

The cost to budget of Patent Box initiatives in other countries

We understand that no formal costings have been undertaken on the introduction of a patent box in Australia and no formal statistics appear to be available in respect of most other jurisdictions.

The UK Patent Box is estimated to have cost HM Treasury around £300m in the tax year 2013/14. By the time the tax reduction has fully tapered in in 2017, the steady state cost is forecast by HM Treasury to be approximately £1.1 billion in terms of corporation tax revenues foregone (as set out in the 2012 UK Budget).

However whilst countries who have introduced a Patent Box style tax regime acknowledge that there is a short term downward impact on tax revenues in the first few years, it is expected that this trend is reversed over the long term, as businesses reposition their strategic direction in order to take full advantage of the benefits.

The ATO itself has noted the long-term economic benefits of introducing a Patent Box style tax regime, observing that much of the economic value associated with Australia's exploitation of intellectual property (such as royalty payments, licence payments, ownership of IP, etc.) is actually transferred out of Australia, to countries that have implemented government policies aimed at attracting intellectual property to that country. Increased royalty and licence income flows to countries that have a Patent Box style of tax regime increases the taxable income of companies within these countries.

Service innovation and non-technological innovation

In OECD countries innovation policy increasingly addresses service innovation (Denmark, Finland Germany, Ireland, Korea, Sweden and the United Kingdom) and many have adopted targeted support instruments (Australia, Austria, Denmark, Finland, France, Germany, Japan and Sweden). Service innovation is also being mainstreamed into broader STI policy agendas, for example to address societal challenges (Germany, Japan, Korea, Sweden and the United Kingdom) and to revitalize public-sector services.

Many OECD countries have launched specific policy instruments to promote service innovation or are currently reviewing how existing innovation policy instruments could better support service innovation. Possibilities include:

- i) embedding service innovation in generic innovation policies such as R&D tax credits or grants (in the Netherlands the R&D tax credit was extended to include the development of service-based software);
- ii) adjusting demand-side innovation policies and instruments such as public procurement (Finland, United Kingdom and regulations to better accommodate service innovation (Sweden, Denmark, Germany, United Kingdom);
- iii) embedding service innovation in R&D and innovation policies to address societal challenges such as services for an ageing population (Korea) and sustainable cities (Stockholm Royal Seaport); and
- iv) Integrating service innovation in policies to better link industry and public research (commercialization policies).

Major new policy options for fostering service innovation policy in selected OECD countries*

Policy option	Instrument	Examples
Launch a specific instrument to foster service innovation	<i>Service innovation research programmes</i>	Austria, Finland (Serve), Germany (innovation with services) and Japan (service science solutions research programme) have dedicated research and innovation programmes covering issues such as engaging users/employees in development, new business models and the “servitisation” of industry.
	<i>Service cluster</i>	Denmark introduced the Service Cluster Denmark which supports R&D-based co-creation for services by businesses and researchers.
	<i>Innovation voucher</i>	France introduced the green service innovation voucher for SMEs in the construction sector. Ireland has an SME voucher that supports new business models, customer interfaces or a new service delivery.
	<i>Service lab</i>	The United Kingdom introduced the public services innovation lab to test innovative solutions and bring them to scale across the country's public services.
Adjusting the scope of horizontal policy instruments	<i>Procurement of innovative services</i>	Sweden introduced an innovative procurement programme to spur procurement of innovation in the public sector.
	<i>R&D tax credit</i>	The Netherlands extended the R&D tax credit to include development of service-based software.
Adjusting the governance structure for innovation	<i>Fountain collaboration, i.e. user-defined scope within cross-sector collaborations</i>	Sweden has embedded service innovation in its new challenge-driven innovation approach which emphasises co-creation with customers/users and cross-sector collaboration focused, for example, on sustainable cities and future health and care.

* Source: Country responses to the OECD Science, Technology and Industry Outlook 2012 policy questionnaire and national sources.

Summary of current patent box jurisdictions

The countries which currently have a patent box type model are Belgium, China, France, Hungary, Italy, Luxembourg, the Netherlands, Spain, Switzerland and the UK.

Ireland is proposing to introduce one and the US has also started to consider their position.

The following seeks to broadly describe the current and proposed patent box or innovation box initiatives, including examples of changes that have been made to ensure that they do not constitute harmful tax practices under the BEPS action plan.

It is notable that each of the different schemes can apply to different types of income and types of IP so comparison merely of the headline rates would be misleading.

Existing schemes

France

Introduced in 2000, the French patents and royalties regime allows companies paying French corporation tax to pay a reduced rate of 15% (instead of 33%) on patent and royalties income as they are treated as a long term capital gain.

There are also asymmetric provisions such that if the licensee is a French corporation and actually uses the qualified IP licensed, the licensee may deduct the royalty payments from its income taxable at the standard 33.33% rate even if the licensor is taxed at the reduced 15% rate.

