

Via email: PatentBoxConsultation@treasury.gov.au

Paul Fischer
The Treasury
Corporate and international Tax Division
Langton Crescent
PARKERS ACT 2600

16 August 2021

PATENT BOX REGIME - REQUEST FOR FEEDBACK AND COMMENTS

Dear Mr Fischer

We are pleased to provide you with BDO's feedback and comments in response to the Patent Box Regime Discussion Paper on policy Design. Please note that BDO has not included comments for all questions in the below response.

In summary, BDO believes the Government should be applauded for introducing a patent box regime to act as an incentive for technology to be both developed and commercialised in Australia. If done well, this will act as the missing link to the incentive regime and lead to numerous flow-on benefits, including further investment in research and development activities. However, as a late adopter of a patent box regime, Australia has a great opportunity to learn from the mistakes of other regimes and make its patent box policy truly competitive and attractive to entities to align with the policy aims and encourage companies to base their R&D operations in Australia, retain ownership of patented inventions in Australia and commercialise innovations in Australia.

Such encouragement should not be limited to individual sectors if the regime is intended to be retained consistently for years to come. Such certainty, as well as simplicity, should be key a cornerstone for any new tax regime to enable entities to make appropriate decisions and limit the administrative burden of access. With this in mind, BDO's focal feedback is that the proposed patent box regime should:

- Be inclusive for all sectors
- Offer a more competitive concessional tax rate
- Include a range of IP qualifying assets including patents, software/computer programs as well as plant breeders right
- Include granted patents filed prior to 11 May 2021.



Such recommendations will ensure the Australian patent box regime is simple, attractive and effective at meeting the aims of the Government's policy.

Should you wish to discuss any of the items raised within the response further, please don't hesitate to contact me on +617 3237 5648 or via email on Nicola.Purser@bdo.com.au.

Yours Sincerely

A handwritten signature in black ink, appearing to read 'NP', is written over a light blue horizontal line.

Nicola Purser

Partner

Contents

Contents	3
Patent box design considerations	6
Question 1	6
BDO's Response.....	6
Eligible IP to enter the patent box	7
Question 2	8
BDO's Response.....	8
Targeting medical and biotechnology	8
Question 4	8
BDO's Response.....	8
Question 5	9
BDO's Response.....	9
Low emissions technologies.....	10
Question 6	10
BDO's Response.....	10
Question 7	10
BDO's Response.....	10
Question 8	10
BDO's Response.....	10
Question 9	11
BDO's Response.....	11
Question 10	11
BDO's Response.....	11
Applying the substantial activity requirement	11
Question 11	12
BDO's Response.....	12
Definition of R&D	12
Question 13	13
BDO's Response.....	13

Question 14	13
BDO's Response.....	13
Question 15	14
BDO's Response.....	14
Implementation and start date.....	14
Question 18	14
BDO's Response.....	14
Question 19	15
BDO's Response.....	15
Eligible revenue to enter the patent box.....	15
Question 20	15
BDO's Response.....	15
Question 21	16
BDO's Response.....	16
Question 22	16
BDO's Response.....	16
Question 23	16
BDO's Response.....	16
Subtraction of related patent expenses from eligible revenue.....	16
Question 24	17
BDO's Response.....	17
Treatment of losses and related offsets with the patent box	17
Question 25	17
BDO's Response.....	17
Administration and compliance	18
Question 26	18
BDO's Response.....	18
Question 27	18
BDO's Response.....	18
Question 28	19
BDO's Response.....	19



Other considerations	19
Question 29	19
BDO's Response.....	19
Appendix	20

Patent box design considerations

In Australia, profits on corporate IP are taxed at the relevant corporate income tax rate, which is currently either 30 per cent or 25 per cent from 1 July 2021 (depending on an entity's annual aggregate turnover).

The ownership of patented inventions and any associated profits can be relocated offshore, making patent profits sensitive to preferential tax treatments. More than 20 countries have implemented patent boxes. The design features of these regimes vary significantly.

The following broad design features will form the basis of Australia's medical and biotechnology patent box:

- *an effective concessional tax rate of 17 per cent for companies on eligible profits from eligible patented inventions;*
- *only inventions claimed in standard patents granted by IP Australia, which were applied for after the Budget announcement (that is, have a priority date after 11 May 2021), will be eligible; and*
- *the patent box will be designed to be consistent with the OECD/G20 Forum on Harmful Tax Practice (FHTP) framework governing IP regimes, including the OECD's Base Erosion and Profit Sharing (BEPS) Action 5 minimum standard.*
 - *This includes that 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.*

The Australian Government will draw on approaches in comparable international jurisdictions with patent boxes to maximise effectiveness and minimise compliance burdens.

Question 1

What features of patent boxes in other jurisdictions are most significant and important for designing the Australian patent box to support the medical and biotechnology sectors?

BDO's Response

The most significant and important features for designing the Australian patent box includes:

- The effective concessional tax rate under the regime: While BDO acknowledges the differential between each jurisdiction's tax rates that would otherwise apply, the proposed concessional tax rate of 17% is not overly competitive, particularly for the small or medium entities with a tax rate of 25%, where the difference between the concessional tax rate and corporate tax rate will only be 8%. This is not adequate to encourage small to medium sized entities that rely on incentives to increase investment into additional R&D and patent filings. It is worth noting that of the Australian patent applications filed in 2020, 81% were filled by small and medium sized entities with operations in Australia¹.

¹ IP Australia, *Australian Intellectual Property: Chapter 2 - Patents* (Annual Report, 2021).

As shown in Appendix 1, the tax rates under intellectual property (IP) regimes in the following jurisdictions provide a greater benefit:

- Belgium with a 3.76% concessional tax rate (21.24% difference c.f. tax rate that would otherwise apply)
- Netherlands with a 7% concessional tax rate (13% - 18% difference c.f. tax rate that would otherwise apply)
- United Kingdom with a 10% concessional tax rate (9% difference c.f. tax rate that would otherwise apply)
- Switzerland with an 11.8% concessional tax rate (9.4% difference c.f. tax rate that would otherwise apply).

