INTERNATIONAL JOURNAL OF LEGAL SCIENCE AND INNOVATION

[ISSN 2581-9453]

Volume 7 | Issue 1

2025

© 2025 International Journal of Legal Science and Innovation

Follow this and additional works at: https://www.ijlsi.com/

Under the aegis of VidhiAagaz – Inking Your Brain (https://www.vidhiaagaz.com)

This Article is brought to you for free and open access by the International Journal of Legal Science and Innovation at VidhiAagaz. It has been accepted for inclusion in International Journal of Legal Science and Innovation after due review.

In case of **any suggestion or complaint**, please contact **support@vidhiaagaz.com.**

To submit your Manuscript for Publication at **International Journal of Legal Science and Innovation**, kindly email your Manuscript at **editor.ijlsi@gmail.com.**

Patent Box Regime: Indian Scenario

AISHI MUKHERJEE[1]

ABSTRACT

A patent box regime is a tax incentive structure that offers advantageous tax rates on income from patents and specific forms of intellectual property (IP) in order to promote R&D and the commercialization of IP. Businesses can take advantage of lower tax rates on profits from the use of eligible patents, trademarks, copyrights, and other innovations under this scheme. The objective is to encourage innovation, support domestic R&D, and stop IP assets from moving to countries with lower tax rates.

By providing a lower tax rate on income from patents, India's patent box scheme is a tax incentive designed to promote innovation and R&D domestically. Indian-resident patent holders are entitled to a 10% tax rate reduction on worldwide revenue derived from the use of patents created and registered in India under Section 115BBF of the revenue Tax Act, which was added in the Finance Act of 2016. This clause aims to boost domestic R&D, promote IP retention in India, and increase India's competitiveness as an innovative jurisdiction.

India's patent box law and its function in offering advantageous tax breaks to inventors and intellectual property (IP) owners are the subjects of this study. The government aims to boost India's competitiveness in high-tech businesses globally and foster an environment that encourages research and development (R&D) by providing a 10% tax rate on income from patents that are filed and produced in India.

Keywords*: Patent Box Regime, Tax Incentive, Intellectual Property (IP), Research and Development (R&D), Section 115BBF.*

I. INTRODUCTION

A patent is a legal document that grants an inventor the temporary, exclusive right to produce, utilize, or market their invention without facing competition. In order to obtain these rights, inventors must submit an application, and each nation has its own rules governing the process. Once awarded, the patent safeguards the creator's intellectual property by prohibiting unauthorized use, production, or financial gain from the creation. The person or entity listed as the patent's legal owner for the duration of its validity is the patent holder, sometimes referred to as the patentee.

[1] Author is a student at University of Petroleum and Energy Studies, India.

© 2025. International Journal of Legal Science and Innovation [ISSN 2581-9453]

By enabling inventors to profit from their inventions and promoting additional study and development, patents act as a protection for innovation. Patents guarantee that inventors can profit from their labor while promoting a competitive market that promotes uniqueness and ingenuity by legally safeguarding the rights to an invention. Additionally, patents are crucial for the advancement of technology because they incentivize innovators to share their knowledge with the public in return for temporary exclusivity, which advances industry standards and knowledge collectively.

II. NEED FOR A PATENT BOX REGIME

India is not the only country that uses tax planning and tax evasion techniques. Big conglomerates and international firms frequently have the freedom to strategically arrange their business operations to reduce their tax obligations. For instance, even when the idea was created in another nation, it is usual for inventors to file their patents in tax havens. This strategy makes it possible for earnings to be transferred out of the developing nation, so denying it the right to receive any revenue from foreign-registered patents.

Many nations throughout the world have implemented advantageous tax treatment for income obtained from intellectual property exploitation in an effort to preserve intellectual property within their borders and encourage domestic research and development. Preferential IP regimes may be susceptible to abuse, according to the Organization for Economic Co-operation and Development (OECD). The OECD responded by recommending the "nexus approach" under Action Plan 5, which seeks to combat detrimental tax practices in its Base Erosion and Profit Shifting (BEPS) project—a framework in which India and other G20 countries are involved.

The nexus method suggests that rather than only taxing the jurisdiction where the legal ownership of the IP is held, income derived from the exploitation of intellectual property should also be taxed in the jurisdiction where substantial research and development activities take place. By ensuring that tax advantages are in line with the real economic activity fostering the production and growth of intellectual property, this strategy seeks to stop the erosion of the tax base due to profit shifting to low-tax jurisdictions.

