

Review of Federal Support to Research and Development

Submission by the
Intellectual Property Institute of Canada

February 18, 2011



INTELLECTUAL PROPERTY INSTITUTE OF CANADA
INSTITUT DE LA PROPRIÉTÉ INTELLECTUELLE DU CANADA

“Canadians enjoy an enviable standard of living, but sustaining our prosperity will depend on maintaining economic competitiveness in an increasingly challenging global context.”

Review of Federal Support to Research and Development
Expert Panel Consultation Paper

Introduction

Competing in today’s world of intellectual property is increasingly challenging.

The Intellectual Property Institute of Canada (IPIC) is pleased to respond to the consultation by the Expert Review Panel on Research and Development. In this submission we provide four specific recommendations to increase the competitiveness of Canada’s intellectual property (IP) framework and thus encourage business research and development.

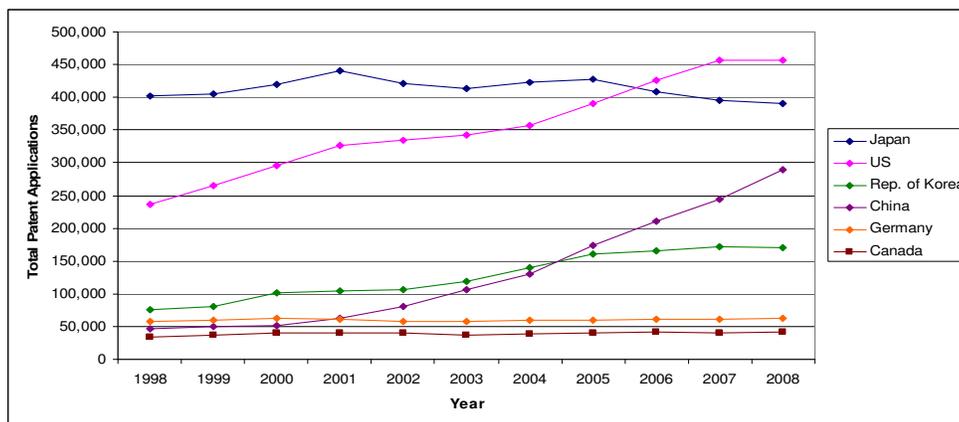
As the Panel states in its Consultation Paper, one of the principal factors that influence a business’s decision to compete on the basis of innovation is the country’s IP framework. The Canadian Intellectual Property Office (CIPO) explains, in its strategic plan, that “[i]n recent years, IP has taken on a much more significant role in the economy, where the effective use of knowledge is a decisive determinant of business success. Innovators are making IP protection decisions in the context of an increasingly global marketplace. Indeed, IP rights are increasingly becoming the ‘currency’ that businesses use to secure competitive advantage in the global marketplace.”¹

A competitive economy that encourages companies to invest in R&D and commercialize new products requires a robust intellectual property (IP) system. However, a strong IP framework alone will not suffice if it is not internationally competitive. In its “Action Plan for Prosperity”, the Coalition for Action on Innovation in Canada recommends that Canada “adopt the world’s strongest IP regime” and “seize current opportunities to improve its protection of intellectual property and thereby create a more attractive environment for investment in innovation.”²

Are we competitive?

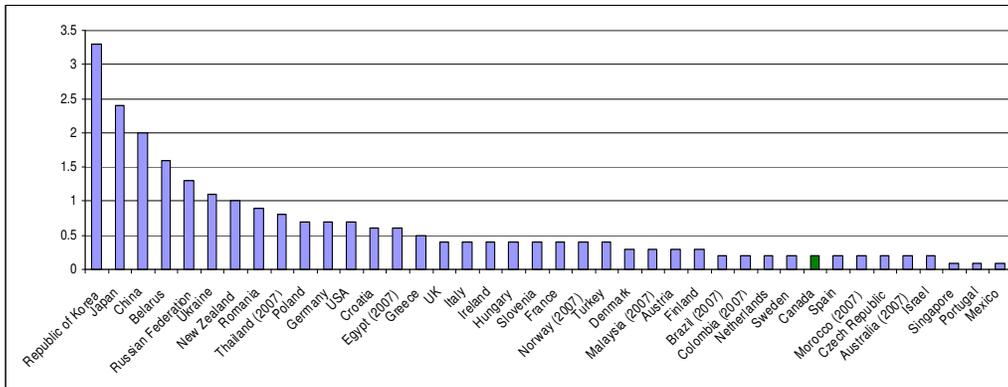
As shown in Figure 1, in 1999, Canada, Germany, Korea and China were relatively close in terms of number of patent applications in comparison with the US and Japan. Ten years later, however, while Canada and Germany kept a relative pace, Korea’s applications more than doubled, and Chinese applications experienced exponential growth: a 479% increase over the same time period.³

Figure 1: Total Patent Applications, Top 5 Countries and Canada, 1999-2008⁴



Further statistics from the World Intellectual Property Organization (WIPO) show that Canada is 24th in resident patent filings per R&D expense⁵. Although part of this situation may be explained by Canadian companies that file applications outside, but not in Canada, it does raise concerns because the ultimate goal of business R&D is commercialization and to profit from the R&D.

Figure 2: Resident Patent Applications per \$million R&D Expenditure⁶



The members of IPIC have a unique perspective on Canada's IP regime and how it compares to those of other countries around the world. IPIC is the professional association of patent agents, trademark agents and lawyers practicing in all areas of intellectual property law. Our membership totals over 1,700 individuals, consisting of practitioners in law firms and agencies of all sizes, sole practitioners, in-house corporate IP professionals, government personnel, and academics. Our members' clients include virtually all Canadian businesses, universities and other institutions that have an interest in IP (e.g. patents, trade-marks, copyright, and industrial designs) in Canada or elsewhere, and also foreign companies who hold intellectual property rights in Canada.

IPIC recommends that the Government of Canada:

- Enhance the scope of the SR&ED Program to include patenting costs as eligible expenses;
- Consistently apply the law regarding patentable subject matter to reduce uncertainty that can affect R&D investment decisions;
- Provide protection for confidential communications between clients and their patent and trade-mark agents; and
- Amend IP legislation and/or regulations to prevent inadvertent loss of patents and other IP rights in cases of exceptional circumstances.

These recommendations are aligned with the work of two previous expert panels. In 2006, the Expert Panel on Commercialization stated: "We recognize there are many potential explanations for the relatively weak state of Canadian private sector investment in R&D, including a lack of competitive pressures, the effects of Canada's tax system on corporate decisions, and the effects of the country's regulatory and intellectual property regimes."⁷ In 2008, the Competition Policy Review Panel recommended: "56. The federal government should monitor the scientific research and experimental development tax credit program annually in order to ensure that business investment in research and development and innovation in Canada is effectively encouraged." And "57. (...)The federal government should assess and modernize the Canadian patent and copyright system to support the international efforts of Canadian participants in the global economy in a timely and effective manner."⁸

Furthermore, in accordance with the Panel's mandate that recommendations not result in an increase or decrease to the overall level of funding, three of the recommendations require no funding. The expansion of the SR&ED may generate additional tax credits but since the goal is to facilitate commercialization, the cost should be recuperated through increased income tax.

