HM TREASURY

HM Revenue & Customs

Consultation on the Patent Box

June 2011

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ISBN 978-1-84532-884-9
PU1151

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Foreword

The Government's Plan for Growth emphasises the importance of creating the right conditions for businesses to succeed, removing barriers that are preventing them from performing to their full potential.

As part of this, the Government is committed to creating the most competitive tax system in the G20, in order to drive private sector growth. Since last May, the Government has set out a series of reductions in the main rate of corporation tax – bringing it down to just 23% by the end of this Parliament – as well as a substantial programme of corporate tax reforms as set out in last year's Corporate Tax Road Map. These reforms include:

- significant changes to the UK's controlled foreign company regime, to better reflect the way that businesses now operate in a globalised economy,
- reforms to the R&D tax credits regimes, to reinforce their importance in promoting innovation, and
- the Patent Box

The Patent Box is a key initiative to make the UK tax regime competitive for innovative high-tech companies. Britain has a long and proud history of great inventions and discoveries which have been made in this country. But in recent years, too many companies have been choosing to move their patents offshore. This has cost the country valuable jobs in development, manufacturing, and exploitation of patented technologies, which have been attracted to other countries with more favourable corporation tax regimes.

It is time to reverse that trend. The Patent Box will help to re-establish the UK as a top location of choice for innovative industries. The Patent Box will be a broad, inclusive regime which will encourage businesses across a wide range of sectors to invest in the UK, generating growth and creating jobs.

I am pleased to publish this consultation paper and hope that businesses, representative bodies and others interested in the promoting the growth of innovative companies in the UK will play a full part in the consultation process.

David Gauke

Exchequer Secretary to the Treasury

1 Introduction

1.1 The Government is committed to providing the most competitive corporate tax system in the G20, in order to support strong and sustainable growth. To achieve this, it will be critical to create an attractive regime for companies to develop and exploit intellectual property (IP) in the UK.

1.2 In the last two budgets the Government announced significant year on year reductions in the main rate of corporation tax. And in November 2010, it announced a wide-ranging review of the taxation of innovation and intellectual property. The consultation encompassed the support provided to innovation by R&D tax credits and announced the introduction of a Patent Box, which will allow companies to apply a 10% corporation tax rate to profits attributed to patents from 1 April 2013. This document builds on that consultation and explains the proposed detailed design for the Patent Box.

1.3 These proposals reflect the Government's dual aims for the Patent Box: to cover a wide range of patent income and to minimise where possible uncertainty and risk of dispute.

1.4 However, it is necessary to recognise that identifying the relevant profits that should benefit from the reduced 10% rate may still, in many cases, be an additional compliance burden for companies that choose to benefit from the Box.

1.5 And of course, to be sustainable over the longer term, the regime will have to be proof against abuse from artificial arrangements that attempt to distort the proportions of profits that properly belong inside or outside the Box.

1.6 There are a number of areas where it is challenging to achieve the right balance, and the document gives a range of policy options on which it seeks views from business about the best way forward.

Aim of the Patent Box

1.7 The aim is to provide an additional incentive for companies in the UK to retain and commercialise existing patents and to develop new innovative patented products. This will encourage companies to locate the high-value jobs associated with the development, manufacture and exploitation of patents in the UK and maintain the UK's position as a world leader in patented technologies.

1.8 The Government is focusing on patents because they have a particularly strong link to high-tech Research and Development (R&D) and manufacturing activity. Special regimes for patent income are available in some other countries and there have been concerns that the UK system has become less competitive, leading to pressure to locate elsewhere.

1.9 An important feature of patents in the UK and some other jurisdictions is that they are individually examined by an independent patent authority before being granted, to verify that the patent represents a genuinely novel and useful invention. Independent verification provides a foundation for the Patent Box regime, enabling the benefits of the box to be focused on real technological innovation.

1.10 There are some other limited forms of IP which are comparable to patents both in terms of their strong link to R&D and high-tech activity, and because they are subject to examination by an independent authority prior to being granted. These include regulatory data protection (also called "data exclusivity") and certain plant variety rights, and the Government is proposing to include these forms of IP within the Patent Box regime as well as patents.

1.11 The Government has received a number of representations to extend the Patent Box to other forms of IP such as copyright and trademarks, but is not planning to extend the scope of the Patent Box this widely. The Government continues to believe that lower tax rates for all will usually be the fairest and most cost-effective way to foster economic growth, other than where there is strong evidence that action needs to be taken to make the UK tax regime more competitive.

Design Principles

1.12 The November 2010 document outlined a number of high level principles for the Patent Box to guide the design process:

- **The box should have a broad scope**: The regime should include both patent licence income and patent income embedded in the sale proceeds of a patented product, in order to make the Patent Box competitive for the widest range of businesses.
- **A formulaic approach**: The inclusion of embedded income increases the difficulty of identifying what level of profit should be attributed to patents. The Government believes that a formulaic approach will reduce the administrative burden on both business and HMRC compared to requiring companies to make an arms-length valuation of their individual patent profits.
- **The box should apply to profits, not receipts**: The Patent Box should apply to net patent profit after associated expenses, including pre-commercialisation expenses, rather than to gross income.
- **The box should benefit active ownership and innovation**: The Patent Box aims to encourage companies to be actively engaged in the patent development cycle by rewarding successful patent innovation rather than rewarding the acquisition and passive holding of patents.

1.13 The proposals in this document incorporate these principles, and include a flexible formulaic approach for calculating patent profits which aims to balance the desire for certainty and simplicity with the need for the Patent Box to be flexible enough to take into account different business models and group structures.

Overview of proposed model

1.14 All businesses within the scope of UK corporation tax will potentially be eligible to elect for the Patent Box regime to apply to their trading profits. In order to claim the Patent Box tax deduction the business must actively hold a qualifying patent or other qualifying IP, and must receive income related to that patent or IP. The detailed rules for qualifying IP rights and income are set out in Chapters 2 and 3 of this consultation document.

1.15 The proposed model for calculating patent profits is based on the fact that valuable patents and other forms of IP will produce additional returns over companies without valuable IP. The amount of this extra profit, known as the "residual profit", is a measure of the profit created by the IP rather than though routine business activities. The proposed model operates on a company-by-company basis, and is set out in detail in Chapter 4 of this document. It has three main steps:

- **First**, businesses must allocate a proportion of their profits to qualifying income. To achieve this, the whole company's taxable trading profits (before finance costs and R&D

enhancement) will be apportioned pro-rata based on the proportion of the company's total turnover which qualifies for the Patent Box. Where a pro-rata profit allocation is inappropriate, divisionalisation rules can be used.

- Second, the company must calculate the amount of residual profit they have achieved, by deducting a simple fixed percentage return on routine activities carried out by the company from the profit allocated to qualifying income.

- Third, the business must identify how much of the residual profit on a qualifying product is due to the patent and how much to other forms of IP, such as valuable brands, copyright and artistic design. The Government currently favours the use of a ratio of relevant costs to attribute the appropriate part of the residual profit to patents, rather than requiring a valuation of patent and brand IP.

Chart 1.A: Overview of proposed formulaic framework

Patent ownership	• **Does the business hold a qualifying patent or patent right?**
Qualifying income	• **Does the business receive qualifying income related to the qualifying patent?**
Profit on income	• **Calculate total profits attributed to qualifying income.**
Residual profit	• **Remove routine profit to calculate residual profit on qualifying income.**
Patent profit	• **Attribute residual profit to patent and non-patent IP to calculate patent box profit.**

Commencement

1.16 The November consultation document announced that the Patent Box would apply to all patents first commercialised after 29 November 2010. The Government has received a number of representations that:

- the date of initial commercialisation may be hard to identify; and

- including all patents would help encourage retention of existing patents in the UK.

1.17 In response, the Government has developed an alternative which extends the regime to all qualifying patents while managing the short term fiscal impact by phasing-in benefits over five years. This is discussed in Chapter 6.

Issues covered in this consultation document

1.18 This consultation document addresses the questions about detailed scope and implementation raised as a result of the November consultation document and covers:

- which patents and associated IP types will be eligible for the Patent Box (Chapter 2);

- what types of income will be eligible for the Patent Box (Chapter 3);
- how the profit attributable to patents will be calculated (Chapter 4);
- the computational methodology and interaction with group loss relief, chargeable gains, double tax relief and transfer pricing regimes; and potential anti-avoidance rules (Chapter 5); and
- commencement of the regime (Chapter 6).

Consulting with business and other stakeholders

1.19 The consultation is being conducted in line with the principles outlined in the document "Tax policy making: a new approach"[1] published in June 2010. This document sets out three stages for policy development:

- Stage 1 – set out objectives and identify options;
- Stage 2 – determine the best option and develop a framework for implementation, including detailed policy design; and
- Stage 3 – draft legislation to effect the proposed change.

1.20 The November 2010 consultation document was stage 1 of the process. This consultation is taking place during stage 2 of the process. The purpose of the consultation is to seek views on the policy options developed as a result of stage 1 and the likely impacts of implementing these proposals, to input into design of the draft legislation.

Next Steps

1.21 The Government welcomes responses to this consultation by 2 September 2011. Details on how to get involved with this consultation are given in Chapter 8 of this document. This consultation will be focused on developing a Patent Box based on these proposals. The Government intends to publish draft legislation to implement the Patent Box in autumn 2011.

[1] *Tax Policy Making,* HM Treasury and HMRC, June 2010 (http://www.hm-treasury.gov.uk/junebudget_tax_policy_making.htm)

2 Qualifying patents

2.1 The Government wishes to ensure that the Patent Box is an internationally competitive regime which will act as an effective incentive for companies to develop and commercialise patented technologies in the UK. This chapter sets out the Government's proposals for which patents and associated IP types will be eligible for the Patent Box, and the ownership and development criteria which must be satisfied by companies wishing to claim Patent Box benefits.

