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The Patent Box

Patent ownership requirements

- Rights included
- Development condition
- Active ownership

Profit Calculation

- Profit apportionment
- Relevant IP income
- Routine expenses return
- Marketing return / small claims election

Other features

- Streaming
- Patent Box losses
- R&D claw-back
- Anti avoidance rules
- Partnerships & cost contribution arrangements

10 January 2012

Corporate Tax Reform

- The Government is implementing a wide reaching programme of reforms to build a stronger and more balanced economy for the future
- Part of this is the Government's ambition is to establish the most competitive tax system in the G20 to support current enterprises and attract new business to the UK
- To achieve this, the Government has set out a substantial programme of reforms including:
    - a series of reductions to the main rate of corporation tax;
    - significant changes to the UK's CFC regime;
    - reforms to the R&D tax credits regimes; and
    - the Patent Box

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The Patent Box: Aims

- To create a competitive tax environment for companies to develop and exploit patents in the UK
- To provide an incentive for companies to retain and commercialise patents in the UK and to develop new innovative patented products here
- To encourage companies to locate high-value jobs associated with the development, manufacture and exploitation of patents in the UK
- To encourage investment and growth in the UK

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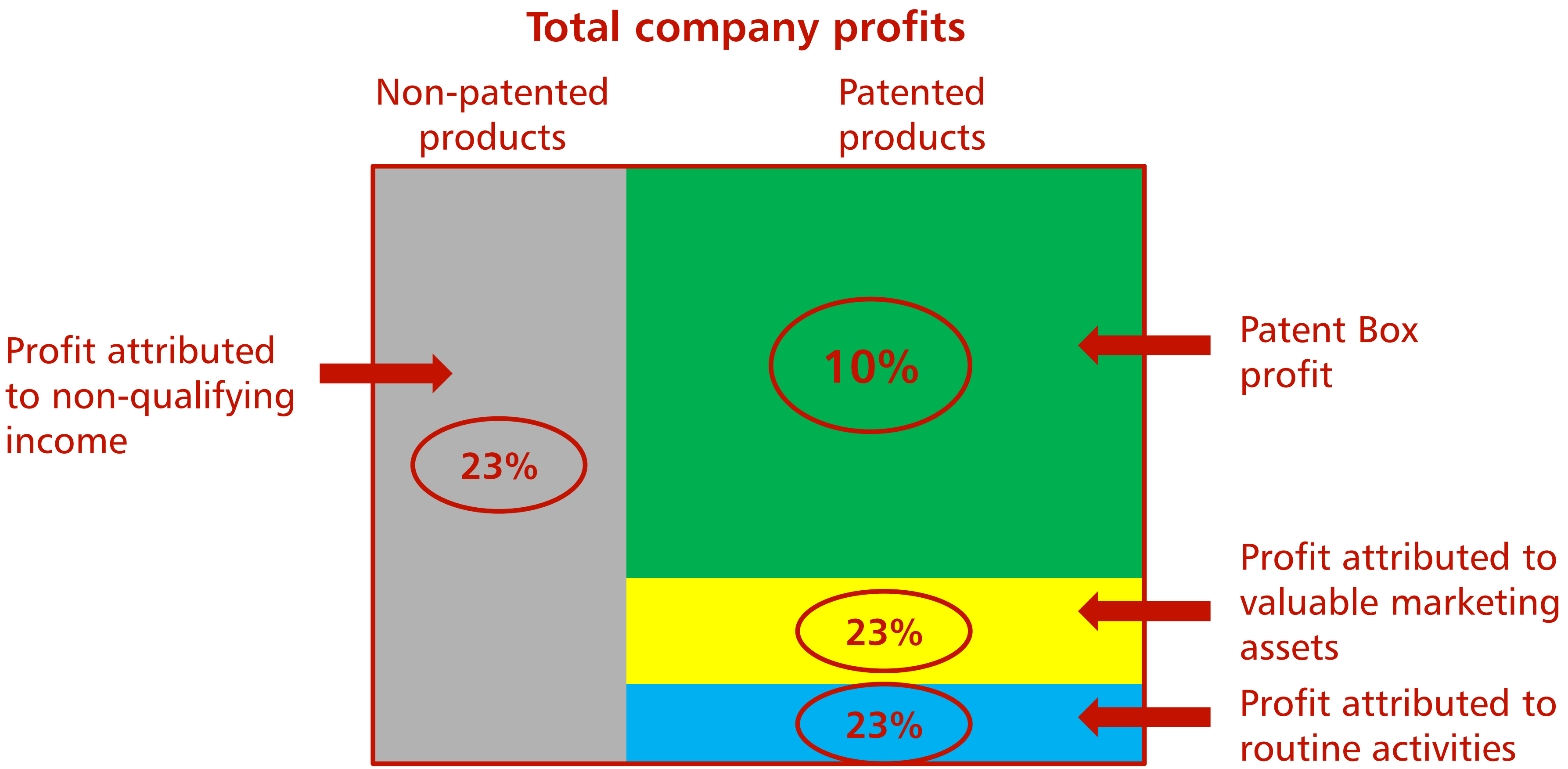
The Patent Box: Who will benefit?