IPIC believes that implementation of these recommendations will promote business R&D and promote commercial R&D arrangements in Canada. We now explain these recommendations.

Recommendation 1: The Government of Canada should enhance the scope of the SR&ED Program to include patent costs as eligible expenses.

The creation of technological innovations arising from research and development activities in Canada is financially supported by the SR&ED tax credit program (the Program). To capture the full potential of those technological innovations, the Program should also support the acquisition of intellectual property, and in particular patents, which:

- can provide significant competitive advantage;
- assist in facilitating transactions required on the path from research to commercialization; and
- will increase the Program's return to the Canadian economy on the taxpayers' investment.⁹

In general, with the possible exception of prior art searches, costs related to the acquisition, preservation, enforcement or commercialization of patents do not currently qualify as eligible expenses under the Program. However, even when owners of technological innovations recognize the value of IP rights, and in particular patents, the costs to secure these rights can be a deterrent. Companies with limited financial resources may decide not to protect, or to delay in protecting, their innovations.¹⁰ Patent law rewards the early protection of such innovations by the filing of patent applications; serious penalties can arise from filing delays, such as the awarding of a patent to a competitor or the barring patent of protection altogether. It is vital to encourage owners of such innovations to seek a patent sooner rather than later. Furthermore, a good idea that is properly secured can still be commercialized even if the original innovator fails and exits the marketplace; in such circumstances the intellectual property can be resold or re-licensed to a more successful entity for another chance at commercialization.

An increasing number of jurisdictions around the world are subsidizing patent costs to stimulate innovation.¹¹ In the US, "research & experimental expenditures" may be treated as an expense under IRC § 174, and receives specialized tax treatment which amounts to a credit or subsidy. The IRS has construed the term "research & experimental expenditures" to include all the costs required to perfect a patent right. Although not directly analogous to the Canadian SR&ED tax incentives, the US system does provide tax related subsidies for research expenditures that include patenting costs.¹² Various US States, including California, piggy-back on the federal system to offer further tax incentives.¹³

At least Belgium¹⁴ and France¹⁵ have research and development support programs that are believed to be similar to Canada's Program. However, the Belgian and French programs appear to include financial assistance/tax credits relating to certain types of patent costs. India and Japan also provide direct subsidies of patent costs for qualifying applicants¹⁶, instead of providing tax credits or deductions. Chinese companies that file foreign patent applications receive a grant of approximately \$8,000 USD.¹⁷ The UK is currently holding a national consultation on the "patent box", an initiative that would significantly reduce corporate tax on income from IP, namely, patents, giving further incentive for companies to protect their IP in that region and commercialize their innovations.¹⁸ The UK government's consultation paper is attached as Appendix A.

Given that some of Canada's most important trading partners, including the US, China and India, have adopted subsidies that include patenting costs, Canada needs to take steps to remain a competitive place to conduct research and invest in technology. With respect to China specifically, in addition to having to compete against very low costs of labour and manufacturing, the significant improvements that China is making to its IP system will force Canadians to compete against the increased intellectual property clout of Chinese companies.

South Korea is another country that has created an IP system that significantly encourages innovation. The Korean Development Institute, in a study cited at a WIPO seminar on IP strategy for economic development, indicates that "an increase of 1% in national patent applications correlates with an increase of 0.11% in national growth within three to five years."¹⁹

Of note, two incentive programs in Canada cover some patenting costs. In Québec, the Ministère du Développement Économique, de l'Innovation et de l'Exportation (MDEIE) operates a financial

assistance program intended to further the development of technology and innovation in Québec. The MDEIE program provides financial assistance for expenditures that include the costs leading up to the filing of a patent application. The Atlantic Canada Opportunities Agency (ACOA) provides funding for research and development of initiatives through the Atlantic Innovation Fund (AIF). The AIF does cover a portion of patent costs, and legal fees for patent searches and patent filings.

The Program's return to the Canadian economy on its investment could be significantly increased by encouraging those involved in creating innovations to also secure patent rights, where appropriate. To fully encourage the realization of this higher-value output, the Program should explicitly include costs associated with obtaining patents as eligible expenses.²⁰

Recommendation 2: To reduce uncertainty that can affect R&D investment decisions, the Government of Canada should consistently apply the law regarding patentable subject matter.

Advances in productivity are based on innovation and the spread of knowledge of such innovation. The *Patent Act* exists for precisely that two-fold purpose: innovators are provided with the incentive to share knowledge of their innovations with the public in return for an exclusive, time-limited right to reap the benefit of those innovations.

The private sector invests in research and development in the hope of commercial benefit. One of the means by which individuals and companies seek to protect that investment is to seek a patent for innovations arising from their R&D. The types of innovations eligible for patent protection world-wide play a significant role in R&D investment decisions.

In his June 25, 2010 speech at the G-20 Summit, Minister of International Trade Peter Van Loan called Canada "a modern and innovative business destination", and said "Canada offers an environment where innovators can create, businesses thrive and investors succeed."²¹ However, in recent years the Canadian Intellectual Property Office (CIPO) has adopted policies that appear at odds from this view, excluding from patentability, as a class, all innovative business methods as well as certain other information-based innovations²². These broad exclusions appear to lack support in Canadian law.

IPIC is concerned that the uncertainty created by CIPO's policies on what is proper subject matter for a patent increases the cost, and risk, of conducting business for innovators and their competitors alike. The public has a right to know where it can, and cannot, tread. It would be an odd result if patent applicants who could afford appeals to the Federal Court of Canada were to have patentability assessed on one standard, while those with fewer resources were assessed on another. This uncertainty does not aid in fostering an economic climate suitable for encouraging business innovation, and would appear to be inconsistent with Canada's long term economic public policy objectives.

Notably, in Canada's most important trading partner, while apparently drawing-back from the perhaps over-exuberant statements of patentability in earlier court decisions²³, the U.S. Supreme Court has recently ruled²⁴ that business methods are not ineligible for patent protection merely by virtue of being business methods

The current interpretation of statutory subject matter by CIPO is unsupported by Canadian jurisprudence. Moreover, recently, the Federal Court has criticized CIPO's position and has expressly stated that there is no blanket exclusion for business methods in Canada, there is no requirement that an invention be "technological", and that there is a requirement for practical application, rather than a requirement for physicality.²⁵

We therefore recommend that the Government of Canada return to granting the full scope of patent protection provided by the *Patent Act* on the basis of sound legal principles and binding legal precedent, with the objective of establishing and maintaining a stable, predictable legal regime for the protection of inventions.

Recommendation 3: The Government of Canada should provide protection for confidential communications between clients and their patent and trade-mark agents in order to align Canada with the legislative and business standards of its trading partners.

