Amendments to Clause 60: Profits from the exploitation of patents etc.

Summary

1. Clause 60 and Schedule 9 modify the Patent Box legislation in Part 8A CTA2010 to comply with new international rules set out by the Organisation for Economic Cooperation and Development (OECD) (see Chapter 4 of "Countering harmful Tax Practices More Effectively, Taking Into account Transparency and Substance", OECD, Paris, 2015). This framework is to apply from 1 July 2016.

2. The amendments (x-y) make changes to provide greater flexibility in a number of places, tighten the rules in others and in general, to take account of comments made on the clause and schedule since these were published.

Details of the amendments

3. Amendment 50 allows any company to elect to be treated as a new entrant, instead of having relevant income dealt with under both the current and modified Patent Box schemes. A company may wish to make such an election if, for example, it has only a small amount of grandfathered IP and wishes to avoid operating the two sets of rules in parallel.

4. Amendments 64, 82, and 115-120 make changes consequential upon the introduction of the new election into section 357A.

5. Amendments 58, 59, 67, 83 and 84 taken as a group widen the scope of the "small claims" treatment. The Bill as originally introduced contained "small claims" provisions modelled closely on those in the current Patent Box legislation at s357CM CTA2010, which allows companies making smaller claims, which meet certain criteria, to elect for simplified treatment in calculating their marketing asset return.

6. These amendments provide three different options for companies which meet the criteria, all or any of which can be elected for in order to simplify the computation in cases where the amounts involved are not significant. The intention is to reduce the administrative burden on smaller companies to encourage them to elect into the Patent Box.

7. The entry criteria for "small claims" treatment are unchanged from those in section 357BK of the Finance Bill, but additional flexibility is provided. The amendments will provide three options to companies. These are

   - to use the simplified Marketing Assets Return of 25% as in the existing legislation at new section 357BKA;

   - to use a simplified method of calculating a notional royalty when the company has 'IP derived income' as defined in s357CD(2)(b). The company may take the 'appropriate percentage' as defined in s357CD(5) to be 75% instead of having to calculate this using steps outlined in s357CD(6)-(9).

- to use a global sub-stream containing all new relevant IP income instead of separating different income streams into sub streams. This is intended to prevent a requirement to create sub streams consisting of insignificant amounts.

8. Amendments 58, 59 and 64 remove the current provisions contained in the Finance Bill concerning Small Claims Treatment

9. Amendment 83 inserts new sections 357BNA-357BND into Chapter 2A and makes consequential changes in Chapter 2B.

10. New section BNA sets out eligibility for small claims treatment. This is broadly in line with the current Patent Box rules in S357CL, but as the provisions now need to be applied where profit is calculated across a number of sub-streams, an additional simplifying condition is applied, requiring that the company only carries on one trade in the period.

11. New section 357BNB sets out the optional notional royalty treatment, new section 357BNC the simplified marketing assets return figure treatment and new section 357BND the provisions allowing global streaming.

12. Amendment 84 provides that the global streaming election is not available where a company has profits eligible both for the current Patent Box treatment (from grandfathered IP) and profits eligible for the revised Patent Box. Without this provision, profits under both sets of rules would need to be included in a single stream, requiring a further set of complex rules.

13. Amendments 51-56, 60-63, 69, 70 and 78-112 taken as a group provide greater flexibility for companies to track intellectual property (IP) income, and the corresponding research and development (R&D) expenditure, at the level of individual IP assets (such as patents), products, or families of products, in particular by removing the requirement that a product contains more than one IP asset. That requirement would mean, for example, that a "product family" could not include particular products that only included one IP asset - even where such a product was clearly part of a family with other, multi IP products.

14. The revised patent box legislation requires that income from IP, and expenditure on developing the IP, be allocated to "substreams" corresponding to IP assets, products or groups of products (product families) so that a profit can be calculated for each substream. The amendments change the way that the substreams are defined.

15. Amendments 51-53 modify Step 2 of new section 357BF(2) so that instead of referring to a product as a "multi IP item" it is simply an "IP item". They also introduce an explicit reference to processes - income from processes (rather than products) would otherwise have to be tracked in an individual IP rights sub-stream, which might not always be practicable.

16. Amendments 61-63insert references to the new definitions of "IP Item" and "IP process" and indicate that there is further provision in subsections (5A) and (6) concerning sub-streams.

17. Amendment 60 inserts new definitions, of "IP item" and "IP process". These build on the current definition of Head 1 income in section 357CC(2) CTA2010.

18. Amendments 12-14 change the rule governing when income can be attributed to a product (or now, process) sub-stream to reflect the change from "multi IP item" to "IP item or process".

19. It is also necessary to apply the same rules when tracking R&D costs as when tracking income.

20. Amendments 69 and 70 make corresponding changes to those set out above to new section

357BMB (qualifying expenditure on relevant R&D undertaken in-house). These also apply to new sections 357BMC and BMD, which deal with subcontracted expenditure.

21. Amendments 78 and 79 make corresponding changes to new section 357BME, which defines qualifying expenditure on the acquisition of relevant IP rights.

22. Amendments 89 - 112make consequential changes elsewhere, adding references to process sub-streams and replacing the term "multi IP item" with "IP item".

