



# Institute for Fiscal Studies



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## Corporate taxes and intellectual property

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# Corporate tax reform

- *Corporate Tax Reform: Delivering a More Competitive System*  
*HM Treasury (Nov 2010)*
  - competitive
  - stable – provide firms with certainty
  - avoid complexity & distorting firms' commercial decisions

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1. Potential refocusing of the research and development (R&D) tax credit
  2. Reforms to the Controlled Foreign Companies (CFC) regime
  3. Reductions in statutory corporate rates & increase in tax base
  4. Introduction of Patent Box

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1. Potential refocusing of the research and development (R&D) tax credit
  2. Reforms to the Controlled Foreign Companies (CFC) regime
    - rules defining how offshore income is taxed
    - intellectual property is an important aspect of the reform
  3. Reductions in statutory corporate rates & increase in tax base
  4. Introduction of Patent Box

# Corporate tax reform

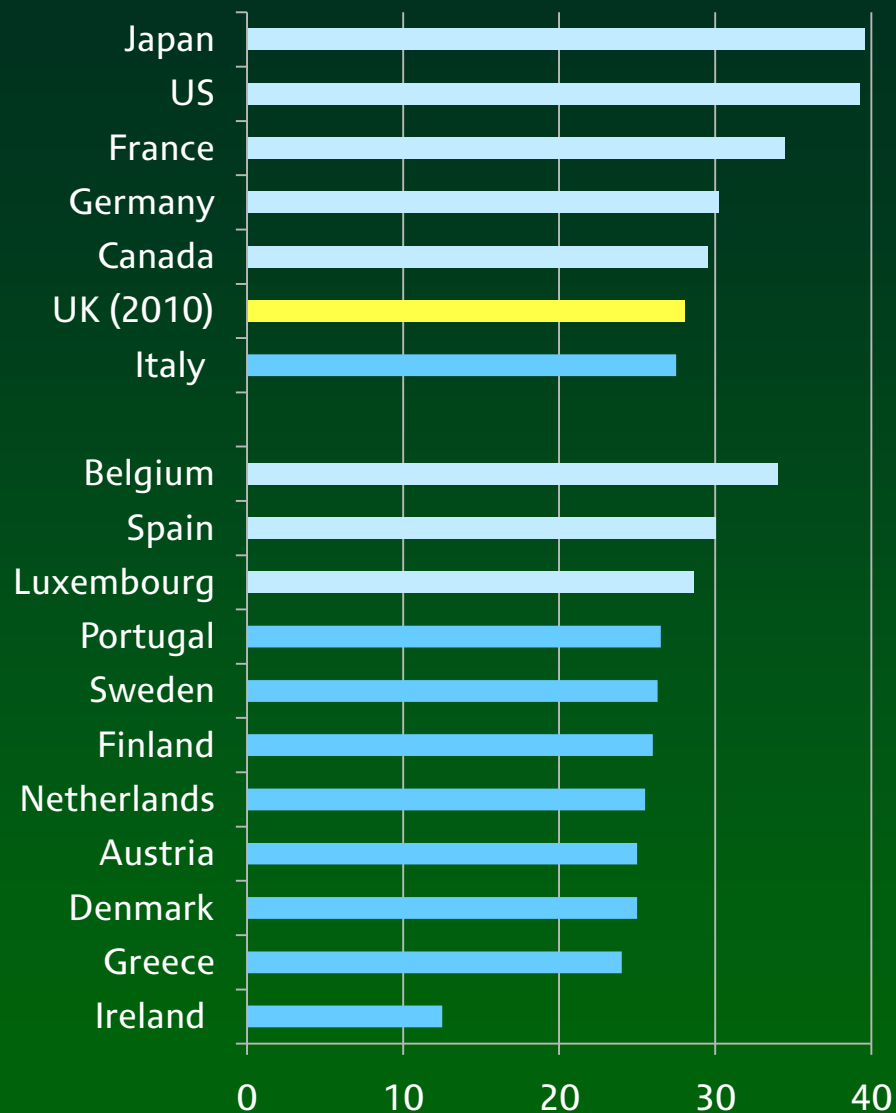
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    - main rate and small profits rate
  4. Introduction of Patent Box

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    - reduce rate corporate tax on income from patents to 10%