Patent authorities

2.2 A key feature of the Patent Box will be that the reduced corporation tax rate will be available on profits arising from inventions which have been independently validated as innovative and useful by a patent authority. Around the world, some patent regimes do not perform a full search and examination of patents before granting a patent application. In such jurisdictions, patents may be granted on inventions which would not be recognised as being sufficiently novel or innovative to receive patent protection if a full process of examination were undertaken. Patents that have not been fully examined before being granted carry a greater risk of being overturned if subsequently challenged.

2.3 There are also significant differences in the types of invention which can be patented worldwide, with some regimes allowing patenting of things such as business models and forms of medical treatment which are not considered patentable in the UK.

2.4 For these reasons the Government proposes that the Patent Box should include patents granted by the UK's Intellectual Property Office (IPO), and the European Patent Office (EPO). The box will, however, include worldwide income earned by UK businesses from inventions covered by a qualifying patent, not just income that falls within the territorial limitations of the particular IPO or EPO patent.

2.5 The types of invention which can be patented in certain EU Member States are similar to those permitted in the UK, and some other Member States do require a full examination process prior to granting a patent. The Government will therefore consider whether it should also allow patents granted by the national patent offices of some other Member States to be eligible for the Patent Box, where they operate a similar examination process before granting a patent, and whether it is practical to draw up a list of such regimes.

2.6 The Government has ruled out extending the regime to patents granted by other authorities which would have been patentable in the UK. It would be impractical to expect HMRC or businesses to judge this in practice. In addition it could lead to patentability being tested in tax tribunals as well as in the patent courts, which could create inconsistent legal precedents which would harm the wider UK patent system.

Question 1: Will the requirement for a patent granted by the IPO or EPO cause significant commercial distortion? Do you believe that patents granted by any other EU national patent offices should be included, and if so which jurisdictions?

IP associated with patents

2.7 Supplementary protection certificates (SPCs) act to extend the protection afforded by qualifying patents in respect of pharmaceutical and agrochemical products. They recognise the fact that in these industries the lengthy regulatory approval process acts to reduce the effective lifespan of patents. The Government proposes that SPCs which act to extend a patent originally granted by the IPO or EPO will also be eligible for the Patent Box.

2.8 There are other areas of innovation which have a similarly strong link to R&D and high-tech activity as patents but where patenting is not permitted. Some of these are also subject to a similar process where new inventions are independently examined for novelty and centrally registered. These include regulatory data protection, granted to new pharmaceutical and agrochemical products which cannot be patented; and plant variety rights. The Government is proposing to include these rights because of their similarity to patents.

2.9 However, the Government does not propose to include other forms of IP such as trademarks or copyright, as these have a weaker or more variable link to high-tech activity and have no parallel process of independent examination which would allow the Government to be confident that the resulting product is technologically innovative.

Ownership requirements

2.10 The Government wants the Patent Box to be accessible for a wide range of trading companies and does not want it to distort normal commercial arrangements around patent ownership. It therefore proposes that the benefits of the Patent Box will be accessible both through legal ownership and through holding an exclusive licence to exploit a patent commercially. The licence can be limited by field or territory, provided that it still results in effective market exclusivity.

2.11 The Government also wants the Patent Box to apply to patents developed under partnership, joint venture and cost-sharing arrangements. Where a company is entitled to receive patent income or exploit a patent under such an arrangement this income will be included in the Patent Box, provided that the company meets the development criteria set out below and that the parties to the arrangement own the patent or hold an exclusive licence.

2.12 The Government has also decided to include acquired patents within the Patent Box, to further minimise any distortion of commercial collaborative behaviour.

Question 2: Do the ownership criteria adequately permit on-licensed patents and patents developed or commercialised in commercial cost sharing, partnership and joint venture arrangements to qualify for the Patent Box?

Development criteria

2.13 As stated in the November 2010 consultation, the Government wants to ensure that companies benefiting from the Patent Box are actively involved in the patent development cycle and are not merely passive recipients of income from holding patents. To achieve this, the company claiming a Patent Box tax deduction must remain actively involved in the ongoing decision making connected with the exploitation of the patent.

2.14 In addition the company, or another group company, must have performed significant activity to develop the patented invention or its application. Groups will therefore retain the flexibility to transfer patents between group companies without losing Patent Box eligibility.

2.15 This work need not necessarily occur before the patent is granted or result in further patents, but it must extend beyond activities related to the management of a financial investment or the legal protection of the patent. To determine whether a company has performed significant development activity, the Government proposes to take account of the active decision-making functions related to the management of risks associated with the project, as well as actual R&D activity. Subcontracting of R&D work will not therefore necessarily prevent a group from meeting this requirement.

2.16 Where the patent or its application has been developed solely by the claimant or its group, it will be clear that the group has performed significant development activity. However, where a patent has been acquired or developed in collaboration with unrelated companies it may be less clear. Two options in this case are:

- for this test to be met only if the group's expenses associated with the development of the patented invention or its application exceed a pre-defined proportion of the value of the patent on acquisition or the total costs of a joint project;
- alternatively, the requirement could be left to a judgement in each case whether the group's involvement could reasonably be termed significant, taking into account all the circumstances.

2.17 The former would require some additional valuations and has a cliff-edge effect where the work carried out is close to the threshold value. The second option would introduce a greater requirement for individual judgement and so gives less certainty. The Government would welcome views on which approach businesses would prefer.

Question 3: Do businesses think that the development criteria are workable or are there commercial situations which should be included but would fall outside these rules?

3 Qualifying income

3.1 Companies will generally earn income from a variety of sources, only some of which are associated with patents they own. This chapter sets out the Government's proposals for how qualifying income should be identified for the purposes of the Patent Box. In order to derive patent profits from these qualifying income streams appropriate expenditure must first be deducted, and the proposed framework for this is set out in the next chapter.

3.2 The proposals for qualifying types of income set out in this chapter mainly focus on income from products rather than attempting to separately identify income from individual patents. This focus on products will make it easier for a wide variety of companies to benefit as the information required to separate income by product line should be accessible from commercial accounting records. The Patent Box will include worldwide income earned by UK businesses from inventions covered by a currently valid qualifying patent, which will avoid the need for companies to track sales made in each jurisdiction separately.

Income from patent licensing and royalties

3.3 The Government proposes to include all royalties or licence fees received for use of an invention covered by a currently valid qualifying patent, regardless of whether the invention is used by the licensee in an industrial process or incorporated into patented products sold by them.

Income embedded in patented products

3.4 In order to ensure that the Patent Box is accessible to a wide variety of businesses, the Government proposes to include income from the sale of any products incorporating at least one invention covered by a currently valid qualifying patent. The incorporation of the invention or inventions into the product must be genuinely commercial and the patent must not have been added just with the intention of making the product qualify for the Patent Box. Where parts, components or separate items are aggregated for sale, the items must together constitute a single composite product in which they are functionally interdependent. Where extraneous items are included, or non-patented products are simply sold together with a patented product, then the income related to them will not become qualifying income.

3.5 Where a business also sells spare parts for a qualifying product, these will also be included, recognising that in some cases this can constitute a significant part of the commercial return on a patented product. Some spare parts may be separately covered by a qualifying patent, and these may be recognised as patented products themselves when sold separately.

3.6 The Government also proposes to include income from the licensing of a bundle of intangible assets which are genuinely related and licensed as a single product. Such products may include, for example, a licence permitting the use of all proprietary technology required to make a patented product. As with tangible products these must incorporate rights to use at least one invention covered by a valid qualifying patent which must be an integral part of the bundle, and will be subject to similar anti-avoidance rules.

3.7 The Government recognises that patents are regularly contested and that damages paid by third parties for infringing a qualifying patent largely represent compensation for lost income which would otherwise have qualified for the Patent Box. Such compensation and damages will therefore also qualify.

> **Question 4:** Do businesses believe that it is necessary to set out rules to more closely define the circumstances where a composite tangible or intangible product should be considered a single functionally interdependent item? Or can this requirement be tested through a motive test on a case-by-case basis?

Patents used in process

3.8 Some patented inventions are not incorporated in products but are used by the business holding the patent in industrial processes. The Government has considered whether there are cases where income from products made by a patented process should be included in the Patent Box in the same way as patented products. It currently considers that this would extend the box to income from a wide variety of generic goods and commodities where the profits are not directly associated with the patent itself or with technical innovation.

3.9 Companies with valuable patents used in industrial processes can, however, use the divisionalisation rules set out in Chapter 4. This will enable them to impute an arm's length royalty for the use of that patent, and this royalty will be included as qualifying income as shown in example C in Annex A. Income from patented processes will also qualify when a licence to use a patented process is granted or if production equipment incorporating the patented process is sold.

Services

3.10 The Government has carefully considered representations that service income should be included in the Patent Box. However, the provision of services is not covered by patent protection under UK law, and the inclusion of service income would potentially bring a significant amount of income into the Patent Box which is only peripherally linked to the development of patented technology. Where services and products are sold together the income will need to be apportioned between the two elements in a just and reasonable way.

3.11 There may be some circumstances where the service provider would be willing to pay a royalty for use of a particular patent if it was operating at arm's length. In those cases companies will be able to use the divisionalisation rules set out in Chapter 4 in the same way as for patents used in industrial processes.

> **Question 5:** The Government would welcome views on how the arm's length profit attributable to patents used in processes or to provide services should be calculated.

Income from the sale of patents

3.12 The Government is proposing to include income from the sale of patents in the Patent Box. Patents sold by UK businesses may potentially be commercialised offshore, but the aim of the Patent Box is to encourage both the development and commercialisation of new patented technologies. Some smaller companies which develop new patents do not have the scale of operations required to fully commercialise a new product in-house. Extending the Patent Box to include income from the sale of patents will provide an incentive for these innovative small companies to be located in the UK.

