PATENTLY CLEAR TAX BENEFITS?

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The Patent Box tax regime offers the potential for substantial Corporation Tax savings, but a low volume of claims are being submitted to HM Revenue and Customs.

Introduced on 1 April 2013, the Patent Box allows companies to pay a lower rate of Corporation Tax on relevant Intellectual Property (IP) profits. Despite a slow start, with benefits introduced incrementally over a four year period, the full savings have been available from 1 April 2017 to deliver the headline 10% Corporation Tax rate on qualifying profits. Compared to the current standard Corporation Tax rate of 19%, a saving of 9p for every £1 of profit is very attractive. For example, based on £2m of relevant IP profits, the Corporation Tax saving would be £180,000.

Low uptake

The latest statistics released by HM Revenue and Customs show 1,160 claims were made throughout the UK in 2015/16 and 1,025 in 2016/17, although figures for this latter year are expected to be revised upwards once further statistics are released in Autumn 2019. Of these claims, Northern Ireland companies accounted for just 35 and 30 in each respective year. Compare this to the number of patents granted by the UK Intellectual Property Office (IPO) – 5,602 in 2016 and 6,311 in 2017.

Reasons for an apparent low uptake likely include:

- It is a Corporation Tax regime only, so individuals and partnerships cannot make claims;
- The costs and timescale for registering patents, although the Corporation Tax savings will usually outweigh the legal and admin costs and it is possible to make claims in relation to relevant IP profits for the period between patent application and grant (the 'patent pending' period);
- The complexity of calculations and reduced benefits during phase-in, but a number of simplifications and elections are available to reduce this complexity and the phase-in period is now over;
- For companies which initially make relevant IP losses, it will be better not to elect into the regime; and
- A lack of awareness about the regime and how it works.

How to qualify

UK companies liable to Corporation Tax are potentially eligible to make a claim. The company must either hold or exclusively licence-in a qualifying patent and this patent must have been granted by the UK IPO, the European Patent Office (EPO) or certain countries in the European Economic Area (EEA). The company, or group of companies of which it is a member, must also have carried out the qualifying development (R&D) on the patent. Additionally, the company must meet an active ownership test in the case of a group company claimant, by being able to demonstrate that it has performed a significant amount of management activity in relation to the IP rights held.

Relevant IP Income

Income earned from exploiting patented inventions can be derived from:

- sales of patented products – it is important to note that the full sale value of a larger product into which a patented item is intended to be physically incorporated over its full operating life will qualify. For example, even if only the braking system of a car is patented then the full sale value of the car would be within the regime;
- licencing out patent rights;
- selling patented rights;
- infringement income; and
- damages, insurance or other compensation related to patent rights.

Calculating relevant IP profits and the 'New Regime'

At a basic level, the approach to calculating relevant IP profits is as follows:

1. Allocate taxable profits to either a patent box income stream or a non-patent box income stream;
2. Deduct a 'routine return' to account for an element of normal profit; and
3. Deduct a 'marketing asset return' for an element of profits relating to brand (this can often be nil for business to business sales driven by technical requirements).

Despite its relative infancy, the Patent Box rules were modified from 1 July 2016, following recommendations from the OECD Forum on Harmful Tax Practices. The 'New Regime' requires R&D expenditure to be tracked and traced on a cumulative basis at a qualifying IP right, product or product family level and a 'modified nexus' fraction potentially restricts the patent box deduction where there is significant R&D subcontracted to connected companies or significant expenditure on the acquisition of qualifying IP.

'Grandfathering' provisions allow companies elected into the 'Old Regime' to continue to use the old rules until 30 June 2021.

Election

It is important to note that a company must actively elect into the regime. The deadline for doing this is two years from the end of the accounting period for which a claim is to be made. Submitting a first claim on the Corporation Tax return counts as making an election.

An increased risk that the election deadline will be missed arises in relation to the 'patent pending' period, for which a claim can only be made on the Corporation Tax return for the accounting period in which the patent is granted. It is not uncommon for a patent to take 3, 4 or 5 years to be granted, but the election must be made within two years of the end of the accounting period in which the 'patent pending' profits arose or the tax benefits will be lost for that period.

Find out more

ASM Chartered Accountants recently ran a breakfast seminar at The Merchant Hotel, 'To Patent or Not To Patent', covering the tax and legal aspects of patents in conjunction with HM Revenue and Customs, Invest NI, FR Kelly and Pinsent Masons. Due to high demand for places, the event will be repeated soon at a location and on a date TBC.

If you would like to register your interest in attending, or for further information, please contact our Tax Senior Manager, Richard Blakeman, on 028 90 249222 or richard.blakeman@asmbelfast.com, or visit our website at www.asmaccountants.com

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