

**Knowledge Development Box 2016**  
**Regulatory Impact Analysis - Final**

| <b>Summary of Regulatory Impact Analysis (RIA)</b>                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                              |                                                                                                      |
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| <b>Department/Office:</b><br>Department of Jobs, Enterprise and Innovation                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                      | <b>Title of Legislation:</b><br>Knowledge Development Box<br>(Certification of Inventions) Bill 2016 |
| <b>Stage:</b> Publication                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                                       | <b>Date:</b> 2016                                                                                    |
| <p><b>Related Publications:</b></p> <p>Department of Finance Public Consultation January 2015<br/> <a href="http://www.finance.gov.ie/sites/default/files/Knowledge_Development_Box_%20DFinance_consultation_finalweb%20cover.pdf">http://www.finance.gov.ie/sites/default/files/Knowledge_Development_Box_%20DFinance_consultation_finalweb%20cover.pdf</a></p> <p>Department of Finance Feedback Statement July 2015<br/> <a href="http://www.finance.gov.ie/sites/default/files/Knowledge%20Development%20Box%20%20Feedback%20Statement.pdf">http://www.finance.gov.ie/sites/default/files/Knowledge%20Development%20Box%20%20Feedback%20Statement.pdf</a></p> <p>OECD(2015) Countering Harmful Tax Practices More Effectively, Taking into Account Transparency and Substance, Action 5 – 2015 Final Report, OEC/G20 Base Erosion and Profit Shifting Project, OECD Publishing, Paris<br/> <a href="http://dx.doi.org/10.1787/9789264241190-en">http://dx.doi.org/10.1787/9789264241190-en</a></p> <p>Finance Act 2015 <a href="http://www.irishstatutebook.ie/eli/2015/act/52/enacted/en/html">http://www.irishstatutebook.ie/eli/2015/act/52/enacted/en/html</a></p> <p>Summary of 2016 Budget Measures Policy changes<br/> <a href="http://www.budget.gov.ie/Budgets/2016/Documents/Summary%20of%20Budget%202016%20Taxation%20Measures%20-%20Policy%20Changes.pdf">http://www.budget.gov.ie/Budgets/2016/Documents/Summary%20of%20Budget%202016%20Taxation%20Measures%20-%20Policy%20Changes.pdf</a></p> |                                                                                                      |
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**Policy options considered:**

1. No policy change / Do nothing
2. Introduce new legislation to create and administer a Certification of Inventions Scheme to allow smaller companies access the Knowledge Development Box
3. Re-introduce substantive patent examination to amend the Patents Act 1992

**Preferred options:**

Option 2: Introduce new legislation to create and administer a Certification of Inventions Scheme to allow smaller companies access the Knowledge Development Box

and

Option 3: Re-introduce substantive patent examination by way amendments to the Patents Act 1992

|                                                                                                                | <b>Costs</b>                                                                               | <b>Benefits</b>                                                            | <b>Impacts</b>                                                                                                                                                                                                                     |
|----------------------------------------------------------------------------------------------------------------|--------------------------------------------------------------------------------------------|----------------------------------------------------------------------------|------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| <b>1. Do nothing/no policy change</b>                                                                          | No additional costs.                                                                       | None.                                                                      | Will place SMEs at a competitive disadvantage in being unable to access the benefits of the Knowledge Development Box.<br><br>May undermine the value of national patents leading to declining national patenting activity levels. |
| <b>2. Introduce new legislation to create and administer a Certification Scheme to allow access to the KDB</b> | The additional cost of the KDB certification scheme was already factored into Budget 2016. | Will encourage and stimulate innovation, research and development in SMEs. | Additional line of business for the Patents Office to assume within existing resources.                                                                                                                                            |

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|--------------------------------------------------------------------------------------------|-----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|---------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
|                                                                                            | <p>Costs for participating SME's to engage Patent Agent professional services.</p>                                                                                                                                    | <p>Should assist in improving Ireland's competitiveness as the first country to introduce a Knowledge Development Box in line with the approved OECD "Nexus Approach".</p> <p>Will enable smaller companies to access this scheme which provides for a 6.25% rate of corporation tax to profits on intellectual property arising from R&amp;D activities.</p> | <p>Reduced corporation tax to the Exchequer from participating companies.</p> <p>Should incentivise the undertaking of R&amp;D activities at SME level.</p> <p>Will facilitate the generation of profits from IP assets that are not being patented thus allowing SMEs to use IP assets without necessarily incurring costs associated with patenting.</p> |
| <p><b>3. Re-introduce substantive patent examination to amend the Patents Act 1992</b></p> | <p>Costs associated with out-sourcing additional function of obtaining an opinion on patentability from UK IPO.</p> <p>The additional cost of the KDB certification scheme was already factored into Budget 2016.</p> | <p>Inventions protected by national long-term patents will be eligible for KDB tax relief. Patent examination process will meet with best international standard/practice.</p> <p>Will encourage and stimulate innovation, R&amp;D</p>                                                                                                                        | <p>Patents office will assume a substantive role in substantive patent examination although the search/patentability function will be outsourced.</p> <p>Irish long-term patents will represent a higher value patent resulting from substantive patent examination.</p>                                                                                   |