Hungary

Hungary introduced an incentive scheme in 2003 allowing 50% of the pre-tax amount of royalties received to be deducted from the tax base, reducing the effective corporate tax rate on such royalties to 8%.

Belgium

The patent box scheme in Belgium was introduced in January 2007, and is known as a patent income deduction (PID). This PID allows companies which are liable to pay Corporation Tax in Belgium, to deduct 80% of gross patent income from its taxable income. The remaining 20% of gross patent income is taxed at the standard corporation tax rate of 34% (including 3% surtax). This results in an effective tax rate of 6.8% on the qualifying income.

Netherlands

The Netherlands also introduced a patent box tax regime referred to as the 'innovation box' in January 2007. This initial regime applied only to patents and applied a 10% rate of corporate tax. On 1 January 2010 the regime was expanded to include a much wider range of IP and the headline rate was reduced to 5%. The reduced rate of corporate tax applies to the net positive income derived from the qualifying IP (gross income minus all related expenses and depreciation).

Luxembourg

In Luxembourg, an IP regime became effective in January 2008 and was soon amended to exclude qualifying IP assets from Luxembourg's net wealth tax. The scheme applies to the net income derived from the use of qualifying intellectual property acquired or developed after December 2007. The scheme allows 80% of income to be exempted, giving an effective tax rate of 5.76%.

Spain

As of 1 January 2008, 50% of the gross income of Spanish domiciled companies derived from qualified IP can be exempt from Spain's Corporation tax resulting in an effective tax rate of 15%.

Switzerland

Mixed-company

Switzerland formerly allowed companies who predominantly trade internationally to benefit from an advantageous “mixed-company” status that allows them to be taxed at a rate of just 8.5%. In 2007 the EC alleged the tax schemes were State Aid. In May 2014 the EU and Switzerland reached agreement whereby the disputed tax regimes would be abolished.

Nidwalden Licence-Box regime

In 2011 the canton of Nidwalden introduced the Licence Box rule which allows companies located in Nidwalden to benefit from a cantonal tax rate on net license income; reduced by 80% the effective corporate income tax rate is 8.8%

China

China’s regime provides a lower patent box rate to firms that spend at least 3% to 6% of their gross revenue on R&D (depending on firm size), have 60 percent of firm revenue from core IP (defined as inventions, utility model patents, software, copyrights, proprietary layout designs, and new plant varieties), have 30 percent of their workforce with a college degree, or 10 percent employed in R&D or high tech occupations.

UK

The UK introduced a Patent Box scheme in 2013 taxing qualifying IP at a corporate tax rate of 10% and was seen to be very successful. However in the light of the BEPS action paper and the focus on harmful practices (Action 5) the scheme was subsequently reviewed by the EU Code of Conduct group.

Action 5 focuses on “substantial activity” that must occur in a jurisdiction for a company to benefit from a specific preferential tax regime.

In November 2014, a compromise agreement for the UK patent box scheme based on a ‘modified nexus’ approach was announced by the UK and Germany on 11 November 2014. The acceptance of a nexus based approach has had significant implications for the UK patent box scheme; fundamentally, patent box relief will ultimately be restricted to profits generated from IP initially developed in the UK.

This new method of calculating benefits for IP-incentive tax schemes will be required under a BEPS landscape. That is, the so-called nexus approach (where underlying expenditure to create the IP will be used to define the proportion of qualifying income generated from the IP), rather than the conventional transfer pricing approach (where transfer pricing principles define a substantial activity test and either the IP commercialisation activity passes the test or it does not, and all IP income thus either qualifies or it does not).

In the UK a practical and proportionate tracking and tracing approach will be introduced that can be implemented by companies and tax authorities with practical methodologies that companies and tax authorities can adopt to map R&D expenditure to IP creation. These methodologies would need to be introduced by all jurisdictions in the future.

Proposed schemes

Ireland

A scheme ran between 1973 and 2010 which exempted revenue from qualifying Patents from Irish corporation tax. It is currently proposed for the former exemption to be replaced by a “Knowledge Development Box” in 2015 offering a reduced tax rate – this proposal is still subject to public consultations.

Although the introduction of the proposed new knowledge development box approach follows sustained criticism from the OECD and EU of the controversial “double Irish” tax relief, it is intended that the new regime, if enacted, will comply with OECD recommendations and restrict tax concessions to innovations that derived from spending in Ireland.

US

The United States has recently started to consider its response to a new post-BEPS landscape. [The United States Senate Committee on Finance, International Tax, Bipartisan Tax Working Group Report](#) has recently concluded that the US may need to create its own concession for IP income to stop the loss of jobs and potential tax revenue.

The report concluded “we must take legislative action soon to combat the efforts of other countries to attract highly mobile U.S. corporate income through the implementation of our own innovation box regime that encourages the development and ownership of IP in the United States, along with associated domestic manufacturing. They continue to work to determine appropriate eligibility criteria for covered IP, a nexus standard that incentivizes U.S. research, manufacturing, and production, as well as a mechanism for the domestication of currently offshore IP.”