

Dr Megan O'Connor  
Managing Director, Kantara Consulting  
meganconnor@kantaraconsulting.com.au

Paul Fischer  
Corporate and International Tax Division  
The Treasury  
Langton Crescent  
PARKES ACT 2600  
PatentBoxConsultation@treasury.gov.au

## Response to the Australian Government's Patent Box Discussion Paper

### About Kantara Consulting

Kantara Consulting works with some of Australia's most exciting biotech companies seeking commercial success and to make a positive impact on the world. Kantara Consulting does this by helping Australian biotech companies fund their commercialisation pathway and communicate their journey to Government and a broader stakeholder network. We are passionate about driving the vibrancy and success of Australia's biotech ecosystem, particularly about improving the support available for the Australian biotech industry.

### Creating a sustainable, vibrant Australian biotech industry

We believe that success breeds success and that the proposed Patent Box regime, directed towards the Australian biotech industry could be an important industry incentive to influence business decisions and grow a vibrant and sustainable Australian biotech industry.

Australia is already a world-leader in medical research but has had a long and widely acknowledged history of very low rates of commercialising this research. As such, the success metrics of the Patent Box regime should focus on is not the level of new R&D that is generated, but the *rate of commercialisation* in the industry. Additionally, to create change in the commercialisation landscape, we need measures that drive commercialisation **today**. We need significant incentives that support and grow the biotech industry to reach a critical mass where it is able support industry infrastructure and the skills base needed to achieve a sustainable, vibrant Australian biotech industry.

Kantara Consulting strongly believes that in its current form the proposed Patent Box regime is too restrictive and does not create sufficient commercialisation incentive for the Australian biotech sector. **As drafted it will have little, if any impact on commercialisation rates in the Australian biotech industry.** Critically, the current policy design completely disregards the intellectual property (IP) the sector has developed to date (and is able to commercialise in the short term) and provides no incentive to keep existing IP in Australia.

Accordingly, Kantara Consulting proposes the following six key recommendations for the current Patent Box design.

## **Kantara Consulting's Key Patent Box Recommendations**

**Recommendation 1:** Lower the concessional tax rate to be globally competitive and create a sufficient incentive to influence business decisions.

**Recommendation 2:** Broaden the eligibility requirement to include existing IP in addition to new IP, and in doing so, eliminate the current eligible start date of 11 May 2021.

**Recommendation 3:** Qualifying R&D expenditure should include expenditure on R&D activities which need to be undertaken overseas. The criteria used to assess eligible overseas expenditure for the R&D Tax Incentive program should be adopted to assess qualifying overseas expenditure under the Patent Box regime.

**Recommendation 4:** Adopt the definition and compliance requirements for the Patent Box to replicate those of the R&D Tax Incentive, and limit restrictions of eligible IP where possible.

**Recommendation 5:** Adopt a refundable tax offset approach for SME's already applies to the R&D Tax Incentive

## Discussion of Key recommendations

### Patent Box Design Considerations

Q1: 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?

#### Concessional Tax Rate

- **Recommendation 1: Lower the concessional tax rate to be globally competitive and create a sufficient incentive to influence business decisions.**

The concessional tax rate in other jurisdictions should be taken in account when designing the Australian Patent Box to support the medical and biotechnology sector. Currently, the proposed concessional tax rate of 17% is much higher in comparison to other countries and only results in a single figure reduction of 8% when compared to the Australian company tax rate of 25% for base rate entities.

An analysis of 2020 data provided by the Organisation for Economic Co-operation and Development (OECD) reveals that among OECD countries whose peer review status is classified as not harmful, the effective tax rate on IP income varies greatly. This data is listed in Table 1<sup>1</sup>. In the UK for example, the tax rate under the regime is 10% instead of 19%. In France, this rate is 10% instead of 32%, and closer to home in the Asia Pacific region, Singapore's recently introduced IP Development Incentive (IDI) in 2017 offers a reduced corporate tax rate of either 5% or 10% instead of 17%.