## **Description of Policy Context**

### **1.1 Policy Context**

The Minister for Finance announced in the context of Budget 2016 that a Knowledge Development Box (KDB) would be introduced in 2016 and provision for this was included in the Finance Act 2015<sup>1</sup>. The Department of Finance held a public consultation on the introduction of the KDB in early 2015 which saw a strong level of public interest in this initiative.

The KDB is a policy tool to encourage innovation by providing a 6.25% rate of corporation tax on profits from intellectual property which is the result of qualifying R&D carried out within the European Economic Area (EEA). The intellectual property assets that will qualify are patents, copyrighted software and in relation to smaller companies, other intellectual property that is similar to an invention which could be patented.

The issue of harmful tax practices was examined by the OECD and G20 countries; the outcome being the adoption of a 15 point plan to address base erosion and profit shifting (BEPS) and the publication of Countering Harmful Tax Practices More Effectively, Taking into Account Transparency and Substance, 2015 Final Report<sup>2</sup>. This report was endorsed by the G20 in October 2015.

Action 5 of this report sets out the principles and guidelines under which profitable intellectual property assets can qualify for a more favourable corporation tax; the OECD “Nexus Approach”.

This Nexus Approach focuses on establishing a link between expenditure, IP assets and income. Under the OECD Nexus Approach, long term patents and copyrighted software automatically qualify for tax benefits. A third pillar IP asset can also be included; IP assets that share features of patents i.e. are non-obvious, useful and novel. Certification by a competent government authority that is independent from the tax administration is a requirement of the Nexus approach. The introduction of these third pillar assets is specifically aimed at smaller companies only to encourage more innovation and research and development within these entities.

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<sup>1</sup> Finance Act 2015 <http://www.irishstatutebook.ie/eli/2015/act/52/enacted/en/html>

<sup>2</sup> Countering Harmful Tax Practices More Effectively, Taking into Account Transparency and Substance, 2015 Final Report <http://www.oecd.org/ctp/countering-harmful-tax-practices-more-effectively-taking-into-account-transparency-and-substance-action-5-2015-final-report-9789264241190-en.htm>

The certification scheme created by the Knowledge Development Box (Certification of Inventions) Bill will enable smaller companies with income arising from intellectual property assets of less than €7,500,000 over a twelve month period to apply for this favourable rate of corporation tax. A further qualifying aspect is the company must have a turnover of less than €50,000,000 within the same twelve month period.

Ireland was the first country to introduce a Knowledge Development Box in line with the OECD Nexus Approach. The establishment of the certification scheme will ensure that small companies are able to avail of the full remit of the modified nexus. The introduction of the certification scheme will further strengthen the attractiveness of Ireland as a place for innovation, entrepreneurship and investment for small companies. It will also continue to build on Ireland's competitiveness which is at the core of Ireland's future economic development and growth.

The Taxes Consolidation Act 1997, as amended by Finance Act 2015, provides that certain patents will automatically qualify for the KDB. The definition of "qualifying patent" in the amended 1997 Act means long-term 20 year patents issued on foot of a "substantive examination" by the patent granting authority will automatically qualify. Currently, Irish patents are not subject to substantive examination; therefore amendments to the Patents Act 1992 are required to re-introduce substantive examination of patent applications. This will result in Irish long term patents qualifying for KDB and bring them up to best international standard.

## **2. Policy Objectives**

Primary legislation - Knowledge Development Box (Certification of Inventions) Bill 2016 - is required to introduce a certification scheme for these third pillar IP assets. The Attorney General's Office has advised that such a certification scheme must be underpinned on a statutory basis.

The Finance Act 2015 provides that the certification scheme for these third pillar IP assets will be administered by the Controller of Patents, Designs and Trade Marks and so meet OECD requirements. The OECD Forum on Harmful Tax Practices will review the third pillar IP assets certified for access to this scheme no later than 2020 so it is imperative that the scheme is introduced in line with these approved international guidelines.

This KDB certificate system will allow smaller companies with IP assets that are non-obvious, useful and novel to access to this favourable rate of corporation tax.