According to the nexus paradigm, a nation can only grant favorable tax treatment for intellectual property revenue if there is a direct and obvious link between such income and domestic R&D operations. By deterring businesses from registering intellectual property in tax havens with little economic activity, this strategy, which is a component of the OECD's Base Erosion and Profit Shifting (BEPS) Action Plan 5, aims to combat unfair tax practices. By associating IP income with the jurisdiction that really fosters and maintains innovation, the

objective is to advance equity in the global tax system. Countries can better maintain the financial gains from domestic R&D endeavors and create an atmosphere that supports true, homegrown innovation by aligning these two areas.

India's larger objectives to promote domestic innovation, protect intellectual property (IP), and raise its reputation internationally in high-tech industries are the reasons behind the country's need for a patent box regime. Businesses and inventors will be encouraged to develop and register their intellectual property in India under a patent box scheme, which provides preferential tax rates on income produced from patents. This strategy could reduce the loss of potential tax income and innovation that arises from IP being registered abroad by discouraging Indian enterprises from looking for lower-tax nations that are more IP-friendly.

Due to the comparatively high corporate tax rates that Indian businesses currently face and the dearth of IP-specific tax incentives, foreign nations may become more alluring for patent registration. In addition to causing profit shifting, IP created in India that is registered elsewhere denies the nation the accompanying tax income and the opportunity for economic expansion that innovation-driven enterprises may provide. By encouraging businesses to retain their intellectual property locally, a patent box policy may improve the climate for R&D investments in vital sectors such as manufacturing, biotechnology, pharmaceuticals, and technology.

India's strategic initiatives, such "Make in India" and "Digital India," which seek to establish India as a manufacturing and technology hub, are well suited to a patent box regime. A patent box might draw both foreign and domestic investment by providing reduced tax rates on IP-related income. This would increase India's competitiveness as a global innovation hub and strengthen its independence in high-value industries.

Additionally, an Indian patent box system would comply with international tax regulations, particularly the OECD's nexus approach under its Base Erosion and Profit Shifting (BEPS) framework. In order to ensure that tax benefits are only given in jurisdictions that actually contribute to the development of IP, the nexus method necessitates a demonstrated connection between IP income and the location of significant R&D activity. Adopting a patent box that complies with these guidelines would deter tax incentive abuse and improve India's standing internationally in terms of IP administration and taxation procedures.

All things considered, a patent box policy would propel India's economic growth, encourage the creation of high-tech jobs, and cultivate an atmosphere that is conducive to invention. India may improve its position as a globally competitive location for R&D and high-value IP-based

enterprises, fostering long-term technological and economic growth, by keeping IP domestically and making sure tax income is in line with actual economic activity.

III. PATENT TAX REGIME ALL OVER THE WORLD

European nations are more likely to have patent tax regimes; Ireland was the first to implement one, which was initially known as the "Patent Box." The country's tax forms had a special patent checkbox, which is where the phrase came from. Ireland recently upgraded its system and changed its name to the "Knowledge Development Box," which reflects a new emphasis on a wider variety of intellectual property, including patents. Similar tax breaks are also offered by several European nations, including France (Patent and Royalties regime), the UK (Patent Box), the Netherlands (Dutch Innovation Box), and Spain (Spanish IP Box). These regimes have been modified to conform to the OECD's BEPS (Base Erosion and Profit Shifting) guidelines, or they were implemented prior to their introduction.

Guidelines for ensuring that tax benefits for intellectual property are connected to significant research and development activities are provided by the OECD's BEPS framework. In order to combat detrimental tax practices, stop base erosion, and promote true innovation domestically, numerous European nations have adjusted their patent tax policies to comply with BEPS principles. The goals of these updated regimes are to stimulate domestic R&D, draw in high-tech businesses, and stop the abuse of tax breaks that could result in tax evasion or the transfer of earnings to low-tax jurisdictions. These nations foster innovation and encourage the expansion of knowledge-driven economies by providing tax benefits for intellectual property income while maintaining adherence to international tax norms.

(A) Patent box regime in India:

Through the Finance Act of 2016, India implemented its Patent Box regime by amending the Income Tax Act to include Section 115BBF. Patents were placed in a particular "box" on tax forms in Ireland, the first nation to adopt such a system, hence the phrase "Patent Box." Its use is further justified by the fact that the name represents the idea of separating patent money from other forms of income.

A research and development incentive was already in place under Section 80RRB of the Indian tax law prior to the implementation of the Patent Box Regime (PBR) in India. By offering a weighted deduction on R&D expenses for assessees receiving patent royalty income, this provision provided a front-end incentive. This strategy was investment-linked, providing tax breaks for associated costs to entice companies to spend money on R&D.

