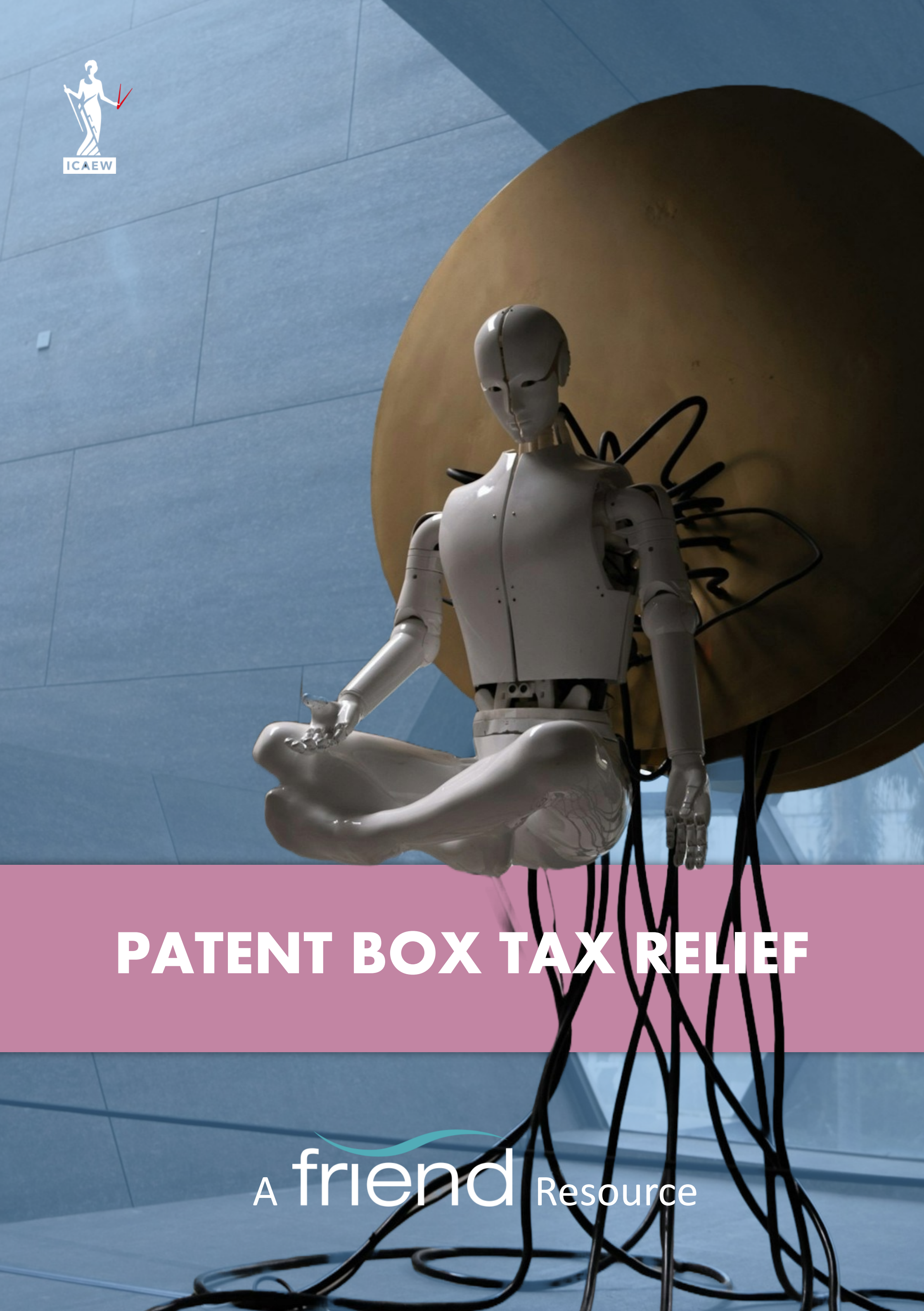

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PATENT BOX TAX RELIEF

A friend Resource

Introduction to the Patent Box

In line with similar regimes across the OECD, the UK Patent Box system is designed to encourage companies to retain and commercialise their intellectual property within the UK. It does this by offering a reduced effective tax rate of 10% on profits derived from qualifying patented inventions, known as *relevant IP profits*. This benefit is achieved through a deduction mechanism that adjusts the company's corporation tax liability so that qualifying profits are effectively taxed at 10%, despite the main corporation tax rate currently being up to 25% (for companies with profits over £250,000).

