

Tax incentives for Innovative companies

The Patent Box – a reduced rate of corporation tax for profits from patents

Overview

The UK patent box came into effect on 1 April 2013. It gives a reduced rate of corporation tax (10%) to the profits earned from the exploitation of either UK or European patents (or similar intellectual property rights) owned by the company. The UK Government's aim is to provide another tax incentive (in addition to **R&D tax relief**) to those UK companies that innovate.

As a direct result of the OECD's Base Erosion and Profit Shifting (BEPS) Action Plan, the UK's patent box rules ("old rules") have been modified. With effect from 1 July 2016 "new rules" have been introduced. These place an additional restriction on the patent box benefit if the R&D that led to the patent is not undertaken by the company itself or unconnected third parties. Under the old rules there is no such requirement.

In general, the following will come under the new rules with the restrictions outlined above:

- any new patents or products created after 1 July 2016; or
- any companies electing into the patent box for the first time for an accounting period beginning on or after 1 July 2016 ("new entrants").

However, the old rules will also continue to operate until 1 July 2021. Those companies who have made (or are eligible to make) a patent box election under the old rules may continue to calculate their patent box profit under these rules but only for existing patents or products.

So, for the next few years (until 1 July 2021) companies may find themselves in the position of operating patent box under both old and new rules on different products or patents.

Whether your company is under the new or old rules, there is much to consider with the patent box and it is important to get the strategy right from the start.





Action point

There is still time to elect into the patent box under the old rules

The patent box is a company-wide election. Although the old rules are now closed to new entrants there is a two year deadline after the end of an accounting period to elect into the patent box. If your company qualified for the old rules at 30 June 2016, and the accounting period in question began **before 1 July 2016** there is still time to make the election.

Example: A company has a 31 December 2016 year end. It has not elected into the patent box before. It owned a qualifying patent at 30 June 2016. This would be eligible to be treated under the old rules. It would have until 31 December 2018 to make the election for the old rules to apply to the 31 December 2016 year end.

Contact us for more information

The specifics - Old rules - period prior to 1 July 2016

Key features

All worldwide sales (and hence profits) derived from a UK- or EU-patent (or exclusive patent rights) may be included in the patent box.

Key conditions

- The company must own either the exclusive rights to a UK or EU patent.
- The company must have made a significant contribution to the creation of the patented invention or item incorporating the invention.
- There is a 3 step calculation to identify the profits that go into the box:
 - Step 1: Allocate all taxable profits to either a patent box or non-patent box stream.
 - Step 2: Reduce the patent box profit by an element of normal profit (known as the routine return deduction).
 - Step 3: Reduce this by an amount that relates to brand (rather than the innovation itself) known as the Marketing Asset Return.

The result is known as the Relevant IP Profit (RIPP) and this is the element that is taxed at 10%.





New rules - applicable from 1 July 2016

Key additional conditions

An additional final step has been added to the calculation above. The effect is to require a link between the underlying R&D expenditure (and who performs it) and the patents or patented items.

Step 4: Multiply RIPP (i.e. what came out of Step 3) by the R&D fraction.

The R&D fraction is the lesser of 1 and

(D+S1) x 1.3 D+S1+S2+ A

D = Qualifying expenditure on relevant R&D undertaken in-house

S1 = Qualifying expenditure on relevant R&D subcontracted to third parties

S2 = Qualifying expenditure on relevant R&D subcontracted to connected parties

A = Qualifying expenditure on acquisition of relevant qualifying IP rights

The R&D fraction is based on cumulative R&D expenditure (max 20 years).

Action points

- If R&D is conducted by a connected party (e.g. a fellow subsidiary) this may reduce the amount of benefit from patent box. Careful attention needs to be paid to the definitions of in house and subcontracted expenditure and who performs the relevant R&D.
- Companies will need to think about how to link their relevant R&D expenditure to the patents in the box – data may need to be gathered in a way not previously done.
- As the R&D fraction is based on cumulative data (for up to 20 years) it is important to consider longer term implications for how R&D is undertaken.
- Companies acquiring IP may need to consider the impact on the R&D fraction specific exemptions exist in certain circumstances.
- Companies currently under the old rules will need to think about the effect of modification of existing patents/products and whether the new rules are triggered.

How we can help

Although patent box is in its relative infancy, our tax advisers and accountants have already made elections on behalf of clients saving them thousands of pounds. We offer a pragmatic and customised approach. We will guide you through the process in a way that fits your needs.





Our **tax team** also includes science graduates who are familiar with scientific and technological processes and terminology and who have written articles on the patent box. As a firm of chartered accountants and tax advisers we also understand the accounting and audit context of patent box, its interaction with **R&D tax relief** and the wider international context of intellectual property ownership.

We have good working relationships with the relevant HMRC departments and are in regular contact with HMRC specialists to ensure our clients benefit from the most up-to-date knowledge.

Please contact your usual James Cowper Kreston contact or email msavory@jamescowper.co.uk if you would like to know more about the patent box.

This factsheet has been carefully prepared but it has been written in general terms and should be seen as broad guidance only. The factsheet cannot be relied upon to cover specific situations and you should not act or refrain from acting upon the information contained therein. Please contact James Cowper Kreston to discuss these matters in the context of your particular circumstances.

