



The Ontario *Ideas for the Future Act, 2008* 10 Year Tax Holiday for Companies that Commercialize Academic IP

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The *Ideas for the Future Act, 2008* (the “**Act**”) is currently being debated in the Ontario Legislature and, when passed, will provide a 10 year exemption from provincial corporate tax in Ontario for certain corporations. The legislation is directed at promoting the commercialization of intellectual property created at post-secondary learning institutions. However, the narrow scope of the availability of the tax exemption provided by the Act may prove too restrictive to attract the capital investment required for effective commercialization.

Qualifying for the Exemption

In order to qualify for the exemption a corporation must be a “qualifying corporation” that carries on and derives substantially all of its income from the commercialization of intellectual property that was created in the course of employment or academic study at a “qualifying institute”.

(i) Qualifying Corporation

A corporation is a “qualifying corporation” for a taxation year if it is incorporated after March 24, 2008 but before March 25, 2012 and it carries on and derives substantially all of its gross revenue from an “eligible commercialization business”. The corporation must not be a member of a partnership or participant in a joint venture unless all other partners or participants are also “qualifying corporations”.

(ii) Eligible Commercialization Business

An “eligible commercialization business” must be one of the following three types of business:

- i) an advanced health technology business¹;
- ii) a bioeconomy business²; or

¹ An advanced technology business means a business that is primarily engaged in using technology: (a) in the development of assistive medical devices, pharmaceutical drugs, regenerative medicine, biologics, medical procedures or surgical procedures, or (b) in human tissue engineering.

² A bioeconomy business means a business that is primarily engaged in: (a) the production of biofuel, biogas or bioplastics, or (b) the development of technology or processes that enable the use of wind, water, a biomass resource, hydrogen, biofuel, landfill gas, solar energy, geothermal energy, tidal forces or thermal waste as a source

- iii) certain telecommunication, computer or digital technologies production businesses.³

In addition, an “eligible commercialization business” must have as its sole purpose either the sale of property that derives at least 50% of its value from, or an essential element of which is, “eligible intellectual property”, or the licensing of computer programs that are “eligible intellectual property”. The Ontario Minister of Research and Innovation is responsible for the determination of whether a business is an “eligible commercialization business”.

(iii) Eligible Intellectual Property

“Eligible intellectual property” includes a patent, pending patent or a copyright in a computer program that was developed in the course of employment or academic study at a “qualifying institute”. In addition, the intellectual property must never have been owned by a person other than the creators, the “qualifying institute” or the “qualifying corporation”.

(iv) Qualifying Institute

A “qualifying institute” includes a university or college of applied arts and technology in Ontario, a university or college outside of Ontario but within Canada, a hospital research institute and certain non-profit organizations to be prescribed by the Ontario Minister of Research and Innovation.

The Exemption

A “qualifying corporation” is entitled to a refund of its Ontario corporate tax and Ontario corporate minimum tax for the first 10 years after its incorporation. Based on current tax rates, this would amount to a 5.5% tax savings if the small business rate applies to the “qualifying corporation” on its income up to \$500,000 and a 14% tax savings with respect to income subject to the general corporate tax rate.

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³ These must be primarily engaged in activities described in categories 3341 (computer and peripheral equipment manufacturing), 3342 (communications equipment manufacturing), 3344 (semiconductor and other electronic component manufacturing) or 5112 (software publishers) of the North American Industry Classification System 2007 – Canada, as published by Statistics Canada.

Exemption Deemed Nil

Despite qualifying for the exemption, the amount of the exemption is deemed to be nil where the corporation is associated with another corporation, is related to another corporation, or where control of the corporation is acquired, directly or indirectly, after March 25, 2012. The related and associated company restrictions do not apply if the related or associated company is the “qualifying institute”. It is anticipated that other limited exceptions with respect to associated and related corporations will be prescribed by regulation.

Comments

The proposed tax incentive is designed only to promote new corporations that have been incorporated for the sole purpose of commercializing new intellectual property initially invented in connection with academic institutions. This will apply to a very small subset of Ontario’s technology community.

Established corporate groups are precluded from benefitting from the exemption. For example, “qualifying intellectual property” cannot be sold to established corporations because the exemption is not available for corporations in existence prior to March 14, 2008. An established corporate group cannot access the exemption through a newly incorporated subsidiary because the amount of the exemption is deemed to be nil where the “qualifying corporation” is associated with another corporation.

The proposed structure of the tax holiday may be restrictive even to non-corporate investors. For example, any investor holding a portfolio of investments, including venture capitalists, may be prevented from taking more than a minority position in a “qualifying corporation” in order to avoid triggering the associated or related company restrictions. Further, the restriction on change of control after March 25, 2012 may limit the ability of the corporation to seek additional financing in the future, even where the associated and related company provisions would otherwise have been satisfied.

The result is that the “qualifying corporation” seeking to commercialize “eligible intellectual property” must engage in careful planning early on in order to secure both the requisite resources for product development while at the same time preserving the tax exemption under the Act. Given the very restrictive nature of the requirements that must be met in order to access the tax exemption (as currently drafted), it is questionable whether the legislation will assist these start-up companies in attracting outside equity investment. However, in the event that the associated and related company restrictions are relaxed by the Minister of Finance either by revised draft legislation or by way of regulations, the Act could be a positive incentive to invest in the commercialization of “eligible intellectual

property” given the potential magnitude of the tax break for corporations that can become profitable within the 10 year period.

This update is intended as a summary only and should not be regarded or relied upon as advice to any specific client or regarding any specific situation.

If you would like further information regarding the issues discussed in this update or if you wish to discuss any aspect of this commentary, please feel free to contact us.

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