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Taxation of Intellectual Property


Presentation to
MBA Students on Intellectual Property
Management

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Presenters

- ✦ Paul Fletcher, CA
 - Partner, Deloitte & Touche
 - Lead client service partner for **Technology, Media, Telecom Group**
- ✦ Chris Gimpel, CA
 - Tax Senior Manager, Deloitte & Touche
 - International tax specialist within the **Technology, Media, Telecom Group**




Overview

- ✦ Creation of Intellectual Property
- ✦ Tax Treatment of Acquisition Costs
- ✦ Commercializing Intellectual Property
- ✦ Allocation of Proceeds
- ✦ Transfer off-shore




Creation of Intellectual Property

- ✦ Patents
- ✦ Registered Industrial Designs
- ✦ Registered Integrated Circuit Designs
- ✦ Trademarks
- ✦ Copyright including software




Creation of Intellectual Property

- ✦ Research and Development
 - Tax incentives for R&D performed in Canada
 - Deduction of costs - flexible
 - Investment tax credits - 20%; 35%
 - Refundable credits for CCPCs




SR&ED Guidelines

- ✦ Advancement (scientific or technological)
- ✦ Uncertainty (scientific or technological)
 - Outcome
 - Approach
- ✦ Content (scientific and technical)
 - SR&ED work was done
 - By qualified personnel
 - Results were recorded



Tax Treatment of Patent Costs


- ✳ Costs to develop I/P may be SR&ED
- ✳ Cost of representation deductible
- ✳ Cost to register patent are capital
- ✳ Patent costs may be deducted as
 - Class 14 asset over life of patent
 - Class 44 asset at 25 percent declining balance



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Tax Treatment of Patent Costs


- ✳ License to use patented information
 - Class 44 - 25 percent declining balance or
 - Class 14 for limited life license
 - ECE for unlimited life license



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Tax Treatment of Industrial Designs, Circuits, Trademarks


- ✳ Representation and registration costs deductible
- ✳ Acquisition of existing I/P
 - Class 14 if limited life
 - ECE if unlimited life



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Tax Treatment of Software


- ✳ Development costs
 - Expensed in year or
 - Capitalized
 - May be SR&ED
 - Generally Class 12



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Taxation of Software


- ✳ Acquisition of Rights to Existing Software
 - Class 12 for license to use applications software
 - Class 10 for license to use systems software



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Taxation of Software



- ✳ Acquisition from Foreign Vendor
 - Non-resident withholding tax on payments for the right to use IP
 - Rate 25 percent
 - May be reduced by treaty - eg 10 percent
 - Canada-US rate now 0 percent
 - Canada-Netherlands rate 0 percent



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Summary of Acquisition Costs

- ✘ Internally created I/P may be
 - deductible in the year plus ITC
 - deductible in the year, no ITC
 - deductible over time as CCA claims
 - partially deductible over time as ECE claims
 - not deductible



Commercialization

- ✘ Created IP has value – now what?
- ✘ Valuation
- ✘ Value realization
 - License
 - Sell
 - Build the business



License of IP

- ✘ Use of property vs services
- ✘ Business profits vs royalties
- ✘ Non-resident withholding taxes
- ✘ Lower rates typical for treaty countries



Sale of Intellectual Property

- ✘ Sale of Core Technology - capital
- ✘ License of Core Technology - income
- ✘ Technical Assistance



Sale of Core Technology

- ✘ Exclusive license for unlimited term
- ✘ Capital treatment
- ✘ Proceeds less cost equals capital gain
- ✘ Cost less UCC equals recaptured income
- ✘ Lump sum payment with periodic payments based on production or use
 - capital treatment for lump sum
 - income treatment for periodic payments


License of Core Technology

- ✘ Non-exclusive license for limited term
- ✘ Income treatment
- ✘ license fees from foreign entity may be subject to withholding tax on royalties
- ✘ Lump sum with periodic payments - all income

Technical Assistance


- ✦ Show-how
- ✦ Payments deductible
- ✦ May qualify as SR&ED
- ✦ Receipts are income
- ✦ Separate from royalty payments to avoid withholding tax



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Allocation of Proceeds


- ✦ Purchase price less
Value of tangible assets equals
Goodwill
- ✦ Goodwill proceeds are taxed at lower tax rate but
no reserves
- ✦ Goodwill cost is only partially deductible over
extended period



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Allocation of Proceeds


- ✦ Should be identified in transfer agreement
- ✦ Purchaser and vendor must agree to same
allocation
- ✦ Revenue Canada may reallocate if unreasonable



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Structuring Technology Transfers


- ✦ Collaboration agreement
- ✦ Joint ventures
- ✦ Cost sharing agreements
- ✦ Identify opportunities before value increases -
before technology proven



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Structuring Technology Transfers


- ✦ Value may be significantly higher than cost
- ✦ Transfer may result in income, taxable capital
gains
- ✦ Tax-deferred transfer only available to Canadian
corporation or partnership



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Strategy - Offshore transfer


- ✦ Transfer of technology to lower tax jurisdiction
- ✦ Disposition taxable in Canada
- ✦ Future business income not taxable in Canada
- ✦ Future investment income taxable in Canada as
FAPI



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Strategy - Offshore transfer


- ✦ Create active business offshore
 - Manufacturing
 - Marketing
 - Selling
- ✦ Business profits taxed in foreign jurisdiction and returned to Canada as exempt surplus



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Strategy - Offshore Transfer


- ✦ Retaining R&D in Canada
 - Cost Contribution Arrangement
 - R&D conducted in Canada
 - Right to exploit in Canada
 - SR&ED earned in Canada on 100% of costs
- ✦ Many alternatives



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Summary


- ✦ Intellectual property covers many different properties, each with its own tax treatment
- ✦ Tax treatment should be considered in allocation of proceeds
- ✦ Tax position of vendor and purchaser may not be the same



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Summary

- ✦ Disposition of Intellectual Property often results in tax liability
- ✦ Tax planning may reduce or at least defer this liability



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