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Corporate and International Tax Division  
The Treasury

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# Response to the Patent Box Discussion Paper

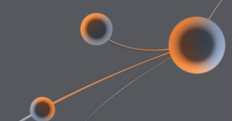
## Introduction

Research Australia welcomes the opportunity to make this submission. We are the national peak body for Australian health and medical research (HMR), representing the entire pipeline from the laboratory to patient and the marketplace. Research Australia works to position Australian HMR as a significant driver of a healthy population and a healthy economy, and the successful commercialisation of Australian HMR is critical to this objective.

This paper is prepared in response to the Treasury consultation on the proposed Australian Patent Box. While not responding directly to all the questions posed in the discussion paper, this paper addresses the key design features of the patent box as outlined in the Budget announcement and reiterated in the Discussion paper.

## Key Points

- Research Australia supports the introduction of a Patent Box in Australia. (We have called for the introduction of a patent box for many years.)
- Research Australia acknowledges the need for the design of the patent box to be consistent with the OECD's Base Erosion and Profit Sharing (BEPS) Action 5 Minimum Standard.
- The UK's patent box provides a model for Australia which is superior to some of the measures outlined in the discussion paper.



# Response to the key features of the proposed Australian Patent Box

## 1. The patent box tax concession will apply only to income generated directly from patents, typically royalty income or capital gains that arise from the licencing or sale of patents.<sup>1</sup>

Responding to questions 20 and 21 in the Discussion Paper

The current proposed structure of the patent box incentivises the sale of patents to another company and disincentivises a company that develops intellectual property from using it to develop and manufacture products in Australia. This approach is at odds with the Government's focus on creating jobs, its Modern Manufacturing Strategy, its investment in biosciences research and with the concerns about medicine security and the capacity to manufacture medical products in Australia.

**Research Australia submits the design of the patent box should be changed to reward companies that undertake research & development and invest in the manufacturing of products that rely on and utilise the patents they own.**

## 2. An effective concessional tax rate of 17% for companies on eligible profits from eligible patented inventions

Responding to question 29 in the Discussion Paper

This effective rate of 17% is higher than other equivalent jurisdictions. The UK, France and Spain are all major jurisdictions with a 10% rate (see Appendix 1.)

While reference is made in the Discussion paper to the relative difference between the corporate tax rate and the rate that will be applied under the patent box, the real issue is the rate available in other jurisdictions. **Research Australia proposes the rate be lowered to 10% to be internationally competitive.**

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<sup>1</sup> Parliamentary Library Research Publications Research Papers Budget Review 2021–22 Patent Box, page 2.

### 3. Only inventions claimed in standard patents granted by IP Australia will be eligible

Responding to questions 2 and 3 in the Discussion paper

Many Australian medical and biotechnology companies apply for patents in countries other than Australia. While recognising the need to ensure the IP is of a high standard, Research **Australia proposes that patents applied for in specified overseas countries should be eligible.**

For example, in addition to patents issued by the UK Intellectual property Office, the UK Patent Box applies to patents issued by the European Patent Office and 13 other countries<sup>2</sup>.

Research Australia is not suggesting the adoption of the same list for Australia, but that a similar list of suitable countries be developed for the Australian Patent Box to reflect where Australian medical and biotechnology companies lodge patents.

### 4. Only patents applied for after 11 May 2021 are eligible

Responding to questions 16 and 18 in the Discussion Paper

The effect of this restriction is to ensure that no benefit will be available to any company for many years because of the long time required to successfully commercialise new intellectual property in the medical and biotechnology sector.

Research Australia understands the policy intention to only provide an incentive for ‘new’ R&D, and not for R&D expenditure incurred prior to the announcement on 11 May 2021. However, the reality of commercialisation in the medical and biotechnology sector is that significant R&D is undertaken **after** a patent is applied for. Commercialisation of a medical or biotechnology product requires significant investment in development, testing and the conduct of clinical trials which is undertaken after the patent has been granted, in part to protect this substantial ongoing investment in R&D.

In fact, it is this further, post patent investment in R&D that is currently most frequently lost to Australia. This is the point at which IP is frequently licensed or sold to a large multinational company with the capability and capital to invest in the further R&D required to commercialise the product. The future profits then accrue to that overseas company, and Australia imports the finished product.

The policy intention of only rewarding new R&D would be better met by extending eligibility for the patent box to patents granted before 11 May 2021 but only to R&D expenditure incurred after that date. In particular this will help meet the second of the Government’s stated aims in the Discussion paper of retaining the ownership of eligible patented inventions in Australia.

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<sup>2</sup> <https://www.gov.uk/guidance/corporation-tax-the-patent-box>, accessed 20 July 2021

## 5. The concessional tax treatment will only apply to company profits from patented inventions in proportion to the amount of associated R&D that was conducted in Australia by the company

### Responding to questions 12 in the Discussion Paper

In the course of developing a new medical or biotechnology product, there are often circumstances where some of the R&D needs to be performed overseas. For example, late stage clinical trials frequently require a large number of clinical trial participants who meet the specific eligibility criteria to participate on a clinical trial. There are many instances in which there are not sufficient eligible Australian participants, and a clinical trial will often be conducted in a number of countries to ensure the required recruitment targets can be met in a timely way. Where the product is being developed by an Australian company, this expenditure will be incurred by the company as the clinical trial sponsor.

