

COURT OF APPEAL

CANADA

PROVINCE OF QUEBEC

CITY OF MONTREAL

No.: 500-09-028280-196

(500-80-034811-175)

DATE: October 20, 2020

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**TRAINING: HONOURABLE**

**ALLAN R. HILTON, JCA**

**MARIE-JOSEE HOGUE, JCA**

**STEPHEN W. HAMILTON, JCA**

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**QUEBEC REVENUE AGENCY**

APPELLANT – defendant

vs.

**PCI GEOMATICS ENTERPRISES INC.**

RESPONDENT – plaintiff

[ 1 ] The appellant (“the QRA”) is appealing a rectified judgment rendered on April 2, 2019, by the Court of Quebec, Civil Division, district of Montreal (the Honorable Daniel Dortéus), allowing the appeal of the respondent (“PCI”) and deferring to the QRA the contributions for the years 2012, 2013 and 2014, so that it may issue new ones granting to PCI the credits relating to the salaries related to its research and development activities (“ R&D”) which were refused.

[ 2 ] The only issue raised by the appeal is whether the trial judge erred in justifying the courts intervention by concluding that a contribution made by the Canadian government in PCI does not constitute government assistance. within the meaning of the [Taxation Act \[1\]](#).

[ 3 ] For the reasons of Justice Hogue, with which Justices Hilton and Hamilton concur, **THE COURT:**

[ 4 ] **GRANTS** the appeal;

[ 5 ] **REVERSES** the rectified judgment rendered by the Court of Quebec on April 2, 2019;

[ 6 ] **DISMISSES** the respondent's appeals for assessment;

[ 7 ] **REINSTATES** the notices of assessment issued by the QRA for the years 2012, 2013 and 2014;

[ 8 ] **THE WHOLE** with legal costs both in the first instance and on appeal.

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ALLAN R. HILTON, JCA

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MARIE-JOSEE HOGUE, JCA

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STEPHEN W. HAMILTON, JCA

Mr. Gabriel Dery

LARIVIÈRE MEUNIER

For the appellant

Mr. Dominic C. Belley

Ms. Catherine Dube

NORTON ROSE FULBRIGHT CANADA

For the respondent

Hearing date:

September 2, 2020

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## REASONS FOR JUSTICE HOGUE

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[ 9 ] PCI is a company involved in R&D activities related to the development of software for the satellite remote sensing industry.

[ 10 ] In 2009, it signed an agreement with the Canadian government (then represented by the Minister of Industry) within the framework of a program called *the Strategic Aerospace and Defense Initiative* (“SADI”), a federal program administered by the Industrial Technologies Office (“ITO”), an agency of Industry Canada. This agreement has been amended twice, in particular, to modify certain provisions and to agree on the creation of security in favour of the State.

[ 11 ] Under this agreement, the State undertakes to pay PCI a maximum of \$7,665,000. This sum will be paid in several installments, spread over several years, according to certain expenses incurred by PCI. The program allows PCI to choose how it wants to repay the amount invested by offering her two options: 1) through fixed amounts, up to 1.5 times the amount received, or 2) through amounts that vary according to the fluctuation of his income, up to 1.65 times the amount received.

[ 12 ] PCI opts for the variable payment method under which the amount it must repay each year depends on the gross income it generates in a given year compared to the income of the previous year. I will come back to this in more detail.

[ 13 ] In January 2014, the QRA audited PCI's tax returns for the years 2011 to 2014. It sought to determine whether the payments it had received from the Canadian government under this agreement constituted "government assistance" within the meaning of section 1029.6.0.0.1 of the *Taxation Act* since, if such is the case, certain tax credits to which it would otherwise be entitled must be reduced:

**1029.6.0.0.1.** Dans le présent chapitre, l'expression:

« aide gouvernementale » désigne une aide qui provient d'un gouvernement, d'une municipalité ou d'une autre administration, que ce soit sous forme de subvention, de prime, de prêt à remboursement conditionnel, de déduction d'impôt, d'allocation d'investissement ou sous toute autre forme;

**1029.6.0.0.1.** In this chapter:

“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;

[...]

[...]