23. Amendments 57, 66, 77, 80, 81 and 121 taken as a group

    - provide that some acquisition costs are not to be included in the R&D fraction. These are income-related payments and they are excluded because they would otherwise have a double effect on the profit eligible for the Patent Box, both by affecting the profit calculation directly and by reducing the R&D fraction;
    - modify the time when acquisition costs are included in the R&D fraction, to ensure this is as closely aligned as possible with the period when the corresponding IP is protected;
    - ensure that where companies acquire intellectual property (IP) form which qualifying IP later arises, the acquisition costs are still reflected in the R&D fraction; and,
    - provide that in the Patent Box provisions, 'payment' includes the provision of value other than by payment of money

24. Amendments 57 and 66 provide that 'income-related payments' are only deducted at Step 4 of section 357BF(2) if it affects the R&D fraction. (As there is a 30% uplift in the fraction it is possible that the fraction will be 1 regardless of whether or not the payment is included).

25. Amendment 77modifies the timing rule for the inclusion of IP acquisition costs in the R&D fraction, so that they are included when paid rather than when deductible, includes costs associated with acquisitions that fall short of qualifying IP but later give rise to such IP (new subsection 357BME(1C)) and ensures that where a company makes a series of payments, their inclusion in the R&D fraction is based on when the first payment is included (new subsection 357BME(1D)).

26. Amendment 77 also adds to the current provision concerning expenditure on the acquisition of a qualifying IP right - which covers acquisition of either a right or an exclusive licence to a right - a new category, expenditure in return for disclosure of an item or process in respect of which the company applies for and is granted a relevant qualifying IP right.

27. Amendment 80 makes consequential changes and Amendment [5AQ] extends the meaning of "payment" in the Patent Box provisions to cover payments made, for example, by the provision of shares or other forms of consideration than money.

28. Amendment 65 excludes finance income from receiving relief under the Patent Box by being treated as "notional royalty". Patent Box relief is given where the company receives income from its patents either by selling goods incorporating patents or using patents to produce goods or services for sale.

29. In the second case, income is treated as a "notional royalty" i.e. it is as if the company earned a royalty from the patents.
30. In response to representations, the amendment makes clear that finance income cannot form part of such a notional royalty.
31. Amendments 71, 72 and 75, taken as a group, include the entire amount of any subcontracted expenditure in the R&D faction, whether the principal and the subcontractor are related or not. This simplifies the calculation of these costs, which was linked to a condition in the R&D legislation which not all claimants would have had to previously comply with. The revised position remains in line with the international framework.
32. Amendments 68, 73 and 74, taken as a group, provide that R&D expenditure incurred in a branch in respect of which a company has made an election under section 18A CTA2009 (an exempt branch) is not direct R&D expenditure or expenditure on subcontracting R&D to unconnected persons but is instead treated as R&D sub-contracted to connected persons.
33. Amendments 85-87, taken as a group, modify the provisions concerning IP acquired from a connected person between 2 January and 30 June 2016, setting these out more clearly and in particular clarifying that the power may be exercised after Royal Assent. As originally drafted it could have been read as meaning that the foreign tax needed to have been designated at the time the IP transfer of IP from the foreign jurisdiction. The amendments also provide that the power may not be exercised after the end of 2016.
34. Amendment 76 adds a new item to the list of ways by which Patent Box deductions can be inflated - the R&D fraction being increased compared to the fraction which would have applied in the absence of the scheme.
35. Amendment 114 inserts an additional new section 357GCA into CTA2010, making provision for where a trade or part of a trade is effectively "transferred" from one company to another, allowing the transferee to assume the R&D history from the transferor. This prevents the history being alienated from the corresponding IP.
36. This case is distinct from a simple acquisition of an IP right in that the trade - the means of exploiting the IP - is also transferred.
37. Subsection (1) sets out when the new section applies. This is when a company ceases a trade and transfers IP to another company which begins to carry on that trade.
38. Subsection (2) makes provision for the transferee to not be regarded as a new entrant if the transferor was not a new entrant
39. Subsection (3)) makes provision for the relevant qualifying IP right to be treated as an old qualifying IP right in the hands of the transferee if it was an old qualifying IP right of the transferor.
40. Subsections (4) - (6) deal with the various types of R&D and acquisition expenditure, so that these are counted as expenditure of the transferee for the purpose of the R&D fraction.
41. Subsection (7) excludes any expenditure incurred by the transferee in acquiring the IP.
42. Subsection (8) provides that "trade" includes part of a trade and, with subsection (9) defines 'relevant research and development'.

Background note

43. 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.

44. 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. ("See Chapter 4 of "Countering harmful Tax Practices More Effectively, Taking Into account Transparency and Substance", OECD, Paris, 2015). This framework is to apply from 1 July 2016.

45. 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.

46. Following a consultation launched on 22 October, in December 2015 draft legislation set out proposals to implement this new approach by amending the design of the Patent Box legislation in Part 8A of Corporation tax Act (CTA) 2010. The Government considered responses to the consultation and made changes in the Bill published in March 2016.

47. Following further representations the Government has now brought forward amendments to the Bill addressing further issues.