



December 04, 2009

Reference number: IFA 2009-0005

XXX

Dear XXX:

Re: XXX

Thank you for your letter dated XXX and email of XXX, requesting an advanced ruling with respect to the provisions of the *International Financial Activity Act* (“IFA Act”) in relation to your client, XXX and the proposed transactions described below. The issues outlined in your letter were further discussed in our telephone conversations of XXX and XXX, and XXX.

#### FACTS

Our understanding of the facts is as follows:

- XXX is incorporated and resident in Canada for income tax purposes. XXX is not a securities corporation as defined in section 2(1) of the IFA Act.
- XXX has established a permanent establishment, pursuant to regulation 400(2) of the *Income Tax Act* (Canada) (“federal Act”), in British Columbia from which it will carry on its proposed international financial business (“IFB”) within the meaning of the term in the IFA Act. XXX will be liable to income tax pursuant to section 2(1) of the federal Act and section 2(2) of the *Income Tax Act* (British Columbia). XXX taxation year-end will be XXX.
- XXX is a validly registered corporation as defined in section 1 of the IFA Act.
- XXX business is the development of a XXX (the “Technology”). XXX.
- Under the XXX Agreement, effective XXX, (“XXX Agreement”), the Inventors assigned to XXX all of the XXX.

- The XXX Agreement contemplated the formation of XXX and the eventual license of the Technology by XXX to XXX to develop it for commercialization<sup>1</sup>.
- Effective XXX, XXX entered into a Technology License Agreement<sup>2</sup> (“TLA”) with XXX wherein XXX has acquired an exclusive worldwide license to the Patents and Technology<sup>3</sup> for XXX. The TLA:
  - a) XXX.
  - b) XXX.

### PROPOSED TRANSACTIONS

Our understanding of the proposed transactions is that

- XXX will enter into an exclusive license and research collaboration agreement (“License Agreement”)<sup>4</sup> with XXX, a corporation organized and existing under the laws of XXX<sup>5</sup>. At all relevant times, XXX will be a non-resident<sup>6</sup>.
- The significant terms of the License Agreement are as follows:
  - XXX will grant to XXX an exclusive worldwide license to grant and authorize sublicenses, to research, develop, make, have made, use, offer to sell, sell or import for any and all uses of the XXX Technology<sup>7</sup>.
  - XXX and XXX will engage in the Research Program<sup>8</sup> as set out in the License Agreement. XXX shall retain certain rights<sup>9</sup> to the XXX Technology for the sole purpose of performing XXX’ obligations under the Research Program.
  - XXX.

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<sup>1</sup> Clause XXX of the XXX Agreement.

<sup>2</sup> You have provided us with an unsigned copy of the TLA which refers to a XXX dated XXX. In your email to us dated XXX you advised that the original TLA of XXX was amended and signed XXX. You advised that the signed version had no material differences from the unsigned version provided to us.

<sup>3</sup> The terms “Patents” and “Technology” are defined in clause XXX of the TLA.

<sup>4</sup> This will be a sublicense agreement.

<sup>5</sup> Recitals to the License Agreement.

<sup>6</sup> The IFA Act defines “non-resident” to have the same meaning as in section 248(1) of the federal Act and means not resident in Canada.

<sup>7</sup> Clause XXX of the License Agreement.

<sup>8</sup> Clause XXX of the License Agreement.

<sup>9</sup> Clause XXX of the License Agreement.

- Future payments from XXX to XXX will consist of the following<sup>10</sup>:
  - an upfront license fee as consideration for the licenses and other rights to be granted;
  - funding for XXX research staff under the Research Program to further develop the XXX Technology;
  - milestone payments based on achievement of certain milestones relating to the XXX Technology; and
  - various royalty payment amounts based on future sales.
  
- The XXX Technology under the License Agreement includes the following Patents<sup>11</sup> (owned by XXX) that have not yet expired or ceased to be in force:

<b>Patent Number</b>	<b>International Patent Classification (IPC) Number</b>
XXX	XXX

### RULINGS REQUESTED

You have requested our rulings, with respect to the proposed transactions described above, as to whether:

1. All of the activities carried on by XXX under the License Agreement will be considered international financial activities under section 2(2)(q.1).
2. The upfront license fee, research program funding, milestone payments and royalties to be received by XXX under the License Agreement will be considered international financial business income (“IFB income”).

### ANALYSIS AND LEGISLATION

For the purposes of the IFA Act, an IFB is defined under section 1 of the IFA Act as follows:

- “international financial business”, in relation to a corporation, means a business
- (a) that is a qualifying business carried on by the corporation through a fixed place of business in British Columbia, and

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<sup>10</sup> Clause XXX of the License Agreement.

<sup>11</sup> Schedule XXX of the License Agreement.