As the objective of the proposed patent box regime is to encourage companies to keep and commercialise IP in Australia, then it needs to be as or more attractive than other jurisdictions offering similar incentives

- IP qualifying assets: multiple jurisdictions include patents, software/computer programs as well as plant breeders rights. In some jurisdictions such as France, industrial manufacturing processes can also qualify provided they are necessary accessories to the use of eligible patents and patentable inventions (refer to appendix 1). To achieve a globally competitive patent box regime, BDO believes that the proposed Australian patent box regime should include a range of IP qualifying assets including patents, software/computer programs as well as plant breeders rights
- Eligibility definition: a number of long-standing foreign patent box regimes are sector agnostic. In the United Kingdom, companies are eligible for the patent box regime if the company is liable to Corporation Tax, makes a profit from exploiting patented inventions, owns or has exclusively licenced-in the patents and has undertaken qualifying development on the patents regardless of the industry.

We understand that the Australian Government is proposing a patent box regime for medical and biotechnology sectors in the first instance, with the potential of revising to include additional sectors. However, we believe that the patent box regime should be inclusive for all sectors at the outset; whereby, the definition refers to a company or group with qualifying patents and qualifying development rather than adding the layered complexity of defining eligible sectors in addition to defining the qualifying patents.

Eligible IP to enter the patent box

The scope of the Government's announcement relates to profits derived from inventions that would fall within the scope of Australian standard patents (including where the invention is protected by foreign patents). Standard patents are granted in Australia if there is sufficient evidence of the invention or process being new, inventive and useful. Standard patents provide protection in Australia for up to 20 years and up to 25 years for some pharmaceutical patents.

Question 2

Are patents applied for by medical and biotechnology companies with domestic R&D operations generally Australian standard patents?

BDO's Response

Based on the Australian Government's 'IP report 2020'² and 'Australian Intellectual Property Report 2021'³, 29,758 standard patent applications were received in Australia in 2019 with 29,293 received in 2020, with 4,586 innovation patent applications and 4,863 provisional patent applications. Of these standard patent applications, applications in medical technology, pharmaceuticals and biotechnology were the top three.

Targeting medical and biotechnology

The Government's aim is to target the patent box regime to new patented inventions related to the medical and biotechnology sectors.

Limiting the patent box regime to these sectors will be based on the use or classification of individual patented inventions, rather than the overall industry classification of the company that owns the patented invention. This could be achieved using a number of approaches including:

- *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.*
- *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.*

Regardless of the ring-fencing approach, definitions of medical and biotechnology sectors or patents will need to be clearly identified.

Question 4

What is the best approach to provide certainty around access to the regime for the medical and biotechnology sectors?

BDO's Response

The patent-level test is a more suited approach in identifying qualifying patented inventions. Using this test would minimise the amount of framework that an entity would need to implement compared to the income streaming test and, thereby, would reduce administrative burden and complexity.

The best approach in providing certainty would be defining what would classify as being in the medical and biotechnology sectors (ideally this should come from a single source of truth such as the patent

² IP Australia, *Australian Intellectual Property: Chapter 2 - Patents* (Annual Report, 2020) Patents Data Visualisation.

³ IP Australia, *Australian Intellectual Property: Chapter 2 - Patents* (Annual Report, 2021).

application category). Given the objective is to enable companies to access the patent box regime based on the classification of the individual patent inventions, clear definitions of what these patent inventions are would need to be provided.

However, the medical and biotechnology sectors are not the only sectors with patent filings, and certainly not the only sector for which we should be encouraging to base themselves in Australia to research, develop and commercialise innovations. Therefore, we recommend the best approach in providing certainty and reducing complexity would be similar to that of the United Kingdom; whereby, a company is required to have undertaken ‘qualifying development’ rather than be classified in a particular sector. In the UK, qualifying development⁴ includes:

- Creating, or significantly contributing to the creation of, the patent invention
- Performing a significant amount of activity to develop the patented invention, any product incorporating the patented invention, or any process incorporating the patented invention.

As mentioned in response to Question 1, however, we would also recommend opening this up to additional IP assets such as plant breeders rights to improve the competitiveness of the regime.

Question 5

What are the core concepts/applications that need to be covered by any definition of the medical and biotechnology sectors for the purpose of defining access to the patent box?

BDO’s Response

The core concepts and applications that need to be covered by a definition for the purpose of defining access to the patent box includes:

- The types of patented innovations covered by the patent box regime
- The development activities for which eligible profits can be attributed to. For example, will the development of methods and processes to attain the patented innovation also be deemed eligible
- The level of contribution the company is required to undertake in the development for the patent to be eligible. For example, whether significant contribution is required to either the creation of the patented invention or a product incorporating the patented invention
- Clear guidance for how to define the profits from patented inventions in proportion to the amount of associated R&D conducted in Australia by the company. Without clear guidance this could lead to complexity and uncertainty. To simplify this, we believe safe harbour rates should also be defined based on sectors
- The legislative requirements when a company is a member of a group particularly around patent ownership and its role in management of eligible patents.

⁴ HM Revenue & Customs, *HMRC Internal Manual: Corporate Intangibles Research and Development Manual – CIR210190 – Patent Box: qualifying companies: qualifying IP rights: meaning of ‘qualifying development’*

Low emissions technologies

The Government is committed to the Paris Agreement; meeting and exceeding our 2030 Paris target of reducing greenhouse gas emissions by 26 to 28 percent below 2005 levels by 2030; and to achieving net zero emissions as soon as possible, and preferably by 2050.

The Government is taking a practical, technology-focused approach to reducing emissions. The Technology Investment Roadmap will guide \$20 billion of Australian Government investment in low emissions technologies by 2030, including through the Australian Renewable Energy Agency and the Clean Energy Finance Corporation, which backs early stage technology through the Clean Energy Innovation Fund. The Government is seeking to maximise co-investment and exceed at least \$80 billion of total public and private investment in low emissions technologies over the decade.

A patent box may provide an additional lever for the Government by encouraging further innovation in low emissions technologies.