**1029.7.** Un contribuable qui n'est pas un contribuable exclu, qui exploite une entreprise au Canada, qui effectue au Québec ou fait effectuer pour son compte au Québec dans le cadre d'un contrat des recherches scientifiques et du développement expérimental concernant une entreprise du contribuable et qui joint à sa déclaration fiscale qu'il doit produire en vertu de l'article 1000, ou devrait produire s'il avait un impôt à payer en vertu de la présente partie, pour l'année d'imposition au cours de laquelle ces recherches et ce développement ont été effectués, le formulaire prescrit contenant les renseignements prescrits, est réputé, sous réserve du deuxième alinéa, avoir payé au ministre à la date d'échéance du solde qui lui est applicable pour cette année, en acompte sur son impôt à payer pour cette année en vertu de la présente partie, un montant égal à 14% de l'ensemble des montants suivants:

a) les salaires qu'il a versés à ses employés d'un établissement situé au Québec à l'égard de ces recherches et de ce développement effectués dans l'année;

[...]

**1029.8.18.** Aux fins de calculer le montant qui est réputé avoir été payé au ministre, pour une année d'imposition, par un contribuable en vertu de l'un des articles 1029.7, 1029.8, 1029.8.6, 1029.8.7, 1029.8.9.0.3, 1029.8.9.0.4, 1029.8.10, 1029.8.11, 1029.8.16.1.4 et 1029.8.16.1.5, les règles suivantes s'appliquent :

**1029.7.** A taxpayer, other than a tax-exempt taxpayer, who carries on a business in Canada, who undertakes scientific research and related to a business of the taxpayer, in Québec, or causes such research and development to be undertaken in Québec on the taxpayer's behalf as part of a contract, and who encloses the prescribed form containing the prescribed information with the fiscal return the taxpayer is required to file under section 1000, or would be required to file if tax were payable under this Part by the taxpayer, for the taxation year in which the research and development was undertaken is deemed, subject to the second paragraph, to have paid to the Minister, on the taxpayer's balance-due day for that year, on account of the taxpayer's tax payable for that year under this Part, an amount equal to 14% of the aggregate of :

(a) the wages paid by the taxpayer in respect of the research and development undertaken in the year to his employees of an establishment situated in Québec;

[...]

**1029.8.18.** For the purpose of computing the amount that is deemed to have been paid to the Minister for a taxation year by a taxpayer pursuant to any of sections 1029.7, 1029.8, 1029.8.6, 1029.8.7, 1029.8.9.0.3, 1029.8.9.0.4, 1029.8.10, 1029.8.11, 1029.8.16.1.4 and 1029.8.16.1.5, the following rules apply:

a) le montant des salaires ou d'une partie d'une contrepartie versés, d'une dépense admissible, à l'exclusion d'un montant de remplacement prescrit, d'une cotisation admissible ou d'un solde de cotisation admissible, visés à l'un des articles 1029.7, 1029.8.6, 1029.8.9.0.3, 1029.8.10 et 1029.8.16.1.4, selon le cas, doit être diminué, le cas échéant, du montant de tout paiement contractuel, de toute aide gouvernementale ou de toute aide non gouvernementale, attribuable aux salaires ou à la partie d'une contrepartie versés, à la dépense admissible, à la cotisation admissible ou au solde de cotisation admissible, selon le cas, que le contribuable a reçu, est en droit de recevoir ou peut raisonnablement s'attendre à recevoir, au plus tard à la date d'échéance de production qui lui est applicable pour cette année d'imposition;

[...]

[Soulignements ajoutés]

[ 14 ] In the opinion that this is indeed “government assistance”, the QRA, therefore, sends PCI notices of assessment for the years 2012 to 2014 (the year 2011 being prescribed) under the terms of which PCI is denied tax credits resulting from the payment of salaries paid in the context of carrying out R&D projects.

[ 15 ] PCI opposes these notices of assessment, but the QRA maintains them.

[ 16 ] PCI, therefore, appealed to the Court of Quebec, Civil Division, which allowed its appeal. This is the judgment made.

## **THE FIRST INSTANCE OF JUDGMENT**

[ 17 ] Having first concluded that the agreement contained ambiguities, which, however, he did not identify, the trial judge chose to resort to the general rules of interpretation of contracts to, he said, determine the true intention of Parties.

(a) the amount of the wages or of part of the consideration paid, of a qualified expenditure, except a prescribed proxy amount, of an eligible fee or of an eligible fee balance, referred to in any of sections 1029.7, 1029.8.6, 1029.8.9.0.3, 1029.8.10 and 1029.8.16.1.4, as the case may be, shall be reduced, where applicable, by the amount of any contract payment, government assistance or non-government assistance attributable to the wages or to part of the consideration paid, to the qualified expenditure, to the eligible fee or to the eligible fee balance, as the case may be, that the taxpayer has received, is entitled to receive or can reasonably expect to receive on or before the taxpayer's filing-due date for that taxation year;

[...]