The focus switched from front-end incentives like Section 80RRB, which offered relief based on R&D expenditures, to a back-end incentive that offers a concessional tax rate on income produced from patents with the establishment of the Patent Box Regime. In an effort to foster innovation and increase India's competitiveness in high-tech and R&D-driven industries, this shift is in line with international standards and offers businesses an extra incentive to create and preserve their intellectual property in India.

A back-end incentive known as the Patent Box Regime (PBR) was implemented in India to meet particular demands for the nation's innovation environment. First, India's innovation and patenting activity were not sufficiently encouraged by the current front-end incentives, which offered deductions based on R&D spending. The nation's IP creation and patent filings increased only somewhat in spite of these input-based incentives.

Second, in keeping with the "Make in India" initiative to promote homegrown manufacturing and innovation, the government sought to phase down investment-linked tax incentives gradually. This goal is supported by switching to a back-end incentive like the PBR, which encourages companies to preserve and utilize intellectual property in India by rewarding revenue from patents rather than merely R&D expenditures.

Finally, by using the "nexus approach," the PBR strengthens India's commitment to the OECD's Base Erosion and Profit Shifting (BEPS) project. This strategy, which is suggested by BEPS Action Plan 5, ensures that only income that is directly related to domestic innovation is eligible for preferential rates by linking IP tax benefits to significant R&D activity within the taxing nation. As a result, the PBR makes India more competitive and aligns its intellectual property tax laws with international norms.

In order to encourage research and development at home and build India as a global center for R&D, the government created a tax system that is specifically lenient for patent income. The lowered tax rate is another reason why businesses are encouraged to keep, market, and create new, patented items in India. In industries including development, manufacturing, and intellectual property management, this regime promotes companies to generate and preserve high-value jobs by creating an environment where patents are both created and exploited locally.

In addition to attracting and stabilizing high-tech firms in India, this advantageous taxation system aims to promote continuous innovation. In line with India's overarching goal of becoming a major force in global innovation, it encourages the development of new patents and fortifies incentives for businesses to use their current intellectual property in the local

market. By making it more appealing for businesses to invest in long-term R&D projects domestically, the effort demonstrates a strategic approach to combining R&D and manufacturing, fostering economic growth, and securing India's position in the global intellectual property environment.

a. Section: 115BBF-Dealing with patent tax in India:

Royalties received by Indian residents from the utilization of patents are subject to a 10% concessional tax rate under Section 115BBF of the Indian Income Tax Act. By providing tax breaks to people and companies who are actual inventors of patents issued under the Patents Act of 1970, this clause—known as the Patent Box Regime—aims to promote innovation in India. Only taxpayers who are listed on the official patent registry as patentees—either as lone or joint inventors—are eligible for the regime.

The taxpayer's total income must include royalty revenue solely from patents created and registered in India in order to be eligible for the reduced tax rate. One crucial requirement is that the invention's research and development costs must have been at least 75% domestic. This provision supports the government's objective of encouraging local innovation by guaranteeing that the benefit is only granted to patents with significant R&D inputs from within India.

Under Section 115BBF, royalty income is defined broadly to include a variety of considerations, including payments made for the transfer of patent rights (including licensing) and the dissemination of knowledge about how a patent is used or operated. Earnings from services associated with any of these activities as well as from the direct use of the patent are included. Nonetheless, profits categorized as capital gains and proceeds from the commercial sale of goods produced with the patented method or item are expressly excluded under the system. Instead of focusing on indirect commercial exploitation, this exclusion maintains the tax benefit's concentration on direct income from patent usage.

In order to benefit from Section 115BBF, taxpayers must submit Form No. 3CFA by the deadline for submitting returns under Section 139(1). The form, which includes comprehensive patent data (such as patent number, description, and ownership details), essential taxpayer details (such as name, PAN, and address), and a thorough account of royalty income and R&D expenses both inside and outside of India, must be digitally verified by an authorized individual. To maintain clarity and compliance, each qualified patent, along with the related revenue and costs, must be reported separately.

The safe processing of Form 3CFA is supervised by the Director General of Income-tax (Systems), who establishes standards, formats, and procedures for the collection, transfer, and

storage of data. This regulatory monitoring supports the integrity and efficacy of India's patent box regime as a mechanism for fostering innovation and preserving intellectual property inside the nation by guaranteeing the safe and methodical gathering of patent-related tax data.

b. OCED comments on India's Concessional taxation on Patents:

According to the OECD's 2018 Progress Report on Preferential Regimes on damaging Tax Practices, India's patent tax system is "Not harmful." This designation indicates that India's tax system excludes provisions that would weaken the tax bases of other jurisdictions or encourage tax rivalry, which could result in a worldwide drop in tax rates—a process referred to as a "race to the bottom." The "Not harmful" designation denotes adherence to the OECD's Inclusive Framework, which offers standards for avoiding tax actions that could compromise the integrity of international taxation.

