Patent Box

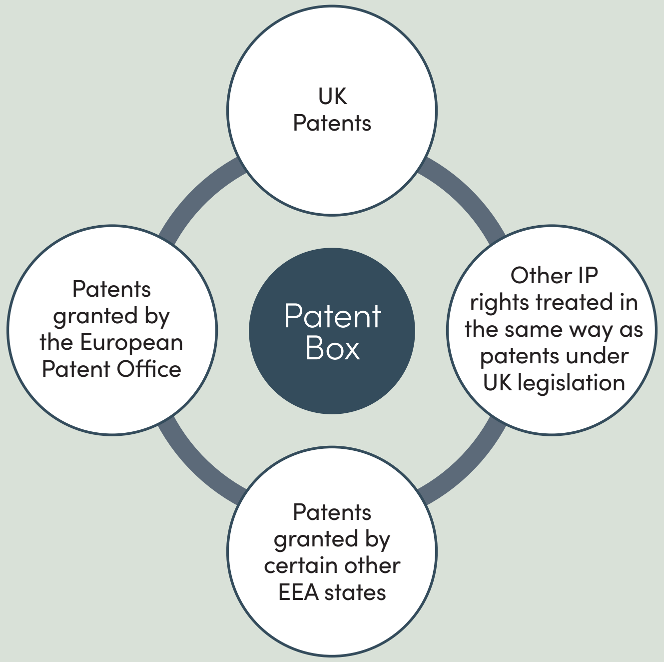
The UK Patent Box Regime effectively applies a reduced 10% corporate tax rate on profits from patents and patented products.

How does the Patent Box work?

The Patent Box provisions do not simply apply a 10% tax rate to the profits identified. Instead, an adjustment is made to deduct an amount from a company's taxable profits, such that the effect will be the same as taxing the Patent Box profits at a reduced rate of 10%.

What IP does it apply to?

Intellectual Property ('IP') qualifying for the Patent Box includes:



- Existing as well as new patents are eligible for the 10% tax rate.
- Acquired patents or exclusively licensed patents may also qualify, provided the company or a group company has undertaken further work in developing the IP or products in which the IP is incorporated.

Which profits will be taxed at only 10%?

Worldwide profits eligible for Patent Box include those derived from:

- Sales of patented products or products incorporating patented items
- License fees and royalties derived from rights in the qualifying IP
- Income arising from the sale of qualifying IP rights or exclusive licenses in respect of such rights
- Amounts received in respect of infringement or alleged infringement of qualifying IP rights
- Income derived from the exploitation of qualifying IP rights, for example from selling non-patented goods that are produced using a patented process or for hiring assets containing the IP

Profits from the IP during the last six years of the 'patent pending' phase can be included in the year which the patent is granted provided that an appropriate election has been made within two years of the end of the relevant period in which the profits have been generated.

Patent Box profits – sales of goods

This can be wide-ranging. Patent Box profits can include those arising from sales of:

- Products protected by qualifying patents/rights.
- Products incorporating one or more patented items (whole sale included, not just that relating to the patented item).
- Items designed to be incorporated into patented products, even if sold separately (e.g. bespoke spares).

How are the patent box profits calculated?

There are a number of steps to calculating Patent Box profits, as follows:

Stage 1

Identify the proportion of taxable profits relating to relevant patents and rights, in patent 'streams'.

Stage 2

Exclude a 'routine return' (i.e. a hurdle level of profit based on a mark up on routine expenses to each stream).

Stage 3

Exclude a proportion of profit attributable to marketing / brand intangibles.

Stage 4

Apply an R&D fraction reflecting the underlying R&D expenditure to each stream.

Stage 5

Reduce taxable profits by an amount giving 10% tax on PB profits, as calculated from the 4 stages above.

Important points and opportunities

- **The Patent Box is optional and will not apply automatically;** it must be claimed in the company's corporation tax return.
- **This is a tax relief for Innovative Companies;** therefore, as well as holding the relevant IP, the development condition must be met.
- **Company / group structures can affect the amount of Patent Box tax savings.** It is therefore important to review existing structures to ensure the tax position is optimised.
- **Profits earned in the patent pending period can potentially qualify for the 10% tax rate (in which a 'catch-up' claim is made for the year in which the patent is ultimately granted).** The company still needs to elect into the Patent Box in its tax computations during the patent pending period.
- **Beneficial interaction with R&D tax incentives.** A valid R&D claim will not only reduce the Company's total taxable profits, but will also move more of that taxable profit into the 10% Patent Box rate.
- **Group of companies.** Groups of companies need to consider carefully whether their intra-group arrangements and structure might impact their Patent Box relief, particularly as regards transfer of IP and subcontracting of R&D activities. If so, appropriate tax planning might be required to address this.
- **Records.** Companies will also need to maintain records of underlying R&D expenditure in order to comply with the 'track and trace' requirements for stage 4.

It is therefore important that companies seek specialist IP and tax advice at the earliest opportunity so that appropriate planning can be considered.