

Guidance on the Patent Box regime



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Introduction and background

An element of the economic policy of the United Kingdom Government is to move the economy away from its over reliance on financial services to a more balanced position in which manufacturing plays a much greater role. It is particularly concerned that the UK should retain its attractiveness not only as a place for carrying out original research, an area in which this country retains its position as a world leader, but more fundamentally as a location in which original ideas are developed and exploited, an area in which the UK has possibly not been so successful in the past.

One element of this strategy involves increasing the competitiveness of the UK from a Corporation Tax point of view. And as part of that effort Government decided that it needs to provide favourable tax treatment for profits deriving from inventions and their exploitation, hence the Patent Box regime. This regime was originally proposed by the previous Labour Government, but it is a proposal which has been seized on enthusiastically by the current Government and adopted as part of its overall strategy.

The primary legislation enacting the new regime is contained in the Finance Act 2012 which enacts amendments to the Corporation Taxes Act 2010. In addition reference should be made to the Patent Box guidance published in the HMRC Corporate Intangibles Research & Development manual starting at paragraph CIRD 200000.

In the rest of this note we provide outline guidance on the regime and what it might mean for companies which hold and exploit rights in patents and other qualifying intellectual property. We stress that this is only intended to be a guidance note and should not be regarded as a definitive statement as to how these rules will apply to an individual company's tax position. The legislation is very complex from a technical taxation point of view and how it will apply in particular circumstances will require detailed analysis; EIP is not, and does not purport to be, capable of advising on issues of Corporation Tax. Accordingly anyone wishing to ascertain how these provisions could apply to their particular circumstances is advised to consult with their tax advisor.

An overview of the Patent Box regime

- Companies which elect to be within the Patent Box will be taxed on profits arising from the exploitation of the patents and other qualifying rights at 10% instead of the normal Corporation Tax rate (currently between 20% and 24% depending on the size of the company and the size of the profits);
- An election into the Patent Box must be made in writing, specifying the accounting period, by the last day on which the company would be entitled to amend its tax return;
- In order to qualify companies must not only own the rights in question; they must also have contributed to their development. Furthermore in certain cases they must be actively involved in the management of the rights. This is to prevent companies transferring the rights to “passive” entities simply to take advantage of the favourable tax treatments;
- The Patent Box will also apply to qualifying IP rights which are held under an exclusive licence;
- Calculation of the element of profits which qualify for this favourable treatment involves a seven step process which includes removing from the total profit:
 - the element of profit which could be expected in any event even if there was no patent protection [i.e. the “normal rate of return”]; and
 - the element of profit attributable to other indirect marketing rights such as trademarks and brands;
- The relief will be phased in over five years from April 2013 through to 2017
- The regime includes an anti-avoidance rule to prevent unreasonable tax benefits arising from tax-motivated schemes.

Qualifying IP rights

Patents which will be covered by the scheme are those which have been granted by the UK Intellectual Property Office (“UKIPO”), by the European Patent Office (“EPO”), or by patent offices located in other European states which are considered by HMRC to have similar patentability and examination criteria to the UK and the EPO. However this does not mean that the relief only arises from exploitation of patented products in Europe – the relief applies to exploitation of those products worldwide. This is explained in greater detail below.

The regime has been dubbed “the Patent Box” and discussion tends to centre on patents as the main vehicle for relief. However the following rights also come within the scope of the new regime:

- Supplementary Protection Certificates;
- UK and European Plant Breeders' rights;
- Medicinal and veterinary products with marketing authorisations and marketing or data protection;
- Plant protection products with data protection benefits.

For ease of reference we shall in the rest of this note simply refer to "patents". However, it will be understood that that term is intended to include these other rights as well where appropriate.

Patent Box treatment will be available not only for those rights which are owned outright by the tax-paying entity but also for those which have been in-licensed on an exclusive basis. It should be noted that the licence must be exclusive and for that purpose must be exclusive for the whole of a country or territory; territories cannot be split. For the purpose of determining whether a licence is exclusive regard has to be had as to whether the licence is exclusive for a particular activity. This recognises that different entities may be given "exclusive" licences in respect of different applications; e.g. in the case of a new display screen one entity may be granted exclusivity in the field of mobile telephones while another might be granted the exclusive right to exploit the patent in the field of screens for laptop computers. Both would qualify for treatment in the Patent Box.

Qualifying company conditions

In addition to owning the rights in question, or having the right to exploit them under an exclusive licence, companies which wish to come within the Patent Box must fulfil certain other conditions, namely a "development condition" and, in certain circumstances, an "active ownership" condition.

The development condition requires the entity in question to have either:

- created the patented invention or made a significant contribution to its creation;
or
- carried out significant activity to develop the patented invention or any product incorporating that invention or the way in which that invention may be applied.

Thus the entity claiming the relief does not have to have played a part in devising the invention in the first place if it has subsequently taken significant steps towards developing that invention into a commercial proposition. But it can also qualify if those activities:

- have been carried out by another member of a group of which it is a member (but see active ownership below); or
- by a predecessor in title provided that the purchasing company continues with the development activity for at least 12 months after a change of ownership (although not necessarily on the same invention).

