



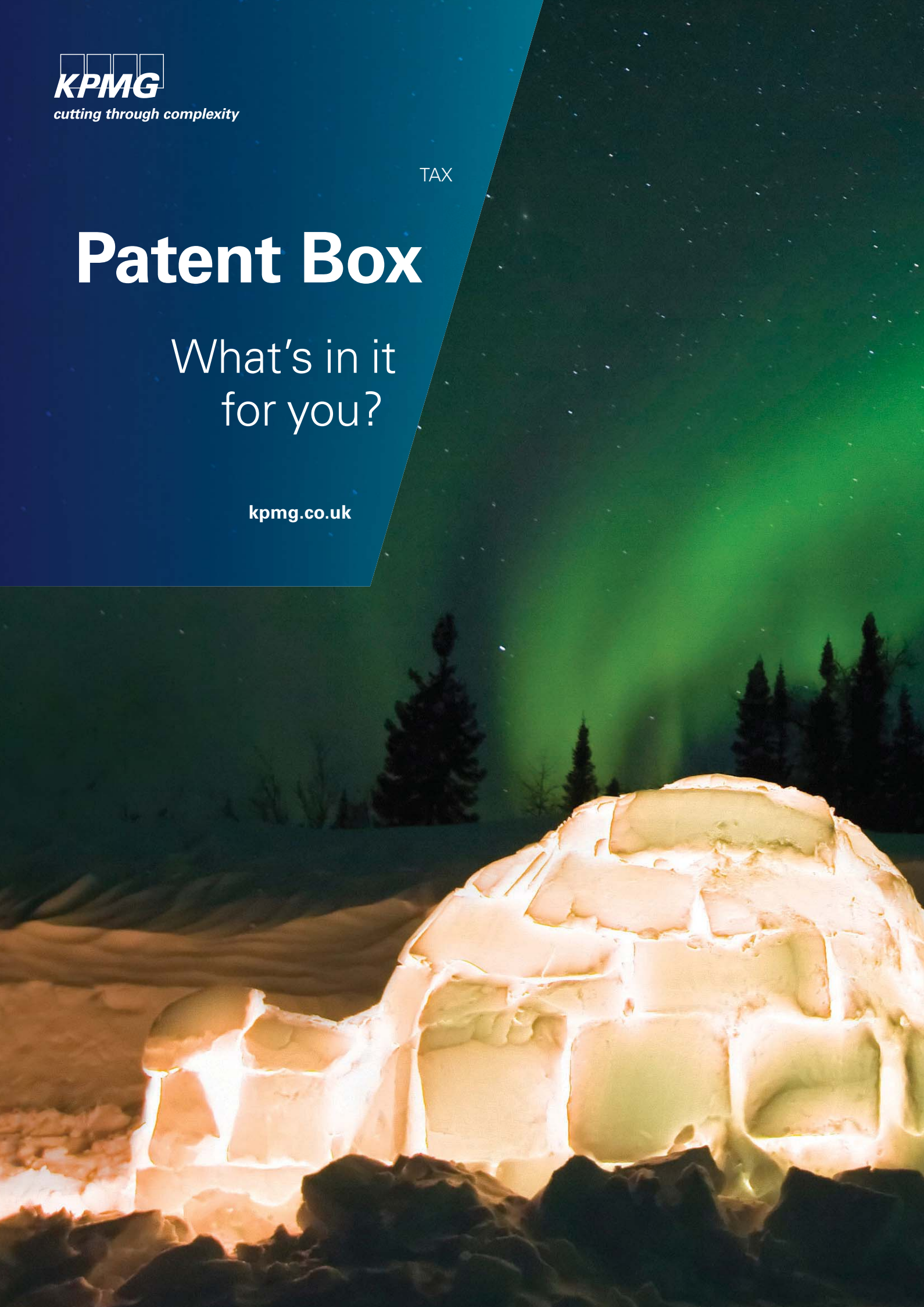
cutting through complexity

TAX

Patent Box

What's in it
for you?

kpmg.co.uk



“The Patent Box gives companies that hold patent interests and use them in their business the opportunity to significantly reduce their UK tax burden”





What you need to know in five key points

- 01** ➤ Profits from qualifying patent interests will be taxed at 10% delivering cash tax and effective tax rate benefits. Patent Box will also enable more economical use of tax losses.
- 02** ➤ Qualifying profits will be calculated by reference to qualifying product sales and licence fee income.
- 03** ➤ Any UK company which holds interests in qualifying patents (or certain other rights) can elect into the regime.
- 04** ➤ R&D tax credits will still be available if a company elects into the regime. Maximising R&D tax credit relief will increase the benefits of the Patent Box regime.
- 05** ➤ KPMG can help groups assess the potential benefits of electing into the regime and can advise on the opportunities available in order to maximise the relief.

Understanding the opportunity

What is the benefit?