[Emphasis added]

[ 18 ] Relying essentially on the testimony of the financial director of PCI, Mr. Robert Lang, he holds that the parties intended that the loan be repaid. He then points out that the State has the possibility of making a profit on its investment thanks to the formula used, that the parties amended the initial agreement to add guarantees and that it contains restrictive clauses as to the possibility for PCI to pay dividends or sell the business. According to him, these elements suggest that the existing relationship between PCI and the government is more of a *joint venture*.

[ 19 ] He also rejects the QRA's proposal that the loan is conditional since its repayment depends on the growth of PCI's income. In doing so, he essentially relies on the reasons of the majority in the *McLarthy case* [2] which, according to him, rejects this idea by establishing that a loan is not conditional simply because it may not be repaid at maturity.

[ 20 ] Finally, he affirms that “[t]here is no debt forgiveness clause after 15 years” and that “the QRA's suggestion on this point is pure speculation” [3].

[ 21 ] He, therefore, concluded that PCI succeeded in demolishing the presumption of validity enjoyed by the assessments and that the QRA has subsequently failed to prove its validity.

## **THE POSITION OF THE PARTIES**

[ 22 ] The QRA essentially repeats the grounds it argued before the trial judge. According to it, the agreement is clear: the contribution made by the Canadian government is a conditional loan since it will only have to be repaid, in whole or in part, if PCI's income is maintained or increased over the years. Moreover, relying on article 2.2 of its appendix 3 and on article 7.1 of its general conditions, it maintains that the obligation to repay expires after 15 years, independently of the amount reimbursed until then by PCI, which she says constitutes a *forgiveness clause*.

[ 23 ] The trial judge, says the QRA, modified the terms of the agreement and this constitutes a manifest and decisive error justifying the Court's intervention.

[ 24 ] PCI, for its part, argues that the judge made no palpable and overriding error in his interpretation of the agreement. He exercised his discretion in concluding that it is ambiguous and was right, then, to seek to determine what the intention of the parties, in this case, PCI and the Canadian government, was. A contract, she writes, is not the instrumental writing that establishes it, but rather the common intention of the parties.

[ 25 ] However, it said, the evidence clearly shows that the parties intended that the loan be repaid. The State also checked PCI's financial health and ability to repay before agreeing to enter into the agreement and ensured that it benefited from various rights and security in the event of default on its part.

[ 26 ] Citing an excerpt from the *2012 Report of the Auditor General of Canada to the House of Commons*, she argues that it expressly recognizes that contributions made to for-profit enterprises must be repaid and constitute debts to the Canadian government.

[ 27 ] The uncertainties identified by the QRA, as to when the repayments will be made, as to the amount thereof and as to whether they will be made, do not, in its view, lead to the conclusion that the loan is conditional. Relying in turn on the *McLarty* case [4], it maintains that these uncertainties constitute conditions that in no way affect the very existence of the loan.

[ 28 ] Moreover, she says, it is possible to obtain a contribution from the Government under the SADI program and to benefit simultaneously from tax credits.

\* \* \*

## **ANALYSIS**

[ 29 ] It is well established that the interpretation of a contract is a mixed question of law and fact, in light of which an appeal court will only intervene when the trial judge has made a manifest error and decisive [5].

[30] That being the case, I consider that I am in the presence of such an error in this case.

[ 31 ] The interpretation of a contract is indeed a step-by-step process, and the first step is to determine whether the terms it contains are clear or ambiguous. When they are unambiguous, the judge must limit himself to applying them to the factual situation submitted to him. Although he may consider the context surrounding the conclusion of the contract to determine whether the terms are clear, he must do so only superficially and, in principle, must not, at this stage, resort to the principles of contractual interpretation provided for in [articles 1425 to 1432 C.c.Q](#) [6]. Thus, it is only if the terms of the contract contain a real ambiguity that it is appropriate to seek the intention of the parties.

[ 32 ] However, I am of the opinion that the terms of the agreement concluded between PCI and the Government of Canada clearly make PCI's obligation to reimburse the contribution made by the government conditional. Let's take a closer look.

[ 33 ] The agreement, signed in 2010, has only nine articles but includes seven annexes in which the terms are found. Appendix 1 contains the applicable general provisions, Appendix 2 defines the project undertaken by PCI, Appendix 3 deals with the reimbursement by PCI of the contribution made by the government, while Appendix 5 lays down the terms and conditions surrounding this contribution. Appendices 4, 6 and 7, which respectively deal with communication requirements, the obligation to produce certain reports and the equipment required, are not relevant, moreover, to answer the question in dispute.

