

THE HIGH COURT

2006/200 R

BETWEEN

THE REVENUE COMMISSIONERS

APPELLANTS

AND

WEN-PLAST (RESEARCH AND DEVELOPMENT) LIMITED

RESPONDENT

Judgment of Miss Justice Laffoy delivered on 9th March, 2007.

1. This judgment gives the opinion of the court on a point of law referred to it pursuant to s. 141 of the Taxes Consolidation Act, 1997 (TCA 1997) by Appeal Commissioner Ronan Kelly (the Commissioner). The question of law on which the opinion of the court is sought is stated as follows in the case stated:

"The question of law for the opinion of the High Court is whether I was correct in law in determining that the exemption provided by the provisions of section 141(5)(d) [TCA 1997] for '... income from a qualifying patent in respect of an invention which involved radical innovation ...' applied to income from the fire door set developed by the Respondent in circumstances where I concluded that it is not necessary that radical innovation is capable of being demonstrated as part of the process leading to a patent but that it is sufficient that a combination of known technology could, and does in the instant case, result in an invention which involved radical innovation."

2. The determination of that question involves ascertaining the proper construction of the phrase from s. 141(5)(d) quoted in the question and applying it to the facts which form the basis of the respondent's claim for an exemption from tax by virtue of s. 141(5)(d).

3. Section 141(5)(d) TCA 1997 must be read in the context of s. 141 as a whole and s. 141 has to be read in conjunction with s. 234 TCA 1997. Section 234 deals with the treatment of certain income derived from patent royalties for income tax and corporation tax purposes, whereas s. 141 deals with distributions out of income from patent royalties, for example, distributions by a company to its shareholders by way of dividend.

4. The core exempting provision in s. 234 is sub-s. (2) which provides that a resident of the State who makes a claim in that behalf and makes a return in the prescribed form of total income from all sources, as estimated in accordance with the Income Tax Acts, shall be entitled to have any income from a qualifying patent arising to the resident disregarded for the purposes of income tax, in the case of an individual, and corporation tax, in the case of a company. The expression "qualifying patent" is defined in sub-s. (1) as meaning a patent in relation to which the research, planning, processing, experimenting, testing, devising, designing, developing or similar activity leading to the invention which is the subject of the patent was carried out in the State. The expression "income from a qualifying patent" is defined in sub-s. (1) as meaning any royalty or other sum paid in respect of the user of the invention to which the qualifying patent relates where the royalty or other sum is paid in circumstances which fall within the ambit of paragraph (a) or (b) of the definition. Paragraph (a), in broad terms, covers income derived from the manufacture of goods.

5. The core exempting provision in s. 141 is sub-s. (3), which exempts distributions out of disregarded income, as defined in sub-s. (1), from tax. Sub-paragraph (i) of s. 141(5)(d) in issue here provides as follows:

"Notwithstanding paragraph (c) but subject to sub-paragraph (ii), if in an accounting period the beneficial recipient (in this paragraph referred to as 'the recipient') of the specified income shows in writing to the satisfaction of the Revenue Commissioners that the specified income is income from a qualifying patent in respect of an invention which –

(I) involved radical innovation, and

(II) was patented for *bona fide* commercial reasons and not primarily for the purpose of avoiding liability to taxation,

the Revenue Commissioners shall, after consideration of any evidence in relation to the matter which the recipient submits to them and after such consultations (if any) as may seem to them to be necessary with such persons as in their opinion may be of assistance to them, determine whether all distributions made out of specified income accruing to the recipient for that accounting period and all subsequent accounting periods shall be treated as distributions made out of disregarded income and the recipient shall be notified in writing of the determination."

6. The words to which emphasis has been added in the above quotation are the words which are the subject of the case stated.

7. In construing sub-para. (i) a number of matters come into play.

8. First, its effect is prefaced by the words "notwithstanding paragraph (c)". Paragraph (c) provides as follows:

"Where for an accounting period a company makes one or more distributions out of specified income which accrued to the company on or after 28th day of March, 1996, so much of the amount of that distribution, or the aggregate of such distributions, as does not exceed the amount of aggregate expenditure on research and development incurred by the company in relation to the accounting period shall be treated as a distribution out of disregarded income."

