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UK-Germany Joint Statement provides increased Certainty for Patent Box Regimes

Various countries have regimes that provide tax incentives to encourage companies to carry out research and development work. They are often called "Preferential IP Regimes". The UK government introduced its Patent Box regime with significant publicity in 2011 and the scheme took effect from April 2013. These regimes are effective in stimulating investment in hi-tech industries, and the UK Patent Box has been popular with hi-tech businesses. Some regimes have, however, been criticised in recent years because some commentators believe they may encourage corporate tax practices that artificially shift profits to tax-favourable countries, to the detriment of others.

Dr Paul Brady
Partner, London
paul.brady@abelimray.com

Patent box regimes are thus currently under consideration by the OECD Forum on Harmful Tax Practices. Work by the Forum has led to the development of a proposal that national patent box schemes should only reward expenditure that has been incurred in the country in question, an approach that has been termed the Nexus Approach. Notably, the UK and Germany had disagreed about this approach. In an encouraging step, ahead of a meeting of the Forum on Harmful Tax Practices and ahead of the meeting of G20 finance ministers in Brisbane in November, the UK and German governments made a joint proposal on preferential IP regimes.

The proposal has the following elements:

• Tax benefits in the proposed regimes will depend on the amount of qualifying expenditure that has been incurred. "Qualifying expenditure" will be based on expenditure in the country offering the tax incentive. Methodology and rules for the calculation of qualifying expenditure are still to be decided on.

• Outsourcing and acquisition costs will generally not be qualifying expenditure. However, qualifying expenditure can be uplifted by up to 30% if significant outsourcing and acquisition costs were involved.

• Existing schemes (e.g. the current UK Patent Box scheme) to remain open until June 2016 for entrants (both in terms of companies and the IP rights in question), and then to continue until June 2021 (running in parallel with new schemes).

• A practical and proportionate expenditure tracking approach, which can be implemented by companies, is to be devised by June 2015.

The UK patent box 10% corporation tax rate is available to any UK company paying UK corporation tax in respect of profits derived from a product that is protected by a patent. If the proposals are adopted and implemented in the UK, it will additionally be necessary for there to have been qualifying expenditure on the product within the UK and that will, in some cases, place a cap on the profit that can qualify for the reduced tax rate.

It remains to be seen whether the proposals will be adopted by the OECD and/or the G20 countries. However, the joint statement is to be welcomed in that it removes some of the uncertainties that the debates around the UK and other Patent Box schemes had been creating: patent box regimes will continue for the long term, and benefits under the current schemes will continue to be available until at least 2021.

London
20 Red Lion Street
WC1R 4PQ, UK
T 020 7242 9984
F 020 7242 9989

Cardiff
3 Assembly Square
Britannia Quay
CF10 4PL, UK
T 029 2089 4200
F 029 2089 4201

Bath
Westpoint Building
James Street West
BA1 2DA, UK
T 01225 469 914
F 01225 338 098