Financial Income

3.13 The Government intends the Patent Box to benefit companies involved in patent development and commercialisation activities rather than financing. Any income arising from financial arrangements, including interest, interest equivalents (such as amounts relating to credit for the sale of products), income from financial assets, and any other type of finance income will therefore be excluded from the Patent Box.

North Sea Ring fence income

3.14 Any income or profits which fall within the North Sea ring fence regime will not qualify for the Patent Box. However, any other income related to patented technology in the extractive industries will qualify in the same way as any other patented product or process.

Income arising before a patent is granted

3.15 A patent will qualify for the Patent Box in full from the date of grant. The Government recognises that there can be a long period between the application for a patent and the grant date, and does not want to discriminate against companies with shorter development cycles. However, it is important that the regime is limited to valid patents and the Government does not believe that a system of granting relief and clawing it back where an application is unsuccessful would be workable or would provide sufficient certainty to business.

3.16 In order to reconcile these considerations, the Government proposes that once a patent is successfully granted, the company will be able to claim Patent Box benefits for any income which arose between the patent application and the date of grant, for up to four years prior to grant. To avoid excessive administrative burdens caused by recalculating taxable income for multiple years the additional benefit will be available in the accounting period when the patent is granted. No Patent Box benefits will apply to profits made prior to the patent application.

Question 6: Do businesses think that the proposed claim of retrospective benefits for the period while a patent is pending is fair and workable?

4 Calculation of Patent Box profits

4.1 The reduced 10% tax rate in the Patent Box is applicable to the net profit attributed to patents, not to gross income. Including sale proceeds of a patented product as qualifying income allows more companies to benefit from the Patent Box, but involves increased difficulty in identifying what level of profit should be attributed to the patents involved.

4.2 The November consultation announced that the Government preferred to calculate Patent Box profits using a formulaic approach rather than requiring an arm's length valuation of each patent individually. This approach was broadly welcomed by businesses as a way of improving certainty and reducing administrative burdens on both businesses and HMRC.

Model overview

4.3 The Government proposes that a company's Patent Box profit should be calculated using a flexible, **three step**, model based on a "residual profit split" method. This is a recognised transfer pricing method for identifying and valuing patent profits. In this proposed model:

- **Step one** is to determine the part of the company's corporation tax profit that is attributable to qualifying income. To do this the company's total taxable trading profit and expenses will be apportioned pro-rata, based on the proportion of the company's total trading income which is qualifying income for the Patent Box (as set out in Chapter 3). Where a simple pro-rata allocation is inappropriate a more accurate allocation can be achieved by use of "divisionalisation" rules which are described later in this chapter.
- **Step two** reflects the fact that valuable patents and other forms of IP will produce higher profits than can be made by companies without valuable IP. The amount of this extra profit, known as the "residual profit", is a measure of the profit created by the IP rather than through routine business activities. Step two requires companies to calculate this residual profit by deducting a simple fixed percentage return on routine activities from the corporation tax profit attributed to qualifying income.
- The residual profit attributed to patented products will have been derived from all valuable IP associated with that income, and not just to the patent itself. Other forms of IP, in particular valuable brands, can give rise to very high levels of residual profits. So **Step three** requires businesses to identify how much of the residual profit on a qualifying product is due to the patent and closely related IP, and how much to other forms of IP.

4.4 Worked examples of the model are set out in Appendix A. Example A shows a simple example of the proposed Patent Box model, and B shows a more detailed example.

Question 7: Do businesses agree that the proposed model will produce an acceptable result in most circumstances, given the flexibility provided by the ability to apply the model to company divisions separately if required?

Step one: Division of taxable profit between qualifying and non-qualifying income

4.5 The first step aims to identify the amount of profit and expenses which are attributable to qualifying income.

4.6 The Government proposes to use taxable rather than accounting profit as the starting point for calculating profits attributed to qualifying income. Before apportionment between qualifying and non-qualifying income, the profit will be adjusted by:

- Excluding the R&D tax credit enhancement, but not the base R&D costs themselves. This will mean that companies retain the full benefit of R&D tax credit enhancement, relievable at the main rate of tax. For example if a company incurred £100 of R&D expenditure eligible for 30% enhancement under the large company R&D tax credit scheme, it would have total tax deductions of £130 relating to its R&D spend. Of these, the base cost of £100 would remain within the Patent Box, but the enhancement of £30 is added back to increase the relevant profit for the Patent Box calculation.
- Excluding interest receipts and financing expenses. Finance costs are fungible and very difficult to attribute to a particular income stream.

4.7 The Government proposes that the apportionment of all remaining profit and expenses should be done on a simple pro-rata basis according to the proportion of total trading income which is qualifying income. This approach significantly reduces the administrative burden compared to requiring companies to individually apportion each type of expense between qualifying and non-qualifying income streams. In particular cases where this may produce an anomalous result, the divisionalisation rules described below may be used instead.

4.8 The Government would welcome views on whether the current proposals strike the right balance between simplicity and accuracy, or whether a different system for apportioning residual profit to qualifying income in straightforward cases would be preferred.

Question 8: Is there any alternative basis of apportioning residual profits between different products which is more appropriate without introducing excessive complexity?

4.9 The Government currently envisages that no adjustments to the apportionment method will be made for one-off income and expenses such as the sale of a patent, damages received for patent infringement, or exceptional costs. One-off receipts will be treated as qualifying or non-qualifying under the same rules as used for regular income streams, and one-off expenses will be apportioned pro-rata between qualifying and non-qualifying income. While the Government recognises that this may lead to excessive or insufficient Patent Box profits in the year the item is brought into account, where this occurs there is likely to have been a corresponding reduction or increase respectively in the Patent Box profits in prior years, giving a fair result overall. However, the Government will need to ensure that this is not open to manipulation.

Question 9: Should there be special rules for any one-off items of income or expenditure? If so what form should the rules take?

Divisionalisation

4.10 Allocation of profits and expenses on a pro-rata basis is expected to result in a reasonable amount of profit being allocated to the Patent Box in most cases. In some cases, however, this may produce anomalies. In order to address this issue the Government proposes that in certain cases step one can be replaced by apportionment of expenses and profits separately to suitable "divisions" of the company. Where any division has a mixture of qualifying and non-qualifying income the profits and expenses within that division will be apportioned on a pro-rata basis.

4.11 In certain pre-defined cases where the model would otherwise result in an excessive figure for Patent Box profits, this "divisionalisation" will be mandatory. The Government currently envisages that this would apply where a company receives significant royalties that are mainly for use of IP other than patents, as well as where a company has overseas branches, but would welcome views on whether there are other circumstances where mandatory divisional application should also apply.

4.12 Where the model would otherwise lead to less profits being attributed to patents than appropriate, companies will have the option of defining divisions and applying the model separately to each such division. This may apply, for example, where profit margins in different areas of the business are significantly different.

4.13 It is also likely to be helpful where a company makes use of a patented process but the products it produces are not covered by any patent. In this case the company will be able to treat the patent as owned in a separate division which charges an arms-length royalty for its use, provided an appropriate allocation of expenses is determined for such a division.

4.14 Once a company opts to apply the Patent Box on either a whole-company or divisional basis this must be applied consistently. A company will not be permitted to change from a whole-company to a divisional basis or to change divisions on a year-by-year basis. Changes will be permitted only where these reflect a genuine long-term change in the company's commercial activities.

4.15 Divisionalisation inevitably will require considerable additional computational effort. In order to apply the model on a divisional basis, the company will be required to produce a tax computation for each division. It will also be required to document the basis for allocating income, expenditure and assets to each division, and to ensure that inter-divisional transfer prices, including those for notional royalties and capital items, are calculated in accordance with the OECD's Transfer Pricing Guidelines. An appropriate share of expenses must be allocated to each division, taking into account not just the expenses directly related to the qualifying income stream, but also all other indirect expenses of the business line producing that income stream.

4.16 Examples C, D, and E demonstrate application of the divisionalisation proposals in various circumstances.

Question 10: Is divisionalisation the most effective and least burdensome way to deal with a wide range of situations in which pro-rata allocation of profits and expenses would produce an inappropriate result? Are the conditions set out above to govern the use of divisionalisation appropriate? The Government would welcome any alternative suggestions, and would appreciate sufficient detail that these can be evaluated by HMT and HMRC.

Question 11: Are there any other circumstances in which divisionalisation should be mandatory?

Step two: Identification of residual profit

4.17 This step aims to calculate the residual profit which the company has achieved on its qualifying income. In order to calculate the residual profit, a notional routine profit must be deducted from the profits attributable to the qualifying income calculated in step 1 above.

Calculation of notional routine return - mark-up on expenses

4.18 Companies who do not own any valuable IP will still expect to make a certain level of profit, commonly known as a "routine" profit, from the value adding activities carried out by the company. The Government is proposing to calculate this routine profit using a cost-plus methodology, as this is easy to apply and commonly used in many commercial situations. The mark-up will be applied to "tax deductible expenses" calculated by deducting the profit attributed to qualifying income from that gross income.

4.19 The proposed method will exclude certain costs from the mark-up calculation:

- where functions are outsourced to a third party or other group company the routine profit associated with these activities should have already been accounted for in that other company. The Government therefore proposes to allow companies to exclude outsourced costs from the routine return calculation, and would welcome views from business as to how such outsourcing should be defined;
- the cost of raw materials and goods purchased for resale can be excluded, as these are inventory costs rather than costs of the value-adding activity carried out by the company itself; and
- companies may also exclude licence fees paid to use patents or trademarks.

4.20 Remaining costs will be marked up at a fixed rate of 15%. This rate has been proposed as a reasonable return in a range of situations, taking into account the narrow cost base proposed which includes only the value-adding activities of the company. The Government has considered allowing using a flexible rate dependent on circumstances, but would prefer a simple fixed rate approach as this will avoid the administrative burden of companies having to justify rates for each type of activity.