- A wide range of companies which own and use patents and other qualifying intellectual property (IP)
- In many cases companies can benefit where they have rights to IP owned by others
- Companies must meet development and active ownership criteria
- Companies can benefit regardless of how the IP is used

The Patent Box – what profits are eligible?



The Patent Box: Key Points

- A reduced 10 per cent rate of corporation tax on profits attributed to patents and other similar IP from 1 April 2013
- Worldwide income from existing as well as new IP will be included. To enable this, the full benefits will be phased in over five years
- UK businesses can benefit regardless of how they use their patents
- In many cases the profit attributed to patents is calculated from total profits using a step-by-step method
- Companies which use their patents to perform processes or provide services can benefit up to the level of an arm’s length royalty
- Smaller claims benefit from a simplified calculation
- Technical changes made in response to the June 2011 consultation will result in a more competitive and accessible regime

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Questions?

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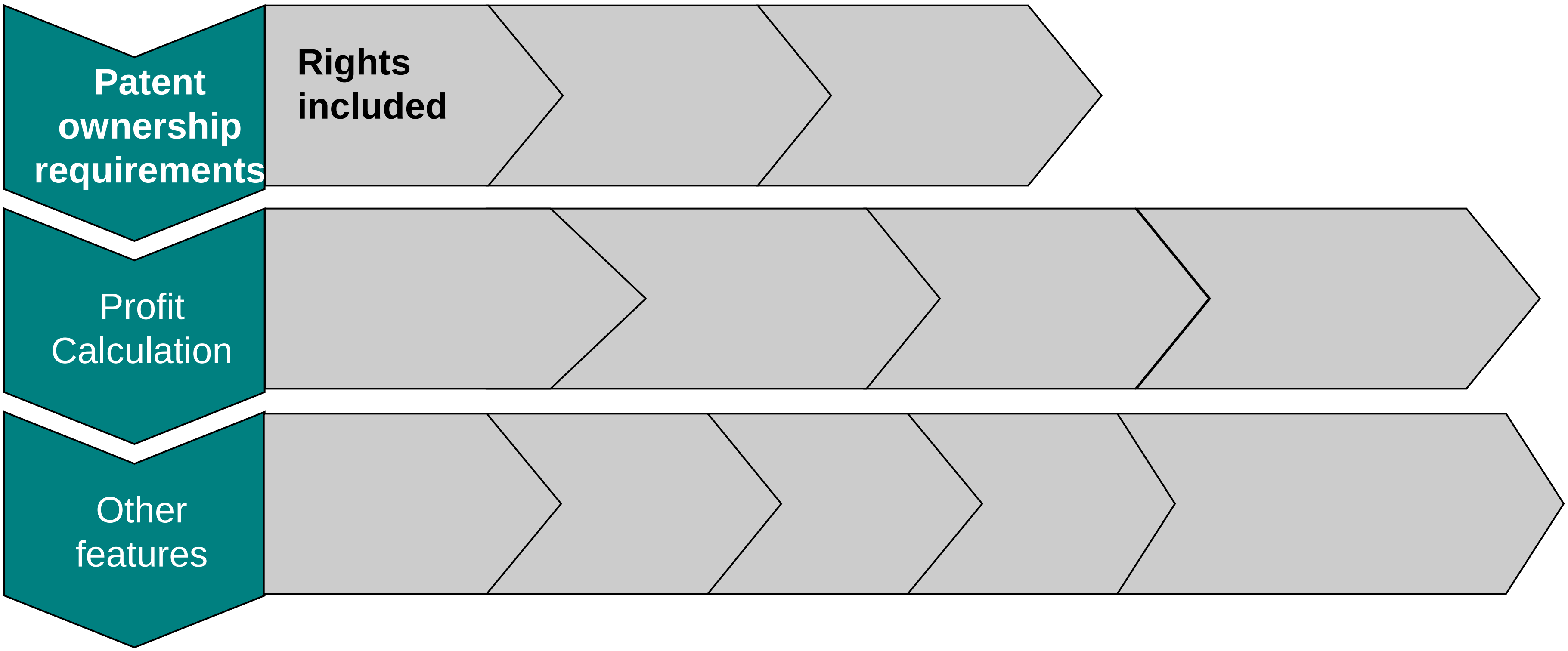
The Patent Box: Overview

