

In April 2013 the government introduced a low tax regime, known as Patent Box, applicable to a company's profits, derived from the commercial exploitation of inventions protected by certain types of patents.

Under the Patent Box scheme a company can, when calculating its profit for UK corporation tax purposes, claim an extra deduction against its income so as to reduce the amount of tax it pays on that profit. The scheme is still being phased in: in fiscal 2015, 80% of the full relief is available, but that percentage increases by 10% a year so that for the 2017 fiscal year, 100% of the relief will be available. The deduction will mean that, for fiscal 2017, a qualifying company will only pay 10% corporation tax on relevant income instead of the currently scheduled 19%.

For more details about how Patent Box works see our previous article: [Patent Box – How to Maximise the Benefits](#)

Closure of Current Patent Box Scheme

However, as a result of a November 2014 agreement reached by a European intergovernmental group looking at tax practices¹, the existing Patent Box scheme is going to be closed for new entrants with effect from 30 June 2016.

The reason for the change was that some countries (notably Germany) were concerned that

the current UK Patent Box scheme could be misused by businesses to unfairly reduce their overall tax payments. That opportunity for misuse arose as the UK's existing Patent Box regime does not require a claimant for the relief to carry out any R&D in the UK.

The intergovernmental group agreement did however provide that the existing UK Patent Box scheme will remain in operation, for those that have opted into it before 30 June 2016, until 30 June 2021.

The New Regime

The existing Patent Box regime will be replaced by a new scheme with effect from 1 July 2016. Details of the new scheme have yet to be published but in light of the intergovernmental group agreement referred to above any new scheme is likely to have the following features:

- There will be what is called a "modified nexus approach" – the amount of relief available will depend on the extent to which the R&D leading to the new patented invention or the product embodying it was carried out in the UK.

- Money not spent on R&D conducted in-house but rather on outsourced R&D or on acquiring technology, will be able to be taken into account when determining the amount of claimant R&D spend, subject to a cap of 30% of actual R&D spend.
- The claimant will have to have substantial economic activities in the UK.

It is also possible that some form of quantitative cap may be imposed on the level of the relief available so as to create a more level playing field across Europe. Other patent box type reliefs available in Europe bring the rate of applicable corporation tax down to closer to 15% rather than the 10% that will ultimately be available under Patent Box from 2017. In short, expect the replacement regime to be less favourable than the current regime.

Getting the Benefit of the Existing Regime Before It Is too Late – the Importance of Making a Patent Box Election

The absolutely crucial point is that a company must opt in to Patent Box before 30 June 2016 to have any prospect of thereafter enjoying, until 30 June 2021, any of the benefits under the existing regime. This is done by simply writing to the claimant's tax office, confirming the election to opt in under section 357G of the *Corporation Tax Act* 2010. The election must identify the claimant making the election and specify the first accounting period for which the election will apply. The accounting reference date for that first accounting period must not have ended more than 24 months prior to the filing of the opt in notice²: i.e. the opt in notice must typically be filed within a year of the filing of the relevant tax return.

Patents Applications

As the law currently stands, a company does not have to own or be exclusively licensed granted patents either at the time it makes the election or for the accounting period for which the election first has effect³. Clearly if the patent(s) has not yet been granted in an accounting period then a company can not make a Patent Box deduction for that period in its tax return. Nonetheless, electing in to Patent Box before 30 June 2016, before any patent(s) is granted provides the best (and only) chance of enabling a company to preserve its position to subsequently back claim patent box relief⁴ for the patent pending period (potentially as far back as the later of April 2013 or up to six years prior to the grant of a relevant patent) in its tax return for the accounting period during which the patent is finally granted.

² Section 357G(3) CTA 2010.

³ [Patent Box: supplementary: how to make a Patent Box election](#)

⁴ Under section 357 CQ of the CTA 2010.

¹ The OECD Forum on Harmful Tax Practices

It is of course possible that this position might be changed by any transitional provisions which are ultimately introduced. All we currently have to go on is the brief 11 November 2014 UK and Germany Joint Statement on the closure of Patent Box⁵ which stated as follows:

“to allow time for transition to new regimes... IP within existing regimes will be able to retain the benefits of these until June 2021.”

It is unclear precisely what “IP within existing regimes” actually means. It will certainly cover patents granted before 30 June 2016 belonging to or exclusively licensed to an entity which has made a valid Patent Box election prior to that date. It is arguably less certain whether or not patent applications, still pending on 30 June 2016, but owned by or exclusively licensed to an entity that has made a Patent Box election before that date will be considered to be “IP within existing regimes” for these purposes. This will become clearer once the transitional provisions are published, which is likely to be at sometime within the next six months. It is submitted that such pending applications should still be “IP within existing regimes”: disallowing Patent Box claims on patents subsequently granted after 30 June 2016 would go well beyond the mere closure of the existing scheme, which has so far been announced. An application for a patent is still IP.

Because of the current uncertainty, companies with pending patent applications should also check with their patent attorneys as to when they expect economically significant patent applications to be granted and should instruct their patent attorney to apply for accelerated grant of such patents, where that is a viable option which could lead to grant before 30 June 2014.

No Patents?

It is hard to see how patents acquired or exclusively licensed after 30 June 2016 could be regarded as “IP within existing regimes” on 30 June 2016 for which the current Patent Box regime will remain open. For those that don't have any pending or granted patents on that date, there are two options.

1. Firstly it may still be just about possible to file and prosecute to grant a UK patent application at the UKIPO. Although some UK patent attorneys are fond of telling stories of how they have managed to get a patent to grant in less than a year, the length of time available now before 30 June 2016 is so short that this route is unlikely to succeed in all but exceptional cases.
2. A more plausible solution would be for the company to buy in or take an exclusive licence from a third party of a relevant patent before 30 June 2016.

⁵ [Proposals for New Rules for Preferential IP Regimes \(PDF\)](#)

The company could then then attempt to satisfy the Qualifying Development Test⁶ in relation to a product or process based on and incorporating that invention. As the company does not have to be qualified for Patent Box relief either at the time it makes the election or for the accounting period for which the election first has effect⁷, there would appear to be no reason why the company could not subsequently satisfy the qualifying development test after 30 June 2016 but before it applies for Patent Box relief in its tax return. To pass that test the company has to perform a significant amount of activity to develop an invention or an item or process incorporating the invention. It can satisfy the test even if it did not itself contribute to the making of the invention, the subject of the granted patent. A detailed record of the development work should be kept.

Conclusion

The next iteration of Patent Box may not be as generous or as easy to obtain as the current version – particularly for businesses that have not conducted relevant R&D in the UK. UK businesses should use the time available before 30 June 2016 to ensure that they have done all that they can to maximise the benefits of the existing Patent Box system, which will be available until 30 June 2021.

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⁶ Section 357BD(1) CTA 2010.

⁷ Under section 357 CQ of the CTA 2010. See footnote 4 above.