The paper focuses on India's implementation of the Nexus strategy, which is a fundamental component of Action 5 of the Base Erosion and Profit Shifting (BEPS) Action Plan. Tax benefits for intellectual property (IP) revenue must be directly related to significant activity in the country providing the benefit, according to the nexus method. This relationship guarantees that tax breaks on intellectual property, such as patents, are linked to significant economic activity in India. This promotes equitable taxes and lessens the possibility of cross-border tax base erosion by bringing India's IP tax policy into compliance with OECD principles.

c. CBDT Notification on Rules and Form for Patent Box Regime under the Income Tax Act:

In accordance with the Base Erosion and Profit Shifting (BEPS) Action Plan of the OECD, the Central Board of Direct Taxes (CBDT) in India released a notification about the implementation of forms and regulations pertaining to the patent box regime under the Income Tax Act, 1961. One important step in promoting innovation while upholding tax compliance and halting the erosion of the tax base is the implementation of the patent box regime. This system is a component of India's larger initiative to promote the growth of intellectual property (IP) and bring its tax laws into compliance with global norms.

On March 1, 2021, the CBDT published a notification (No. 48/2021) outlining the guidelines and documentation that taxpayers need to follow in order to receive the advantages of the patent box regime. The process for claiming the lower tax rates on income obtained from patents is outlined in these regulations.

In particular, Rule 21AD, which describes how a taxpayer can be eligible for the benefits under the patent box regime, was included in the announcement. To support the assertion that the

revenue is due to Indian-developed patents, a taxpayer must keep records and documentation. In order to prove that the income being claimed is patent-related revenue, the taxpayer must additionally submit a declaration to the Income Tax Department.

The taxpayer must submit Form 3CEG with their income tax return in order to take advantage of the patent box system. This form asks for detailed information about the patents, such as their type, the revenue they generate, and proof that the taxpayer's assertion that the revenue comes from qualifying Indian-developed inventions is true. Transparency is ensured by Form 3CEG, which also enables the tax authorities to confirm that the revenue claimed complies with the requirements outlined in the tax legislation and the BEPS Action Plan of the OECD. The form also contains information about the type of development activities carried out to produce the IP and the amount of revenue attributable to patents. This guarantees that tax advantages are only given to those genuinely engaged in innovative activities in India.

According to the OECD's nexus approach, the patent box regime necessitates that the tax benefits for patent income be connected to significant operations conducted in India. This need is strengthened by the CBDT regulations, which stipulate that taxpayers must provide proof of qualifying research and development (R&D) expenditures, such as those associated with the creation, enhancement, or upkeep of the patents. This clause aims to guarantee that tax benefits are exclusively given for income resulting from significant invention and economic activity in India, not for passive income from patents.

Form 3CEG's release and the CBDT's notification and regulations pertaining to the patent box system represent a major step in bringing India's tax laws into compliance with international IP taxation norms. The regime encourages innovation while combating tax evasion by providing preferential tax rates on income produced from patents and imposing precise reporting and documentation requirements. While making sure that tax benefits are connected to actual economic activity and adherence to international tax norms, these initiatives seek to assist India's developing knowledge sector.

d. **What I think**:

A concessional tax scheme for patent revenue has been implemented by the government in an effort to encourage domestic research and development (R&D) activities and establish India as a global center for R&D. This regime's main goals are to encourage the creation of new, inventive patented items and to provide incentives for businesses to keep and market their current patents. This strategy seeks to incentivize companies to create high-value jobs in India, especially those involving patent research, manufacture, and exploitation. These programs

support the nexus strategy, which is recommended by the Organization for Economic Cooperation and Development (OECD) in its Base Erosion and Profit Shifting (BEPS) Action Plan 5. According to this method, profits made from the use of intellectual property must be given to and taxed not just in the country of legal ownership but also in the jurisdiction where significant R&D activities are carried out.

e. How to make India a global R&D hub?

Refinement of existing patent box regime:

It was stressed that "research drives innovation, and innovation fuels economic growth" when India implemented the patent box regime. The government's proactive approach to encouraging domestic companies and local research and development (R&D) was evident in the establishment of this regime. Across the nation, professionals and stakeholders overwhelmingly supported this approach.

