www.pwc.com

Patent Box

29 May 2012

pwc

Agenda

- Overview of patent box relief
- Will the company qualify? - Eligibility
- If so, what's the size of the prize? - Computation
  - 3 stage method
  - Alternative 'streaming' method
- How to optimise patent box benefits
  - Elections and other timing issues

Patent Box policy – The Government's plan for growth

The aim is to provide an additional incentive for companies in the UK to retain and commercialise existing patents and to develop new innovative products

The Patent Box is a key initiative to make the UK tax regime competitive for high-tech companies…

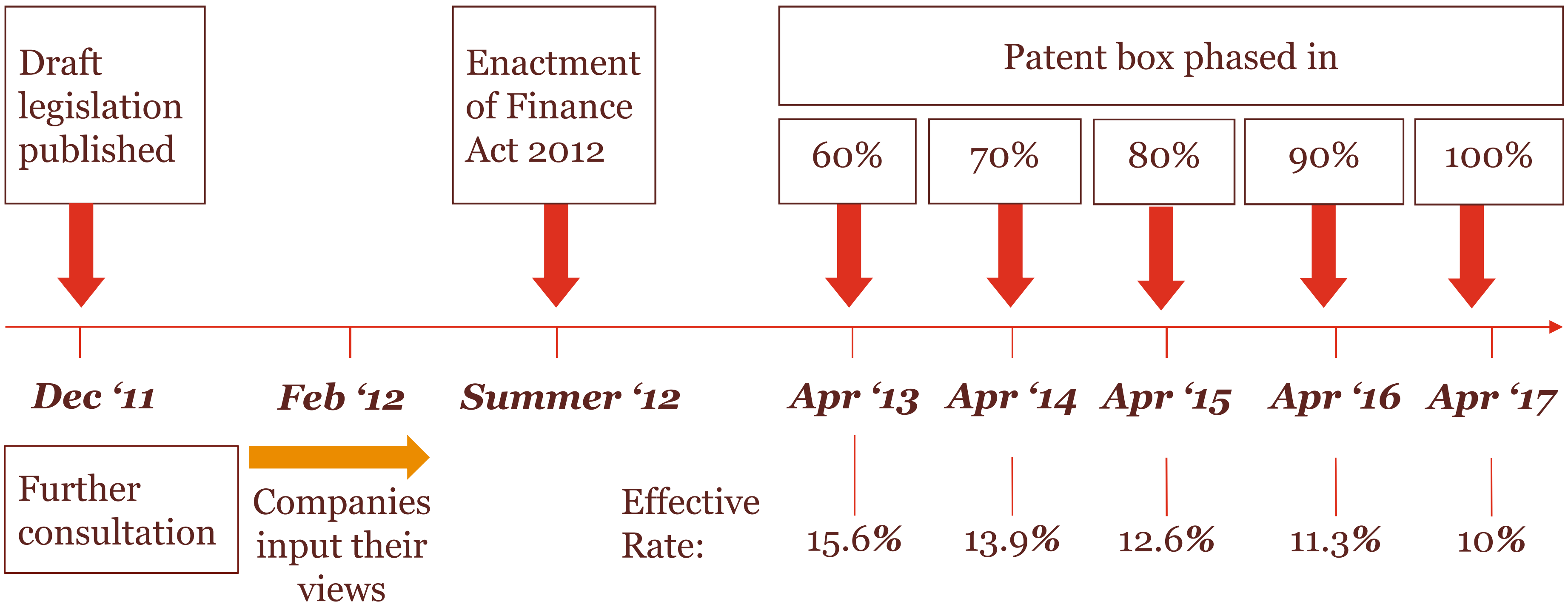
The Patent Box will help to re-establish the UK as a top location of choice for innovative industries. ..

