Helping Canadian Businesses Innovate, Compete, and Grow

Pre-Budget Submission to the

Department of Finance

By the Intellectual Property Institute of Canada

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INTELLECTUAL PROPERTY INSTITUTE OF CANADA
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IPIC

Executive Summary

In this submission, the Intellectual Property Institute of Canada (IPIC) proposes two complementary programs to help Canadian businesses innovate, compete, and grow.

The first proposal addresses the need to foster a culture of innovation in Canada. The proposed "first patent" program would provide a subsidy that encourages new innovators to obtain their first patent. New innovators are often hesitant to allocate resources to the protection of their intellectual property (IP). The program would result in a valuable asset useful in leveraging funds and attracting partners for commercial development.

The second proposal is meant to help Canada become a global centre of innovation, help companies "scale up", and retain R&D and manufacturing in Canada. The proposed "innovation box" would encourage companies to develop and implement Canadian innovations, by allowing business income derived from intellectual property to be taxed at a lower rate than regular business income.

The two programs are complementary in that they both are intended to support the commercial implementation of Canadian innovations, while targeting both ends of the "innovation gap" in the Canadian economy. Together, these programs will support Canadian R&D, commercialization, and job growth.

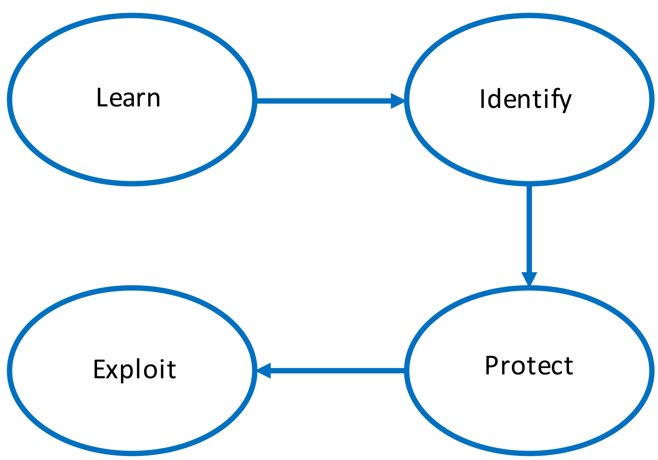
Introduction

The Intellectual Property Institute of Canada (IPIC) is pleased to respond to the Budget 2017 consultation.

Supporting innovation for 90 years, IPIC is the professional association of patent agents, trademark agents, and lawyers practicing in all areas of intellectual property (IP) law. Our membership totals over 1,700 individuals, consisting of practitioners in law firms and agencies of all sizes, sole practitioners, in-house corporate intellectual property professionals, government personnel, and academics. Our members' clients include virtually all Canadian businesses, universities and other institutions that have an interest in intellectual property (e.g. patents, trademarks, copyright, and industrial designs) in Canada or elsewhere, and also foreign companies who hold intellectual property rights in Canada.

