

## Explanatory Note

### Amendments 152 and 153 to Clause 63: Profits from the Exploitation of Patents, etc

#### Summary

1. Clause 63 and Schedule 9 introduce changes to the Patent Box to ensure that it complies with a new international framework set out by the Organisation for Economic Co-Operation and Development (OECD).
2. The amendments correct a technical problem with the legislation which could result in different definitions of the same term ("Qualifying Residual Profit") applying in the same parts of the modified Patent Box legislation.

#### Details of the amendments

3. Amendments 152 and 153, taken together, ensure that the definition of "Qualifying Residual Profit" in the current Patent Box legislation (in section 357GE(1)(b) Corporation Tax Act (CTA) 2010) only applies to Chapters 3 and 4 of Part 8A CTA2010. That is, it will continue to apply to companies that only have grandfathered IP income and to which the current Patent Box rules therefore continue to apply.
4. The new definition of the term (in subsection (6) of new section 357BN, inserted by the Bill - see also subsection (9) of new section 357BNB) applies in other circumstances.

#### Background note

5. 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.
6. 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.

7. 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.
8. 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 and further changes in amendments to the Bill in Committee.