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Monday, 20 September 2021

Mr Paul Fischer
Corporate and International Tax Division
The Treasury
By Email: PatentBoxConsultation@treasury.gov.au

Dear Mr Fischer:

The American Chamber of Commerce in Australia (**AmCham**) welcomes the opportunity to provide comments on the issues raised in the Patent Box discussion paper released by Treasury in July 2021 (the **Consultation Paper**).

Executive Summary

AmCham supports the Patent Box proposal and commends the Government on this initiative. If framed appropriately, the Patent Box will in the medium term deliver increased investment into Australia, outweighing the tax forgone by the reduced tax rate. It is likely to boost jobs and growth in sectors such as biotech, healthtech, medical R&D, clinical trials, and the like. These sectors are all areas in which Australia has a bright future.

Our comments below are to assist in ensuring that the Patent Box is framed appropriately to accomplish these objectives.

1. Background

AmCham was founded in 1961 by Australian and American businesses to encourage the two-way flow of trade and investment between Australia and the United States, and to assist its members in furthering business contacts with other nations. AmCham is Australia's largest and most active international chamber of commerce, representing some of America's most significant companies operating in the Indo-Pacific region, as well as start-ups and SMEs. In pursuing its purpose, the Chamber has found itself not only representing the United States' business view, but also speaking increasingly for a broad range of members involved in the Australian business community.

Earlier this year, we celebrated the 70th year of the ANZUS treaty. The US-Australia alliance is underpinned by core common values including the rule of law, transparency, hard work and fair play. The relationship has provided an immense benefit to Australia – including new jobs, higher wages, elevated productivity, market access, capabilities, intelligence, interoperability, research and development, trade and investment, cultural ideas, and exchanges of people.

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The current two-way trade and investment relationship between our countries is also valued at almost \$2 trillion. US trade and investment in Australia in 2019 accounted for \$131 billion or 7% of Australia’s GDP, roughly equivalent to the mining sector. Over a quarter of all foreign investment in Australia comes from the United States, making it the biggest investor in our country. There are 323,000 Australians working for 1,100 US majority owned companies in Australia on a median salary above \$100,000. US companies also spend \$1.2 billion a year here on research and development.

2. The Patent Box and measuring its success

Against this background, AmCham strongly supports the Patent Box initiative as a means of encouraging US investment into the Australian medical and biotechnology industry. We consider that the Patent Box will ensure the Australian economy is innovative and competitive, and will foster US investment by offering an incentive to commercialise and retain intellectual property (IP) in Australia. In combination with the existing R&D tax incentive (RDTI) for initial growth and development, the proposed Patent Box will make Australia an increasingly attractive proposition for foreign medical and biotechnology companies.

In this respect, in terms of US investment in Australia, the Patent Box will be successful to the extent it leads to additional investment by US medical and biotechnology companies in carrying on R&D activities in Australia and retaining ownership of the resulting patents in Australia. Following implementation of the Patent Box, we suggest that the impact on foreign investment and retention of IP in Australia is measured on an ongoing basis to assess the extent to which the Patent Box is achieving its stated policy aims, and whether any adjustments to the regime are required (pursuant to our recommendation of an ongoing review process at heading 11 below). This could be achieved through analysis of tax return data, patent filings, or surveys by the Australian Bureau of Statistics.

3. Proposed tax rate

In the United States, the federal corporate income tax rate is currently 21%, and state income taxes currently range from 0% to 11.5%. This results in a combined average top tax rate of 25.8% in 2021.¹ In light of this, we consider the proposed 17% tax rate for the Australian patent box should be viewed favourably by US investors. However, we do note that regimes in comparable jurisdictions have lower tax rates - for example, a 10% tax rate is available under the UK Patent Box. The UK also offers a refundable R&D incentive.

4. Concessional tax rate should apply to income derived from the time of application, not time of grant

The concessional tax rate should apply to eligible income derived from the time of application of the relevant patent, not from when the patent is granted. It takes some time (often years) for a patent to be granted, and during that time the patent owner will derive income from use of the patent. In light of this, our suggestion is that the 17% tax rate be available retrospectively, such that once the patent is granted the patent owner is entitled to amend its prior year tax returns and claim the lower tax rate, provided that all other eligibility requirements are met in the historical periods.

5. Income from manufacturing

The proposed exclusion of income from manufacturing from the Patent Box appears to have caused some confusion over the scope of income derived from eligible patents that will be eligible for the concessional tax rate. We understand the intention is that income derived from the sale of patented products (or products incorporating a patented item) or license of eligible patents should qualify as eligible income. The proposed exclusion of manufacturing income relates to income which is not attributable to the patent, and instead attributable to other downstream manufacturing processes. This point should be clarified in the draft legislation and explanatory materials.

¹ The Tax Foundation, available at <https://taxfoundation.org/25-percent-corporate-income-tax-rate/>.