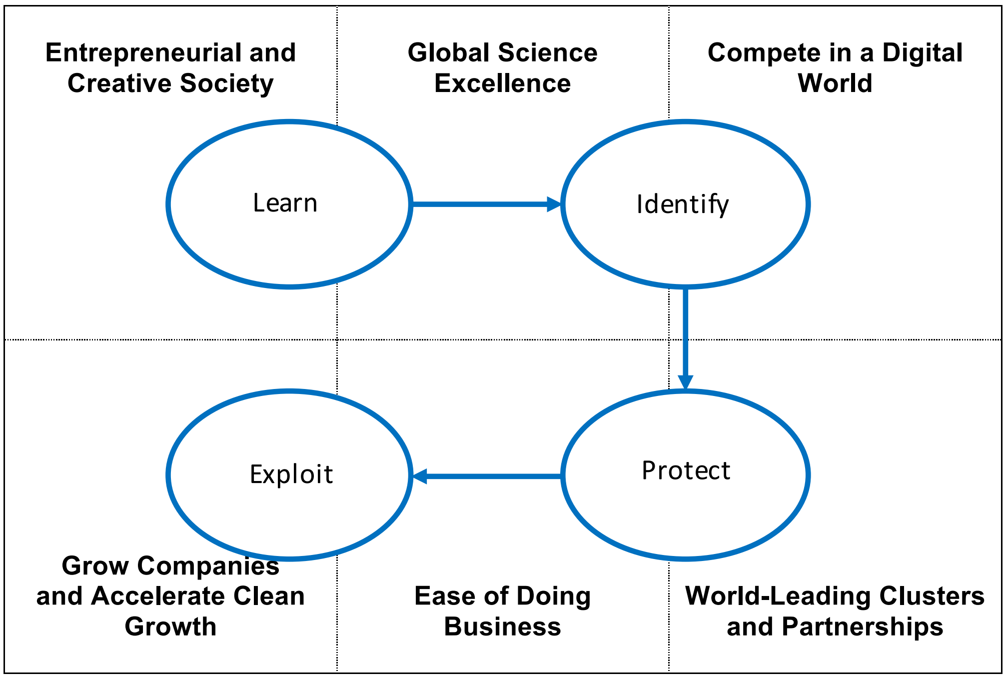
Intellectual property is a fundamental element in the growth of innovative companies. The road from idea to commercial product or service includes the four key steps shown in the diagram below. In essence, entrepreneurs learn about IP, identify the intellectual property that they create or acquire, seek protection for that IP (e.g. in the form of a registered trademark, patent or industrial design), and then exploit the IP by manufacturing a product, licensing the IP, selling a branded service, seeking financing or partners, etc.

Four IP Steps



Intellectual property plays a key role in the Government of Canada's objective to make Canada a global centre of innovation. Overlaying the four basic IP steps over the six areas for action identified in the Government's Innovation Agenda provides this map.

Intellectual Property and the Six Areas for Action



Because innovation and intellectual property are inextricably linked, countries that are global innovation leaders have robust IP systems. These systems function effectively because of many elements including legislation, education, incentives, and the way each IP actor performs to sustain innovation. Accordingly, IPIC has identified issues at the intersections of the four IP steps and the areas for action and, in response to the Innovation Agenda consultation, provided recommendations to help make Canada a global innovation leader.

In this pre-budget submission, we focus on two recommendations for Budget 2017 to help businesses protect and exploit their intellectual property.

1. Create a First Patent Program

In the Fall Economic Statement, the Government reiterated its commitment, for Budget 2017, "to investments that will help businesses and entrepreneurs become more innovative, competitive and successful."

A "first patent" program would be such an investment.

The Office of Chief Economist of the United States Patent and Trademark Office (USPTO) recently studied the effect of a patent on 45,819 start-ups who filed their first patent application in the USPTO. The study confirmed that a patent allowance has a significant economic impact on these start-ups, such as on sales growth (51%), employment growth (36%) and an improvement of the quality of subsequent innovations.[1]

The Québec government launched its First Patent Program in July 2015 to encourage small and medium-sized businesses to patent their inventions. The Québec Program offers eligible businesses a subsidy on expenses related to obtaining a first patent. The credit equals 50% of the incurred expenses, up to $25,000.[2] There has been high demand for this program as funds allocated for the period of July 2015 to March 2016 were exhausted prior to the end of the period.

IPIC proposes that the Government of Canada create a similar program.

The program would provide assistance to inventors, start-ups, and SMEs at a critical point where they have developed an innovative idea and are in a position to seek patent protection but may not have the financial resources to do so – or may not understand the importance of doing so. Thus, the program would encourage qualified Canadian inventors and companies to file patent applications for inventions that provide the foundation of a successful venture. It would thus provide businesses with financial aid for protecting their inventions at an early stage, and allow businesses to reallocate capital saved in the patenting process into further developing their business ventures.

