Patent Box - patent income to be taxed at only 10 percent in the UK

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Using the tax system to drive innovation is one of the key features of a pre-Budget report just released by the United Kingdom government. The report says a corporation tax rate of 10% will be applied from April 2013 to income from patents (a so-called "Patent Box"). That compares with the current UK company tax rate of 28 percent.

The report recognises that innovation is a key driver of productivity, and that an innovative economy will help keep the UK competitive in the global upturn. It says that research in the UK is increasingly being translated into commercial products and economic benefit, patent applications in the UK have doubled since 2000, and that 31 university spinout companies were launched between 2003 and 2007.

The Patent Box is intended to strengthen the incentives to invest in innovative industries and ensure the UK remains an attractive location for innovation. The UK Government says that it will consult with business on the detailed design of the Patent Box, which will apply to patents granted after the legislation is passed.

The Patent Box type approach is not new. Belgium, for example, introduced a maximum effective tax rate of 6.8% on patent income from the 2008 tax year.

The New Zealand Institute Discussion Paper 2009 "Standing on the shoulders of science" (1 December 2009) referred to the OECD observation that "...there is a risk of R&D tax competition among countries…". Strictly speaking, the Patent Box initiative may not be an R&D tax incentive, but it will undoubtedly incentivise R&D and encourage retention of ownership of patent protected intellectual property in the UK.

The New Zealand Government has recently removed R&D tax incentives for New Zealand companies. It may be time for that stance to be revisited and options such as the UK's proposed Patent Box approach introduced. The risk for New Zealand is that revenues from overseas licensing of New Zealand generated innovations will be transferred to other countries and that the incentive to conduct the research in New Zealand will be reduced.

On the presumption that the Patent Box initiative remains in place following the upcoming general election in the UK, New Zealand patent applicants should look at the option of basing IP ownership in the UK. This could be achieved by setting up an IP holding company in the UK, or those companies with UK subsidiaries could transfer ownership of their patent applications to that subsidiary. This, coupled with a strategy to delay grant of international patents until after the Patent Box legislation is passed, may allow them to take advantage of the 10% corporate tax rate. Setting up an IP Holding company based in Belgium may also be an alternative worth considering. The additional revenue retained could then be put into developing UK or European markets. While this would represent a loss for New Zealand, it may be a sensible business decision in the absence of an attractive New Zealand alternative.