The UK Government has confirmed its continued commitment to the patent box regime and has announced changes to the regime from 1 July 2016 to bring it in line with recommendations made by the Organization for Economic Cooperation and Development (OECD).

The patent box regime is a key part of the UK Government’s growth agenda and provides an additional incentive to develop, commercialise and retain innovative technology in the UK. The incentive is available in addition to R&D tax credits and available grants.

What is the patent box benefit?

► Where the qualifying conditions are met, the patent box regime provides a 10% effective rate of tax on profits related to certain patents and other specified IP rights (phased in fully by 2017) which can lower a business’s UK and global effective tax rate.

► Relevant patents include those granted by the UK Intellectual Property Office (IPO), under the European Patent Convention and by specified EEA states.

► A company may still benefit from the patent box regime if it holds an exclusive licence in respect of such rights (or in certain other group scenarios).

► Patent box benefits can start to accrue as soon as a patent application is filed as pre-grant profits can be brought within the regime in the accounting period in which the patent is granted.

How might patents apply to a business?

► For a business’s invention to be patentable it must be new, involve an inventive step, solve a technical problem and be capable of being made or used in any kind of industry.

► Patents are not limited to tangible items; e.g. an invention that solves a technical problem external to a computer or solves a technical issue within a computer may be patentable.

► Both product patents, including product by process patents, and process patents (in addition to exclusive licenses in respect of these) may qualify a company for the patent box regime.

What has changed in the patent box regime?

► Following draft legislation published in December 2015, further legislation has been published seeking to amend the existing rules to align them with the output of Action 5 of the OECD BEPS Project.

► The key change is the introduction of a ‘nexus’ (or R&D) fraction which takes into account the location and nature of a company’s underlying R&D activity in determining the available patent box benefit.

► In particular, the nexus fraction operates to restrict the patent box benefit where R&D is sub-contracted to other group companies and where the company has ‘acquired in’ the qualifying IP rights. The fraction applies even when the R&D is sub-contracted within a UK group.

UK Patent Box
Where a company elects into the regime for an accounting period ending prior to 1 July 2016 (which will be a deemed accounting period when the actual accounting period spans this date), profits in respect of its qualifying IP rights, or patents pending at 30 June 2016, may be ‘grandfathered’ within the existing pre-nexus regime for accounting periods ending after that date where the company meets the other qualifying requirements within the existing pre-nexus regime. The grandfathering period lasts until 1 July 2021.

For patents acquired or granted in respect of applications submitted from 1 July 2016 onwards (‘new IP rights’), or where a company did not elect into the regime as set out above (‘new entrants’), the nexus fraction will apply to associated patent box profits from 1 July 2016.

New rules have also been introduced for companies with multi-IP assets including both new and ‘grandfathered’ qualifying IP rights to dictate how the nexus fraction should be applied.

What should companies be considering?

Companies seeking to ‘grandfather’ their qualifying IP rights must take action to ensure they either hold those rights or have applied for patents prior to 1 July 2016. Additional rules may apply where the rights need to be acquired from another party. The company must also have elected into the regime for the deemed period ending 30 June 2016, with notice to be given within two years of the end of the company’s actual accounting period that straddles 30 June 2016, e.g. for a company with a 31 December 2016 year end, the election must be made by 31 December 2018 at the latest.

For new IP rights or new entrants, the nexus fraction must be calculated and applied from 1 July 2016. Where sufficient information is held this will require the calculation to utilise relevant data from 1 July 2013. Consequently, from 1 July 2016, systems will need to capture the relevant data (‘tracking and tracing’).

For qualifying IP rights that have been ‘grandfathered’, companies will not be required to apply the nexus fraction until 1 July 2021. However they will still be required to track and trace income, costs and relevant R&D expenditure attributable to individual IP rights or products from 1 July 2016 in order to apply the nexus fraction from 1 July 2021, because the fraction is based on cumulative data.

To obtain the optimal outcome, groups may need to consider restructuring.

How can EY help?

Our Innovation Incentives Team of patent attorneys, engineers, IT, tax and transfer pricing specialists have a detailed understanding of the key patent box criteria and opportunities, along with strong working links with HM Treasury and HMRC.

Our services include:

- **Innovation clinics** – where we jointly explore your existing IP and current/planned innovation projects to assess the potential benefit of a patent box election and outline a future patenting strategy.
- **Feasibility studies** – where we undertake activities to identify qualifying IP rights, estimate the patent box benefit and assess patent box election readiness.
- **Developing and designing internal processes and systems** to capture the required data, build patent box calculations and manage risk. This is particularly relevant to the new tracking and tracing requirements.
- **Developing a tailored methodology**, which can include:
  - Validation and analysis of qualifying IP rights across your operations;
  - Product to patent mapping and quantification of income, costs and R&D expenditure;
  - Developing streamlined approaches to building your patent box calculations to ensure the effort is commensurate with the benefits you may be entitled to; and
  - Detailed calculations of patent box profits and supporting tax analysis to support tax filings.
- Where appropriate and required, using our strong working links with HMRC to gain comfort in respect of the key aspects of the methodology and calculation, often in real-time.