

The Copyright Box Model

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“A country without a patent office and good patent laws is just a crab and can’t travel any way but sideways and backwards.”

—Mark Twain, A Connecticut Yankee in King Arthur’s Court

INTRODUCTION

Intellectual property law is territorial in nature. That is why intellectual property assets have always been favorites among international tax planners. Rapid appreciation, even faster transfer times, and a somewhat vague standard for appraisal and valuation make for an interesting field of play. Transfer the assets to a low tax jurisdiction before the appreciation begins, and you find yourself with a large income stream that is taxed at a low rate. Miss the beat, and you have a large tax hit.

For these reasons, many nations have followed the lead of Ireland in providing for so-called “patent box” schemes. These tax incentives provide lower tax rates for corporations who agree to develop intellectual property in the host country. With global IP royalties over \$300 billion in 2014,¹ a tax savings of a few percentage points quickly adds up.

But patents are not the only IP assets that can be developed and licensed. Recently, the Dutch government realized this and expanded their “patent box” regime and renamed it the “innovation box.”

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1. WORLD TRADE ORG., INTERNATIONAL TRADE STATISTICS 2015 124, 139, https://www.wto.org/english/res_e/statis_e/its2015_e/its15_trade_category_e.pdf [https://perma.cc/9LDZ-CTFF]. However, some estimates have put the average growth rate for the intellectual property market at over 10% annually. *Intellectual Property Markets*, ORG. FOR ECON. CO-OPERATION & DEV., <http://www.oecd.org/sti/outlook/e-outlook/stipolicyprofiles/interactionsforinnovation/intellectualpropertymarkets.htm> [https://perma.cc/2D6W-HVTP].

While most of the world has focused on the interesting planning and development opportunities afforded patents and so-called “high-tech startups,” this Article will discuss the opportunities afforded by the lower-hanging fruit of copyrights and copyright royalties.

There are some 194 countries in the world today.² Of those, 152 are Contracting States in the Patent Cooperation Treaty.³ However, that does not mean that patents are filed in all 152 countries, or even that all of those countries maintain patent offices.

For 2015, high-income countries, of which there were fifty-six, accounted for 53.5% of the world patent applications.⁴ In contrast, the fifty-one low and lower-middle income countries accounted for only 2.7%.⁵ The disparity between high-income and low-income countries in terms of their abilities to capture and exploit high technology IP is very stark.

One way that these low-income countries can hope to participate in world wealth is by attracting outside businesses to their shores. This Article discusses the costs and infrastructure associated with developing a world-class ecosystem to attract outside business that is ready and willing to invest research and development (“R&D”) dollars in foreign jurisdictions. Unfortunately, the outlook is not good. It is expensive, in terms of both human and financial capital, to support a high-tech ecosystem capable of producing a high number of patent applications. Because most patents are not valuable,⁶ one might ask if there is a better

2. *How Many Countries Are In the World?*, WORLD ATLAS, <http://www.worldatlas.com/nations.htm> [https://perma.cc/UYM8-C45U]; Matt Rosenberg, *The Number of Countries in the World*, THOUGHTCO (June 15, 2017), <https://www.thoughtco.com/number-of-countries-in-the-world-1433445> [https://perma.cc/6XXQ-4Q9C].

3. WORLD INTELLECTUAL PROP. ORG., PCT APPLICANT’S GUIDE – INTERNATIONAL PHASE – ANNEX A 1–2 (June 9, 2017), http://www.wipo.int/pct/guide/en/gdvol1/annexes/annexa/ax_a.pdf [https://perma.cc/3EAB-WQGB].

4. WORLD INTELLECTUAL PROP. ORG., WORLD INTELLECTUAL PROPERTY INDICATORS 2016 1, 34 (2016), http://www.wipo.int/edocs/pubdocs/en/wipo_pub_941_2016.pdf [https://perma.cc/3FJ7-2MSM].

5. *Id.*

6. See Kimberly A. Moore, *Worthless Patents*, 20 BERKELEY TECH. L.J. 1521, 1526 (2005) (“It is hard to imagine that just four years after paying \$10,000-\$30,000 for preparation and prosecution of a patent application, the successful patentee would decide to let the patent expire rather than pay the \$900 maintenance fee. Nevertheless, this empirical study has found that 53.71% of all patentees do allow their patents to expire . . .”).

In truth, odds are stacked astronomically against inventors, and no marketing outfit can change them. ‘There are around 1.5 million patents in effect and in force in this country, and of those, maybe 3,000 are commercially viable,’ [Richard Maulsby, director of the Office of Public Affairs for the U.S. Patent & Trademark Office], says. ‘It’s a very small

way for lower income nations to attract outside businesses willing to develop IP.

This Article suggests that copyrights are a lower-hanging fruit, and that by providing incentives for copyright development, developing nations will spend less and reap more benefit. Part I will discuss a short history of the patent box. Part II will ask why a copyright box might be preferable. Parts III and IV will discuss criticisms of box schemes, and then look at the OECD's BEPS project in more detail. Part V will examine what issues will govern the design and implementation of a copyright box.

I. HISTORY OF THE BOX MODEL

Imagine a developing country—let's call it Newland. Newland has a middling economy and infrastructure. It wants to increase its tax base and compete with the better-developed countries of the world. One way for Newland to participate in world wealth is to attract outside business to its shores.

Some countries have done so by implementing a patent box regime. Patent boxes group the income generated by patents and tax it at low rates.⁷ By lowering the tax rate of intellectual property licensing income, the host country attracts large R&D companies and high-technology start-ups, generating wealth and promoting intellectual property development. Because of the tax incentives created by patent box regimes, many nations have followed the lead of Ireland, the original creator of the patent box.⁸ Companies caught on quickly: they realized that if they transferred their assets to a low-tax jurisdiction before the appreciation began, they found themselves with a large income stream taxed at a very low rate.

However, the patent box regime will not work for just any country. The problem is that patent boxes assume the infrastructure necessary for their creation. Countries that have not adopted a patent box are unlikely to be able to do so without a more sophisticated infrastructure. For example, some countries do not even have patent offices,⁹ and the disparity between high-income and low-income countries in terms of their abilities to capture and exploit high technology intellectual property is large. By 2014, the

percentage of patents that actually turn into products that make money for people. On top of all that, to get ripped off for tens of thousands of dollars adds insult to injury.⁷

Karen E. Klein, *Smart Answers*, "Avoiding the Inventor's Lament", BUS. WEEK, Nov. 10, 2005.

7. Cherie L. Jones et al., *Should the United States Enact a Patent Box?*, THE TAX ADVISER (Nov. 1, 2016), <http://www.thetaxadviser.com/issues/2016/nov/should-us-enact-patent-box.html> [<https://perma.cc/TBL4-B2JW>].

8. *Tax Update: Irish 6.25% Knowledge Development Box*, MASON HAYES & CURRAN (Oct. 27, 2015), <https://www.mhc.ie/latest/insights/irish-6.25-knowledge-development-box>.

9. See *Directory of Intellectual Property Offices*, WORLD INTELL. PROP. ORG., <http://www.wipo.int/directory/en/urls.jsp> [<https://perma.cc/Y43Z-FP24>].

disparity had grown even larger: the eighty high-income countries accounted for 58.4% of the world patent applications, while low and lower-middle income countries accounted for only 3.1%.¹⁰

Newland finds itself in the latter category. It has no patent office and very little existing R&D infrastructure. One might ask if there is a better way for lower income nations to attract outside businesses looking to develop intellectual property. While most of the world has focused on patents and high-tech startups, patents are not the only intellectual property assets that can be licensed. Moreover, patents are not the only intellectual property assets that generate significant revenue.

Technology is one key to economic growth. In his 1957 paper, *A Contribution to the Theory of Economic Growth*, economist Robert Solow showed that “a large majority of economic growth per hour of labor in the United States between 1909 and 1949 could be attributed to technological advances.”¹¹ For his effort, he was awarded the Nobel Prize in 1987.¹² Since then, the world has accepted the importance technological development plays in economic growth.¹³

If a developing nation wants to advance in terms of gross domestic product, per capita income, or standing in the world economic stage, it must have a stake in the world IP market. To progress towards achieving this goal, tax incentives are one way that developing nations have sought to attract foreign direct investment (FDI) in technology projects located within their borders.¹⁴

After Ireland’s introduction of the patent box scheme, France and Hungary were next to follow suit. Shortly after, other European jurisdictions—including the Netherlands, Luxembourg, Belgium, Cyprus, Liechtenstein, Malta, Spain, and the United Kingdom—jumped on the bandwagon.

10. WORLD INTELLECTUAL PROP. ORG., WIPO IP FACTS AND FIGURES 1, 9 (2015), http://www.wipo.int/edocs/pubdocs/en/wipo_pub_943_2015.pdf [https://perma.cc/4FKR-TV9P].