Clients disclose confidential information to agents in the normal course of considering IP protection, drafting applications, and discussing rights between applicants and third parties. Contrary to the situation in most other major economic jurisdictions, confidential communications between a client and his/her Canadian patent or trade-mark agent are not protected from disclosure in litigation. This results in holders of Canadian patents and trade-marks being at a very serious disadvantage if they are involved in litigation in Canada or elsewhere. This issue alone may discourage innovators from filing in Canada.

Communications between clients and registered patent and/or trade-mark agents are protected by legislation or treaty in Australia, the European Patent Organization (34 member states), France, Germany, Japan, the Netherlands, New Zealand and the United Kingdom. US courts have recognized privilege for communications with an agent from another country, but only if those communications are protected from disclosure in that country.²⁶

In its book “Open Innovation in Global Networks,²⁷” the OECD states that “confidentiality and exclusivity agreements are central to partnerships” and that “the main barrier to internationalization of R&D [is] the risk of leakages of information and proprietary knowledge”. For Canadian businesses to be on a level playing field with their foreign counterparts- and with their own parent organizations and affiliates- and for Canada to be attractive to foreign R&D investments, we recommend that confidential communications between patent and trade-mark agents and clients be protected by law here as they are elsewhere.

Recommendation 4: The Government of Canada should amend IP legislation and/or regulations to prevent inadvertent loss of patents and other IP rights in cases of exceptional circumstances.

The current inflexibility of IP legislation in Canada can cause a person or organization to lose the right to a patent or trade-mark for reasons that have nothing to do with the fundamental principles of the IP system. This issue was brought to light to Canadians and foreign rights owners in recent events.²⁸ For example, in 2003, a power outage in Ontario caused at least one company to lose IP rights because it was impossible for Toronto agents to meet a deadline with CIPO. Although the United States had all the mechanisms in place to avoid any loss of rights during the blackout, Canada did not. This issue, which affects patents, trade-marks, industrial designs and copyright, has not yet been resolved. This is cause for concern as another disruptive event, natural or otherwise, can happen anytime.

The concerns by Canadian and foreign innovators and investors about the potential loss of patent and other IP rights for such exceptional reasons can be a disincentive to file for IP protection in Canada and can harm the perception of Canada’s innovation environment. We recommend that the Government amend IP legislation and/or regulations to address these concerns.

We thank the Expert Review Panel on Research and Development for the opportunity to provide comments. IPIC believes that implementation of these recommendations will promote business R&D and promote commercial R&D arrangements in Canada. This submission was prepared by members of IPIC’s Emerging Issues Committee, IT Committee, Biotechnology Patents Committee and Patent Legislation Committee, and was reviewed and approved by IPIC’s governing Council.

We would be pleased to meet with the Panel to discuss our recommendations. If we may be of further assistance or offer clarification, please do not hesitate to contact our executive director, Michel Gérin, at 613-234-0516 or mgerin@ipic.ca.

¹ Canada. Industry Canada. *Moving Forward to Canada's Advantage: Strategic Plan 2007-2012*. 2007.

² Coalition for Action on Innovation. *An Action Plan for Prosperity*.

http://www.acctcanada.ca/Documents/Coalition_for_Innovation_2010_report.pdf

³ World Intellectual Property Organization. *World Intellectual Property Indicators 2009*. WIPO Publication No. 941 (E)

⁴ World Intellectual Property Organization. *World Intellectual Property Indicators 2009*. WIPO Publication No. 941 (E)

⁵ World Intellectual Property Organization. *World Intellectual Property Indicators 2010*. WIPO Publication No. 941 (E)

⁶ World Intellectual Property Organization. *World Intellectual Property Indicators 2010*. WIPO Publication No. 941 (E)

⁷ Canada. Expert Panel on Commercialization. *People and Excellence: The Heart of Successful Commercialization*. 2006.

⁸ Canada. Competition Policy Review Panel. *Compete to Win*. 2008.

⁹ There is growing evidence that R&D tax incentive programs have an impact on where companies choose to do their research and development. See: HM Revenue and Customs. "An Evaluation of Research and Development Tax Credits." Online: <http://hmcrc.gov.uk/research/report107.pdf>

¹⁰ In 2009, Industry Canada, Foreign Affairs and International Trade Canada and Statistics Canada embarked on a joint project called the Survey of Innovation and Business Strategy (SIBS) to "understand the market and policy factors that encourage or discourage the adoption of entrepreneurial and innovation-oriented business strategies". See: http://www.ic.gc.ca/eic/site/eas-aes.nsf/eng/h_ra02115.html. Of particular note, those surveyed in the manufacturing sector in Canada cited "internal financing" as the second most common obstacle to innovation. Providing tax credits is a very straightforward way to increase internal funding of any organisation. Obtaining intellectual property protection was listed as the seventh most common obstacle, suggesting that Canadian firms did not generally have a problem obtaining the intellectual property rights sought (whether through patents or through the licensing of third party technology) once those rights were identified as important. See: <http://www.ic.gc.ca/eic/site/eas-aes.nsf/eng/ra02097.html>.

¹¹ Guribqbal Singh Jaiya and Christopher M. Kalanje. "Managing Patent Costs." World Intellectual Property Organization. Online: http://www.wipo.int/sme/en/documents/managing_patent_costs.htm. This article contains additional examples of funding models used around the world to subsidize patent costs.

¹² See US IRC § 41(d)(1)(A) and IRC § 174, and US Treas. Reg. § 1.174-2. "Expenditures incurred in connection with the taxpayer's trade or business which represent research and development costs in the experimental or laboratory sense. The term includes all such costs incident to the development or improvement of a product. The term includes the cost of obtaining a patent, such as attorneys fees expended in making and perfecting a patent application."

¹³ See California Revenue and Taxation Code sections 17052.12 and 23609. Online: <http://www.ftb.ca.gov/businesses/credits/rd/seventests.shtml>

¹⁴ http://www.proinno-europe.eu/docs/reports/documents/Country_Report_Belgium_2006.pdf

¹⁵ See generally, <http://media.education.gouv.fr/file/42/6/20426.pdf>, <http://media.education.gouv.fr/file/42/0/20420.pdf>, <http://media.education.gouv.fr/file/42/4/20424.pdf> and http://www.proinno-europe.eu/docs/reports/documents/Country_Report_France_2006.pdf at 39

¹⁶ See <http://english.peopledaily.com.cn/90001/90778/90862/6782417.html> for a summary of recent changes to the Chinese support subsidies, which are generally applicable to foreign applications only. See http://www.kantei.go.jp/foreign/policy/titeki/kettei/050610_e.pdf at pages 96 and 97 regarding Japanese support. See also http://www.indextb.com/pdf/gr_4.pdf at section 7.0 entitled, "Patent registration" for support provided by the State government of Gujarat in India.

¹⁷ As cited by the Chartered Institute of Patent Attorneys, UK: <http://www.cipa.org.uk/pages/press/article?7F2048E8-DD95-47D4-A950-9ED13254C998>

¹⁸ Some jurisdictions are considering other methods to subsidize patent costs apart from tax credits. The UK is considering lowering taxation rates on net income derived from patents. Patent royalties would be taxable at a rate of 10% instead of the regular tax rates. There are a number of other jurisdictions that have lowered the rates on patent royalties as well, to encourage innovative businesses to reside there. See UK Treasury: Patent Box. Online: http://www.hm-treasury.gov.uk/consult_patent_box.htm. A number of other countries have preferential tax rates for royalty income. Up until recently, Ireland has a 0% tax rate on patent royalties.