(b) all the activities of which are international financial activities;

To be a “qualifying business”, a corporation will have to satisfy one of the following criteria establishing a substantial British Columbia presence:

- the corporation carries on an active business<sup>12</sup>;
- the corporation carries on a separate business within a corporation that carries on an active business where that separate business earns income principally from property (such as treasury activities), other than from property used in or incident to the active business, or
- the corporation is affiliated with another corporation that carries on an active business, the corporation pays at least \$300,000 in annual salary and wages to employees employed in the active conduct of the corporation’s qualifying business and the corporation has “capital employed in BC”<sup>13</sup> of at least \$10 million.

The IFA Act defines “business” as having the same meaning as under section 248(1) of the federal Act, except it does not include an adventure or concern in the nature of trade. To qualify as an international financial business, “all the activities” of the “business” must be “international financial activities”. For this purpose, “international financial activities” has the meaning as provided in section 2 of the IFA Act.

The following international financial activities qualify as patent activities under the IFA Act:

- Section 2(2)(q.1) of the IFA Act includes selling, assigning or licensing to a non-resident person<sup>14</sup> a patent within a prescribed class of patents.
- Section 2(2)(q.2) of the IFA Act includes selling, to a non-resident person, a good or service in respect of which the sales revenue is principally derived from an invention for which a patent within a prescribed class of patents is owned by the corporation (“qualifying patent”).

Section 5(1) of the IFA Regulation prescribes the eligible classes of patents. The patents’ terms must not have expired or ceased to be in force and may not be related to tobacco products. The eligible classes of patents include the following IPC numbers – XXX.

The reference to licensing in section 2(2)(q.1) of the IFA Act includes sublicensing.

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<sup>12</sup> For this purpose, active business has the same meaning as under section 248(1) of the federal Act.

<sup>13</sup> Defined to mean an amount equal to the total capital stock of the corporation multiplied by the corporation’s BC taxable income for the year divided by the Corporations federal taxable income for the year.

<sup>14</sup> “Non-resident person” is defined in section 2(1) of the IFA Act and excludes a business carried on in Canada by that non-resident person.

It is our view that to meet the requirements of section 2(2)(q.2) of the IFA Act, a corporation must own at least one qualifying patent that is used to produce the invention. Licensing a patent will not fulfill the ownership requirement of the patent as set out in section 2(2)(q.2) of the IFA Act.

Section 19(1.1) of the IFA Act defines IFB income as

- the income or loss, as determined under Subdivision b of Division B of Part I of the federal Act, of the IFB as if the business's income for the taxation year was only from international financial activities that are patent activities for that part of the taxation year that the corporation was a registered corporation.
- the income or loss, if a corporation is not a securities corporation, incurred by the IFB in the taxation year due to currency fluctuations, from a prescribed foreign currency agreement which is incident to the underlying international financial activity. The prescribed foreign currency agreement must provide for the purchase, sale or exchange of foreign currency and must reasonably be considered to have been made to reduce the risk of currency fluctuations related to the underlying international financial activity.

The above definition of IFB income ensures that for a corporation that is not a securities corporation, the income or loss from an international financial activity and any related hedging transaction are treated in the same manner. In determining IFB income, any allocation method chosen to comply with the IFA Act should be reasonable in the circumstances and should substantiate the amount claimed.

In each taxation year, a registered corporation may choose to claim a tax refund either on its patent activities or on its other eligible activities, but not on both.<sup>15</sup>

#### RULINGS GIVEN

Provided that our understanding of the relevant facts and the proposed transactions as set out above is correct and complete and the proposed transactions are carried out as described above and in your letter dated XXX, and your email of XXX, our rulings are as follows:

1. Provided that XXX is a non-resident person at the relevant times, the proposed licensing transaction under the License Agreement will qualify as an international financial activity under section 2(2)(q.1) of the IFA Act.
2. Subject to 1. above, provided that XXX is carrying on an active business, XXX will be considered to be carrying on an IFB in respect of its licensing of the prescribed patents at issue in the License Agreement.

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<sup>15</sup> Section 17.1(1)(c) of the IFA Act.

3. Subject to 2. above, provided that the payments from XXX to XXX with respect to the upfront fee, research program funding, milestone payments and future royalty payments are included in income or loss for the purposes of Subdivision b of Division B of Part I of the federal Act, the respective payments will be considered to be part of IFB income, as defined in section 19(1.1) of the IFA Act.

This advance ruling ceases to be valid if the law on which it is based is subsequently changed as a result of a court decision or if the legislation on which the ruling is based is subsequently amended. The branch is not responsible for updating this advice if there are changes to the law after the date of this letter.

Yours truly,

Marcia E. Knowles, CA  
Manager, Income Tax Advisory – Related Programs  
Income Tax Advisory and Intergovernmental Relations  
Ministry of Finance