Question 12: The Government would welcome views and evidence on the appropriateness of step 2 in identifying residual profits, as well as on how outsourced functions should be defined and whether there are any other costs which should be excluded from the mark-up.

Step three: Identification of Patent Box profit

Allocation of residual profit to patent and non-patent drivers

4.21 The final step in calculating profit attributable to patents is to consider how much of the qualifying residual profit is due to the patent and how much is due to other non-patent assets. This step is necessary as there are certain other forms of IP which may also support patented products and which may give rise to very high levels of profits unrelated to patents. Although all other types of IP may contribute to this residual profit to some degree, the largest contribution will often come from valuable brands.

4.22 One option is to allocate residual profit to patent and brand IP according to the ratio of expenses incurred by the company that are classified as "patent" or "brand" expenses. Patent expenses would include all research and development expenses recognised in the statutory accounts (not only those eligible for R&D tax credits), as well as expenses related to patent filing, renewal and protection. Brand expenses would include marketing, selling and promotion costs, expenses related to trademark development and protection, and design costs not classified as research or development.

4.23 The Government's preferred approach for this option would be to use current year expenditure in the whole company as a proxy for costs incurred in relation to specific products. However, it recognises that it may be more appropriate to look only at costs related to patented products, and that an alternative approach may be required for companies with a small number of products and where either patent development expenses or marketing expenses are incurred considerably in advance of much of the additional income they generate.

Question13: The Government would welcome business' views on an appropriate formula to allocate residual profit to patents, and on what types of expenses should be taken into account in calculating the relative contribution made by the patent and brand to the residual profit.

4.24 If use of a cost ratio is not supported by business, the Government proposes that companies should apportion the qualifying residual profit by identifying the relative contribution of the brand and the qualifying patents to the success of the product. Any reasonable method could be used provided that it is applied on a consistent basis; often the historical levels of expenditure incurred in developing the specific assets used in each product line might be an appropriate basis. The Government would consider whether other forms of IP should also be separately identified for these purposes and would welcome business' views on this.

4.25 The Government recognises that smaller companies may not have experience in identifying the relative contribution of patents and brands, and that for smaller claims in particular this requirement may be too complex and prevent companies from claiming Patent Box benefits. The Government therefore proposes that, if the cost ratio approach is not adopted, groups making smaller claims of up to £500,000 a year may instead chose to simply allocate 50% of their qualifying residual profits to patents.

Question 14: Can businesses suggest any alternative ways of effectively separating patent profits from those arising from other types of IP? If a relative contribution approach is chosen, is the proposed safe harbour set at an appropriate level to simplify smaller claims?

Treatment of patent box losses

4.26 In some circumstances the Patent Box calculation will result in a Patent Box loss rather than a profit. If this loss is given immediate effect in the corporation tax computation at a 10% rate, this would increase the corporation tax payable by the company in that year as compared with the position if it had not opted in to the regime. The Government does not want companies to be worse off as a result of applying for the Patent Box, and therefore proposes that any Patent Box loss will not be taken into account in computing the company's current year profits chargeable to corporation tax.

4.27 However, in order to retain the objective of applying the 10% rate to total net patent profits, these Patent Box losses must be calculated and carried forward, and Patent Box profits in later periods will be reduced by Patent Box losses carried forward until these are used up. In addition, there is a case for requiring Patent Box losses to be set off against Patent Box profits in other group companies, in order to provide for a similar total Patent Box tax deduction regardless of the number of companies a group chooses to use to hold its patents.

4.28 The detailed rules for this are still under consideration and the Government would welcome business' views on an equitable way to achieve the objective of ensuring a symmetrical treatment of Patent Box profits and losses without disincentivising future investment.

4.29 The Government does not intend to restrict or claw-back losses incurred prior to entry into the box, other than to the extent these are taken into account by the claw-back of excess pre-commercialisation expenses discussed below.

4.30 Example F of Annex A illustrates how these rules are likely to work in practice.

Question 15: Are the proposed rules for the carry-forward of Patent Box losses appropriate? Should Patent Box losses also have to be set against Patent Box profits of other group companies in the same accounting period, in order to achieve a symmetrical treatment of Patent Box profits and losses?

Opting out of the regime

4.31 A company will be free to opt out of the Patent Box at any time, in which case no further calculation of Patent Box losses is required. However, in order to prevent manipulation, a company will not be able to opt back in to the Patent Box for five years after opting out. This restriction will also apply where any other associated company acquires the trade or assets of the company which has previously opted out of the Patent Box.

Taking into account pre-commercialisation expenses

4.32 In the November 2010 document the Government made it clear that it considers that pre-commercialisation expenses should be taken into account when considering appropriate net patent profits. This will ensure that the reduced rate applies to the overall profit attributable to the patent, and will avoid creating perverse incentives by aligning the regime to commercial incentives to create products that are profitable across their lifecycle.

4.33 The model set out above includes current year R&D costs, which will normally relate to the next generation of products, in the calculation of residual profits. Many companies spend a similar amount on R&D each year as they continually develop new patents and products, and the Government considers that where this is the case current year costs will provide a reasonable proxy for pre-commercialisation expenses. In these cases no further claw-back of pre-commercialisation expenses will be required. This is a pragmatic approach which will significantly reduce complexity and will avoid the need for detailed tracking of expenses for the majority of companies.

4.34 However, this will not always be the case, as some companies may develop only a small number of patented products. In cases where ongoing costs do not provide a reasonable proxy for the prior year costs of developing current products some pre-commercialisation development costs will need to be clawed back. The Government will discuss the detailed implementation of these claw-back rules with stakeholders over the summer, and will release detailed proposals with draft legislation in the autumn.

Question 16: Do businesses consider that taking pre-commercialisation expenses into account in these circumstances is proportionate and fair, or are there better ways of ensuring that the benefit accrues to total net patent profits?

5 Computational issues

5.1 Previous chapters have covered the types of patents and income which are eligible for the Patent Box and how businesses should quantify the patent profits which qualify for the reduced rate of tax. This chapter covers how the reduced tax rate will be delivered through the tax return system, as well as covering interactions with other associated tax regimes.

Computational method

5.2 The Government proposes to implement the 10% Patent Box rate by allowing companies to claim an additional Patent Box tax deduction when calculating the level of taxable profits. The resulting reduced profits will then be taxed at the normal rate of corporation tax. This deduction will give the same tax result as direct application of the 10% rate. The Patent Box tax deduction will therefore be calculated as:

$$\text{Total Patent Box profit} \quad \text{X} \quad \frac{\text{Main CT Rate less Patent Box rate}}{\text{Main CT rate}}$$

5.3 Where a company is eligible for the small profits rate of corporation tax this will be used instead of the main rate in the above calculation.

5.4 Where there is a negative result from the Patent Box calculation these Patent Box losses will be treated separately according to the proposals set out in Chapter 4, so negative Patent Box tax deductions (which would equate to additional taxable amounts), will not occur. No additional restrictions will be made to the other current loss relief rules, so companies will be able to group relieve and carry forward losses against any remaining profits as usual.

Question 17: Do respondents see any practical or technical problems with the approach of implementing the 10% Patent Box rate through a computational tax deduction?

Income from sale of patents

5.5 As indicated in Chapter 3, income from the sale of patents is included in the Patent Box. Where the patent falls under the post-2002 IP regime, the income from the sale will be treated as a normal trading receipt or expense as the tax treatment follows the profit or loss reflected in the statutory accounts. However, the sale of older patents may give rise to an income charge or be considered under the capital allowances rules for patents. Where disposal of a patent right or a licence gives rise to an income charge, balancing allowance or balancing charge, then these will form part of the Patent Box calculation.

Treatment when a patent no longer qualifies

5.6 A patent will cease to qualify once the patent or associated SPC has expired. The Government has considered making Patent Box benefits available for a fixed period from first commercialisation of a patented product, but considers that this would add unnecessary complexity due to the need to define the first commercialisation date and protect against artificial re-launching of a "new" product just before patents are due to expire. It would also be contrary to the policy intention which is to target the Patent Box at legally protected, novel technologies.

5.7 If a company loses rights to a patent after it is granted, for example due to a successful legal challenge, no further Patent Box benefits may be claimed but benefits already accrued will not be clawed back.

Double Tax Relief (DTR)

5.8 The Government will ensure that double tax relief for withholding tax suffered on royalties will continue to be available up to the lower of the overseas tax suffered and the tax payable in the UK on profits deriving from the licensed assets after taking the Patent Box deduction into account. Similarly, relief for tax paid on the profits of a non-exempt overseas branch will also continue to be available, also up to the lower of the tax paid overseas and the final tax payable on branch profits in the UK.

5.9 As the calculation of tax payable in the UK will depend on the final details of the implementation of the Patent Box, the Government intends to consider the interaction of the Patent Box deduction with the current DTR rules with affected businesses over the consultation period. Proposals for changes to the calculation method, if required, will be released in the autumn with the draft legislation.

Question 18: Do respondents have any initial comments about interaction with double tax relief rules or have any views on the Government's stated aims for giving relief?

Transfer Pricing

5.10 The Patent Box will apply on a company-by-company basis. The Government has considered applying the Patent Box on the basis of UK consolidated results but considers that this would introduce unnecessary complexity and administrative burden, as many groups do not currently produce accounts calculated on a UK consolidated basis. Consolidated accounts produced by UK parented groups generally include the whole worldwide group rather than just those companies subject to UK corporation tax.

5.11 In order to prevent tax avoidance it is therefore important that all companies claiming Patent Box benefits comply with the Transfer Pricing regime in their transactions with associated companies. Currently small companies are exempt from the regime in most cases. While the Government does not wish to impose excessive administrative burdens on small companies by requiring a full transfer pricing analysis, where companies do opt in to the Patent Box it is necessary to have rules available to prevent artificial diversion of profits. The Government therefore proposes extending the powers of HMRC to require normally exempt companies to apply transfer pricing rules to particular transactions, currently applicable to medium sized companies, to small companies claiming a Patent Box deduction. These powers would only be used in cases of clear tax avoidance through the artificial manipulation of profits between associated companies.