**Research Australia proposes that concessional tax treatment should be applied to all R&D expenditure directly incurred by the taxpayer, regardless of whether it is conducted in Australia or overseas.**

## 6. Targeting the Patent Box to the Medical and Biotechnology Sectors

### Responding to question 4 in the Discussion Paper

The Discussion paper provides two options for how to target the patent box regime to the medical and biotechnology sectors:

1. Patent-level test: Patented inventions only qualify for the regime if the invention defined in the patent claim is primarily used or classified in the medical and biotechnology sectors. All their eligible profits would then receive the concessional rate, including eligible profits attributable to activity in other sectors.
2. Income streaming test: All patented inventions qualify for the regime, but only eligible profits attributable to activity in the medical and biotechnology sectors would receive the concessional rate.

The medical and biotechnology sectors can draw on research and development that has applications beyond this sector, or has its origins in other areas. For example, nanomaterials can have antimicrobial properties that find applications in medical devices as well as in veterinary and agricultural products and water purification.<sup>3</sup>

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<sup>3</sup> The Australian Institute for Bioengineering and Nanotechnology undertakes research in several of these domains. <https://aibn.uq.edu.au/>

**For this reason, Research Australia proposes *Option 2 Income Streaming Test* be adopted as the approach to targeting the Patent Box to the Medical and Biotechnology sector.**

## Conclusion

Research Australia is pleased the Australian Government has taken the initiative to introduce a patent box. We believe a properly designed patent box has the potential to provide a significant impetus to Australian R&D in the Medical and Biotechnology sector, complementing the existing R&D Tax Incentive and providing the support to further develop and exploit Australian Intellectual property.

While there are elements of the patent box proposed in the discussion paper which are unsatisfactory, we believe these can be remedied, and commend the Australian Treasury for consulting on this proposal at an early stage, before legislation is drafted.

We look forward to participating in further consultations as the design of the scheme is further refined and remain available, as always, to discuss any of the above.

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## Appendix 1: Patent Box Regimes in Europe as of 2020

Source: Tax Foundation.org at <https://taxfoundation.org/patent-box-regimes-in-europe-2020/>

	Qualifying IP Assets			Tax Rate Under Patent Box Regime	Statutory Corp. Income Tax Rate
	Patents	Software	Other <sup>1</sup>		
Andorra	X	X		2%	10%
Belgium	X	X		4.44%	29.58%
Cyprus	X	X	X	2.5%	12.5%
France	X	X		10%	32.02%
Hungary <sup>2</sup>	X	X		0% or 4.5%	9%
Ireland	X	X	X	6.25%	12.5%
Italy <sup>3</sup>	X	X		13.95%	27.9%
Lithuania	X	X		5%	15%
Luxembourg	X	X		4.99%	24.94%
Malta	X	X		1.75%	35%
Netherlands	X	X	X	7%	16.5% to 25%
Poland	X	X		5%	19%
Portugal	X			10.5%	21%
San Marino <sup>4</sup>	X	X		0% or 8.5%	17%
Slovakia	X	X		10.5%	21%
Spain – federal <sup>5</sup>	X	X		10%	25%
Spain – Basque Country	X	X		7.2%	25%
Spain – Navarra	X	X		8.4%	25%
Switzerland <sup>6</sup>	X			Varies from canton to canton, up to a 90% exemption from corporate tax	Varies from canton to canton; 11.9% to 21.6%
Turkey <sup>7</sup>	X			11%	22%
United Kingdom	X			10%	19%

## Notes:

1. "Other" refers to IP assets that are non-obvious, useful, and novel. These can only be applied to small and medium-size businesses.
  2. Hungary's patent box regime applies a zero percent rate in the case of capital gains of reported qualifying IP and 4.5 percent in the case of benefits related to royalty income.
  3. Italy has a federal corporate income tax (IRES) of [24 percent](#) and a regional production tax (IRAP) of [3.9 percent](#), thus a combined statutory rate of 27.9 percent. Italy's patent box regime reduces both tax rates by 50 percent, leading to a tax rate of 13.95 percent on IP income.
  4. San Marino has three IP regimes. The "New companies regime provided by art. 73, law no. 166/2013" grants a tax rate of 8.5 percent. The "Regime for high-tech start-up companies under law no. 71/2013 and delegated decree no. 116/2014" and the "IP regime" both grant tax rates of 0 percent. All three apply to patents and software.
  5. The Spanish regions "Basque Country" and "Navarra" have separate IP regimes.
  6. Switzerland [introduced](#) a patent box regime which went into effect in 2020 at the cantonal level covering all of Switzerland. The regime provides a maximum [tax base](#) reduction of 90 percent on income from patents and similar rights developed in Switzerland. Cantons can opt for a lower reduction.
  7. Turkey has [a second IP regime](#) which allows for a full [tax deduction](#) (0 percent effective tax rate) of qualified IP income resulting from R&D activities that were undertaken in Turkish Technology Development Zones.
- Liechtenstein [has abolished](#) its patent box regime because it did not comply with the OECD's Modified Nexus Approach.

Sources: [OECD Dataset Intellectual Property Regimes](#); Deloitte: [The Cyprus IP regime](#); PwC: [French Finance Act for 2019](#); Ireland's Office of the Revenue Commissioners: [Guidance Notes on the Knowledge Development Box](#).