The active ownership condition applies where the entity in question is only able to meet the

development condition by reason of the activities of another member of the group of which it is a part. In that case the entity in question must show that it is involved in planning and decision making activities related to the development and exploitation of substantially all of the qualifying IP rights. The Guidance Notes issued by HM Treasury refer to the following activities as constituting active management:

- deciding whether to maintain protection in certain jurisdictions;
- helping to decide in which products the patented invention is incorporated and which go to market;
- granting of licences (and presumably negotiating them); and
- researching for alternative applications for the innovation (or licensing others to do so).

Thus simply being a passive holder of patents and other rights will not qualify an entity for the Patent Box. This is in line with the Government's stated aim of encouraging actual development of inventions into commercial products and UK based entities being involved in that commercialisation with a view to promoting investment in the high tech sector and safeguarding jobs in the high tech industries.

Some examples of group situations giving rise to Patent Box claims are shown in Appendix A. It should be noted that these provisions are quite detailed and complex and thus care needs to be taken to ensure that the calculations will apply to any particular group of companies. Many of these scenarios will require formalisation of intragroup licences of IP rights, something which groups of companies should have that in mind when reviewing how they hold their IP.

Calculation of the proportion of profits which qualify

Terminology

The calculation of the element of a company's overall profit which will come within the Patent Box and qualify for favourable treatment is somewhat complicated. It involves a seven step calculation. Unfortunately a ready understanding is not facilitated by the confusing terms which the legislation uses to define the various elements involved in those calculations. We set these out here for ease of reference:

"Total Gross Income"

This will include the revenue receipts of the trade in question and any profits from realisation of trade intangibles but excludes any finance income.

"Relevant IP Income" or "RIPI"

This is the proportion of the Total Gross Income attributable to the exploitation of the rights in question. That same proportion is then applied to the total profit to give the qualifying profit.

“Qualifying Residual Profit” or “QRP”

This is what is left after removing a routine return on certain specified expenses (called “deductions”) from the qualifying profit. This is done so there is not included within the Patent Box the return which the trade would normally expect to receive absent patent protection so that only that element of profit attributable to the patent receives the benefit of the reduced rate.

“Relevant IP Profit” or “RP”

This is arrived at by deducting from the QRP the return which is derived from marketing assets. The concept here is that sales of patented products may also be driven by other elements notably branding, advertising etc. This element also needs to be deducted.

Total Gross Income

The elements of income which can be included under this head are determined by standard accounting rules. Certain elements of income are excluded, notably finance income. Discussion of these accounting rules is beyond the scope of this note and will not be considered further.

Relevant IP Income (“RIPI”)

RIPI can arise from five different ways of exploiting IP rights:

- Head 1 Sales of “qualifying items” and associated items;
- Head 2 Licence Fees or royalties from the grant of rights over qualifying IP assets;
- Head 3 Proceeds of realisation of qualifying IP assets (i.e sale or other disposal)
- Head 4 Infringement income, that is compensation paid from an infringement or alleged infringement.
- Head 5 Damages, Insurance and other compensation receipts

Heads 2, 3 and 4 are self-explanatory and require no further comment.

Heads 2, 3 and 4 are self-explanatory and require no further comment. Head 5 seems designed to close a potential loophole where the damages and other compensation receipts do not relate directly to “qualifying rights.” The example given in the HMRC technical guide is where a company’s patent rights are being infringed in both the UK and the US and it takes actions in both territories against the infringer. It reaches a settlement under which it receives a significant payment. In so far as that payment relates to the UK patent, the receipts will be treated under Head 4 since that is a “qualifying right.”(see below). However, Head 5 means that the payment in respect of the US patent is similarly so treated and thus there is no need to apportion between the two.

For most entities Head 1 will be in the most significant. In this context RIPI can arise from:

- “qualifying items” these are items which are protected by a qualifying IP right. We

discuss what is meant by a “qualifying IP right” below.

- items incorporating a qualifying item, or designed to incorporate a qualifying item, if sold together at a single price; and
- items wholly or mainly designed to be incorporated into a qualifying item.

It is important to appreciate the significance of what constitutes a “qualifying item”. The legislation has been drawn so that it is clear that the tax payer does NOT have to hold patents in every country of sale, manufacture or use of the product or process in question. Instead the taxed entity simply has to hold one patent issued by one of the approved Patent Offices. Assuming that the entity holds such a right then it will be permitted to include within the Patent Box all profits arising from income arising from sales or other exploitation throughout the world of products or processes which fall within the scope of that patent irrespective of whether it holds a patent in the country of sale, manufacture or use.

For example, assume that an entity holds a patent on a product granted by the UKIPO. It will be able to include within its Patent Box calculations all relevant profits attributable to sales of that product in the United States irrespective of whether it holds a corresponding patent in the United States. Thus the grant of a qualifying patent is in effect treated as an objective certification that the invention in question (and any products or processes incorporating it) is the result of the necessary degree of research and development entitling it to qualify for this special treatment, rather than being dependent on its actual protection in these other countries.

These provisions are also designed to include within RIPI items of which the invention may only form part (but presumably an important part) and spare parts. The example given by the Treasury is that of a patented printer cartridge designed to be installed into a printer and once installed not removed until it is empty. The Treasury Guidance states that income from the sale of the printer including the cartridge (whether actually installed at the time of sale or simply included within the box for a single price) will count as RIPI. Conversely if the printer is patented but the cartridges are not, replacement cartridges will still qualify as items wholly or mainly designed to be incorporated into the qualifying item i.e. the printer.

