Corporate taxes and intellectual property

Rachel Griffith and Helen Miller
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
Corporate tax reform

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
Corporate tax reform

- *Corporate Tax Reform: Delivering a More Competitive System*
  *HM Treasury (Nov 2010)*

1. Potential refocusing of the research and development (R&D) tax credit
   - certainty is important

2. Reforms to the Controlled Foreign Companies (CFC) regime

3. Reductions in statutory corporate rates & increase in tax base

4. Introduction of Patent Box
Corporate tax reform

- *Corporate Tax Reform: Delivering a More Competitive System*
  
  *HM Treasury (Nov 2010)*

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

• *Corporate Tax Reform: Delivering a More Competitive System*
  *HM Treasury (Nov 2010)*

1. Potential refocusing of the research and development (R&D) tax credit

2. Reforms to the Controlled Foreign Companies (CFC) regime

3. **Reductions in corporate rates & increase in tax base**
   - main rate and small profits rate

4. Introduction of Patent Box
Corporate tax reform

- *Corporate Tax Reform: Delivering a More Competitive System*
  *HM Treasury (Nov 2010)*

1. Potential refocusing of the research and development (R&D) tax credit

2. Reforms to the Controlled Foreign Companies (CFC) regime

3. Reductions in corporate rates & increase in tax base

4. **Introduction of Patent Box**
   - reduce rate corporate tax on income from patents to 10%
Corporate rates and base

• UK rate currently 28%
  – almost lowest in G7
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