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Accounting For Growth



Patent Box Tax Relief

Introduction to Patent Box

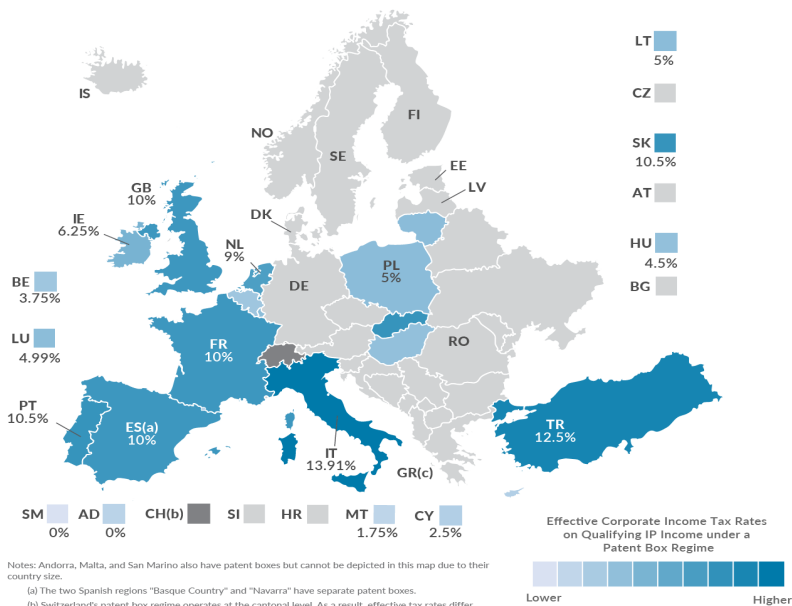
In common with other patent box schemes in operation in the OECD, the UK system encourages companies which make profits from the exploitation of patents to keep their intellectual property in the UK. It achieves this by offering an effective corporation tax rate of 10% on the qualifying profits of the company's trade, known as the 'relevant IP profits'. The tax incentive operates by applying a tax deduction to the relevant IP profits, which has the same effect as taxing them at 10%.

Across the Organisation for Economic Co-operation and Development (OECD), tax subsidies for R&D and patent boxes are common. From a total of 37 OECD countries, 20 have special deductions for R&D, 18 have an R&D tax credit scheme and 19 have a patent box incentive. The UK has both an R&D tax credit scheme and a patent box scheme. This article will focus on the UK patent box regime and the potential benefits it offers to eligible companies.

The Finance Act 2012 introduced part 8A to the Corporation Tax Act 2010. It was snappily entitled 'Profits Arising from the Exploitation of Patents, Etc'. It is better known as the Patent Box regime and it came into effect in April 2013.

Patent Box Regimes in Europe

Effective Corporate Income Tax Rates on Qualifying IP Income under a Patent Box Regime, as of July 2021



TAX FOUNDATION

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"Friend Partnership has considerable experience in calculating and claiming Patent Box relief for our clients and we are in a position to advise companies on how best to maximise their eligibility to the relief and optimise their Corporation Tax position."

We act for entrepreneurial businesses and successful individuals on a national and international basis."

"Innovation is recognised as a key factor in productivity and value in any economy. Innovation leads to increases in economic growth and consequently to higher living standards. Governments recognise the benefits of innovation and use tax policy to drive research and development (R&D) and patents."

Profits arising from the exploitation of Patents

The patent box regime allows qualifying companies to apply the reduced corporation tax rate to profits arising from:

- selling the patented products or selling a product which incorporates the patented invention.
- licensing patent rights.
- selling patented rights.
- damages or other compensation related to patent rights.
- manufacture using a patented process.
- providing a service using a patented tool or process.

The regime is not restricted to those profits generated in the UK. It will apply to worldwide profits from the exploitation of patents.

What IP rights does the patent box regime apply to?

Part 8A Corporation Tax Act 2010 lists the rights to which the Patent Box regime applies. These are:

- a patent granted by the UK Intellectual Property Office under the Patents Act 1977.
- a patent granted by the European Patent Office.
- a patent granted under the law of certain specified European Economic Area states.
- rights similar to patents including rights arising under new legislation which came into force after the end of the UK transition. As a consequence of the UK leaving the EU.

The 'rights similar to patents' which are listed in the legislation include supplementary protection certificates relating to medicinal and plant protection products and medicinal and veterinary products with marketing authorisations and marketing or data protection.

How to access the patent box benefits

The patent box tax incentive is available to companies which pay UK corporation tax and which also have profits arising from the exploitation of patents (see above). Access to the tax incentive is not automatic. Companies must make an election into the regime. The election must specify the first accounting period for which it is to apply and it will automatically have effect for all subsequent accounting periods until it is revoked by the company. If an election is revoked, the company cannot then re-elect into the regime for five years. This is to prevent them dipping in and out of the regime depending on profits or losses in order to gain a tax advantage.

Patents pending

A company which has applied for a patent which has not yet been granted can still elect into the regime and calculate the relevant corporation tax deduction. It cannot immediately access the effective 10% rate of tax but in the accounting period in which the patent is eventually granted, it can apply the accumulated deductions for up to six years to the profits of the year of grant. Clearly, it makes sense to make a patent box election at the same time as a patent application.

Calculating relevant IP profits

The calculation of relevant IP profits is admittedly complex and relies on the application of accounting principles. In essence it consists of a number of stages. These are:

- identification of the income arising from exploiting a patented invention.
- deducting a figure from that income expenses which are allocated on a just and reasonable basis.
- deducting further amounts which relate to routine activities and marketing activities.

The idea behind the various stages is to arrive at a deduction that has been pared down so that it only reflects profits relating to underlying patented technology.

As a final hoop to jump through, an R&D fraction is then calculated and applied to the deduction. The R&D fraction ensures that companies which undertake their R&D in-house or subcontract it to an unconnected third party will benefit more from the patent box tax incentive.

How could my company Benefit?

The best way to illustrate this is by way of an example. If we assume that your company makes profits of £1 million in an accounting year and, of that amount, your profit from qualifying IP items is £500,000. In the absence of a patent box claim the corporation tax due at today's rate would be £250,000. However, if a Patent Box election is made, the corporation tax bill is reduced to £175,000

Is the Patent Box underused?

Yes, it is. Despite the very valuable tax benefits, some accountants are put off by the complexity of the calculation and discourage their clients from electing. Possibly they do not understand the full extent of the profits to which the tax incentive applies.

On the other hand, we have heard anecdotal evidence from patent attorneys that they have some clients who apply for patents with no intention of benefiting from the protection that they afford. Instead, they make their application solely to access the patent box tax deduction.

Next steps

If you believe that your company qualifies for the Patent Box and you would like information, help and advice on how best to utilise it, please contact David Gillies on 0121 633 2000 or by email to

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