The Patent Box

- Patent ownership requirements
  - Rights included
  - Development condition
  - Active ownership

- Profit Calculation
  - Profit apportionment
  - Relevant IP income
  - Routine expenses return
  - Marketing return / small claims election

- Other features
  - Streaming
  - Patent Box losses
  - R&D claw-back
  - Anti avoidance rules
  - Partnerships & cost contribution arrangements
Corporate Tax Reform

- The Government is implementing a wide reaching programme of reforms to build a stronger and more balanced economy for the future
- Part of this is the Government’s ambition is to establish the most competitive tax system in the G20 to support current enterprises and attract new business to the UK
- To achieve this, the Government has set out a substantial programme of reforms including:
  - a series of reductions to the main rate of corporation tax;
  - significant changes to the UK’s CFC regime;
  - reforms to the R&D tax credits regimes; and
  - the Patent Box
The Patent Box: Aims

• To create a competitive tax environment for companies to develop and exploit patents in the UK

• To provide an incentive for companies to retain and commercialise patents in the UK and to develop new innovative patented products here

• To encourage companies to locate high-value jobs associated with the development, manufacture and exploitation of patents in the UK

• To encourage investment and growth in the UK
The Patent Box: Who will benefit?

• A wide range of companies which own and use patents and other qualifying intellectual property (IP)
• In many cases companies can benefit where they have rights to IP owned by others
• Companies must meet development and active ownership criteria
• Companies can benefit regardless of how the IP is used
The Patent Box – what profits are eligible?

Total company profits

- Non-patented products
  - Profit attributed to non-qualifying income: 23%

- Patented products
  - Profit attributed to valuable marketing assets: 23%
  - Profit attributed to routine activities: 23%
  - Patent Box profit: 10%
The Patent Box: Key Points

• A reduced 10 per cent rate of corporation tax on profits attributed to patents and other similar IP from 1 April 2013

• Worldwide income from existing as well as new IP will be included. To enable this, the full benefits will be phased in over five years

• UK businesses can benefit regardless of how they use their patents

• In many cases the profit attributed to patents is calculated from total profits using a step-by-step method

• Companies which use their patents to perform processes or provide services can benefit up to the level of an arm’s length royalty

• Smaller claims benefit from a simplified calculation

• Technical changes made in response to the June 2011 consultation will result in a more competitive and accessible regime
Questions?
The Patent Box: Overview

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The Patent Box: Patent Ownership requirements

- Patent ownership requirements
  - Rights included
- Profit Calculation
- Other features
The Patent Box: Rights included

- IPO/EPO Patents
- SPCs, Plant variety and Data exclusivity rights including paediatric and orphan drug rights
- Secret patents
- Company must hold a qualifying IP right or hold an exclusive licence over it
- Exclusive licensing definition relaxed for certain intra-group arrangements
The Patent Box: Patent Ownership requirements

- **Patent ownership requirements**
  - Rights included
  - Development condition

- **Profit calculation**

- **Other features**
The Patent Box: Development Condition

• Qualifying development is:
  – Creating or significantly contributing to creation of protected item
  – Developing protected item (includes developing ways in which item may be used/applied) or item incorporating protected item

• Qualifying development must be undertaken by company or a member of the same group

• Allows development activity to be undertaken pre acquisition of IP right
The Patent Box: Patent Ownership requirements

- Patent ownership requirements:
  - Rights included
  - Development condition
  - Active ownership

- Profit calculation

- Other features
The Patent Box: Active Ownership

• Only has to be met if company is a member of a group

• Must meet one of the active ownership conditions for all or almost all of company’s “qualifying IP rights portfolio”

• Active ownership conditions are:
  – performs a significant management activity, i.e. formulate plans, make decisions re development/exploitation
  – Meets the development condition by virtue of qualifying development company itself has undertaken

• “Qualifying IP rights portfolio” includes any exclusive licences held in respect of a qualifying IP right
The Patent Box: Profit Calculation

Patent ownership requirements:
- Rights included
- Development condition
- Active ownership

Profit calculation:
- Profit apportionment

Other features:
The Patent Box: Profit apportionment

• Start from taxable trading profit

• Add back:
  – R&D additional deduction (not base cost)
  – Finance expenses

• Deduct:
  – Finance income
  – And if relevant additional R&D claw-back amount

• Then can use a formulaic method to apportion profits pro-rata between those generated by qualifying IP and non-qualifying IP
The Patent Box: Profit apportionment

- Pro-rata apportionment based on ratio of “RIPI” (relevant IP income that forms part of total gross income) to total gross income

- Total gross income is the sum of:
  - amounts recognised as revenue under GAAP and taken into account as credits in calculating the profits of the trade in an accounting period;
  - credits on realisation of intangible assets; and
  - profits from the sale of pre-2002 patents patent right

- Income from financial assets is excluded from total gross income
The Patent Box: Profit Calculation

Patent ownership requirements
- Rights included
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- Active ownership