By contrast a patented DVD will not carry with it income from the sales of DVD players since the DVD is designed to work with a wide variety of DVD players and after each use is intended to be removed.

The legislation specifically provides that packaging is to be treated as a separate item, which is to be excluded from the calculation of RIPI unless:

- the packaging performs a function that is essential to the use of the item for the purposes for which it was intended e.g. the container of an inhaler; or
- the value of the packaging is trivial.

Where items which would give rise to RIPI are sold along with non-qualifying items at a single price, that income is designated as mixed income and has to be apportioned so as to determine how much of it is RIPI, unless the non-qualifying proportion can be regarded as trivial. The apportionment is to be carried out on a “just and reasonable” basis.

Notional Royalty

Certain entities may be exploiting their patents in ways which do not generate RIPI. Examples given are patented tools used in the manufacture of non-patented products or service companies using patented items in order to provide those services. For these entities a notional royalty can be treated as RIPI for the purposes of the Patent Box. Certain rules apply as to how that notional royalty is to be calculated. Most notable is that it has to take the form of a periodic royalty as opposed to single, up-front payment. We are expecting in due course further guidance from the HMRC on this potentially complex area.

The routine return

In order to ensure that the favourable tax treatment only applies to that element of the totals profits which can be said to arise from the qualifying IP, there has to be deducted from the profit attributable to RIPI the return which a trader might expect to receive in the absence of any patent protection ("routine return"). Rather than requiring each company to conduct a potentially detailed and expensive analysis of its profit profile so as to establish what that return might be, the Government has instead opted for a formulaic approach by means of a fixed percentage (10%) on certain items of expenditure.

The items of expenditure which are used to arrive at the "routine return" are the ones which one would expect, namely premises, personnel, plant and machinery costs and other normal overheads together with certain other accounting allowances. But they do not include R&D expenditure — this recognises this element is likely to be directly related to the creation of the qualifying IP and therefore it would be inappropriate to allocate to them a "routine return".

After applying the 10% mark-up to these elements to establish the overall routine return, the resulting figure is then apportioned to the RIPI element by applying the same RIPI/Total Gross Income proportion. The resulting amount is then deducted from the profit attributable to RIPI to give the "Qualifying Residual Profit" or "QRP".

Marketing Assets Return

The figure within the QRP represents not only the profit attributable to qualifying IP but also the profit which is generated by virtue of any other significant marketing assets held by the entity in question e.g. brands, trademarks, goodwill etc. Assets that fall within this definition include:

- trade marks (both registered and unregistered)
- signs or indications of geographic origin;
- information about actual or potential customers.

Since any profit arising from these assets is not attributable to qualifying IP assets, it also needs to be deducted to arrive at the final figure.

Small companies which have a QRP of less than £3 million can apply a "small claims treatment". There are two conditions:-

- either the company's QRP is less than £1 million;
- or its QRP is less than £3 million and in the previous four years the company has

not elected to conduct the more accurate calculation set out below.

In either case the maximum amount which can be included in the Patent Box is 75% of the QRP or £1 million whichever is the lower.

For companies whose QRP is above this figure (or whose QRP is below this figure but who wish to have a more accurate assessment) then the legislation requires that a Notional Marketing Royalty be allocated. This notional royalty is the appropriate percentage that a third party would pay for the exclusive right to exploit the relevant marketing assets.

Certain assumptions have to be made in arriving at the notional royalty including the fact that the third party and notional IP owner are dealing at arm's length and that the rights to be granted are exclusive.

From the notional marketing royalty one then deducts any actual marketing royalty paid and that resulting figure is then deducted from the QRP to arrive at "Relevant IP Profit" or RP.

Relevant IP Profit or RP

It is this final element which is taxed at the Patent Box rate — effectively 10% (after the phase-in period) although due to the technical method of computation, it may be slightly less in some circumstances.

Examples

In Appendix B there are a couple of worked examples showing how these calculations can be expected to work in practice and the impact of this upon a company's tax liability.

Other provisions

RIPP earned prior to grant

The Patent Box only applies to patents which have actually been granted — it does not apply to applications for patents which are still before the relevant patent offices. However, once a patent is granted applicants will be able to claim the relief on any RP earned from the date of filing the patent application (after the Patent Box comes into force), subject to a maximum of six years prior to the date of grant and having elected into the Patent Box in the accounting period in which the patent application was filed.

Phasing In

Originally the Government proposed that the new regime would only apply to IP Commercialised after 2010. However, in the light of comments it decided to include all patents whenever filed or commercialised but the relief will be phased in over five years. Thus in 2013/4 the Patent Box rate will be 60% of the full allowance rising to 100% in 2017/8.

Anti-Avoidance

The legislation includes provisions aimed at making sure that companies do not set up structures which have little or no commercial usefulness but are designed solely to take advantage of the Patent Box. The details of these are highly technical and are beyond the scope of this Guidance Note.

What does this mean for patentees?

How radical is the Patent Box regime?