Question 19: Would having to comply with transfer pricing rules for transactions with associated companies in cases of tax avoidance be an unreasonable burden for smaller companies?

Anti-avoidance rules

5.12 The Government is considering the need for targeted anti avoidance rules in order to maintain the intended scope of the Patent Box. An effective strategy to prevent abuse is a key requirement to maintain the long term stability of the Patent Box regime. The Government will in particular consider whether rules are required in the following areas:

- The inclusion of patented inventions in products, or combinations of qualifying and non-qualifying products which are not functionally interdependent, for a main purpose of securing that income from the sale of a product will qualify for the Patent Box where it would not otherwise have qualified.
- Artificial manipulation of income or expenses in any way, in order to obtain tax deduction for expenses at full rate while income is taxed at the 10% box rate.
- Transfers of patents within groups of companies in order to avoid restrictions on losses or clawback of development costs.

Question 20: Can respondents suggest any alternative ways to prevent artificial tax avoidance abuse of the Patent Box?

Clearances

5.13 The formulaic approach is generally expected to provide business with enough certainty to be able to self-assess without the need for a formal clearance process. HMRC envisages that companies may wish to seek advance agreement where divisionalisation applies or where there is uncertainty about application of step 3. Consistent with its current approach to significant business tax issues, HMRC will operate a non-statutory clearance system on the Patent Box in response to applications from business.

Question 21: Do respondents consider that other aspects of the formula apart from divisionalisation and step 3 will give rise to clearance applications? Will the current non-statutory clearance system be sufficient to respond to the range of enquiries that the Patent Box is likely to generate?

6 Commencement of the Patent Box

Commencement date

6.1 The November consultation document announced that the Patent Box would apply to all patents first commercialised after 29 November 2010. However, the Government has received a number of representations that the date of initial commercialisation may be hard to define or identify, particularly where a chain of companies is involved in bringing a product to market, and that applying the regime only to new patents will fail to encourage retention of existing patents in the UK. Setting a cut-off date for patent eligibility will also require the development of complex transitional rules which will need to be retained and enforced for up to 20 years until all older patents have expired.

6.2 The Government has therefore developed an alternative transitional method which would replace the cut-off date and extend the benefits of the regime to all qualifying patents, while managing the immediate impact on tax receipts as required in the current financial environment. The alternative transition could be achieved by phasing in the Patent Box benefit over the first five years of operation. It is important that the benefits available in the early years are still sufficient to provide an effective incentive to new investment into the UK and the proposed rates have been developed to reflect this.

Table 6.A: Proposed phase-in of available benefits

	2013/14	2014/15	2015/16	2016/17	2017/18
Proportion of full benefit available	60%	70%	80%	90%	100%

6.3 The Government welcomes views on which approach businesses would prefer. Consistent transitional rules will apply across the regime; it will not be possible for some companies to use the cut-off date while others use a phase-in approach.

Question 22: The replacement of a cut-off date with a phase-in approach will have different effects for each company. The Government would welcome comments on the impact of this proposal on different sectors as well as views on whether businesses prefer a cut-off date as originally announced or would favour the proposed phase-in approach.

Transitional Provisions

6.4 The Patent Box will apply to profits arising after 1 April 2013. Where a company's accounting period straddles 1 April 2013 then companies will be able to benefit from the Patent Box in relation to those profits which arose after 1 April 2013. During the phase-in period where a company's accounting period straddles 1 April, companies will be able to allocate appropriate profits to each period so that they can benefit immediately from the additional proportion of Patent Box benefits available.

7 Tax impact assessment

7.1 This section looks at the impacts of introducing the Patent Box. The policy objectives, the scope of the Patent Box and the proposed mechanism of how it will work have been looked at in previous chapters.

What will it cost? The Exchequer and wider economic impact

Exchequer impact

7.2 The Patent Box was included in the forecasts in Budget 2011 with the following costings:

Estimated Fiscal Impact (£m)				
2011-12	2012-13	2013-14	2014-15	2015-16
0	0	500	800	900[1]

7.3 The current proposals are consistent with this estimate, although policy changes as a result of responses to the consultation, including any move from cut-off date to phase-in commencement provisions, may have an impact on the final exchequer cost. Final costings may be subject to the Office of Budget Responsibility scrutiny.

7.4 The estimate of how much profit is related to patents in the UK is based on the best available data, but this is limited due to the availability of evidence. The Government would welcome evidence from business about what proportion of their income and profits will qualify under these proposals to help it refine the estimate of eligible patent income and profits in UK companies.

Behavioural impact

7.5 The behavioural response to a change in the incentives for multinational companies to locate patents and their profits in the UK is included in this costing. A reduction in the corporation tax rate will reduce the incentive for companies to shift patent profits out of the UK, and will make the UK more attractive (relative to other locations) as a destination to locate patents.

7.6 Another behavioural impact included in the costing is an estimate of additional patenting by companies where currently no patent protection is sought. The estimate of the cost arising from this behaviour is based on academic research on the extent to which patenting increases the value of an invention.

7.7 An estimate has also been made of the costs associated with income shifting from other income types to patent income, where this cannot be addressed through transfer pricing rules.

[1] *The costs of this measure will rise to £1.1 billion in steady state.*

7.8 The Government would welcome comments and evidence from businesses about the expected behavioural impact of this regime, and how this will affect their UK tax liabilities.

Economic Impact

7.9 The Patent Box will benefit companies which obtain profits from patents. Patents are used by a wide variety of businesses, but particular sectors likely to benefit are pharmaceuticals, life sciences, electronics and defence. The Government expects that all businesses which derive profits from patented products will be able to benefit from the Patent Box. The final number of companies which will benefit has not been established at this stage; this figure will be determined as the policy and impact assessment are developed.

7.10 The Patent Box will encourage investment and development of new patents and prevent movement of IP offshore by innovative business who otherwise might invest elsewhere, creating high value jobs and boosting economic activity in the UK.

What will it cost customers? Impact on business and the third sector

7.11 This is a corporate tax measure and will only impact on businesses which are liable to corporation tax in the UK. It is therefore not expected to have any impact on the third sector.

Administrative Burdens

7.12 As the Patent Box will only be available to patents granted by the IPO and EPO, some businesses who do not currently patent through these routes will need to apply for patents and will incur additional costs. The IPO fees to acquire a UK patent, including application and renewal fees, are £950 for ten years and £4770 for the maximum 20 years. The proposed model design, which requires only one patent over a product in order for the worldwide profits to qualify, also reduces the impact of this requirement.

7.13 The Government has developed a formulaic approach to calculating the net profit from patents to improve certainty and reduce administrative burdens. However, this is an unavoidably complex regime and will impose an additional administrative burden. This impact is mitigated as this is an optional regime. Additionally there will be some cases where the formula produces an inappropriate result and some additional effort will be required to calculate the net patent profit. This will be in the areas of claw-back of pre-commercialisation expenses (where ongoing expenses are not a reliable estimate of past expenditure) and divisionalisation (where elements of a company must be calculated separately).

7.14 The Government would welcome comments on the impact of these proposals on businesses, and any areas where administrative burdens could be reduced while still meeting the objectives of the regime.

Impact on small companies

7.15 Several aspects of the proposals have been designed to help reduce the impact on small businesses. The largely formulaic approach will help small businesses to be able to accurately self-assess their corporation tax. The Government recognises that some small companies may not have the experience in identifying the relative contribution of patents and brand IP, so if this is required in the final legislation the proposed safe harbour for the attribution of profits to patent and brand IP in smaller claims of up to £500,000 a year will be available for small companies. The Government intends to produce comprehensive guidance which will further assist small businesses. However, the regime will unavoidably increase administrative burdens for small companies which chose to elect into the regime.

7.16 The Government would welcome comments on how the regime could be made simpler for small businesses that derive profits from patents.

What will it cost the public sector?

7.17 Indicative estimated annual costs of HMRC administering the regime are in the range of £2m-£5m, although these costs are very much reliant on the final design. Training and familiarisation on the new legislation will be required. It is not anticipated that there will be any significant operational impacts on other government departments, including the IPO, but this position will be clarified as the requirement is finalised.

Summary of other impacts

Impact on Individuals and households	This is a corporate tax measure so will not impact on individuals.
Equalities impact	This is a corporate tax measure. No impacts on race, gender, disability or other equalities are anticipated.
Wider environment Impact	By encouraging development and innovation in high-tech industries the Patent Box is expected to contribute to the development of low carbon technology and technology to reduce carbon emissions but we cannot quantify actual impacts at this stage.
Health impact	By encouraging development and innovation in high-tech industries such as pharmaceuticals the Patent Box is expected to have a beneficial effect on health areas although these benefits have not been quantified at this stage.
Competition	The Patent Box is not sector specific and is generous in its scope by also including SPCs and data exclusivity. Any company with eligible patents and qualifying income may be able to take advantage of the Patent Box.

Question 23: The Government would welcome comments or evidence to support the assessment of the impacts of the regime.

Evaluation and monitoring

7.18 Patent Box is a new tax measure containing new rules. Given the scope and complexity of the new regime unforeseeable issues may emerge. These may not be apparent immediately and a full picture may not be available until there is data for perhaps three years after commencement. It is possible that there may be changes required to how the regime is implemented. The policy will be monitored and assessed alongside other measures in the Government's package of corporate tax reforms.

Question 24: The Government would welcome comments on the best forum for dealing with emerging issues once the Patent Box is introduced

8 Next steps

8.1 The Government welcomes views by 2 September 2011 on the issues raised in this document, in particular:

- The workability of the proposals in enabling companies to compute profits eligible for the lower Patent Box rate
- The expected economic and administrative impacts of the proposals on businesses; and
- The detailed questions raised throughout the document.