- **Patent ownership requirements**
  - Rights included
  - Development condition
  - Active ownership
- **Profit Calculation**
  - Profit apportionment
  - Relevant IP income
  - Routine expenses return
  - Marketing return / small claims election
- **Other features**
  - Streaming
  - Patent Box losses
  - R&D claw-back
  - Anti avoidance rules
  - Partnerships & cost contribution arrangements

The Patent Box: Patent Ownership requirements



The Patent Box: Rights included

- IPO/EPO Patents
- SPCs, Plant variety and Data exclusivity rights including paediatric and orphan drug rights
- Secret patents
- Company must hold a qualifying IP right or hold an exclusive licence over it
- Exclusive licensing definition relaxed for certain intra-group arrangements

The Patent Box: Patent Ownership requirements

Patent ownership requirements

Rights included

Development condition

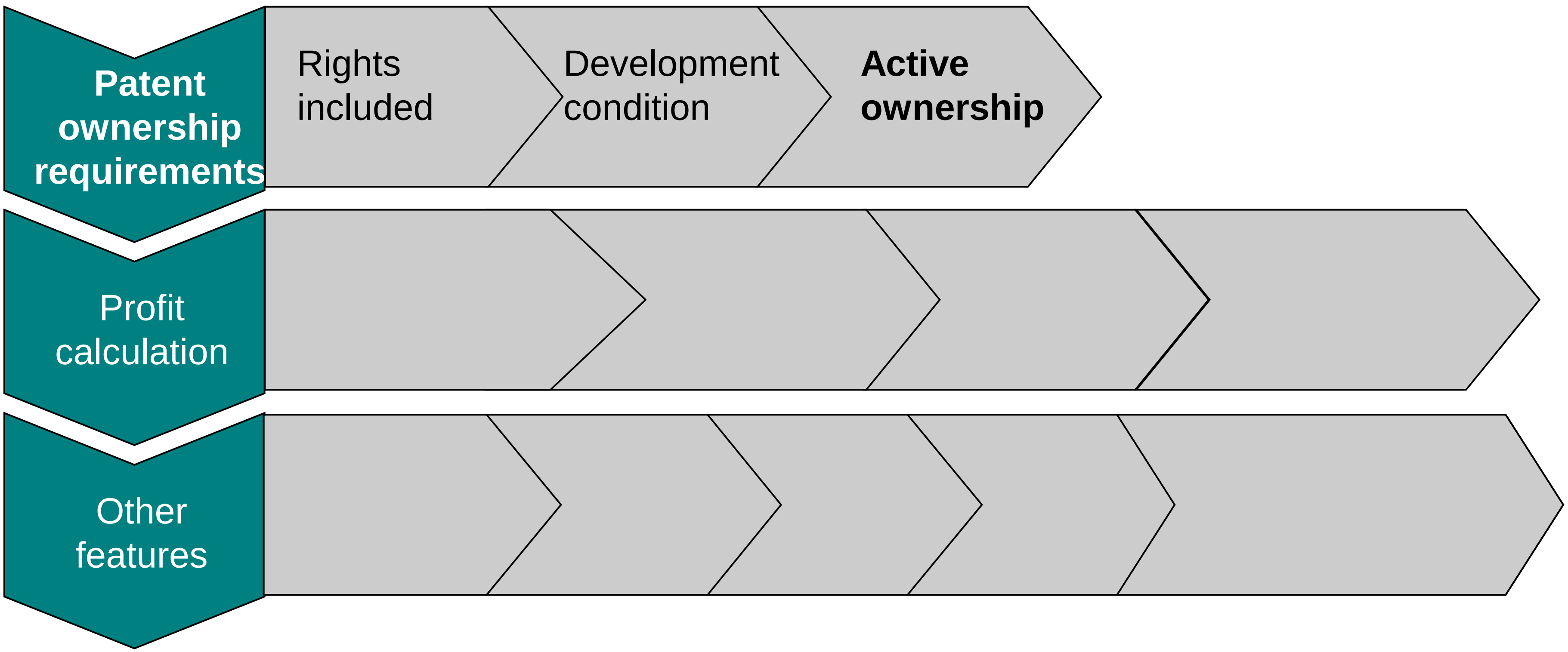
Profit calculation

Other features

The Patent Box: Development Condition

- Qualifying development is:
  - Creating or significantly contributing to creation of protected item
  - Developing protected item (includes developing ways in which item may be used/applied) or item incorporating protected item
- Qualifying development must be undertaken by company or a member of the same group
- Allows development activity to be undertaken pre acquisition of IP right

