THE PATENT BOX

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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:

1. Sale of products incorporating patents.
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.

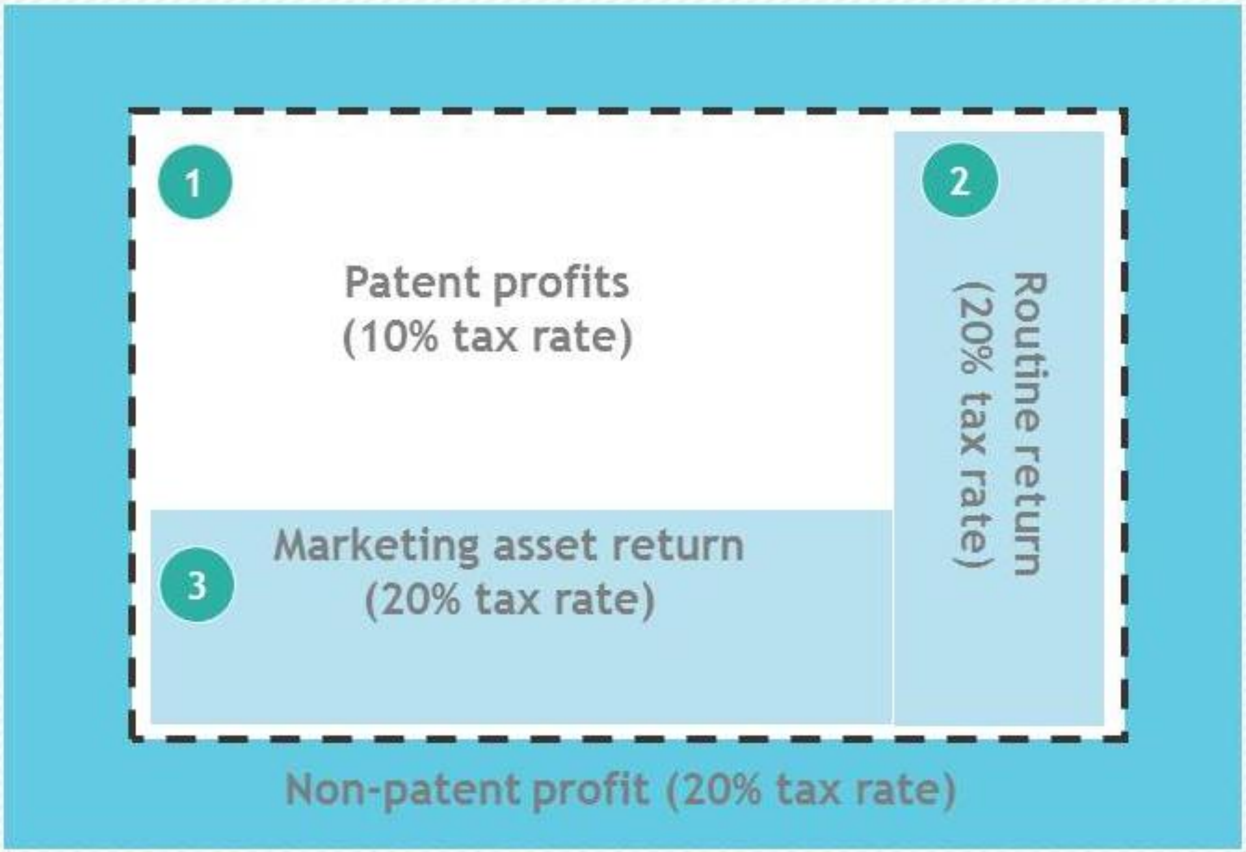
- Qualifying development is:
  - creating, or significantly contributing to the creation of the patented invention; or
  - performing a significant amount of activity to develop the patented invention, any product incorporating the patented invention or any process incorporating the patented invention.

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

Sales (all RIPI)	10,000,000			1,750,000
Costs (all routine)	8,250,000			
Profit = taxable profit	1,750,000		Routine profit	825,000
Patent Box deduction	346,875		Qualifying Residual profit (QRP)	925,000
Taxable profit	£1,403,125		Marketing asset return	231,250
Tax at 20%	£280,625		Residual IP Profit	£693,750

Routine profit liable at 20%	165,000	(£825,000 x 20%)
Marketing asset return liable at 20%	46,250	(£231,250 x 20%)
IP profit liable at 10%	69,375	(£693,750 x 10%)
	£280,625	

THE PATENT BOX
Streaming

- 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.

THE PATENT BOX
Streaming example

- Company A has patent and non patent income in streams
- Company B has identical profile but its income is not streamed

- Patent income
- Non Patent income
- Patent and Non Patent income

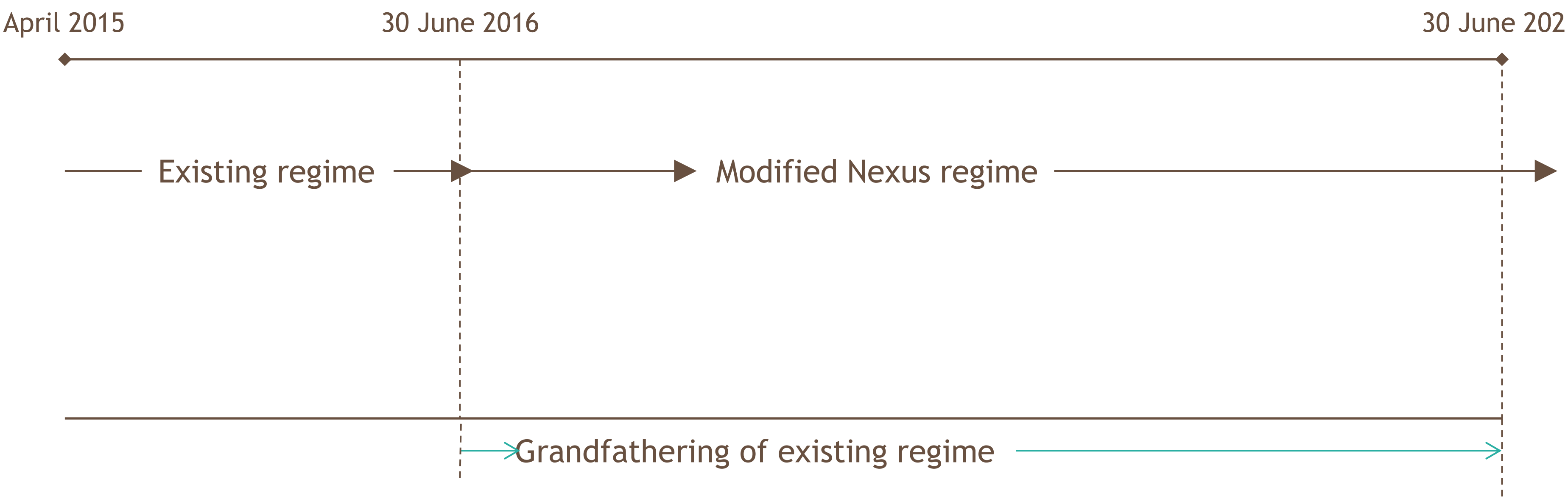
	Company A		Company B
	RIPI	Non RIPI	Mixed
	£000	£000	£000
Turnover	2,000	2,000	**4,000**
Costs	(200)	(1,800)	(2,000)
Profit	1,800	200	2,000
Patent Box Profit	**1,800**	**Nil**	**1,000**

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

PATENT BOX - THE FUTURE
Interaction with existing patent box regime



Existing regime – closed to 'new entrants' by 30 June 2016.

Grandfathering – for tax payers 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