(<http://www.mazars.ie/Home/News/Latest-News/Patent-Royalty-Structures-Post-Finance-Bill-2011>). Belgium allows a company to deduct from their Belgian taxable base 80% of the patent royalties resulting from R&D performed by the company (see http://www.twobirds.com/English/News/Articles/Pages/Belgium_tax_exemption_patent_royalties.aspx). Luxembourg and the Netherlands also have comparatively low tax rates for IP royalties. (See also <http://www.newenergyworldnetwork.com/alternative-energy-analysis/intellectual-property-becomes-taxing-issue-for-cleantech.html>.)

¹⁹ Jong-Hyub Choi, *Theme II: Creator Management and Use of IP-An Integrated and Proactive IP Policy and Strategy 2*, at WIPO Asia Pacific Regional Seminar on Intellectual Property (IP) Strategy for Economic Development, WIPO Doc. WJPO/IP/KUL/03/3 (Nov. 2003).

²⁰ IPIC's Specific Proposal: that eligible expenses under the Program be extended to cover the following:

1. Costs associated with prior art searching and preparing an original patent specification;
2. Costs associated with filing an initial patent application in a Patent Office utilizing the prepared original patent specification;
3. Costs associated with filing one or more patent application(s) corresponding to initial patent application (as per item 2 above) in additional foreign jurisdictions;
4. Costs associated with prosecuting (the activities associated with advancing a patent application towards the issuance of a patent) and maintaining (attending to the payment of government maintenance / renewal fees) the applications filed pursuant to items (2) and (3) above;

Costs associated with appeals, re-examination, conflict and re-issue proceedings; that are paid to a governmental authority or to Canadian intellectual property services firms (such as Canadian patent agents).

²¹ “Minister Van Loan Promotes Canadian Economy and Technologies at G-20 Summit”

http://www.international.gc.ca/media_commerce/comm/news-communicues/2010/202.aspx?lang=eng

²² CIPO adopted revised chapters of the Manual of Patent Office Procedure (MOPOP) in 2010 setting out types of innovations which, in its view, are not eligible for patent protection. These include the following innovations: innovative business methods, innovations that are not “physical”, innovations that are not “technological”, and new types of electromagnetic signals.

²³ *Diamond v. Chakrabarty* 447 US 303; 206 USPQ 193 (USSC 1980); *State Street Bank v. Signature Financial Group* 149 F.3d 1368; 47 USPQ (2d) 1596 (Fed. Cir. 1998)

²⁴ *Bilski et al. v. Kappos* 561 U.S. (2010) Slip Opinion USSC June 28, 2010.

²⁵ *Amazon.com, Inc. v. Canada (Commr of Patents)* (2010) FC 1011 (FCA); see also *Progressive Games Inc., v. Canada (Commr of Patents)* (1999) 3 CPR (4th) 517 (FCTD), aff’d 9 CPR (4th) 479 (FCA).

²⁶ A 1999 case in the US between a French pharmaceutical company and a competitor, in which the French company was forced to divulge its communications while the other company was not, prompted France, the Netherlands and the European Patent Organization to adopt statutes to protect communications. Therefore, companies having employed a Canadian agent can be at a disadvantage when entering IP litigation outside Canada. This issue also affects Canadian companies and foreign companies who perform R&D in Canada. Another example highlighting how lack of privilege can negatively affect foreign investment in Canada took place in December 2006 during litigation between two major pharmaceutical corporations. In this instance, the judge ordered one company to divulge the confidential communications held with its UK patent agent. This is significant because in the UK, these communications are protected by statute; however, they are not in Canada. The judge indicated that the company had to live with the “burdens” of Canada’s system of justice. The problem with the Canadian system is that it has the potential to affect more than just the Canadian operations of a company: foreign companies may hesitate to do business in Canada because it may put their foreign patents at risk.

²⁷ Organisation for Economic Co-operation and Development. *Open Innovation in Global Networks*. Retrieved June 24, 2010, from <http://browse.oecdbookshop.org/oecd/pdfs/browseit/9208071E.PDF>

²⁸ Some court decisions brought to light the problems with the system. For example, the 2001 *Dutch Industries* decision by the Federal Court put into question the validity of an estimated 7000 patents. This was caused because Canada’s “incentive” for small entities to seek patent protection actually put those patents under unnecessary risk. Unfortunately, even the retroactive solution adopted by legislation, while solving the immediate problem, harmed Canada’s reputation further because all the right holders of the affected patents around the world had to be contacted.

Appendix A: Excerpt from *Corporate Tax Reform: delivering a more competitive system*

This document is a consultation paper published by HM Treasury and HM Revenue and Customs, United Kingdom, November 2010.

Part IIB: The taxation of innovation and intellectual property

1

Introduction

1.1 The Government's aim is to provide the most competitive corporate tax system in the G20, in order to support strong and sustainable growth. The Government is committed to listening to business' concerns and responding to business' needs, and the Corporate Tax Road Map, Part I of this document, initiates an open and high level debate about the future of the corporate tax system.

1.2 In recent years businesses have become more focused on building and deriving value from creating and exploiting intangible assets. These form an increasing proportion of the new and future assets of many multinational businesses, and for some businesses a large part of their value is based on their ability to exploit patents, brands and other intangible assets. Consequently the taxation of intellectual property (IP), and its impact on attracting and encouraging further innovation in the UK, forms a key part of the Government's ambitions for the corporate tax system.

1.3 Although the Government recognises the value of all types of IP, it is focusing on scientific and high-tech IP because of their particularly strong link to Research and Development (R&D) and technical innovation activities and in order to protect the UK's status as a world leader in patented technologies. Patents on high-tech products and processes are identifiable and legally protected, and so can be easily traded or licensed between companies. Multinational groups therefore have a choice over where they locate work generating scientific and high-tech IP, and over where ownership of patents is located. The majority of businesses hold some intangibles, covering a variety of different types of assets, and the Government has set a clear direction for reform by prioritising rate reductions over broadening reliefs.

1.4 The Government intends to introduce a preferential regime for profits arising from patents, known as a Patent Box. Encouraging innovative business to invest in the UK will play a key part in supporting a strong, growing private sector. The Patent Box will encourage companies to locate the high-value jobs and activity associated with the development, manufacture and exploitation of patents in the UK. It will also enhance the competitiveness of the UK tax system for high-tech companies that obtain profits from patents.

1.5 Achieving a competitive corporate tax regime is not just about introducing new incentives; it is about ensuring the current set of rules are effective, and looking for ways to improve them. So the Government will also review the support R&D tax credits provide for innovation, including the proposals of the Dyson review¹.

