End of patent box grandfathering

What you need to know

From 1 July 2021, all companies will be required to make patent box claims under the new Nexus regime, including companies that were grandfathered under the old patent box regime. The Nexus regime introduces a number of key changes that could have a significant impact on the patent box benefits, potentially preventing some companies from claiming. Companies moving from the old grandfathered regime to Nexus will need to assess the impact of these changes on their claim.

Key contacts

Our team of experts are best placed to help you maximise the benefits under the Nexus regime.

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What are the key changes?

Mandatory streaming

Under the Nexus regime, relevant IP profits must be calculated using the streaming method (generally optional under the old regime). The streaming method requires debits taken into account in calculating relevant IP profits to be allocated to relevant IP income streams on a 'just and reasonable' basis.

Nexus fraction

Under the Nexus regime, the proportion of relevant IP profits that can benefit from the lower 10% rate of corporation tax is limited to the following fraction (the 'nexus fraction', which cannot be greater than 1):

$$\frac{(\text{Own R\&D expenditure} + \text{Third party subcontract}) \times 1.3}{\text{Own R\&D expenditure} + \text{Third party subcontract} + \text{Intragroup subcontract} + \text{Acquisition cost}}$$

1 'Own R&D expenditure' is the company's qualifying expenditure on relevant R&D undertaken in house which means the expenditure incurred by the company on staffing costs, software or consumable items, externally provided workers or relevant payments to the subjects of clinical trials, and is attributable to relevant R&D undertaken by the company itself.

2 'Third party subcontracted R&D' is the company's qualifying expenditure on relevant R&D subcontracted to unconnected persons. It is the amount incurred by the company on the R&D contracted out by the company to an unconnected person.

3 'Connected party subcontracted R&D' is the company's qualifying expenditure on R&D subcontracted to connected parties. It is the amount incurred by the company for R&D purposes in respect of connected subcontractor payments.

4 'Acquisition cost' is the company's qualifying expenditure on the acquisition of relevant qualifying IP rights. It is the cost of an assignment, grant or transfer of an exclusive licence, or disclosure of a relevant IP right. This includes both single assignments and the making of a series of payments.

For accounting periods ending after 30 June 2021, the Nexus fraction is a cumulative fraction that includes data from 1 July 2016 to the end of the relevant accounting period. Companies may however elect to include data from as far back as 20 years.

Potential impact of Nexus changes

Significant connected party subcontracted R&D and acquisition costs

Cumulative connected party subcontracted R&D and acquisition costs will result in the Nexus fraction being less than 1 where it exceeds 30% of total cumulative own R&D and third party subcontracted R&D. Businesses can streamline their processes by collating this data as part of the R&D claim work.

Mandatory streaming

Unless companies have used the streaming method under the old regime, there could be significant differences in relevant IP profits as a result of moving from a pro-rata basis to a 'just and reasonable' basis of allocating debits to relevant IP income streams.

Tracking and tracing

Companies with multiple income streams may need to track and trace data for the purposes of calculating a Nexus fraction. Depending on the company's specific facts and circumstances, that could range from not needing to track and trace to potentially having to track and trace for multiple relevant IP income streams.

What do you need to be doing now?

- Consider the need to track and trace. Where tracking and tracing is required, determine the most reasonably practicable basis to track and trace and establish processes for collecting data for the purposes of calculating a Nexus fraction(s) for relevant IP income streams. Efficiencies should be gained by combining the tracking and tracing procedure with processes to identify qualifying research and development expenditure for research and development expenditure credit purposes.
- Consider the current and potential future impact of any connected party subcontracted R&D and acquisition costs on the Nexus fraction, and the need for possible restructuring.
- Consider the impact of mandatory streaming, including what could be a 'just and reasonable' basis for allocating debits to relevant IP income streams and the impact that has on relevant IP profits.

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