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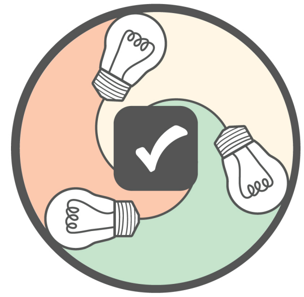
[1] Farre-Mensa, Hegde and Ljungqvist, "The Bright Side of Patents", Office of Chief Economist, USPTO Economic Working Paper Series, Working Paper No. 2015-5, December 2015

[2] Additional information on the Program may be obtained at: Ministère de la science, de l'économie et de l'innovation, *Programme premier brevet*, updated on March 15, 2016, https://www.economie.gouv.qc.ca/bibliotheques/programmes/aide-financiere/programme-premier-brevet/ (accessed on April 14, 2016)

Estimated Costs of the Program

- The grant would cover 50% of patenting expenses. Such expenses would include patenting costs and professional fees incurred up to the patent's grant.
- IPIC believes the maximum funding provided by the program (the 50% of expenses) should be $25,000.
- We estimate that there are currently about 600 to 800 applicants/year who file a first patent application.
- Therefore, if the program is successful in increasing the number of applications, we could use the figure of 1,000 applicants/year for financial estimates.
- The program cost would therefore be in the range of $25 million plus administration costs.

2. Launch an "Innovation Box"



To encourage R&D and manufacturing, Canada must be competitive on a number of fronts, the newest being incentives for innovation and IP. Appendix A provides an overview of incentives offered by other countries.

The federal government should consider adopting an innovation box model to provide favorable tax treatment for income derived from intellectual property.

The expression "innovation box" comes from a checkbox provided on tax forms to identify revenues that would be eligible for the reduced innovation tax rate. The expression "patent box" is also often used.

There is a distinction between R&D tax incentives and innovation boxes. R&D incentives support technology developments or input into the innovation process; conversely innovation boxes support the output or commercialization of R&D. In other words, innovation boxes differ from tax credits for R&D because they operate on the "back end" of the production cycle; innovation credits and deductions, on the other hand, operate on the "front end" of the cycle. These incentives are complements and not substitutes, working together to improve both R&D activity and commercialization activity in Canada.

Notably, Québec announced, in its last budget, an innovation box initiative that would lower corporate income tax from 11.8 to 4 percent, as of January 2017, on income that meets a number of criteria.

Cost Indicators

- In its 2016 budget, the Québec government estimated costs of $135 million over five years for its fiscal incentive.

- Statistics released on September 14 by the UK Revenue and Customs department indicate that in 2013-14, the first year of the UK Patent Box, 700 companies claimed the tax relief, for a total value of £342.9 million (approx. $590 million).[3] Note that the UK program has since been revised following discussions within the EU and the OECD about setting certain common rules for innovation box type program.

[3] Available at: https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/552641/Sep2016_201314_PB_Official_Statistics.pdf

A Note About the *Invest in Canada Hub*

In the Fall Economic Statement, the Minister of Finance announced the creation of the *Invest in Canada Hub* to "ensure that Canada makes the most of every opportunity to attract global investment and the jobs that come with it."

Part of attracting global investment is ensuring that our intellectual property system is competitive with the systems in other jurisdictions. In this regard, there have been many accomplishments in recent years, notably the coming into force last June of a statutory privilege for the communications between clients and their patent and trademark agents, including the recognition of privilege where it exists in other countries.

More needs to be done and IPIC has made recommendations to Innovation, Science and Economic Development Canada to continue improving the competitiveness of the IP system, by amendments to the *Patent Act* and *Trade-marks Act*, and by modernizing the regulatory framework for patent and trademark agents.

All these changes are important because intellectual property is often inherent to foreign investment, especially if it involves R&D and manufacturing in Canada.

