The patent box comes to Canada: Government announces consultation on adopting IP tax incentive program

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On January 31, 2024, the Canadian federal government announced a consultation on the implementation of a patent box regime in order to encourage the creation and retention of intellectual property (IP) stemming from research and development activities carried out in Canada.

In conjunction with the announcement, the Department of Finance released a consultation paper that provides background on the consultation. Stakeholders have until **April 15, 2024**, to provide their comments and suggestions. The federal government has also announced a related consultation on potential changes to the Scientific Research and Experimental Development (SR&ED) tax incentive program. You can learn more about it here.

Background to the consultation

Businesses that own IP are more competitive, grow faster and bring substantial benefit to the economy. The consultation paper notes that Canada lags behind its peers in attracting and retaining IP for commercialization. In fact, the gap in IP performance between Canada and other G7 countries has been widening over the past two decades.

As a result, the federal government is undertaking steps to improve Canada's IP performance. In Budget 2022, the federal government made nearly $100 million in investments in various IP initiatives. As part of this effort, the federal government is also considering the suitability of adopting a patent box regime.

What is a patent box regime?

Intellectual property, by its very nature, is a mobile source of income that is relatively easy to move from one jurisdiction to another. A patent box regime taxes income from certain types of IP at preferential rates. In so doing, it discourages the transfer of mobile IP, such as computer software, from its jurisdiction of development to a lower tax

jurisdiction for further commercialization. Patent box regimes are currently used in the U.K. and 13 EU member states, including France, Spain and the Benelux countries.

To date, the Canadian federal government has not adopted a patent box regime at the federal income tax level. However, some provinces have recently enacted their own patent box regimes, such as the Saskatchewan Commercial Innovation Incentive in 2017 and the Québec Incentive Deduction for the Commercialization of Innovations in 2020.

A patent box regime adopted by the federal government would need to comply with the "nexus approach" agreed to by OECD countries, including Canada, in 2015. In general terms, the nexus approach allows taxpayers to benefit from patent box regimes only to the extent that they have incurred the underlying research and development expenditures that generated the IP assets. This is meant to prevent inappropriate tax competition between countries by not offering preferential treatment to IP developed in other countries (particularly those that do not have patent box regimes).

According to the OECD's Final Report on Action 5 of the Action Plan on Base Erosion and Profit Shifting (the Action 5 Final Report), eligible assets under the nexus approach include patents and other IP assets that are "functionally equivalent to patents". Other IP assets that are functionally equivalent to patents must both be legally protected and subject to similar approval and registration processes, where relevant. Examples of functionally equivalent IP assets include:

- Patents defined broadly, e.g., including utility models, plants and genetic material, orphan drug designations, and extensions of patent protection;
- Copyrighted software; and
- Other IP assets that are non-obvious, useful, and novel.

Key questions for consideration

The federal government is seeking feedback from stakeholders on the following questions:

1. Why do businesses in Canada pay more to entities in other countries for the use of IP than they receive from such entities that use Canadian-based IP?
2. Would creating a patent box regime make Canada more competitive for developing, commercializing and retaining ownership of IP, and how would it compare with the SR&ED program?
3. How important are tax considerations in deciding where IP is commercialized and what other factors influence decisions about where to locate and commercialize IP derived from R&D conducted in Canada?
4. To what combined federal-provincial/territorial tax rate should a Canadian patent box regime apply?
5. Which IP assets that are in-scope of the nexus-compliant approach set out in the OECD Action 5 Final Report should be included in a Canadian patent box regime, and what relevant differences exist among them?
6. What lessons can Canada draw from other countries that use patent box regimes that might usefully inform the design of a Canadian version, and how can the cost to governments providing them be suitably minimized?

Takeaway

The consultation on developing a patent box regime represents a welcome effort on the part of the Canadian government to improve Canada's IP performance and boost its economy. The exact scope of eligible assets with regard to where an IP is held and whether it should be issued or registered are further considerations that may be of relevance to the scope of this consultation. **Interested parties should ensure that they make submissions by the April 15 deadline**. Comments are to be sent to SRED-PB-RSDE-RPB@fin.gc.ca with "Patent box" as the subject line.

If you have any questions about a potential patent box regime in Canada or the submission process, please reach out to any member of BLG's Tax Group or IP Group.

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