-69, see EY Tax Alert 2024 Issue No. 36.

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Key highlights

Bill C-69 included the following changes with respect to the treatment of concessional loans:

- **Exclusion of certain concessional loans as government assistance**: The ITA has been amended to exclude certain bona fide concessional loans from being considered government assistance, as detailed below. Prior to this amendment, the Canada Revenue Agency (CRA) regarded certain types of loans as government assistance, necessitating the deduction of the loan value from the eligible SR&ED expenditures associated with the relevant project.

- **Effective date and applicability**: Since the amendments are effective retroactive to 1 January 2020 and apply to loans made after 2019, SR&ED claims for the 2020 taxation year and onwards may be affected.

- **Impact on SR&ED claims**: The exclusion of these loans from the definition of government assistance means that the amount of SR&ED ITCs claimed by taxpayers may increase, as concessional loans will no longer reduce the pool of qualified SR&ED expenditures. This will also impact allowable SR&ED expenditures for purposes of the SR&ED pool deduction.

Details of the changes to the ITA

The following amendments were made to the ITA to implement the revised rules:

- **Amended definition of "government assistance"**: Subsection 127(9) of the ITA has been revised to effectively exclude certain loans from being treated as government assistance.

- **Excluded loan criteria**: An "excluded loan" is defined in subsection 12(11) of the ITA as a non-forgivable loan, evidenced in writing, that is from a payer that is a government, municipality, or other public authority in Canada (or from a Canadian resident or partnership, if it is reasonable to conclude that the Canadian resident or partnership would not have made the loan but for the receipt of amounts from a public authority). In addition, bona fide arrangements for repayment of the loan within a reasonable time must be made at the time the loan was granted, and the funds must be used for the purpose of earning income from a business or property.[2]

- **Application to SR&ED claims**: The exclusion of such concessional loans from the definition of government assistance means that taxpayers can potentially claim a higher amount of SR&ED ITCs and SR&ED pool deduction. The amendments ensure expenditures for SR&ED purposes are not reduced by the receipt of an "excluded loan."

[2] In addition, under subparagraph 12(1)(x)(ix) of the ITA, an income inclusion will not result to the extent the amount was received by the taxpayer as an "excluded loan".

Action required

Taxpayers who have received concessional loans since 1 January 2020 should review their SR&ED claims to determine if the change in the treatment of concessional loans affects their ITC calculations.

There may also be a potential opportunity to adjust prior year returns within a taxpayer's normal reassessment period (i.e., for non-statute barred years); however, we have requested clarification from the CRA on this issue and are waiting for their response. It is advisable to consult with EY tax professionals to ensure compliance with the new legislative provisions and to optimize SR&ED benefits.

Learn more

For further information or assistance in reviewing and adjusting your SR&ED claims in light of these amendments, please contact one of the following EY advisors. Our team can assist you in assessing how the changes to the concessional loan rules affect your SR&ED claims.

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