The Patent Box has to be seen in context. In recent years a number of European jurisdictions have introduced specific reliefs for revenues arising from intellectual property. Ireland has had long standing favourable treatment for such revenues although these may be falling victim to that country's austerity measures taken in the light of the current Euro crisis. The Netherlands taxes net income from self-developed patents and software at 5%. Belgium provides an 80% exemption from net income for self-developed patents resulting in an effective tax rate of just below 7%. Luxembourg has a similar approach under which such income is taxed at approximately 6%. Spain takes a different approach in that it exempts 50% of revenues from tax but allows expenses to be deducted in full resulting in an effective tax rate much below its headline corporation tax rate.

Against that background the UK Government's regime for an effective tax rate of 10% is not overly generous and it may be questioned as to whether it is sufficient to persuade companies to alter their existing set ups in order to relocate to the UK. Nevertheless, the UK Government seems to be banking on the fact that, coupled with the other attractions of locating in the UK (e.g. strong research base, lowering of corporation tax generally and Research & Development credits), this relief will be enough to persuade companies who are already located in the UK not to seek to transfer their holdings elsewhere and also that companies who are on the point of setting up in Europe for the first time or whose tax arrangements are not that mature may be sufficiently attracted to come to the UK.

The regime also needs to be seen as part of a bigger picture. Many countries, particularly within Europe, are seeking to raise revenue and are looking at anti avoidance measures aiming to reduce the scope for companies to use off shore jurisdictions in which to shelter their IP assets and the income arising from it. The recent publicity regarding the activities of Starbucks, Amazon and Google is further evidence of the pressure which companies are now coming under to eschew such aggressive tax avoidance. Thus to some extent this represents a carrot and stick approach.

How useful is the Patent Box to my organisation?

The answer to this will depend on the amount of income which is patent related. As can be seen from the worked examples Annex B where patent related income (or "RIPI") is only a small proportion of a company's TGI, then, not surprisingly, the overall reduction in tax liability is relatively small. Conversely, however, if RIPI represents a large proportion of the TGI then the savings in corporation tax will be significant. Each company will need to make an assessment. Nevertheless, it goes without saying that there are many companies in the high tech and life sciences fields which can properly claim that virtually all their products are protected by qualifying IP and for whom RIPI will be a large proportion of TGI. For those companies this new regime is likely to prove of significant value. Also even if RIPI is only a small proportion of TGI, if the overall profits are large enough the savings in tax will still be sufficient to make the Patent Box election worthwhile.

Should I change how my organisation currently holds its IP?

This is a complex question which will require detailed consideration with the organisation's

tax specialists. Recent events have demonstrated quite graphically that many organisations, in particular multi-national organisations, are already holding their IP Assets in tax efficient ways; they will need to determine whether the Patent Box is likely to yield significant additional benefit. By contrast there are likely to be many national corporations and SME's who currently do not have the benefit of complex international tax planning and for whom this regime could represent significant extra relief for their corporation tax liabilities and for whom "patent tax planning" could prove useful. Also, as stated, international companies who are considering setting up in Europe for the first time or who have only recently set up in Europe would do well to consider the potential tax advantages that might now be available by locating in the UK.

Furthermore, where patents are held in a group situation with a UK entity having the right to exploit them, consideration will need to be given as to whether that licence needs to be formalised so as to qualify that entity as one which can claim Patent Box relief.

Do I need to modify my current patenting strategy?

Again the answer to this question will depend on an organisation's particular circumstances. Organisations that already patent heavily may not need to change their approach, while others who patent selectively or not at all will need to give careful consideration to their approach to patenting. The following points should in any event be considered.

As a basic point, the Patent Box is a corporation tax relief. It is only available to those entities that pay corporation tax, namely companies. Thus sole traders, partnerships and limited liability partnerships who wish to take advantage of this regime will need to incorporate and will obviously need to calculate whether the potential savings will make that worthwhile.

Moreover, companies will need to review the economics of deciding whether it is worthwhile seeking patent protection in the first place. Up to now a significant consideration has been "Do we have the necessary resources to defend the patent even if we secure it?" Now companies will need to see whether it is merited to seek patents simply as a way of qualifying their products for Patent Box treatment.

And what if an organisation has no patents? There are two possibilities. The first is to review your products and processes and any recent developments to determine if there might be some aspects which can be the subject of protection. This may be tricky since it is a basic requirement of a patent that it is novel at the date of application and if a feature has already been incorporated into a product made available to the public (whether by sale, demonstration, advertisement or otherwise) then that will no longer be patentable. But nevertheless there may be improvements or additional features currently in development for which securing patent protection may still be an option. In this respect it should be remembered that in order to qualify for patent box relief the patent in question does not have to cover the whole of the relevant product or process, merely a part of it. The second option may be to acquire relevant patents from a third part, either by way of purchase or by exclusive licence, or even by acquisition of the patent holding entity itself.

How well is this likely to work from an administrative point of view?

It is not possible to pre-judge how HMRC is going to administer this new regime, but one can see considerable scope for some lively discussions between the tax payer and HMRC. The following are some of the issues which will need to be resolved:

What proportion of my TGI is RIPI?

