

The UK Patent Box regime

The patent box regime allows qualifying companies to elect to apply a 10 per cent rate of corporation tax on its relevant IP profits, subject to any restriction imposed by the company's nexus fraction.

What is a qualifying company?

A company is a qualifying company if it holds any qualifying IP rights, or holds an exclusive licence in respect of any qualifying IP rights and meets the active ownership condition. A right is a qualifying IP right if it is a right to which the regime applies and the company meets the development condition in relation to the right.

It should be noted that there are special rules in relation to cost share arrangements that can apply to deem a party to the cost share arrangement as holding qualifying IP rights.

Meaning of 'qualifying IP rights':

The rights to which the regime applies include:

- a patent granted under the UK Patent Act 1977;
- a patent granted under the European Patent Convention; and
- a right of a specified description, which corresponds to a right above and is granted under the law of a specified EEA state.

Other rights to which the regime applies include rights under certain supplementary certificates and certain plant breeders' rights. Where a product benefits from specific marketing protection or data protection the person who holds the relevant marketing authorisation in respect of the product is treated as having been granted a right to which the regime applies in respect of the product. **An IP right becomes a qualifying IP right if the development condition is met.**

Meaning of 'exclusive licence':

A company is regarded as holding an exclusive licence in respect of qualifying IP rights where the licence is granted by a person that holds the rights (the 'principal rights'), and the licence confers on the company holding the licence:

- one or more rights in respect of the principal rights to the exclusion of all other persons in one or more countries or territories; and
- the right to bring proceedings without the consent of any other person in respect of any infringement of the rights or to receive the whole or the greater part of any damages awarded in respect of any such infringement.

It should be noted that there are special rules that can apply to deem a company (within a group) that has been conferred all the rights held by another member of the same group, as holding an exclusive licence.

Development condition:

The development condition will generally be met where the company (or another group member) at any time has carried out qualifying development in relation to the right. A company is regarded as carrying out 'qualifying development' in relation to a right if it creates, or significantly contributes to the creation of, the invention, or it performs a significant amount of activity for the purposes of developing the invention or any item or process incorporating the invention (including developing ways in which the invention may be used or applied).

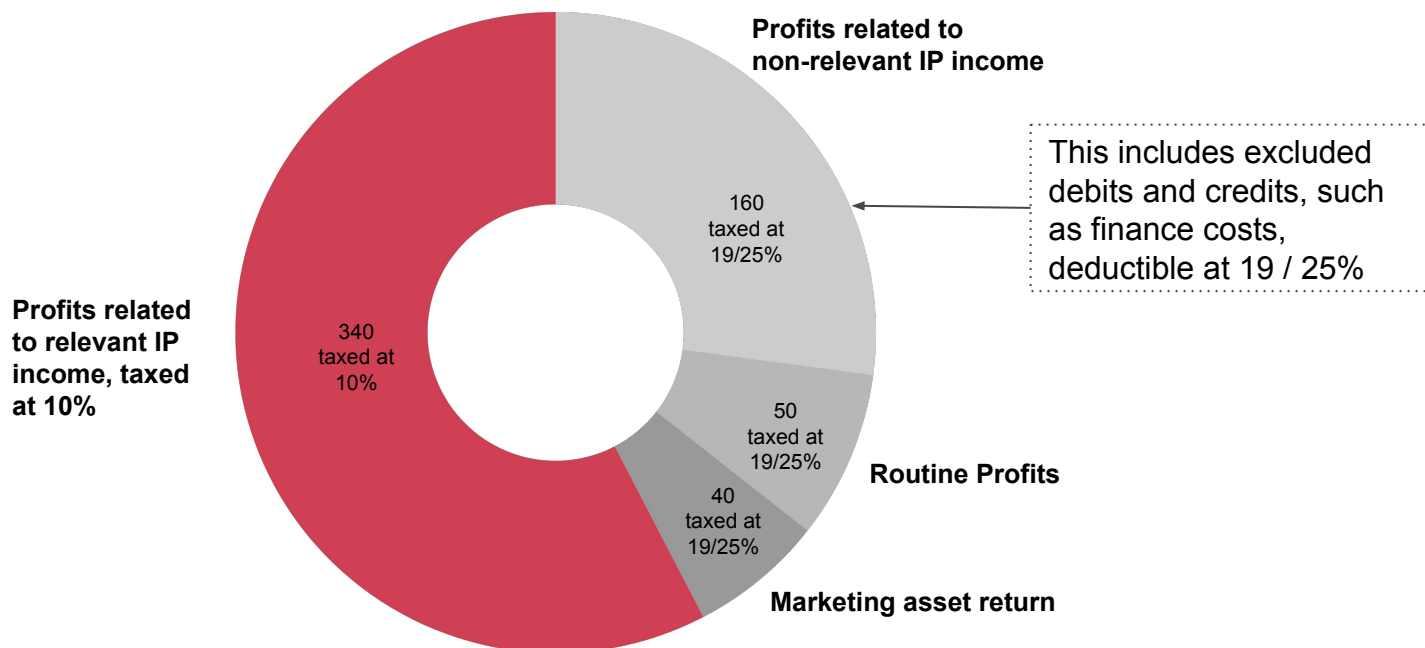
Active management condition:

The active management condition will generally be met where all or almost all of the qualifying IP rights held by the company are rights in respect of which the company performs a significant amount of management activities or in respect of which the company itself has carried out qualifying development. Management activities in relation to any qualifying IP rights means formulating plans and making decisions in relation to the development or exploitation of the rights.