The Patent Box: Patent Ownership requirements



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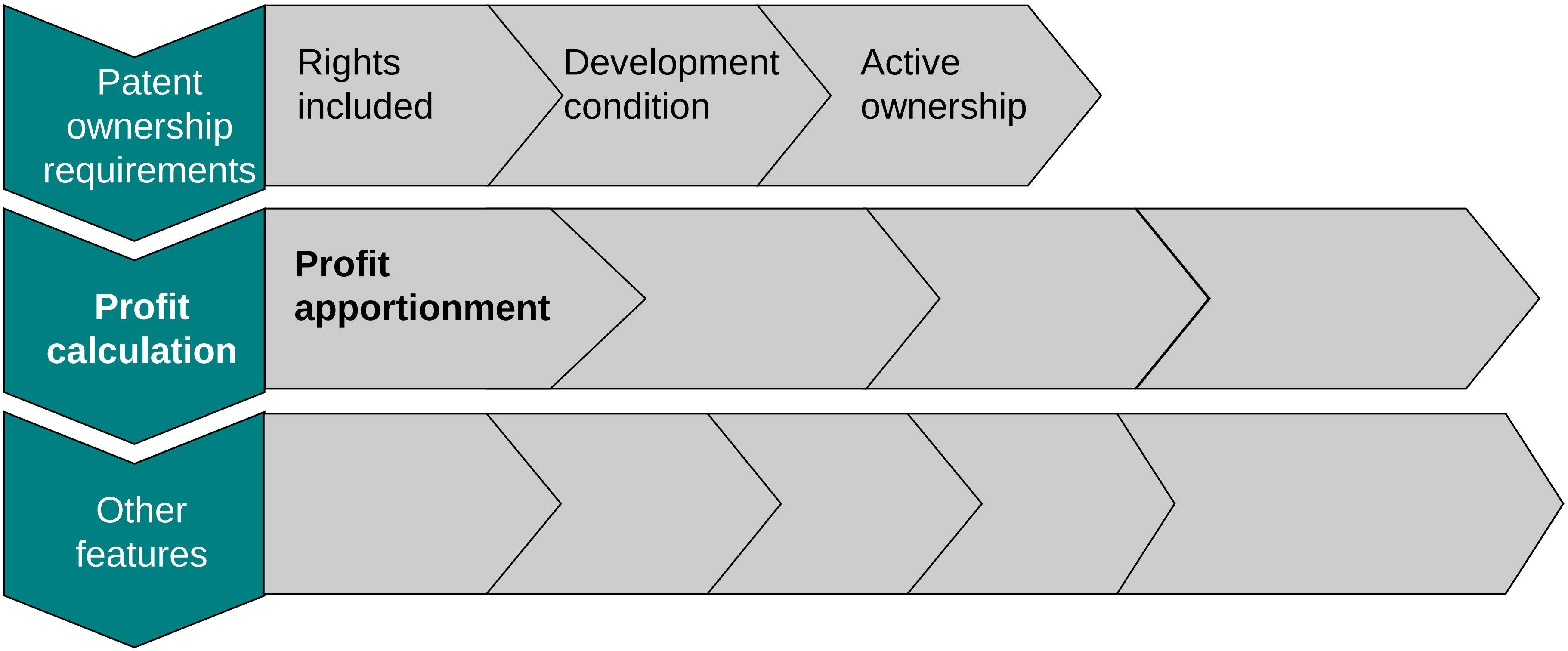
The Patent Box: Active Ownership

- Only has to be met if company is a member of a group
- Must meet one of the active ownership conditions for all or almost all of company's "qualifying IP rights portfolio"
- Active ownership conditions are:
  - performs a significant management activity, i.e. formulate plans, make decisions re development/exploitation
  - Meets the development condition by virtue of qualifying development company itself has undertaken
- "Qualifying IP rights portfolio" includes any exclusive licences held in respect of a qualifying IP right

The Patent Box: Profit Calculation



The Patent Box: Profit apportionment

- Start from taxable trading profit
- Add back:
  - R&D additional deduction (not base cost)
  - Finance expenses
- Deduct:
  - Finance income
  - And if relevant additional R&D claw-back amount
- Then can use a formulaic method to apportion profits pro-rata between those generated by qualifying IP and non-qualifying IP