11. Michael J. Graetz & Rachael Doud, *Technological Innovation, International Competition, and the Challenges of International Income Taxation*, 113 COLUM. L. REV. 347, 348 n.2 (2013).

12. Press Release, The Royal Swed. Acad. of Sci., The Sveriges Riksbank Prize in Econ. Sci. in Memory of Alfred Nobel 1987 (Oct. 21, 1987), http://www.nobelprize.org/nobel_prizes/economic-sciences/laureates/1987/press.html [https://perma.cc/S2UF-LG8F].

13. Graetz & Doud, *supra* note 11, at 348.

14. In addition to tax incentives, developing nations typically attempt to attract foreign direct investment through privatizing various business sectors, lowering trade barriers such as tariffs, investing in infrastructure, and reducing hassle costs. See Padma Mallampally & Karl P. Sauvart, *Foreign Direct Investment in Developing Countries*, FIN. & DEV., Mar. 1999, at 34, <http://www.imf.org/external/pubs/ft/fandd/1999/03/mallampa.htm> [https://perma.cc/8GLU-DFVV].

Country (Year established)	Tax Rate		In addition to patents, what IP qualifies?	Can the IP be acquired?	Does existing IP qualify?
	IP Box	Corporate			
Ireland (1973, 2015)	6.25%	12.50%	Computer programs or IP for small companies	Yes	Yes
France (2001, 2005, 2010)	15.50%	33.33%	Supplementary Protection Certificates (SPC), patentable inventions, manufacturing processes associated with patents, improvements of patents	Yes	Yes
Hungary (2003)	9.50%	19%	Secret formulas and processes, industrial designs and models, trademarks, trade names, copyrights (including software), know-how, business secrets	Yes	Yes

¹⁵ See Gordon Gray, *Key Elements of a Potential U.S. Patent Box*, AM. ACTION F. (Aug. 26, 2015), <https://www.americanactionforum.org/research/key-elements-of-a-potential-u-s-patent-box/> [https://perma.cc/PX3P-YJYQ]; see also #Luxleaks: *The Reality of Tax ‘Competition’*, UNCOUNTED (Dec. 17, 2014), <http://uncounted.org/2014/12/17/luxleaks-reality-tax-competition/> [https://perma.cc/VN7S-25QR]; ORG. FOR ECON. CO-OPERATION & DEV., COUNTERING HARMFUL TAX PRACTICES MORE EFFECTIVELY, TAKING INTO ACCOUNT TRANSPARENCY AND SUBSTANCE 31 (2014) [hereinafter COUNTERING HARMFUL TAX PRACTICES], http://www.keepeek.com/Digital-Asset-Management/oced/taxation/countering-harmful-tax-practices-more-effectively-taking-into-account-transparency-and-substance-action-5-2015-final-report_9789264241190-en#.Wa2X1siGPIU [https://perma.cc/85PP-4S2K]. Note that several of these jurisdictions have modified or enacted a plan of transition for their box schemes to comply with this report.

Belgium (2007)	6.80%	33.99%	SPC, certain know-how closely linked to a patent of SPC	No, unless further developed	No
Netherlands (2007, 2010)	5%	25%	IP for which R&D certificate has been obtained (includes inventions, processes, technical scientific research, designs, models, certain software)	No, unless further developed	No
Luxembourg (2008)	5.84%	29.22%	SPC, designs, models, utility models, trademarks, brands, domain names, copyrights on software	Yes	No, unless from a related company and acquired after 2007
Spain (2008)	12%	30%	Secret formulas and procedures, plans, models	No	Yes
Malta (2010)	0%	35%	Trademarks, copyrights (including software)	Yes	No
Liechtenstein (2011)	2.50%	12.50%	Designs, models, utility models, trademarks, copyrights (including software)	Yes	No
Cyprus (2012)	2.50%	10%	Secret formulas, designs, models, trademarks, service marks, client lists, internet domain names, copyrights (including software), and know-how	Yes	No

United Kingdom (2013)	10%	23%	SPC, certain other rights similar to patents	No, unless from related group that developed the IP and acquiring company must manage use of the patent	Yes
Portugal (2014)	15%	30%	Models and industrial designs, protected by IP rights (excludes explicitly trademarks and other IP)	Yes	Yes

A. Other Countries

Nations such as the United States, Canada, Japan, and Australia have strong legal and regulatory environments in comparison to that of other countries.¹⁶ These countries do not currently have a patent box regime, but have considered it. These countries' corporate tax regimes could be amended; commentators have suggested that the lack of adoption of such a regime could result in a loss of business and the possibility of losing existing IP to countries that have more favorable tax regimes.¹⁷

B. Base Erosion and Profit Shifting (BEPS)

The OECD's Action Plan on BEPS was published in July 2013 with a view to addressing perceived flaws in international tax rules. The 40 page Action Plan, which was negotiated and drafted with the active participation of its member states, contained 15 separate action points or work streams, some of which were further split into specific actions or outputs. The Plan was squarely focused on addressing these issues in a coordinated, comprehensive manner, and was

16. Jim Shanahan, *Is It Time for Your Country to Consider the "Patent Box"?*, PWC 1, 8 (May 23, 2011), http://download.pwc.com/ie/pubs/2011_is_it_time_for_your_country_to_consider_the_patent_box.pdf [https://perma.cc/5HVE-WQAL].

17. *Id.*

endorsed by G20 leaders and finance ministers at their summit in St. Petersburg in September 2013.¹⁸

The “primary aim is to address situations where profits are perceived as geographically divorced from activities”¹⁹ and to “develop measures to counter the distorting effects of harmful tax competition on investment and financing decisions, and the consequences for national tax bases”²⁰ While the language used was less than clear, the message was clear, and rather than take their chances with parsing words, many countries have decided to revise or abandon their plans for patent box schemes.

The . . . OECD . . . has called for a “nexus” approach to benefits granted under such regimes as part of its package of final reports under the OECD’s Action Plan on Base Erosion and Profit Shifting. Many countries are already amending or have amended their existing patent box structures to align with the OECD’s nexus approach, under which a company would have to locate its R&D and associated jobs in the country offering the preferential tax rate in order to receive the benefit.²¹

However, it is possible to design a box scheme that does not run afoul of BEPS concerns. If we return to the basic question—whether it is possible to encourage economic activity in a jurisdiction—we are not automatically led to ignore the possibilities of a box scheme.

II. WHY A COPYRIGHT BOX?

Any jurisdiction interested in economic growth through increased IP development would do well to consider a few reasons why a copyright box may be preferable to other types of boxes: (A) the copyright industry’s contribution to GDP frequently rivals that of the patent industry (i.e. copyrights produce as much revenue as patents); (B) a copyright ecosystem may be easier to foster; (C) the legal system for a copyright box is much easier to create and manage; and (D) the costs of a copyright system are much less. Each of these points will be covered in turn.

18. *Base Erosion and Profit Shifting (BEPS) Action Plan*, PWC, <http://www.pwc.com/gx/en/services/tax/tax-policy-administration/beps.html> [<https://perma.cc/3WXH-K6NT>].

19. *Id.*

20. *Recommendation of the Council on Counteracting Harmful Tax Competition*, ORG. FOR ECON. CO-OPERATION & DEV. (Apr. 9, 1998), <http://acts.oecd.org/Instruments/ShowInstrumentView.aspx?InstrumentID=92&InstrumentPID=89&Lang=en> [<https://perma.cc/PSC4-627Q>].

21. *Thinking Inside the Box: Why It’s Time to Pay Attention to Innovation/Patent Box Regimes*, EY 4 (2016) [hereinafter EY, *Thinking Inside the Box*], [http://www.ey.com/Publication/vwLUAssets/EY-thinking-inside-the-box/\\$FILE/EY-thinking-inside-the-box.pdf](http://www.ey.com/Publication/vwLUAssets/EY-thinking-inside-the-box/$FILE/EY-thinking-inside-the-box.pdf) [<https://perma.cc/8PQ2-KWD6>].

A. Copyright Contributions to GDP

Let's return to Newland, a developing country that has decided it wants to participate in some of the copyright industry's²² growth.²³ A look at the copyright growth in the United States will help paint a clear picture of the growth potentially available to Newland.

According to the International Intellectual Property Alliance the U.S. copyright industry has grown almost three times as fast as the economy as a whole for the past 20 years. In 1997, the total copyright industries contributed an estimated US\$ 529.3 billion to the U.S. economy with the core copyright industries accounting for US\$ 348.4 billion. Between 1977 and 1997, the absolute growth rate of value added to the U.S. GDP by the core copyright industries was 241%. Also the copyright industry's foreign sales in 1997 (US\$ 66.85 billion for the core copyright industries) were larger than the U.S. Commerce Department International Trade Administration's estimates of the exports of almost all other leading industry sectors. They exceeded even the combined automobile and automobile parts industries, as well as the agricultural sector.²⁴

The copyright sector—those industries that produce and use copyrights—is large, and the number of jobs and the value that they add to the economies of the world is surprising.²⁵

22. Those industries that create copyrighted works as their primary product include the motion picture industry (television, theatrical, and home video), the recording industry (records, tapes and CDs), the music publishing industry, the book, journal, and newspaper publishing industry, the software industry (including data processing, business applications and interactive entertainment software on all platforms), the legitimate theater industry, the advertising industry, and the radio, television, and cable broadcasting industries.