One of the basic questions which will need to be resolved is whether the products being sold by the claiming entity are qualifying products i.e. are they “protected” by a qualifying patent? Given that questions of what exactly a patent protects and what constitutes an infringement are frequently issues which are argued over fiercely and at length by highly experienced lawyers before very eminent judges, one can anticipate some lively debates on this topic.

Of possibly greater complexity will be the issues relating to items which are to be incorporated into qualifying items and vice versa and how far one can go? Obviously from the point of view of patentees, they will want as much income as possible to be regarded as RIPI while one anticipates that the Revenue will be anxious to put limits on that so that the new regime is not abused.

What is the appropriate notional marketing royalty?

Again one can foresee some fierce debates around this issue going forward. Tax paying companies will want to limit the amount of the notional royalty. One can anticipate some very difficult questions arising. Take for example the Apple iPhone. It is generally reckoned that this is protected by a vast portfolio of patents and thus the revenue from its sales would count as RIPI. But what is the value of the “Apple” brand as part of those sales? Quite how those questions will be determined is likely to be something of a conundrum.

What proportion of my “mixed revenues” is attributable to RIPI?

There are many other issues which should provide considerable scope for discussion with the tax inspectors going forward.

How can EIP assist?

Many questions to be considered

A thorough understanding of the Patent Box is an important starting point. However translating Patent Box accounting principles into a practical patent action plan is not straightforward. Companies at the very least will need to evaluate their patent portfolios and modify their existing patent strategy, and companies embarking on a patent filing programme for the first time will need patent education and expert guidance. The following questions at least need careful consideration:

- Are our products covered by our existing patents and if not should we be filing additional patents?
- In which Patent offices should we be filing applications for patents to ensure rapid grant and earlier Patent Box benefit?
- Does the new regime mean that previous assumptions regarding whether and when to file for patents no longer hold true?
- Up to now we have not thought it worthwhile securing patents; does this require reconsideration?
- In which corporate entities should we hold our patents?
- Do we need to formalise our intercompany arrangements regarding use of group held patents?
- Should we be looking to acquire patents by other means, including joint ventures with universities etc?
- Should we consider opportunities for in-licensing patents?

Expert team

EIP has a specialist team dedicated to dealing with Patent Box issues. The team closely monitored the Patent Box proposals from their inception and made a number of representations to HMRC regarding the scope and coverage of the proposed relief. It has written and presented widely on Patent Box issues and has continued to work closely with organisations of all sizes, ranging from SME to FTSE status. The team includes both patent attorneys and solicitors; it is thus able to deal with all issues which may arise and ensure that all necessary patents and agreements are in place for full Patent Box relief.

A new conversation

An important aspect in any patenting strategy is to ensure that the right teams are working together. We believe that to devise the best Patent Box strategy it is essential that there is close collaboration between a number of stakeholders who traditionally may not have worked closely together. We have considerable experience of bringing together and interfacing multi-disciplinary teams, involving specialists in technology, markets, IP, legal, tax and accounting. Our team has experience working at all levels within a company and with all of these specialists.

Patentise™, a proprietary EIP framework

Patentise™ is a programme developed by EIP that provides the practical assistance that companies need. Our five-part modular and scalable process guides companies and their advisors through the key Patent Box decisions. Whether a company has an active patent filing programme and is already fully committed to the Patent Box, or is just exploring the feasibility of the Patent Box for their business, our Patentise™ programme fits their needs. The programme covers all aspects of the Patent Box life cycle from initial analysis through to ongoing management of the patent portfolio.

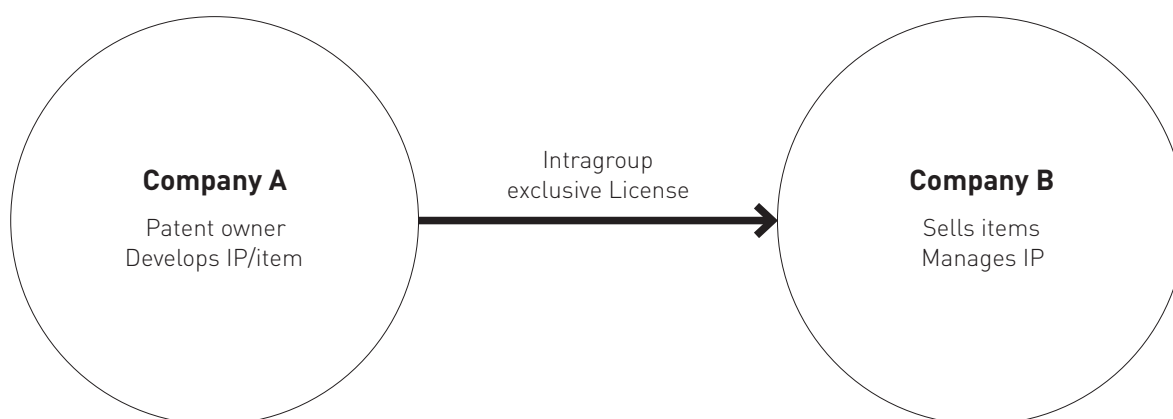
When do I need to review this?

