Patent Box – The Basics

If you pay UK corporation tax and develop your own products but still haven't taken a look at the Patent Box, you really should. From April 2013, companies which satisfy specific criteria will be able to claim an additional deduction against their taxable profits, effectively taking the tax rate applied to a proportion of their profits down to 10%. There will be some companies for whom the new Patent Box will make no difference at all but, equally, there will be some for whom it will offer a relatively easy way of reducing their tax burden.

The concept of the Patent Box is relatively simple – for a tax regime. At a very basic level, if a company which is involved in R&D derives profit from the sale of a product which includes a feature which is protected by a UK or European patent, then it is entitled to an additional tax deduction against its UK taxable profit. The profit can be derived from sales made by the company itself or it can be in the form of a royalty received from a licensee. Moreover, the company in question does not need to be the one which carries out the R&D; the R&D can be carried out by another company in the same group. But the company does need to own or be the exclusive licensee of a UK or European patent which protects at least one feature of the product from which the profit is derived. If the company is an exclusive licensee rather than the owner of the rights, it must also exercise control over those rights. In a group situation where the relevant company does not carry out the R&D itself but this is done by another company in the same group, the relevant company must perform a significant amount of active management of the patents which protect the features included in the products.

The above explanation is, out of necessity, short and simplified. Nothing I say here can substitute for full and detailed advice from your tax adviser. But, unusually for something involving tax, there are actually quite a number of additional points which, for most companies, will add to the benefit of the Patent Box rather than clawing some of it back. For example, if you happen to be one of those companies which prefers to seek its protection from individual national offices around Europe (but not the UK), you too may be in luck because patents issued by quite a few of the national offices within Europe will also qualify you for a tax deduction. A further benefit is that companies with pending patent applications will be able to back-date claims once the patent is granted.

But the additional benefit which comes as a pleasant surprise to most companies is that profits derived from sales outside the jurisdiction covered by the relevant patent rights – and even outside Europe – still qualify for the tax deduction. So, as long as the product you sell in the US includes the same features which, if it were sold in the relevant country (e.g. UK), would be protected by the patent right which qualifies you for the deduction (e.g. your UK patent), then the profits you derive from your US sales will also qualify for the deduction.

The calculation which companies will have to carry out in order to work out how much of their profit qualifies for the tax reduction will be complicated for some and easier for others. Essentially, it goes like this:

- First, you work out how much of your profit is attributable to products which include features which are protected by at least one granted patent issued by one of the qualifying Patent Offices.

- Next, you take off a fixed percentage (10%) which is deemed to be attributable to normal or routine business activities.

- Lastly, you must take off an amount which is attributable to brand or marketing assets. This might be quite a complex exercise for some companies but easier for others.

- What you have left will qualify for the additional tax deduction.

There will be many companies who will have great difficulty identifying the correct reduction attributable to brand and marketing. HMRC is offering simplified calculations for smaller businesses or those who do not wish to make large claims. If you can come to some sort of conclusion on that amount, the rest should be reasonably straightforward.

It is worth saying that the Patent Box is being phased in over 5 years. In the first tax year, commencing in April 2013, only 60% of what would have been the full deduction will be available to any company. The percentage will increase by 10% each year until the full deduction becomes available in the tax year commencing April 2017.

As I said at the outset, if you pay UK corporation tax, have some sort of R&D going on, but haven't yet checked out whether the Patent Box applies to your company, you really need to do that. All I have tried to do here is to highlight the very top-level points which may, I hope, encourage you to think about whether you may qualify for the Patent Box tax deduction and seek appropriate advice.

Gill Smith, 6 November 2012