Question 6

What sort of businesses own patented inventions relating to low emissions technologies, and would introducing a tax concession through a patent box support the clean technology energy sector?

BDO's Response

Typically, businesses in integrated energy, oil and gas, hydrogen, battery and automobile own patented inventions related to low emissions technologies.

While low emissions technologies have been identified as a priority in Australia's technology investment roadmap, introducing a tax concession through the patent box regime would further support the clean technology energy sector.

Question 7

Do patents play a strong commercial role in the clean technology energy sector, or are other strategies for using IP more important (such as being first to market)?

BDO's Response

Yes, our understanding from clients is patents do play a strong commercial role as companies rely on patents to protect their R&D particularly in circumstances where the technology can be reversed engineered and not capable of being protected by trade secrets.

Question 8

What factors drive decisions about the location of clean technology R&D?

BDO's Response

From information provided by our clients, key drivers can include cost, access to capital, economic competitiveness, market demands and barriers (e.g. policy setups, environmental and social externalities). Dependent on the type of clean energy technology, location is also driven by the

available infrastructure, transport infrastructure, environmental factors and availability of development areas close to key infrastructure.

Question 9

How would the clean technology sector best be defined for the purposes of a patent box?

BDO's Response

The definition of the clean technology sector should identify the categories of low emissions technologies that would qualify. For example, low emissions technologies, emerging and enabling technologies and watching brief technologies per the Australia's technology investment roadmap⁵.

Question 10

Would a patent box be an effective way of supporting the clean technology sector? Are there other options available to encourage growth in this sector?

BDO's Response

A patent box would be an additional method of supporting the clean technology sector; however, given a priority date of 11 May 2021, the lengthy timeframes in application filings being granted and subsequent time in generating related income, financial support won't be realised for a number of years.

Government incentives, such as the R&D Tax Incentive program and other grants, will continue to be available options to support and encourage growth in this sector. If the Government is wanting to immediately encourage entities from the clean energy sector to innovate in Australia, the mechanism through which the patent box is applied (e.g. through a refundable offset rather than concessional rate on profits) would need to be considered. This would also make Australia a far more attractive place to research, develop and commercialise innovations.

Applying the substantial activity requirement

International tax cooperation has been elevated by the Organisation for Economic Co-operation and Development's (OECD) Base Erosion and Profit Shifting (BEPS) agenda in recent years. Over 135 countries and jurisdictions are collaborating to implement various measures to tackle tax avoidance, improve the coherence of international tax rules and ensure a more transparent tax environment. To protect Australia's reputation for strong international tax cooperation and to provide certainty to taxpayers who engage in the patent box, the Government will implement a regime design that accords with OECD guidelines and standards.

For all IP regimes, the nexus approach requires a link between the benefits of the IP regime and the extent that the underlying R&D that generated the IP asset was undertaken within the home jurisdiction, known as the substantial activity requirement. In relation to income earned from a

⁵ Department of Industry, Science, Energy and Resources, *First Low Emissions Technology Statement – 2020* (Technology Investment Roadmap, September 2020).

patented invention, concessional treatment will only apply to net IP income where the company undertook the associated R&D within the home jurisdiction.

The nexus is implemented by requiring businesses to adjust their qualifying IP income by the R&D fraction - which represents qualifying Australian R&D expenditure as a proportion of overall R&D expenditure on the IP asset. The proportion of expenditures on associated R&D is therefore a proxy for substantial activities.

R&D expenditure conducted in Australia with the Australian Government's support can be included when calculating the R&D fraction.

Where possible, expenditure should be linked directly to a specific patented invention. However, general and speculative R&D could be divided pro rata across patented inventions. Since a patented invention is often not directly correlated to a product, or a single R&D project, there is a need to understand how R&D expenses will be recorded and reported to the ATO to allow for the OECD standards to be met transparently.

It is desirable to design requirements that are flexible enough to accommodate different businesses whilst providing a clear framework to ensure IP regime benefits are commensurate with a company's relevant domestic R&D activities.

Question 11

Do existing record keeping systems allow companies to show how R&D expenses are related to patented inventions? Can companies divide this into expenses incurred in Australia and elsewhere in order to calculate the proportion of R&D related to the patented invention that occurred in Australia?

BDO's Response

Existing record keeping systems could allow companies to show how R&D expenses are related to patented inventions, particularly in the medical and biotechnology sectors. However, given the varying commercial and administrative abilities across different companies, BDO recommends that the record keeping requirements of the patent box regime are not complex such that record keeping becomes too burdensome for the patent box regime to be commercially viable for eligible companies.

Definition of R&D

The substantial activity requirement necessitates a definition of qualifying R&D expenditure.

The Research and Development Tax Incentive (R&D Tax Incentive or R&DTI) has an existing definition of R&D activities. The R&DTI helps to offset some of the costs an eligible entity puts into eligible R&D activity. This may help guide the definition of R&D expenditure for the purposes of the patent box.

R&D activities eligible for the R&DTI are comprised of 'core R&D activities' and 'supporting R&D activities', as defined in section 355-25 and 355-30 of the Income Tax Assessment Act 1997 (ITAA 1997).

- *Core R&D activities are defined as experimental activities whose outcome cannot be known in advance but can only be determined by applying a systematic progression of work, and conducted for the purpose of generating new knowledge. Some activities are*

expressly excluded, such as market research, minerals exploration, management studies, research in social sciences, aspects of patenting and licensing, statutory compliance, commercial reproduction and computer software for internal administration.

- *Supporting R&D activities are activities directly related to core R&D activities. Certain activities must be undertaken for the dominant purpose of supporting core R&D activities to be considered supporting R&D activities.*

Under the substantial activity requirement, the definition of qualifying expenditure must only include expenditures that are incurred for the purpose of actual R&D activities directly connected to the IP asset. It can include the types of expenditures that currently qualify for the Australia's R&DTI but need not be limited to activities and expenditure eligible for the R&DTI.