This legislation will create the certification scheme that is sufficiently robust to comply with the OECD Nexus Approach and will authorise the Controller of Patents, Designs and Trade Marks to administer this scheme on the State's behalf. The Bill will set out the definitions and procedures of this certification scheme which includes a requirement for applicants to provide the Controller with an opinion from a professional patent agent, along with accompanying evidence, attesting that the invention which is the subject of an application is non-obvious, useful and novel.

Smaller companies tend to shy away from patents to protect their Intellectual Property because of the costs involved e.g. professional agent fees, annual renewal fees, and legal costs in defending patents. Patents are publicly disclosed eighteen months after grant whereas this certification scheme will enable smaller companies to exploit and protect their IP assets as inventions certified under this scheme will not be publicly disclosed. The introduction of this scheme is intended to help stimulate innovation, research and development in our SMEs and will encourage smaller companies to exploit their IP Assets.

In addition, amendments to the Patents Act 1992 are also required in order for Irish long term patents to qualify for the KDB and to bring them up to best international standards by re-introducing substantive patent examination.

Section 769G of the Taxes Consolidation Act 1997 inserted by the Finance Act 2015 defines intellectual property as including a qualifying patent which in turn is defined as

*“(a) a patent granted following substantive examination for novelty and inventive step, or  
(b) a patent, other than a short term patent within the meaning of section 63 of the Patents Act 1992, or an equivalent provision in another jurisdiction, where—*

*(i) the Patents Office in the State, or equivalent Office elsewhere, has caused a search to be undertaken in relation to the invention and a search report (within the meaning of section 29 of the Patents Act 1992) prepared, and*

*(ii) either—*

*(I) the patent was granted prior to 1 January 2016, or*

*(II) the patent was granted on or after 1 January 2016 and before 1 January 2017 and a patent agent, within the meaning of section 105 of the Patents Act 1992, certifies that in his or her opinion such a patent meets the patentability criteria,*

*but this paragraph is subject to section 769I(6)(a)(i)(VII)”.*

Paragraph (a) above applies to long-term 20 year patents issued on foot of a substantive examination by the patent granting authority. Substantive examination is the full and detailed examination of the contents of a patent application against prior art by a patent office examiner to determine whether a patent should be granted or not. Patents granted by, for example, the UK's Intellectual Property Office, the German Patent Office and the European Patent Office would be eligible for KDB purposes, assuming other eligibility criteria are met. However, national long term patents issued by the Irish Patent Office will not be eligible on the basis that the Irish Patents Office does not carry out substantive examination on Irish patent applications since our patent regime was changed in 1992 when this function was discontinued to ease severe backlogs of patent applications at the time.

In order to ensure inventions protected by Irish long-term patents can qualify for KDB, substantive examination of Irish applications must be re-introduced. This will ensure Irish long-term patents meet best practice international standards and are on a level playing field with patents granted by other patent examining authorities.

### **3. Identification and Description of Options**

#### **3.1 Option 1: No policy change / Do nothing**

The “*do nothing*” option would:

- most likely exclude the majority of our SMEs from the certification scheme. This is not an option. One of the objectives of this scheme is to encourage our smaller companies to be more innovative and to participate in research and development activities that could result in the development of intellectual property assets.
- mean that unless patent law is changed, the status quo would prevail with the outcome that inventions protected by Irish long-term patents would be excluded from the KDB thus undermining the standing/effect of an Irish patent more generally.

#### **3.2 Option 2: Introduce new legislation to administer Certification Scheme to allow for access to KDB**

The introduction of this legislation will allow smaller companies access the KDB assuming other eligibility criteria are met. The legislation will enable the Controller of Patents, Designs and Trade Marks to administer this scheme and to issue a KDB certificate on a qualifying third pillar asset as being non obvious, useful and novel. The legislation will ensure compliance with the approved international guidelines. The KDB certification scheme should encourage and stimulate innovation, research and development in our SMEs.

### 3.3 Option 3: **Re-introduce substantive patent examination via new standalone legislation to amend the Patents Act 1992**

The re-introduction of substantive examination by way of standalone legislation to amend the 1992 Patents Act will make Irish national patents eligible for KDB tax purposes assuming other eligibility criteria are met. The legislation will be amended to enable the Controller of Patents, Designs and Trade Marks to grant or reject a patent application based on substantive examination. The Controller will be in a position to engage with the application as regards the essential criteria of novelty, inventive step and industrial applicability. In addition such legislation will put Ireland's patent legislation in line with best international standards and practice.

## **4. Analysis of Costs, Benefits and Other Impacts**

### 4.1 Costs

#### Option 1: **Do nothing/no policy change**

The “*do nothing*” option will not result in additional cost for the State; however this option may weaken our innovation culture and stagnate the growth of R & D. This option will undermine the value of our national long-term patents as inventors are likely to consider other patenting options and will also exclude our long term patents and most likely SME's from this scheme. It may also lead to a reduction in patent fee income to the Patents Office.

