

**CHANGES TO THE INCENTIVE DEDUCTION FOR THE COMMERCIALIZATION OF INNOVATIONS IN QUÉBEC AND ADJUSTMENTS TO OTHER MEASURES**

This information bulletin announces changes to the incentive deduction for the commercialization of innovations in Québec (IDCI) to clarify the definition of “qualified intellectual property asset” and to announce future requirements regarding the Québec nexus ratio.

In addition, it announces an adjustment to the exemption granted to municipalities in respect of the public utility tax to extend its scope to certain entities wholly owned by a municipality.

It also makes public a clarification added to the notion of government assistance, for the purposes of the refundable tax credit for the production of multimedia events or environments presented outside Québec, with respect to amounts received as a financial contribution.

Finally, it announces an easing of the mandatory disclosure mechanism with respect to requests for the payment of a refundable tax credit under the *Taxation Act*.

To obtain information on the matters dealt with in this information bulletin, contact the Secteur du droit fiscal, de l'optimisation des revenus et des politiques locales et autochtones at [secteurdudroitfiscaletdelafiscalite@finances.gouv.qc.ca](mailto:secteurdudroitfiscaletdelafiscalite@finances.gouv.qc.ca).

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1. CHANGES TO THE INCENTIVE DEDUCTION FOR THE COMMERCIALIZATION OF INNOVATIONS IN QUÉBEC.....	3
2. ADJUSTMENT TO THE MUNICIPAL EXEMPTION GRANTED UNDER THE PUBLIC UTILITY TAX .....	5
3. PRECISION ON THE NOTION OF GOVERNMENT ASSISTANCE FOR THE APPLICATION OF THE TAX CREDIT FOR THE PRODUCTION OF MULTIMEDIA EVENTS OR ENVIRONMENTS PRESENTED OUTSIDE QUÉBEC.....	6
4. CHANGE TO THE MANDATORY DISCLOSURE MECHANISM FOR CERTAIN TRANSACTIONS.....	7

## 1. CHANGES TO THE INCENTIVE DEDUCTION FOR THE COMMERCIALIZATION OF INNOVATIONS IN QUÉBEC

To encourage the competitiveness of Québec businesses while fostering the retention and valorization of intellectual property developed in Québec, the incentive deduction for the commercialization of innovations in Québec (IDCI) was introduced in the budget released on March 10, 2020.<sup>1</sup>

In short, the IDCI takes the form of a deduction in calculating the taxable income of a qualified corporation and enables such a corporation that commercializes a qualified intellectual property asset developed in Québec to benefit, for a taxation year that begins after December 31, 2020, from an effective taxation rate of 2% on the qualified portion of its taxable income attributable to that asset.

In this regard, the expression “qualified corporation” means a corporation that has an establishment in Québec, carries on a business in Québec and from which it derives income from the commercialization of a qualified intellectual property asset to which it holds the rights.<sup>2</sup>

The expression “qualified intellectual property asset” means an incorporeal property that is either an invention protected by a patent or by a certificate of supplementary protection, or a plant variety protected by plant breeder’s rights, or a software protected by copyright. In addition, the property must result from scientific research and experimental development (R&D) activities carried out in whole or in part in Québec.<sup>3</sup>

The amount that a corporation can deduct in calculating its taxable income under the IDCI is obtained by applying a formula, which can be broken down into three elements that are used to determine, respectively:

- the qualified profits from a qualified intellectual property asset of the corporation, which profits represent an approximation of the value added attributable to that asset;
- the Québec nexus ratio, which takes into account the relative extent of the R&D activities carried out in Québec by the qualified corporation;
- the rate of the tax benefit, which leads to the determination of a factor making it possible to attain an effective taxation rate of 2% on the qualified income derived from the commercialization of a qualified intellectual property asset.