Conclusion

To help Canadian businesses innovate, compete, and grow, IPIC makes two recommendations for Budget 2017. The proposed "first patent" program would provide a subsidy that encourages new innovators to obtain their first patent. The proposed "innovation box" would encourage companies to develop and implement Canadian innovations, by allowing business income derived from intellectual property to be taxed at a lower rate than regular business income.

We thank the Minister of Finance for considering our recommendations. For more information, please contact our Acting Executive Director, Anne-Josée Delcorde, at 613-234-0516 or ajdelcorde@ipic.ca.

APPENDIX A: International IP Incentives – August 2016

LEGEND

Initial Stages: Refers to the initial stages of the company's existence and R&D. It reflects assistance provided at the initial research stage, before attempting to secure IP protection, and before trying to commercialize. This stage covers incentives for hiring people to do R&D, and other related investments.

Innovative R&D: Refers to the stages where there is key innovation and where the company will attempt to secure IP protection. This stage covers incentives relating to the acquisition of IP and associated research.

Commercialization: Refers to the stages where the incentives relate to the commercialization of the innovation, such as lower tax rates on income derived from patented products.

Country	**Incentive**	**Type**
Belgium	Belgium has taken advantage of tax incentives to drive patent applications. Here the patent income deduction (PID) provides for 80% tax exemption of gross patent income. This deduction can be applied to patents that are fully or partly developed by Belgian companies or to patents that have been acquired from foreign parties so long as they are "improved" in R&D centres in Belgium.	Commercialization
China	In 2012 China's Ministry of Finance issued the "Measures for the Administration of Special Funds for Subsidizing Foreign Patent Applications". These policies are financially supported by local governments and regulated at the provincial and municipal level.[4] The program allows individuals who file patent applications abroad to qualify for subsidies related to charges for the process of filing and searching, service expenses paid to patent agents, and fees paid for patent examination. In order to qualify, applicants need to be domestic small and medium enterprises, public institutions or scientific institutions. Importantly, subsidies are only granted after the patent is issued.[5] Each patent project appears to support up to 5 countries, the amount of subsidy for each country of not more than 10 million Yuan (C$2M), excluding major innovative projects.[6]	Innovative R&D
China	Since 1985 China has employed the "patent fund policy" where any applicant having difficulty paying patent fees has the right to apply to the State Intellectual Property Office for reduced or postponed fees.	Innovative R&D
Colombia	A five-year tax exemption is available from 1 January 2013 to 31 December 2018 for new software, developed in Colombia and covered by new patents registered with the competent authority, provided they have a high	Commercialization

[4] Haijun Jun, "Government-Backed Patent Funds in China", 2013 Tech Monitor 24, online: <http://www.techmonitor.net/tm/images/f/f1/13oct_dec_sf2.pdf>

[5] Blog: "China IPR", online: (Accessed Aug 8, 2016) <https://chinaipr.com/2012/06/12/china-to-provide-financial-incentives-for-filing-patent-applications-abroad/>

[6] "Grants to foreign patent special funds Interim Measures", online: (Accessed Aug 9, 2016) <http://www.wipo.int/wipolex/en/text.jsp?file_id=335868>.