1.6 This document will start the review and rebalancing of the UK's approach to the tax treatment of IP and innovation. In pursuing this reform the Government will apply the principles set out in the Corporate Tax Road Map. The key issues on which the Government is seeking business' views, which are discussed in chapters 2 – 4 below, are:

¹ *Ingenious Britain: Making the UK the leading high tech exporter in Europe*, James Dyson, March 2010.

- the current balance of incentives to attract and retain IP in the UK;
- the introduction of a Patent Box to improve the competitiveness of the system; and
- the support R&D tax credits provide for innovation.

1.7 The Government is also consulting on proposed reforms to the Controlled Foreign Company (CFC) rules, including rules on artificially diverted IP income, discussed in Part II A: Controlled Foreign Company reform.

Consulting with business and other stakeholders

1.8 The consultation is being conducted in line with the principles outlined in the document “Tax policy making: a new approach” published alongside the Budget. This document sets out three stages for policy development:

- Stage 1 – set out objectives and identify options;
- Stage 2 – determine the best option and develop a framework for implementation, including detailed policy design; and
- Stage 3 – draft legislation to effect the proposed change

1.9 This consultation is taking place during stage 1 of the process. The purpose of the consultation is to seek views on the objectives and key design options for the reforms, and the Government is committed to an open discussion with business about the best way to proceed.

Next Steps

1.10 The Government welcomes responses to this consultation by 22 February 2011. Details on how to get involved with this and the wider corporate tax reform consultation are given in Chapter 5 of this document and Chapter 5 of the Corporate Tax Road Map. This consultation will be focused on developing a Patent Box based on these proposals. The Government will publish further details on the new Patent Box regime for consultation in spring 2011.

2

UK tax rules and the IP lifecycle

The IP Lifecycle – Beyond R&D

2.1 The process of innovation is far wider than R&D activities alone. The successful transformation of innovative R&D into a competitive marketed product requires a range of complementary activities. The Government has considered the support given to innovation during key phases of the lifecycle of high-tech IP.

2.2 The Government recognises that tax is not the only important factor in encouraging innovative firms to invest in the UK, and that a competitive tax system must be complemented by a world class science and skills base. To support long term innovation and growth the Government has prioritised support for the UK's world class science, maintaining ring fenced resource spending in cash terms at £4.6 billion in each of the Spending Review (SR) years. The Government will also provide funding of around £300 million over the SR period for extension of the cutting edge facilities of the Diamond Synchrotron and the new UK Centre for Medical Research and Innovation. Finally, to drive commercial investment in scientific knowledge the Government has announced reform of the Higher Education Innovation Fund.

Phase 1 - Creation

2.3 The creation of high-tech and scientific IP often involves intensive research activity, with businesses incurring substantial up-front cost with an uncertain future reward. The UK's R&D tax credits regimes are key elements of the Government's support to business during this phase. In Chapter 4 of this document the Government asks for business' views on the support provided by R&D tax credits, including the recommendations of the Dyson review.

Phase 2 - Development

2.4 Turning an initial patent or concept into a marketable product requires a range of complementary activities, including further R&D activity either on the IP itself or the processes required to manufacture or deliver the product or service. The R&D tax credits scheme provides further support during this phase, where the work is seeking to resolve scientific or technological uncertainty.

Phase 3 – Commercialisation

2.5 Successful exploitation in the global market requires significant further high value activity. There are currently no specific incentives for companies to retain IP in the UK during commercialisation. In contrast, several other jurisdictions provide incentives for companies to own and exploit IP, particularly patents, in addition to R&D incentives.

2.6 As a result, the UK tax regime can be uncompetitive for companies to hold and exploit patents. This provides incentives for businesses to transfer patents offshore prior to the full realisation of their value, in order to benefit from more advantageous regimes elsewhere. Rather than tightening exit rules, which could inhibit commercial transactions and risk making UK businesses uncompetitive on the global stage, the Government would prefer to encourage businesses to retain and exploit IP in the UK through the introduction of the Patent Box,

discussed in Chapter 3. The UK would then benefit both from activities associated with the commercialisation of patents and from the additional tax on the consequential profits.

General tax treatment of IP

2.7 A new corporate tax regime was introduced in 2002 to modernise the tax treatment of IP throughout its life cycle¹. HM Revenue and Customs (HMRC) recently published an external report on the impact of the introduction and operation of the corporate intangible assets regime on businesses' commercial decision-making². Building on the findings of that report, the Government would like to explore with business how well the regime is working in delivering the Government's ambition for an efficient and competitive corporate tax regime.

¹ Corporation Tax Act 2009, Part 8.

² *Decision making and Intangible Assets*, Ipsos MORI, November 2010 (<http://www.hmrc.gov.uk/research/report100.pdf>)

3

Patent Box

3.1 This chapter outlines a possible approach to the design of a Patent Box with the aim of creating an affordable regime which encourages investment in the UK. The Government intends to develop a detailed implementation strategy in partnership with business to enable this regime to apply to relevant profits arising from 1 April 2013.

3.2 The Government has used internal and publically available information to estimate the likely cost of the Patent Box, but it is very difficult to assess the likely behavioural impact of a Patent Box on business and the resulting impact on tax revenue. Given the range of behavioural responses the Government would like to explore this further in consultation with business through the Patent Box working group.

The Case for Reform

3.3 The Government also recognises that IP is mobile and that multinational groups have a choice as to where to locate their IP ownership. IP ownership is distinct from the R&D, management, and manufacturing activity necessary to develop and exploit it, but there are clear commercial links and IP ownership is frequently co-located with high value jobs and economic activity.

3.4 The Government recognises that some patent-rich UK businesses face a higher overall effective tax rate than their foreign competitors, who may benefit from special regimes available in other countries. While the Government does not feel that it is necessary to match these regimes, it does recognise that there is a need to improve the competitiveness of the UK corporate tax regime to complement the non-tax advantages of the UK as a leading location for R&D and IP.

Policy Aims

3.5 The Patent Box will aim to reward successful technical innovation. The Government believes that it is right to introduce this reform now in order to prevent movement of IP offshore and encourage the development of new patents by UK businesses, protecting and enhancing the status of the UK as a world leader in this field.

Options Available

3.6 The Government believes that specific reliefs should be targeted to produce the greatest benefit. For this reason it has decided that this regime should focus on patents rather than on other forms of IP. Patents have a particularly strong link to ongoing high-tech R&D and manufacturing activity which the Government sees as a priority to encourage in the UK. They are also clearly identifiable, and provide exclusive legally protected rights to exploit a novel product or process.

3.7 The Government recognises that not all forms of IP which share these characteristics are capable of being patented, and that there are genuine commercial reasons why some businesses may choose not to patent IP even where it is legally possible. Other forms of legally protected IP can also be extremely valuable and are critical to the success of many UK businesses. For example brand names and trademarks developed in the UK have been successfully exploited

throughout the world. However, other forms of IP have a weaker or more variable link to R&D and high-tech manufacturing activity. R&D provides growth opportunities not only for the companies investing but also the wider economy through the development of new skills and technology, and improved products and services. Given the amount of IP in the UK a general relief would also be very expensive.