8.2 Officials will spend time between now and the autumn consulting with business on these proposals. A Patent Box working group will continue to take these proposals forward. Nominations for additional members of the working group should be sent to corporatetaxreform@hmtreasury.gsi.gov.uk by 24 June 2011.

How to respond

8.3 Any comments or technical queries on the proposals in this part of the document should be addressed to Anna Floyer-Lea or Richard Rogers at:

CT Reform
Corporate Tax Team
HM Treasury
1 Horse Guard's Road
London
SW1A 2HQ

Or if responding by e-mail please send to: corporatetaxreform@hmtreasury.gsi.gov.uk

Telephone (Treasury switchboard): 020 7270 5000

The Consultation Code of Practice

8.4 This consultation is being conducted in accordance with the Code of Practice on Consultation. A copy of the Code of Practice criteria and a contact for any comments on the consultation process can be found in Annex D.

Confidentiality

8.5 Information provided in response to this consultation, including personal information, may be published or disclosed in accordance with the access to information regimes. These are primarily the Freedom of Information Act 2000 (FOI), the Data Protection Act 1998 (DPA) and the Environmental Information Regulations 2004.

8.6 If you want the information that you provide to be treated as confidential, please be aware that, under the FOI, there is a statutory Code of Practice with which public authorities must comply and which deals with, amongst other things, obligations of confidence. In view of this it would be helpful if you could explain to us why you regard the information you have provided as confidential. If we receive a request for disclosure of the information we will take full account of your explanation, but we cannot give an assurance that confidentiality can be maintained in all circumstances. An automatic confidentiality disclaimer generated by your IT system will not, of itself, be regarded as binding on HM Treasury (HMT) and HM Revenue and Customs (HMRC).

8.7 HMT and HMRC will process your personal data in accordance with the DPA and in the majority of circumstances this will mean that your personal data will not be disclosed to third parties.

A Worked examples

Example A Simple worked example

Company A has trading turnover of 1000, of which 700 (70%) is from the sale of qualifying patented products. Its tax deductible expenses of 775 include 100 for R&D, none of which qualifies for R&D tax credits, and 75 for marketing.

Tax adjusted trading statement

Sales			1,000
Trading expenses			
(after computational adjustments)			
R&D		100	
Marketing		75	
Other costs		600	
			(775)
Taxable trading profit			225

Step 1: Divide taxable profit between qualifying and non-qualifying income

Qualifying income				700
Total trading income				1,000
Ratio of qualifying:total income				70%
Qualifying income				700
Trading expenses	Full		Apportioned	
R&D	100	x 70%	70	
Marketing	75	x 70%	52	
Other costs	600	x 70%	420	
				(542)
Pro rata trading profit used for step 2				158

Step 2: Calculate routine profit and residual profit

Total qualifying income		700
Trading profit from step 1		(158)
Total trading expenses used as basis for mark-up (step 1)		542
Mark-up rate	x	15%
Routine profit		81
Apportioned trading profit from step 1		158
Less: routine profit		(81)
Residual profit attributable to qualifying income		77

Step 3: Identification of Patent Box profit

R&D		100
Marketing		75
Total		175
R&D as share of total		57%
Multiplied by residual profit from qualifying income	x	77
Patent box profit		44

Example B More detailed worked example

This example illustrates the treatment of R&D tax credits, and also exclusion of certain costs from the routine profit calculation in step 1.

Company B has trading turnover of 1000, of which 700 is from the sale of qualifying patented products. Its tax deductible expenses of 795 include 100 of R&D costs plus an enhancement of 20 under the large company scheme, 75 of marketing expenditure, 200 for raw materials and 150 for contract manufacturing.

Tax adjusted trading statement

Sales		1,000
Trading expenses		
(after computational adjustments)		
Raw materials	200	
Contract manufacturing fees	150	
R&D	100	
R&D tax credit enhancement	20	
Marketing	75	
Other costs	250	
		(795)
Taxable trading profit		205

Step 1: Divide taxable profit between qualifying and non-qualifying income

Taxable trading profit				205
Add R&D tax credit enhancement				20
Trading profit for allocation				225
Qualifying income				700
Trading expenses	Full		Apportioned	
Raw materials	200	x 70%	140	
Contract manufacturing fees	150	x 70%	105	
R&D	100	x 70%	70	
Marketing	75	x 70%	53	
Other costs	250	x 70%	175	
				(543)
Pro rata trading profit				(157)

Step 2: Calculate routine profit and residual profit

Total pro rata trading expenses	543
Less costs not marked-up	
Raw materials	(140)
Outsourcing costs for contract manufacturing	(105)
Total costs for mark-up	298
Mark-up rate 15%	15%
Routine profit	45
Pro rata trading profit	157
Less: routine profit	(45)
Residual profit attributable to qualifying income	112

Step 3: Identification of Patent Box profit

R&D		100
Marketing		75
Total		175
R&D as share of total		57%
Multiplied by residual profit from qualifying income	x	112
Patent box profit		64

Example C Divisionalisation for a patented process

This example illustrates a company which uses divisionalisation to bring into the Patent Box profits due to a process patents. It uses the patented processes in the manufacture of products which are not covered by any product patents.

Company C has trading turnover of 1000, none of which is from the sale of qualifying patented products. However, it uses manufacturing processes which are covered by eligible patents. To bring an amount of profit in respect of these patents into the Patent Box it designates part of its business as the "Plant Development Division". This is the part of the R&D department which works on improvements to the manufacturing line rather than on developing new products. It designates the remainder of the company the "Production Division".

The company has determined, following the OECD's Transfer Pricing Guidelines, that were the two divisions independent companies the Plant Development Division would be able to charge an annual royalty of 35 (=3.5% of sales) for its patents and know-how. This is the Plant Development Division's notional income. Its only expenses are R&D costs of 20. The remaining 80 of R&D costs fall in the Production Division. None of the R&D costs qualify for R&D tax credits. The company performs the Patent Box calculation on the Plant Development Division, as shown below, resulting in a Patent Box profit of 12. There is no need to perform the patent box calculation for the Production Division as it has no qualifying income.

Tax adjusted trading statement

	Production division	Plant dev't division	Total company
Sales	1,000		1,000
Notional inter-divisional royalty		35	
Less trading expenses			
(after computational adjustments)			
Notional inter-divisional royalty	(35)		
R&D	(80)	(20)	(100)
Marketing	(75)	-	(75)
Other costs	(600)	-	(600)
Taxable trading profit	210	15	225

Step 1: Divide taxable profit between qualifying and non-qualifying income

The income of the plant development division is a royalty for use of a patents and know-how relating to manufacturing innovations, some of which are covered by eligible patents. As all the division's income is qualifying no apportionment of the divisional income statement is needed.

Step 2: Calculate routine and residual profit

Trading income		35
less: trading profit		(15)
Total trading expenses used as basis for mark-up		20
Mark-up rate	x	15%
Routine profit		3
Trading profit		15
Less: routine profit		(3)
Residual profit		12

Step 3: Identification of Patent Box profit

R&D		20
Marketing		-
Total		20
R&D as share of total		100%
Multiplied by residual profit from qualifying products	x	12
Patent box profit		12

Example D More complex example for a patented process

This example illustrates a company which uses divisionalisation to bring into the Patent Box profits due to process patents. It uses the patented processes in the manufacture of all its products, only some of which incorporate innovations covered by eligible patents.

Company D has trading turnover of 1000, of which 700 (70%) is from the sale of qualifying patented products. It uses processes which are covered by eligible patents in the manufacture of all its products (both qualifying and non-qualifying). To bring into the Patent Box an amount of profit in respect of the patented processes used to make non-qualifying products, it designates part of its business as the "Plant Development Division". This is the part of the R&D department which works on improvements to the manufacturing line rather than on developing new products. It designates the remainder of the company the "Production Division".

The company has determined, following the OECD’s Transfer Pricing Guidelines, that were the two divisions independent companies the Plant Development Division would be able to charge an annual royalty of 35 (=3.5% of sales) for its patents and know-how. This is the Plant Development Division's notional income. Its only expenses are R&D costs of 20. The remaining 80 of R&D costs fall in the Production Division. None of the R&D costs qualify for R&D tax credits. The company performs the Patent Box calculation on two divisions separately as shown below, resulting in total Patent Box profits of 47. This can be compared to the Patent Box profit of 44 without divisionalisation calculated in Example A, which has similar facts.

Tax adjusted trading statement

		Production division		Plant dev't division	Total company
Sales		1,000			1,000
Notional inter-divisional royalty				35	
Less trading expenses					
(after computational adjustments)					
Notional inter-divisional royalty		(35)			
R&D		(80)		(20)	(100)
Marketing		(75)		-	(75)
Other costs		(600)		-	(600)
Taxable trading profit		210		15	225

Step 1: Divide taxable profit between qualifying and non-qualifying income

		Production division		Plant dev't division	Total company
Qualifying income		700			
Qualifying notional inter-divisional royalty				35	
Less trading expenses					
Proportion of qualifying:non-qualifying income in division		70%		100%	
Apportioned trading expenses					
Notional inter-divisional royalty		(24)			
R&D		(56)		(20)	
Marketing		(53)		-	
Other costs		(420)		-	
Pro rata trading profit		147		15	162

Step 2: Calculate routine profit and residual profit

		Production division		Plant dev't division	Total company
Qualifying income		700		35	
Trading profit from step 1		(147)		(15)	
Total pro rata trading expenses		553		20	
Less costs not marked up: royalties payable		(24)			
Total costs for mark up		529		20	
Mark up rate 15%		15%		15%	
Routine profit		79		3	82
Trading profit from step 1		147		15	
Less: routine profit		(79)		(3)	
Residual profit attributable to qualifying income		68		12	80

Step 3: Identification of Patent Box profit

		Production division		Plant dev't division	Total company
R&D		80		20	
Marketing		75		-	
Total		155		20	
R&D as share of total		52%		100%	
Multiplied by residual profit from qualifying income	x	68	x	12	
Patent box profit		35		12	47

Example E Divisionalisation for mix of product and royalty income

This example illustrates a company that has income both from the sale of manufactured products and from licensing. All the licensing income qualifies for the Patent Box, but only some of the product sales income does. The net profit margin of the licensing business is greater than that from product sales, so the company uses divisionalisation to ensure that all the higher-margin licensing business is brought within the box.

