

ABG[®]

 ICAEW
CHARTERED
ACCOUNTANTS

November 2017



Patent Box

www.abgggroup.co.uk

Telephone 020 7330 0000 30 City Road, London, EC1Y 2AB



Patent Box

The patent box regime applies a reduced rate of corporation tax to profits attributable to qualifying patents and similar intellectual property (IP). Unincorporated businesses can't qualify for the patent box.

The patent box tax rate has gradually been reduced to 10% since the introduction of the regime in 2013 (see table).

To benefit from this reduced rate, your company must:

- hold a qualifying patent or other qualifying IP
- receive income relating to that patent or IP
- elect into the regime.

Qualifying patents or IP

Your company must own, or hold an exclusive licence to use, one or more patents issued by the UK Intellectual Property Office, European Patent Office or any of these countries:

- Austria
- Bulgaria
- Czech Republic
- Denmark
- Estonia
- Finland
- Germany
- Hungary
- Poland
- Portugal
- Romania
- Slovakia
- Sweden

Your company can also qualify for the patent box regime if it holds any of the following:

patents that would have been granted but for a prohibition on publication on the grounds of national security or public safety (such as for nuclear fuel)

UK and European Commission plant breeders' rights

regulatory data protection granted in respect of medicinal, veterinary and plant protection products

marketing exclusivity granted to orphan status medicines and medicines for paediatric use

supplementary protection certificates.

What is IP income?

Profits from the company creating or developing the patented invention, or from a product incorporating the patented item, qualify for the patent box regime.

Where the patented device is an essential component within a larger product, the income from that bigger product falls within the 'gross income' definition for the patent box regime.

Profits from holding patents as investments do not qualify and are taxed at the normal rate of corporation tax, which is 19% in 2017/18.

Patents pending

You may wish to examine carefully what IP your company owns to assess whether it would be worthwhile seeking new patents for components in order to bring the related income from the entire product within the patent box regime.

Applying for a patent is not necessarily an expensive process.

Your company can't benefit immediately from the patent box on profits from items pending patent approval.

However, the benefit from that patent pending can be rolled-up for up to six years (see step five of the calculation section).

To do this, you calculate what the relevant IP profits of the trade (RP) would have been had the patent been granted already.

These amounts of RP are aggregated over a period of up to six years ending with the grant of the patent.

For the year the patent is granted, add that aggregated total of RP to the relevant IP profits for the year and apply the patent box deduction on the total relevant IP profits.

Six-step calculation

The calculation of profits which are subject to the patent box regime is not simple, but can be broken down into six steps:

One

Identify how much of the company's total gross income includes relevant IP income (RIPI), which is broadly income derived from its qualifying patents and from items incorporating patented components. RIPI can be:

- sales income
- worldwide licence fee or royalties
- compensation including damages
- insurance proceeds.

Two

Isolate the amount of net profits which relate to RIPI by either:

apportioning the total tax-adjusted profits according to the ratio of RIPI to total gross income

allocating all expenses on a just and reasonable basis to the two 'streams' of income (RIPI and non-qualifying income) to arrive at an appropriate profit derived from the RIPI stream.

Three

Remove 10% of certain specified tax-deductible costs from the profits derived from the previous step.

This leaves an amount called qualifying residual profit (QRP). The specified costs include those relating to personnel, premises, plant and machinery or miscellaneous services.

R&D-related costs are not part of this specified list.

Four

Assess whether the QRP from step three is more than £3 million or not.

If the QRP doesn't exceed £3 million, the company can elect for the small claims treatment. Under this method remove 25% of QRP as a deemed marketing return, leaving the remaining 75% (up to a maximum £1 million) as the relevant IP profits (RP) which is inside the patent box.

If the QRP is more than £3 million, or the company has not elected for the small claims treatment, remove a return on marketing assets used to derive RIPI by deducting a notional marketing royalty for use of the assets.

