

The Patent Box repackaged

From 1 July 2016 the rules concerning the UK Patent Box have been revised. For some companies the amount of relief available remains attractive, while for others the benefits of the scheme may be substantially reduced and the administrative burden required to operate the scheme may now make it less attractive.

This article seeks to provide an outline of the revised scheme. The author is a patent attorney whose expertise lies in the protection of IP. For advice on how your company may benefit from the Patent Box scheme, you are advised to speak to a specialist financial advisor.



Matthew Fletcher
Partner, Bath
matthew.fletcher@abelimray.com

What is the Patent Box?

The UK's Patent Box was introduced in 2013 to encourage commercialisation of innovation in the UK. A reduced rate of corporation tax (10%) was offered on company profits derived from innovative activities. A relatively straightforward calculation was used to determine qualifying profits. A company involved in developing a product that was covered by a patent owned by, or exclusively licensed to, a related company was able to elect into the scheme and have a proportion of their profits taxed at the reduced rate.

The revised scheme seeks to limit the applicability of the scheme to those companies that have themselves borne a major proportion of the Research and Development (R&D) investment that resulted in the patented invention. While the full benefit remains available to some companies, for others the benefit is reduced. In addition, the determination of which profits are eligible is now more onerous and requires more detailed record keeping.

Why the change?

In a review of various national IP holding and patent box schemes, the Organisation for Economic Cooperation & Development (OECD) considered that tax benefits should be linked to R&D activity (the "Nexus Approach").

The UK's Nexus Approach

Following OECD recommendations, the UK has acted to restrict the benefit of the Patent Box to companies that invest in R&D.

+ Linking Patent box profits to R&D

expenditure - The proportion of profits that benefit from the scheme are now linked to the proportion of the total R&D costs that went into developing the patented product, that were borne by the company claiming the relief.

+ **The Nexus Fraction** - Expenditure on in-house R&D and externally sub-contracted R&D is divided by the total R&D costs, including expenditure by related parties and on IP acquisitions. For a company that does its own R&D, the fraction could be 1, but companies that buy-in IP, sub-contract R&D to a group innovation centre or place IP in holding companies, may now find that only a small proportion of profits qualify.

Profit Streaming

A calculation is required to determine the proportion of profits relating to each patented product that is eligible.

+ **Tracking of Expenditure** - In order to make the calculation, it is now necessary for a company to track the R&D expenditure and other IP-related

costs such as acquisitions linked to each product line.

- + **Tracking of Profits** - It is also necessary to apportion which profits apply to which products.
- + **Calculation of IP Profits** - As with the previous regime, profits attributable to patented products are adjusted to make a deduction for a routine return and marketing activities in order to arrive at an approximation of the profits that are attributable to the innovative nature of the products.
- + **Product specific calculations** - The R&D Nexus fraction needs to be calculated for each patented product and applied to profits derived from that particular product.

Existing and New Products

Companies that have already elected into the previous Patent Box scheme, or that make elections for accounting periods ending before 1 July 2016 for pre-existing IP rights, will be able to continue to use the previous regime until 30 June 2021. However, the revised rules will apply to new elections into the scheme for accounting periods ending after 1 July 2016, and to profits associated with products protected by new IP rights that were applied for, acquired or licenced after 1 July 2016.

Possible Action

- + **Implement Tracking Systems** - To make use of the scheme it is necessary to record expenditure on R&D for patented product lines and attribute profits to those products. Internal processes and systems may need to be revised to ensure they are able to track and compartmentalise expenditure and profits.
- + **Review IP ownership** - The manner in which the R&D Nexus fraction is calculated favours company structures in which the same entity receives profits relating to patented products, owns the IP and invested in the underlying R&D.
- + **Seek financial advice early** - Companies that may wish to utilise the Patent Box in the future should seek advice now as to whether their systems and structures enable them to make best use of the new regime. The necessity to track R&D expenditure to qualify for the scheme under the new rules means that appropriate systems need to be in place from the outset. Waiting until a patent is filed or a product is developed before taking action may make it difficult to comply with the rules or obtain the full benefit.
- + **File Patent Applications** - The fundamental requirement for electing

into the Patent Box is to hold patents. Companies that develop new products are likely to be making patentable inventions. Small incremental developments as well as entirely new concepts are eligible for patent protection. Your Patent Attorney at Abel & Imray will be able to advise you as to whether a new or modified product or system includes a patentable element that could be protected and enable your company to benefit from the Patent Box.

Conclusions

As the headline rate of corporation tax is falling and the new rules increase the complexity of the scheme, some companies may find that the savings offered do not offset the administrative burden of electing into the Patent Box. However, **many companies still stand to make substantial savings**, especially those who obtain high profit margins on innovative products and/or those who bear their own R&D costs. In order to make best use of the scheme it is necessary to take action now to ensure that the appropriate structures are in place and to file patent application for new developments going forward.



London

20 Red Lion Street
WC1R 4PQ, UK
T +44(0)20 7242 9984
F +44(0)20 7242 9989

Cardiff

3 Assembly Square
Britannia Quay
CF10 4PL, UK
T +44(0)29 2089 4200
F +44(0)29 2089 4201

Bath

Westpoint Building
James Street West
BA1 2DA, UK
T +44(0)1225 469 914
F +44(0)1225 338 098