To ensure integrity and reduce ambiguity for taxpayers, it is anticipated that certain expenses, such as head office costs and finance costs, will not be an eligible expense in the calculation of qualifying R&D undertaken to generate the eligible IP.

Question 13

Is the existing legal framework for the R&D tax incentive appropriate for determining R&D conducted in Australia for the purposes of the patent box? Do companies already collect this type of data and report it to the Government in some way (such as for the R&DTI)?

BDO's Response

For the purpose of defining qualifying expenditure, the existing legal framework for the R&D tax incentive would be appropriate for the purposes of the patent box and a similar approach has been taken in the UK. However, while the above notes that exclusion of head office costs (i.e. overheads) would ensure that the ambiguity for tax payers is reduced, this does not align with the eligible R&D expenditure that can be claimed as part of the Australian R&DTI. If the framework were to be amended for the patent box regime (for example by removing some eligible R&D Tax Incentive expenditure such as overheads from the calculation), it may actually lead to additional calculation steps and, therefore, unnecessary complexity and increased ambiguity. Having said that, if there were to be some expenses such as overheads removed, we would recommend other expenses that in some circumstances are not eligible for the R&D Tax Incentive but that would be typical expenses of Australian patented inventions, such as legal and administrative aspects of patenting itself (refer to question 14 response), be explicitly included in the quantum of the patent box regime.

Question 14

To what extent are the R&D expenses of Australian patented inventions not entirely the subject of R&DTI claims?

BDO's Response

A number of expenses that form part of Australian patented inventions are not eligible under the R&DTI legislation. For example, commercial, legal and administrative aspects of patenting and licencing is itself specifically excluded from being claimed as a core R&D activity and can, therefore,

only be claimed as a supporting activity if it is undertaken for the dominant purpose of supporting core R&D activities of a project.

Question 15

Could any existing definitions of qualifying expenditure (such as in the UK) in relation to the development of patented inventions be adopted in the Australian context?

BDO's Response

In some jurisdictions, such as Belgium and the United Kingdom, qualifying expenditure encompasses costs incurred in relation to R&D that is performed for a specific IP right by the company or an unrelated third party. Taking the UK as a specific example, R&D expenditure for patent box purposes is aligned with the R&D definition for R&D tax purposes. However, the requirements pertaining to the determination of the nexus fraction for each type of IP is complex. In practice, companies tend to use the R&D qualifying expenditure as a proxy for the R&D expenditure of the patent box where they have these figures at hand. However, where the companies can track and trace other R&D expenditure falling outside a R&D cost category to the development of the IP asset then it would be possible to include these costs.

BDO recommends clear definitions around qualifying expenditure, particularly around the minimum amount of expenditure required to be incurred, and how the interaction with how the IP is held by a company (i.e. whether the company is required to directly undertake the R&D) will impact on the relevant attributable income.

Implementation and start date

The patent box is a long-term tax measure to attract R&D activity and retain IP income in Australia. The benefit any taxpayer can receive from the patent box will be dependent on R&D undertaken in Australia.

Given that commercialisation of intellectual property can occur many years after the initial R&D takes place, taxpayers may have to track R&D expenditure split between Australia and other jurisdictions over a long time period.

Question 18

What will be the implications of targeting the patent box to new patented innovations (i.e. have a patent priority date after 11 May 2021)?

BDO's Response

While there are some mechanisms in place to accelerate the granting of a patent, it typically takes several years (typically around 8 years for some of our clients) for filed patent applications to be granted. Further to this, these patented innovation(s) may not generate income immediately. This means that profits derived from granted patented invention(s), filed on or after 11 May 2021, eligible for inclusion in the patent box regime may not be realised for several years. In this way, the targeted priority date will limit the immediate incentive of the regime.

A recommendation would be to include granted patents filed prior to 11 May 2021 as, to encourage more R&D and commercialisation, companies need an incentive now, not in several years' time which will be the case with the proposed patent priority date of after 11 May 2021.

Question 19

Would a start date for the patent box's concessional tax treatment of income years commencing on or after 1 July 2022 give companies enough time to prepare for the regime? How would it impact on new R&D?

BDO's Response

A start date of income years commencing on or after 1 July 2022 would be sufficient to give companies enough time to prepare for the regime.

Eligible revenue to enter the patent box

Value derived from IP comes in many forms. But the following revenue forms are most commonly associated with the commercialisation of patented inventions:

- 1. Royalties or licence fees derived from an eligible patented invention*
- 2. Revenue embedded in the sale of patented good or services or the use of patented processes in production*
- 3. Revenue from damages or an account of profits for infringement of an eligible patented invention*
- 4. Revenue by sale or assignment of an eligible patented invention*

Where a royalty or license fee is not applied, revenue from sales of a product or performance of a service will be partially attributable to an underlying patented invention or group of patented inventions and partly attributable to certain downstream activities. The OECD's substantial activity requirement places limits on the extent to which IP tax regimes can provide concessional treatment to the revenue attributable to downstream activities.

Once a company starts producing revenue from an eligible patented invention, the company will require an apportionment mechanism to separate eligible revenue and non-eligible revenue for the purposes of the patent box.

Under the previously discussed substantial activity requirement, only companies that conducted the relevant R&D in Australia would be able to include revenue in the patent box.

Question 20

What types of patent-related revenue should be eligible for the patent box?

BDO's Response

The test for identifying revenue eligible for inclusion in the patent box should ideally capture as much revenue as possible. BDO recommends that the test for inclusion of a revenue amount in the patent box should not stipulate just those specific items outlined in the question. Rather, a principles-based

nexus test should be implemented. Patent-related revenues included in the patent box should, therefore, be any amount of revenue that is directly or indirectly due to exploiting the patent, disposing of the patent to another Australian resident, or defending an eligible patent.

Such a test would ensure revenue inclusion in the patent box from direct sources (e.g. the licence of the patent), and from indirect sources (for example, from the sale of products manufactured using a patented process, or providing a service using a patented tool).

Question 21

How far downstream can the patent box's concessional treatment apply, and what principle should be used to define eligible income derived from the patented innovation?