9. I will return to the significance of that provision in the context of para. (d)(i) later.

10. Secondly, sub-para. (i) is subject to sub-para. (ii). It is sub-para (ii) which provides for an appeal from a determination of the Revenue Commissioners to the Appeal Commissioners and provides for the jurisdiction of the Appeals Commissioners to state a case to this Court on a point of law.

11. Thirdly, sub-para. (i) refers to "specified income" and "disregarded income". The meaning of both expressions is to be found in the rather convoluted definition of "disregarded income" contained in sub-s. (1) of s. 141. Generally speaking, "disregarded income" is income from a qualifying patent which has been disregarded for income tax or corporation tax purposes by virtue of sub-s. (2) of s. 234. The concept of "specified income" was introduced into s. 141 when that section was amended by s. 32 of the Finance Act,

1996. Thereafter, "specified income" was not included in "disregarded income" for the purposes of s. 141. I gratefully adopt the pithy exposition of the effect of the introduction of the definition of "specified income" in 1996 contained in the respondent's written submission. Its effect, subject to sub-s. (5) of s. 141, which was also introduced by the 1996 amendment, was to exclude from "disregarded income" patent royalties paid by a connected party which would previously have been tax-exempt if they related to manufacturing activities.

12. Returning to the interaction between para. (c) and para. (d) of sub-s. (5), I again draw on the respondent's written submission in summarising the effect of the two provisions. In effect they provided for two specific circumstances in which "specified income" could be treated as "disregarded income" so as to enable a tax exempt distribution to be made. Under para. (c) such amount of specified income as would not exceed the aggregate expenditure by the company on research and development (as defined) in a relevant accounting period would be treated as disregarded income. Under para. (d)(i) specified income shown to the satisfaction of the Revenue Commissioners to be income from a qualifying patent in respect of an invention which complied with the requirements at (I) and (II) are to be treated as disregarded income for the relevant accounting period and subsequent accounting periods as the Revenue Commissioners shall determine.

13. As regards the application of sub-s. (5)(d)(i) to the respondent, no issue arises here as to compliance with the requirement at (II). What is at issue is the meaning of, and the application to the facts, of the requirement at (I). If that requirement was complied with, the effect is that any distribution out of the specified income in an accounting period is tax exempt by virtue of the core exempting provision in s. 141, that is to say, sub-s. (3).

14. The obvious rationale underlying both s. 234 and s. 141 is to incentivise investment within the State in research and development generally and in the manufacturing sector.

15. In my view, neither sub-para. (i) of para. (d) as a whole nor the words "invention which ... involved radical innovation" in it present any difficulty of construction when considered in the abstract. I see no reason to invoke s. 5 of the Interpretation Act, 2005 because its meaning is clear and unambiguous. The sub-paragraph as a whole consists of a number of elements. It envisages exemption from tax on distributions from income in one or more accounting periods. The distributions are out of specified income, as defined, which is certain income from a qualifying patent, as defined. We know from the definition of qualifying patent in s. 234 that the legislature envisages three steps in the process which leads to a qualified patent: the research and development phase, which must be carried out in the State; the invention, the ordinary meaning of which is the discovery; and the patenting of the invention. It is absolutely clear that the word "which" which prefaces the requirements at (I) and (II) in sub-para. (i) refers to the immediately preceding word "invention", and not to "qualifying patent", because that is the only basis on which the requirement at (II) makes sense.

16. As to the meaning of the words "an invention which ... involved radical innovation" in my view, the approach to be adopted in construing the words in the phrase is the approach suggested by the Supreme Court in the judgment of Henchy J. in *Inspector of Taxes v. Kiernan* [1981] I.R. 117 in the following passage (at p. 122):

"Thirdly, when the word which requires to be given its natural and ordinary meaning is a simple word which has a widespread and unambiguous currency, the judge construing it should draw primarily on his own experience of its use. Dictionaries or other literary sources should be looked at only when alternative meanings, regional usages or other obliquities are shown to cast doubt on the singularity of its ordinary meaning, or when there are grounds for suggesting that the meaning of the word has changed since the statute in question was passed."