Five

Where patents have been granted during the year, the RP for up to six earlier years in relation to periods during which those patents were awaiting approval is added at this stage.

Six

The figure of RP from step four and step five used to calculate the appropriate amount of the deduction from the profits of the trade which gives effect to the lower rate of corporation tax (see table).

Streaming

Using the overall ratio of RIPI to total gross income, as required by step two in the calculation, may work to the company's disadvantage where the non-IP income produces little profit.

In which case the company may opt for a streaming method, where costs and revenues are allocated on a patent-by-patent or product-by-product basis.

Streaming is compulsory for new entrants to the patent box regime from 1 July 2016 and for all eligible companies from 1 July 2021.

From 1 April 2017, the streaming rules are amended where R&D is undertaken collaboratively by two or more companies under a cost sharing arrangement.

The regime's benefit is therefore restricted where R&D activity is subcontracted to connected parties or where IP rights are acquired.

Deadlines

The election for patent box can only apply to accounting periods beginning on or after 1 April 2013.

The election must be made within two years of the end of the first accounting period it will apply to and remains in place until it is revoked.

In practice, the election is made as part of the corporation tax computation or by a separate written notice to HMRC.

A company may opt out of the patent box regime by revoking the election in writing, specifying the first accounting period for which the revocation is to take effect.

Once the company has opted out of patent box, it can't elect back in again for at least five years.

Prepare your accounting system

To benefit fully from the patent box, your company's accounting system must deliver all the information required for the complex patent box calculation.

Financial year starting	Effective patent box rate when companies pay:	
	Main corporation tax rate	Small profits corporation tax rate
1 April	%	%
2017	10	10
2016	11	11
2015	12	12
2014	13.3	12.67
2013	15.2	13.2



ABG Arram[®] Berlyn Gardner

**Accounts | Auditing/Specialist Audits | Taxation
and Tax Planning | Estate Planning | Benchmarking |
IT Consultancy | Outsourced Accounting |
Banking Advice | Company Secretarial Services |
Management Consultancy**

ABG[®] Corporate Finance LLP

**Mergers and Acquisitions | Due Diligence
Investigations | Business Disposals | Business
Plans | Cash Management including Preparation
of Budgeted and Forecast Information | Raising
Finance | Corporate Restructuring**

ABG[®] Outsourced Finance & Accounting

**Bookkeeping | Preparation of VAT Returns and
Payrolls | Preparation of Management Accounts |
Assistance in the Preparation of Cashflows,
Forecasts and Budgets | Financial Reporting |
Auto enrolment**

Arram Berlyn Gardner LLP is registered to carry out audit work in the UK and Ireland by the Institute of Chartered Accountants in England and Wales. Details about our audit registration can be viewed at www.auditregister.org.uk under reference number C006321677. Arram Berlyn Gardner LLP is not authorised under the Financial Services and Markets Act 2000 but we are able in certain circumstances to offer a limited range of investment services to clients because we are members of the Institute of Chartered Accountants in England and Wales. We can provide these investment services if they are an incidental part of the professional services we have been engaged to provide. Arram Berlyn Gardner LLP is a member of EuroAudit with worldwide representation.

Arram Berlyn Gardner (AH) Limited is registered in England with the company number 9178155. ABG and Arram Berlyn Gardner are registered trademarks of Arram Berlyn Gardner LLP and trading names of Arram Berlyn Gardner LLP and Arram Berlyn Gardner (AH) Limited and both are regulated by the Institute of Chartered Accountants in England and Wales for a range of investment business activities. ABG Corporate Finance LLP is authorised and regulated by the Financial Conduct Authority (FCA).

Important: This newsletter has been written for the general interest of our clients and contacts and is correct at the time of going to print. No responsibility for loss occasioned to any person acting or refraining from acting as a result of material in this publication can be accepted.

www.abgggroup.co.uk

Telephone 020 7330 0000 30 City Road, London, EC1Y 2AB

