

# Patent Box Briefing

If you own, or hold an exclusive licence over a patent, you may be able to reduce the tax liability on the profit that patent generates.

## Introduction

Legislation was included in Finance Act 2012 to introduce a Patent Box regime into the UK. Relevant IP Profits arising on or after 1 April 2013 will be taxed in the box at a reduced rate. The reduced rate of taxation on these profits is currently set at 10% but with the full benefit of the reduced rate phased in over five years.

The UK has agreed to end the old Patent Box regime completely by June 2021 and new legislation was introduced to amend the regime and make it compliant with the OECD's BEPS report. From 1 July 2016 New Entrants to the Patent Box will have to comply with the new rules in full. Companies elected into the old regime before 1 July 2016 will be able to continue applying the old rules in respect of "old IP" until July 2021.

Companies have to elect into the Patent Box regime and they then remain in until the election is revoked. However, it may not always be beneficial to elect into the Patent Box.

## Will we be able to benefit?

You could qualify if you own qualifying IP rights or an exclusive licence over such rights. You could also qualify if your company has held such rights in the past and you now have taxable income arising from an event in respect of those rights that occurred at a time when the company was a qualifying company and had elected into the Patent Box. This would cover, for example, damages for an infringement that occurred in an earlier period but were only received now, after the right has expired (or was sold).

Companies benefiting from the Patent Box must have been actively involved in the innovation underlying the patent and/or the development of the patented invention. This means that either the company, or another group company, must have undertaken (or undertake) the 'development work'. If your company is a member of a group and didn't undertake the development work itself, then it will also need to be actively involved in management of the IP.

Your company does not have to meet the development condition in respect of all of its IP rights in order to be a qualifying company. However, only those rights for which it meets the development condition will be qualifying IP rights.

The key element of the new rules is the "nexus" condition. This means that there will need to be a clear link between R&D expenditure on the patented invention and the IP profit. This is achieved by means of an "R&D fraction".

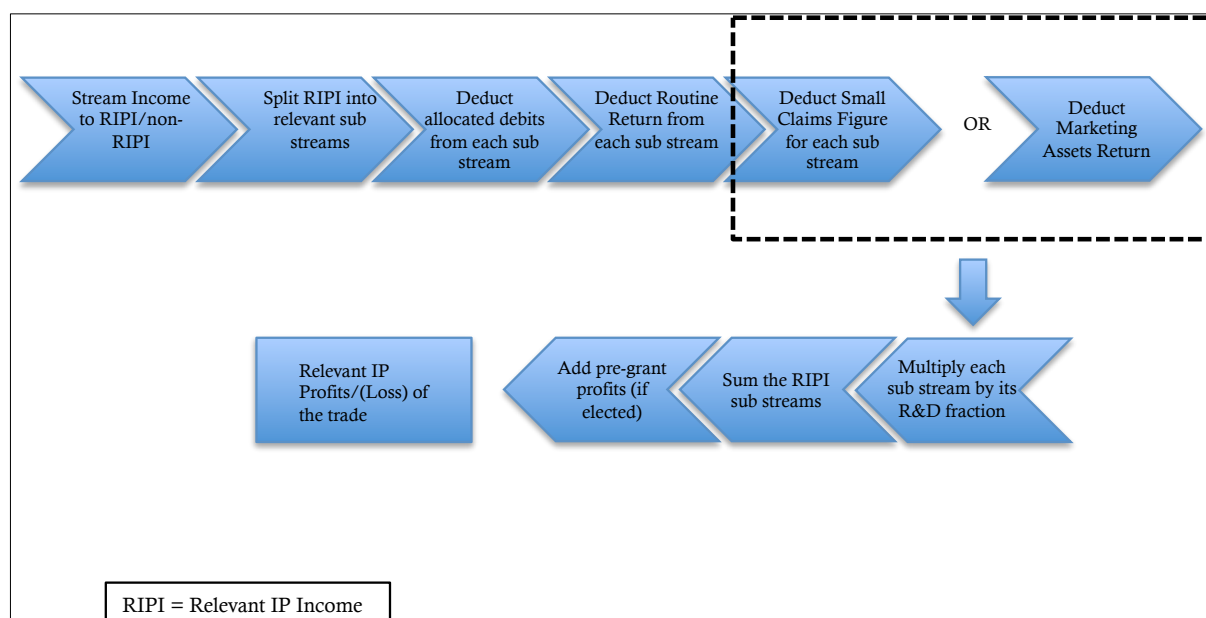
## Qualifying Intellectual Property Rights

The legislation only applies to patents issued by either the UK's Intellectual Property Office (IPO), the European Patent Office (EPO) or under the law of certain specified EEA states. At the moment, these are: Austria, Bulgaria, Czech Republic, Denmark, Estonia, Finland, Germany, Hungary, Poland, Portugal, Romania, Slovakia and Sweden.

In addition, certain other specialised rights, with rather limited application, will be included.

## Identifying the Relevant IP Profit

The legislation provides a staged process for working out the qualifying profit to be included in the Patent Box. The basic process is as shown in the flowchart.



### *Small claims treatment*

This simplifies the process to enable companies with a single trade and small levels of qualifying residual profit (QRP) to avoid having to make the 'marketing assets return' adjustment. QRP is the sum of the IP sub streams after deducting the Routine Return.

Your company is eligible to make a small claims election if either:

- its total QRP for the period is not more than the small claims threshold (SCT) of £1m; or
- its total QRP for the period is not more than £3m and it has not deducted a marketing assets return in the previous 4 years.

The £3m upper limit is shared amongst all associated companies that are elected into the Patent Box.

If your company is eligible to make the election, the Small Claims Figure for each IP sub stream will be the lower of:

- 25% of the amount of the IP sub stream after deducting the Routine Return; and
- The amount of the IP sub stream after deducting the Routine Return multiplied by  $(1 - (SCT/QRP))$ .

As with the upper limit, the £1m SCT is shared amongst associated companies elected into the Patent Box.

### **Losses**

If the calculation results in a relevant IP loss:

- If there are other group companies with RIPP, then the loss must first be offset against their RIPP;
- If there is still some relevant IP loss not surrendered (or there are no such group companies), the balance is carried forward for use in future periods (either by offsetting against RIPP of the company or appropriate group companies in that future period as appropriate).

### **Commencement**

The original Patent Box regime came into effect from 1 April 2013 but with the full benefits phased in over 5 years. The revised "nexus approach" regime is effective from July 2016 for new entrants and new IP, companies already in the "old" Patent Box regime will be grandfathered in respect of their "old" IP until July 2021.

### **What should we be doing now?**

Qualifying patents will need to be identified and evidence obtained that the various conditions are satisfied. Consider the sources of income related to those patents: Are the patents embedded in product, used in a manufacturing process or are the patents being licensed out? How can that income be identified and recorded? The nexus approach will necessarily require more information to be recorded than under the old regime. Companies wishing to participate in the Patent Box should start to record information on their R&D expenditure in a compliant format.

Companies with Patent Box losses may be better off delaying entry to the regime.

### **How can I help?**

At face value, the Patent Box is an obvious choice for companies with patent profits, even with the new nexus rules. In practice, however, there are many factors that need to be considered in deciding when, or indeed whether, to elect into the regime. Then there's the process of collating all the information needed to compute the RIPP, which will factor into the decision making process even before an election is made.

This can seem a complex relief and the transitional provisions in particular can make it difficult to navigate. I have been involved with HMT and HMRC in the discussions and consultations throughout the development of both the old and the new regimes. I also have experience of advising on Patent Box regimes in practice.

Contact me now for a no-obligation chat about preparing your company for the Patent Box.

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