The Innovation Box
What It Is and Why We Need It

To help keep research and development as well as high-paying jobs in America, Rep. Charles Boustany (R-LA) and Rep. Richard Neal (D-MA) today released a bipartisan discussion draft of an "innovation box"—or a special, lower tax rate for income derived from intellectual property. They are seeking feedback on their proposal, and an updated version is expected to be included in the broader international tax legislation that the Ways and Means Committee is pursuing this fall.

Why Do We Need It?

To discourage foreign takeovers of American companies and to keep good-paying jobs in the United States. The U.S. tax code is hobbling American job creators, who are facing stiff competition in the global economy. First, the U.S. has the highest corporate tax rate in the developed world. Second, the U.S. is one of the few developed countries to use a worldwide tax regime that charges U.S. companies twice. Third, the tax code perversely encourages foreign companies to acquire U.S. companies, costing American jobs.

Other countries have been creating "innovation boxes," or special, lower tax rates for IP-related income—typically between 5 and 15 percent. And in recent months, more foreign competitors have been acquiring U.S. companies and accelerating cross-border mergers. Meanwhile, the Organization for Economic Development and Cooperation's (OECD) project on base erosion and profit shifting (BEPS) will only make these problems worse. Unless we act, several aspects of the OECD project will harm both U.S. companies and the U.S. Treasury by increasing foreign taxes on U.S. companies (some of which are allowed as credits against U.S. taxes).

In addition, The OECD BEPS project will soon require every innovation box to include a nexus component. In other words, a company will have to locate its research and development—and the high-paying jobs that go with it—in the country offering the special tax rate.

As a result, multinational companies conducting R&D in the U.S., but paying taxes in lower-tax jurisdictions will feel pressure—from both shareholders and foreign governments—to move their R&D facilities into countries with innovation boxes. The OECD's final guidelines will be published by the end of 2015, so many U.S. companies will have to decide soon whether to restructure.

By creating an innovation box in the U.S. tax code, American companies can better compete with foreign competitors, and we can remove one of the increasing incentives for U.S.-based businesses to relocate abroad.

How Would It Work?

Under the proposal, here's how a U.S. company would use calculate its taxes on IP-related income:

1. Identify gross receipts attributable to certain technology-based IP.
2. Subtract any related costs to determine the net profit from the IP.
3. Multiply this IP profit by the ratio of domestic R&D costs to total costs.
4. Apply a 10 percent tax rate to the resulting profit (instead of the general 35 percent corporate rate).

The discussion draft also would allow companies with foreign-based IP to move that IP back to the United States without paying any U.S. tax on the transfer, so that this "domesticated" IP may be eligible for the innovation box.

Although this proposal is still being developed, an innovation box would encourage U.S. companies to invest in America's workers. Reps. Boustany and Neal and all the members of the Ways and Means Committee look forward to hearing from the public about how to encourage more companies to set up shop in America—and stay here.