23. The International Intellectual Property Alliance determined that “value added to U.S. GDP by the ‘total’ copyright industries in 2010 was \$1.627 trillion, or 11.10% of U.S. GDP.” STEPHEN E. SIWEK, INT’L INTELLECTUAL PROP. ALL., COPYRIGHT INDUSTRIES IN THE U.S. ECONOMY: THE 2011 REPORT 4 (Nov. 2011), <http://www.iipaweb.org/pdf/2011CopyrightIndustriesReport.PDF> [https://perma.cc/J2A2-VHXJ]. This agrees with WIPO’s assessment. WORLD INTELLECTUAL PROP. ORG., WIPO STUDIES ON THE ECONOMIC CONTRIBUTION OF THE COPYRIGHT INDUSTRIES 2–3 (2014) [hereinafter WIPO STUDIES].

24. *The Copyright Industry*, WORLD-INFORMATION.ORG, <http://world-information.org/wio/infostructure/100437611725/100438658710/?ic=100446326381> [https://perma.cc/CJH2-7GGY].

25. *See generally* STEPHEN E. SIWEK, INT’L INTELLECTUAL PROP. ALL., COPYRIGHT INDUSTRIES IN THE U.S. ECONOMY: THE 2016 REPORT (Dec. 2016), <http://www.iipaweb.org/pdf/2016CpyrtRptFull.PDF> [https://perma.cc/S8S7-JW8S]. “The ‘core’ copyright industries are those industries whose primary purpose is to create, produce, distribute or exhibit copyright materials.” *Id.* at 1 n.1. These industries include computer software, videogames, books, newspapers, periodicals and journals, motion pictures, recorded music, and radio and television broadcasting. *Id.* at iii. Partial copyright industries “are industries in which only some aspect or portion of the products that they create can qualify for copyright protection. These industries range from fabric to jewelry to furniture to toys and games.” *Id.* at 2 n.3. Non-dedicated support industries include those “that distribute both copyright and non-copyright protected materials to businesses and consumers.”

Evidence strongly suggests that workforce location is influenced by innovation boxes.²⁶ In addition, according to the OECD,²⁷ research jobs in member countries went from 2.8 million in 1995 to 4.2 million in 2007.²⁸ Among the economies with greater than 200,000 researchers, they make up the highest proportion of the workforce in Japan, South Korea, and the United States²⁹ The incentive for moving research overseas is proven by further data from the Council on Foreign Relations.³⁰ In recent years, U.S. multinationals almost doubled their overseas R&D jobs, going from 137,800 in 2004 to 267,400 in 2009.³¹ However, they only created 22,300 new jobs domestically.³² The job creation by the patent box is undeniable, but we should consider the potential job numbers from the copyright industries.

Last year, for the first time ever, the copyright industries contributed over \$1 trillion to the U.S. economy.³³ According to the International Intellectual Property Alliance, in 2015, copyright industries accounted for nearly 6.9% of GDP, which was nearly 4.6% of all private sector jobs (5.5 million) in the United States.³⁴ In addition, from 2012 to 2015, copyright

Examples here include transportation services, telecommunications and wholesale and retail trade. As in past studies, only a portion of the total value added by these industries is considered to be part of the copyright industries.” *Id.*

Interdependent industries “include those that produce, manufacture, and sell equipment whose function is primarily to facilitate the creation, production, or use of works of copyrighted matter. These industries include manufacturers, wholesalers and retailers of TV sets, personal computers[,]” and usage dependent products, including blank recording material and certain categories of paper. *Id.* We refer to the four groups together—core, partial, non-dedicated support, and interdependent—as the “total” copyright industries.” *Id.*

26. See W. Wesley Hill & J. Sims Rhyne III, *Opening Pandora’s Patent Box: Global Intellectual Property Tax Incentives and Their Implications for the United States*, 53 IDEA 371, 387 (2013); ROBERT D. ATKINSON & SCOTT ANDES, INFO. TECH. AND INNOVATION FOUND., PATENT BOXES: INNOVATION IN TAX POLICY AND TAX POLICY FOR INNOVATION 1 (Oct. 2011), <http://www.itif.org/files/2011-patent-box-final.pdf> [<https://perma.cc/U4W6-UJPW>].

27. Current member countries include: Australia, Austria, Belgium, Canada, Chile, Czech Republic, Denmark, Estonia, Finland, France, Germany, Greece, Hungary, Iceland, Ireland, Israel, Italy, Japan, Korea, Luxembourg, Mexico, Netherlands, New Zealand, Norway, Poland, Portugal, Slovak Republic, Slovenia, Spain, Sweden, Switzerland, Turkey, United Kingdom, and the United States. *Members and Partners*, ORG. FOR ECON. CO-OPERATION & DEV., <http://www.oecd.org/about/membersandpartners/> [<https://perma.cc/8ECB-ZWWF>].

28. *Global S&E Labor Force*, NAT’L SCI. FOUND., <http://www.nsf.gov/statistics/seind12/c3/c3s5.htm#s3> [<https://perma.cc/Z3H6-46CW>].

29. *Id.*

30. Steven J. Markovich, *Promoting Innovation Through R&D*, COUNCIL ON FOREIGN REL. (Nov. 2, 2012), <http://www.cfr.org/innovation/promoting-innovation-through-rd/p29403> [<https://perma.cc/XSR9-65F8>].

31. *Id.*

32. *Id.*

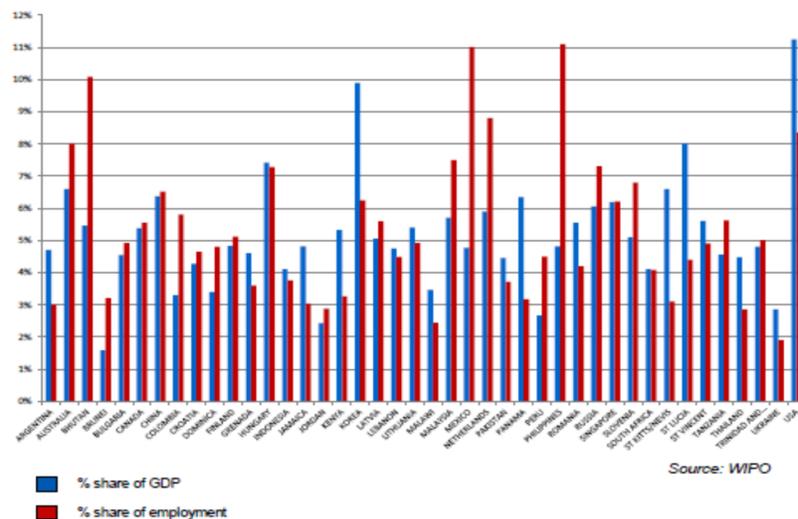
33. David Newhoff, *Spin This: Copyright Industries Grow at Twice the Rate of US Economy*, ILLUSION OF MORE (Nov. 19, 2013), <http://illusionofmore.com/copyright-industries-economy/> [<https://perma.cc/8N74-HKS7>].

34. SIWEK, *supra* note 25, at 2.

industries grew at an aggregate annual rate of 4.81%, which is more than twice the rate of the U.S. economy overall (2.1%).³⁵

Looking at the growth of the U.S. economy through its copyright industries shows the potential growth for a developing country, such as Newland. Newland could capitalize on some of this growth and increase tax revenue by attracting FDI into their country through the tax incentives a copyright box would provide. Those jurisdictions who think that they might be settling for the “soft” IP instead of pursuing the “hard” IP of patents would be well advised to examine just how large a contribution to GDP the copyright industries make.

The following chart, created by the World Intellectual Property Organization, shows the overall contribution to GDP and employment in a number of countries³⁶:



While IP-intensive industries accounted for 18.8[%] of all jobs in the economy in 2010, their \$5.06 trillion in value added in 2010 represented 34.8[%] of total GDP. This total share of GDP has edged down since 2003. . . . Patent-intensive and copyright-intensive industries accounted for 5.3 and 4.4[%] of GDP, with \$763 billion and \$641 billion in value added, respectively.³⁷

35. *Id.* at 2, 7.

36. WIPO STUDIES, *supra* note 23, at 2.

37. ECON. AND STAT. ADMIN. & U.S. PAT. AND TRADEMARK OFF., U.S. DEP'T OF COM., INTELLECTUAL PROPERTY AND THE U.S. ECONOMY: INDUSTRIES IN FOCUS 45 (Mar. 2012), http://www.uspto.gov/news/publications/IP_Report_March_2012.pdf [<https://perma.cc/79B8-XY9Q>].