	content of national scientific and technological research, certified by COLCIENCIAS. New software development has to be produced in Colombia, registered and certified by the relevant authorities, and be a result of a research project. The incentive is applicable to current investments.[7]	
France	Similarly to Belgium, France has also implemented a tax regime where the tax rate on income derived from patents is reduced from 34% to 15%. In addition to the tax deduction France also provides R&D grants which are allowed to cover costs related to patent maintenance. In addition to the tax deduction France also provides R&D grants which are allowed to cover costs related to patent maintenance.	Commercialization
Hungary	Hungary's scheme includes a provision according to which 50% of the pre-tax amount of the royalties received may be deducted from the tax base. The adjustment is capped at 50% with no carryforward of the total accounting profit before tax. The result is a 5% or 9.5% nominal tax rate on profits of licensing activities. The definition of royalties for the purposes of this deduction is broad and can include income from patent licensing and other industrial IP, know-how, trademarks, trade names, business secrets and copyrights.[8]	Commercialization
India	Although India does not allow for deduction of revenue generated from patents, it does allow for a "super-deduction" of 200% for qualifying scientific research and R&D expenditures. Expenditures on scientific research include expenses incurred performing clinical drug trials, obtaining approvals from regulatory authorities and filing patent applications.[9]	Innovative R&D
Ireland	Ireland implemented a Knowledge Development Box scheme in 2015 after having abolished the Patent Royalty Income Exemption in 2011. The Knowledge Development Box offers a reduced tax rate of 6.25% (down from standard 12.5%[10]) on qualifying profits generated from patented or similarly protected inventions and copyrighted software in periods commencing on or after January 1, 2016. The Irish scheme is the first to be compliant with the Organisation for Economic Co-operation and Development's (OECD's) Base Erosion and Profit Shifting program.[11] The standard corporate income tax rate in 2014 was 12.5%.	Commercialization

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[7] "Worldwide R&D Incentives Reference Guide, 2014-2015", Ernst and Young, online: (Accessed Aug 8, 2016) <http://www.ey.com/Publication/vwLUAssets/EY-worldwide-randd-incentives-reference-guide/$FILE/EY-worldwide-randd-incentives-reference-guide.pdf> [*EY*].

[8] "Taxation and Investment in Hungary 2015", Deloitte Touche Tohmatsu Ltd, 2015, online: (Accessed Aug 8, 2016) <http://www2.deloitte.com/content/dam/Deloitte/global/Documents/Tax/dttl-tax-hungaryguide-2015.pdf>.

[9] *EY, supra* note 7.

[10] *EY, supra* note 7.

[11] "Knowledge Development Box - Adding to Ireland's R&D incentives", Deloitte Touche Tohmatsu Limited, online: (Accessed Aug 8, 2016) <http://www2.deloitte.com/ie/en/pages/tax/articles/knowledge-development-box-ireland.html>.

Luxembourg	The IP box will be repealed as of tax year 2016 to comply with the conclusions of the EU and the OECD regarding IP taxation.[12] However, existing IP companies may continue to benefit from the current favorable regime (i.e. an 80% exemption from income tax on income and gains deriving from the qualifying IP rights and a full net wealth tax exemption) until June 30, 2021. The old rules should be applicable during this time period (i.e. until June 30, 2021) to IP rights developed or acquired before June 30, 2016.[13] The 80% scheme covers patents, trademarks, designs, domain names and software copyrights. The tax exemption only applies provided the following conditions are met: • The qualifying IP must have been established or acquired after December 31, 2007. • The expenses, amortization and deductions for write-downs related to the right shall be recorded as an asset in the taxpayer's balance sheet.[14]	Commercialization
Netherlands	The Netherlands employs an innovation box, where income derived from either the finished product or the capital gain from the sale of IP can be claimed. These profits are taxed at 5% rather than the statutory rate of 25%. Qualifying IP includes self-developed patent or plant breeder rights.	Commercialization
Portugal	The Portuguese Government also uses a taxable means to incentivize use of patents as only 50% of the gains obtained from the disposal or lease of patents and other industrial IP rights developed in Portugal will be taxed.[15]	Commercialization
Portugal	Portugal also offers R&D cash grants which can be used towards expenses associated with patent applications and patent maintenance fees.[16] The conditions applicable to this incentive are: • Minimum investment of €100,000 • Minimum incentive rate of 25%, which can be increased by 20% for small companies, 10% for medium companies or 25% for industrial investigation projects • Nonrefundable grant for attributed incentive amounts below €1 million • For attributed incentives above €1 million, a nonrefundable grant is attributed up to €1 million and for the exceeding	Innovative R&D

12 Christophe Clément, "Proposed Abolition of the Luxembourg IP Tax Regime", Clément & Avocats, November 2015, online: (Accessed Aug 8, 2016) <http://cc-law.lu/en/publications/november-2015--ip-box-regime>.