The new regime starts on 1 April 2013. It is phased in over five years so that in the first year it will only apply at 60% of the rate. Nevertheless companies need to commence their Patent Box planning as soon as possible. Patents are long term assets and in many cases can take several years to obtain. Thus where companies do not have any patents, or only have a limited number covering their products, they need to start putting in hand now the necessary processes and procedures. This applies just as much to start ups and new companies – although they may not contemplate profits for several years in the future, given the time-scales involved in securing patent protection it could well be that action now will enable those patents to come on stream just at the time when profits are beginning to arise.

Appendix A

Examples of group situations giving rise to Patent Box relief.

Group example 1

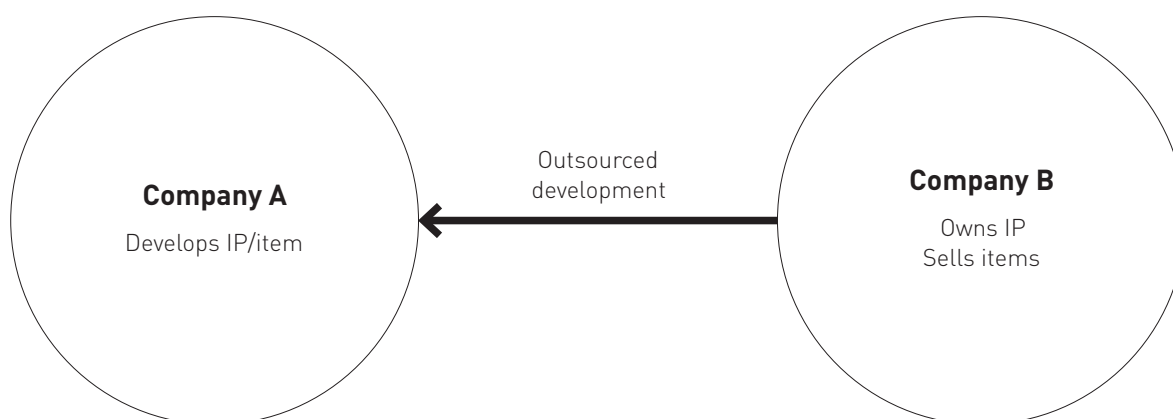


- Company B satisfies Condition A under “qualifying company” since it holds an exclusive licence (s357B(2)). It also satisfies Condition A under “The active ownership condition” by reason of its management of the IP (s.357BE). Thus it can claim Patent Box relief.
- Activities such as deciding on whether to maintain protection in particular jurisdictions, grant licences, research alternative applications for the innovation or licensing others to do so, count as management activity (source: CIRD210210)
- Similarly, where the rights are being exploited by incorporating the item into products, activities such as deciding on which products will go to market, what features those products will have and how and where they will be sold will also count as management activity (source: CIRD210210)

Appendix A

Examples of group situations giving rise to Patent Box relief.