Design Principles

3.8 The Government will be consulting on the detailed design of the Patent Box through the consultation and working group process set out in the Corporate Tax Road Map. This document sets out the key high level principles that will guide the design process.

Election

3.9 The Government does not wish to place unnecessary compliance burdens on businesses that will not benefit significantly from the Patent Box, and the regime will therefore be optional.

Rate

3.10 The Government intends to introduce a 10 per cent rate for profits arising from patents, to apply from 1 April 2013. The Government wants to provide an effective incentive to create and retain IP in the UK, but believes that it is not necessary to match the rates offered by other countries in order to be competitive, given the significant non-tax strengths of the UK as a location for IP development and exploitation. A rate of 10 per cent strikes a good balance between affordability and competitiveness.

Qualifying date for eligible patents

3.11 There are two main options for identifying patents eligible for inclusion in the Patent Box. One is to use the date of grant of the patent and the other is to look at the date when the patent was first commercialised.

3.12 Some industries have very long development cycles and therefore hold existing valuable patents which have not yet been commercialised. The Government therefore intends that all patents first commercialised after 29 November 2010 will qualify for inclusion in the Patent Box. More detailed qualification and transitional rules will be discussed during the consultation period.

Question 3A: The Government welcomes views on appropriate conditions for patents to qualify for the regime, including the practicality of determining the date of initial commercialisation of a patent, and appropriate ownership criteria.

Income included in box

3.13 The form of income arising from patents differs depending on the type of patent and the commercial structure of the group. The policy should be aligned with the variety of modern business practices, and should not interfere with commercial business arrangements. The Government therefore intends to make the Patent Box available to both royalty income and 'embedded' income included in the price of patented products.

3.14 The identification and quantification of embedded income is a complex area, but the Government has identified two possible approaches. One is to use the "arm's length principle", as set out in the Organisation of Economic Co-operation and Development (OECD)'s Transfer Pricing Guidelines, to determine the proportion of income commercially related to patents. The second is to take a more formulaic approach, which should provide greater certainty and ease of

administration, although at the cost of producing a less accurate estimation of the true value of a patent.

3.15 The Government aims to avoid complexity wherever possible while delivering its policy objectives, and currently thinks that to require businesses to value individual patents using an arm's length standard would impose an excessive administrative burden on both business and HMRC. There is no universally applicable method for patent valuation, and all methods, despite their complexity, provide uncertain estimates. The arm's length approach may therefore also fail to provide businesses with the certainty they require to base long term investment. The Government therefore intends to adopt a largely formulaic approach.

Question 3B: The Government would like to discuss with business the proposed approach to determining patent income, and the challenges of practical implementation.

Treatment of associated expenses

3.16 In order to align with policy objectives and remain affordable, the Government believes that the Patent Box should apply to net patent income after associated expenses, including pre-commercialisation expenses, rather than to gross income. The Government's view is shaped by three main considerations:

- a tax rate applicable to gross income would result in an effective tax rate well below the headline rate for the box, which would be very costly and create opportunities for artificial tax avoidance. The Government does not believe that an effective tax rate significantly below 10 per cent is required to make the UK a competitive location to hold patents;
- a Patent Box applying to gross income would encourage a focus on sales rather than profit, which could create perverse incentives for business rather than encouraging sustainable successful innovation; and
- excluding pre-commercialisation expenses would create a perverse incentive for businesses to delay commercialisation of a new product as long as possible in order to achieve a better overall tax rate.

3.17 However, the Government is committed to retaining full rate relief for the additional deduction available from the R&D tax credit regime. The Government is also aware of the need to avoid creating any barriers to patent development and does not intend to restrict deductibility for companies for any expenses before they benefit from the lower rate on the income received, and also recognises that tracking and assigning expenses to specific products can be very difficult. The design must also take into account deferred tax effects with the aim of ensuring that there is no unintentional short term increase in the effective tax rate during the transitional period.

3.18 During stage 2 of the consultation process the Government will set out design options which aim to reconcile these priorities and wishes to discuss the practicality and effectiveness of these fully with business before developing detailed proposals.

Question 3C: The Government welcomes views from business on whether the proposals are well aligned with commercial incentives to create profitable products.

Encouraging continuing innovation

3.19 The aim of the Patent Box is to encourage continuing successful development and exploitation of patents by UK businesses by rewarding successful patent innovation. The

Government does not wish to incentivise purely passive holding of IP, or to encourage artificial tax avoidance behaviours. An effective strategy to prevent abuse is a key requirement to maintain the long term stability of the Patent Box regime.

3.20 The Government is considering a number of ways to achieve this, such as linking the amount of income which can be attributed to the Patent Box to the level of ongoing R&D or associated manufacturing activity. The Government would not intend any such measures to limit the benefit of the box to those businesses actively engaged in the patent development cycle, and welcomes engagement from business on this or on other potential measures to prevent abuse.

Question 3D: The Government would like to discuss with business the most appropriate ways to prevent artificial tax avoidance or other types of abuse.

Question 3E: The Government welcomes any further general views on the Patent Box.

4

Research and Development Tax Credits

Introduction

4.1 The Government believes that business is the main driver of economic growth and innovation. The UK's R&D tax credit schemes have a key role to play in supporting innovative activity by UK companies, and are an important factor for companies when considering the competitiveness of the UK's corporate tax system. The Government will ensure that the R&D tax credit schemes continue to be effective in encouraging innovation by UK companies.

Research and Development

4.2 R&D drives innovation and provides growth opportunities not only for the companies undertaking such activity, but also for the wider economy through the development of new technology and improved products and services. However companies tend to under-invest in R&D because they are unable to fully appropriate all the benefits for themselves. The private returns on R&D are exceeded by the social returns due to the presence of positive externalities that benefit the wider economy. R&D tax credits were introduced to address this market failure. There are three separate R&D tax credit schemes in the UK, the Small and Medium sized Enterprise (SME) scheme¹, the large company scheme and Vaccine Research Relief (VRR).

4.3 The SME scheme, introduced in 2000, allows eligible companies to enhance qualifying R&D expenditure by 75 per cent in order to reduce tax liabilities. If a SME company is loss-making then it may be able to exchange the tax relief for a payable credit worth 24.5 per cent of qualifying expenditure.

4.4 The large company scheme, introduced in 2002, allows companies to enhance qualifying R&D expenditure by 30 per cent.

4.5 VRR, introduced in 2003, allows companies to enhance qualifying expenditure by an additional 40 per cent where R&D expenditure is on drugs and vaccines for strains of tuberculosis, malaria and HIV /AIDS prevalent in the developing world.

4.6 In 2008-09, the latest year for which statistics are available, around 8,350 companies claimed an estimated £980 million of support through the schemes. Since their introduction, the schemes have supported nearly £52 billion of R&D activity by UK companies.

Evaluation

4.7 Following a commitment to evaluate the R&D tax credit schemes by the end of 2010, HMRC commissioned independent research into their impact on the decision making processes of companies investing in R&D². HMRC have also undertaken internal evaluation work assessing the impact of the schemes on the levels of R&D expenditure undertaken by companies.

