

the Patent Box

How it impacts your company

The preferential Patent Box tax regime was introduced from April 2013. The regime provides a reduced rate of Corporation Tax of 10% on profits attributable to products or processes that are covered by a patent. This document provides an overview of the tax regime and considers how the Patent Box may affect your patent filing strategy.

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An Overview of the Patent Box

The aim of the Patent Box scheme is to encourage the development of innovative products and processes in the UK to boost investment, economic growth and numbers of high-value jobs. The regime is designed to complement the existing R&D tax credit system and increase the attraction of the UK for companies that commercialise innovation.

What kinds of IP are needed?

In order to benefit from the regime, companies must own or have an exclusive license to a Relevant IP Right, typically a patent granted by either the UK Intellectual Property Office (UK IPO), the European Patent Office or other approved European national patent authority, such as the German Patent Office. Other patent-like rights are included but these apply only in specific areas, such as the pharmaceutical sector. IP covering brands and the creative industries, including trade marks, copyright and design rights, are not eligible for the regime.

Do my existing patents count? What about pending applications?

Profits relating to the exploitation of technologies whether covered by existing patents filed prior to the introduction of the regime or by newly obtained patents are eligible for preferential treatment. Also, tax can be reclaimed on profits generated during the time in which a patent application is pending once a patent has been granted.

Do I need to enforce my patents?

HMRC uses the patent system as a filter to indicate whether profits are derived from exploiting innovation. Whilst it is necessary for a patent that covers a product from which profits are derived to be granted and in force, it is immaterial whether the patent has a high commercial value, is enforced against or an effective deterrent to competitors, or whether the patent relates to significant departures from what was previously known.

What must the patent cover?

So long as one element of a product is patented, the whole product is a qualifying item and profits arising from sales of the product are eligible for preferential treatment under the current regime. For example, if a photocopier includes a patented light source, profits relating to the sale of the whole photocopier will qualify. Profits from sales of items designed to be incorporated into a product that includes a patented element will also qualify therefore profits from sales of ink cartridges designed to be incorporated into the photocopier will also qualify.

What kinds of income count? Is it only sales of patented products?

As well as income from selling patented products, royalty income from licensing patented technologies, proceeds from disposing of patented technologies, damages payments or settlements and notional royalties from using patented processes in-house all fall within the Patent Box.

The “Development Criteria” - Do I need to have made the invention?

The regime is intended to reward UK companies which have been involved in creating or developing the subject matter of the RIPR Relevant IP Right. It is not necessary for the claimant company to have devised the patented invention; so long as the company has contributed to the development of patented technology, profits arising from the sale of the products will be eligible. If however, the company is merely a distributor of patented goods, is a licensing company or has bought in a fully developed technology, they will not meet the “development criteria”.

What about licensees?

As well as the patent owner, a license holder who has exclusive rights and who fulfills the development criteria can benefit from the Patent Box regime. Thus, both the royalty income received by a licensor that patented an invention and the profits of the licensee that further developed the technology can fall within the Patent Box.

How do I calculate which profits are taxed at 10%

- 1) The first step is to apportion profits to those that relate to patented products.
- 2) Then a routine return of 10% of routine costs (excluding R&D activity) must be deducted from the profit to arrive at a Qualifying Residual Profit.
- 3) After that a brand/marketing return is deducted to arrive at Relevant IP Profit. If the Qualifying Residual Profit is not more than £3 million, Relevant IP Profit can be assumed to be the lower of 75% of the Qualifying Residual Profit or £1 million using a small claims treatment. Alternatively, a company can perform a bespoke calculation of the brand/marketing return to be deducted from the Qualifying Residual Profit, which may be more favourable.

At the end of the calculation, a tax of 10% is applied to the Relevant IP Profit and the usual

corporation tax rate (e.g. 20%) is applied to the rest of the company profits. The Patent Box tax benefits has been phased in from April 2013. In 2015/16, the tax benefit will apply to 80% of the Relevant IP Profit; this will continue to increase by 10% per year to 100% in 2017/18.

Can I hold the patent in a separate company?