Across the OECD, tax incentives supporting R&D and intellectual property development are widespread. Of the 37 OECD member states, 20 provide special deductions for R&D, 18 offer R&D tax credits, and 19 operate patent box regimes. The UK offers both an R&D tax credit and a patent box incentive. This article focuses on the UK Patent Box and how it can benefit eligible companies.

The Patent Box regime was introduced by the **Finance Act 2012**, adding **Part 8A to the Corporation Tax Act 2010** under the heading "Profits Arising from the Exploitation of Patents, Etc." It came into effect in **April 2013**.

The Economic Rationale for Patent Box

Innovation is widely recognised as a key driver of economic growth, productivity, and rising living standards. As such, governments use tax policy to incentivise research and development (R&D) and the commercial exploitation of patents.

Profits Arising from the Exploitation of Patents

Under the Patent Box regime, qualifying companies may apply the reduced effective tax rate to profits derived from:

- Selling patented products or products incorporating a patented invention
- Licensing patent rights
- Selling patented rights
- Receiving damages or compensation related to patent rights
- Manufacturing using a patented process
- Providing a service using a patented tool or process

These benefits apply to **worldwide profits**, not just those generated within the UK.

David Gillies - Head of Tax

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What IP Rights Does the Patent Box Cover?

Under **Part 8A Corporation Tax Act 2010**, the regime applies to:

- Patents granted by the UK Intellectual Property Office (UKIPO) under the Patents Act 1977
- Patents granted by the European Patent Office (EPO)
- Patents granted in specified European Economic Area (EEA) countries
- Rights similar to patents, including:
  - ◊ Supplementary protection certificates for medicinal and plant protection products
  - ◊ Certain regulatory protections relating to marketing authorisations or data exclusivity

How to Access the Patent Box Regime

Companies that pay UK corporation tax and generate profits from the exploitation of qualifying patents can elect into the regime. This **election is not automatic** and must be made within two years after the end of the accounting period in which the relevant profits arise.

The election must specify the first accounting period to which it applies and remains effective until revoked. If revoked, a company **must wait five years before re-electing**, preventing opportunistic entries based on profit fluctuations.

What About Patents Pending?

Companies with a pending patent application can still elect into the regime and begin calculating the potential deduction. Although the 10% effective rate cannot be applied until the patent is granted, retrospective relief can be applied to profits from up to six years prior to the grant, provided the election was made in time.

Therefore, it's advisable to elect into the Patent Box as soon as a patent application is filed.

Calculating Relevant IP Profits

The calculation of relevant IP profits is complex and involves several stages:

- **Identify relevant income** derived from the exploitation of patented inventions
- **Deduct expenses** reasonably attributed to that income
- **Subtract routine return** and **marketing asset return** to isolate profits only related to the IP
- **Apply the R&D fraction**, which enhances the deduction based on how much of the R&D was carried out in-house or through unrelated third parties

These steps ensure that only the portion of profits linked to patented innovations qualifies for relief, rewarding companies that invest in UK-based innovation.

How Could My Company Benefit?

Here's an example:

If your company earns £1 million in profit and £500,000 is from qualifying IP, the standard corporation tax at 25% would lead to a £250,000 liability. With a Patent Box claim, the effective rate on the £500,000 of relevant IP profits drops to 10%, reducing the tax bill by **up to £75,000** - a total corporation tax liability of **£175,000**.

Is the Patent Box Underused?

Yes. Despite its generous benefits, many businesses do not take advantage of the regime, often because their accountants find the calculations daunting or are unaware of the full scope of qualifying activities. Conversely, some companies apply for patents primarily to access Patent Box tax relief, recognising its value even beyond IP protection.

Friend Partnership has considerable experience in calculating and claiming Patent Box relief for clients and is well placed to advise on how to maximise eligibility and optimise corporation tax outcomes. We act for entrepreneurial businesses and successful individuals across the UK and internationally.

Next Steps

Is the If you believe your company may qualify for the Patent Box and would like expert advice on how to benefit, please contact **David Gillies** on 0121 633 2000 or alternatively email him at david.gillies@friendllp.com.

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