BDO's Response

As per our response to question 20, to maximise the value to innovators of the patent box, downstream revenue should be maximised. If, on an objective analysis, the basis of the revenue can be determined to be due to an eligible patent, then some or all of the revenue should be included in the patent box. Revenues eligible for concessional treatment from further along the value chain may need to be determined based on an economic contribution analysis. That is, if 50% of the economic value of the goods sold, or from services provided, is due to using patented products or processes, then 50% of the revenue from such sales or services should be included in the patent box.

Question 22

In circumstances where a single product comprises of a group of related patented innovations, what approach could the patent box use to simplify the calculation of eligible revenue and the R&D fraction?

BDO's Response

If a product or process utilises multiple patents, an economic contribution model such as that outlined in the response to question 21 would permit appropriate revenue inclusion in the patent box.

Question 23

As non-patent revenue will need to be separated from the eligible revenue, how might this be achieved optimally (having regard to existing systems and record keeping)?

BDO's Response

The model should be that eligible patent revenue is identified from all revenue. Thus, on a subtractive basis, non-patent revenue would be total revenue *less* eligible patent revenue.

Subtraction of related patent expenses from eligible revenue

Expenses that arise in developing, exploiting, generating, and maintaining the relevant patented invention need to be subtracted from eligible patent revenue, and hence separated from non-eligible expenses that are unrelated to the patented invention.

Similar to patent box regimes overseas, there will need to be rules to ensure that expenses relevant to earning eligible revenue are included in the patent box design.

Question 24

Having regard to existing systems and record keeping how might eligible expenses be optimally separated from non-eligible expenses?

BDO's Response

Direct patent expenditures are generally easily identifiable.

Indirect patent expenditures are generally less easy to identify. In this instance, an apportionment approach would be appropriate, using the ratio of eligible patent revenue to total revenue as the basis of apportionment. To avoid complication and ambiguity such has been the case with the administration of R&D Tax Incentive apportionments, BDO believes that a safe harbour apportionment methodology should be available to companies where these indirect expenses are less easy to identify.

Treatment of losses and related offsets with the patent box

Tax losses arise when a business's allowable deductions exceed its assessable profit. For corporate tax purposes a tax loss can be carried forward into future years until the entity returns to profitability. It follows that by default a taxpayer not subject to tax on profits due to losses does not benefit from the concessional rate under the patent box until those losses have been utilised. However, providing arrangements to allow firms to benefit during loss making years could add to the regime's complexity and pose integrity risks.

Question 25

How should losses associated with either the development of a patented invention or its commercialisation be treated, both within the patent box and for general corporate tax purposes?

BDO's Response

Costs associated with the creation, registration or defence of a patent, may not be deductible for tax purposes, but rather form part of the tax cost of the patent. The tax cost of the patent is deductible for income tax purposes over the effective life of the patent. If the deduction of the tax cost exceeds the taxable income from the patent, then a tax loss will arise.

Additionally, R&D expenditures generally, which may result in future patents but not known with certainty at the time the expenditure is incurred, may give rise to tax losses (subject to any claims made under the R&D Tax Incentive). Commercialisation expenditures would also give rise to tax losses, to the extent that they exceed assessable income.

The current tax law does not require tax losses arising from patents to be separated. Consideration should be given to separately identifying and tracking such losses for the purposes of the patent box regime. In this regard, eligible expenditure giving rise to patent losses should be measured from the registration of an eligible patent. This would ensure that R&D expenditures more broadly do not distort the eligible net patent box revenue calculation.

A mechanism to provide benefits during loss making years may be to provide a carry forward tax offset or through another mechanism such as a refundable offset.

Administration and compliance

The patent box will be administered as part of the corporate tax system. To determine eligibility a taxpayer will need to be confident that they can evidence:

- *Nexus 1: Appropriate nexus between R&D activity and eligible patented invention*
- *Nexus 2: Appropriate nexus between eligible patented invention and eligible profits*

Question 26

What is the likely regulatory burden in relation to administrative, record keeping or evidentiary requirements required to access the patent box concession?

BDO's Response

Depending on the eligibility requirements for a patented invention and the approach taken in identifying eligible income (i.e. patent-level test vs. income streaming test), there would be a level of burden to companies having to identify qualifying patented inventions (per a legislative definition) or that eligible profits are attributable to qualifying development. This burden will be in the form of companies needing to potentially restructure frameworks to separate costs incurred and profits attributed to different aspects of the patented invention as well as generate additional documentation to demonstrate the nexus between an eligible patented invention and eligible profits.

In identifying qualifying and non-qualifying income, companies will need to establish processes to separate the two using approaches that are accepted by the ATO while remaining commercially feasible and reasonably administrable. Where a company is required to identify the appropriate nexus between eligible patented inventions and eligible profits (i.e. nexus 2 approach) the process would likely result in complicated formulas as well as become time-consuming and costly.

Question 27

Are there design features of any existing patent boxes that, if adopted in Australia, would minimise the regulatory burden on companies?

BDO's Response

Design features of existing patent boxes that would minimise regulatory burden include:

- **Qualifying income:** Enable all income relating to a qualifying patented innovation to be eligible (i.e. patent-level test)
- **Location of IP development:** Enable IP developed through R&D activities conducted in Australia and overseas to qualify
- **Advance ruling:** The Belgium patent box provide companies the option to obtain an advance ruling to determine the extent of the patent box in advance and provide certainty for a period of five years.

Question 28

The ATO will administer the patent box via taxpayer self-assessments within the corporate tax system. What types of evidence would taxpayers be able to provide that would support claims that patented inventions relate to eligible sectors?

BDO's Response

Types of evidence taxpayers would typically be able to provide include the filed patented applications themselves along with design documents, experimental protocols and reports. Administrative burden should be kept in mind when determining the level of documentation required. In our opinion, filed patent applications should suffice.

BDO iterates that the best approach in reducing complexity and providing certainty is to allow companies in all sectors access to the patent box regime. This would mean that companies would only be required to demonstrate qualifying patents rather than proving which sector the patent is classified as.

