

## Taxation of Intellectual Property

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## Taxation of Intellectual Property

- Tax Treatment of Acquisition Costs
- Tax Treatment of Proceeds
- Allocation of Proceeds
- Structuring
- Transfer off-shore

## 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

## Creation of Intellectual Property

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

## 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

## Tax Treatment of Patent Costs

- Licence to use patented information
  - Class 44 - 25 percent declining balance or
  - Class 14 for limited life licence
  - ECE for unlimited life licence

### 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

### Tax Treatment of Software

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

### Taxation of Software

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

### Taxation of Software

- Acquisition from Foreign Vendor
  - Non-resident withholding tax on royalty payments
  - Rate 25 percent
  - May be reduced by treaty - eg 10 percent
  - Canada-US rate now 0 percent
  - Canada-Netherlands rate 0 percent

### 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

### Sale of Intellectual Property

- Sale of Core Technology - capital
- Licence of Core Technology - income
- Technical Assistance

### Sale of Core Technology

- Exclusive licence 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

### Licence of Core Technology

- Non-exclusive licence for limited term
- Income treatment
- Licence 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

### 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

### Allocation of Proceeds

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

### Allocation of Proceeds

- Unbundle “goodwill”
- Identify underlying assets
- Consider tax position of both parties
- Remember withholding tax issues

### 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

### Off-shore 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

### Offshore transfer

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

### Transfer Pricing

- Taxation
  - Fair value
  - Non-arm's length
    - Fair market value
    - Foreign reporting rules
- Contemporaneous documentation
- Interest and penalties

### 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

### Summary

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