B. Copyright Box is Easier

A copyright box is easier to implement than a patent box. Consider the fact that a patent box requires a patent regime. This means that Newland would have to have, at the very least, a Patent Office and a staff of examiners,³⁸ a legal system that can handle infringement disputes,³⁹ and enough of an R&D ecosystem (including universities) to make the jurisdiction attractive to outside interests.⁴⁰ In addition, because no investor is going to invest significant research dollars without legal protections, Newland will also need a fairly significant business structure regime. To the extent that these new regimes require court participation, there will be a significant time and training expense required to prepare Newland's courts for the influx of novel cases it will inevitably see (not to mention a waiting period while the first cases make their way through the system).⁴¹ It will be tough to get early adopters to Newland.

Perhaps most importantly, the ecosystem necessary to support a copyright box is much different than that for a patent regime. The types of industries that create copyrights—authors and publishers, software developers, designers, film and television producers, and artists, musicians, and the recording industry—do not require near the infrastructure that scientists do.⁴²

The ecosystem also attracts a different type of consumer:

38. See Mark A. Lemley & Bhaven Sampat, *Examining Patent Examination*, 2010 STAN. TECH. L. REV. 2 (2010).

39. See Xuan-Thao Nguyen, *Justice Scalia's 'Renegade Jurisdiction': Lessons for Patent Law Reform*, 83 TUL. L. REV. 111, 142 (2008).

40. See, e.g., Christian A. Angotti, *The Industry Too Big to Fall . . . Stumbling: Evaluating Academia's Use of Patent Rights and Its Consequential Effects on Public-Private Partnership Negotiations with Pharmaceutical Companies*, 18 DUQ. BUS. L.J. 219 (2016).

41. *The New Unified Patent Court in Europe*, JONES DAY 1 (Feb. 2013), <http://www.jonesday.com/files/Publication/e6e10384-c95e-4da1-b9ad-5bf6ca044121/Presentation/PublicationAttachment/7aa81706-3a18-43a6-be7b-7ab19f9e7e38/New%20Unified%20Patent%20Court.pdf>.

In assessing Europe's new patent regime, the core change is not just the addition of a new type of IP right. It is just as much about disempowering the national court systems and entrusting patent litigation into a new (and untested) court system, with its structure and rules of procedure built from scratch. This carries risks, as well as opportunities.

Id.

42. See Robert Spoo, *Fair Use of Unpublished Works: Scholarly Research and Copyright Case Law Since 1992*, 34 TULSA L.J. 183, 198 (1998) ("The progress of science and useful arts depends vitally on the robust participation of the members of this ecosystem as well as on their ability to exercise self-restraint. Righteous self-assertion and negative capability must work together to achieve a delicate balance."); Pamela Samuelson & Members of the CPP, *The Copyright Principles Project: Directions for Reform*, 25 BERKELEY TECH. L.J. 1175, 1181 (2010) ("A successful copyright 'ecosystem' should nurture a diverse range of works. It should encourage creators to make and disseminate new works of authorship and support readers, listeners, viewers, and other users in experiencing those works.").

Certainly, users are rational consumers in many of their interactions with creative expression. But at other times, users are deeply passionate about creative work, and, given an opportunity to connect with the creative process and a reason to do so, they will willingly invest in creative production. Users—or, more accurately, fans—fundamentally want to support artists.⁴³

Attracting copyright creators is also a different process. Richard Florida posits that the “creative class” flocks not to corporate communities or traditional working centers, but instead to “creative centers.” “What they look for in communities are abundant high-quality experiences, an openness to diversity of all kinds, and, above all else, the opportunity to validate their identities as creative people.”⁴⁴

C. Copyright Regime

Copyright protection has influenced the intellectual, cultural, and economic history of European and world society.⁴⁵ At copyright’s earliest point, English book printers and sellers created guilds that used private agreements not to publish other members’ work.⁴⁶ In 1557, a royal charter was granted that reserved to members of the Stationers Company the exclusive right to print works.⁴⁷ The Statute of Anne, enacted in 1710 by British Parliament, is known as the world’s first official copyright statute.⁴⁸

However, since the early 1960s, international treaty negotiations have underlined the differing opinions between developed and developing countries on the copyright industry.⁴⁹ Developing nations believe intellectual property rights are excessively restricting the nation’s access to technology.⁵⁰ These growing nations do not want to be denied access to technology or pay burdensome royalty and licensing fees.⁵¹ Developed nations answer these arguments with the fact that intellectual property

43. Nicolas Suzor, *Access, Progress, and Fairness: Rethinking Exclusivity in Copyright*, 15 VAND. J. ENT. & TECH. L. 297, 334 (2013).

44. Richard Florida, *Cities and the Creative Class*, 2 CITY & CMTY. 3, 9 (2003).

45. RUTH L. OKEDIJI, UNCTAD-ICTSD PROJECT ON IPRS AND SUSTAINABLE DEV., THE INTERNATIONAL COPYRIGHT SYSTEM: LIMITATIONS, EXCEPTIONS & PUBLIC INTEREST CONSIDERATIONS FOR DEVELOPING COUNTRIES 1 (Mar. 2006), http://unctad.org/en/Docs/iteipc200610_en.pdf [<https://perma.cc/L3HF-5468>].

46. *Id.* at 37 n.1.

47. *Id.*

48. *Id.*

49. Douglas L. Rogers, *Increasing Access to Knowledge Through Fair Use—Analyzing the Google Litigation to Unleash Developing Countries*, 10 TUL. J. TECH. & INTELL. PROP. 1, 52 (2007).

50. DANIEL C.K. CHOW & THOMAS J. SCHOENBAUM, INTERNATIONAL BUSINESS TRANSACTIONS: PROBLEMS, CASES AND MATERIALS 21 (2005).

51. *Id.*

rights “protect their substantial investments in research and development and offer a fair return for their efforts.”⁵² An example of this debate was demonstrated when Taiwan passed legislation creating a new copyright regime after being placed on the Priority Watch List by the United States and receiving pressure from various intellectual property groups.⁵³

For a nation that has never entered the world copyright stage, implementing a copyright regime may be relatively easy. Model copyright statutes are available.⁵⁴ While a copyright office is necessary, the workload, at least initially, is smaller.⁵⁵

D. Budget

The U.S. Copyright Office receives approximately \$52 million from Congress and uses a staff of about 460 full-time equivalents.⁵⁶ The U.S. Copyright Office recorded 670,044 works in fiscal year 2011.⁵⁷ By comparison, the U.S. Patent and Trademark Office (PTO) had 10,210 employees for the same time period.⁵⁸ The PTO handled 536,604 patent filings and 398,667 trademark filings.⁵⁹ The PTO today is run 100% from program fees, but for many years it operated in the red (today’s surplus is due to an increase in user fees).⁶⁰ For fiscal year 2011, the PTO’s total program cost was \$2,148,097,000.⁶¹ This means the PTO costs forty times more than the Copyright Office to operate, and significantly, the PTO’s

52. *Id.*

53. Francis S.L. Wang & Laura W. Young, *Taiwan’s New Copyright Regime: Improved Protection for American Authors and Copyright Holders*, 27 THE INT’L LAW. 1111, 1111 (1993).

54. See, e.g., *Draft Law on Copyright Including Model Exceptions & Limitations for Libraries and Their Users* (Electronic Info. for Libraries, Work in Progress, 2016), http://www.eifl.net/system/files/resources/201607/eifl_draft_law_2016_online.pdf [https://perma.cc/KK7T-9SF6]; Kevin Smith, *A Model Copyright Law*, SCHOLARLY COMM. @ DUKE (Aug. 22, 2009), <http://blogs.library.duke.edu/scholcomm/2009/08/22/a-model-copyright-law/> [https://perma.cc/3B35-9ZRB].

55. See *infra* Part III.D.

56. U.S. COPYRIGHT OFF., ANNUAL REPORT OF THE REGISTER OF COPYRIGHTS 9 (2011), <http://www.copyright.gov/reports/annual/2011/ar2011.pdf> [https://perma.cc/TLW8-8MBJ].

57. *Id.* at 43.

58. U.S. PAT. & TRADEMARK OFF., PERFORMANCE AND ACCOUNTABILITY REPORT 10 (2011) [hereinafter PERFORMANCE AND ACCOUNTABILITY REPORT], <http://www.uspto.gov/about/stratplan/ar/2011/USPTOFY2011PAR.pdf> [https://perma.cc/QW43-GQB4].

59. *Id.* Patent filings were at the office for an average of 33.7 months, and trademarks for an average of 10.5 months. *Id.* at 14 tbl.2.