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The Patent Box: Profit apportionment

- Pro-rata apportionment based on ratio of “RIPI” (relevant IP income that forms part of total gross income) to total gross income
- Total gross income is the sum of :
  - amounts recognised as revenue under GAAP and taken into account as credits in calculating the profits of the trade in an accounting period;
  - credits on realisation of intangible assets; and
  - profits from the sale of pre-2002 patents patent right
- Income from financial assets is excluded from total gross income

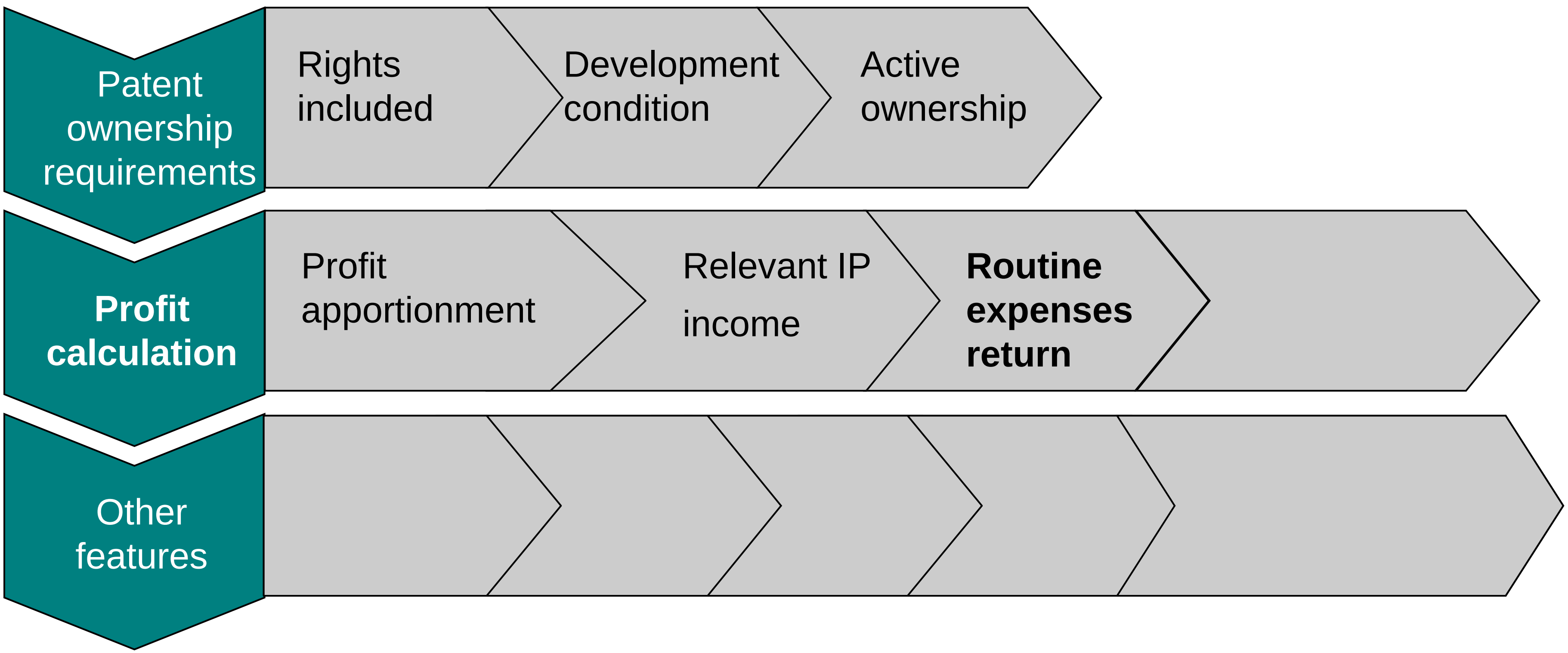
The Patent Box: Profit Calculation

Patent ownership requirements	Rights included	Development condition	Active ownership
Profit calculation	Profit apportionment	**Relevant IP income**	
Other features			

The Patent Box: Relevant IP Income

- Five Heads:
  - Patent royalties and other income from licensing
  - Income from the sale of patents
  - Infringement income
  - Income from sales of products with patents
  - Sales of mixed patented & non-patented items
- Notional Royalty - patents used in processes & services
- Leasing
- Patent Pending

The Patent Box: Profit Calculation



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The Patent Box: Routine expenses return

