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Note to Malcolm Turnbull: Australian patent box regime could trigger 'race to the bottom', economic pain

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The adoption of a patent box in Australia could push neighbouring countries such as New-Zealand and Singapore to follow suit with the slight risk of triggering a fiscal race to the bottom, according to a new report prepared for the Australian government.

The report, prepared by the Department of Industry, Innovation and Science's Office of the Chief Economist, says "patent box policies are winner-takes-all policies and adjustments at the margin are likely to hurt the economy". It boost profits for firms participating in the scheme but lower government revenue.

There has been pressure on the federal government to lower taxes on profits from patents developed in Australia to stop companies moving their manufacturing offshore.

Patent boxes have been put forward as a tax break that would help encourage the research and development needed as part of Prime Minister Malcolm Turnbull's innovation agenda.

A raft of [submissions to the Senate inquiry into Australia's innovation system](#) has called for a UK-style patent box system – where a 10 per cent tax rate rather than the higher company tax rate was applied to profits from the license or sale of patents.

A joint submission by AusBiotech, Cook Medical Australia, the Export Council of Australia and the Medical Technology Association of Australia, said a UK-style patent box incentive is needed.

But advocacy group the [Tax Justice Network has urged Canberra to resist the calls](#), saying the UK rules created a new way for large businesses to avoid tax in the countries in which they operate.

The UK has now agreed to close its patent box tax break, following German concerns about artificial shifting of profits between European countries. But since, Ireland has introduced a "Knowledge Development Box" with a rate of 6.25 per cent (half the rate of its 12.5 per cent company tax rate).

But the report, prepared by tertiary institution Gaéten de Rassenfosse and the University of Melbourne said a policy aimed at attracting mobile IP income is a "winner-takes-all policy and therefore requires an aggressive lowering of the headline tax rate".

"In addition, it opens the door to a fiscal race to the bottom as more and more countries seek to offer patent box regimes," it said.

The report said there were "no solid theoretical or empirical grounds for claiming that patent box regimes induce more innovation".

While the implementation of a patent box policy would increase the number of patent applications filed at IP Australia, most of these additional patent applications were likely to be "opportunistic".

"Inventions that would previously have been kept secret will be patented and will not be tied to real economic activity," it said. "The risk is high that R&D leading to these patent applications is performed abroad," it said.

There would be a fall in tax revenues collected from innovative companies. "Since the fall is likely to exceed revenues collected from re-allocation of IP income to Australia, the overall return of a patent box regime is likely to be negative," it said.

The report is based on the assumption that research has to be conducted in Australia in order to qualify for the patent box exemption and that the patent box would apply only to technologies protected with standard patents - therefore not to trademarks, industrial secrets or innovation patents.

Such a patent box regime was likely to have little effect on large multinational enterprises such as Apple that were already "optimising" their tax base.

"Revenues that the country is most likely to attract come from foreign firms that have a research centre in Australia and that have their IP located in a medium-to-high tax jurisdiction," it said, but added that deeper investigation of the impact on the mining industry was warranted.

Deloitte tax partner Helen Fisher said the report's definition of 'innovation' was too narrow. "It seems to be equating innovation to research. Innovation should encompass commercialisation of research and inventions, otherwise the society misses out on the benefits of R&D," she said.

Australia's R&D tax incentive was mainly aimed at early stage developments. "We do not have anything that would incentivise companies to locate their commercialisation efforts in Australia," she said.

According to the Organisation for Economic Cooperation and Development, Australia is one of the lowest spenders on direct research and development funding for business, ranking 34 out of 36 among OECD nations. Offering a more lucrative R&D tax incentive could raise Australia's rank to 18th.

This story was found at: <http://www.smh.com.au/business/the-economy/note-to-malcolm-turnbull-australian-patent-box-regime-could-trigger-race-to-the-bottom-economic-pain-20151110-gku98n.html>