# Corporate rates and base

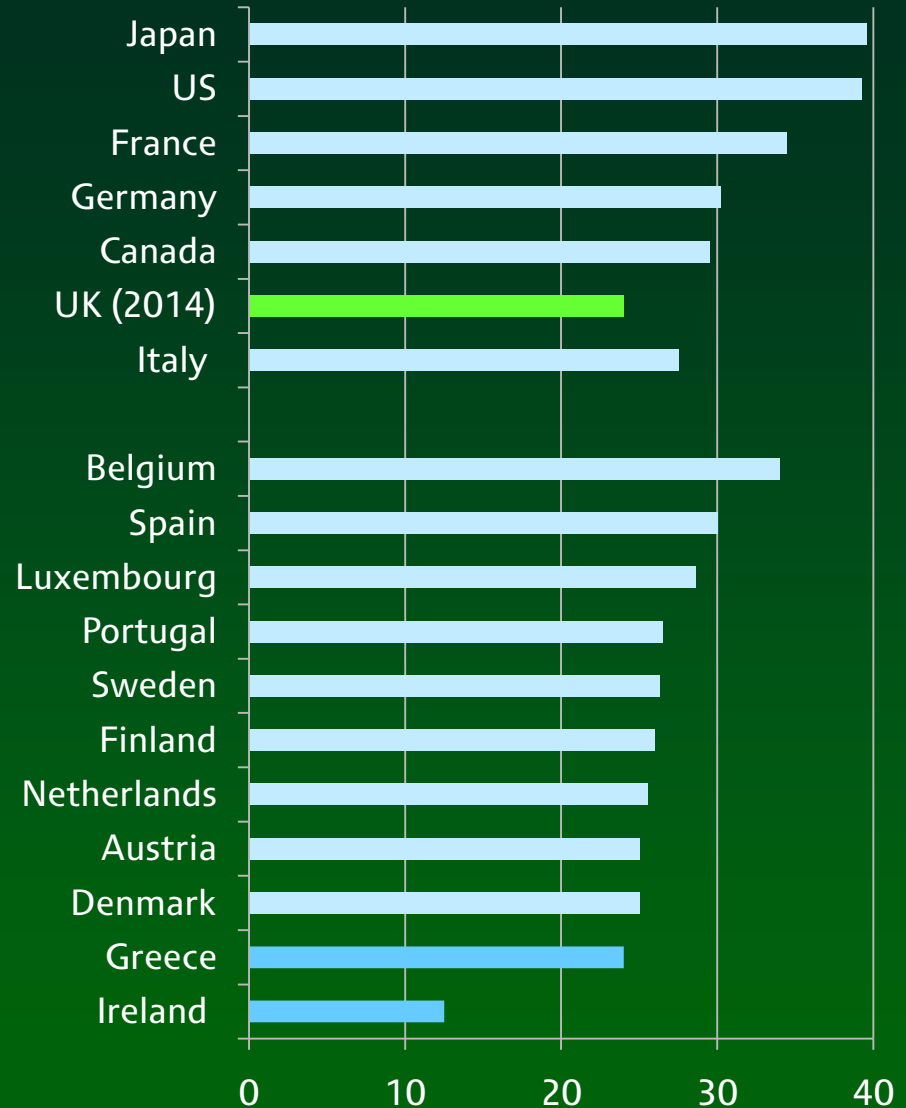
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# Corporate rates and base

- UK rate currently 28%
  - almost lowest in G7
- Reduced incrementally to 24% by April 2014



# Tax base broadening

- From April 2012,
  - main rate of capital allowances: 20% to 18%
  - special rate: 10% to 8%
  - Annual Investment Allowance: £100,000 to £25,000
- Package largely revenue neutral
  - winners: high-profit, low-investment firms
- In line with the trends across Europe in recent decades

# Small Profits Rate

- Applies to businesses with profits below £300,000 per year
- Currently 21%, to be reduced to 20% in April 2011
- Long standing incentive to be incorporated rather than unincorporated
  - distortion with respect to organisational form
- Uncertainty is undesirable
  - small companies' rate changed seven times since 1997

# Patent Box

- Reduces corporation tax rate to 10% for the income (net of development costs ) from patents
- Already in place in Benelux countries and Spain
- Under previous government aim was to encourage innovation
  - Patent Box poorly targeted at research (targets income)
  - distorts investment in patentable technologies
- Current government:
  - revenue
  - attract / retain activity

# Revenue impact

- Government forecast - £1.1 billion a year revenue loss
  - includes effect of UK becoming more attractive location for patents
- Large deadweight cost (since subsidising activity that would have occurred anyway)
- Large benefits to handful of firms
- Effects on general corporate tax revenues?
  - increase tax revenue from other activities relating to patents
  - differentiate tax on mobile income

# Making the UK an attractive location for IP

- Q. Will a Patent Box succeed in preventing firms holding real activity offshore?
- Depends crucially on the extent to which firms co-locate intellectual property and real activities
  - there can be both commercial and tax motivated reasons for doing so
  - firms can and do separate IP from real activity
    - legislation will not be able to specify that research took place in the UK
- and is it the best policy mechanism?
  - why not target activity directly?
  - other factors (inc services funded from taxation) attract firms

# Practically

- Implementation difficult
  - which patents are eligible
  - how to measure the income derived from patents
- Add significant complexity

# Summary

- Welcome that ‘road map’ sets out how corporate taxes will be reformed over next 5 years
  - corporate tax rates lowered & base broadened
  - CFC reform to produce a more territorial system
  - to reduce the tax burden on income derived from intellectual property
- Package of reforms has some unwelcome characteristics
  - small profits rate will continue to distort decisions over organisational form
  - Patent Box will significantly increase complexity, distort investment in patentable technologies, and is poorly targeted at research activity