

## Explanatory Note

### Clause 32: Exploitation of patents etc: commencement and transitional provision

#### Summary

1. This clause sets out how changes to the Patent Box legislation in Part 8A of Corporation tax Act (CTA) 2010, made by clause 31, take effect.
2. The Patent Box provides a reduced rate of Corporation Tax on profits from patents and similar intellectual property (IP). The changes are to ensure compliance with the new international framework developed by OECD (see Chapter 4 of "Countering harmful Tax Practices More Effectively, Taking Into account Transparency and Substance", OECD, Paris, 2015).
3. The amended rules will require profit for the purpose of the Patent Box to be calculated at the level of an IP asset (eg a patent), or a product or a product family relying on an IP asset or assets. The profit will be adjusted to reflect the proportion of the development activity on the asset (or product, or product category) undertaken by the company itself. The measure will have effect for new entrant companies to the Patent Box on or after 1 July 2016, and also for some IP assets acquired on or after 2 January 2016. The new rules are being phased in, with the current Patent Box rules applying to some companies and IP during a transitional period lasting until 2021. The new rules will apply to all companies and IP after 2021.

#### Details of the clause

4. Subsection 1 provides that the amendments made by Clause 31 and its Schedule have effect in relation to accounting periods beginning on or after 1 July 2016.
5. Subsections 2 and 3 address accounting periods that are split across either of both of 1 July 2016 and 1 July 2021. Where this is the case, the periods falling before those dates, and the periods on or after those dates, are treated as separate periods for Patent Box purposes.
6. If a company has an accounting period which straddles 1 July 2016 it will therefore have to determine the relevant IP profits for the notional accounting period which begins on 1 July 2016 using Part 8A as amended. It will use Part 8A as originally enacted to determine the relevant IP profits for the notional accounting period which ends on 30 June 2016.
7. Similarly, a non-new entrant company (see new subsection (11) of S357A) with an accounting period that straddles 1 July 2021 will apply section 357BF for the purpose of determining the relevant IP profits for the notional accounting period which begins on 1 July 2021 and will apply Chapter 2A, 3 or 4 to determine the relevant IP profits for the notional accounting period which ends on 30 June 2021.

8. If a company has an accounting period which straddles 1 July 2016 and has not yet elected into the Patent Box it will therefore have a choice. It will be able to make an election under section 357A in relation to the notional accounting period which ends on 30 June 2016 (in which case it will not be a new entrant) or it will be able to make an election under that section in relation to the notional accounting period which begins on that date (in which case it will be a new entrant).
9. Subsections (4) and (5) create a special rule in relation to relevant IP income of a non new entrant company attributable to a new qualifying IP right acquired by the company within the period beginning with 2 January 2016 and ending with 30 June 2016.
10. The effect of new section 357BP is that in certain circumstances such IP could be a "new qualifying IP right" (ie new IP). The effect of the special rule is that if the income accrued to the company between 1 July 2016 and the end of the calendar year the income is to be treated for the purposes of Part 8A as not attributable to a new qualifying IP right. This means that income arising before the end of the calendar year is "grandfathered", as the OECD rules allow, even where the IP right was acquired from a connected person which did not benefit from an IP regime

## Background note

11. The UK Patent Box gives companies a reduced rate of tax on their profits from patents and similar intellectual property (IP). It is intended to provide incentives for companies to patent IP developed in the UK and ensure new and existing patents are further developed and commercialised in the UK
12. The Organisation for Economic Cooperation and Development (OECD) has been coordinating a multinational effort to address Base Erosion and Profit Shifting (BEPS) - tax planning by multinational enterprises (MNEs) that exploits gaps and mismatches in tax rules to artificially shift profits to low tax locations where there is little or no economic activity. This has resulted in a new internationally harmonised framework for preferential IP regimes (like the UK's Patent Box). This framework is to apply from 1 July 2016.
13. The central point is that for a business to gain the benefit of a preferential regime, it should have conducted the substantial activities which generated the income benefiting from that regime. The agreed approach uses R&D expenditure as a proxy for substantial activity and links benefits to the requirement to have undertaken the R&D expenditure incurred to develop the IP. This is referred to as the nexus approach.
14. Following a consultation launched on 22 October, the draft legislation sets out proposed modifications to the UK patent Box to implement this new approach. Final legislation, taking full account of the consultation responses and of comments on this draft, will be proposed in 2016.
15. The final legislation will include additional provisions relating to the calculation of the R&D fraction where
  - companies engage in collaborative development (such as a cost-contribution arrangement); or,

- businesses with separate R&D histories combine (eg by acquisition of a trade).
16. It will also address the use of the "rebuttable presumption" allowed by the OECD framework.
  17. If you have any questions about this change, or comments on the legislation, please contact David Harris on 03000 586834 (email: david.harris@hmrc.gsi.gov.uk)