

## The Patent Box is Changing Shape

### The current UK Patent Box system is closing to new entrants from 30th June 2016

The Patent Box regime, which was introduced in April 2013, allows UK companies to elect to pay a reduced rate of corporation tax on profits derived from the exploitation of patents and certain other types of IP (e.g. supplementary protection certificates (SPCs) for pharmaceutical products). In effect, the regime allows for a 10 per cent tax rate, rather than 20 per cent, on qualifying profits derived from UK or European patents.

The basic criteria which a company must satisfy to benefit from the scheme are as follows:

- It must have a qualifying IP right. Qualifying IP rights are:
  - Patents granted by the UKIPO or the EPO;
  - Patents granted by some, but not all, states in the European Economic Area (EEA); and
  - Certain other European IP rights (e.g. SPCs, plant breeders' rights, plant variety rights);
- It must "actively hold" the qualifying IP right as an owner or an exclusive licensee. The company must be

creating, or significantly contributing to, the protected invention, or performing a significant amount of activity to develop the protected invention or any product or process incorporating the protected invention. If a company is part of a group and satisfies this requirement through the activities of another group member, the company in question must actively manage its portfolio of qualifying IP rights; and

- It must have an income related to the qualifying IP right (e.g. sales of patented products).

#### Why the change?

The original UK Patent Box legislation does not require a claimant for tax relief to carry out any Research & Development (R&D) in the UK. Following the introduction of the Patent Box in April 2013, a number of multinational companies sought to take advantage of the regime by relocating their tax domicile to the UK, prompting some EU states, most notably Germany, to claim that the UK Patent Box scheme could provide scope for abusive tax avoidance practices.

Consequently, the Organisation for Economic Co-operation and Development (OECD) identified the UK Patent Box as being a 'harmful tax practice' in an October 2015 report. In response, the UK government announced a consultation and, in December 2015, draft legislation was published.

#### What is changing?

The new UK Patent Box regime, which will enter into force from 1st July 2016, introduces a "modified nexus approach" by which the amount of tax relief available will depend on the extent to which the R&D leading to the patented invention (or a product embodying it) was carried out in the UK. Some of the R&D may be outsourced or acquired, but only to a cap of 30% of the qualifying expenditure.

#### What does this mean?

The upshot of the new Patent Box regime is that claimants will need to engage in significant R&D efforts in the UK to benefit from the available reduction in corporation tax. The aim is that this will allow the



Patent Box to fulfil its intended purpose, namely incentivising innovative companies to develop new patented products in the UK, more successfully, whilst minimising the opportunity for harmful tax avoidance.

Critics of the new rules have pointed out that the proposed changes may considerably increase the administrative cost of compliance on companies that wish to take advantage of the scheme, and that small and medium-sized enterprises (SMEs) with limited resources may be penalised.

The general view from the vast majority of observers is that the new Patent Box regime will be less favourable to most claimants than the existing regime.

## What can I do?

Whilst the existing Patent Box regime will be replaced by the new regime from 1st July 2016, transitional provisions mean that companies that have already entered the scheme, or that enter the scheme before this date (i.e. by 30th June 2016), will benefit from the old rules, and will continue to do so until 30th June 2021.

To qualify for Patent Box relief under the old, seemingly more favourable rules, companies must have elected into the Patent Box scheme (by writing to HM Revenue & Customs (HMRC)) and filed a qualifying patent application by 30th June 2016.

It is not necessary to own a granted patent to elect into the Patent Box (a pending patent application is sufficient), but tax relief cannot be claimed until a qualifying patent has been granted. Therefore, any companies wishing to take advantage of the old Patent Box rules should contemplate filing any relevant qualifying patent applications by 30th June 2016.

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## Need advice?

For more information, please contact [email@carpmaels.com](mailto:email@carpmaels.com).

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