

Patent Box or Patent Joke



The government's proposals to introduce a 10% tax regime for income attributable to the exploitation of patented inventions, whether by way of sale of the patented product or patent licence fees, does not go far enough.

There is a major problem with the current proposals, which are intended to be introduced into law by April 2013, which has been largely overlooked. The reliefs currently proposed are simply insufficiently generous to materially impact on the behaviour of corporates in relation to their patent strategy.

That this is the case is readily apparent from even a cursory review of the six worked examples set out at the back of in HM Treasury's Consultation on the Patent Box, published in June 2011, (and available at http://www.hm-treasury.gov.uk/consult_patent_box_stage2.htm).

WORKED EXAMPLES

In the first such worked example, Company A has sales of £1,000,000, taxable trading profits of £225,000 and profits subject to the Patent Box regime of £44k.

The net saving of applying the Patent Box regime to Company A's profits is therefore ten percent of £44,000 (i.e. £4,400), as the small companies rate of corporation tax (which would otherwise apply but for Patent Box relief) has been 20% from April 2011 and 10% is the Patent Box rate. In other words instead of paying £45,000 of tax (20% of its £225k of profits), Company A would pay £40,600 of tax: i.e. a saving of about 10% of the tax it would otherwise have paid, (£4,400). Put another way that is a saving of just under 2% of the total taxable trading profits.

Applying the same methodology to worked example C, which involves a process patent, is even more disappointing: company C pays just £1,200 less tax on profits of £225k as a result of using Patent Box: instead of paying £45,000 of tax it pays £43,800 – a saving of just 2.7% of its pre-Patent Box corporation tax bill.

COMPARISON WITH OTHER SCHEMES DESIGNED TO INCENTIVISE INVESTMENT IN INNOVATION

If one compares the proposed Patent Box reliefs to those available under two other schemes, designed to promote investment in innovation - the R&D tax credit scheme or the Enterprise Initiative Scheme, one gets some idea of just how low the proposed incentives to patent will be under the current proposals.

Under the R&D tax credits scheme, the tax relief on allowable R&D costs is currently 175 per cent for SMEs - that is, for each £100 of qualifying costs an SME makes, it can have its corporation tax bill reduced by an additional £75 on top of the £100, which it actually spent. That is a real incentive and it applies in year one. Under the Patent Box proposals an SME will not get any relief unless and until its patent has actually been granted by the UKIPO or EPO, which could be several years down the line.

Similarly under the Enterprise Initiative Scheme the investor gets 30% of his qualifying investment back as a credit he can set off against his income tax liability for the year in which the investment was made and his entire gain (if he is lucky enough eventually to make one) will eventually be tax free. If he loses his shirt he can offset the 70% left of his investment against his income for tax purposes – so that a top rate tax payer currently only has 35% of his money at risk.

Compared to these reliefs, which clearly work in practice to incentivise innovation, the current Patent Box proposals look woefully inadequate. They are hardly likely to change anyone's behaviour. The incentives for process patents (where apportionment further reduces the upside of Patent Box) are particularly dismal.

LONG TERM BENEFITS?

It could be said against that the net effect of the Patent Box proposals will, unlike R&D tax credits or EIS relief, build cumulatively, year on year, over the life of the patent but that ignores:-

1. The costs of patenting, which will typically be at least £2,000 up front and will be followed by the material professional fees of patent agents, incurred during prosecution, as well as the official fees of the relevant patent offices and translation fees. For even a selective patent portfolio in 6 or 7 countries these costs are likely to run into tens of thousands of pounds.
2. The delays in getting the patent granted – although patents filed in the UKIPO are generally either granted or rejected within a statutory period of four and a half years from the filing date of the first application disclosing the invention this is not the case in the EPO, where a significant proportion of patent applications are still pending more than five years after filing.
3. The uncertainties that surround the projected commercial life of products protected by the patent. As the pace of technological development becomes ever quicker there is no guarantee that what is new today will still have a market three or four years down the line.

CHANGES THAT NEED TO BE MADE

Our country's wealth was founded on innovation. Increasingly, as the World sees an explosion of new technologies in the coming years, the UK's wealth will be founded on licensing and the ability to properly protect innovation from competition at home and abroad. Unless the government does more to incentivise the patenting process then Patent Box will become the worst of all possible worlds – it will give the impression of providing a material incentive but in practice it will have no real effect at all.

If the government is genuinely serious about encouraging patenting then the reliefs available under Patent Box need to materially reduce a corporate patentee's overall tax bill. A good start would be:-

- (a) to make the effective Patent Box tax rate not ten percent but zero percent for both product and process patents;
- (b) to introduce a relief for products, made at least in part by the use of a patented process, which is based on using a multiple of the currently proposed Patent Box profit figure (obtained using the divisionalisation method for process patents – which seeks to apportion the value added by the patented part of the manufacturing process) instead of simply using that figure itself;
- (c) back relief should be available in respect of sales and licence fees made after the filing date of the patent, once the patent has been granted.

Introducing such changes would ensure that Patent Box becomes a material incentive for UK companies to file more patents.

ANDREW CLAY

PARTNER – INTELLECTUAL PROPERTY

Birmingham

T: +44 (0)121 222 3358

E: andrew.clay@ssd.com

5867/11/11

These brief articles and summaries should not be applied to any particular set of facts without seeking legal advice. © Squire, Sanders & Dempsey (UK) LLP 2011.

If you do not wish to receive further legal updates or information about our products and services, please write to: Richard Green, Squire, Sanders & Dempsey (UK) LLP, Freeport, LS2540, Leeds, LS3 1YY or email richard.green@ssd.com. The status "Partner" denotes either a member or an employee or consultant who has equivalent standing and qualifications.

Squire Sanders Hammonds is the trade name of Squire, Sanders & Dempsey (UK) LLP, a Limited Liability Partnership registered in England and Wales with number OC 335584 and regulated by the Solicitors Regulation Authority. Squire, Sanders & Dempsey (UK) LLP, is part of the international legal practice Squire, Sanders & Dempsey which operates worldwide through a number of separate legal entities. Please visit www.ssd.com for more information.