- 10% mark up on specified expenses (routine expenses)
- Included expenses:
  - Director and employee related expenses
  - Premises expenses
  - Plant and machinery expenses, including capital allowances
  - Utilities, transport, communication and consultancy fees
- Excluded expenses:
  - Outsourcing
  - Routine expenses that qualify for an additional R&D deduction
  - Additional deduction for R&D expenditure

The Patent Box: Profit Calculation

Patent ownership requirements
- Rights included
- Development condition
- Active ownership

Profit calculation
- Profit apportionment
- Relevant IP income
- Routine expenses return
- **Marketing return / small claims election**

Other features

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The Patent Box: Marketing return/small claims election

- Marketing return is removed from residual profit to arrive at profit attributable to patents
- Marketing return is a notional royalty for use of marketing assets calculated using arm’s length principles
- If actual marketing royalty is paid this reduces notional royalty
- If marketing return is de-minimus no need to make an adjustment
- For small claims possible to elect for profits in box to be lower of 75% of residual profit or £1m

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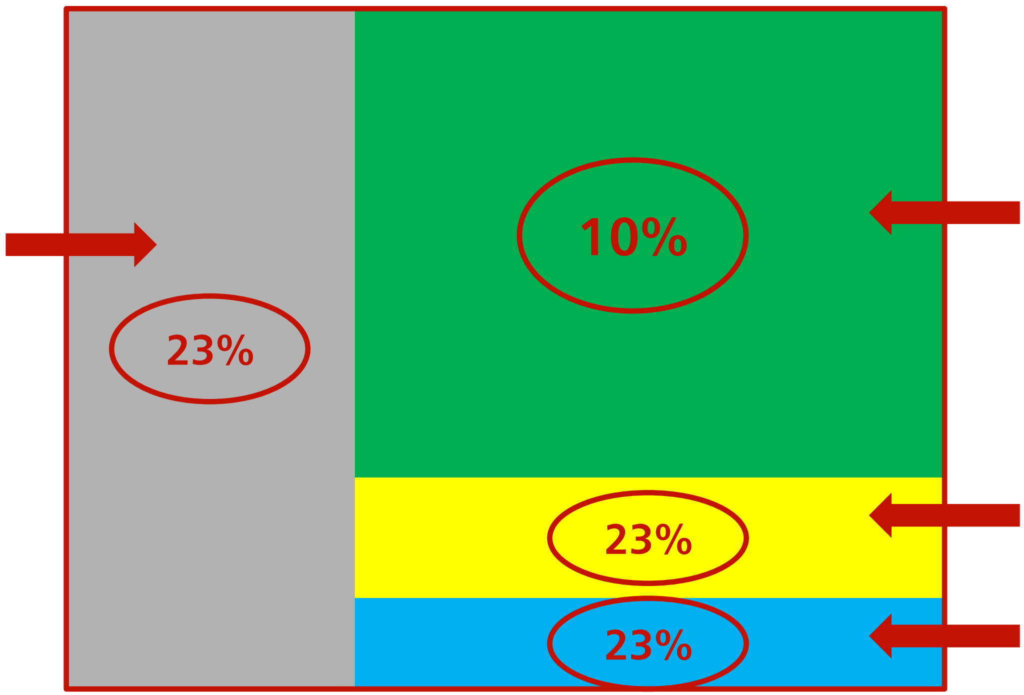
The Patent Box – what profits are eligible?

