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PATENT BOX – A 10% RATE OF TAX

If your company has registered patents its tax bill could be reduced markedly

The Patent Box regime is intended to “provide an additional incentive for companies to retain and commercialise existing patents and to develop new innovative patented products”. The regime is another element of the UK tax code designed to encourage the development and exploitation of intellectual property ('IP') in the UK. Other European countries have similar reliefs.

Since 1 April 2013 companies can elect for a reduced rate of corporation tax on profits generated from qualifying patents and limited other forms of IP. This will be on a phased basis with the effective rate falling to 10% from 2017.

Who and what qualifies for the regime?

The patents which qualify are those granted from the UK Intellectual Property Office, the European Patent Office and certain other European Economic Area countries. Certain other IP rights may also qualify.

The regime applies to new as well as existing patents. The claimant company, or group, must have had or intend to have a significant involvement in development of either the patented invention or activity, or a product incorporating the patented item or activity.

The benefits of the Patent Box will be available by reference to legal ownership and through holding a licence to commercially exploit a patent. The regime will also apply to patents which have been developed through partnerships, joint ventures and cost-sharing arrangements.

Income from the following sources is treated as qualifying:

- patent licensing and royalties;
- sales income from the patent or patent protected products even if the patent only applies to a small part of the total product;
- patents used in processes or services; and
- patent right damages for infringement.

How is patent income determined?

The method for determining the profit eligible for the reduced rate is, in principle, a three-step process as follows.

1. Identify the relevant IP income and profits

This is found by identifying the proportion of relevant IP income as a percentage of gross income of the trade.

The income of this trade can include gross sales for products, where only a small part of the product is patented. For example, the full proceeds on the sale of a washing machine is included if, say, it only includes a patented soap dispenser.

The percentage is used to apportion the company's adjusted total taxable trading profit between qualifying patent and non-qualifying income.

In some instances this may not be clear, for example for services or processes, and so 'notional royalties' may need to be calculated. It is therefore essential to consider how to determine which products will qualify and whether a company's management accounting systems can determine the qualifying income.

The above method may, in certain situations, under or over allocate trade profits to relevant IP income. It is therefore possible to use a 'streaming' approach, which requires a just and reasonable apportionment of a company's expenses.

2. Deduct the routine profit

The 'routine profit' is calculated by deducting a notional 10% return on certain operating expenses from the profits ascertained in step one. The expenses include: capital allowances, premises, personnel and plant and machinery costs along with miscellaneous services.

3. Reduction for profit derived from marketing assets

Businesses need to identify how much of the IP profit arrived at after steps one and two above is due to the patent and how much is due to marketing assets such as brands. In the absence of a small claim election, this is done by deducting a notional marketing royalty based on transfer pricing principles.

There is a welcome exemption from this calculation for smaller companies which can elect to simply reduce the IP profit by 25%.

The profits generated between application and grant, subject to certain conditions, may also be added to the figure derived above.

The resulting figure is the profit subject to the reduced corporate tax rate.

In the case of a relevant IP loss arising, relief may be available to set off against other IP profits of other company or group trades or may be carried forward to use in the next period.

Companies without patents may wish to consider whether they have products or processes which could be patented.

As with other technology based reliefs such as R&D it may be necessary for the company to review its procedures and processes so as to ensure that the required information is easy to extract.

It should be noted that officials from the European Union are looking at the Patent Box rules suggesting that they are discriminatory. It is not expected that there will be any material changes to the rules as there are similar rules in other territories.

There is no doubt that the Patent Box regime will give certain companies massive tax savings. Indeed certain companies are repatriating their IP activity to the UK as a result of the new legislation. This can only be good for the UK economy.

How can we help?

In order to benefit from the new regime it may be appropriate to take action now.

Friend can help with advice in the following areas:

- patent identification, in conjunction with patent attorneys and assessing whether other IP can fall within the Patent Box regime;
- determining qualifying income from patents;
- performing the three-step calculation;
- general advice on patent box;
- structuring of trading and other amounts to secure benefits e.g. intra-group IP/profit agreements; and
- planning for IP in general.

If you have any questions in connection with this briefing please contact Simon Littlejohns, Tax Partner, on 0121 633 2007 or your usual contact at Friend.

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