

FOCUS ON

Patent box changes

The patent box regime is being modified for new entrants from 1 July 2016. The BEPs project (Base Erosion and Profit Shifting) identified the UK's patent box regime as 'open to abuse' and as a result the UK Government committed to making changes to the regime.

Background

Since April 2013, companies could elect into the regime and benefit from a lower rate of tax on profits earned from patented inventions and certain other intellectual property rights (IPR). The lower rate of corporation tax is 10% (as compared to the normal rate of 20%) and its application was being phased over a period of 5 years, with only 60% of the profits initially benefitting, increasing by 10% each year to April 2017 when the full benefit would be available.

Which type of patent qualifies - pre July 2016 rules?

The regime applies to UK and European Patent Office patents, as well as those granted by certain EEA countries. In addition to outright ownership, an exclusive licence over such patents also qualifies.

The company must then also meet one of two other conditions:

1. The Development condition – the company has been involved in the innovation behind the patent.
2. The Active Ownership condition – if the company does not meet the development condition because that condition has been met by another member of the group, it must actively manage the patents i.e. formulate plans and make decisions around exploitation.

This regime will continue until 30 June 2021 for those who were within the regime before 1 July 2016.

Which type of patent qualifies - rules from July 2016?

Under the new regime, the company claiming the relief will have to have incurred expenditure in developing the IPR and so simply managing the rights will no longer be sufficient.

What part of the income qualifies?

The patent box rate applies broadly to a proportion of the company's profits derived from:

- the sale of a patented invention or products that incorporate it
- licensing the IPR (such as royalties)
- the outright sale of the IPR
- notional royalties, i.e. where the patented invention does not directly generate income but its use results in increased income (e.g. in a process or service)

“ *MHA MacIntyre Hudson can assist you in arranging your tax affairs to maximise your patent box benefit.* ”

Under the old rules, two possible methods for calculating the profits benefiting from the patent box rate were available: the standard method and the streaming method. Only streaming will be permitted now.

Streaming used to require income and expenditure to be allocated to two streams, one for all IP income and the other for all non-IP income. Under the new regime the company must hold separate sub-stream records for each individual IP right. Companies within the old regime will also need to carry out more detailed allocation of expenditure as they will need streaming information from July 2016 for when the old regime comes to an end in July 2021.

The nexus fraction

The nexus fraction was designed to ensure that only companies that are engaged in 'substantial activities' in relation to the IPR qualify for favourable treatment.

The nexus fraction is the lower of 1 and the following:

$$\frac{(D + S1) \times 1.3}{D + S1 + S2 + A}$$

Where:

D = qualifying expenditure on relevant R&D undertaken in-house

S1 = qualifying expenditure on relevant R&D sub-contracted to unconnected persons

S2 = qualifying expenditure on relevant R&D sub-contracted to

connected persons (i.e. group companies)

A = qualifying expenditure on the acquisition of relevant qualifying IP rights

It is applied once the profits from IP have been calculated and the effect is that patent box relief will only be available to the extent that the company holding the IP has incurred expenditure itself on relevant R&D or has subcontracted the expenditure to an unconnected third party.

The 30% uplift in the numerator of the fraction allows for IP acquisition costs and R&D subcontracted to connected companies to qualify up to a maximum of 30% of the sum of the R&D expenditure incurred by the company itself and the R&D subcontracted to unconnected parties.

How can we help?

MHA MacIntyre Hudson can assist you in arranging your tax affairs to maximise your patent box benefit which is especially important now given the much increased complexity of the new regime. For example we can:

- Help maximise qualifying income to be taxed at 10%.
- Advise on methods of income identification and tracking and on R&D expenditure tracking for the nexus fraction.
- Maximise claims for R&D related costs.
- Apply transfer pricing methodologies to value notional royalties and the notional marketing royalty.
- Optimise group IP holding structures and licences.

Contact us

For more information on any of these points please contact Tom Byng, our expert Patent Box Tax Partner, or your local MHA MacIntyre Hudson office.



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