Tax Law and Innovation Policy: Thinking Outside the Patent Box

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Abstract

This paper asks what steps beyond R&D tax incentives and patent box regimes can be taken to make our tax systems more innovation friendly? In other words, what else can be done to promote private sector innovation through the tax system?

It is now widely accepted that technological innovation – based as it is on knowledge-based capital – is the only long-term solution to the incompatibility of continued population and commodity growth and the limits placed upon us by our environment. Dismantling the current system of income taxation and replacing it with an expenditure tax on land use and resource consumption is simply not a practicable solution. One only has to look at the scale of the BEPS initiative to see how wedded we are to the income concept and income taxation. Therefore, we tax academics are tasked with the job of future-proofing the tax system we have and doing it through incremental steps.

This means that either we conceptualise new ‘add-ons’ to our tax systems – such as resource productivity tax credits – or we take a good hard look at the various elements of the income tax system and evaluate the extent to which they, in their current form, promote private sector innovation and the extent to which things might be improved in respect of these elements.

The various elements can be separated into two broad categories: taxable receipts and allowable deductions. Elsewhere, I have identified some of the failings in relation to sustainable development of five elements of the UK corporate income tax (i.e., trading income, R&D relief, capital allowances for plant and machinery, debt interest deductibility and trade loss relief). However, this exercise was not specifically undertaken in relation to promoting private sector innovation and there is still plenty of scope for analysing and suggesting improvements in relation to these and other elements of other income tax regimes. For example, the treatment of capital income, participation exemptions and group loss relief stand out as potential candidates for analysis.

In sum, as tax law academics, we can either think-up ‘add-ons’ to mitigate any harmful effect that the various elements of the income tax might have on promoting private sector innovation or we can seek to identify and address those failure at their source. This paper explores the latter option.