Corporate Tax Association

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Mr Paul Fischer
Acting Assistant Secretary
Corporate Tax Branch
Corporate and International Tax Division
The Treasury
Langton Crescent
PARKES ACT 2600

By email: PatentBoxConsultation@treasury.gov.au

Dear Paul,

Patent Box Consultation

The Corporate Tax Association (**CTA**) welcomes the opportunity to make a submission to Treasury in relation to the *Patent Box – Discussion Paper on Policy Design* (**Discussion Paper**).

The CTA is the key representative body representing major companies in Australia on corporate tax issues and is a united voice for the collective view of the 139 large corporates we represent in advocating for a better corporate tax system in Australia. Further information about the CTA can be found on our website at www.corptax.com.au.

General observations – Is the regime really a cost to the Budget bottom line?

In the 2021-22 Federal Budget, the Government announced[1] the introduction of a patent box regime:

> The Government will introduce a patent box tax regime to further encourage innovation in Australia by taxing corporate income derived from patents at a concessional effective corporate tax rate of 17 per cent, with the concession applying from income years starting on or after 1 July 2022.

The Government's policy intent[2] behind the introduction of a patent box regime for patented inventions in the medical and biotechnology sectors is two-fold (summarised below):

1. To create an additional incentive by offering a concessional tax rate on profits to encourage companies to base their medical and biotechnology

[1] Refer to the *Patent Box — tax concession for Australian medical and biotechnology innovations* measure contained in Budget Paper No.2 of the 2021-22 Federal Budget.
[2] Refer to p2 of the Discussion Paper

research and development (R&D) operations and commercialise innovation in Australia; and

2. To retain ownership of eligible patented inventions in Australia.

The CTA welcomes the intent of the patent box regime proposal though considers the proposed design considerations set out in the Discussion Paper will inhibit the Government from achieving the desired policy intent as the regime's design is narrow and unnecessarily complex. We suspect the proposal may be designed to ensure a modest cost to the Budget. We are not privy to the Budget costing of the proposal and in particular the assumptions behind how such a regime in fact will decrease government receipts by $200 million over the forward estimates. While we acknowledge the design of any tax concession (relative to the 30% corporate tax rate) is a notional cost to the Budget, the reality of any effective patent box regime is it retains income and profits in Australia that would not otherwise be subject to Australian tax given the global mobility of intangibles. If anything, the regime should increase Budget receipts, particularly in an imputation context.

In this regard, the CTA encourages the Government to fully consider other technology-based sectors this regime could be applied to, including the low emissions technology sector, in order to achieve the articulated goals of greater R&D, and commercialised innovation and retention of ownership of patents in Australia. This should be undertaken sooner rather than later. Further, any legislative framework design of the current proposal should be simple and practical to apply and have the ability to be easily expanded to apply to other sectors in the future.

In what follows, we provide some specific observations with the proposal.

Specific Issues

The rate is too high

The tax rate of 17% applicable to eligible profits from eligible patented inventions, while concessional with respect to Australia's corporate rates of 25% (for base rate entities) and 30% for all other corporate tax entities, is not concessional nor internationally competitive when compared to patent box regimes[3] of other countries competing to attract, retain and exploit mobile intangible technology. Most patent box regimes have a rate of 10% including, for example, the UK.

The proposed rate of 17% for Australia is one of the highest rates among the applicable rates across patent box and equivalent regimes of OECD member and non-member countries and is unlikely to attract (or retain) the desired R&D and patented innovation activity into Australia. More specifically in the Asia Pacific region, 17% is the highest rate.

We suggest consideration be given to reviewing the proposed rate for its competitiveness as it is unlikely all of a company's profits would fall into the patent box regime and therefore breach any minimum tax rate requirements arising from

[3] See the Intellectual property regime rates for OECD member and non-member countries: https://qdd.oecd.org/data/IP_Regimes

BEPS Action 5 on Harmful Tax Practices or potentially any Inclusive Framework Pillar 2 minimum tax rate.

The overall effective tax rate a company would pay on all its profits, both from patents and other sources, is still likely to be much higher than any minimum tax rate when taking into account the combined effect of both the patent box regime concessional rate and the ordinary corporate tax rate.

The start date should reference existing or new patents on or after Budget night not new patents registered after Budget night

The regime is intended to apply to standard patents granted by IP Australia[4] that were applied for after the Budget announcement, being after 11 May 2021.

We question the practical value the regime will have to encourage innovation and exploitation in Australia with such an extensive delay in the impact and effect of the regime. The benefits of patents (including profits) are usually not seen for many years until after a patent is granted (at least 5 – 10 years). This means that the tax concessional benefit of the regime as proposed is unlikely to have any real impact until the profits from the patents that are applied for after Budget night 2021-22 are ready to be taxed in many years' time.

The timing of the impact of the regime could be brought forward by permitting the regime to apply to all existing patents on Budget night 2021-22, automatically or by way of election by a taxpayer, particularly for patents at or near the commercialisation stage. Taxpayers holding existing patents would benefit from the regime much sooner than taxpayers who could only apply the regime to patents applied for after Budget night 2021-22, as existing patents would be much closer to the stage of deriving taxable profits.

Counteracting this delay and bringing the impact of the regime forward would support the Government's intention to encourage more R&D activity and innovation in Australia.

The patent level and income streaming tests are too narrow

The Discussion Paper suggests two possible tests to limit the application of the patent box regime to the medical and biotechnology industries, namely the 'patent-level test' and the 'income streaming test'. We consider that, rather than trying to adopt one of these tests, the criteria for eligible patents should be kept as simple as possible.

In addition, patents can cover one or more aspects of a product though may not cover the 'whole' product, so trying to define what part of the revenue/profits relate to the medical or biotechnology patent will overly-complicate the rules. It may also narrow the rules and unduly exclude profits from patents that may otherwise be intended to be covered by the regime.

In this regard, we suggest that the rules be kept as simple and broad as possible to help ensure the practicality and useability of the regime.

[4] See https://www.ipaustralia.gov.au/

Limiting to patents registered in Australia is overly restrictive

In our view, limiting the regime to Australian registered patents is overly restrictive. It should not matter where the patent is registered or located. Corporates generally obtain patents in the markets in which they want to sell the patented products. In our view, the regime should be expanded to recognise patents granted in other jurisdictions which have been subject to a substantive examination from an overseas patent office equivalent to that of IP Australia are eligible.

Recognition and reasonable allocation of income and expenses

Income qualifying for the patent box regime should include all profit from the sale of the product covered by the patent, including royalties and other income derived from the sale or licencing of the patent rights.

As overseas unrelated party expenditure is permitted under the OECD rules, similarly this expenditure should be permitted to be recognised in the patent box. Additionally, overseas related party expenditures that are a 'pass through' of third party costs which are permitted under the OECD rules should also be permitted to be recognised in the patent box.

We consider that a reasonable allocation of expenses related to an eligible patent be permitted to be included in the patent box rather than the rules trying to articulate specific types of expenses which can be included in the patent box. Certain expenditures (e.g. building costs) will need to be excluded, though taxpayers should be able to rely on their own systems to determine on a reasonable basis which costs are necessarily incurred in relation to the patent product and should be included in the patent box.

Losses arising should also remain in the patent box. This will ensure the rules stay clear and simple to use and apply.

Location of the rules in the tax law

For ease of reference and application, we suggest all the relevant rules for this regime, including the rules for recognition and allocation of income and expenses, be located in the same section in the tax law.

Should you have any questions, please do not hesitate to contact me on 0408 028 196.

Yours sincerely,

Stephanie Caredes
Senior Tax and Policy Adviser
Corporate Tax Association