Further, this dataset reveals that the median Patent Box tax rate under the regime<sup>2</sup> is 5.17% (average tax rate is 5.83%), and the median reduction between this rate and the tax rate that would otherwise apply is 14.00% (average reduction 14.60%).

Taken together, this means that the proposed Australian Patent Box concessional tax rate of 17% is *roughly three times as high* as the median in other jurisdictions, and the proposed likely reduction in taxes is *almost half as low* as the median reduction in other jurisdictions. This higher concessional tax rate, when considered together with the current very restrictive conditions (e.g. only new IP) and high compliance burden makes it unlikely to incentivise commercialisation in Australia, particularly when other commercial factors are considered (for e.g. location to key markets, transport costs, etc.) are taken into account. Therefore, Kantara Consulting strongly recommends that the Australian concessional tax rate is reduced to be competitive with overseas regimes.

#### Existing IP

- **Recommendation 2: Broaden the eligibility requirement to include existing IP in addition to new IP, and in doing so, eliminate the current eligible start date of 11 May 2021.**

Existing IP should be considered eligible IP to account for the lengthy and complex commercialisation pathway typical of the biotech sector. It is not uncommon to see commercialisation timeframes of 10 years in the sector.

Additionally, inclusion of only existing IP will reduce the complexity of the regime as it is very common that the IP underpinning a drug or medical technology involves many patents and patent families applied for at several different time points. We explore this complexity further in Question 26.

We note that including existing IP is a common characteristic of overseas Patent Box regimes<sup>3,4</sup>. Existing patents are included in many other comparable jurisdictions including the UK, Belgium,

---

<sup>1</sup> See Appendix for more details.

<sup>2</sup> Please note that if countries had more than one tax regime rate, the average rate was used for ease of comparison. This applied for the existing corporate tax rate as well. See Appendix for more details.

<sup>3</sup> Fabian Gaessler & Bronwyn H. Hall & Dietmar Harhoff. (2021). Should there be lower taxes on patent income?, Research Policy, vol 50 (1).

<sup>4</sup> Alstadsæter, Annette, Salvador Barrios, Gaetan Nicodeme, Agnieszka Maria Skonieczna and Antonio Vezzani (2018). Patent Boxes design, patents locaGon, and local R&D. Economic Policy 33 (93): 131-177.

Switzerland and France. See Table 2 for a list of countries with Patent Box regime's and whether they include existing patents, as identified by Gaessler et. al (2021).

Unfortunately, it is highly unlikely that commercialisation of Australian IP within the short to medium term in the biotech sector will be incentivised by the proposed Patent Box which limits eligible IP to only new IP. Furthermore, as currently drafted, the proposed Patent Box tax regime will not discourage selling of existing Australian IP to overseas companies, a prevalent practice in the sector which leads to the erosion of the domestic tax base and/or loss of skilled job creation and local growth in the biotech sector.

Therefore, one of our key recommendations is to broaden the eligibility criteria to include both existing and new Australian IP. Doing so will incentivise biotech companies to further develop and commercialise existing Australian IP in Australia, or Australian IP that have applied for patenting previously to this date but are awaiting grant status. This will also greatly benefit pre-revenue companies such as biotech startups to develop and grow and stay in Australia.

### Applying the Substantial Activity Requirement

Q12: How much R&D activity (related to patented inventions) occurs outside Australia?

- **Recommendation 3: Qualifying R&D expenditure should include expenditure on R&D activities which need to be undertaken overseas. The criteria used to assess eligible overseas expenditure for the R&D Tax Incentive program should be adopted to assess qualifying overseas expenditure under the Patent Box regime**

Kantara Consulting is strongly supportive of the recommendation to implement various measures to tackle tax avoidance, improve the coherence of international tax rules and ensure a more transparent tax environment.

However, we believe that the substantial activity requirement should consider the specific constraints, the Australian biotech industry faces when undertaking R&D and commercialisation activities. Currently, the industry lacks many key resources including pre-clinical testing facilities, manufacturing facilities and suffers from chronic skill shortages. Additionally, the industry will almost always encounter constraints when completing clinical trials in Australia due to our small population. The Australian R&D Tax Incentive already recognises these constraints and allows for R&D expenditure on overseas R&D activities to be eligible under the R&D Tax Incentive where certain conditions are met.