60. See PERFORMANCE AND ACCOUNTABILITY REPORT, *supra* note 58, at 9 (“The USPTO has evolved into a unique government agency. In 1991 – under the *Omnibus Budget Reconciliation Act (OBRA) of 1990* – the USPTO became fully supported by user fees to fund its operations.”).

61. *Id.* at 76.

most significant program cost is personnel services and benefits, which comprise approximately 70% of PTO's total program costs.⁶²

In short, when we consider that: (1) copyrights produce the same amounts of revenue as patents and trademarks; (2) a copyright ecosystem and legal regime are simpler; and (3) a patent office can be up to forty times more expensive, the justification for a copyright box is much easier.

III. CRITICISMS OF BOXES

For all the benefits of boxes, they are not without drawbacks. One concern is that the creation of new box schemes may reduce the value of the already established box regimes in other countries. Another concern is the loss of tax revenue relative to any forecast increase in investment or business activity. More practically, the cost of implementing a new regime is also prohibitive for both developed countries and underdeveloped countries.

A. Value Decreases When the Number of Boxes Increase

Box regimes significantly affect decisions concerning the location of new IP, but there can be a race to the bottom:

[W]hen the United Kingdom introduces a patent box regime, the Benelux patent share will decrease (though it will still be greater than the initial share). Therefore, the benefits to a nation of introducing a patent box are diminished as more countries adopt patent boxes. . . . [I]ntroduction of patent box regimes will decrease patent revenue for all affected countries.⁶³

Graetz and Doud's research tends to support both the conclusion that a copyright box would attract IP producers to a jurisdiction, and the conclusion that the spoils go to the jurisdictions that act first. However, as more jurisdictions adopt these types of schemes, the system becomes zero-sum (or worse, it may become a race to the bottom if investors come to expect lower taxes).

B. Loss of Revenue

The loss of revenue criticism of creating a box regime argues that the developing nation will lose more in tax revenues than it gains in increased direct investment and the related "spillover"—increased national awareness, related infrastructure development, increased jobs for the local

62. *Id.* at 64.

63. Graetz & Doud, *supra* note 11, at 373.

population, etc. Because the spillover effects are difficult to measure, this argument is hard to prove or disprove.

The . . . argument, that tax incentives are ineffective and harmful because their cost in forgone revenue exceeds their benefits, is also problematic. If tax incentives are as ineffective as alleged, then no harm is done. Investors are not attracted, behavior is not distorted, and tax revenue is not forgone. Tax incentives cannot be harmful and ineffective at the same time unless taxpayers can take advantage of the tax incentives without actually investing, or unless investors who would have made the investment even without the tax incentives benefit from them.⁶⁴

There are examples for both sides, which may suggest that the criticism is misdirected. Obviously with a number of examples of successful tax subsidy schemes, the underlying premise is sound: you *can* offer a tax subsidy in exchange for direct investment and have it work to the benefit of the developing country. However, the examples of failed regimes also pose the warning corollary: you *must* design the scheme carefully. It is possible to pay too much for the foreign investment, resulting in harm to the jurisdiction.

C. Costs Associated with Creating a Box

1. Infrastructure and Ecosystem

Patent boxes assume the very infrastructure necessary for their creation. If a low-income country does not have a patent box because it is poor, it probably has poor infrastructure and is not ready to attract high-tech businesses.

Copyright boxes need infrastructure too, but specifically one that encourages the production, distribution, and consumption of creative works. “If the copyright system works like an ecosystem, the goal of copyright law should be to encourage sustainable development of creative resources in a way that provides incentives to creators, yet preserves the resources essential for new creations.”⁶⁵

2. Problems with Proposed Boxes in the United States

In 2001, then-House Ways and Means Committee Chairman Dave Camp proposed a limited patent box for the United States.⁶⁶ The box

64. Yoram Margalioth, *Tax Competition, Foreign Direct Investments and Growth: Using the Tax System to Promote Developing Countries*, 23 VA. TAX REV. 161, 182 (2003).

65. DEBORAH TUSSEY, COMPLEX COPYRIGHT: MAPPING THE INFORMATION ECOSYSTEM 2 (2012).

66. Graetz & Doud, *supra* note 11, at 369.

would have been part of a larger corporate income tax reform, which would have reduced the corporate tax rate from 35% to 25% and provided a 95% exemption for overseas profits when repatriated to the United States.⁶⁷ Specifically, the patent box was one of the alternatives the former Chairman offered as an answer to the eroding tax base.⁶⁸ The change would have created a tax rate of 15% on this intangible income.⁶⁹

Because it was part of a larger and quite costly tax reform package, Camp's proposal eventually died.⁷⁰ However, others like it have been proposed since 2011. In the summer of 2015, House Ways and Means Committee Members Charles Boustany and Richard Neal proposed draft legislation deemed the Innovation Promotion Act of 2015.⁷¹ The draft was meant to encourage discussion and outlined a basic framework for the creation of an innovation box in the United States.⁷² One problem was that there was likely to be a substantial revenue loss.⁷³ The United States is not a developing nation, but does share a concern about the amount of foreign investment directed to the United States compared with its trading partners.⁷⁴

D. Other Criticisms

1. Addressing Other Needs

Historically, developed nations needed approximately 150 years to establish a patent regime.⁷⁵ Rushing to create an IP regime without recognizing basic human needs may not be the wisest course of action:

67. *Id.*

68. *Id.* at 370.

69. *Id.*

70. See generally Alexandra Thornton, *Patent Tax Dodge: Why the Patent Box Does Not Answer America's Need for Tax Reform*, CTR. FOR AM. PROGRESS (June 1, 2015, 10:12 AM), <https://www.americanprogress.org/issues/economy/news/2015/06/01/114088/patent-tax-dodge-why-the-patent-box-does-not-answer-americas-need-for-tax-reform/> [<https://perma.cc/4YW7-5LY9>].

71. Michael Cohn, *Congressmen Propose 'Innovation Box' to Lower Taxes on Intellectual Property*, ACCOUNTING TODAY (July 29, 2015, 2:42 PM), <http://www.accountingtoday.com/news/tax-practice/congressmen-propose-innovation-box-to-lower-taxes-on-intellectual-property-75342-1.html> [<https://perma.cc/C5CX-DLUQ>].

72. JON TRAUB ET AL., DELOITTE, INNOVATION BOXES, INTERNATIONAL TAX REFORM, AND INFRASTRUCTURE SPENDING: THE PILLARS OF THIS FALL'S TAX LEGISLATIVE DEBATE 1 (2015), <http://www2.deloitte.com/us/en/pages/tax/articles/innovation-boxes-international-tax-reform-and-infrastructure-spending.html?id=us:em:na:eng:tax:092815> [<https://perma.cc/X42J-NC3U>].

73. *Id.* at 9.

74. Graetz & Doud, *supra* note 11, at 351.

75. Srividhya Ragavan, *Can't We All Get Along? The Case for A Workable Patent Model*, 35 ARIZ. ST. L.J. 117, 149 (2003).

However, developing countries lack local manufacturing capabilities. Without aiding the development of indigenous industries, the WTO policy merely facilitates trade. Devoid of local manufacturing potential, mere trade will result in the loss of indigenous industries

‘The core issue in developing countries is . . . the need for infrastructure, the provision of basic human needs, the guarantee of basic human rights, and the upward mobility [of people].’ The economies of developing countries face crises similar to what developed nations faced during the depression, including diseases, overpopulation, lack of infrastructure, and inadequate industrialization. ‘In light of such priorities, intellectual property rights, divorced from [the] immediate needs of a country’ are a mere luxury.⁷⁶

2. Short-Term Fixes

In addition, IP box schemes do not exist in a vacuum. Part of the attractiveness depends on the interplay of other nations, including other nations which may react to the creation of new legal schemes over time. Some have warned that the benefits of changing regimes may only be seen long-term and that other harms—including welfare losses,⁷⁷ a redistribution of wealth to more developed nations,⁷⁸ or increased competition with more powerful nations—may result.⁷⁹

3. Tax Incentives Distort Behavior

“Conventional wisdom weighs against using tax incentives to attract investment in general and foreign direct investment in particular. International organizations including the United Nations, World Bank, IMF, OECD and the EU have unanimously opposed the use of tax incentives to attract investments.”⁸⁰

In any discussion of tax incentives—whether at the local, national or global level—there is never a consensus that tax incentives are appropriate. Critics of tax incentives, at least as a means to encourage foreign investment, generally raise one of three issues: (1) tax incentives

and increased dependence on foreign companies. This will stunt the economies of developing countries. Developing nations are currently not at the crossroads of industrialization, where it makes sense to promote patent policies. Since developing countries have nothing to trade and cannot afford to trade with developed nations, there is a lack of logic in thrusting the TRIPS patent policy onto these nations.

Id. at 150.

76. *Id.* at 152 (quoting Ruth L. Gana, *Prospects For Developing Countries Under The TRIPS Agreement*, 29 VAND. J. TRANSNAT'L L. 735, 771 (1996)).