It is also important to mention that *Information Bulletin 2020-15* had announced that the definition of the expression “qualified intellectual property asset” would be amended to remove the requirement that the intellectual property asset result from R&D activities carried out in whole or in part in Québec.<sup>4</sup>

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<sup>1</sup> MINISTÈRE DES FINANCES DU QUÉBEC, *Budget 2020-2021 – Additional Information*, March 10, 2020, pp. A.20-A.26.

<sup>2</sup> *Taxation Act*, s. 737.18.43.

<sup>3</sup> See the preceding note.

<sup>4</sup> MINISTÈRE DES FINANCES DU QUÉBEC, *Information Bulletin 2020-15*, December 21, 2020, pp. 6-8.

However, this approach has highlighted the need to refocus the parameters of this tax measure to ensure that the benefits of R&D activities, funded in part by Québec taxpayers early in the innovation cycle, are maximized without sacrificing the integrity of the measure. To achieve these objectives, changes will be made to the tax legislation regarding the IDCI. Thus, the definition of the expression “qualified intellectual property asset” will be clarified. In addition, the parameters for determining the Québec nexus ratio will be modified to require a direct link between the R&D activities and the intellectual property asset.

### ❑ Clarifications of the definition of “qualified intellectual property asset”

In order to ensure that the IDCI encourages businesses to commercialize Québec-based innovations from Québec, the change in the definition of the expression “qualified intellectual property asset” announced in *Information Bulletin 2020-15* will not be introduced in the tax legislation.

Moreover, in order to more accurately reflect the objective of the IDCI to foster the retention and valorization of intellectual property developed in Québec, while respecting the spirit of the actions established by the Organisation for Economic Co-operation and Development (OECD) to address base erosion and profit shifting (BEPS),<sup>5</sup> the definition of the expression “qualified intellectual property asset” will be amended to specify that, in order to receive this qualification, an intellectual property asset must result from R&D activities carried out at least in part in Québec, which activities must contribute significantly to the creation, development or improvement of the intellectual property asset.

The criteria for determining whether the R&D activities carried out in Québec have contributed significantly to the creation, development or improvement of the intellectual property asset will take into account all the facts surrounding such creation, development or improvement. Accordingly, qualified corporations must be able to demonstrate to the Minister of Revenue the link between these R&D activities and the intellectual property asset.

Also, the R&D activities carried out in Québec must reflect an active participation in the creation, development or improvement of the intellectual property asset and involve the deployment of financial and human resources in Québec.

These changes will apply in respect of a taxation year of a corporation that begins after December 31, 2020.

### ❑ Changes to the Québec nexus ratio

Under the OECD standards, tax benefits associated with income from an intellectual property asset are permitted provided that there is a direct link between the income receiving the benefits and the R&D expenditures contributing to that income.

However, as a transitional measure, the OECD standards also allow for the use of a nexus ratio based on a moving average of R&D expenditures, which is reflected in the current nexus ratio of the IDCI, which takes into account the relative importance of recent R&D activities carried out in Québec by the qualified corporation.

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<sup>5</sup> OECD (2016), *Countering Harmful Tax Practices More Effectively, Taking into Account Transparency and Substance, Action 5 - 2015 Final Report*, OECD/G20 Base Erosion and Profit Shifting Project, OECD Publishing, Paris. [<https://doi.org/10.1787/9789264241190-en>]. Action 5, which is one of the four minimum standards of the BEPS Project, specifically requires substantial activity for any preferential tax regime.

Considering that the “nexus approach” is based on the existence of a direct link between the R&D expenditures and the intellectual property asset, as well as on the application of a cumulative ratio of historical R&D expenditures, corporations wishing to benefit from the IDCI will have to monitor their R&D expenditures required for the application of the Québec nexus ratio, per intellectual property asset, on a historical basis, and retain the supporting documents for subsequent audits by the Minister of Revenue.

In this regard, work is underway to establish the rules that will allow the nexus ratio to be directly linked to a qualified intellectual property asset, property, service or family of properties or services.

As such, the Ministère des Finances will announce at a later date the application of this new requirement, which will apply in respect of a taxation year that begins after December 31, 2023.