¹ The European Commission has agreed an enhanced SME definition for the purposes of this scheme. Companies with up to 500 employees and either turnover under €100 million or balance sheet assets under €86 million are eligible. These thresholds are effectively double those of the normal EU SME definition.

² *Qualitative research into businesses' Research and Development (R&D) decision-making processes*, Databuild Research and Solutions Ltd, August 2010 (<http://www.hmrc.gov.uk/research/report101.pdf>)

4.8 The broad conclusions of the independent research are that the schemes are perceived by claimants to increase the overall amount of R&D they are able to undertake, although they have little effect on decisions to conduct particular projects. The cash flow benefit of the payable credit was cited by smaller companies as being of particular importance in enabling them to proceed with R&D projects. HMRC's internal economic analysis has concluded that the schemes have a positive impact on the levels of R&D expenditure by regular claimants. This is consistent with the findings of academic literature into the impact of fiscal incentives for R&D in a number of territories.

Objective

4.9 The Government has the aim of creating the most competitive corporate tax regime in the G20. As part of its approach to reform the Government announced in the June 2010 Budget that it would review the support R&D tax credits provide for innovation and the proposals of the Dyson Review³.

Dyson Review

In March 2010 James Dyson published *Ingenious Britain: Making the UK the leading high tech exporter in Europe*. The report made two specific proposals for the R&D tax credit schemes, detailed below:

- Refocus the schemes on high tech companies, small businesses and new start-ups. When the public finances allow, the rate should be increased to 200 per cent.
- Improve the ease with which the R&D tax credit can be claimed.

4.10 A competitive tax system, together with a regulatory environment that encourages innovation and enterprise, and a skilled workforce are all important factors in the growth of innovative companies. Through this consultation the Government wants to ensure that the R&D tax credit schemes play their part in creating the right environment for such companies to prosper.

4.11 Stability and certainty are key factors for companies when making R&D investment decisions. Changes to the schemes would require companies to invest time and resources in adapting to new rules and processes. However, the Government welcomes views on any changes that respondents feel would significantly improve the impact or delivery of the schemes.

4.12 When considering responses to the consultation, the Government will assess whether proposals put forward enhance the effectiveness of the schemes in addressing the market failure in the provision of R&D, whether they represent value for money for the taxpayer and if they are affordable within the wider Government priority of reducing the deficit. The schemes must also remain compliant with European Commission rules, including those on the provision of State aid.

4.13 Given the current fiscal framework, it is important that where respondents suggest changes that will carry additional Exchequer cost, they also seek to identify areas where appropriate savings might be made.

³ *Ingenious Britain: Making the UK the leading high tech exporter in Europe*, James Dyson, March 2010

Structure and scope

4.14 A number of countries offer support through their tax systems to promote R&D activity through a variety of mechanisms, including super deductions (as in the UK) and direct reductions of tax liability (as in Canada). The Government believes that the combination of low corporation tax rates, with the main rate of corporation tax falling to 24 per cent by 2014, and the presence of the R&D tax credit schemes, makes the UK an attractive location for UK companies and multinationals to undertake R&D activity.

Question 4A: Are there any changes to the structure of the schemes that would significantly improve their impact in stimulating investment in R&D by UK companies, in the context of the wider corporate tax reforms?

4.15 The Dyson report raised concerns that the schemes may not be sufficiently well targeted and proposed refocusing them on hi-tech companies. The Government does not intend to restrict qualification for R&D tax credits to specific sectors as the schemes are intended to remedy a market failure that exists for companies across the economy. Positive spillovers from R&D will be present in all sectors.

4.16 However, the Government will examine the extent to which the relief is appropriately targeted at those costs that are most closely linked to genuinely innovative activity. The relief is currently available for expenditure on staff, materials, power and software development.

Qualifying costs and activities

4.17 Adding further qualifying costs would increase both the impact on tax revenue and the complexity of the schemes but the Government is interested in views on whether there are any specific costs that should be brought within the scope of the schemes, although adding such costs will need to be rebalanced by savings elsewhere.

4.18 The Government is interested in views on whether there are any costs which do not genuinely contribute towards innovative activity but which are currently eligible for relief through the schemes. The Government is also interested in whether there are specific costs that are currently eligible for relief which could be limited in the context of refocusing the schemes on stimulating high tech companies to undertake greater levels of innovative activity. One example could be relief for expenditure on developing internal use software, which some countries exclude or limit under their R&D relief regimes.

Question 4B: Are there additional costs that should be eligible for relief under the schemes?

Question 4C: Are there costs, such as internal use software, which could be limited or excluded from being eligible for relief under the schemes?

4.19 R&D tax credits use a definition of R&D contained in guidelines issued by the Department for Business, Innovation and Skills (BIS)⁴. The definition was last revised in 2004, following consultation. Whilst there are specific issues, such as 'production', the Government believes the R&D definition generally works well and accurately captures what is R&D for tax purposes.

⁴ *Guidelines on the Meaning of Research and Development for Tax Purposes*, Secretary of State for Trade and Industry, March 2004 (<http://www.bis.gov.uk/files/file13258.pdf>)

Question 4D: Is the R&D definition contained in the guidelines issued by BIS an effective definition for recognising genuine R&D activity through the R&D tax credit schemes?

Production

4.20 Under the current definition, R&D activities must seek an advance in general knowledge or capability in science or technology through the resolution of scientific or technological uncertainty in order to be eligible. The BIS guidelines state that production and distribution of goods and services does not directly contribute to the resolution of such uncertainty. However, 'production' is not defined in legislation or the BIS guidelines, consequently there is a lack of clarity around exactly what constitutes production, particularly when the activity involves experimental trials and prototypes.

4.21 HMRC's approach so far has been to issue guidance and to seek to address the issue on a case by case basis. An alternative approach would be to legislate a statutory definition of production. This would provide certainty but might leave less flexibility around R&D claims for claimant companies. Any extension to the scope of allowable costs in this area will add to the overall cost of the scheme and will have to be balanced through savings elsewhere.

Question 4E: Would respondents welcome a statutory definition of production? If so, what should it include and exclude?

Refocusing

4.22 The Dyson report proposed refocusing the schemes to specifically benefit start-ups and small companies⁵. The Government recognises the importance of cash flow for such companies, which may be undertaking significant amounts of R&D in advance of generating income. The SME scheme already acknowledges that smaller companies face additional barriers in financing R&D investment by offering an increased rate of relief and the option of claiming a payable credit, if a company is loss-making. In addition, as part of the Government's wider corporation tax reforms, the small profits rate of corporation tax is reducing from 21 per cent to 20 per cent with effect from April 2011, instead of the planned increase to 22 per cent.

Question 4F: What further enhancements would be most effective in promoting additional investment in R&D by the smallest companies, taking into account the risk of adding additional complexity to the schemes?

Vaccine Research Relief

4.23 VRR was introduced to incentivise investment in R&D into drugs and vaccines for strains of tuberculosis, malaria and HIV/AIDS which mainly occur in less-developed countries. Take up of VRR has been low, with around ten claims a year made through the scheme.