Total company profits

Non-patented products

Patented products

Profit attributed to non-qualifying income

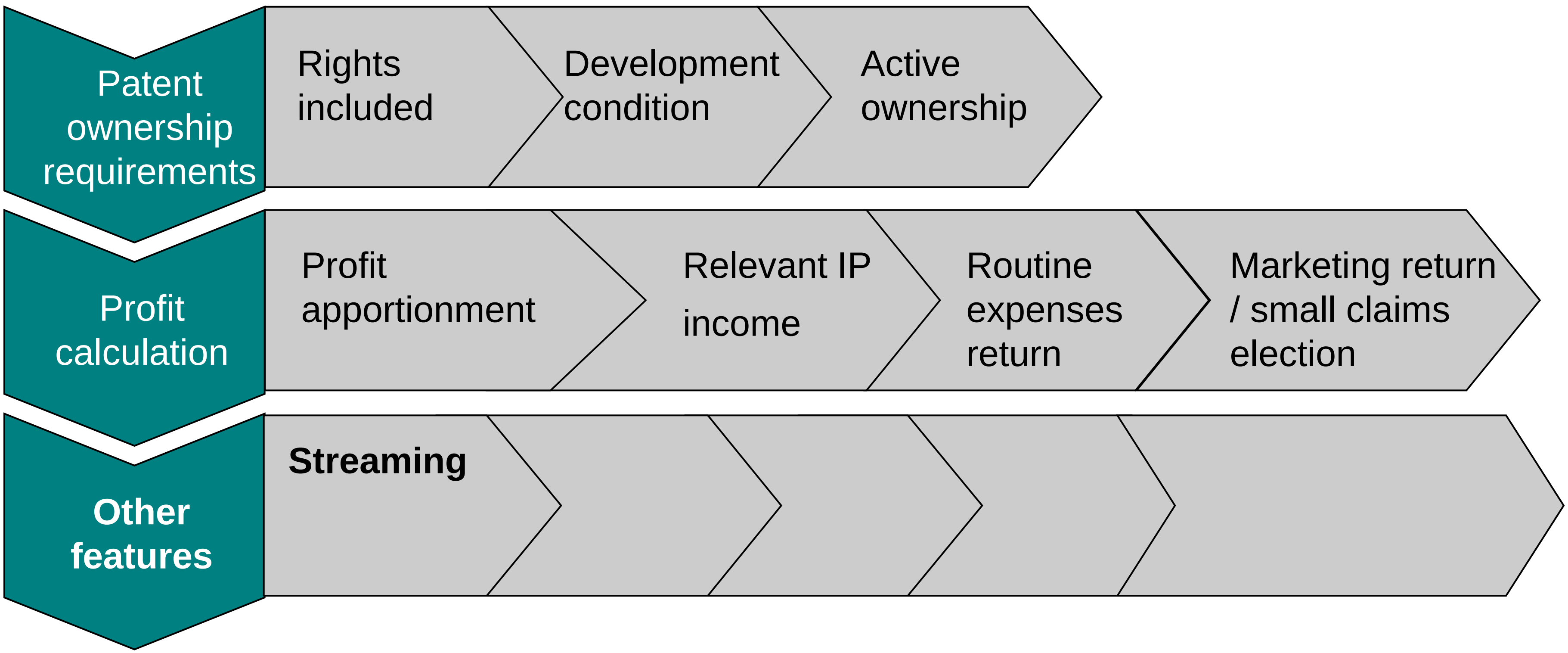


Patent Box profit

Profit attributed to valuable marketing assets

Profit attributed to routine activities

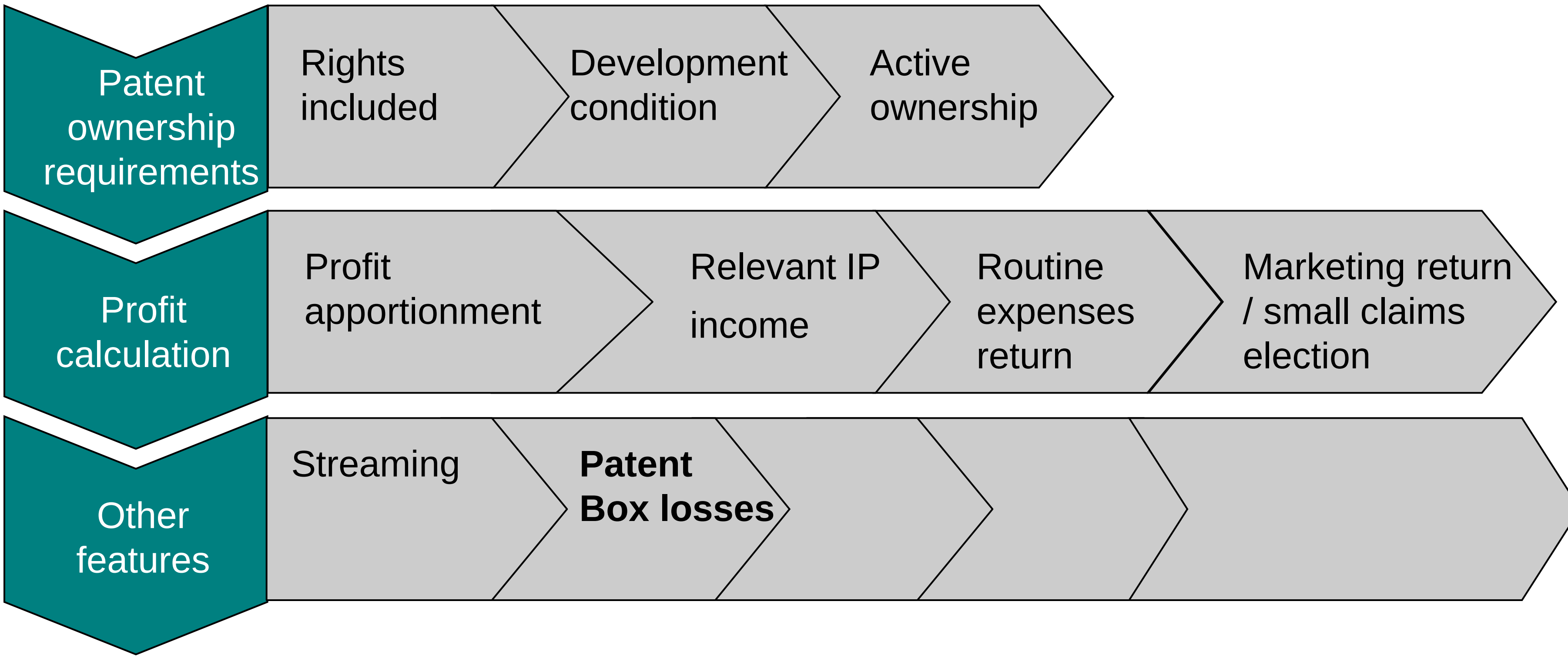
The Patent Box: Other features



The Patent Box: Streaming

- Alternative method to pro-rata of profits
- Involves dividing income into qualifying and non-qualifying streams and arriving at profits by allocating expenses to qualifying streams on a just and reasonable basis
- More straightforward than full transfer pricing approach
- Mandatory streaming in certain cases

The Patent Box: Other features



The Patent Box: Patent Box losses

- Must be offset again relevant IP profits of other trade/other group members, and any excess carried forward
- Group may choose how loss is to be allocated
- Rules for intra-group transfers of trade
- Rules where trade ceases

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The Patent Box: Other features

Patent ownership requirements
- Rights included
- Development condition
- Active ownership

Profit calculation
- Profit apportionment
- Relevant IP income
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Other features
- Streaming
- Patent Box losses
- **R&D claw-back**

The Patent Box: R&D claw-back

- Formulaic approach assumes current year R&D costs are a good proxy for prior year expenses
- Claw-back mechanism for first 4 years company elected into Patent Box
- If R&D expenditure in that time falls to below 75% of the average of four years expenditure before election into box then R&D is increased to 75% of the previous average annual R&D expenditure, before the profits of the year are apportioned.
- R&D for this purposes is R&D recognised in accordance with UK GAAP

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The Patent Box: Other features

Patent ownership requirements	Rights included	Development condition	Active ownership	
Profit calculation	Profit apportionment	Relevant IP income	Routine expenses return	Marketing return / small claims election
Other features	Streaming	Patent Box losses	R&D claw-back	**Anti avoidance rules**

The Patent Box: Anti avoidance rules

- Exclusive licences
- Product
- Tax avoidance schemes where aim is to:
