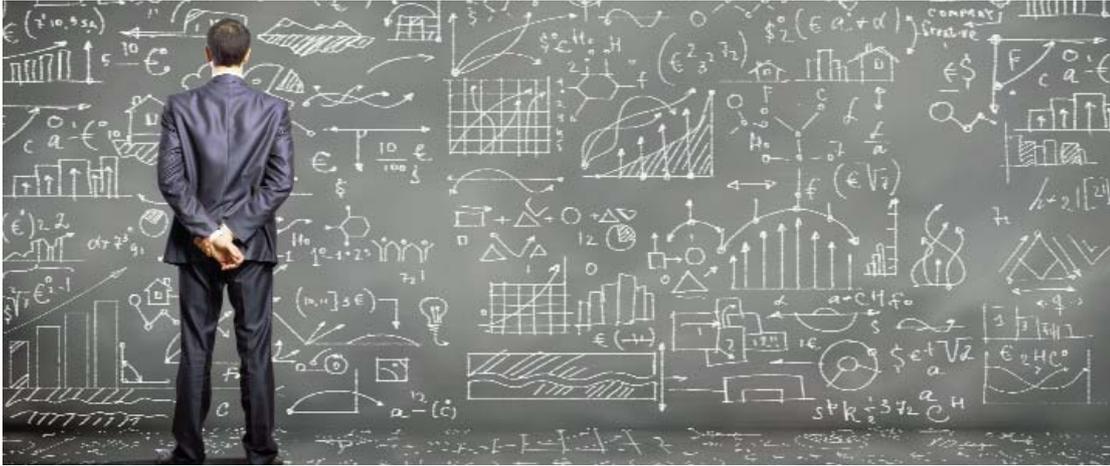


The Patent Box



OVERVIEW

Part of the Government's package of measures to encourage innovation in the UK is the introduction of a 10% tax rate applicable to qualifying income falling within the so-called 'Patent Box'. Even with the main rate of corporation tax falling to 20% from 1 April 2015, the Patent Box regime provides opportunity for a significant tax saving.

A company qualifies for the Patent Box regime if it is trading, owns the intellectual property rights of patents registered with the UK Intellectual Property Office or European Union Patent Office, and meets the qualifying development conditions. The regime is an 'opt in' process, meaning that a company is required to make an election in order to obtain its benefits.

The Patent Box regime was introduced on 1 April 2013 but the full tax benefit is being phased in over a four year period, so that the 10% rate of tax will not be available until 2017.

The **current scheme will close to new entrants in June 2016** and will be closed completely by 2021. However, a new scheme will be introduced, probably in June 2016, to provide a similar incentive for innovation, but this is likely to be focused on companies with UK Research & Development ('R&D') activity.

Conditions to qualify

To qualify, a company must be within the charge to UK corporation tax, and must generate 'qualifying income' from exploiting patented inventions. In addition, the claimant company must own or have an exclusive licence in the patents from which profits are derived, and have undertaken 'qualifying development' on the property subject to the patent.

What is qualifying income?

Most, if not all, sources of income from the patented products will fall within the Patent Box. This includes income derived from selling patented products or products incorporating the patented invention, the licensing and/or selling of patented rights and income, damages and other compensation received in connection with its patent rights.

In certain circumstances it is also possible to make a claim for a 'notional royalty' where a company uses its qualifying patented invention in processes or services.

What is qualifying development?

Qualifying development requires a company to have made a 'significant contribution' to the creation or development of the patented invention, or to any product or process incorporating the patented invention.

Given the time taken for patents to be granted, there is a six year look back period in respect of which claims can be made for a 'patent pending', which can be brought into account in

the year for which the patent is granted. This is subject to a company electing to be within the scheme for periods during which the patent is pending, in addition to that in which the patent is granted.

Making a claim

An election must be made within two years following the end of the accounting period in which the relevant profits arise, either as part of the computations accompanying the Company Tax Return, or separately in writing.

Calculating the qualifying profits

The reduced tax rate will only be available to that proportion of the company's profits arising from qualifying activities. To identify the attributable profits, it is necessary to follow one of the two prescribed methodologies. The processes for each are complex and beyond the scope of this summary. However the purpose of both methodologies is to identify relevant income and to allocate expenditure between what qualifies for the Patent Box and what relates to other activities, having adjusted for R&D tax credits and a 'marketing cost' intended to represent the cost to the company of paying a marketing royalty for its use of the asset(s) falling within the Patent Box.

Finally, the methodologies require the deduction of a 'routine return'. This is intended to represent the return that the company would make, even if it was not to have access to the IPR falling within the Patent Box regime.

Tax rate applicable to Patent Box profits

The reduced tax rate is being phased in, with the full 10% rate coming into effect from April 2017. The effective tax rate on Patent Box Regime profits over this period are as follows:

1 April 2014	13%
1 April 2015	12%
1 April 2016	11%
1 April 2017	10%

Patent Box losses

Whilst the regime does permit the claiming of losses, it would be advisable for a company with losses from intellectual property to stay outside of the scheme.

Losses incurred within the Patent Box are only permitted to be offset against Patent Box profits. If there are insufficient profits, the losses must be surrendered and set against other group members' Patent Box profits. If losses remain after following both of these steps, they may be carried forward and set against future Patent Box profits.

If you are interested in further information in this regard, please call the Rawlinson & Hunter partner who normally acts for you. Where you are not one of our regular clients, please contact Craig Davies or Andrew Shilling, who would be delighted to discuss this with you in more detail.

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