77. CARLOS M. CORREA, *INTELLECTUAL PROPERTY RIGHTS, THE WTO AND DEVELOPING COUNTRIES: THE TRIPS AGREEMENT AND POLICY OPTIONS* 23 (2000).

78. Keith E. Maskus, *Intellectual Property Challenges for Developing Countries: An Economic Perspective*, 2001 U. ILL. L. REV. 457, 472 (2001).

79. Ragavan, *supra* note 75.

80. Margalioth, *supra* note 64, at 181.

distort behavior; (2) they are ineffective and harmful; and (3) tax incentives are indirect solutions, and direct solutions are better.⁸¹

a. Tax Incentives Distort Behavior

This argument is usually followed up by one of two conclusions, both of which are seen as bad. First, distorting behavior is inefficient, as a matter of economic analysis.

Second, distorting behavior does not solve the underlying problem, which is that the jurisdiction is seeking to increase its desirability as a place to invest and the incentives only serve as a false or temporary “fix.”

If developing countries could create good infrastructure, a highly skilled labor force, zero inflation, a progressive tax and transfer system, political stability, and a functioning judicial system, they would not be developing countries; they would be the United States. . . . Tax incentives are not used to attract FDI instead of adopting sound policies and building good institutions, but in addition to such efforts.⁸²

b. Tax Incentives Are Ineffective or Harmful

This type of argument focuses on the fact that a tax incentive, to the extent the government agrees to forgo the collection of revenue, is roughly equal (at least in some form) to a direct expenditure. If so, then would such a direct expenditure survive a cost-benefit or cost-effectiveness analysis?⁸³

It also involves the claim that tax incentives may harm the nature of the tax system or the nature of the market that the tax incentive seeks to influence (i.e. the market of foreign capital). “In theory, tax incentives could be used to correct market failures or compensate for positive externalities; however, it is impossible to trust governments and especially those of developing countries to use tax incentives in such a way that will exclusively achieve those goals.”⁸⁴

81. See Avi Nov, *Tax Incentives to Entice Foreign Direct Investment: Should There Be A Distinction Between Developed Countries and Developing Countries?*, 23 VA. TAX REV. 685, 688 (2004).

82. Margalioth, *supra* note 64, at 184.

83. See generally Stanley S. Surrey, *Tax Incentives as a Device for Implementing Government Policy: A Comparison with Direct Government Expenditures*, 83 HARV. L. REV. 705, 714 (1970).

84. Nov, *supra* note 81, at 700.

c. Direct Measures Are Better

“[E]mpirical findings from a panel of 19 OECD countries indicated that direct support seems to have a larger impact than R&D tax incentives”⁸⁵

This, of course, is balanced by the relative ease that tax measures have in terms of having the bureaucratic infrastructure in place and a certain measure of non-transparency.⁸⁶

4. Responses

Tax incentives are designed to distort behavior. If the behavior were working in the way the designers of the tax system wanted, there would be no reason to try to influence it. However, if the desired behavior (i.e. increased revenues from copyright license fees) cannot be sustained without the tax system “priming,” then the criticism about harm and effectiveness takes on new importance.

In many cases, however, governments are trying to overcome natural or external deficiencies in the market. There is a balance that needs to be drawn when implementing new tax incentives. On the one hand, such measures (hopefully!) are temporary as a way to jump-start industry and investment. On the other hand, temporary measures are inefficient because investors tend to feel skittish about measures that may disappear. As a result, it is fair to question the efficacy and wisdom of adopting “permanent” temporary tax incentives to jump start the production of IP.

China’s Effectiveness in Attracting FDI

There is a world of data examining the factors that may affect an investor’s decisions regarding the chosen location of investment.⁸⁷ Surveys of investors have shown that “tax exemption is like a dessert; it is good to have, but it does not help very much if the meal is not there.”⁸⁸ That data shows that tax incentives are important to have, but they are not a deciding factor to an investor.⁸⁹ On the other hand, surveys of

85. Elina Gaillard & Bas Straathof, *Will R&D Tax Incentives Get Europe Growing Again?*, VOXEU.ORG (Jan. 20, 2015), <http://voxeu.org/article/rd-tax-incentives-new-evidence-trends-and-effectiveness> [<https://perma.cc/TBL9-GLRE>].

86. See, e.g., Jinyan Li, *The Rise and Fall of Chinese Tax Incentives and Implications for International Tax Debates*, 8 FLA. TAX REV. 669, 689–90 (2007).

87. *Id.* at 681–84.

88. *Id.* (quoting Jacques Morisset & Neda Pirmia, *How Tax Policy and Incentives Affect Foreign Direct Investment: A Review* 5 (The World Bank and Int’l Fin. Corp. Foreign Inv. Advisory Serv., Policy Research Working Paper No. 2509, 2000), https://openknowledge.worldbank.org/bitstream/handle/10986/19742/multi_page.pdf?sequence=1&isAllowed=y [<https://perma.cc/66C3-UTV3>]).

89. *Id.*

government officials have ranked tax incentives as a key factor in attracting FDI.⁹⁰

China is the largest recipient of FDI among developing countries and has received exponential growth over the past thirty years.⁹¹ Over this time, China has offered generous tax incentives to FDI, which can lead to the conclusion that China's tax incentives were a significant factor in attracting FDI.⁹² Most Chinese scholars and international scholars generally share in this assessment and attribute China's growth in FDI to its generous tax incentives.⁹³ Further, an apparent correlation exists between FDI and the Chinese location-specific and activity-specific tax incentives offered: over 70% of FDI has been in manufacturing,⁹⁴ and over 80% of FDI in China was invested in the coastal areas.⁹⁵ "However, using the FDI growth as a basis for asserting the effectiveness of tax incentives is unreliable as it fails to identify the amount of FDI inflow that would not have occurred in the absence of the tax incentives."⁹⁶

The European Union has conducted a survey on the factors influencing investors' decisions to invest in China.⁹⁷ Ninety-one percent of investors put incentive packages on a medium or higher position and 41% considered them highly important.⁹⁸ However, this study does not explicitly speak to whether it was tax incentives that played a critical role in choosing China. Ultimately, the data and studies suggest that tax incentives play a part in an investor's locale decisions, at least in China, but the criticism does not offer a clear picture as to how important they really are.

IV. BACK TO BEPS

The OECD began working on addressing the issue of harmful tax competition in the late 1990s and released a report in 1998.⁹⁹ The OECD

90. See generally Jacques Morisset, *Using Tax Incentives to Attract Foreign Direct Investment* 1 (Public Policy for the Private Sector, The World Bank Group, Note No. 253, 2003), <http://siteresources.worldbank.org/EXTFINANCIALSECTOR/Resources/282884-1303327122200/253Moris-020603.pdf> [<https://perma.cc/N5BN-TC6F>].

91. Li, *supra* note 86.

92. *Id.*

93. *Id.*

94. *Id.*

95. *Id.*

96. *Id.*

97. *Id.*

98. *Id.*

99. *OECD Releases Final Report on Countering Harmful Tax Practices Under Action 5*, EY (Oct. 8, 2015), <http://www.ey.com/gl/en/services/tax/international-tax/alert—oecd-releases-final-report-on-countering-harmful-tax-practices-under-action-5> [<https://perma.cc/5AH9-QPCQ>]; see ORG. FOR ECON. CO-OPERATION & DEV., *HARMFUL TAX COMPETITION: AN EMERGING GLOBAL ISSUE* 19–25 (1998) [hereinafter *OECD, HARMFUL TAX COMPETITION*],

nations were worried about “base erosion” and “tax flight”—that companies headquartered in their jurisdictions would use IP boxes to escape tax in their home countries. The OECD reports were noticeably vague, but centered on two types of threats: “Tax havens” and “harmful tax competition.” Trying to define what constituted a tax haven or harmful tax competition when the OECD nations themselves engaged in tax competition proved difficult.¹⁰⁰ After all, not everyone thinks that “tax havens” are “wrong.”

This campaign against low-tax jurisdictions is fundamentally misguided. Tax havens (to use the pejorative term coined by proponents of big government) have a valuable role in the global economy. They provide a low-tax platform for economic activity. They facilitate the efficient allocation of capital. They encourage the accumulation of capital. And, because of tax competition, they encourage better tax law in the rest of the world.¹⁰¹

A. Where is the “Harm”?

On April 18, 2002, the OECD issued its most recent list—the List of Uncooperative Tax Havens. In a statement issued on the day the list was issued, OECD Deputy Secretary-General, Seiichi Kondo, expressed his sorrow that the seven jurisdictions on the list had ‘decided that it is not in their interest to join OECD countries and other members of the international community in ending harmful tax practices that facilitate tax cheating and distort the market for financial services.’ . . . By providing a framework within which all countries—developed and developing—can work together to fight harmful tax practices, the OECD seeks to encourage transparent and fair tax competition.¹⁰²

However, not everyone bought the story that the OECD had global welfare in mind with this project:

http://www.uniset.ca/microstates/oecd_44430243.pdf [<https://perma.cc/57YK-SDB8>].