  - avoid operation of any provisions in rules
  - mismatch income and expense
  - manipulate account recognition of income

The Patent Box: Other features

- **Patent ownership requirements**: Rights included → Development condition → Active ownership
- **Profit calculation**: Profit apportionment → Relevant IP income → Routine expenses return → Marketing return / small claims election
- **Other features**: Streaming → Patent Box losses → R&D claw-back → Anti avoidance rules → **Partnerships & cost contribution arrangements**

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The Patent Box: Partnerships

- Provides a mechanism for a corporate partner in a partnership to obtain the benefits of the Patent Box
- Achieved by allowing the partners to elect to be taxed as if the partnership itself had elected into the regime
- The election is made on a company-by-company basis. So some partners/parties may elect in and some may not

The Patent Box: Cost contribution arrangements

- Applies to cost contribution arrangements where one of the parties to the arrangement holds a qualifying IP right and each party to the arrangement contributes to the qualifying development.
- Provided each party is entitled to a share of the income from exploiting the right then it is treated as if it held the relevant right itself.
- The election is made on a company-by-company basis. So some parties may elect in and some may not

The Patent Box: Commencement and implementation

- Phase in benefit:

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

- 10% rate is delivered via a super deduction against trading profits
- Formula is:

$$\text{Relevant Profits} \times \frac{(\text{Main CT rate} - 10\%)}{\text{Main CT rate}}$$

The Patent Box: Next Steps

- Consultation on the draft legislation closes 10 February 2012
- Comments are welcome on all aspects of the draft legislation and HMRC's interpretation as set out in the Technical Note
- Questions included in the response document invite comment in specific areas, but are not exhaustive
- Legislation based on these proposals is intended to be included in Finance Bill 2012
- Draft guidance will be published in spring / summer 2012

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Q&A

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