1 Introduction

1.1 We refer to the consultation document published on 22 October 2015 regarding changes to the design of the UK Patent Box to comply with a new international framework for preferential tax regimes for intellectual property (IP) set out by the OECD.

1.2 We welcome the Government’s decision to modify the existing UK Patent Box regime to comply with the nexus approach proposed by the OECD in its work in relation to Action 5 (Harmful tax practices) of the G20/OECD BEPS project, rather than to legislate for an entirely new regime. We think that this will be helpful to businesses who are already benefiting from the UK Patent Box.

1.3 Before considering the detail of the consultation document, we would like to comment on something which is not included in it, which is software copyright. The BEPS framework allows software copyright to qualify, but the Government has not given any indication that it intends to take up this option to expand the patent box. We would like to encourage the Government to consider this.

2 New International Framework

2.1 The consultation document notes in Chapter 3, that the new international framework defines what is meant by ‘income’. We agree with the Government’s proposed approach to retain the current approach to defining profits.

2.2 With regard to the small claims election, our view is that this should be retained, unless there is a specific reason not to retain it. This election was introduced to minimise complexity for smaller businesses and, since the proposed changes will
result in there being additional complexity within the regime overall, the small claims election will, arguably, be more important to small businesses going forward.

2.3 We support the Government’s proposal to require streaming in all cases. Businesses with multiple products or patents will need to track and trace R&D expenditure and income to patents, products and/or product classes, and thus, will have to stream anyway. For those businesses with a simple model of, say, just a single patent the issue will not arise.

2.4 With regard to the two suggested ways that the rebuttable presumption might be given effect in the revised Patent Box legislation, we agree that the first approach in paragraph 3.14 (i) of the consultation document is the preferred option.

2.5 We welcome the approach proposed to address co-development arrangements. We suggest that clarity will be required in order to distinguish between ‘R&D contributions’ and ‘funding provided under a co-development agreement’.

2.6 We support the suggestion that the same definition of R&D should be used for nexus as for R&D tax credits. To have a different definition for each would add unnecessary complexity to the tax system. Similarly, we agree that the definitions and rules for calculating direct and subcontracted expenditure should be aligned with the R&D tax credit rules.

2.7 With regard to the approach to the timing of expenditure for the nexus fraction, our understanding of the OECD recommendation is that their intention is that expenditure should be fully included in the year it is incurred, irrespective of the accounting treatment.

Thus, at the end of Paragraph 39 on page 27 of the 2015 FHTP report they say:

‘Qualifying expenditures will be included in the nexus calculation at the time they are incurred, regardless of their treatment for accounting or other tax purposes. In other words, expenditures that are not fully deductible in the year in which they were incurred because they are capitalised will still be included in full in the nexus ratio starting in the year in which they were incurred.’

If the rules for R&D tax credits are followed there would be a difference between expenditure included within a tangible asset and that included within an intangible asset. R&D expenditure included within a tangible asset on the balance sheet would not be included until it is amortised through the P&L. Our understanding is that this would be in contradiction to the OECD recommendation.

3 Establishing the R&D base for nexus

3.1 With regard to dealing with tracking and tracing, it is suggested that the legislation will not ‘tightly constrain the choice’ available to companies as to whether to track to IP assets or product. Therefore the legislation will not define ‘product’ and ‘product family’. Whilst there are merits in this approach in terms of flexibility for business, we suggest that the result will be that HMRC will, broadly, have to accept the approach taken by companies.
3.2 The factors set out in paragraph 4.03 of the consultation document are sensible, but they are subjective. Therefore, in practice, the result may be the company’s opinion versus HMRC’s opinion and a sensible approach will be required to ensure it works in practice. A significant practical difficulty with the proposed approach is likely to be that by the time HMRC has challenged the company’s self-assessment it may be too difficult for the company to go back and redo the tracking.

3.3 With regard to pre-merger costs and the company history, while we can understand the concerns that this relief may encourage companies to acquire other companies, rather than the target IP, it should not be forgotten that for a small IP company, acquisition by a larger company may well be the preferred, and most viable, growth strategy. Any rules introduced around these points should not prevent commercial acquisitions and mergers.

3.4 With regard to retiring expenditure from the nexus fraction, the approach of a simple fixed rule is attractive for its simplicity. However, as summarised in paragraph 4.13 of the consultation document, the issue is that patent protection may be extended. Where patent protection is extended, it is likely that the company will anticipate significant future benefit from that added protection. Removing the earlier expenditure would be unreasonable.

3.5 Would it be possible to have a rule whereby the expenditure is removed after (say) 15 years unless the company can demonstrate that the expenditure is still generating benefit?

4 Transitional issues

4.1 Broadly, we are of the view that the transitional rules suggested are reasonable. We would suggest, however, that any company with ‘grandfathered’ IP should have the option of moving straight into the new regime. Whilst it may seem unlikely, at first glance, that any company would choose this option, we believe that the added complexity of managing two different sets of requirements may make this an attractive option. In particular, in a scenario outlined in paragraphs 5.07 and 5.08 of the consultation document, the ability to avoid the need to apportion profits and R&D expenditure could be quite beneficial.
5 The Chartered Institute of Taxation

5.1 The Chartered Institute of Taxation (CIOT) is the leading professional body in the United Kingdom concerned solely with taxation. The CIOT is an educational charity, promoting education and study of the administration and practice of taxation. One of our key aims is to work for a better, more efficient, tax system for all affected by it – taxpayers, their advisers and the authorities. The CIOT’s work covers all aspects of taxation, including direct and indirect taxes and duties. Through our Low Incomes Tax Reform Group (LITRG), the CIOT has a particular focus on improving the tax system, including tax credits and benefits, for the unrepresented taxpayer.

The CIOT draws on our members’ experience in private practice, commerce and industry, government and academia to improve tax administration and propose and explain how tax policy objectives can most effectively be achieved. We also link to, and draw on, similar leading professional tax bodies in other countries. The CIOT’s comments and recommendations on tax issues are made in line with our charitable objectives: we are politically neutral in our work.

The CIOT’s 17,500 members have the practising title of ‘Chartered Tax Adviser’ and the designatory letters ‘CTA’, to represent the leading tax qualification.

The Chartered Institute of Taxation
4 December 2015