



UK Patent Box Update

We look at the changes to the UK Patent Box that were introduced in 2016 and their impact on the scheme and its participants

What is the Patent Box?

The UK Patent Box scheme was introduced in April 2013 and 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).

A company must satisfy three basic criteria to benefit from the scheme:

- 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).

In effect, the Patent Box allows for a 10 per cent corporate tax rate, rather than 20 per cent, on qualifying profits derived from UK or European patents.

2016 changes

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



The reason for the change in legislation was that the original legislation did 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.

The updated UK Patent Box regime, which has been in 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. The hope was that this would 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.

Although the old Patent Box regime was replaced by the new regime on 1st July 2016, transitional provisions mean that companies that had already entered the scheme before this date (i.e. by 30th June 2016) can continue to benefit from the old rules until 30th June 2021.

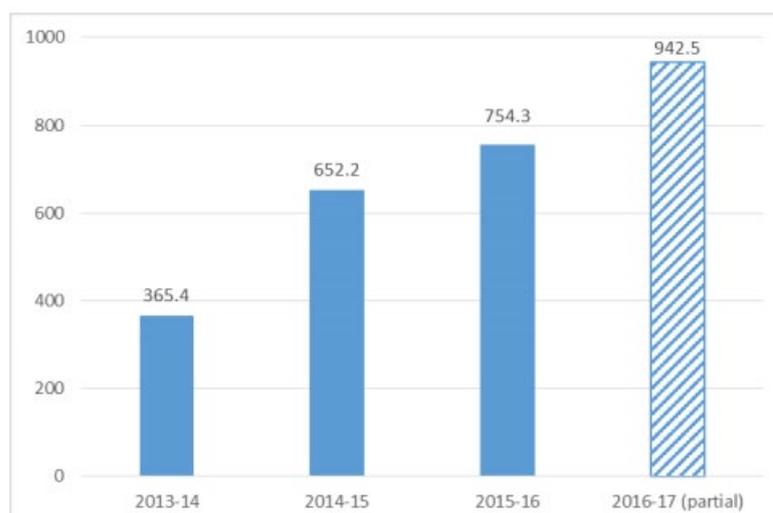
How have the changes been received?

Since the election to benefit from the Patent Box is made up to two years after the end of the accounting period in which the relevant profits and income arose, there is currently limited data available on how the 2016 changes have affected the scheme and its participants.

However, in September 2018, HM Revenue & Customs (HMRC) published [updated statistics on the uptake of the Patent Box](#) that included partial statistics for the 2016-17 fiscal year based on Patent Box claims made up to the end of the first quarter of the second year after the end of the accounting period (claims made up to and including 30th June 2018). This data gives us a first indication as to how companies of all sizes and across all industry sectors might be responding to the 2016 changes.

The key message communicated in the HMRC publication is that the total value of the relief claimed through the Patent Box regime continues to grow year on year, as it has done since 2013.

Figure 1: Value of relief claimed under the Patent Box (£ million)



Source: HMRC data

1. Amounts of relief claimed have been rounded to the nearest £100,000.



Whilst the number of companies claiming relief in 2016-17 appears to have decreased since the previous year, HMRC indicates that these statistics are based on partial data and are expected to be revised upwards when a complete set of data becomes available.

The “company size” breakdown provides further interesting insight. In 2016-17, “large” companies accounted for 96.3% of the total relief claimed, which is a noticeable increase on 95.5% in 2015-16 and 94.6% in 2014-15.

One reason for this could be the increased complexity of the tax reduction calculations since the 2016 changes and the associated cost and effort of ensuring compliance. Critics of the 2016 changes pointed out that they could penalise small and medium-sized enterprises (SMEs) with limited resources and it is possible that this is happening.

A further HMRC update is expected in autumn 2019 and it will be interesting to see whether this trend continues.

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