Other considerations

Question 29

Are there any other issues you would like to raise for consideration in the design of the patent box?

BDO's Response

Other considerations include what method will be used to identify the value contributed by multiple patents in instances where patents are aggregated. Depending on the type of test applied (i.e. patent-level test vs. income streaming test), these instances could lead to complexity in identifying income related to qualifying patents. This could be further complicated where multiple patents, such as those relating to manufacturing processes, form part of one product/service.

Appendix

Table 1: 2020 Intellectual Property Regimes (obtained from external source⁶)

Country	Regime Name	IP Qualifying Assets	Tax Rate that would otherwise apply	Tax Rate Under Regime	Regime Information
Andorra	Special regime for exploitation	Patents, Software	10%	2%	The regime applies to patents, utility models and copyrighted software.
Belgium	Patent income deduction	Patents, Software	25%	3.76%	Qualifying assets refers to patents and supplementary protection certificates. Copyrighted computers programs (software). Plant variety rights. Orphan drugs.
China	Reduced rate for high and new tech enterprises	Patents	25%	15%	The scope of the qualifying IP income explicitly excludes trademarks and includes a variety of patents on crops, new medicines, exclusive rights for integrated circuit design, utility models and software copyrights, which is also nexus compliant.
Curaçao	Innovation box	Patents, Software, Category 3	22%	0%	The regime is applicable for the following intangible assets: 1) in respect of which a patent or plant breeder's right was granted to the taxpayer or for which an application was filed for a patent or plant breeder's right; 2) which has the form of copyrighted software, protected by a patent for plant breeder's right; 3) for which a license to sell a medicinal product was granted; 4) for which a supplementary protection certificate was granted by a patent office or similar

⁶ Organisation for Economic Co-Operation and Development, '2020 Intellectual Property Regimes', *Data* (Web Page) <https://qdd.oecd.org/data/IP_Regimes>.

organization to the taxpayer; 5) for which a registered utility model for the protection of innovation was granted to the taxpayer; or 6) that is related to an intangible asset as referred to in parts 1 up to and including 5 before; For small taxpayers: an intangible asset with similar characteristics as those listed above that is the result of research and development. The term “intangible asset”, includes an exclusive license to use such an intangible asset in a specific way, for a certain period or in a specific geographical area. If the research and development referred to above relates to the further development of an intangible asset, which was not produced by the taxpayer himself, then there will only be an intangible asset produced by the taxpayer, if the research and development resulted in a new intangible asset, and the new intangible asset resulted from this research and development.

France	Reduced rate for long term capital gains and profits from the licensing of IP rights	Patents, Category 3	32.02%	10%	Qualifying assets refers to patent, patentable inventions or improvements thereto provided they are capitalized as a fixed asset. Industrial manufacturing processes may also qualify provided they are necessary accessories to the use of eligible patents and patentable inventions.
Greece	Tax patent incentives	Patents	28%	10%	
Hungary	IP regime for royalties and capital gains	Patents, Software	9%	0.00% in case of capital gains of reported Qualifying IP and 4.50% in case of the benefits related to royalty income.	Qualifying assets refers to patents and supplementary protection certificates, copyrighted computers programs (software), plant variety rights, orphan drugs.



India	Tax on income from patent	Patents	30.91% to 35.54%	10.3% to 11.85%	Qualifying assets refers to patented article and patented process
Ireland	Knowledge development box	Patents, Category 3	12.5%	6.25%	Qualifying assets refers to computer programs, qualifying patents, plant breeders rights and supplementary certificates e.g. under Council Regulation (EC) No. 469/2009, which are the result of R&D, may qualify for relief. Qualifying patents means: any patent granted following a substantive examination for inventive step; any patent granted prior to 1 January 2016; and a patent granted between 1 Jan 2016 and 1 Jan 2017 without a full examination which is certified by a patent agent as having met the patentability criteria. Short term patents, petty patents and utility models are excluded. Marketing and brand-related IP are excluded. Irish patent legislation follows the patentability criteria set out in the European Patent Convention. In order to qualify for the KDB under the third category of IP, the IP asset must be certified as patentable, meaning it meets the patentability criteria and is not yet part of the prior art at a given date, but has not been patented.
Israel	Amended preferred enterprise regime	Patents, Software, Category 3	23%	5.00%/8.00%/7.50%/16.00%	<p>A right under the Patents Act, 1967, computer software protected by the Copyright Act Regulations, 2007, a right under the Plant Breeders' Rights Act, 1973, these aforementioned rights under the laws of foreign countries and rights under other acts determined by the Minister of Finance's through a decree. It is understood that the Minister will use this authority to include only rights that comply with Action 5 requirements.</p> <p>A third category asset requires certification by the newly founded Authority for Technological Innovation that it is qualified to be subject of an R&D plan. Criteria for evaluation by the Authority for Technological Innovation of R&D plans by</p>

companies applying for approval of third category assets will be in line with written procedure 300-01.					
Italy	Taxation of income from intangible assets	Patents, Software	24% + 3.9% IRAP	12% + 1.95% IRAP	Software protected by copyright, industrial patents, trademarks, designs and models, as well as processes, formulas and information relating to experience acquired in the industrial, commercial or scientific field, capable of legal protection
Jordan	Development zones	Assets not restricted to three allowed asset categories	20%	0% to 5%	-
Korea	Special taxation for transfer, acquisition, etc. of technology	Patents, Category 3	10% to 25%	5.00% to 12.50% Transfer; 7.50% to 18.75% Licence	<p>The rates that apply for the tax base, up to KRW 300 billion are (transfer) 5% to 10.93% and (license) 7.5% to 16.40%. For the portion of the tax base which exceeds KRW 300 billion the rates are (transfer) 12.5% and (license) 18.75%.</p> <p>Qualifying assets refers to software protected by copyright, industrial patents, trademarks, designs and models, as well as processes, formulas and information relating to experience acquired in the industrial, commercial or scientific field, capable of legal protection.</p> <p>Patent rights, utility model rights, technical know-how that a national has obtained through his/her research and development activities in the field of science and technology(excluding industrial property rights, overseas construction services and engineering services), and technology defined under subparagraph 1 of Article 2 of the Technology Transfer and Commercialization Promotion Act.</p>