Company E has trading turnover of 1000. 800 of this is from the sale of products and the remaining 200 is income from licensing for use in other geographic markets the same patents and trademarks it uses for the products it sells. Turnover from product sales is split 500 (62.5%) from the sale of qualifying products and 300 from the sale of products which do not qualify. To reflect better the different economics of the licensing and product sales business, the company designates two divisions. The "Licensing Division" generates all the licensing income and the remaining income accrues to the "Product Division".

The company has determined, following the OECD's Transfer Pricing Guidelines, that were the two divisions independent companies that had entered into cost-sharing arrangements for all their shared functions, the Licensing Division would bear R&D costs of 60, marketing costs of 15 and other costs of 50. The remaining costs would fall to the Product Division. None of the R&D costs qualify for R&D tax credits. The company performs the Patent Box calculation on two divisions separately as shown below, resulting in total Patent Box profits of 58. This can be compared to the Patent Box profit of 44 without divisionalisation calculated in Example A, which has similar facts.

Tax adjusted trading statement

		Product division		Licensing division	Total company
Sales		800			800
Royalties and other licensing income				200	200
Total turnover		800		200	1,000
Less trading expenses					
(after computational adjustments)					
R&D		(40)		(60)	(100)
Marketing		(60)		(15)	(75)
Other costs		(550)		(50)	(600)
Taxable trading profit		150		75	225
as a margin of turnover		*19%*		*38%*	*23%*

Step 1: Divide taxable profit between qualifying and non-qualifying income

		Product division		Licensing division	Total company
Qualifying income		500			
Qualifying royalties and other licensing income				200	
Less trading expenses					
Proportion of qualifying:non-qualifying income in division		63%		100%	
Apportioned trading expenses					
R&D		(25)		(60)	
Marketing		(37)		(15)	
Other costs		(344)		(50)	
Pro rata trading profit		94		75	169

Step 2: Calculate routine profit and residual profit

		Product division		Licensing division	Total company
Qualifying income		500		200	
Less: trading profit from step 1		(94)		(75)	
Total trading expenses used as basis for mark-up		406		125	
Mark-up rate	x	15%	x	15%	
Routine profit		61		19	80
Trading profit from step 1		94		75	
Less: routine profit		(61)		(19)	
Residual profit attributable to qualifying income		33		56	89

Step 3: Identification of Patent Box profit

		Product division		Licensing division	Total company
R&D		40		60	
Marketing		60		15	
Total		100		75	
R&D as share of total		40%		80%	
Multiplied by residual profit from qualifying income	x	33	x	56	
Patent box profit		13		45	58

Example F Patent box losses

This example illustrates the treatment of losses arising in the Patent Box.

Company F elects into the Patent Box in 2013. In 2017, it has trading turnover of 1000, all from the sale of qualifying patented products. In that year its taxable profits are below a routine return because of a high level of investment in R&D (see trading statement below). Consequently the patent box calculation (below) splits the small taxable trading profit of 50 into a larger non-box profit of 124 partially offset by a patent box loss of 74. This represents the investment in R&D which will generate future box profits. However, so that the Patent Box is not disadvantageous to the company, where there is a patent box loss it is proposed to tax the overall profit at the main rate. This means the loss has been relieved at main rate. It is, therefore, carried forward (there are no other companies claiming Patent Box in Company F's group) as a restriction to be applied to the amount of future Patent Box profits that are taxable at the Box rate.

In 2018, Company F's trading turnover increases to 1500 as a result of the new product developed in 2017, yielding an overall taxable trading profit of 500. The patent box calculation (below) splits this into a patent box profit of 175 and other trading profits of 325. The patent box loss brought forward is deducted from the 2018 box profit to give a profit of 101 taxable at the patent box rate. The remaining profit of 399 is taxed at main rate.

The final column in the table below is a summation of the two periods and shows that the proposed loss rules result in the total patent box profit for the 24 month period being taxed at the patent box rate.

Tax adjusted trading statement

		AP ended 31/12/2017		AP ended 31/12/2018	24 months ended 31/12/2018
Sales		1,000		1,500	2,500
Less trading expenses					
(after computational adjustments)					
R&D		(300)		(100)	(400)
Marketing		(75)		(100)	(175)
Other costs		(575)		(800)	(1,375)
Taxable trading profit		50		500	550

Step 1: Divide taxable profit between qualifying and non-qualifying income

All income is from qualifying products, so no apportionment of actual income statement needed.

Step 2: Calculate routine profit and residual profit

Trading income		1,000		1,500
less: trading profit		(50)		(500)
Total trading expenses used as basis for mark-up		950		1,000
Mark-up rate	x	15%	x	15%
Routine profit		143		150
Trading profit		50		500
Less: routine profit		(143)		(150)
Residual profit/(loss)		(93)		350

Step 3: Identification of Patent Box profit

R&D		300		100
Marketing		75		100
Total		375		200
R&D as share of total		80%		50%
Multiplied by residual profit from qualifying products	x	(93)	x	350
Patent box profit/(loss)		(74)		175

Treatment of losses arising in the Patent Box

Patent box profit/(loss)	(74)	175	101
Non-patent box trading profit (balancing figure)	124	325	449
Total taxable trading profit	50	500	550
Patent box profit	-	175	
Less patent box losses b/f	-	(74)	
Profits taxable at patent box rate	-	101	101
Trading profit taxable at main rate (balancing figure)	50	399	449
Total taxable trading profit	50	500	550
Patent box losses c/f	74	-	

B Summary of questions

B.1 This consultation seeks answer to the following specific questions:

Chapter 2: Qualifying patents

- **Question 1:** Will the requirement for a patent granted by the IPO or EPO cause significant commercial distortion? Do you believe that patents granted by any other EU national patent offices should be included, and if so which jurisdictions?
- **Question 2:** Do the ownership criteria adequately permit on-licensed patents and patents developed or commercialised in commercial cost sharing, partnership and joint venture arrangements to qualify for the Patent Box?
- **Question 3:** Do businesses think that the development criteria are workable or are there commercial situations which should be included but would fall outside these rules?

Chapter 3: Qualifying income

- **Question 4:** Do businesses believe that it is necessary to set out rules to more closely define the circumstances where a composite tangible or intangible product should be considered a single functionally interdependent item? Or can this requirement be tested through a motive test on a case-by-case basis?
- **Question 5:** The Government would welcome views on how the arm's length profit attributable to patents used in processes or to provide services should be calculated.
- **Question 6:** Do businesses think that the proposed claim of retrospective benefits for the period while a patent is pending is fair and workable?

Chapter 4: Calculation of Patent Box profits

- **Question 7:** Do businesses agree that the proposed model will produce an acceptable result in most circumstances, given the flexibility provided by the ability to apply the model to company divisions separately if required?
- **Question 8:** Is there any alternative basis of apportioning residual profits between different products which is more appropriate without introducing excessive complexity?
- **Question 9:** Should there be special rules for any one-off items of income or expenditure? If so what form should the rules take?
- **Question 10:** Is divisionalisation the most effective and least burdensome way to deal with a wide range of situations in which pro-rata allocation of profits and expenses would produce an inappropriate result? Are the conditions set out above to govern the use of divisionalisation appropriate? The Government would welcome any alternative suggestions, and would appreciate sufficient detail that these can be evaluated by HMT and HMRC.
- **Question 11:** Are there any other circumstances in which divisionalisation should be mandatory?

- **Question 12:** The Government would welcome views and evidence on the appropriateness of step 2 in identifying residual profits, as well as on how outsourced functions should be defined and whether there are any other costs which should be excluded from the mark-up.
- **Question 13:** The Government would welcome business' views on an appropriate formula to allocate residual profit to patents, and on what types of expenses should be taken into account in calculating the relative contribution made by the patent and brand to the residual profit.
- **Question 14:** Can businesses suggest any alternative ways of effectively separating patent profits from those arising from other types of IP? If a relative contribution approach is chosen, is the proposed safe harbour set at an appropriate level to simplify smaller claims
- **Question 15:** Are the proposed rules for the carry-forward of Patent Box losses appropriate? Should Patent Box losses also have to be set against Patent Box profits of other group companies in the same accounting period, in order to achieve a symmetrical treatment of Patent Box profits and losses?
- **Question 16:** Do businesses consider that taking pre-commercialisation expenses into account in these circumstances is proportionate and fair, or are there better ways of ensuring that the benefit accrues to total net patent profits?

Chapter 5: Computational issues

- **Question 17:** Do respondents see any practical or technical problems with the approach of implementing the 10% Patent Box rate through a computational tax deduction?
- **Question 18:** Do respondents have any initial comments about interaction with double tax relief rules or have any views on the Government's stated aims for giving relief?
- **Question 19:** Would having to comply with transfer pricing rules for transactions with associated companies in cases of tax avoidance be an unreasonable burden for smaller companies?
- **Question 20:** Can respondents suggest any alternative ways to prevent artificial tax avoidance abuse of the Patent Box?
- **Question 21:** Do respondents consider that other aspects of the formula apart from divisionalisation and step 3 will give rise to clearance applications? Will the current non-statutory clearance system be sufficient to respond to the range of enquiries that the Patent Box is likely to generate?