#### Option 2: **Introduce new legislation to administer Certification Scheme to allow for access to KDB**

Operating this certification scheme will be an extra administrative duty to be carried out by the Controller of Patents, Designs and Trade Mark and the Patents Office within current resources.

However the benefits of introducing this scheme should outweigh the costs. The introduction of this KDB certification scheme will encourage innovation, research and development within our SMEs which in turn should stimulate employment growth. Ireland is the first country to have introduced a Patent Box regime in line with the OECD Nexus Approach which will further strengthen the attractiveness of Ireland as a place for innovation, entrepreneurship and investment.



**Option 3: Re-introduce substantive patent examination to amend the Patents Act 1992**

The intention is to out-source the search and examination function to another patent office that carries out this function thus avoiding additional resource implications for the Irish Office. Currently the UK's Intellectual Property Office (IPO) carries out a search function on behalf of the Irish Patents Office with the cost to the applicant subsidised by the Irish Patents Office. Negotiations with the UK's IPO on the cost of the additional service required have been progressed and will result in a higher cost factor for applicants. However, as is the case now, an element of State subsidisation is expected to continue which practice is in line with that internationally in a bid to increase patenting activity and grow Innovation.

4.2 Benefits

**Option 1: Do nothing/no policy change**

There are no benefits readily associated with option 1.

**Option 2: Introduce new legislation to administer Certification Scheme to allow for access to KDB**

There are numerous benefits to this option including encouraging innovation and research and development in our SMEs as they will be able to access the KDB through the certification process. It will increase our competitiveness and Ireland's attractiveness as a place to do business, particularly for SMEs.

It will enable smaller companies to claim a reduced rate of 6.25% corporation tax on profits arising on IP assets which directly result from R&D carried out in the European Economic Area. This certification scheme will encourage smaller companies to exploit their IP Assets and access this scheme without incurring the costs associated with patenting.

**Option 3: Re-introduce substantive patent to amend the Patents Act 1992**

The benefits of this options are two-fold. Firstly, inventions protected by national long-term patent will become eligible for KDB purposes. Secondly, this option will see control being returned to the Irish Patents Office with regards to scrutiny of the novelty step, the inventive step and industrial application of patent applications thus putting national patents on a par with best international standards and practices.

### 4.3 Impacts

#### Option 1: **Do nothing/no policy change**

The “*do nothing*” option will disadvantage smaller companies accessing the Knowledge Development Box and will disadvantage holders of Irish long-term patents vis à vis holders of long-term patents which have been the subject of substantive examination.

#### Option 2: **Introduce new legislation to administer Certification Scheme to allow for access to KDB**

The operation of this certification scheme will be an extra administrative duty to be carried out by the Controller of Patents, Designs and Trade Marks and the Patents Office within its current resources.

#### Option 3: **Re-introduce substantive patent examination to amend the Patents Act**

This option will put holders of Irish long-term patents on a par with non-Irish/international patent holders which have been the subject of substantive examination.

Overall there will be a reduction in corporation tax collected from the participating companies, however this has already been factored into the Budget. This cost also has the potential to be outweighed by the benefits to our economic competitiveness environment which will result from the introduction of the Knowledge Development Box.

No impacts are envisaged for rights of citizens, socially excluded or vulnerable groups, gender equality, economic markets, consumers and competition, the environment or North South and East West relations.

### **Conclusion**

For the reasons set out above Options 2 and 3 are the appropriate actions to take:

- Introduce new legislation to create and administer a Certification of Inventions Scheme to allow smaller companies access the Knowledge Development Box
- Re-introduce substantive patent examination by way amendments to the Patents Act 1992

### **5. Consultation**

Extensive consultation<sup>3</sup> was carried out with stakeholders including smaller companies on the proposal to introduce a Knowledge Development Box by the Department of Finance before it was introduced by Budget 2016. In 2010, the Department of Jobs, Enterprise and Innovations consulted with stakeholders regarding the re-introduction of substantive examination on long term patents.

## **6. Enforcement and Compliance**

None

## **7. Review**

The effect and impact of the new legislation will be kept under review by the Department of Jobs, Enterprise. The legislation introduced will allow for statistical information on companies participating and inventions certified to be reported on an annual basis.

## **8. Publication**

This RIA is being published on the website of the Department of Jobs, Enterprise and Innovation.

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<sup>3</sup> The Knowledge Development Box Public Consultation  
[http://www.finance.gov.ie/sites/default/files/Knowledge\\_Development\\_Box\\_%20DFinance\\_consultation\\_finalweb%20cover.pdf](http://www.finance.gov.ie/sites/default/files/Knowledge_Development_Box_%20DFinance_consultation_finalweb%20cover.pdf)