Calculation of benefits

Total income (excluding finance income) should first be split into qualifying relevant IP income ('RIPI') and non-qualifying income before applying these steps:

	Relevant IP income (RIPI) streams	Standard income stream	
Total taxable credits	1000	450	The RIPI may be split into RIPI sub-streams, each either related to an individual relevant IP right, a product including a relevant IP right or a process including a relevant IP right
Total allowable debits	(600)	(260)	Costs are allocated to the streams on a just and reasonable basis to calculate a taxable trading profit per stream
Remove excluded credits and debits	30	10	This includes credits and debits in respect of loan relationships or derivatives contracts, as well as R&D claims
Net relevant income	430	200	
Deduct routine costs	(50)		Remove 'routine return' from each sub-stream, which is computed as 10% of 'routine deductions' in the stream
Deduct Marketing Asset Return	(40)		Remove profits arising on relevant marketing assets
Relevant IP profits	340		
Apply Nexus fraction	100%		Nexus R&D fractions are calculated and applied to each RIPI sub-stream
Patent Box profit	340		
Patent Box deduction (Main CT rate of 19%)	(161)		The deduction is calculated to ensure that the tax rate applied to patent box profits is 10%, the size of the deduction depends on the main CT rate
Tax saving	31		



Relevant IP income:

Relevant IP income means income falling within any of the following heads:

- Head 1: Income arising from the sale of the following items:
 - Items in respect of which a qualifying IP right has been granted ('qualifying item')
 - Items incorporating one or more qualifying items
 - Items that are wholly or mainly designed to be incorporated into the items above
- Head 2: Income consisting of any licence fee or royalty under an agreement granting another person any of the following rights only:
 - a right in respect of any qualifying IP right
 - any other right in respect of the qualifying item or process
 - a right granted for the same purposes as those for which the above rights were granted
- Head 3: Income arising from the sale or other disposal of a qualifying IP right or an exclusive licence in respect of such a right
- Head 4: Any amount received in respect of an infringement, or alleged infringement, of a qualifying IP right
- Head 5: Any amount of damages, proceeds of insurance or other compensation, other than an amount in respect of an infringement or alleged infringement of a qualifying IP right, which is received by the company in respect of an event and is paid in respect of items that fell within Head 1 or represents a loss of income which would, if received, have been relevant IP income.

Routine return figure:

A 'routine return' amount is deducted from each relevant IP stream, which is 10% of certain 'routine deductions' included in calculating the profits of the stream. 'Routine deductions' include capital

allowances, cost of premises, personnel costs, plant and machinery costs, professional services and miscellaneous services.

Importantly, cost of sales, other payments for raw materials, R&D related expenses and finance costs are not routine.

Marketing asset return figure:

Each relevant IP stream is further reduced by a marketing asset return figure, which is equal to the notional marketing royalty less the actual marketing royalty. Where the actual marketing royalty is greater than the notional marketing royalty, or the difference between them is less than 10% of the profit in the IP substream after step 4, then the marketing asset return figure is nil. This step effectively removes income from the patent box claim which is deemed to relate to relevant marketing assets, rather than IP.

The notional marketing royalty is the appropriate percentage of income within the IP stream, which the company would pay a third party on an arm's length basis for the right to exploit the relevant marketing assets in the period, if the company could not otherwise exploit them.

The actual marketing royalty is the aggregate of amounts paid by the company in acquiring any relevant marketing assets, or rights to exploit such assets, which fall into the IP stream.

Relevant marketing assets can include anything in respect of which proceedings for passing off could be brought (such as UK or equivalent overseas trade marks), signs or indications used in trade to show geographic origin of a good or service, or information on customers or potential customers intended for marketing purposes.

Companies with patent box profits below a certain threshold (qualifying residual profit less than £1m or less than £3m divided by one plus the number of its associated companies elected into the patent box) can elect for a simplified 'small claims treatment' when calculating the notional marketing royalty.

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):

$$\frac{(A + B) \times 1.3}{A + B + C + D}$$

- A 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.
- B is the company's qualifying expenditure on relevant R&D subcontracted to unconnected persons. It is the amount incurred by the company on relevant R&D contracted out by the company to an unconnected person.
- C is the company's qualifying expenditure on relevant R&D subcontracted to connected persons. It is the amount incurred by the company on relevant R&D contracted out by the company to a person connected to the company.

- D is the company's qualifying expenditure on the acquisition of relevant qualifying IP rights. It is the payment in respect of the assignment of a relevant IP right, the grant or transfer of an exclusive licence or payment in respect of disclosure of confidential information that allows a patent application to be made. 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. For earlier accounting periods, the Nexus fraction generally includes data from 1 July 2013. A Company can elect to go back up to 20 years for the purposes of calculating the Nexus fraction.

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, this could range from not needing to track and trace to potentially having to track and trace for multiple relevant IP income streams. Tracking and tracing must be done at the most granular level that is reasonably practicable to perform the calculation steps.

Key contacts



Rachel Moore

Partner

M: +44(0)7841 561935

E: rachel.moore@pwc.com



Vinod Keshav

Director

M: +44 (0)7921 632302

E: vinod.j.keshav@pwc.com



Adrian Gregory

Director

M: +44 (0)7740 923462

E: adrian.gregory@pwc.com

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