

## 10 FREQUENTLY ASKED QUESTIONS ABOUT PATENT BOXES

- 1. *What is a patent box?*** No, it's not a box companies put their patents in. A patent box is a tax incentive that allows business income from the sale of patented products to be taxed a lower rate than regular income.
- 2. *What kind of business income qualifies for the lower patent box tax rate?*** Most patent box nations allow income from more than just patented products to qualify. Some countries have gone further and established "innovation boxes" that allow income from designs, copyrights, models and trademarks to also be taxed at the lower patent box rate. And with the broadest definition of IP-sourced income, China extends its patent box to allow income from certain types of commercial "know-how", such as process innovation, to qualify for the lower rate.
- 3. *Why haven't I heard more about patent boxes?*** Patent boxes are relatively new. While Ireland was the first nation to develop a patent box in 1973, the seven other nations with them (Belgium, China, France, Luxembourg, Netherlands, Spain, Switzerland) all put them in place in just the last few years. And the UK is set to put theirs into play in 2013 with a tax rate of 10 percent from income of patented products, compared to the standard rate of 26 percent. (For reference, the U.S. federal corporate rate is 35 percent with state government corporate taxes making the effective rate even higher.)
- 4. *Why have so many nations adopted patent box regimes recently?*** Most nations with patent boxes established them in the mid- to late 2000s. They did so because they recognized that the race for global innovation advantage has heated up and that if they were to retain and grow innovation-based jobs, they needed to do more to make their countries attractive for innovation. Increasingly innovation is highly mobile as the talent and infrastructure to conduct innovation-based activities are available in many nations around the world. Because of this, these countries instituted patent box policies, plus a host of other innovation policies, including in most nations boosting government support for R&D.
- 5. *If a nation wants to better compete for innovation-based economic activities, why not just boost R&D incentives?*** R&D tax incentives are an important component of an effective national innovation strategy. Patent boxes differ from R&D incentives, though, because they provide firms with an incentive for commercialization of innovation, rather than just for the conduct of research. Commercialization of innovation, rather than the simple conduct of R&D, is a key driver of economic growth and jobs and therefore creating tax incentives linked to success at commercializing innovation is an important strategy for growth, competitiveness and job creation.
- 6. *Don't firms already have all the incentives they need to develop patented products and services?*** No they do not. Even after patenting and successfully commercializing an innovation firms are still unlikely to capture all the benefits of their patent in the form of profits. Economists have found that some, and in many cases, much of the benefits "spill over" to other firms and consumers. A patent box thereby, not only reduces the financial risk involved in innovation, it better matches firm rewards with societal benefits, thereby inducing firms to engage in more innovation.

## 10 FREQUENTLY ASKED QUESTIONS ABOUT PATENT BOXES (CONT.)

- 7. *Are patent boxes effective?*** Because most patent boxes have only been in effect for a few years, precisely answering this question is difficult. However, some data are available that allow, at minimum, a comparison between countries with and without patent boxes. Griffith, Miller and O’Connell analyzed the likely short-term effect of patent box regimes on the distribution and revenue from patents throughout Europe. They found that patent box policies do induce firms to patent more in the nations with the patent boxes. The data paint an unclear picture as to whether or not patent boxes are serving their intended purpose, to “attract R&D and increase commercialization of innovation from domestic firms.” One reason for this is that because of EU restrictions, the European nations have not linked the receipt of the lower tax revenues on income from patented products either to the conduct of R&D or the production of the product or service upon which the IP is based in the nation. If a patent box were designed in way that links the incentive to the conduct of R&D and/or production of the patented product it would go even further in spurring the creation of more innovation-based jobs.
- 8. *How does a patent box relate to more comprehensive efforts at corporate tax reform, including moving to a territorial system?*** The development of a patent box is quite consistent with efforts at more comprehensive corporate tax reform. It works effectively in a regime where global profits are taxed domestically (as is the case in the United States) or in a territorial system where only the profits earned domestically are taxed domestically. And it works in a system of lower rates and significantly reduced incentives, deductions and credits. Tax reform does not necessarily mean, nor should it, that the tax code eliminates all incentives. Rather, it should eliminate incentives that are not pro-growth and pro-innovation. The patent box is clearly pro-growth and pro-innovation. Finally, the patent box would lower the effective corporate tax rate for knowledge-based firms located in the United States, a key goal of any effective corporate tax reform effort.
- 9. *Isn’t this just corporate welfare?*** Corporate welfare is giving corporations something in return for nothing. If properly designed, a patent box is an incentive linked to a company innovating and/or producing in the United States, which produces jobs, most of them paying above the median wage level. Moreover, as long as the United States is in the race for global innovation advantage, policymakers have no choice but to provide a competitive environment in which firms will choose the United States as a home to their innovative activity, including production.
- 10. *Should the United States adopt a patent box?*** Yes, is the short answer. The United States is in the midst of a competitive crisis. Once the unquestioned world leader in cutting-edge technologies and high-value added manufacturing and services, today competitor nations are racing ahead at enhancing their innovation capacity while U.S. progress stagnates. In its report, *The Atlantic Century II: Benchmarking EU and U.S. Innovation and Competitiveness*, ITIF found that out of forty-four countries and regions, the United States ranks 4th in overall innovation-based competitiveness but 43<sup>rd</sup>, second from the last, in the rate of progress made over the last decade. A patent box would be one of a number of key steps policymakers can take to restore U.S. competitive advantage.