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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 and communicate what they do to Government as well as 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 tax regime, directed towards the Australian biotech industry could be a real driver of greater commercialisation of biotech inventions in Australia. However, to be effective, Kantara Consulting believes that key changes which take into account industry feedback will need to be addressed in the proposed patent box policy design as ultimately, the success of the patent box regime hinges on its policy design features that can support the Australian biotech industry.

Kantara Consulting strongly believes that the proposed patent box regime is rather restrictive and does not create sufficient incentive for the Australian biotech sector, and as drafted will have little, if any impact. It is useful to note that recent findings[1] reveal that Australia's currently trails behind other developed economies for provision of incentives for research. Crucially, the proposed restrictions completely abandons the Intellectual Property (IP) that the sector has developed to date and provides no incentive for this potentially viable IP to remain in Australia.

Australia already does excellent research and early stage development but what we don't do as well unfortunately, is great prolific commercialisation of this research. This is the missing piece we need to build the critical mass of commercially viable companies in Australia. To truly be a world leader in R&D, we need to drive commercialisation *today*. As such, the focus and success metric should not be on how much new R&D is generated, but how much *commercialisation* is generated. That is Australia's critical need and the part of the value chain that needs support and needs to reach a critical mass so as to create a sustainable, vibrant Australian biotech industry.

Accordingly, to propel the international competitiveness of Australian innovation, Kantara Consulting proposes the following key recommendations listed overleaf and will delved deeper into these recommendations in the Discussion section of this response.

[1] Rassenfosse, G.D. (2015). Patent box policies.

Kantara Consulting's Five Key Recommendations

Recommendation 1: To **lower the concessional tax rate** to be comparable to the median in other jurisdictions.

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

Recommendation 3: Access to the regime should be **aligned with the related ANZIC categorie**s and should be used **product by product**.

Recommendation 4: The substantial activity requirement for the patent box should **replicate the R&D Tax Incentive**, and **companies should not need to reduce their R&D fraction by amounts spent on overseas R&D where key requirements are met**.

Recommendation 5: Standardise 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.

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: To lower the concessional tax rate to be comparable to the median in other jurisdictions.**

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% for the likely company tax rate of 25%.

A quick 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[2]. 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 tax rate under the regime[3] 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 (for e.g. only new IP) and high compliance burden makes it unlikely to incentivise commercialisation to remain 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 at least the median of other jurisdictions (5.17%), so as to be comparable.

Existing IP

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

Existing IP should be included in addition to new IP so as to take into account the lengthy and complex commercialisation pathway typical of the biotech sector. The current eligibility requirements (only priority date after 11 May as eligible) ignores the fact that in the medical and biotechnology sector, there is usually a lag of 4 to 5 yeas before the earliest profits can be seen. In fact, it is not uncommon to see commercialisation benefits only after 10 years as the patent grant application process itself could take several years.

Additionally, 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 involves many patents and patent families applied for at several different time points. We explore this complexity further in Question 26.

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[2] See Appendix for more details.

[3] 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.

We note that including existing IP is a common characteristic of overseas patent box regimes[4] [5]. Existing patents are included in many other comparable jurisdictions including the UK, Belgium, Switzerland and France. See Table 2 for a list of countries with patent boxes and whether or not they include existing patents, as identified by Gaessler et. al (2021).

In the UK for instance, one of the aims of the patent box is to provide additional incentive for companies to increase the level of patenting of IP developed in the UK, and to ensure that new and existing patents are further developed and commercialised in the UK[6]. In line with this, patent applications in the UK are not qualifying IP rights, but when the patent applications are granted, they become qualifying IP rights, and the patent box tax *reduction can be applied retrospectively* to profits earned in accounting periods up to six years before the grant, provided that the company elected into the patent box for those accounting periods[7][8].

It is also useful to note that some research[9] has suggested that patents are found to be more sensitive to the tax advantages offered by patent boxes when these have a large coverage in terms of the types of IP covered and when they grant their benefit to *pre-existing patents,* acquired patents, and/or embedded royalties. This makes intuitive sense.

Unfortunately, given what the legislation is proposing now, which is to limit eligible IP to only new IP, 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 tax regime. 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 might consequently lead to the erosion of the domestic tax base and/or loss of skilled job creation and local growth in the biotech sector.

Therefore, our key recommendation is to broaden the eligibility criteria to include both existing and new R&D. Doing so will incentivise biotech companies to further develop and commercialise existing Australian IP that have been granted patents, 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 start ups to develop and grow.