## 2. ADJUSTMENT TO THE MUNICIPAL EXEMPTION GRANTED UNDER THE PUBLIC UTILITY TAX

In general, municipalities collect a property tax on immovables located in their territory. For this purpose, municipalities draw up a property assessment roll by establishing the value of these immovables and this roll is used to calculate the property tax.

However, immovables that are part of a telecommunications system, a gas distribution system or an electrical power production, transmission or distribution system are not included on a municipality’s property assessment roll and are therefore excluded from the regular property tax system. However, the operator of any of these public utility systems is subject to an alternative regime whereby it must pay to the Minister of Revenue the public utility tax<sup>6</sup> (hereinafter referred to as “PUT”).

The PUT was introduced as part of Budget 2004-2005.<sup>7</sup> It replaced a tax that was calculated on the basis of the revenue generated by the operation of such a public utility system.

Thereby, a person or partnership that is an operator of a telecommunications system, a gas distribution system or an electrical power production, transmission or distribution system in a calendar year must pay the PUT for that year on or before March 1 of that year. In summary, the PUT is calculated based on the net value of the assets that are part of the operator’s system.

The *Taxation Act* provides however that a municipality is exempt from the PUT.<sup>8</sup>

Nonetheless, the operation of a public utility system by a municipality may require, in certain circumstances, the use of certain legal forms. For example, the municipality may operate a public utility system through a corporation or partnership. In such a case, even though the municipality indirectly operates the system, the corporation or partnership does not benefit from the PUT exemption available to municipalities.

In order to allow a municipality, under certain conditions, to benefit from the PUT exemption even if it indirectly operates a public utility system, the tax legislation will be amended.

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<sup>6</sup> *Taxation Act*, ss. 1175.29 to 1175.42.

<sup>7</sup> MINISTÈRE DES FINANCES DU QUÉBEC, *Budget 2004-2005 – Additional Information on Budgetary Measures*, March 30, 2004, section 1, pp. 125-132.

<sup>8</sup> *Taxation Act*, s. 1175.39.

Accordingly, the *Taxation Act* will be amended so that the exemption granted to municipalities for the purposes of the PUT will also be granted, for a given calendar year, to an operator that is a corporation or a partnership where, throughout the last fiscal period of the operator that ended in the calendar year preceding the given calendar year, all of the shares of the capital stock of the corporation or all of the shares of the partnership, as the case may be, are held by one or more of the following entities:

- a municipality;
- a corporation all of the shares of the capital stock of which are held, directly or indirectly through one or more corporations or partnerships, by a municipality;
- a partnership all of the shares of which are held, directly or indirectly through one or more corporations or partnerships, by a municipality.

The application of this change will be declaratory.

However, where an operator qualifies for the PUT exemption for a calendar year in respect of which the operator has already paid the PUT on or before the date of publication of this information bulletin, the operator will not be entitled to the PUT exemption in respect of that calendar year unless the operator files an application for a PUT refund in writing with the Minister of Revenue on or before June 30, 2022. If the Minister accepts the application for a refund of the PUT so filed, interest on the amount then refunded to the corporation or partnership, as the case may be, will not begin to accrue until the date of receipt of the application for a refund by the Minister of Revenue.<sup>9</sup>

Finally, starting in 2022, a corporation or partnership that qualifies for the PUT exemption for a calendar year will be required to file a return with the Minister of Revenue for that calendar year.

### **3. PRECISION ON THE NOTION OF GOVERNMENT ASSISTANCE FOR THE APPLICATION OF THE TAX CREDIT FOR THE PRODUCTION OF MULTIMEDIA EVENTS OR ENVIRONMENTS PRESENTED OUTSIDE QUÉBEC**

The refundable tax credit for the production of multimedia events or environments presented outside Québec was introduced on March 20, 2012, to support, on the one hand, the production of educational, cultural or entertainment content by Québec businesses using multimedia technologies that promote interactivity with the target audience and, on the other hand, the international influence of these businesses.<sup>10</sup>

This refundable tax credit allows a qualified corporation to benefit, under certain conditions, from tax assistance equal to 35% of the qualified labour expenditure it has incurred to produce a qualified production. The qualified labour expenditure relating to a qualified production may not exceed 50% of the production costs directly attributable to the making of such production.