17. The issue in that case was whether a farmer who engaged in intensive pig production was a "dealer in cattle". In adopting the approach adumbrated in the passage just quoted to the issue before the court, Henchy J. went on to say:

"In regard to 'cattle', which is an ordinary and widely used word, one's experience is that in its modern usage the word, as it would fall from the lips of the man in the street, would be intended to mean and would be taken to mean no more than bovine animals. To the ordinary person, cattle, sheep and pigs are distinct forms of livestock."

18. As the first quotation above indicates, the rule enunciated in it was the third of three basic rules of statutory interpretation which Henchy J. stated should inform the approach to the construction of a taxation statute. The first rule is that, if the statutory provision is one directed to the public at large, rather than a particular class who may be expected to use the word or expression in question in either a narrowed or an extended connotation, or as a term of art, in the absence of internal evidence suggesting the contrary, the word or expression should be given its ordinary colloquial meaning. The second rule is, if a word or expression is used in a statute creating a penal or taxation liability, and there is looseness or ambiguity attaching to it, the word should be construed strictly so as to prevent a fresh imposition of liability from being created unfairly by the use of oblique or slack language.

19. As I understand it, it was common case before the Commissioner, as it was in this Court, that the words and the phrase in issue are to be construed by reference to their ordinary colloquial meaning.

20. Applying that approach, in my view, the meaning of the expression "invention which ... involved radical innovation" contended for by the appellant is not correct and the Commissioner properly rejected it. It was submitted on behalf of the appellants that the use of the word "involved", that is to say, the use of the past tense, meant that the "radical innovation" which must be identified is radical innovation in the process leading to the invention which has been patented, and that it is immaterial whether or not any invention is, in itself, a radical innovation. That submission ignores the fact that the definition of "qualifying patent" distinguishes the invention from the process leading to it. It also ignores the fact that when sub-para. (ii) is being applied, both the invention and the patenting are events which occurred in the past. Accordingly, in my view, the use of the past tense in the phrases at (I) and (II) of sub-para. (i) is wholly appropriate. I agree with the submission made on behalf of the respondent that the clear purpose of the requirement that the invention should have "involved radical innovation" is to distinguish inventions having that quality and inventions which involved minor modifications to an invention which was the subject of a previous patent or refinements which were less than radical.

21. In the application of sub-para. (ii), one has to identify the invention first and then one must ask was it radically innovative. The appellants' submission that the requirement of radical innovation goes beyond the qualities of novelty, inventive step and industrial applicability, which give an invention the essential characteristics for eligibility for patenting, is correct. They are also correct in their contention that radical innovation involves root change. However, their focus on the word "involved" is misplaced and the meaning they ascribe to the phrase because of the focus on the use of the past tense (that radical innovation must predate the invention, or be co-terminous with it, and must be linked with or connected to the invention, in the ordinary sense of the word "involved", rather than necessarily being the essential, defining characteristic of the invention) is to read something into the phrase which is not there. Indeed, it seems to me that instead of the phrase which was deployed, the legislature might have referred to an invention which "was

radically innovative”, which in ordinary parlance has the same meaning as “involved radical innovation”.

22. In the case stated the Commissioner identified the question for determination by him as whether the respondent’s invention of a fire-resistant, hygienic door set, which included an intumescent strip encased in plastic material “involved radical innovation” within the meaning of s. 141. He set out the facts which were proved or admitted, including the fact that the inventive aspect of the door set was the encasing of an intumescent (fire resistant) strip in a specific type of door frame made from cured plastic materials. He outlined the evidence of the four witnesses who testified on behalf of the respondent. One of them, Mr. Leslie Blennerhassett, the Technical Director of the respondent, testified that prior to the invention of the door set, two separate door sets were required for pharmaceutical “clean rooms”, one to provide fire-resisting capabilities, which could not meet the required hygiene standards, and the second to provide the required hygienic capabilities. There was no single door set available to designers of “clean rooms” that combined both of the required characteristics. The invention, the capacity to encase a fire-resistant strip in plastic material which could be used in a hygienically-approved door set, allowed the respondent to produce a single door set which had both the hygienic and fire-resistant qualities necessary for “clean rooms” in the pharmaceutical industry. The invention required finding a combination of an intumescent material and a plastic material that could incorporate it that gave the new door set the seamless quality specifically required to meet hygienic standards. A copy of the patent application is annexed to the case stated as an appendix thereto.