Targeting medical and biotechnology

Q4: What is the best approach to provide certainty around access to the regime for the medical and biotechnology sectors?

- **Recommendation 3: Access to the regime should be aligned with the related ANZIC categories and should be used product by product.**

Targeting of the regime to the to the medical and biotechnology sectors should be aligned with the related Australian and New Zealand Standard Industrial Classification (ANZIC) categories. This approach enables IP that may have been patented and categorised for another area (i.e. software,

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[4] Fabian Gaessler & Bronwyn H. Hall & Dietmar Harhoff, 2021. "Should there be lower taxes on patent income?," Research Policy, vol 50(1).

[5] 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.

[6] https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/921792/2020_Patent_Box_Publication_-_accessible.pdf

[7] https://www.aathornton.com/current-summary-uk-patent-box-regime/

[8] https://www.boult.com/bulletins/uk-patent-box/

[9] 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.

agriculture, etc.) to benefit from the regime where the revenue generated from the commercialised product has a medical application.This application should also be used product by product in recognition that a company may have a range of products in slightly different fields.

Applying the substantial activity requirement

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

- **Recommendation 4: The substantial activity requirement for the patent box should replicate the R&D Tax Incentive, and companies should not need to reduce their R&D fraction by amounts spent on overseas R&D where key requirements are met.**

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. Local development conditions that are put in place will no doubt incentivize this.

However, at the present time, the Australian biotech industry faces significant constraints when undertaking R&D. Currently, the industry is relatively immature as it lacks some key facilities. It is also small; clinical trials often need to be done overseas to get sufficient recruitment numbers. Additionally, IP in the biotech sector is often developed in collaboration with overseas partners. To address these constraints, the Australian R&D Tax Incentive already recognises that not all aspects of the R&D process can be done in Australia, especially considering our size and lack of specialised R&D infrastructure.

Thus, the substantial activity requirement should then replicate the R&D Tax Incentive requirements. Companies should not need to reduce their R&D fraction by amounts spent on overseas R&D where

- The Australian entity owned all IP generated from the overseas activity
- The Australian entity demonstrated that they could not undertake the activity in Australia (as per the Advanced Overseas Finding process[10])
- The overseas expenditure was less than the Australian R&D expenditure (as per the Advanced Overseas Finding criteria)

Most importantly, the inclusion of overseas R&D activities which meet the requirements of the R&D Tax Incentive Overseas Finding requirements would not be in breach of the agreed nexus approach. This is because under the requirements of the Advanced overseas finding regime, the Australian entity is incurring the costs. Additionally, the Australian Government will have also likely incurred the costs of this R&D expenditure as a result tax incentive under the R&D Tax Incentive regime.

Therefore, Kantara Consulting strongly suggests that the substantial activity requirement for the patent box should replicate the R&D Tax Incentive and companies should not need to reduce their R&D fraction by amounts spent on overseas R&D where key requirements are met.

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 eligibility requirement to include existing IP in addition to new IP, and in doing so, to 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

[10] https://business.gov.au/grants-and-programs/research-and-development-tax-incentive/claiming-overseas-rd-activities#overseas-findings

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 5: Standardise 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 though that will significantly increase the compliance burden and delete any incentives that the program may potentially bring are that there are too many restrictions for eligible IP currently. Thus, we propose to standardise the definition and compliance requirements for the patent box to replicate those of the R&D Tax Incentive, and to limit restrictions of eligible IP where at all possible.

Further questions for the Australian Box Design

- It will also be crucial for industry to understand what exactly is patentable? For instance, are clinical trials patentable, and if not, is that included in the R&D Expenditure?
- How will the patent box policy take into account the multiple patents to contribute to a product? This is relevant to Question 22.
- Would it work to have a refundable regime for SMEs?

Australia as a world leader for biotech R&D

To conclude, Kantara Consulting would like to reiterate that we are very supportive about the introduction of the Australian Patent Box regime. To ensure the success of the Australian patent box as a powerful incentive for companies to develop and commercialise medical technologies in Australia though, a well thought out policy design which thoroughly takes into account feedback from industry stakeholders is key.

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 biotech sector. We are confident that doing so will propel Australia to become a world leader for biotech research and development.

Appendix

Table 1: 2020 Tax Rate Under Regime[11] and that which would otherwise apply for OECD countries with 'not harmful' peer review status.

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%
Median	**5.17%**	**22.50%**	**14.00%**
Average	**5.83%**	**25.04%**	**14.60%**

[11] 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) [12]

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

[12] Data accurate as of 2014