- The new Patent Box regime presents the opportunity to tax qualifying profits at 10% in the UK, rather than the standard tax rate (26% from April 2011 reducing to 23% in April 2014). This will help Groups to reduce their effective tax rate and cash tax payable. The mechanics of the rules also enable companies to make more economic use of losses and other reliefs.
- Action should be taken by companies now to understand how to benefit from the regime and what business change might be advantageous prior to the rules coming into effect. For example, many groups currently hold valuable patents used in business processes which do not attract revenue streams. There are a number of ways to deal with this to secure patent box benefits.
- The regime is an elective regime to be applied on a company by company basis.

When do the rules apply?

- It is proposed that the regime will come into effect from 1 April 2013. The regime will be legislated in Finance Bill 2012. There will be transitional rules phasing in the benefits over the first five years of the regime i.e. 60% of the Patent Box benefit will be available in 2013/14 increasing to 100% by 2017/18.

Which patents will qualify?

- The draft legislation restricts qualifying patents to those granted by the UK Intellectual Property Office and the European Patent Office. Supplementary protection certificates, regulatory data protection and plant variety rights will also qualify.
- Government has also committed to extending the regime to include patents granted by certain other EU patent offices.
- The regime will not be limited to the legal owners but will extend to exclusive licence holders (for example, an exclusive right to exploit patents in a single territory or field of application) and to companies entitled to exploit patents through cost-sharing arrangements or acting together in partnerships.

What types of income will qualify?

The following types of patent income will fall within the scope of the regime:

- Income from sale of qualifying products (i.e. products incorporating a patented invention).
- Licence fees/royalties for granting rights over qualifying patents.
- Proceeds of realisation of a qualifying patent or exclusive licence.
- Income from infringements.
- Notional royalty income (to cover valuable patents used in processes that underpin non-patented products/services).

How will the qualifying profits be calculated?

The basic method used to calculate Patent Box profits (known as relevant IP profits - "RIPP") will involve a three stage formulaic approach:

Stage 1

Identify relevant IP income and associated trade profits.

Stage 2

Deduct routine profits from stage 1 associated trade profits to arrive at residual IP profit.

Stage 3

Deduct notional marketing royalty from residual IP profit to arrive at Patent Box profit i.e. RIPP.

Why are the Government introducing these rules?

- The objective of the regime is to encourage innovative businesses to invest in the UK and to locate high value jobs and activity associated with the development, manufacture and exploitation of patents in the UK.
- The regime is expected to enhance the competitiveness of the UK tax system, recognising that IP income streams are mobile and that multinational groups have a choice as to where to locate IP ownership and associated activity.

Key P&L considerations

Optimising Patent Box benefits will require focus on a number of P&L components.

ABC Company Profit & Loss Account for year ended 31 December 2014	
Revenues	50,000,000
Cost of sales	(20,000,000)
	<u>30,000,000</u>
<i>Sales, administration & distribution expenses</i>	
Outsourced costs	(4,000,000)
Licence fees	(1,000,000)
R&D	(7,000,000)
Marketing & advertising	(1,800,000)
Other costs	(8,200,000)
	<u>8,000,000</u>
<i>Trading profit</i>	8,000,000
Profit on sale of non-current assets	1,000,000
Amortisation of intangibles	(750,000)
	<u>8,250,000</u>
Operating profit	8,250,000
Finance costs	(1,400,000)
Finance income	450,000
	<u>7,300,000</u>
Profit before tax	7,300,000

Maximise Patent Box revenue

- Which revenues (product sales, licence fees, patent supported process/service income) qualify?
- How do I track these income streams?

How can KPMG help?

- Develop income tracing methodology.
- Develop best use of streaming - preparation of defensible expense allocation.
- Optimise structuring of licence agreement arrangements.
- Identify hidden value (attaching to unrewarded valuable patents).

Optimise sub-contracting arrangements

- Subcontracted costs do not require a mark-up under stage 2.

How can KPMG help?

- Determine which activities can be best contracted intra-group or otherwise.

Optimise R&D costs

- R&D costs qualifying for R&D tax credits will be excluded from the stage 2 routine profits calculation.

How can KPMG help?

- Maximise R&D tax credit claims to ensure all costs are captured.

Minimise residual IP profits allocated to brand value

- To what extent does brand value support/generate revenues?

How can KPMG help?

- Perform marketing intangibles valuation to determine notional marketing royalty amount.

Looking forward...

How can KPMG help?

There are a number of ways that KPMG can help group assess the potential benefits of the Patent Box Regime. These include:

- 01** Model the potential benefit for your business.
- 02** Track and trace qualifying income through reporting systems.
- 03** Design optimum structures, including use of streaming and structuring of licence and maintenance agreements.
- 04** Perform patent box claim computation and preparation of disclosures.
- 05** Securing clearances from HMRC on claim methodology.

What's next?

The regime will be legislated in Finance Bill 2012. The regime will start from 1 April 2013 therefore now is the time for you to assess what the Patent Box means for your business and whether existing structures maximise the benefits from the regime.

Contact us

We have an experienced multi-disciplinary team including members of our corporate tax, transfer pricing, R&D and Intellectual Property team. Members of our team have also worked closely with HMT and HMRC as the proposals have been developed.

While on secondment to HMT, Jonathan Bridges also acted as the lead policy advisor on Tax and Innovation including Patent Box.



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