Dual aims to cover a wide range of patent income and to minimise where possible uncertainty…

Overview of draft legislation

- 10% corporation tax rate (through additional deduction) on net profits attributed to patents
- Applies from 1 April 2013, benefit phased in over four years
- Worldwide profits on sales with underlying patents granted by UK IP office and European Patent Office
- Profits arising up to **6** years before grant of patent
- Formulaic approach to calculation of net profits rather than a method based on valuation of the underlying patented invention
- Flexibility to use the 'true' profit rather than the formula result through 'streaming'
- Potentially much wider application than anticipated

Overview of Patent Box implementation process



Eligibility – a qualifying company if:

- ***Ownership*** of ***Intellectual Property Rights ('IPR')*** *and*
- ***Development*** activity → Qualifying IPR ('QIPR')
- If a group company, ***Active Ownership*** required for substantially all QIPR
- ***Relevant IP Income ('RIPI')***
  - Income from sale of patented items and notional royalties from process patents and services
  - Patent royalties and income from licensing
  - Income from the sale of patents
  - Patent infringement income

Qualifying income

- Income from sale of a patented item
  - there only has to be **one current patent** for the entire product revenue to qualify
  - Spare parts qualify (see below)
- Patent royalties and income from licensing
- Income from the sale of patents
- Patent infringement income
- Notional royalties – ‘IP derived income’
  - process patents and services
  - e.g. flight simulator training facility services

Patent Box calculations

Stage 1

Simple pro rata or ***"streaming"*** approach

Determine profits on qualifying income

Stage 2

10% mark up excluding certain costs (such as raw materials & qualifying R&D)

Deduct routine return to identify residual profit

Stage 3

Deduct notional brand royalty or elect for small claims treatment

Determine residual profits allocable to patents

Patent box example

	Patent £m	Non-patent £m	Total £m
Stage 1: split profits			
Turnover (say 25% of total is relevant IP income)	100	300	400
Cost (pro rata or 'streaming')	(90)	(270)	360
Profit	10	30	40
Stage 2: 10% routine return on internal costs (Assume £30m of routine expenses)	(3)		
Stage 3: marketing assets royalty (c2% of patent income)	(2)		
Patent box profit	£5m		
Patent box deduction [£5m x $\frac{24 - 10}{24}$]			(3)
Taxable profit			37
Tax payable (CT rate 24% at 1 April 2013)			£8.9M
Tax saved [CT rate 24% x £3M] or 14% of £5M			**£0.7M**

Stage 1 - Streaming

- Streaming is optional to replace stage 1, but will be mandatory in certain circumstances
- **When is it a good idea?**
- Streaming makes sense where there are higher margins on patented products vs non-patented products
- **When shouldn't you consider it?**
- Streaming may not be the best answer where there are higher margins on non-patented rather than patented products
- **Mandatory streaming** - where total gross income includes qualifying IP income and also a **substantial** amount of licensing income that does not qualify

Patent box examples – why streaming matters

	Pro-rata basis £m	Streamed basis £m
Revenue	100	100
Profit	10.0	20.0
less: routine return	-3.0	-2.7
less notional royalty	-2.0	-2.0
Patent box profit	5.0	15.3
Tax saving	**£0.7M**	**£2.14M**

Note: It is assumed that one third of the £80m costs on the "streamed basis" are routine expenses to which the 10% reduction is applied.

Other practicalities

Making an election

- Must elect in within 12 months of the filing date (i.e. 2 year claim).
- Stay in until election is revoked (then cannot re-enter for 5 years).

Patent Applications

- 6 year look back.

Notional Royalties

- Patented manufacturing process

Patent box losses

- Must be offset against patent box profits in other group companies.
- Any remaining patent box loss must be carried forward and offset against patent box profits in future periods.

R&D floor

- R&D costs cannot be less than 75% of the average R&D expenditure in the 4 years prior to electing in.

Anti-avoidance

- Non-commercial licences.
- Including qualifying items in a larger product.

Issues and opportunities

1. Do you know which current patents you hold?
2. Are patent licences granted to UK group companies exclusive?
3. Are intra-group patent licences documented?
4. Can your systems track patents into products / services?
5. Do you want to agree the approach to applying the Patent Box with HMRC?
6. Is the UK to UK transfer pricing in and out of Patent Box companies robust?
7. Will you need to determine notional royalties as part of a Patent Box claim?
8. If you changed your patenting behaviour, would more turnover come within the scheme?
9. How big is the formula driven benefit likely to be?
10. Would the 'streaming' approach give a better result?

Contact details

Paul Harris
PwC

paul.m.harris@uk.pwc.com
Tel: 0121 265 6669
Mobile: 07702 678332

Paul Cox
PwC

paul.cox@uk.pwc.com
Tel: 0121 265 6697
Mobile: 07818 065705

RD-2012-02-03-14 21-SA