Group example 2

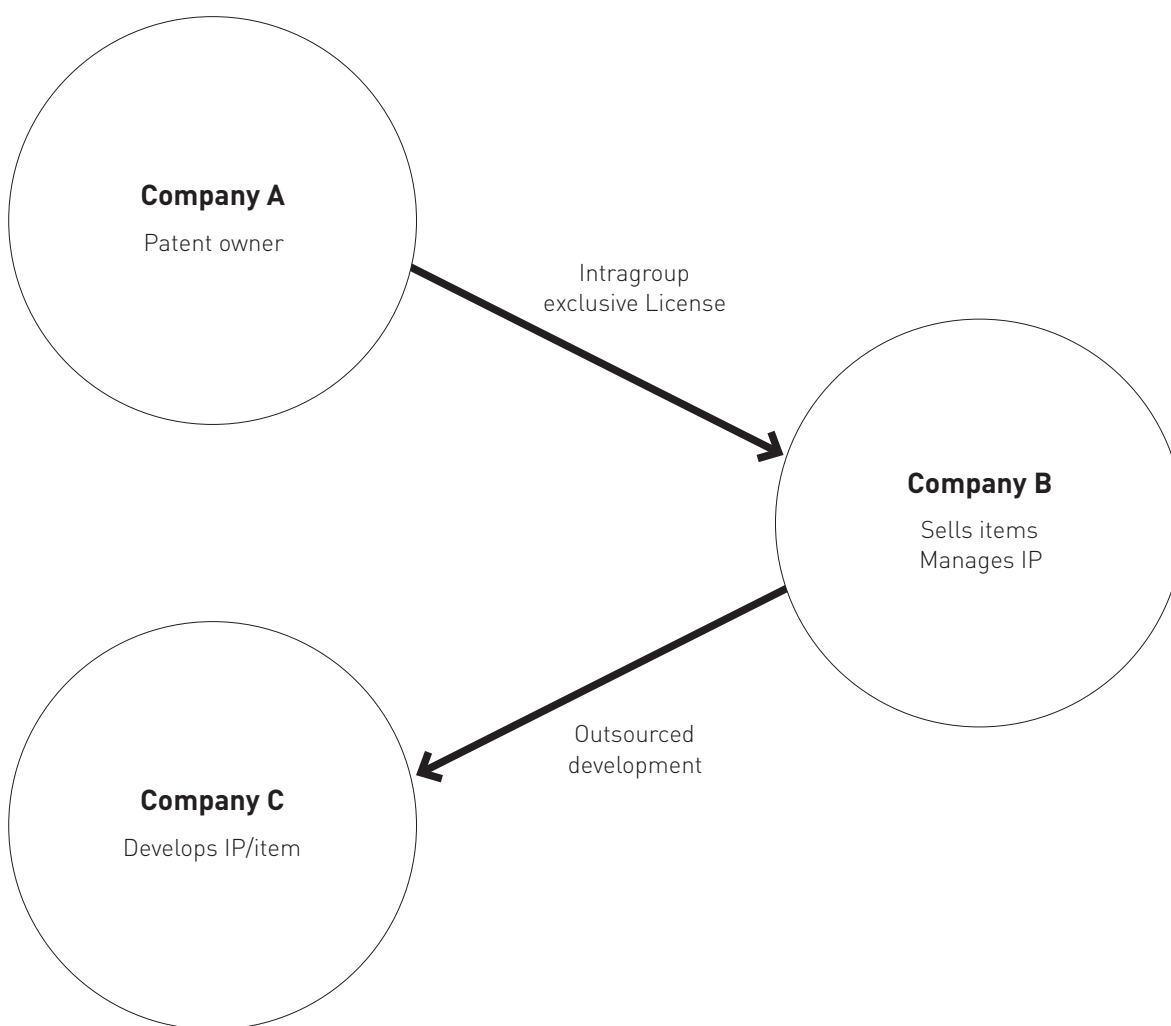


- Company B satisfies Condition A under “qualifying company” since it holds an exclusive licence (s.357B(2)). It also satisfies Condition A under “The active ownership condition” by reason of its management of the IP (s.357BE). It satisfies Condition C under the development condition by reason of the fact that Company A is part of the same group (s.357BC). Thus it can claim Patent Box relief.
- Activities such as deciding on whether to maintain protection in particular jurisdictions, grant licences, research alternative applications for the innovation or licensing others to do so, count as management activity (source: CIRD210210)
- Similarly, where the rights are being exploited by incorporating the item into products, activities such as deciding on which products will go to market, what features those products will have and how and where they will be sold will also count as management activity (source: CIRD210210)

Appendix A

Examples of group situations giving rise to Patent Box relief.

Group example 3

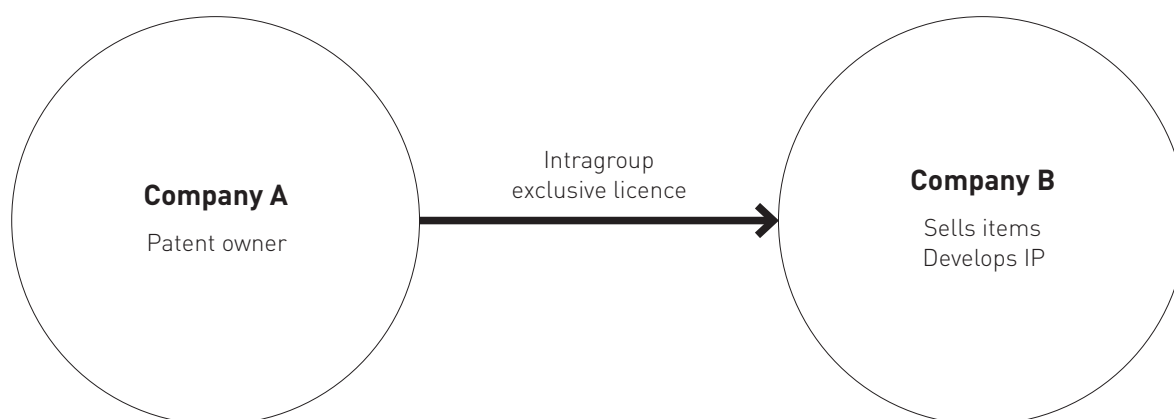


- Company B satisfies Condition A under “qualifying company” since it holds an exclusive licence (s357B(2)). It also satisfies Condition A under “The active ownership condition” by reason of its management of the IP (s.357BE). It satisfies Condition C under the development condition by reason of the fact that Company C is part of the same group (s.357BC). Thus it can claim Patent Box relief.
- Where the rights are being exploited by incorporating the item into products, activities such as deciding on which products will go to market, what features those products will have and how and where they will be sold will also count as management activity (source: CIRD210210)

Appendix A

Examples of group situations giving rise to Patent Box relief.

Group example 4



- Company B satisfies Condition B under “The active ownership condition” by reason of its development of the IP. Thus can claim Patent Box relief (s.357BE).
- That is, the company claiming Patent Box benefits is also the company carrying out development work (Condition A or B under s.357BC).