[ 34 ] The agreement is amended twice; a first time in April 2010 and a second in July 2013. Since the audit carried out by the QRA took place in 2015, it determined the nature of the government's contribution in the light of the agreement as amended by these two amendments. I will do the same.

[ 35 ] First, Article 3 of the agreement details PCI's obligations. Its paragraph (d) reads:

### **Article 3 – Recipient's Obligations**

**3.1** The Recipient covenants and agrees:

(a) [...]

(b) [...]

(c) [...]

(d) to pay Annual Repayment Due and the Maximum Amount to be repaid, as set out in Schedule 3;

[ 36 ] The contribution of the State is for its part provided for in Article 4:

#### **Article 4 – The Contribution**

**4.1** Subject to all the other provisions of this Agreement, the Minister will make a Contribution to the Recipient in respect of the Project, of the lesser of:

(a) 30% of the Eligible Costs; and

(b) \$7,665,000.

**4.2** [...]

[ 37 ] Section 4.1 of the general conditions contained in Schedule 2 establishes that the Minister will pay this contribution in accordance with the procedure set out in Schedule 5:

#### **4. Claims for Payment**

##### **4.1 Payment of Claims**

The Minister will pay the Contribution to the Recipient in respect of Eligible Costs incurred on the basis of itemized claims submitted in accordance with the procedures set out in Schedule 5.

[ 38 ] Appendix 3, which must be used to find out the terms of PCI's obligation to repay the contribution paid by the government, first includes, in article 1, a set of definitions:

#### **APPENDIX 3**

##### **1. Definitions**

**"Adjustment Factor"** is a multiplier applied to the repayment formula to calculate the Annual Repayment Due and is based on how much GBR in the current Recipient Fiscal Year has increased over GBR in the previous Recipient Fiscal Year.

**"Annual Repayment Due"** means the annual repayment payable by the Recipient to the Minister as set out in section 2 below.

**"Benchmark Year GBR"** means the GBR for the Recipient Fiscal Year immediately preceding the first year of the Repayment Period.



**"Gross Business Revenues" or "BGR"** means revenue as reported in the audited consolidated financial statements of PCI Group, as determined in accordance with generally accepted accounting principles, applied on a consistent basis.

**"ITO Contribution"** means the total amount of the contribution actually disbursed by the Minister under this Agreement.

**"Maximum Amount to be repaid"** means 1.65 times the ITO Contribution.

**"Repayment Period"** means the period during which repayments will accrue, as specified in paragraph 2.2 below.

**"Repayment Rate"** means  $\text{ITO Contribution} / \text{Benchmark Year GBR} \times \text{Years to Repay}$ .

**"Years to Repay"** means 15 years.

[ 39 ] This is followed by Article 2, entitled *Conditional Repayments*, which establishes in detail and using a precise formula, the manner of determining the amount, if any, to be reimbursed by PCI in a given year:

## 2. Conditional Repayments

The Recipient will pay to the Minister the Annual Repayment Due during the Repayment Period, as set out below

### 2.1 Annual Repayment Due for all years of Repayment Period

The annual Repayment Due shall be calculated annually based on the Repayment Rate and year-over-year change in GBR by application of the Adjustment Factor as outlined below.

Annual Growth in Royalty Base		Growth Factor	Adjustment Factor	Repayments
less than 0%	→	0%	0	No repayment due
0% to less than or equal to 3%	→	3%	1	Nominal repayment, no adjustment
greater than 3% to less than or equal to 6%	→	6%	1.25	Royalty increased by 25%
greater than 6% to less than or equal to 9%	→	9%	1.33	Royalty increased by 33%
greater than 9%	→	> 9%	1.5	Royalty increased by 50%

### **Repayment Calculation**

For each year of the Repayment Period, **Annual Repayment Due** shall be calculated as follows:

Annual Repayment Due = GBR for the Recipient Fiscal Year x Repayment Rate x Adjustment Factor.

[ 40 ] Under these provisions, the amount that PCI must reimburse annually depends on the fluctuation of its gross income. The amount it must repay is in fact equal to its gross income for the year concerned multiplied by the established reimbursement rate multiplied again by the indexation factor which is a function of the fluctuation of its income.

[ 41 ] Thus, PCI must annually repay one-fifteenth of the contribution received if its gross revenues remain stable. If its gross income increases by more than 3% in a given year, the amount it must repay is increased according to the applicable indexing factor. Moreover, it has no reimbursement to make if its gross income decreases since in such a case the indexing factor it must use to carry out the multiplication is zero, which necessarily leads to an amount of zero.

