THE PATENT BOX

Overview

• From 1 April 2013 effective 10% UK corporation tax rate for profits attributable to patents and similar intellectual property

• The 10% tax rate is being phased in over five years; by 2017 all companies will be able to secure the full 10%

• But note changes for periods beyond 30 June 2016!
THE PATENT BOX

Overview

- A company qualifies and can benefit from the Patent Box if -
  - It owns qualifying intellectual property rights (see below).
  - It receives relevant IP income (see following slide).
  - The company or group meets the development condition.
  - The group meets the active ownership condition (if relevant).

- Qualifying intellectual property rights:
  - Patents granted by the UK IPO or EPO or certain other EEA qualifying patent jurisdictions; or
  - Rights similar to patents relating to human and veterinary medicines, plant breeding and plant varieties.
THE PATENT BOX

Overview

There are five heads of relevant IP income:

2. Royalties and other income arising from licensing patents.
3. Income from the sale of patents.
4. Damages for infringements.
5. Other compensation.

In addition - Notional Royalties in relation to patents used in processes and services.

• Qualifying development is:
  - creating, or significantly contributing to the creation of the patented invention; or
  - performing a significant amount of activity to develop the patented invention, any product incorporating the patented invention or any process incorporating the patented invention.
THE PATENT BOX

Overview

• How it works:
  - Elect into the Patent Box.
  - Calculate profits that benefit from the Patent Box.
  - Calculate an additional deduction in the corporation tax computation.

• Normally there are three stages to calculate the ‘relevant IP profit’ (RIPP)
  1. Identify the relevant IP income
  2. Deduct a routine return figure
  3. Deduct a marketing assets return figure (if any)
THE PATENT BOX
Overview

1. Establish ‘gross’ profit derived from patents.
2. Remove routine operating profit.
3. Remove brand derived profit.

Balance eligible for 10% rate of tax.
THE PATENT BOX

Overview

• The routine return represents the profit a business might have made if it did not have access to unique IP - assumed to be 10% cost plus.

• Costs taken into account:
  - premises costs
  - employee costs
  - plant & machinery costs
  - professional services.

• Marketing assets return:
  - Profits attributable to brand or marketing assets
  - This figure can be calculated
  - In appropriate cases small claims treatment can be adopted.
  - Figure can be £nil.
### THE PATENT BOX
#### Example calculation

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Sales (all RIPI)</td>
<td>£10,000,000</td>
</tr>
<tr>
<td>Costs (all routine)</td>
<td>£8,250,000</td>
</tr>
<tr>
<td>Profit = taxable profit</td>
<td>£1,750,000</td>
</tr>
<tr>
<td>Routine profit</td>
<td>£825,000</td>
</tr>
<tr>
<td>Patent Box deduction</td>
<td>£346,875</td>
</tr>
<tr>
<td>Qualifying Residual profit (QRP)</td>
<td>£925,000</td>
</tr>
<tr>
<td>Taxable profit</td>
<td>£1,403,125</td>
</tr>
<tr>
<td>Marketing asset return</td>
<td>£231,250</td>
</tr>
<tr>
<td>Tax at 20%</td>
<td>£280,625</td>
</tr>
<tr>
<td>Routine profit liable at 20%</td>
<td>£165,000</td>
</tr>
<tr>
<td>Marketing asset return liable at 20%</td>
<td>£46,250</td>
</tr>
<tr>
<td>IP profit liable at 10%</td>
<td>£69,375</td>
</tr>
</tbody>
</table>

**Total: £280,625**
An alternative method to arrive at the relevant IP profit or loss figure: divide trading income into two streams and allocate trading expenses on a just and reasonable basis.

Streaming mandatory if certain conditions are met.

It is also an alternative method to arrive at the residual IP profit/loss.

A company may choose to stream if the normal rules are not to their advantage.

Must continue with streaming until basis of allocating costs no longer appropriate.

RIPI incurs lower specific costs.
Company A has patent and non patent income in streams
Company B has identical profile but its income is not streamed

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Patent Box Profit</td>
<td>1,800</td>
<td>Nil</td>
<td>1,000</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th></th>
<th>Company A</th>
<th>Company B</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>RIPI</strong></td>
<td>£000</td>
<td>£000</td>
</tr>
<tr>
<td><strong>Non RIPI</strong></td>
<td>2,000</td>
<td>2,000</td>
</tr>
<tr>
<td><strong>(200)</strong></td>
<td>(200)</td>
<td>(2,000)</td>
</tr>
<tr>
<td><strong>Profit</strong></td>
<td>1,800</td>
<td>200</td>
</tr>
<tr>
<td><strong>Patent Box Profit</strong></td>
<td>1,800</td>
<td>Nil</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th></th>
<th>Mixed</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Turnover</strong></td>
<td>£000</td>
</tr>
<tr>
<td><strong>Costs</strong></td>
<td>4,000</td>
</tr>
<tr>
<td><strong>Profit</strong></td>
<td>2,000</td>
</tr>
</tbody>
</table>

Source: HM Revenue & Customs
THE PATENT BOX

The future

• UK playing a leading role in OECD’s base erosion and profit shifting (BEPS) project

• The benefits of the existing patent box regime challenged by the German government

• Compromise to move the BEPS project forward

• Nexus approach used from 30 June 2016

• Patent income can now only fall within the regime if directly linked to R&D expenditure with substantial economic activities in the UK
**Existing regime** - closed to ‘new entrants’ by 30 June 2016.

**Grandfathering** - for taxpayers claiming before 30 June 2016 in respect of existing IP assets.

**New entrants** - taxpayers claiming post 30 June 2016 and new IP assets of taxpayers who may have claimed/continue to claim under the existing regime.
THE PATENT BOX
What to do next?

• Establish if you have any relevant IP and map these into revenue and expense streams
• Track R&D expenditure carefully and link to patented products
• Assess the merits of electing into the regime
• Integrate the use of the patent box regime into your overall R&D strategy
• Review your current UK corporate structure
• Seek and take advice from a specialist
This publication has been carefully prepared, but it has been written in general terms and should be seen as broad guidance only. The publication cannot be relied upon to cover specific situations and you should not act, or refrain from acting, upon the information contained therein without obtaining specific professional advice. Please contact BDO LLP to discuss these matters in the context of your particular circumstances. BDO LLP, its partners, employees and agents do not accept or assume any liability or duty of care for any loss arising from any action taken or not taken by anyone in reliance on the information in this publication or for any decision based on it.

BDO LLP, a UK limited liability partnership registered in England and Wales under number OC305127, is a member of BDO International Limited, a UK company limited by guarantee, and forms part of the international BDO network of independent member firms. A list of members’ names is open to inspection at our registered office, 55 Baker Street, London W1U 7EU. BDO LLP is authorised and regulated by the Financial Conduct Authority to conduct investment business.

BDO is the brand name of the BDO network and for each of the BDO Member Firms.

BDO Northern Ireland, a partnership formed in and under the laws of Northern Ireland, is licensed to operate within the international BDO network of independent member firms.