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Tax Alert — Canada

Saskatchewan Commercial Innovation Incentive

Beginning in the summer of 2017, companies can apply for the Saskatchewan Commercial Innovation Incentive (SCII), outlined in *Bill 61: An Act respecting the Saskatchewan Commercial Innovation Incentive*, which was first announced in May 2016 and confirmed in the Saskatchewan 2017-18 budget delivered on 22 March 2017. The incentive will effectively reduce the general corporate income tax rate to 6% for a period of 10-15 years applicable to an eligible corporation's taxable income earned from the commercialization of qualifying intellectual property in Saskatchewan, and will be delivered in the form of a tax rebate. The tax rebate will be effective retroactive to 1 January 2017.

Bill 61, *The Saskatchewan Commercial Innovation Incentive (Patent Box)* Act (SCII Act), received second reading in the Saskatchewan legislative assembly on 11 April 2017. The SCII Act establishes the framework for the new "patent box" incentive, which was first announced in the Saskatchewan Throne Speech delivered on 17 May 2016. Saskatchewan subsequently confirmed the introduction of this incentive as part of its 2017-18 budget, delivered on 22 March 2017.

To implement this new income tax incentive, amendments to the Saskatchewan Income Tax Act, 2000 have also been introduced in Bill 69, *The Income Tax Amendment Act*, 2017. Bill 69 received second reading in the Saskatchewan legislative assembly on 25 April 2017.

Similar to many patent box incentives around the world, this program is intended to encourage corporations to commercialize patents and other innovations in Saskatchewan by reducing the province's tax on income earned from these innovations.

Building a better working world

More specifically, the patent box incentive will reduce the general corporate income tax rate to 6% for a period of ten years, applicable to an eligible corporation's taxable income earned from the commercialization of qualifying intellectual property in Saskatchewan, such as patents, plant breeders' rights, trade secrets, and copyright (computer programs and algorithms). The rebate's application will extend from 10 to 15 years if the research and development (R&D) associated with the intellectual property is substantially conducted in Saskatchewan. The SCII is available to any company in the world operating in any sector (regardless of where or when the R&D for the qualifying intellectual property occurred).

The rebate, which will apply retroactive to 1 January 2017, may be claimed by eligible corporations for 2017 and subsequent taxation years. Corporations that receive the Saskatchewan mineral processing tax refund or the primary steel production rebate will not be allowed to claim the SCII rebate. An application must be made under the SCII Act within three years after the first taxation year for which the eligible corporation intends to claim a rebate.

A corporation generally qualifies as an eligible corporation for purposes of this patent box incentive if it is not exempt from tax under Part I of the *Income Tax Act* (Canada), and its only activities are developing and commercializing intellectual property that is the subject of an incentive application. Additional requirements may be prescribed by regulation.

An eligible corporation will be required to satisfy both a scientific eligibility test and an economic eligibility test. More specifically, the corporation must provide evidence to the minister that the intellectual property is an *exceptional innovation*. To date, the definition of an exceptional innovation has not been finalized. The Government of Saskatchewan has announced that it has partnered with the National Research Council (NRC) – Industrial Research Assistance Program (IRAP) in assessing the scientific eligibility applications.

In addition to proving scientific eligibility, the corporation must meet at least two of the five economic growth benchmarks with respect to the innovation. The five benchmarks for the corporation are that:

- It has created and maintained the prescribed number of new full-time or full-time equivalent positions in Saskatchewan that are a direct result of the innovation (i.e., the positions created must also satisfy certain prescribed requirements);
- It has made the prescribed amount of capital expenditures in Saskatchewan that are directly associated with the eligible corporation's innovation;
- It has paid the prescribed amount in new Saskatchewan corporate income tax;
- It has spent the prescribed amount in new R&D expenditures in Saskatchewan; and
- It has met a prescribed economic growth benchmark.

Regulations establishing the additional prescribed requirements have not yet been released at the time of writing.

If an eligible corporation has met both the scientific and economic growth eligibility criteria, it can apply for and receive an SCII certificate, which allows it to claim the tax rebates provided for by the incentive starting in the corporation's taxation year in which the certificate is received.

The rebate is essentially the difference between taxes paid at the general corporate tax rate and the taxes calculated at the SCII tax rate of 6%. The rebate can be applied for after the Canada Revenue Agency (CRA) provides a Notice of Assessment for the taxation year in question.

Example: Corporation A earns taxable income of $1,000,000 from the commercialization of its intellectual property for its taxation year ended 31 December 2017. Corporation A is not eligible for the Saskatchewan small business deduction. In 2017, Corporation A would pay $117,500 of Saskatchewan tax (11.75%) on that $1,000,000 of income. The SCII qualifying tax would be calculated as $1,000,000 x 6% = $60,000, and the rebate that Corporation A would receive would be the difference between normal and qualifying tax, which is $57,500 (i.e., $117,500 - $60,000 = $57,500).

The SCII Act also provides various administration and enforcement measures, such as corporate record-keeping requirements, appointment of inspectors, routine inspections and penalties for non-compliance. Making false statements or interfering with inspectors can result in fines for an individual of up to $10,000 and corporate fines of up to $100,000.

An important note is that eligible corporations will be able to decide when to begin their 10- or 15-year SCII rebate period, allowing them to scale-up operations and profitability before they start claiming the rebate. However, no new applications may be submitted or accepted after seven years following the coming into force of the SCII Act.

Bill 69 provides that the SCII is effective when Bill 69 receives royal assent, but will apply retroactive to 1 January 2017. However, recent press releases imply that the application process will begin some time during the summer of 2017. As indicated above, the Saskatchewan government will provide further details on the incentive (i.e., detailed criteria for exceptional innovation, prescribed amounts) by regulation.

Process for receiving a tax rebate:

- An eligible corporation would submit an application (with an as yet to be determined fee) for an SCII certificate to the Saskatchewan Minister of the Economy.
- A technical assessor will determine if the applicant's proposed innovation qualifies as an "exceptional innovation".
- If deemed an "exceptional innovation", the Ministry of the Economy will determine if at least 2 of the 5 economic growth benchmarks are met.
- An SCII certificate is issued to the corporation if technical and economic tests are met.
- The corporation files its T2 tax return in the normal manner.
- On receiving a Notice of Assessment from the CRA, the corporation can then apply to the Government of Saskatchewan for a tax rebate.

How we see it

Incentives for conducting R&D activities have existed in Canada for a number of years, in the form of Scientific Research and Experimental Development (SR&ED) tax credits, grants through the IRAP, and other government programs. The SCII patent box initiative will add another form of incentive for innovation in Saskatchewan. From an economic growth standpoint, this is seen to be a positive development for the province.

However, many of the details for this program have not been established, making it hard to predict what impact this new program will ultimately have on encouraging home grown innovation or attracting foreign investment. Once items such as the definition of exceptional innovation, application fees, substantial development and economic growth benchmarks have been formalized, a complete analysis can be conducted. Some of the metrics of this program (for example, the percentage reduction in tax rate) are consistent with patent box regimes in other jurisdictions. To the extent that other criteria are similar to other jurisdictions, a like effect should be expected.

Saskatchewan now joins Quebec as early adopters of "Patent Box" incentives offered in North America. This may well be the start of a trend, as other jurisdictions see the effect these two programs have on increasing the commercialization of innovation in their respective provinces.

Learn more

For more information on the above incentive or any other topics that may be of concern, please contact your EY or EY Law advisor, or one of the following professionals:

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