Accordingly, we recommend that a company's qualifying R&D expenditure should include overseas R&D expenditure where:

- The Australian entity owns all IP generated from the overseas activity
- The Australian entity has demonstrated that they could not undertake the activity in Australia (as per the Advanced Overseas Finding process<sup>5</sup>)
- The overseas expenditure was less than the Australian R&D expenditure (as per the Advanced Overseas Finding criteria)

The inclusion of overseas R&D activities and expenditure which meet the requirements of the R&D Tax Incentive Overseas Finding requirements should not be in breach of the agreed nexus approach<sup>6</sup>. Under the requirements of the Australian R&D Tax Incentive regime, eligible overseas expenditure must be incurred by the Australian entity, therefore the overseas costs are being borne by the Australian entity. Additionally, the Australian Government will have also likely incurred costs relating to this R&D expenditure through tax offsets under the R&D Tax Incentive regime.

---

<sup>5</sup> Australian Government. (2021, June 24). Claiming overseas R&D activities under the R&D Tax Incentive. <https://business.gov.au/grants-and-programs/research-and-development-tax-incentive/claiming-overseas-rd-activities#overseas-findings>. Date last accessed Aug 3, 2021.

<sup>6</sup> As mentioned in the Patent Box Discussion paper, In line with the OECD's Base Erosion and Profit Sharing (BEPS) Action 5 minimum standard, 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

Therefore, Kantara Consulting strongly suggests that qualifying R&D expenditure should include expenditure on R&D activities which need to be undertaken overseas, and that the criteria used to assess eligible overseas expenditure for the R&D Tax Incentive program should be adopted to assess that under the Patent Box regime.

### Administration and Compliance

Q26: What is the likely regulatory burden in relation to administrative, record keeping or evidentiary requirements required to access the Patent Box concession?

- **Recommendation 2: Broaden the eligibility requirement to include existing IP in addition to new IP, and in doing so, eliminate the current eligible start date of 11 May 2021.(Repeat of recommendation for Question 1)**

Recommendation 2 is also relevant to Question 26. The focus of the proposed Patent Box regime on solely new IP (priority date after 11 May) will likely introduce further complexity on how the regime will be applied as it is very common that the IP underpinning a drug or medical technology will involve many patents and patent families applied for at several different time points. Limiting the eligibility date will potentially exclude significant IP which the sector has developed to date and consequently those closer to commercialisation. It also provides no incentive for this potentially viable IP to remain in Australia.

Having too many restrictions of eligible IP will dramatically increase the compliance burden and extinguish any proposed incentives of the program as companies may find the regulatory burden to access the Patent Box concession to be too high. Thus, we strongly recommend to broaden the Patent Box tax policy to include both new and existing IP.

Q27: Are there design features of any existing Patent Boxes that, if adopted in Australia, would minimise the regulatory burden on companies?

- **Recommendation 4: Adopt the definition and compliance requirements for the Patent Box to replicate those of the R&D Tax Incentive, and limit restrictions of eligible IP where possible.**

For companies, the more the definition and compliance requirements (e.g., tracking of costs and definitions of R&D) replicate those for the R&D Tax Incentive, the easier it will be to minimise regulatory burden. Key aspects that will significantly increase the compliance burden and reduce of the incentive of Patent Box is the currently highly restrictive nature of what is considered eligible IP. Thus, we propose to adopt the definition and compliance requirements for the Patent Box to replicate those of the R&D Tax Incentive where practical, and to broaden the definition of eligible IP where possible.

### Other Considerations

Q29: Are there any other issues you would like to raise for consideration in the design of the patent box?

- **Recommendation 5: Adopt a refundable tax offset approach for SME's as already applies to the R&D Tax Incentive**

Kantara Consulting further recommends that the Patent Box regime should adopt a refundable tax offset approach for SMEs as per the R&D Tax Incentive to provide support to small companies in the early stages of their commercialisation journey (i.e. in tax losses). This will be key in ensuring the relevance and influence of the Patent Box regime for biotech SMEs who are often in tax losses for significant periods of time after a product is commercialised due to the long R&D timeframes. A refundable tax offset approach that aligns with that of the R&D Tax Incentive should not introduce any further complexity or integrity risks into the tax system.