13 *Ibid*.

14 *Ibid*.

15 *Ibid*.

16 *EY, supra* note 7.

	amounts; 75% are granted as nonrefundable incentives, and the remaining 25% as a refundable loan.[17]	
Spain	The Spanish regime exempts 50% of the gross income derived from qualified IP from the corporation tax for Spanish-domiciled countries. Qualified IP includes patents, secret formulas, processes, plans, models, designs and know-how. The benefit is capped at six times the costs incurred to develop the IP.[18]	Commercialization
Switzerland	Patents, supplementary protection certificates and marketing authorisations are considered to be qualifying IP for Switzerland's License Box. Either full legal title, beneficial ownership or an exclusive license is required to constitute ownership. Relevant income includes income from production, rendering of services, patent royalties, other income from licensing patents, sale of patents, and sale of products incorporating patents. Damages from infringement may also be included. The envisaged effective tax rate in a draft bill is around 10% (including federal, cantonal and communal taxes) but may be lower depending on the location within Switzerland.[19] The effective tax rates in Switzerland for ordinary taxed companies on the level of federal, cantonal and communal corporate income tax amount from 12.32% to 22.79%.[20]	Innovative R&D
United Arab Emirates	The Takamul program provides for legal and financial support for international patent filings at the USPTO and for the filing of a subsequent patent application the PCT. This program was initiated primarily for Abu Dhabi but now extends its support to all emirates of the UAE, including Dubai. The program offers funding to applicants under the government's initiative to support innovation in the UAE and does not acquire any rights to patents later obtained through such funding. The percentage of financial support is as high as 90% for individuals, 60-75% for academic institutions, and 50% for commercial organizations. The amount of support is dependent upon the applicant's circumstances, the amount available being up to AED48, 000 (C$17k) for filing and AED20,000 ($C7k) for prosecution.[21]	Innovative R&D
UK	The UK patent box regime taxes qualifying IP at 10%. A company can benefit if it owns or exclusively licenses-in patents granted by the: UK Intellectual Property Office, European Patent Office, Austria, Bulgaria, Czech	Commercialization

[17] *EY, supra* note 7.

[18] Peter R. Merrill, James R. Shanahan Jr., José Elías Tomé Gómez, et al., "Tax Practice – Tax Notes: Is It Time for the United States to Consider the Patent Box?", PriceWaterhouseCoopers LLP, March 26, 2012, online: (Accessed Aug 8, 2016) <http://www.pwc.com/us/en/washington-national-tax/assets/merrill0326.pdf>.

[19] Stefan Kuhn, "Introduction of a Swiss Licence Box Regime", International Tax Review, March 11, 2015, online: (Accessed Aug 8, 2016) <http://www.internationaltaxreview.com/Article/3435289/Introduction-of-a-Swiss-Licence-Box-regime.html>.

[20] *EY, supra* note 7.

[21] "TAKAMUL: TERMS AND CONDITIONS", obtained from foreign associate.

	Republic, Denmark, Estonia, Finland, Germany, Hungary, Poland, Portugal, Romania, Slovakia, or Sweden. Other stipulations apply.[22] Changes are expected to align the regime with OECD recommendations.[23] The top UK corporate income tax rate in 2014 was 21%.[24]	

[22] "Business tax – guidance – Corporation Tax: the Patent Box", Government of UK, January 1, 2007, online: (Accessed Aug 8, 2016) <https://www.gov.uk/guidance/corporation-tax-the-patent-box>.
[23] "UK to modify Patent Box in line with OECD recommendations", Pinsent Masons LLP, Oct 23 2015, online: (Accessed Aug 8, 2016) <http://www.out-law.com/en/articles/2015/october/uk-to-modify-patent-box-in-line-with-oecd-recommendations/>.
[24] *EY, supra* note 7.