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Patent Box tax relief guide

Patent Box profits taxed at 10%: why you should act now.

What is the Patent Box?

The Patent Box is a preferential tax regime for UK companies that was introduced from 1 April 2013 and allows relevant profits attributable to patents and certain forms of Intellectual Property (IP) to be taxed at 10%.

The main rate of corporation tax in the UK will be increased from the current 19% to 25% from 1 April 2023 meaning it is an opportune time to consider if your company could qualify for the Patent Box. You can qualify if you sell or enjoy income arising from existing or new patents granted by the UK patent office, the European Patent Office, or by patent offices in certain other EEA states, however, USA patents will not count.

The government's aim for the Patent Box is to provide an additional incentive for companies to retain and commercialise existing patents and to develop new innovative patented items. This should encourage companies to locate high-value jobs associated with the design, development, manufacture and exploitation of patents in the UK. Virtually all of the companies that benefit from the Patent Box, will also be able to make a claim for Research and Development (R&D) tax credits, as the two go hand-in-hand to generate significant corporation tax savings for innovating here.

Income from worldwide sales qualifies for Patent Box and qualifying profits by the legal owner or the exclusive licensee of the patent are taxed at 10% from the date of grant. The company also has to make a significant contribution to the creation or development of the patented item. As an application for a patent can take a long time to process, the tax relief also extends to profits earned from exploiting the patent up to six years prior to the actual date of grant of the patent. This means that you would need to act now to get a patent granted and benefit from the 10% tax rate in the 2023-2024 financial year when the profits would otherwise be subject to 25% corporation tax.

Protection by a registered patent will normally last for 20 years, and so the initial Patent Attorney costs of obtaining the patent give a long-term commercial benefit as well as the opportunity to earn significant sums at the lower 10% rate of tax. Although you might have decided not to register your new technologies in the past, the 15% lower corporation tax rates may make the cashflow benefits even more attractive. If you have historically just bought and sold other people's products, then now may also be a good time to consider developing your own product range in-house.

The Patent Box regime also applies to certain other qualifying IP rights, such as marketing authorisation rights in respect of a product that benefits from 'marketing protection' or 'data protection'; the rights relating to human and veterinary medicines and both plant breeding and plant variety rights.

Qualifying Patent Box income comprises:

- income from the sale of items protected by a qualifying IP right that has been granted to the company. For a patent, the item will be the invention claimed in the patent (qualifying items
- income from the sale of products incorporating one or more qualifying items that are physically part of the larger item and are intended to be so for its operating life
- income from the sale of items that are wholly or mainly designed to be incorporated into qualifying items, such as bespoke spare parts
- licence fees and royalties from qualifying IP rights
- proceeds from the sale of qualifying IP rights or of an exclusive licence
- damages for infringement of the company's qualifying IP rights
- other compensation, such as income received by way of insurance from qualifying IP rights.

Helping you prosper

Measuring the Patent Box profits

The calculation for measuring the Patent Box profits has always been the most complicated part of the process since its inception in 2013. Added to this, in 2015 the OECD named the Patent Box as a ‘harmful tax practice’ as it did not directly link the availability of the 10% reduced tax rate to R&D carried on by the claimant in relation to the patented invention.

Following HMRC consultation, two further changes were subsequently made to the Patent Box Regime from 1 April 2016 onwards which must now be followed:

1. Profit streaming method – only the profit streaming method of calculating the relevant IP profit may now be used. Previously, a simplified calculation based on pro-rata ‘profit apportionment’ could be used which was popular as it was a simpler way of arriving at a relevant IP profit (RIPP) figure. However, if the patented products have a higher margin than the lower margin standard product income stream, this change can actually, in some circumstances, produce a higher Patent Box tax saving.
2. R&D fraction – a nexus approach has been added to the streaming calculation above. This is in order to reduce the profit eligible for Patent Box by the percentage of total costs incurred in subcontracting the R&D to third parties, and also for any relevant IP acquisition costs. There will be no reduction if all of the R&D is undertaken in-house and all of the IP is created by the company itself.

Example of streaming calculation and Patent Box tax saving

To show the corporation tax benefit of making a Patent Box claim, there follows a simple example:
A company has turnover of £10m, 40% of which is a result of the sale of products incorporating a qualifying patented item and 60% of which is from the sale of other products. Column A shows the company's total income and tax-deductible expenses while Column B identifies the relevant IP income ('RIPI') stream and apportions the tax-deductible expenses on a just and reasonable basis. The company sells to the public and so has no marketing assets.

The example illustrates that currently a company with less than half of its income qualifying for RIPI (40%) can still make a corporation tax saving from electing into the Patent Box regime of almost £120,000.

	Column A	Column B
	£000 total	£000 RIPI
Sales	10,000	4,000
Less trading expenses:		
• raw materials (in cost of sales)	(6,000)	(1,000)
• interest payable on loans	(500)	(500)
• marketing costs (all marked up)	(800)	(800)
• R&D costs	(1,000)	(800)
• R&D additional deduction	(300)	(240)
Taxable profit without Patent Box	1,400	
Patent Box profit before adjustment		600
Less routine profit:		
• marketing return at 10% of 800		(80)
Add:		
• interest payable on loans		500
• R&D additional deduction		240
Relevant IP profits ('RIPP')		1,320
Patent Box deduction 1320 x (19%-10%) / 19	(625)	
Taxable profit by Patent Box	775	
Corporation tax payable	147	
Corporation tax saving from Patent Box claim	119	

Electing in and out of the Patent Box regime

Finally, as indicated above you have to make an election to claim Patent Box relief and whilst it can be revoked, you cannot elect back in for five years. Care also needs to be taken not to elect into the Patent Box regime when you are incurring relevant IP losses as these will accrue and reduce the amount that can be claimed as RIPP in the future.

The next step

For more information about the commercial benefits of protecting your company's IP, or to discuss the potential for making a Patent Box claim, please contact Kevin Edwards or your usual UHY adviser.

Read more about us on our website at uhy-uk.com.

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