<sup>9</sup> The Minister of Revenue may make a reassessment despite the expiration of the time limits provided for in section 1010 of the *Taxation Act*.

<sup>10</sup> MINISTÈRE DES FINANCES DU QUÉBEC, *Budget 2012-2013 – Additional Information on the Fiscal Measures of the Budget*, March 20, 2012, pp. 72-77.

When the tax credit was introduced, it was specified that a qualified corporation's qualified labour expenditure and production costs must be reduced by the amount of any government assistance and non-government assistance, other than an excluded amount of assistance, that the corporation has received, is entitled to receive or may reasonably expect to receive.<sup>11</sup>

For the purposes of refundable tax credits in the cultural field, the tax legislation provides that government assistance includes the amount of any financial contribution that a corporation has received, is entitled to receive or may reasonably expect to receive from, among other, a government, municipality or other public authority.<sup>12</sup> Although the provision in question should apply equally to all refundable tax credits in the cultural field, the refundable tax credit for the production of multimedia events or environments presented outside Québec is not specifically mentioned.

In order to be consistent with the tax policy in this regard, the tax legislation will be amended so that, for the purposes of the refundable tax credit for the production of multimedia events or environments presented outside Québec, government assistance includes the amount of any financial contribution in respect of a qualified production that a corporation has received, is entitled to receive or may reasonably expect to receive from a government, a municipality or other public authority, or from a person or partnership that pays that contribution in circumstances where it is reasonable to conclude that the person or partnership would not have paid the contribution but for the amount that the person or partnership or another person or partnership received from a government, municipality or other public authority, unless that contribution is otherwise an excluded amount of assistance for the purposes of this tax credit.<sup>13</sup>

This amendment will apply in respect of a financial contribution that a corporation receives, is entitled to receive or may reasonably expect to receive after the day of publication of this information bulletin, except for any such contribution that is the subject of an agreement entered into with the qualified corporation no later than that day.

#### **4. CHANGE TO THE MANDATORY DISCLOSURE MECHANISM FOR CERTAIN TRANSACTIONS**

In 2009, the Ministère des Finances introduced a mandatory disclosure mechanism for certain transactions to enable the tax authorities to identify, in a timely manner, certain behaviours where the risk of non-compliance with the purpose and spirit of the tax legislation was deemed higher.<sup>14</sup>

This mechanism was amended in 2015 to expand its scope and improve its effectiveness<sup>15</sup>. At that time, a new type of transaction was made subject to the disclosure requirement, bringing to three the types of transactions that must be disclosed, namely, confidential transactions, transactions involving conditional remuneration and transactions with contractual protection.<sup>16</sup>

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<sup>11</sup> *Ibid.*, pp. 76-77.

<sup>12</sup> *Taxation Act*, s. 1029.6.0.0.1, 3<sup>rd</sup> para.

<sup>13</sup> *Ibid.*, s. 1029.6.0.0.1, 2<sup>nd</sup> para., subpara. e.2.

<sup>14</sup> MINISTÈRE DES FINANCES DU QUÉBEC, *Information Bulletin 2009-5*, October 15, 2009.

<sup>15</sup> *Id.*, *Budget 2015-2016 – Additional Information 2015-2016*, March 26, 2015, pp. A.108-A.110.

<sup>16</sup> These transactions are defined in the first paragraph of section 1079.8.1 of the *Taxation Act*.

The mandatory disclosure mechanism stipulates, in summary, that where a taxpayer, or partnership of which the taxpayer is a member, carries out any of these transactions resulting, directly or indirectly, for a taxation year or for a fiscal period, as the case may be, either in a tax benefit of \$25 000 or more for the taxpayer, or in an impact on the income of the taxpayer or the partnership, as the case may be, of \$100 000 or more, the transaction must be disclosed to the Minister of Revenue for that taxation year or fiscal period.