Profit calculation
- Profit apportionment
- Relevant IP income

Other features
The Patent Box: Relevant IP Income

• Five Heads:
  – Patent royalties and other income from licensing
  – Income from the sale of patents
  – Infringement income
  – Income from sales of products with patents
  – Sales of mixed patented & non-patented items

• Notional Royalty - patents used in processes & services

• Leasing

• Patent Pending
The Patent Box: Profit Calculation

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Profit calculation
- Profit apportionment
- Relevant IP income
- Routine expenses return

Other features
The Patent Box: Routine expenses return

- 10% mark up on specified expenses (routine expenses)
- Included expenses:
  - Director and employee related expenses
  - Premises expenses
  - Plant and machinery expenses, including capital allowances
  - Utilities, transport, communication and consultancy fees
- Excluded expenses:
  - Outsourcing
  - Routine expenses that qualify for an additional R&D deduction
  - Additional deduction for R&D expenditure
The Patent Box: Profit Calculation

**Patent ownership requirements**
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**Profit calculation**
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**Other features**
The Patent Box: Marketing return/small claims election

- Marketing return is removed from residual profit to arrive at profit attributable to patents
- Marketing return is a notional royalty for use of marketing assets calculated using arm’s length principles
- If actual marketing royalty is paid this reduces notional royalty
- If marketing return is de-minimis no need to make an adjustment
- For small claims possible to elect for profits in box to be lower of 75% of residual profit or £1m
The Patent Box – what profits are eligible?

Total company profits

Non-patented products

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23%

Patented products

10%

Profit attributed to patent box profit

Profit attributed to valuable marketing assets

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The Patent Box: Other features

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- Other features:
  - Streaming
The Patent Box: Streaming

• Alternative method to pro-rata of profits
• Involves dividing income into qualifying and non-qualifying streams and arriving at profits by allocating expenses to qualifying streams on a just and reasonable basis
• More straightforward than full transfer pricing approach
• Mandatory streaming in certain cases
The Patent Box: Other features

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  - Streaming
  - Patent Box losses
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The Patent Box: Patent Box losses

- Must be offset again relevant IP profits of other trade/other group members, and any excess carried forward
- Group may choose how loss is to be allocated
- Rules for intra-group transfers of trade
- Rules where trade ceases
The Patent Box: Other features

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- Other features:
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  - Patent Box losses
  - R&D claw-back
The Patent Box: R&D claw-back

- Formulaic approach assumes current year R&D costs are a good proxy for prior year expenses
- Claw-back mechanism for first 4 years company elected into Patent Box
- If R&D expenditure in that time falls to below 75% of the average of four years expenditure before election into box then R&D is increased to 75% of the previous average annual R&D expenditure, before the profits of the year are apportioned.
- R&D for this purposes is R&D recognised in accordance with UK GAAP
The Patent Box: Other features

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- Other features:
  - Streaming
  - Patent Box losses
  - R&D claw-back
  - Anti avoidance rules
The Patent Box: Anti avoidance rules

• Exclusive licences
• Product
• Tax avoidance schemes where aim is to:
  – avoid operation of any provisions in rules
  – mismatch income and expense
  – manipulate account recognition of income
The Patent Box: Other features

Patent ownership requirements
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Other features
- Streaming
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- R&D claw-back
- Anti avoidance rules
- Partnerships & cost contribution arrangements
The Patent Box: Partnerships

- Provides a mechanism for a corporate partner in a partnership to obtain the benefits of the Patent Box
- Achieved by allowing the partners to elect to be taxed as if the partnership itself had elected into the regime
- The election is made on a company-by-company basis. So some partners/parties may elect in and some may not
The Patent Box: Cost contribution arrangements

• Applies to cost contribution arrangements where one of the parties to the arrangement holds a qualifying IP right and each party to the arrangement contributes to the qualifying development.

• Provided each party is entitled to a share of the income from exploiting the right then it is treated as if it held the relevant right itself.

• The election is made on a company-by-company basis. So some parties may elect in and some may not
The Patent Box: Commencement and implementation

• Phase in benefit:

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<th></th>
<th>2013/14</th>
<th>2014/15</th>
<th>2015/16</th>
<th>2016/17</th>
<th>2017/18</th>
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<tbody>
<tr>
<td>Proportion of full benefit available</td>
<td>60%</td>
<td>70%</td>
<td>80%</td>
<td>90%</td>
<td>100%</td>
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• 10% rate is delivered via a super deduction against trading profits

• Formula is:

\[
\text{Relevant Profits} \times (\text{Main CT rate} - 10\%) / \text{Main CT rate}
\]
The Patent Box: Next Steps

- Consultation on the draft legislation closes 10 February 2012
- Comments are welcome on all aspects of the draft legislation and HMRC’s interpretation as set out in the Technical Note
- Questions included in the response document invite comment in specific areas, but are not exhaustive
- Legislation based on these proposals is intended to be included in Finance Bill 2012
- Draft guidance will be published in spring / summer 2012
Q&A
## The Patent Box: Contacts

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<thead>
<tr>
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