In order to benefit from the scheme, the UK claimant company (or the group of companies the claimant belongs to) must be either the legal owner or an exclusive licensee of the patent. Furthermore, the UK claimant company must actively manage the patent, including making plans and decisions. There are also provisions dealing with situations where IP is developed by partnerships, joint ventures or under cost sharing arrangements.

How do I claim the tax relief?

UK companies must actively elect into the scheme by notifying HMRC when completing a corporation tax return for the relevant accounting year. Even if a patent is not yet granted, it can be worth electing into the scheme so that a rebate can be claimed for profits that accrue during the patent pending period.

What should be done now?

The Patent Box is a factor to take into account in a patent filing strategy. It is now more attractive to file patent applications (and also to keep existing patents in force) where there had not previously been sufficient justification. In addition, companies should consult their accountants to assess the potential savings and to ensure that they have systems in place to capture the data necessary in order to perform the necessary tax calculations.

The Impact on Patent Filing Strategy

Whilst anti-avoidance rules exist, a revised patent filing strategy is a legitimate response to the Patent Box tax regime. The UK Government is expecting an increase in the numbers of patent applications filed at the UK IPO and anticipates that companies will file patent applications where they would not have done so in the past.

An additional incentive to file patents

A common reason for filing patents is to deter competitors from launching competing products, thus providing a monopoly for the patentee. Where patents are unlikely to serve that purpose (for example, because competitors could easily work around a patent, the cost of enforcing would be too high, it is not possible to tell what competitors are doing or other barriers to entry into the market exist) previously it may not have been worthwhile to file a patent application. However, the ability to benefit from the

reduced tax rate provides a further reason to file patents and may now tip the balance in favour of filing a patent application where it would not previously have been justified.

Isn't patenting prohibitively expensive?

Whilst the costs of obtaining broad patent protection in a number of markets round the world may only be appropriate where a sizable market exists, obtaining a patent in one country that qualifies all worldwide profits for the Patent Box need not be costly.

Targeted patent applications

Patents aimed at deterring competitors from launching competing product are drafted to provide a broad monopoly that covers all foreseeable ways of implementing the invention. Furthermore, they are crafted so as to allow amendments to be made should it become necessary to alter the scope of protection sought during patent prosecution.

In order to take advantage of the Patent Box, it is only necessary to obtain a targeted patent that is narrowly focused on the particular product which is marketed. The drafting and prosecution of a targeted patent without reference to possible competitor activity is usually more straightforward and less costly than for a broad patent having a high deterrent value.

UK vs foreign and European patents

So long as a Relevant IP Right covers the product, profits generated worldwide will be able to benefit from the Patent Box tax regime. Therefore, so long as UK patent remains in force that covers a product, worldwide profits relating to that product will be eligible for preferential treatment under the Patent Box regime.

Whilst applying for patents through the European Patent Office is attractive in many circumstances as they can be used to secure protection in a number of European markets

in order to benefit from the Patent Box regime all that is required is a UK patent. Obtaining patent protection in the UK is significantly less costly, faster and often more predictable than obtaining a patent through the European Patent Office.

Fast-track patent filing

As the benefits of the Patent Box tax regime are only realised following grant of a qualifying patent, obtaining a patent rapidly can be attractive. A “fast-track” UK patent can often be obtained in 12 to 18 months. Obtaining a patent via the traditional route will take around 4 years for a UK patent and around 6 years for a European patent.

Dual-track patent filing

As well as obtaining rapid grant of a UK patent that allows the benefits of the Patent Box to be felt quickly, in some circumstances, it may also be worth continuing with a further UK or European patent application, which is prosecuted at a more leisurely pace. That

subsequent application could be used to seek broader protection covering modifications

that you or your competitors may wish to introduce. A “dual-track” strategy can often be only marginally more costly than pursuing a single broad patent yet it allows both the benefit of the Patent Box to be felt earlier and also greater flexibility and certainty.

Further information

This document is intended to provide a general introduction to the Patent Box and how it may impact your company. Further advice should be sought before relying on any of the information provided in this document. More detailed information on the workings of the Patent Box legislation can be found here: <http://www.hmrc.gov.uk/ct/forms-rates/claims/patent-box.htm>

For further information about the Patent Box tax regime and how it may influence your company’s patent filing strategy, please email patentbox@patentable.co.uk