More recently, in the wake of the Tax Fairness Action Plan, additional measures were put in place to better protect the integrity and fairness of the Québec tax system. The Ministère des Finances announced that the tax legislation would be amended to extend the scope of the mandatory disclosure mechanism so that the Minister of Revenue can determine which transactions must be disclosed. Accordingly, when a taxpayer, or a partnership, enters into a transaction whose form and substance of the facts are significantly similar to the form and substance of the facts of a transaction that has been determined by the Minister of Revenue and published in the *Gazette officielle du Québec*, this transaction must also be disclosed under the mandatory disclosure mechanism.<sup>17</sup>

Moreover, the tax legislation specifies certain transactions that are excluded for the purposes of the definition of a “transaction involving conditional remuneration.”<sup>18</sup> This is the case, for example, of any request related to the analysis and review of an amount of interest payable under the *Taxation Act*, following an assessment, a reassessment or an additional assessment.

At the time of the introduction of the mandatory disclosure mechanism, requests relating to the payment of a tax credit to a taxpayer under the *Taxation Act* were also excluded for the purposes of the definition of “transaction involving conditional remuneration.”

In 2015, however, this exclusion was withdrawn.<sup>19</sup> As a result, a transaction involving conditional remuneration that consists of a request relating to the payment of a tax credit to a taxpayer under the *Taxation Act* must be disclosed to the Minister of Revenue according to the mandatory disclosure mechanism when the transaction results, directly or indirectly, in a tax benefit of \$25 000 or more for the taxpayer.

The withdrawal of this exclusion was part of the changes announced by the federal tax authorities concerning the obligation to provide, in the application forms relating to scientific research and experimental development (R&D) claims, more detailed information about R&D tax preparers and billing arrangements,<sup>20</sup> changes with which the Québec tax system has been harmonized.<sup>21</sup>

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<sup>17</sup> MINISTÈRE DES FINANCES DU QUÉBEC, *Information Bulletin 2019-5*, May 17, 2019, pp. 5-8. See also: *Taxation Act*, s. 1079.8.1, 1<sup>st</sup> para., “specified transaction.”

<sup>18</sup> *Taxation Act*, s. 1079.8.1, 2<sup>nd</sup> para.

<sup>19</sup> See note 15.

<sup>20</sup> DEPARTMENT OF FINANCE CANADA, *Economic Action Plan 2013 – Jobs, Growth and Long-Term Prosperity*, March 21, 2013, p. 352. See also: *Income Tax Act*, subss. 37(11) and 162(5.1) to (5.3).

<sup>21</sup> MINISTÈRE DES FINANCES DU QUÉBEC, *Information Bulletin 2013-7*, July 11, 2013, p. 4. See also: *Taxation Act*, ss. 230.0.0.4.1 and 1045.0.1.1 to 1045.0.1.3.

It appears that preparer information provided on the R&D forms, as well as that provided in connection with requests for the various refundable tax credits, is sufficient to allow the Québec tax authorities to assess the risks of non-compliance with the purpose and spirit of the tax legislation with respect to requests pertain to an amount the taxpayer is deemed to have paid to the Minister of Revenue on account of its tax payable for a taxation year under the *Taxation Act*, that is, requests for the payment of a refundable tax credit.

In this context, and for the purpose of streamlining administrative procedures, the tax legislation will be amended so that a request pertains to an amount the taxpayer is deemed to have paid to the Minister of Revenue on account of its tax payable for a taxation year under the *Taxation Act* will again be an excluded transaction for the purposes of the definition of a “transaction involving conditional remuneration.”

This amendment will apply to such a request in respect of which the time limit for the taxpayer to file the prescribed form containing the prescribed information in respect of the amount deemed to have been paid expires after the day on which this information bulletin is published.