As set out further below, legislative safe harbours or other shortcuts should be utilised where practical to ease the compliance burden on small to medium enterprise, while maintaining sufficient flexibility to allow companies to identify the relevant IP and associated expenses and income, given that products will often incorporate multiple patents and patents may apply across multiple products.

6. Filing date versus priority date (Question 18)

The Consultation Paper states that “only inventions claimed in standard patents granted by IP Australia, which were applied for after the Budget announcement (that is, have a priority date after 11 May 2021), will be eligible”. This statement may be conflating filing dates and priority dates. The priority date can and often is earlier than the filing date (in particular, where the applicant is claiming priority from an earlier overseas patent application). The patent box should apply to a patent application made in the required time period irrespective of what its priority date is (which in any case will only be up to a year earlier than the filing date).

7. Patent Box regime should apply to all patents granted after the Budget announcement

As announced, the Patent Box regime will only apply to patents applied for after the Budget announcement on 11 May 2021. Given the significant time that can elapse between application and grant (as discussed above), the regime should be expanded to apply to all patents granted after 11 May 2021. Rather than extending the historical timeframe for application indefinitely, we suggest it could be limited to patents applied for within a suitable period prior to 11 May 2021, e.g. at least 24 months. Expanding the scope of the regime in this way will further the underlying policy goal of retaining ownership of eligible patent inventions in Australia, noting that patents typically have a life of 20 years (patents relating to pharmaceutical ingredients have a life of 25 years). An alternative option is for the Patent Box to apply to all patents in existence as at the date of effect and new patents granted from that date. This provides sufficient clarity as well as an appropriate limitation. We understand a similar approach has been taken in the UK to prevent opportunities for patent applications to be amended in order to come within the regime.

8. Definition of medical and biotechnology sectors (Question 4)

The Patent Box regime will be based on the use or classification of individual patented inventions, rather than the overall industry classification of the company that owns the patented invention. The Consultation Paper proposes either a patent level test or an income streaming test.

Our preference is for a patent level test, on the basis that this is more straightforward for both taxpayers and the ATO to assess whether a particular patent is eligible for the regime, and will provide greater certainty to taxpayers. Existing concepts should be relied on to the extent practical, in particular the WIPO International Patent Classification system used by patent offices globally to classify patents by technology area.

9. Interaction with the RDTI (Questions 5 and 13)

We support the intention in the Consultation Paper to rely on existing concepts in the RDTI with respect to the definition of R&D activities, and to ensure there is a sufficient nexus between the income benefiting from the IP regime and the extent to which the underlying R&D has been undertaken in Australia, which is important for compliance with OECD guidelines.² The RDTI has been in place for a number of years and is generally well understood by US companies in the medical and biotechnology industry. Many early stage companies - including in the US - access the RDTI by undertaking R&D activities in Australia. Foreign groups are likely to view the Patent Box as an incentive to not only undertake R&D activities in Australia and claim the RDTI, but to also own and commercialise the results of the R&D activities in Australia. This should be encouraged by leveraging the existing definitions and guidance associated with the RDTI where practical, to assist taxpayers already familiar with the RDTI in assessing eligibility for the Patent Box.

² See BEPS Action 5: Agreement on Modified Nexus Approach for IP Regimes, OECD 2015.



10. Introduce safe harbours or other short cut methods where possible (Question 26)

Existing patent box regimes and equivalents in other jurisdictions are notorious for being complex and often requiring input from multiple advisers experienced in income tax, transfer pricing, the R&D tax incentive, and IP law. The need to seek detailed and costly advice on an annual basis can hamper the underlying policy goals of patent box regimes. It runs the risk of limiting the regime to only those taxpayers with sufficient resources to obtain such advice.

In order to ensure the Australian Patent Box meets its stated policy aims, our suggestion is to include legislative safe harbours, or other short cut or simplified methods, where practical in order to assist early stage companies in taking advantage of the Patent Box. These methods could be limited to taxpayers falling below a certain turnover threshold. Introducing such methods will also assist the ATO in administering the regime and applying compliance resources. We would suggest looking to the UK Patent Box for guidance as an example of a regime that sets out relatively straightforward mechanisms for determining eligible costs.

11. Ongoing review of the Patent Box

We suggest that a regular system of review be built into the Patent Box so that issues can be identified and rectified as they emerge, rather than investing considerable time and resources into drafting the Patent Box perfectly from the outset. The interaction of the Patent Box with existing tax laws is likely to be complex and we expect complications will arise as the Patent Box comes into effect. A regular review process will also enable the Patent Box to be tweaked as necessary to maintain its competitiveness. In this respect we suggest including a sunset clause for the proposed tax rate of 17% to enable it to be considered and adjusted in the future to ensure the Australian regime remains attractive, particularly with respect to US investors.

12. Ongoing engagement

We acknowledge the complexity involved in drafting the legislation to give effect to the Patent Box. Beyond this submission, our Health Committee would be happy to engage with Treasury on an ongoing basis to provide assistance as the legislation is drafted and implemented.

Kind Regards,

April Palmerlee
Chief Executive Officer

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