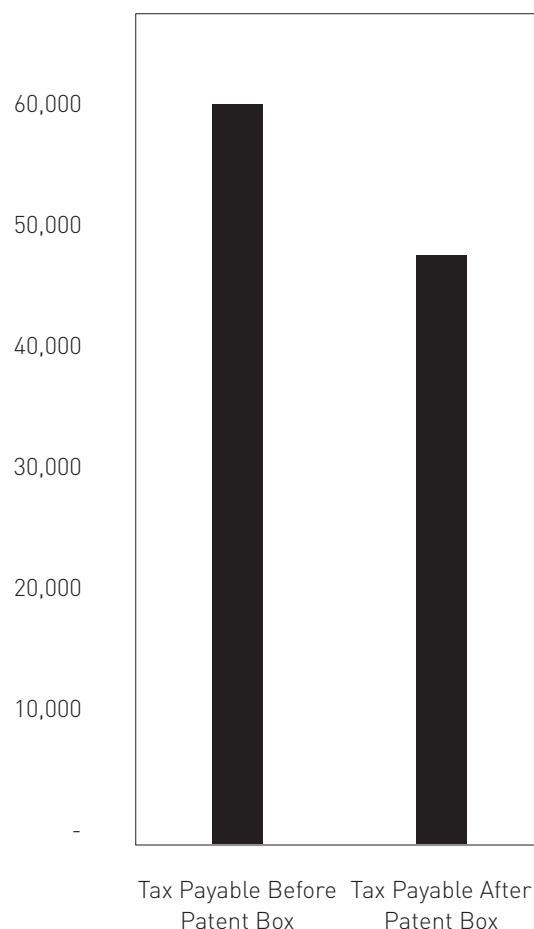
Appendix B

Example calculations of how the relief can be expected to work in practice and the impact of this upon a company's tax liability.

Scenario A —

Based on a company falling within the Lower Corporation Tax Band.

	Trading without Patent Box	% for Qualifying Profit on a Ratio of 90:10	Qualifying Patent Box Profit
Sales	1,400,000	90%	1,260,000
Deductions:			
R&D	150,000	90%	135,000
Marketing	50,000	90%	45,000
All Other Trading Costs	900,000	90%	810,000
	1,100,000		990,000
Profit before Tax	300,000		270,000
Adjust for Routine Return (at the rate of 10%)			85,500
Qualifying Residual Profit			184,500
Adjust for Marketing Asset Return (Std 25%)			75%
Final Patent Box Profit			138,375



Basic Corporation Tax Calculation			
Small Business Rate at 20%	60,000		
Tax on Patent Box Profit at 10%			13,838
Tax on Residual Profit at 20%			32,325
Comparable Corporation Tax Changes	60,000		46,163

The above calculation is for illustrative purposes only, it is recommended that you speak to your accountants in order to get a calculation which is tailored to your business. This calculation is correct at the time of publication as at the third stage of the legislative process.

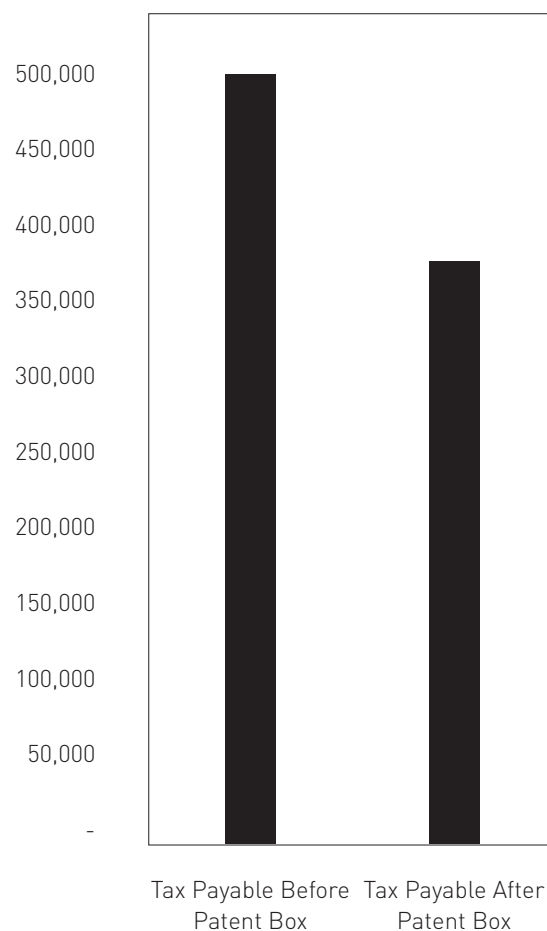
Appendix B

Example calculations of how the relief can be expected to work in practice and the impact of this upon a company's tax liability.

Scenario B —

Based on a company falling within the Higher Corporation Tax Band.

	Trading without Patent Box	% for Qualifying Profit on a Ratio of 80:20	Qualifying Patent Box Profit
Sales	10,000,000	80%	8,000,000
Deductions:			
Raw Materials	3,000,000	80%	2,400,000
R&D	1,500,000	80%	1,200,000
R&D Tax Credit Enhancement	-450,000		
Marketing	1,500,000	80%	1,200,000
All Other Trading Costs	2,550,000	80%	2,040,000
	8,100,000		6,840,000
Profit before Tax	1,900,000		1,160,000
Adjust for Routine Return (at the rate of 10%)			324,000
Qualifying Residual Profit			836,000
Adjust for Marketing Asset Return (e.g. 11%)			89%
Final Patent Box Profit			744,040



Basic Corporation Tax Calculation			
Large Business Rate at 26%	494,000		
Tax on Patent Box Profit at 10%			74,404
Tax on Residual Profit at 26%			300,550
Comparable Corporation Tax Changes	494,000		374,954

The above calculation is for illustrative purposes only, it is recommended that you speak to your accountants in order to get a calculation which is tailored to your business. This calculation is correct at the time of publication as at the third stage of the legislative process.