As long as at least 75% of the development activity takes place in India, royalty income from patents registered by Indian nationals under the Patent Act is now taxed at a lower rate of 10%. Despite the fact that India has had a special regime since 2016, European countries like Luxembourg and the Netherlands are still favored locations for intellectual property (IP) because of their alluring incentives and support systems.

IV. CHALLENGES IN CURRENT REGIME

Limited scope for eligibility and cumbersome registration process:

The influence of India's current patent box scheme is restricted by its restrictive eligibility and onerous registration procedure. Non-resident patent holders, regardless of whether their patents are registered or used in India, are left without any real incentive since it only applies to Indian residents and royalties from patents filed under the Patents Act, 1970. The number of patent applications reflects this, with resident filings rising in India relative to non-resident filings. Innovation is discouraged from being patented domestically in India due of the lengthy and complicated patent registration procedure. Furthermore, even while research and development (R&D) companies in India produce a lot of R&D output, their parent or affiliate companies patent a large portion of it overseas. The percentage of patents awarded in India is low in fields like information and communications technology (ICT), which draw significant foreign direct investment (FDI). Furthermore, since a large portion of India's R&D is focused on software, the Patents Act of India prohibits the patenting of software discoveries unless they are integrated with hardware. This is a significant obstacle. Finally, the regime's market appeal is

limited because it solely protects patents, excluding other intellectual property like know-how, copyrights, drawings, and models.

Inclusion of other intellectual property:

In contrast to countries like France and Luxembourg, India's existing patent box regime only covers royalties on patents and excludes revenue from patent transfers. Furthermore, the advantageous tax status does not apply to revenue derived from internal R&D patents employed in manufacturing or service provision. In addition to the notable surge in patent applications, India has also received a sizable volume of applications for other types of intellectual property (IP), such as 30,988 copyright applications in FY 2021–22 and 21,446 industrial design applications in 2021. This suggests that patents are not the only source of innovation in India. But because the current system only considers patents and ignores other forms of intellectual property like know-how, copyrights, drawings, and models, has limited its appeal and uptake in the market.

Allowability of expenses and carry forward of loses:

There are no provisions for carrying forward losses or mitigating costs associated with royalties under the existing framework. As a result, the patent box regime does not help companies who suffer large losses when creating intellectual property (IP). For innovators and risk-takers involved in new R&D endeavors, the transition from a cost-based incentive scheme to an income-based one is insufficiently motivating. Businesses that face large initial costs in the early phases of IP development are not given the support they need under this framework.

Lock-in of 5 years:

A taxpayer cannot use the patent box regime option again for the next five assessment years if they choose not to do so in a particular year. This restriction is thought to be unduly stringent, preventing decision-making flexibility.

(A) Changes that can be introduced in the current regime:

A number of adjustments could be taken into consideration in order to improve the efficacy of the current patent box regime. First, as demonstrated in countries like France and Luxembourg, the regime would be in compliance with international standards if it were extended to encompass both royalty revenue from patents and income from intellectual transfers. Furthermore, providing incentives for internal R&D patents utilized in production or service delivery would motivate companies to leverage their inventions more widely. In order to represent the diversity of India's innovation landscape, the regime should be expanded to

include additional intellectual properties like know-how, copyrights, industrial designs, and models. Startups and companies investing in high-risk R&D activities would greatly benefit from the ability to carry forward losses or deduct costs associated with royalties.

Last but not least, granting more freedom to choose whether to join or leave the system would enable taxpayers to better control their tax plans without being constrained by a strict five-year lock-in term. These adjustments could greatly increase the regime's attractiveness and efficacy in encouraging domestic R&D and innovation in India.

V. CONCLUSION

In conclusion by providing tax breaks on royalties from patents, India's patent box policy seeks to promote innovation and enhance the nation's standing as a center for research and development. Although the program has been a positive move, the regime can be improved in a number of areas to increase its efficacy. The regime would be more inclusive and representative of the varied nature of innovation in India if its purview were extended to include income from the transfer of patents, in-house R&D patents used in manufacturing or services, and other intellectual properties like know-how, copyrights, and industrial designs. Additionally, entrepreneurs and businesses in the early phases of establishing intellectual property would benefit from the ability to carry forward losses and deduct R&D expenses. Taxpayers would be able to better manage their tax strategies if there was more flexibility in choosing to opt in or out of the regime rather than a strict five-year lock-in period. By filling in these loopholes, India's patent box policy may attract more foreign and domestic companies, boosting local R&D investment, boosting economic expansion, and making India more competitive in the global innovation arena.

*****

© 2025. International Journal of Legal Science and Innovation [ISSN 2581-9453]