23. The Commissioner outlined the evidence of the only witness called on behalf of the appellants, Mr. P. Michael Connor, Patent Agent and Licensing Consultant. Mr. Connor was also of the view that it was the introduction of the intumescent strip in a particular manner, namely, within cured plastic material, which constituted the invention. However, the particular type of intumescent strip used by the respondent and the technology governing the production of cured plastics materials were each part of the prior art at the time of the grant of patent to the respondent. Mr. Connor’s opinion was that, having regard to the wording of s. 141, he did not need to consider whether the resulting product was a radical innovation; what he needed to consider was whether a concept brought into the invention was itself a radical innovation. That essentially is the core of the appellants’ case. Mr. Connor’s opinion was that none of the individual elements in the invention was a radical innovation. While acknowledging that a combination of known elements can be a radical innovation, his opinion was that the combination of the elements in the respondent’s invention, namely, a third-generation graphite intumescent strip encased in a cured plastic material in the overall context of a door frame, did not constitute a radical innovation. While the combination met the criteria for patentability in that it involved novelty, an inventive step and there was industrial applicability, in his view it did not go beyond that and radical innovation did not exist as an additional identifiable characteristic.

24. In a summary of the evidence, the Commissioner recorded that at all times Mr. Connor distinguished between the product which was marketed on foot of the invention and the process leading to the invention. He looked for radical innovation in the process but found none. He accepted, however, on the basis of the respondent’s evidence, that the type of glass-reinforced seamless polyester door produced by the respondent was a unique type of hygienic door of fire-resistant quality, but he did not accept that that was a root and branch invention.

25. As is recorded in the case stated, the appellants’ position before the Commissioner as to the proper application of s. 141(5)(d) was illustrated by reference to three scenarios: an invention which had not involved radical innovation and where the end product on the market did not involve radical innovation either; an invention where there was no radical innovation involved in its development, but the product put on the market was a radical innovation; and an invention where there had been a radical innovation involved in the process leading to the invention. Only the third scenario, it was submitted, was an invention which involved radical innovation and that was the case irrespective of whether or not the product sold on the market was itself a radical innovation. A similar submission was made to this Court. In my view, it does not conform with the proper construction of the phrase at issue here in the context of s. 141 read in conjunction with s. 234.

26. The determination of the Commissioner is set out as follows in the case stated:

“I determined that the fire-resistant, hygienic door set invented by the respondent was a radical innovation. I was satisfied that it is new, novel and revolutionary in its field and that the change in its field is original and fundamental. It is based on combining existing technologies. The technological characteristics differ significantly from previously produced products. It delivers improved quality and performance. It is a completely new product, one which did not exist previously. The degree of innovation is not merely a modest improvement of the existing product but a fundamental re-design of the materials and functions used.”

27. The principles which apply when a court has before it a case stated seeking its opinion as to whether a particular decision was correct in law, whether the case is stated by an inferior court or by the Appeal Commissioners or any other party were stated by the Supreme Court in a judgment delivered by Blayney J. in *O’Culachain (Inspector of Taxes) v McMullan Bros. Limited* [1995] 2 I.R. 217 at p. 222 as follows:

“(1) Findings of primary fact by the judge should not be disturbed unless there is no evidence to support them.

(2) Inferences from primary facts are mixed questions of fact and law.

(3) If the judge’s conclusions show that he has adopted a wrong view of the law, they should be set aside.

(4) If his conclusions are not based on a mistaken view of the law, they should not be set aside unless the inferences which he drew were ones which no reasonable judge could draw.

(5) Some evidence will point to one conclusion, other evidence to the opposite: these are essentially matters of degree and the judge’s conclusions should not be disturbed (even if the court does not agree with them, for we are not re-trying the case) unless they are such that a reasonable judge could not have arrived at them or they are based on a mistaken view of the law.”