Lithuania	IP regime	Patents, Software	15%	5%	<p>Qualifying assets refers to computer programmes protected by copyright, qualifying patents including supplementary protection certificates which are the result of R&D, exclusive licence to exploit aforementioned IP items may qualify for benefit. Qualifying patents mean any patent which meets the patentability criteria (novelty, inventive step, industrial applicability) protected by the European Patent Office, patents or supplementary protection certificates issued in the EEA country or in the country with which a convention for the avoidance of double taxation has been concluded. Existing copyrights and patents that already have been issued are included as qualifying assets. These assets can only benefit from the tax benefits if the taxpayer can track these expenses and documentary evidence shall be provided. In addition, pending patents are included as qualifying assets. Should the patent be ultimately reversed, the corporate income tax paid from the taxable profits from the use, sale or any other transfer into ownership of qualifying IP assets is recalculated for all tax periods when the tax relief has been applied. Also company's annual returns should be specified accordingly including to pay back provided benefits. Qualifying IP assets do not cover utility models (short term patents, petty patents, etc.), plant breeders' rights and orphan drug designation. Marketing- related IP assets such as trademarks never qualify for the tax benefit.</p> <p>Computer programmes protected by copyright, qualifying patents including supplementary protection certificates which are the result of R&D, exclusive licence to exploit aforementioned IP items may qualify for benefit.</p> <p>Qualifying patents mean any patent which meets the patentability criteria (novelty, inventive step, industrial applicability) protected by the European Patent Office,</p>
-----------	-----------	----------------------	-----	----	---

patents or supplementary protection certificates issued in the EEA country or in the country with which a convention for the avoidance of double taxation has been concluded. Existing copyrights and patents that already have been issued are included as qualifying assets. These assets can only benefit from the tax benefits if the taxpayer can track these expenses and documentary evidence shall be provided. In addition, pending patents are included as qualifying assets. Should the patent be ultimately reversed, the corporate income tax paid from the taxable profits from the use, sale or any other transfer into ownership of qualifying IP assets is recalculated for all tax periods when the tax relief has been applied. Also company's annual returns should be specified accordingly including to pay back provided benefits. Qualifying IP assets do not cover utility models (short term patents, petty patents, etc.), plant breeders' rights and orphan drug designation. Marketing- related IP assets such as trademarks never qualify for the tax benefit. Computer programmes protected by copyright, qualifying patents including supplementary protection certificates which are the result of R&D, exclusive licence to exploit aforementioned IP items may qualify for benefit.

Qualifying patents mean any patent which meets the patentability criteria (novelty, inventive step, industrial applicability) protected by the European Patent Office, patents or supplementary protection certificates issued in the EEA country or in the country with which a convention for the avoidance of double taxation has been concluded. Existing copyrights and patents that already have been issued are included as qualifying assets. These assets can only benefit from the tax benefits if the taxpayer can track these expenses and documentary evidence shall be provided. In addition,

pending patents are included as qualifying assets. Should the patent be ultimately reversed, the corporate income tax paid from the taxable profits from the use, sale or any other transfer into ownership of qualifying IP assets is recalculated for all tax periods when the tax relief has been applied. Also company's annual returns should be specified accordingly including to pay back provided benefits. Qualifying IP assets do not cover utility models (short term patents, petty patents, etc.), plant breeders' rights and orphan drug designation. Marketing- related IP assets such as trademarks never qualify for the tax benefit.

Luxembourg	IP regime	Patents, software	24.94%	4.988%
-------------------	-----------	-------------------	--------	--------

Qualifying assets refers to patents, utility models, supplementary protection certificates, prorogations of supplementary protection certificates, plant breeders' rights, orphan drug designations and copyrighted software.

Netherlands	Innovation box	Patents, Software, Category 3	20% to 25%	7%
--------------------	----------------	-------------------------------	------------	----

Qualifying assets refers to SME's • Certain IP derived from R&D activities for which a so called R&D declaration has been issued; Non-SME's: • Certain IP derived from R&D activities for which a so called R&D declaration has been issued; and 1. Patents and breeders rights 2. Applications for patents and breeders rights 3. Software The term software (in Dutch: 'programmatuur') means software as it is understood in spoken language within the social standards. The demanded innovative element of software is ensured by the aforementioned R&D declaration which is obliged to have for every taxpayer opting for the regime of the innovation box. 4. Market authorisation of a medical product 5. Extensions of patent protection 6. Utility models 7. Exclusive licence to exploit IP connected to items 1-6 8. IP connected to items 1-7 The term "IP connected to items 1-7" is meant to qualify IPassets which are so closely connected to each other that it would require an unrealistically detailed level of

administration by the taxpayer that the tax payer would be engaged in a complex track-and-trace-system to monitor the costs related to the IP. This follows from paragraph 57 of the Action 5 Report. IP can therefore qualify for the innovation box if they are closely related to IP mentioned in 1-7. Examples of closely related IP given in the clarification of the legislation is when the research department produces multiple IP's which result from related technologies. In this context is emphasized that IP that is by matter of coincidence produced in the same lab notautomatically related IP is in that sense.

Third Category: IP derived from R&D activities for which a so called R&D declaration has been issued. Conditions for issuance of such declaration are in line with Report. The issuance of a R&D-declaration is done by an organization (RVO.nl) which is a part of the central government (part of the Ministry of Economic affairs). A declaration is issued for two types of 'projects', defined by law. These are technological-scientific research and research to the development of new (parts of) physical products, physical processes or new technical software. The tax payer is obliged to describe the R&D-activities that will be done. RVO.nl checks this and will judge this on its content. The judgement is done by professional, technical experts with technical knowledge and background.

Panama	General IP regime	Patents, Software	25%	0%	
People's Republic of China	Reduced rate for high & new tech enterprises	Patents	25%	15%	The scope of the qualifying IP income explicitly excludes trademarks and includes a variety of patents on crops, new medicines, exclusive rights for integrated circuit design, utility models and software copyrights, which is also nexus compliant.