100. See, e.g., Michael Littlewood, *Tax Competition: Harmful to Whom?*, 26 MICH. J. INT’L L. 411, 472–74 (2004).

101. DANIEL J. MITCHELL, *THE MORAL CASE FOR TAX HAVENS* 3 (2006), <http://www.fnf.org.ph/downloadables/Moral%20Case%20for%20Tax%20Havens.pdf> [<https://perma.cc/LVJ5-8SHF>].

102. Vaughn E. James, *Twenty-First Century Pirates of the Caribbean: How the Organization for Economic Cooperation and Development Robbed Fourteen Caricom Countries of Their Tax and Economic Policy Sovereignty*, 34 U. MIAMI INTER-AM. L. REV. 1, 26 (2002). The OECD is obviously concerned about the effects of globalization, and about the flow of capital from the industrialized countries to the so-called tax havens. As regards the former, Mr. Kondo is clear: “Globalization has enormous potential to improve living standards around the world. But it also brings risks, including the risk of abuses of the free market system.” *Id.*

Given this significant fiscal dependence, any loss of competitiveness in the financial services sector resulting from the OECD's actions would have catastrophic results. It is reported that these developing nations could realize as much as a 25% decrease in GDP should they alter their current tax practices to adhere to OECD guidelines. Such striking losses would lead to an economic collapse devastating enough to return these offshore tax havens to their total dependence on highly unstable industries. Consequently, all recent attempts to achieve the economic development, stability, and independence sufficient to control poverty and other social ailments experienced by these nations would be throttled.¹⁰³

[T]he Organisation for Economic Co-operation and Development's (OECD) effort to stamp out tax competition . . . is designed in effect to create a tax cartel and, if the OECD succeeds, [these nations] will face the risk of higher taxes and a weakened economy while developing nations will be hamstrung in their attempts to promote economic growth . . . Tax competition is a strong factor in both maintaining and increasing the vibrancy of economies across the globe . . . The OECD is even trying to impose its will on nations that are not members of the organization, calling for draconian sanctions against so-called tax havens. This is troubling on several levels. Sovereign nations should be free to determine their own tax policies . . . and it hardly seems right for us to participate in a campaign to force other nations to change their tax laws.¹⁰⁴

B. Nexus Approach

“The nexus approach focuses on establishing a nexus between expenditures, these IP assets, and income. Under the nexus approach, marketing-related IP assets such as trademarks can never qualify for tax benefits under an IP regime.”¹⁰⁵

Why?

The criticisms against the OECD approach are many.¹⁰⁶ At its core, the OECD seems afraid that R&D centers, once housed in the OECD

103. Richard A. Johnson, *Why Harmful Tax Practices Will Continue After Developing Nations Pay: A Critique of the OECD's Initiatives Against Harmful Tax Competition*, 26 B.C. THIRD WORLD L.J. 351, 362 (2006).

104. Alexander Townsend, Jr., Comment, *The Global Schoolyard Bully: The Organisation for Economic Co-Operation and Development's Coercive Efforts to Control Tax Competition*, 25 FORDHAM INT'L L.J. 215 (2001) (citing Letter from Rep. Richard K. Armey, Congress of the United States, House of Representatives, to Lawrence Summers, United States Department of Treasury, Tax Notes Today, Sept. 7, 2000).

105. COUNTERING HARMFUL TAX PRACTICES, *supra* note 15.

106. See Littlewood, *supra* note 100, at 416 (citing Hugh Ault, *Tax Competition: What (If Anything) To Do About It?*, in 26 INTERNATIONAL AND COMPARATIVE TAXATION: ESSAYS IN HONOUR OF KLAUS VOGEL I (Paul Kirchhof et al. eds., 2002); RAJIV BISWAS, INTERNATIONAL TAX

nations, could move (or have their income centers move) to non-OECD nations. Thus, the term BEPS was born.

The problem with the OECD's report on Action 5 is one of perspective. Do box schemes hurt OECD members? Probably. Is the OECD justified in taking action to protect its members? Also, probably yes. Does that mean that the OECD policy is right? No.

Even were we to assume that the OECD statement is correct—that harmful tax competition arises when the locus of income and expenditure are different—we are not correct in assuming (which the OECD has blindly done) that patents are the *only* IP which will qualify for acceptable IP schemes. In fact, the OECD report paints a stark picture between patent and patent-type assets and so-called “marketing-related” trademarks, but they completely ignore copyrights, except for software copyrights.¹⁰⁷

So, we are left to answer the question for ourselves: Do copyright boxes constitute harmful tax competition?

C. Copyright Boxes and the OECD

1. Territoriality

Despite the stated goal of the OECD reports to establish “a nexus between expenditures, these IP assets, and income,” the OECD, in a most non-transparent way, excludes all assets that are not patents or “functionally equivalent” to patents. We can see why the OECD would want to ban trademarks because their value very easily applies to multinational entities as a whole, as opposed to having a value that “lives” in one jurisdiction alone.

COMPETITION: GLOBALISATION AND FISCAL SOVEREIGNTY (2002); WOLFGANG SCHON, TAX COMPETITION IN EUROPE (2003); Reuven Avi-Yonah, *Tax Competition and E-Commerce*, 23 TAX NOTES INT'L 1395 (2001); Reuven Avi-Yonah, *Tax, Trade, and Harmful Tax Competition: Reflections on the FSC Controversy*, 21 TAX NOTES INT'L 2841 (2000); Kimberly Carlson, *When Cows Have Wings: An Analysis of the OECD's Tax Haven Work as it Relates to Globalization, Sovereignty, and Privacy*, 35 J. MARSHALL L. REV. 163 (2002); Frances M. Horner, *Do We Need an International Tax Organization?*, 24 TAX NOTES INT'L 179 (2001); Javier Salinas, *The OECD Tax Competition Initiative: A Critique of its Merits in the Global Marketplace*, 25 HOUS. J. INT'L L. 531 (2003); Miranda Stewart, *Global Trajectories of Tax Reform: The Discourse of Tax Reform in Developing and Transition Countries*, 44 HARV. INT'L L.J. 139 (2002); Townsend, Jr., *supra* note 104; David R. Burton, *Towards a Global Tax Cartel*, POL'Y MAG., Summer 2002–03, at 9; Terry Dwyer, *The New Fiscal Imperialism*, POL'Y MAG., Summer 2002–03, at 12).

107. And they even get that wrong. “[T]axpayers in the software industry are unlikely to outsource the development of their core software to unrelated parties.” COUNTERING HARMFUL TAX PRACTICES, *supra* note 15, para. 36.

Recall that the OECD concern was of shifting profits away from the jurisdiction that created them. Moving a trademark or creating a new trademark does not mitigate against the fact that trademarks apply universally (especially in a connected, digital world). If Apple were to create a new trademarked logo in a developing world, users across the globe would notice and, presumably, the value would increase the value of all subsidiaries.

Copyrights, like patents, are much more territorial and can frequently be tied to tangible media (or at least media that behaves in territorial ways). Copyrights can be controlled.

2. “Rightly Belongs”

[The OECD] acknowledged, for example, that, ‘at certain stages’ of development, tax incentives might be ‘justifiable from the point of view of the country in question’—but this is hardly an enthusiastic endorsement. Moreover, the OECD seems to regard any shifting of investment as suspect. It alludes to countries ‘bidding aggressively’ for other countries’ tax bases and of countries ‘poaching’ a tax base that ‘rightly belongs’ to another country and concludes that ‘such practices would be doubtlessly labeled “harmful tax competition”.’ But none of these terms—‘bidding aggressively,’ ‘poaching,’ ‘rightly belongs’—is defined.¹⁰⁸

Patents may be the easiest type of IP to trace its development. Scientists and researchers frequently keep logs and journals, so expenditures for equipment and costs can be apportioned.¹⁰⁹ Trademarks, as have been discussed, are not as easy to divide, even if the activity to create them occurs in only one jurisdiction. Copyrights can produce similar questions, as will be shown in the next section.

3. Substantiality

In addition, the absence of a requirement that the activity be substantial is important because it suggests that a jurisdiction may be attempting to attract investment and transactions that are purely tax driven. It may also indicate that a jurisdiction does not (or cannot) provide a legal or commercial environment or offer any economic advantages that would attract substantive business activities in the absence of the tax minimising opportunities it provides. The determination of when and whether an activity is substantial can be difficult. For example, financial and management services may in

108. Littlewood, *supra* note 100, at 465.

109. But not always easily. See, e.g., Roger D. Blair & Thomas F. Cotter, *Rethinking Patent Damages*, 10 TEX. INTELL. PROP. L.J. 1, 4 (2001).

certain circumstances involve substantial activities. However, certain services provided by ‘paper companies’ may be readily found to lack substance.¹¹⁰

The substantial activity factor assumes that if activities (and related expenditures) occur within a jurisdiction, then the resulting IP must “rightly belong” there as well. This assumption does not always hold true for patents (researchers can bring knowledge with them to a new jurisdiction), but infringement, breach of non-compete agreements, and trade secret protection is usually felt to police serious violations.