## **Australia as a world leader for medical technologies**

Kantara Consulting would like to reiterate that we are very supportive of the introduction of an Australian Patent Box regime. To ensure that the regime is a powerful incentive for companies to develop and commercialise medical technologies in Australia, significant further review of the current policy design that acutely considers industry feedback is critical.

We strongly believe that addressing the key recommendations presented in this consultation paper will help establish the Australian Patent Box's success and drive the commercialisation of Australia's research in the medical and biotech sector. We are confident that doing so will propel Australia to help drive the Australian economy into an advanced, high knowledge-based one and create a sustainable, vibrant Australian medical and biotech industry.

## Appendix

**Table 1: OECD countries' 2020 Tax Rate Under Regime<sup>7</sup> and that which would otherwise apply for countries with peer review status listed as 'not harmful.'**

Country	Tax Rate Under Regime	Tax Rate that would otherwise apply	Potential reduction
Andorra (AND)	2.00%	10.00%	8.00%
Belgium (BEL)	3.76%	25.00%	21.24%
China (CHN)	15.00%	25.00%	10.00%
Curaçao (CUW)	0.00%	22.00%	22.00%
France (FRA)	10.00%	32.02%	22.02%
Hungary (HUN)	2.25%*	9.00%	6.75%
India (IND)	11.08%*	33.23%	22.15%
Ireland (IRL)	6.25%	12.50%	6.25%
Israel (ISR)	9.13%*	23.00%	13.87%
Korea (KOR)	10.94%	17.50%*	6.56%
Lithuania (LTU)	5.00%	15.00%	10.00%
Luxembourg (LUX)	4.99%	24.94%	19.95%
Malta (MLT)	0.00%	35.00%	35.00%
Mauritius (MUS)	0.00%	15.00%	15.00%
Netherlands (NLD)	7.00%	22.50%*	15.50%
Panama (PAN)	0.00%	25.00%	25.00%
Poland (POL)	5.00%	19.00%	14.00%
Portugal (PRT)	10.50%	21.00%	10.50%
San Marino (SMR)	8.50%	17.00%	8.50%
Singapore (SGP)	7.50%*	17.00%	9.50%
Slovak Republic (SVK)	10.50%	21.00%	10.50%
Spain (ESP)	10.00%	25.00%	15.00%
Spain(Basque Country) (ESP-PV)	7.80%	25.00%	17.20%
Spain(Navarra) (ESP-NA)	8.40%	25.00%	16.60%
Switzerland (All Cantons) (CHE-ALL)	11.8%	21.20%	9.40%
Thailand (THA)	5.33%*	20.00%	14.67%
United Kingdom (GBR)	10.00%	19.00%	9.00%
<b>Median</b>	<b>5.17%</b>	<b>22.50%</b>	<b>14.00%</b>
<b>Average</b>	<b>5.83%</b>	<b>25.04%</b>	<b>14.60%</b>

<sup>7</sup> OECD. (2020). Intellectual Property Regimes [Data file]. Retrieved from [https://qdd.oecd.org/subject.aspx?Subject=IP\\_Regimes](https://qdd.oecd.org/subject.aspx?Subject=IP_Regimes)  
 Please note that if countries had more than one tax regime rate, the average rate was used for ease of comparison. This applied for the existing corporate tax rate as well. These modified rates are identified by the use of an "\*".

**Table 2:** List of countries with Patent Boxes and existing patent inclusion as identified by Gaessler et. al (2021)<sup>8</sup>

Country	Includes existing patents
Belgium	Yes
Switzerland	Yes
Cyprus	Yes
Spain	Yes
France	Yes
UK	Yes
Hungary	Yes
Ireland	Yes
Liechtenstein	No
Luxembourg	Yes
Malta	Yes
Netherlands	No
Portugal	No

---

<sup>8</sup> Data accurate as of 2014