Poland	IP Box	Patents, software	19%	5%	-
Portugal	Partial exemption for income from patents and other industrial property rights	Patents	21%	10.5%	Only patents and industrial designs or models (utility models) subject to registration on National Institute of Industrial Property (INPI) can qualify for the regime. The industrial property rights must be granted (patented) prior to the use of the benefits under the Portuguese IP Regime. The submission of a patent application does not qualify the company for the period the patent is “pending”. Earlier periods do not qualify for the benefits. Marketing and brand related IP are excluded
San Marino	New companies regime provided by art. 73, law no. 166/2013	Patents, Software	17%	8.5%	
Singapore	IP development incentive	Patents, Software	17%	5% or 10% (depending on amount of investment)	This status is subject to final adoption of new legislation. Qualifying assets refers to any patent under the Patents Act (Cap 221) or the equivalent law of any country or territory, or an application for a patent under the Patents Act or the equivalent law of any country or territory; and any copyright subsisting in software by virtue of the Copyright Act (Cap 63) or the equivalent law of any country or territory. (Please refer to Qualifying IPR in Regulation 2 of Draft Reg. 2018.)
Slovak Republic	Patent-box	Patents, Software	21%	10.50%	Qualifying IP assets are: patents or utility models, and copyrighted software. (§ 13a para. 1/ § 13b para. 1) * Assets that are in process of patent/utility model application can benefit from the regime. If application is eventually rejected, the taxpayer is obliged to submit an additional tax declaration

and to pay back provided benefits and relevant sanctions. (§ 13a paras. 9 and 10/ § 13b paras. 10 and 11).

Spain	Partial exemption for income from certain intangible assets.	Patents, Software	25%	7.8% (Federal regime), 8.4% (Basque country), 10% (Navarra)	<p>Spain’s partial exemption for income from certain intangible assets was inconsistent with the nexus approach for IP assets acquired from related parties for the period from 1 January 2017 to 31 December 2017 and for new taxpayers entering the regime in the period from 1 July 2016 to 31 December 2017. Qualifying assets refers to IP assets that generate income derived from the transfer or the assignment of the right to use of any patent, design or model, plan, secret formula or process or from the assignment of information concerning industrial, commercial or scientific experience. In no case shall be eligible for reduction income arising from the assignment of a right to use, of from the transfer of, trademarks, literary, artistic or scientific works including cinematographic films, or from individual rights that might be assigned such as image rights, from software, industrial, commercial or scientific equipment or derived from any other right or asset different from those mentioned in the previous paragraph. (Federal regime)</p> <p>The reduction is available only for revenues from the assignment of the entitlement to use or exploit patents, utility models, supplementary certificates for the protection of medicaments and of phytosanitary products or registered advanced software obtained as a result of research and development projects. In no case will the reduction apply to income from the assigning of the right to use or exploit brands, works of literature, art or science, including cinema films, assignable personal rights such as image rights, industrial, commercial or scientific equipment, confidential procedures, drawings or formulae, rights to information concerning</p>
-------	--	-------------------	-----	---	--

industrial, commercial or scientific experiments, drawings or models or computer programs other than those referred to in the foregoing paragraph, or to any other right or asset other than those indicated therein. (Basque country)

Qualifying assets refers to positive income derived from the right to use or exploit a patent, utility model, supplementary protection certificate of medicines and plant protection products, designs and models liable to legal protection, resulting from research and development and innovation activities, and sophisticated copyrighted software resulting from R&D projects. In no case shall income from the assignment of the right to use, or from the transfer, of trademarks, literary, artistic or scientific works, including cinematographic films, or of personal rights eligible for assignment such as image rights, or software different from that mentioned before, industrial, commercial or scientific equipment, plan, secret formula or process, or of rights on information concerning industrial, commercial or scientific experience, or any other right or asset different from those mentioned, qualify for this reduction. (Navarra)

Switzerland	Licence box	Patents	21.2%	11.8%
-------------	-------------	---------	-------	-------

As part of the 2020 tax reform, Switzerland introduced a mandatory patent box as well as an optional R&D super deduction at the cantonal level. The patent box applies to the cantonal tax liability and allows a maximum exemption of 90% of qualifying income from cantonal level taxation. The rate of exemption varies by canton and is subject to mandatory general limitation rules of tax relief that cap the amount of relief firms can obtain from the use of tax instruments at the cantonal level. This cap also varies by canton. The rates displayed represent the combined effective tax rate applicable in case of maximum relief at the cantonal level accounting for

federal tax liabilities for an investment in the canton of Zurich and include the effect of the patent box, the R&D super deduction and the cap on tax relief. The applicable rate under the schemes varies between 9.1% and 13.9% while the rate that would otherwise apply varies between 11.9% and 21.6% among cantons.

Thailand	International Business Centre	Patents, Software	20%	3% / 5% / 8%	-
Turkey	Technology development zones regime	Patents, Software, Category 3	22%	0%	Qualifying assets refers to patents, software but it is not necessary to have an IP asset. In order to qualify under the 3rd category of IP, the IP asset must be certified as patentable, meaning it meets the patentability criteria, but has not been patented.
United Kingdom	Patent box	Patents	19%	10%	The following IP assets can qualify for benefits under the Patent Box: A patent granted by the UK Intellectual Property Office (IPO) under the Patents Act 1977. A patent granted by the European Patent Office (EPO). A Patent that is granted under the law of a specified European Economic Area state. A right similar to a patent. These rights relate to human and veterinary medicines, plant breeding and plant varieties. Where a person holds marketing authorisation rights in respect of a product in accordance with any European Union legislation and that product benefits from either "marketing protection" or "data protection", the person is treated as having been granted a right to which the Patent Box applies. "Marketing protection" and "data protection" for these purposes are defined in the legislation



United States of America	Foreign derived intangible income (FDII)	Assets not restricted to three allowed asset categories	21%	13.13%	-
-----------------------------	---	---	-----	--------	---