Question 4G: Is VRR an effective intervention for incentivising research into drugs and vaccines for the prevention and treatment of disease prevalent in less-developed countries, or would it be more effective to deliver the support through other mechanisms?

⁵ The European Commission define a small company as one with up to 50 employees and either turnover of under €10 million or balance sheet assets under €10 million. A micro company is defined as one with up to 10 employees and either turnover of under €2 million or balance sheet assets under €2 million.

Claims process

4.24 The Dyson report suggested the cost of claiming the credits and the information obligation for claiming may act as a barrier to companies using the schemes. Administration costs incurred by companies in claiming reduce the value of the incentive, so the Government is keen, where possible, to reduce these costs for companies, particularly in the wider context of simplifying the tax regime.

4.25 In 2006, the Government introduced seven specialist units to handle R&D claims outside the Large Business Service in HMRC. The units aim to provide simplicity, consistency and certainty around the treatment of claims with the general consensus from business being that the process has greatly improved since their introduction.

4.26 The Dyson report suggested options for simplifying the claims process, including allowing external audits of claims or the pre-agreement of projects or activities with companies. External auditing of claims could provide a degree of expertise in analysing claims but has the potential to add significant cost and complexity to the administration of the scheme, both for claimant companies and for HMRC. Where requested, HMRC discuss potential projects with companies and offer guidance on the claiming process, but it does not operate a formal pre-clearance procedure. The additional resource issues that arise from these proposals will also need to be considered.

Question 4H: Are there improvements to the claims process that would make it more streamlined and certain for companies, particularly smaller companies with limited resources? Would there be significant benefits from an external auditing process for claims or a more formal pre-clearance procedure of R&D projects with HMRC?

5

Next steps

5.1 The Government welcomes views by Tuesday 22 February on the issues raised in this document, in particular:

- the effectiveness of these proposals in improving the competitiveness of the UK's corporate tax regime in relation to IP and technical innovative activity;
- the priority of these proposals in comparison with other proposals, including those set out in other parts of this wider consultation; and
- the detailed questions raised throughout the document.

5.2 The Government would also appreciate views on the impact and compliance cost to business of the proposals including the impact of the application for larger and small businesses.

5.3 Details of the Government's wider engagement strategy for corporate tax reform, including consultation and working groups, are given in Chapter 5 of the Corporate Tax Road Map. Officials will spend time between now and Budget 2011 consulting with business on these proposals. A new Patent Box working group will be established to take this work forward. Nominations for working group membership should be sent to corporatetaxreform@hmtreasury.gsi.gov.uk by 9 December 2010.

How to respond

5.4 Any comments or technical queries on the proposals in this part of the document should be addressed to:

For general comments and comments on Patent Box

5.5 Anna Floyer-Lea or Richard Williams

CT Reform
Corporate Tax Team
HM Treasury
1 Horse Guard's Road
London
SW1A 2HQ

E-mail: corporatetaxreform@hmtreasury.gsi.gov.uk; or
anna.floyer-lea@hmtreasury.gsi.gov.uk or richard.williams@hmtreasury.gsi.gov.uk
Telephone (Treasury switchboard) 020 7270 5000

For comments on Research and Development Tax Credits

5.6 Mike Crabtree or James Perry:

R&D Tax Credits Reform
Excise and Enterprise Tax Team
HM Treasury
1 Horse Guards Rd
London
SW1A 2HQ

Email: corporatetaxreform@hmtreasury.gsi.gov.uk; or
mike.crabtree@hmtreasury.gsi.gov.uk or james.perry@hmtreasury.gsi.gov.uk
Telephone (Treasury switchboard) 020 7270 5000

5.7 Details of the Government's wider engagement strategy for CT Reform, including consultation and working groups, are given in Chapter 5 of the Corporate Tax Road Map.

Confidentiality

5.8 Information provided in response to this consultation, including personal information, may be published or disclosed in accordance with the access to information regimes. These are primarily the Freedom of Information Act 2000 (FOI), the Data Protection Act 1998 (DPA) and the Environmental Information Regulations 2004.

5.9 If you want the information that you provide to be treated as confidential, please be aware that, under the FOI, there is a statutory Code of Practice with which public authorities must comply and which deals with, amongst other things, obligations of confidence. In view of this it would be helpful if you could explain to us why you regard the information you have provided as confidential. If we receive a request for disclosure of the information we will take full account of your explanation, but we cannot give an assurance that confidentiality can be maintained in all circumstances. An automatic confidentiality disclaimer generated by your IT system will not, of itself, be regarded as binding on HM Treasury (HMT) and HM Revenue and Customs (HMRC).

5.10 HMT and HMRC will process your personal data in accordance with the DPA and in the majority of circumstances this will mean that your personal data will not be disclosed to third parties.

A

Summary of questions

A.1 The Government welcomes response to the questions put forward in the consultations on the Patent Box and the R&D tax credit schemes. Any proposals put forward by respondents will need to be considered alongside the following criteria:

- Do they enhance the competitiveness of the UK corporate tax regime as a location for businesses to develop, hold and exploit IP?
- Do they represent value for money for the taxpayer, and are they affordable within the wider Government priority of addressing the deficit?
- Where relevant, are they compliant with EU State aid rules?

Chapter 3: Patent Box

- Question 3A: The Government welcomes views on appropriate conditions for patents to qualify for the regime, including the practicality of determining the date of initial commercialisation of a patent, and appropriate ownership criteria.
- Question 3B: The Government would like to discuss with business the proposed approach to determining patent income, and the challenges of practical implementation.
- Question 3C: The Government welcomes views from business on whether the proposals are well aligned with commercial incentives to create profitable products.
- Question 3D: The Government would like to discuss with business the most appropriate ways to prevent artificial tax avoidance or other types of abuse.
- Question 3E: The Government welcomes any further general views on the Patent Box.

Chapter 4: Research and Development Tax Credits

- Question 4A: Are there any changes to the structure of the schemes that would significantly improve their impact in stimulating investment in R&D by UK companies, in the context of the wider corporate tax reforms?
- Question 4B: Are there additional costs that should be eligible for relief under the schemes?
- Question 4C: Are there costs, such as internal use software, which could be limited or excluded from being eligible for relief under the schemes?
- Question 4D: Is the R&D definition contained in the guidelines issued by BIS an effective definition for recognising genuine R&D activity through the R&D tax credit schemes?
- Question 4E: Would respondents welcome a statutory definition of production? If so, what should it include and exclude?

- Question 4F: What further enhancements would be most effective in promoting additional investment in R&D by the smallest companies, taking into account the risk of adding additional complexity to the schemes?
- Question 4G: Is VRR an effective intervention for incentivising research into drugs and vaccines for the prevention and treatment of disease prevalent in less-developed countries, or would it be more effective to deliver the support through other mechanisms?
- Question 4H: Are there improvements to the claims process that would make it more streamlined and certain for companies, particularly smaller companies with limited resources? Would there be significant benefits from an external auditing process for claims or a more formal pre-clearance procedure of R&D projects with HMRC?