[ 42 ] In fact, the agreed formula ensures that PCI must repay the contribution received over 15 years if its gross revenues are stable. It may have to repay up to 1.65 times the contribution received if its income increases sufficiently during the fifteen-year repayment period but may also have nothing to repay if it decreases throughout it.

[ 43 ] PCI's only obligation is to pay annual repayments for 15 years. The agreement also contains no provision obliging PCI, at the end of the repayment period, to repay at least the contribution received if it has not been repaid through annual repayments.

[ 44 ] Section 7.1, on the contrary, provides that the agreement will expire once the stipulated maximum amount has been repaid or at the expiry of the repayment period, whichever comes first:

#### **7.1 Repayments to the Minister and Contractual Benefits**

The agreement will expire once the total amount to be repaid to the Minister pursuant to Schedule 3 has been repaid, or the Repayment Period set out in Schedule 3 has elapsed, whichever shall first occur.

[ 45 ] The trial judge relied on the testimony of PCI's chief financial officer to conclude that the company always intended to repay this contribution. However, this intention, even if it exists, does not allow the terms of the agreement to be modified and the contribution to be qualified as necessarily reimbursable.

[ 46 ] It goes without saying that PCI hopes to reimburse it since such a scenario implies that its gross income has been maintained or has increased, but that does not change the fact that the parties have agreed that it would not be refundable if PCI's gross income instead declines throughout the fifteen-year refund period. Hoping to repay a debt and having an obligation to do so are two separate things.

[ 47 ] PCI also maintains that the State ensured its financial health and its ability to repay the contribution before entering into the agreement while ensuring that it benefited from significant guarantees. This, they say, suggests its intention to get it back.

[ 48 ] Here again, the fact that the government verified PCI's ability to meet its obligations, and requested that certain guarantees be granted to it, does not change the nature of the obligation contracted by PCI. The government, in doing so, verifies the financial health of PCI and ensures that it benefits from sufficient guarantees in the event of default on its part. The warranties granted to it can only be exercised in the event of a default on the part of PCI. However, no fault can be attributed to it if, its income decreases, it does not reimburse the contribution received.

[ 49 ] These elements, therefore, do not have the scope given to them by PCI and certainly do not allow the terms of the agreement to be modified to transform the obligation to repay variable amounts over 15 years into a firm obligation to repay the contribution.

[ 50 ] The obligation to repay the contribution is indisputably conditional here on the achievement of certain financial results by PCI, which makes it a conditionally repayable loan and, by the same token, government assistance within the meaning of the *Income Tax Act*. The conditional obligation, let us recall, being that which *[depends] on a future and uncertain event, either by suspending its birth until the event happens or until it becomes certain that it will not happen, or by subordinating its extinction to the fact that the event occurs or does not occur* [7].

[ 51 ] PCI argues that the trial judge was right to rely on the *McLarthy* case [8] since it supports his position that a debt whose repayment is uncertain nevertheless remains a firm debt.

[ 52 ] I find that this is not the case.

[ 53 ] It is true that the Supreme Court affirms there that the limited recourse of a creditor in the event of non-payment of a debt does not make it a possible debt, but the context of the case and the terms of the loan are very different from those of the present case.

[ 54 ] Mr. McLarthy contracted a debt which he undertook to reimburse under certain conditions. He granted certain guarantees to his creditor and agreed that if at maturity, he were to fail to repay his debt, his recourse would be limited to the exercise of the guarantees. We, therefore, understand that the obligation to repay is not conditional.

[ 55 ] In this case, the agreement does not have the effect of limiting the remedies available to the government in the event of a failure of PCI. Rather, it provides that PCI's obligation to repay will arise only if its income is maintained or increased, which constitutes a future and uncertain event. This condition affects the very nature of the debt.

[ 56 ] The situation would be different if the agreement exempted PCI from making annual repayments in the event of a reduction in its income, but nevertheless imposed on it the obligation to repay the part of the unpaid contribution at the end of the repayment period. The obligation to repay is then only deferred. However, this is not the case, nothing in the agreement imposes such an obligation on PCI.

[ 57 ] That being the case, the QRA was justified in taking the contribution into account in establishing the expenses eligible for the salary credit.

[ 58 ] It should be noted, in conclusion, that a taxpayer is generally entitled to a tax credit if, during a given year, he actually repays part of the government assistance received [\[9\]](#).

[ 59 ] For these reasons, I suggest allowing the appeal, reversing the judgment rendered by the Court of Québec on April 2, 2019, and restoring the notices of assessment issued by the QRA for the years 2012, 2013 and 2014.

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MARIE-JOSEE HOGUE, JCA

Unofficial Translation: Not to be used for legal purposes