Chapter6: Commencement of the Patent Box

- **Question 22:** The replacement of a cut-off date with a phase-in approach will have different effects for each company. The Government would welcome comments on the impact of this proposal on different sectors as well as views on whether businesses prefer a cut-off date as originally announced or would favour the proposed phase-in approach.

Chapter 7: Tax impact assessment

- **Question 23:** The Government would welcome comments or evidence to support the assessment of the impacts of the regime.
- **Question 24:** The Government would welcome comments on the best forum for dealing with emerging issues once the Patent Box is introduced.

C Responses to previous consultation

Table C.1: Table

Issue	**Summary of Business Response**	**Government Position**
3A Qualifying conditions:		
Commercialisation	Clarity on what is meant by commercialisation is required as it can take various meanings and interpretation is dependent on different business models. There are concerns regarding the practical difficulties in establishing the date of first commercialisation. Businesses suggested that the initial commercialisation dates should be based on the first sale of a product (in the UK or Worldwide) or the initial market launch. Some felt that the 29/11/2010 restriction was likely to reduce the attraction for companies with existing patent portfolios.	An update is provided in Chapter 6
Patent Pending	An extension to patent applications and patent pending was requested by many businesses. It is possible for a product to reach the market before a patent is granted, or whilst the product is still in R&D. Businesses suggested that relief could be backdated to the date of commercialisation or the date of application. An alternative approach would be to claw-back relief if an application was refused.	An update is provided in Chapter 3
Ownership requirement	A requirement for legal ownership was seen as unattractive by many respondents and if legal ownership was imposed than it should apply on a group basis. Permitting beneficial or economic ownership of patents to qualify was seen as critical by some and favoured by a majority.	An update is provided in Chapter 2
Patent Jurisdictions	Territorial conditions placed on the registration of patents were considered to be restrictive and would exclude valuable revenues. The inclusion of UK and EU patents was seen as a minimum. Worldwide income from these patents should be included, irrespective of whether protection was sought in each territory. It was considered to be undesirable to protect patents in jurisdictions where there was no commercial need to do so. This would generate additional burden and cost for businesses.	An update is provided in Chapter 2
Types of IP	A call for patented IP and IP capable of being patented to be included was made with particular reference made to: • Data Exclusivity • Regulatory Data Protection • Process patents, • In-licensed patents, • Acquired patents • Supplementary Protection Certificates.	An update is provided in Chapter 2

Expiry date	It was proposed that for eligible products the regime should apply to the end of a product's life, beyond the expiry of patent protection.	An update is provided in Chapter 5
Claw-back of pre-commercialisation expenses	The treatment of expenditure previously written off at full rate was raised by many businesses. A key competitive advantage is the ability to relieve failed & pre-commercialisation expenditure at the ordinary rate of CT. The claw-back introduces complexity and uncertainty for businesses and has potential for deferred tax implications. A claw-back could reduce the attractiveness of the regime as there would be an administrative burden if a company was required to track past costs.	An update is provided in Chapter 4
Revoked patents	Businesses commented on the uncertainty surrounding the retrospective liability when a qualifying patent is later found to be invalid by the courts. It was suggested by some businesses that there should be no claw-back of the benefit on pre-revocation profits. It was suggested that further consideration will need to be given to a situation where a patent is revoked but is then revived.	An update is provided in Chapter 5
Patent portfolios and products with multiple patents	There are barriers and complexities for many Information Communication Technology (ICT) product and service companies that will prevent the relief for applying. Many felt that patents in the ICT sector should qualify even where patents cannot be directly linked to products. Many businesses raised concerns that the regime appeared easier to apply to products with fewer patents than those where there are a large number of patents as it will be difficult to apportion between them. It was suggested that a cost-plus method could be applied to avoid attribution.	An update is provided in Chapter 3 An update is provided in Chapter 4
Joint Venture arrangements	It was felt that consideration was required to be given to contractual joint venture arrangements, which involve patent pooling and the sharing of costs and benefits, in terms of how parties might benefit from Patent Box.	An update is provided in Chapter 2
Integration of old & new patents	The treatment of products which integrate qualifying patents and non-qualifying patents to form a new output was queried. Concern was raised should there be a need to split income in such instances.	An update is provided in Chapter 3
3B Determining patent income and challenges of practical implementation:		
Formulaic approach	A formulaic approach was seen as helpful to avoid complexity and was more practical. Views were that a formula would need to take into account different industry sectors. Concerns were raised regarding the inaccuracy of a formulaic approach. Many businesses suggested an opt-out for those that wished to use Transfer Pricing / Arm's Length principles to determine patent income.	An update is provided in Chapter 4
Embedded income	The inclusion of embedded Income was welcomed by many. A per-patent analysis of embedded income was considered to be infeasible and identification would result in an administrative burden.	An update is provided in Chapter 4

Types of income to be included	Businesses suggested that the definition of patent income should include: • Up front payments • Milestone Payments • Royalties • Lump sums and capital sums • Sales • Licensing income • Servicing of patented products	An update is provided in Chapter 3
Clearances	An advance clearance procedure was requested by some businesses as the certainty of the outcome was desirable.	An update is provided in Chapter 5
3C Alignment with commercial incentives:		
Application to net profit	Many businesses felt that the application of the relief to profits meets commercial incentives.	An update is provided in Chapter 4
Requirement to register patent	Some businesses deliberately do not patent IP for commercial reasons. Many small businesses consider the patent process prohibitive for long term commerciality of IP - much of the technology created is not patented to keep it out of the public domain. There is a risk that these companies will not qualify for relief. Others felt that the requirement to register patents will distort commercial decision making and is likely to result in companies applying for patents that they otherwise would not do so.	An update is provided in Chapter 3
Practical Implementation	Concerns were raised that the operation of the scheme may mean that groups have to use inefficient structures to utilise the relief. It was identified that the expense involved in identifying qualifying patents may be greater than the financial benefit derived from the proposals.	An update is provided in Chapter 4
3D Prevention of artificial tax avoidance:		
Prevention of artificial tax avoidance	Potential areas of abuse were considered to be: • Seeking to obtain tax relief where there is no real innovation taking place; • Artificial product launches; • Filing of patent applications which cannot be granted because they are not new; • Overstating profits benefiting from the low rate by understating expenses An anti-avoidance rule where investment lacks any commercial purpose was considered to be appropriate. The application of Patent Box retrospectively when patents are granted was considered to be an effective anti-avoidance mechanism as this would ensure that genuine innovation is rewarded. Concerns were raised by businesses that complex anti abuse rules may make the regime unattractive. The strategy employed must be one that does not discourage genuine innovation activity but one that clearly targets passive activity and artificial structures.	An update is provided in Chapter 5

3E General views:		
Extension to other forms of IP	It was suggested that the regime is too narrow and fails the Government's competitiveness agenda. Many respondents wish the regime to be extended to other forms of Intellectual Property. Much R&D creates unique and valuable IP that is often not easily patentable and so would not benefit from the regime. More openness on the costings would be welcome to establish the reasons behind the restriction to patents. Patent Box regimes deployed by other territories were referred to by many respondents which highlighted that the effective rates in other territories are more favourable and therefore more advantageous; it was suggested that other attributes of the UK regime will need to be comparatively more attractive. It was noted that the Netherlands regime initially applied to patents but was latterly extended to other forms of IP. A post-implementation review was suggested by business to review the take up in different sectors and the potential extension to other types of IP.	An update is provided in Chapter 2. Comments on post-implementation review are covered in Chapter 7.
Interaction with R&D Tax Credits	The Patent Box regime is seen by many as complementary to R&D, however there are concerns that it should not be at expense of the current R&D scheme.	The R&D regime is to be maintained. See separate consultation on R&D tax credits and treatment of the enhancement in Chapter 4.
Election	There are concerns whether the optional election is all or nothing and whether companies could opt out at a later date if they wished.	An update is provided in Chapter 4
Withholding Tax	It was suggested that consideration be given to the impact that overseas withholding tax on royalty income has on effectiveness of the regime and whether Double Taxation Relief will continue to be available.	An update is provided in Chapter 5
Complexity	Businesses were concerned that the proposed regime is too complex and could be unviable. A simplified approach is preferred to allow ease of implementation, particularly for non tax professionals and company directors. Concerns have also been raised that the benefits of the regime will be disproportionately enjoyed by large companies.	The impact of the regime is covered in Chapter 7
Implementation within a group context	The application of the regime to group companies was highlighted as a concern. Particular reference was made to the treatment of patent income where more than one company in a group is involved in the exploitation of a patent and where there is an IP holding company. It was noted that the regime would not be applicable to multinationals where parent companies are outside the UK, despite having significant R&D presence in the UK.	An update is provided in Chapter 5

D The code of practice on consultation

D.1 This consultation is being conducted in accordance with the Code of Practice on Consultation that sets out the following criteria:

- When to consult – formal consultation should take place at a stage when there is scope to influence the policy outcome.
- Duration of consultation exercises – consultations should normally last for at least 12 weeks with consideration given to longer timescales where feasible and sensible.
- Clarity of scope and impact – consultation documents should be clear about the consultation process, what is being proposed, the scope to influence and the expected costs and benefits of the proposals.
- Accessibility of consultation exercise – consultation exercises should be designed to be accessible to, and clearly targeted at, those people the exercise is intended to reach.
- The burden of consultation – keeping the burden of consultation to a minimum is essential if consultations are to be effective and if consultees' buy-in to the process is to be obtained.
- Responsiveness of consultation exercises – consultation responses should be analysed carefully and clear feedback should be provided to participants following the consultation.
- Capacity to consult – officials running consultations should seek guidance in how to run an effective consultation exercise and share what they have learned from the experience.

D.2 If you feel that this consultation does not satisfy these criteria, or if you have any complaints or comments about the process, please contact

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ISBN 978-1-84532-884-9