28. It was submitted on behalf of the appellants that the Commissioner had adopted a wrong view of the law in not approaching the issue on the basis that radical innovation must be identified in the process leading to the invention, rather than the invention itself or the product marketed on foot of it being a radical innovation. As I have already indicated, it is the appellants who have adopted a wrong view of the law in advancing that proposition, which was properly rejected by the Commissioner. I am satisfied that the Commissioner properly construed sub-para. (ii) in identifying the question for determination as whether the invention involved radical innovation in the sense that it involved a change which was original and fundamental.

29. It was also submitted on behalf of the appellants that the inference drawn by the Commissioner from the facts found and the

evidence heard that the fire-resistant, hygienic door set invented by the respondent is a radical innovation was an inference which it was unreasonable for him to draw in the circumstances, it being common case that what is meant by "radical innovation" is root change. In relation to that submission, the first point I would make is that the test posited by Blayney J. was not whether it was unreasonable of the decision maker to draw particular inference or to reach a particular conclusion on the evidence, but whether no reasonable decision maker could draw the particular inference or arrive at the particular conclusion. It is clear from the case stated that the Commissioner preferred the evidence adduced by the respondents to the opinion expressed by Mr. Connor. In particular, the Commissioner made it clear that he attached particular weight to the evidence of two of the respondent's witnesses: Mr. Tony Muscovitch, a Chartered Engineer and specialist in the construction of clean rooms and sterile areas; and Mr. Peter Jackman, a Corporate Engineer and International Fire Safety Consultant. In my view, the Commissioner was correct in rejecting the opinion of Mr. Connor, which I am satisfied was based on a misinterpretation of the meaning of the phrase "invention which ... involved radical innovation". It was open to the Commissioner to reach the conclusion he reached, and, on the basis of the evidence outlined in the case stated, I find that it was the correct conclusion.

30. There was a second document appended to the case stated, a letter dated 29th July, 1998 from Mr. Connor to the appellants. It appears from the outline of the submissions made on behalf of the respondent before the Commissioner contained in the case stated that it was contended on behalf of the respondent that a statement in that letter supported the respondent's case. The statement was that, although no significant prior art was disclosed in the Patent Office search, prior general knowledge, in Mr. Connor's opinion, rendered the fire door invention a patentable invention consisting of a combination of known principles and known technology, but it was not a root and branch invention considered against what was known. It would appear that the respondent placed emphasis on the fact that Mr. Connor had found that there was no prior art in existence to the respondent's invention. Obviously, it was open to the Commissioner to take a view on that submission.

31. I have adverted to that letter for another reason. It was opened in full in this Court and it seems to me that it may point to a possible source of the fundamental flaw in the appellants' case. Mr. Connor pointed out in the letter that the term "radical innovation" had been used "in EU documents such as the Green Paper on Innovation published in the Bulletin of the European Union, 5/95 Supplements 1995" and that there were a number of internationally recognised documents that assisted in the interpretation of "radical innovation", in particular, "the Frascati Manual and the Oslo Manual of the OECD". While the provision with which this Court is concerned deals with a more arcane topic than was at issue in *Inspector of Taxes v. Kiernan*, there is nothing in s. 141 or s. 234 to suggest that "radical innovation" is to be treated as a term of art or to have any special connotation. As I have already recorded, the appellants accepted that the ordinary canons of construction applied and that the words and phrase in issue have to be given their plain meaning. In any event, Mr. Connor's evidence before the Commissioner was that it connoted root change, which is its ordinary meaning, and there was consensus on that point.

32. Finally, I address a submission made in this Court on behalf of the appellants for the purpose of showing that I have not ignored it. It was submitted that the concept of invention can exist separately from the concept of the product which incorporates it. This argument was presented as a central plank of the appellants' case. Counsel for the respondent contended that this argument is not within the scope of the question posed on the case stated, while submitting that, in any event, the invention was the product. As I have already outlined, it was common case before the Commissioner that the invention was the introduction of the intumescent strip within the cured plastic. The material manifestation of the invention was the door set which incorporated it, that is to say, the product. I do not see how the "hair-splitting" inherent in the appellants' submission advances their case. It seems to me that the man in the street would assume that the assessment of the quality of the invention so as to determine whether it was radically innovative or not would be conducted by reference to its material manifestation.

33. For the foregoing reasons, I answer the question posed in the case stated in the affirmative.