How should copyrights fare under this scrutiny? There are two considerations. While copyrights have a lower standard of innovation, “patent law’s standards of novelty, non[-]obviousness, and utility set a high bar for protectability. That elevated standard accords with society’s frequent willingness to adopt groundbreaking inventions. By contrast, copyright’s standard of originality sets the bar much lower, making it easy for artistic works to gain protection.”¹¹¹

With a lower standard for protectability, it could be argued that some value created in a high-tax jurisdiction could be transferred to a low-tax jurisdiction, even with economic activity occurring in the low-tax jurisdiction. However, copyright requires “fixing” the creative endeavor in a tangible medium (writing, recording, filming, etc.).¹¹² If the “fixing” activities occur in the low-tax jurisdiction, the risks of tax flight are the same as for patents.

The second consideration is that copyrights are much more “mobile.” Consider the following:

Example 1. J, a Korean pop star, decides to travel to country X, which offers a copyright box with lower income rates than Korea for qualifying copyright royalties. J composes 12 songs and licenses those songs to a corporation formed in X.

Example 2. N, a well-known creator of a popular American drama, also decides to travel to X to produce the third season of the drama.

Example 3. P, a German software developer, also relocates to X while in the middle of creating what turns out to be a very popular app.

110. OECD, HARMFUL TAX COMPETITION, *supra* note 99, at 24.

111. Jeanne C. Fromer, *A Psychology of Intellectual Property*, 104 NW. U. L. REV. 1441, 1445 (2010).

112. 17 U.S.C. § 102(a) (2012).

In each of these examples, it can be argued that some of the value of the resulting copyrights started in another country and, therefore, the move to X resulted in base erosion. However, it can also be argued that “substantial domestic activities” have occurred, which are “legally protected.”¹¹³ Is this harmful tax competition? How can that argument stand, given that copyright industries rely much less on R&D infrastructure and much more on “artistic works?”¹¹⁴

V. DESIGNING A BOX

Assuming that a nation decides that a box is the right strategy and that a copyright box is the correct vehicle, there remain several issues in the design of the box that bear mention. Who are the targeted taxpayers? What kind(s) of IP qualify? Which items of income and expense are affected by the regime and what will be the tax benefit? Where must the IP and related activities be located? How will all of this affect a jurisdiction’s other incentives for innovation?

A. Qualifying Taxpayers

A new copyright box regime would need to address whether domestic as well as foreign entities (and/or individuals) would be eligible to participate. There is more control if only domestic entities can participate, as foreign companies would then need a domestic subsidiary (which allows the jurisdiction more control). Some countries limit participation by foreign taxpayers to those with a permanent establishment in the country and who come from a jurisdiction with a tax treaty with the home country.¹¹⁵

Additionally, there should be thought given as to whether the benefits are available to corporations only to the exclusion of individuals (or small businesses) and pass-through entities,¹¹⁶ as this can influence not only the focus and the marketing of the regime, but also its cost. Pass-through entities can allow the tax benefits to flow in ways that might violate the OECD recommendations or to flow outside the jurisdiction.

Finally, some thought should be given to limiting the ability of the entity receiving tax benefits to leave the jurisdiction, possibly by the use

113. The requirement that such activities be subject to “approval and registration processes” seems to be only for protectionism’s sake. As mentioned earlier, patent systems are much more costly to run and, therefore, requiring approval processes is only an argument for bureaucracy.

114. Fromer, *supra* note 111, at 1454.

115. See, e.g., *Patent Box – Tax Benefits on the Use and Transfer of Intangible Assets (Trademarks, Patents, Industrial Processes)*, INVEST IN LOMBARDY (June 10, 2015, 4:05 PM), <http://www.investinlombardyblog.com/en/2015/06/patent-box-tax-benefits-on-the-use-and-transfer-of-intangible-assets-trademarks-patents-industrial-processes/> [<https://perma.cc/DPW6-44LZ>].

116. EY, *Thinking Inside the Box*, *supra* note 21.

of agreements with a claw-back provision (i.e. if an entity attempts to: (1) move to another jurisdiction; (2) a significant percentage of its activities are no longer conducted in the jurisdiction; or (3) a significant percentage of shares are held by residents of other countries, then the tax benefits accrued must be repaid).

B. Qualifying IP

Basic questions in the design of a copyright box scheme include what types of copyrights to include. Software is different from film, which is different from music. Do all types of copyrights qualify?

There is also the question of whether all or a majority of the activities to create, produce, or distribute the media have to occur in the jurisdiction, and what do we mean by production activities or creation activities? Sometimes inspiration strikes and a hit song is written in an evening. Has the creative activity occurred in the jurisdiction even if the song is about a painful relationship that just ended elsewhere?¹¹⁷ Does the writer have to establish residency first? Should work performed outside the jurisdiction where the box is located qualify (because many creative endeavors require a team)?

Finally, copyrights have a long shelf life. Are acquired copyrights included in the box? Consider the following scenarios from Newland:

- A Newland corporation buys or licenses the Newland copyright from an American author.
- A Newland corporation acquires a record label from Germany and then proceeds to register the copyrights in Newland.
- A Newland corporation hires an indie director to produce a Newland version of a popular movie the director made in Spain.

All are arguably “new” and original in Newland and would increase the ecosystem of creativity. Do they meet the standard of substantiality? Would they be considered “poaching” of the creative work of the citizens of another jurisdiction? Does the scheme encourage forum shopping or certain sham transactions, where existing copyright assets are simply placed in a subsidiary within the copyright box jurisdiction to take advantage of the tax savings? Does the income from foreign copyrights qualify?

Further, translation rights are an important feature to consider including in the box.¹¹⁸ New translation rights have been a significant benefit to American authors translating to Taiwanese.¹¹⁹ The same benefit could be implemented for authors needing an English translation. Another

117. You want the jurisdiction to be known for copyrights, not breakups, right?

118. Wang & Young, *supra* note 53, at 1114–15.

119. *Id.*

consideration is choosing the remedies for infringement available for copyright holders.¹²⁰ Lastly, what terms of protection will be offered for copyright holders?¹²¹ This important feature offers an incentive for the life of the copyright.

C. Qualifying Income and Expenditures

1. Expenses

Expenses related to creative endeavors have always proved difficult for tax systems because the dividing line between allowable expenses and personal, non-tax expenses is never clear. Also, allocating expenses between multiple, on-going projects can be difficult.

Further, for individuals and entities engaged in multiple projects, there can be expenses that do not directly relate to any particular property (e.g. interest, rent, utilities, insurance, and salaries). These need to be factored in, especially if the expenses occur in a separate year from the development of the IP.

2. Income

Different jurisdictions define income differently. Whether income includes just royalties or also includes services income, income from embedded product sales, or capital gains from the sale of IP (whether or not the jurisdiction normally recognizes capital gains) is a matter to consider. Income definitions not only affect the IP regime but also affect transfer pricing (in the case of subsidiaries with offshore parents). Capturing too little of the income leaves potential revenues on the table, while capturing too much can brand the jurisdiction as a tax haven (lower taxes on income that is not matched to qualifying expenses).

In addition, outsourcing also creates issues for the development of a box scheme. Are the expenses and income of unrelated entities who perform work for a taxpayer to be treated the same as related parties? In a copyright context, providing for outsourced labor (a production studio, for example) may well play into the strategy of attracting new talent and investment to the jurisdiction, but does it raise the question of substantiality because there would be less direct involvement in the process by “new” participants?

Does the regime require that taxpayers maintain all relevant information for determining the allocation of income to the innovation box

120. *Id.* at 1117–19.

121. *Id.* at 1116.

regime? Is there a provision for information sharing with other tax authorities?

CONCLUSION

Countries have been attempting to use a patent box regime as a tax incentive to bring large, IP producing companies within their borders and add to their tax base. However, a copyright box does not demand an already thriving and sophisticated infrastructure, and it has the potential to generate as much—if not more—revenue than a patent box, making the copyright box highly attractive to developing countries.

A copyright box may be quicker to implement, easier to administer, and requires a smaller budget. Those interested in creating, producing, and distributing copyrights may be more mobile, as projects can be more discrete. In short, a copyright box may be an easier step to attracting foreign investment.

While much of the attention has been directed to patents and “high-tech” box schemes, developing nations would be well served to consider copyrights and their potential effect on GDP. A copyright box has the potential to attract foreign investment, copyright creators and their related industries, and increased growth without the level of infrastructure needed for other types of IP.