



## ICAEW TAX REPRESENTATION

**PATENT BOX: CORPORATION TAX REFORM**

**Comments submitted on 10 February 2012 by ICAEW Tax Faculty in response to the publication on 6 December 2011 of draft clauses *Profits arising from the exploitation of patents etc* to be included in Finance Bill 2012.**

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# **PATENT BOX: CORPORATION TAX REFORM**

## **INTRODUCTION**

1. We set out below our comments on the draft clauses on the taxation of profits arising from the exploitation of patents etc published on 6 December 2011.
2. We commented in TAXREP 41/11 on the earlier consultation document published jointly by HM Treasury and HM Revenue and Customs in June 2011.
3. In our earlier paper we stated that:

‘We welcome the commitment to introduce a patent box regime from 2013. We also welcome the fact that it is additional to the R&D tax credits regime. While R&D tax credits have the benefit of encouraging R&D to be carried out in the UK the patent box encourages exploitation of that R&D in the UK.

As we noted in our earlier submission some of our members would have preferred a more extensive regime to encompass all types of IP but we believe that the current proposal represents a good initial approach and we would recommend that a review should be carried out after say 3 years to determine how successful the new regime has been and what changes might further improve it.’

## **Service Companies**

4. As currently drafted the legislation lacks incentives for companies which use technology to provide services as compared to those companies which produce products. We recommend that the government takes steps to ensure that this sector of the economy can also benefit from the new regime particularly in the light of the increasingly important role which the service sector plays in the UK economy.
5. Our Ten Tenets for a Better Tax System which we use as a benchmark are summarised in Annex A.

## **WHO WE ARE**

6. The ICAEW operates under a Royal Charter, working in the public interest. Its regulation of its members, in particular its responsibilities in respect of auditors, is overseen by the Financial Reporting Council. As a world leading professional accountancy body, the ICAEW provides leadership and practical support to over 136,000 members in more than 160 countries, working with governments, regulators and industry in order to ensure the highest standards are maintained. The ICAEW is a founding member of the Global Accounting Alliance with over 775,000 members worldwide. The Tax Faculty is the focus for tax within ICAEW.
7. Our members provide financial knowledge and guidance based on the highest technical and ethical standards. They are trained to challenge people and organisations to think and act differently, to provide clarity and rigour, and so help create and sustain prosperity. The Institute ensures these skills are constantly developed, recognised and valued.
8. The Tax Faculty is the focus for tax within the Institute. It is responsible for technical tax submissions on behalf of the Institute as a whole and it also provides various tax

services including the monthly newsletter TAXline to more than 11,000 members of the Institute who pay an additional subscription, and a free weekly newswire.

## **GENERAL COMMENTS**

9. We welcome the general thrust of the current proposals which reflect the objectives set out in the summer and should encourage the development of IP in the UK.
10. If the proposals prove successful then we hope that they will be extended to other forms of IP.
11. We note that Luxembourg has already extended its domestic legislation and Malta is in the process of extending theirs.
12. Depending on the outcome of the R&D consultation as to whether R&D expenditure should be recognised 'above the line' we would recommend that similar above the line recognition should also be considered for the Patent Box regime.

## **DETAILED COMMENTS**

13. Our detailed comments on the draft clauses are set out below:

### **Chapter 1 – Reduced corporation tax for profits from patents etc**

14. We recommend that consideration should be given to recognising the patent box reduction in a form that enables it to be taken 'above the line' if as a result of the current consultation a similar decision is taken in relation to R&D tax credits.

### **Chapter 2 – Qualifying companies**

#### **Section 357BB**

15. We hope that the power contained in subsection 1 c provides for the possibility of a 'white list' which will we believe be of great assistance in the proper working of this legislation.
16. We wrote in our earlier submission, TAXREP 41/11, in response to the question whether the new regime should be extended to patents granted by other EU national patent offices:

'We do believe that other EU or EEA national patent offices ought to be included, for instance Norway. We also note that neither Italy nor Spain have subscribed to the new European Patent Agreement, so exclusion of other EU patent offices would particularly adversely affect Italian and Spanish patents. We also believe that non EU national patent offices such as that of Japan also ought to be included.

We believe the most practical way to cover this will be to establish a 'white list' of qualifying jurisdictions, both within and outside the EU, and for this list to be updated as and when appropriate but to be reviewed on a regular basis. Clearly the criteria for registration under the regimes of other countries must be comparable to those of the IPO or EPO in order for the countries to be eligible for inclusion on the list.'

#### **Section 357BD(4)**

17. We are concerned that this provision may cause one company in a group to carry on the development when that company is not necessarily the best person to do so and if the

development by the non-owner of the IP rights produces significant value that may not be recognised in the patent box relief calculations of the original owner.

### **Chapter 3 – Relevant IP profits**

18. We welcome the change to the routine return to 10% and feel that the categories of routine expenses are about right.

#### **Section 357CB(3) and (4)**

19. The intention of the legislation in relation to protected items and packaging is very clearly explained in paragraph 53 of the Explanatory Notes and it would be helpful to include a reference here to section 357CE(6) and vice versa.

#### **Section 357CE(6)**

20. As noted in the paragraph above it would be helpful to include a reference back to 357CB(3) and (4).
21. We also think it would be more practical to replace the term 'trivial' which could easily lead to disputes between the taxpayer and HMRC with a specific percentage.

#### **Section 357CG**

22. We believe that when the R&D expenditure condition is met then the percentage of the amount of expenditure incurred should be lower than the proposed 75% of average expenditure.

### **Chapter 4 – Streaming**

#### **Section 357D et seq**

23. We welcome the simplification of the streaming rules.
24. We do have concerns that services cannot currently be included in the patent box. The service income model is often used by developers of IP and so merits inclusion.

### **Chapter 6 – Anti-avoidance**

#### **Section 357FB(5)**

25. We are concerned at the very wide drafting which potentially means that any understanding, arrangement etc could be considered to be a scheme for the purposes of this legislation.

### **Chapter 7 – Supplementary**

26. We are not sure why it is necessary to make a formal election for the patent box to apply. Is it not sufficient for there to be an appropriate claim in the tax computation to apply for the current and subsequent years until revoked? An informal election is acceptable for streaming in section 357D, as set out in paragraph 138 of the Explanatory Notes.

## **SPECIFIC RESPONSES – QUESTIONS IN CONSULTATION RESPONSE DOCUMENT**

*Question 1: Do the proposed changes to IP ownership, development and active ownership rules now ensure that all innovative companies involved in the development of qualifying IP can potentially benefit from the Patent Box?*

27. We think that is likely to be the case.

*Question 2: Do businesses have any comments on how qualifying income within leasing transactions should be calculated?*

28. If the income arises from the leasing of a qualifying product then the lease rental can be analysed into a payment in respect of the product itself, based on the arms-length selling price and the finance element. The element in respect of the product itself can be included in the patent box and the finance element excluded.

*Question 3: Do businesses have any comments on the new proposals for removing profits attributable to marketing intangibles?*

29. See our comments re Chapter 3 above.

*Question 4: Do businesses have any comments on the proposed rules on the R&D floor?*

30. See our comments re Chapter 3 above.

*Question 5: Are the proposed anti-avoidance rules appropriate and effective?*

31. See our comments re Chapter 6 above. .

#### **Further contact**

32. For any further enquiries please contact:

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**THE TAX FACULTY'S TEN TENETS FOR A BETTER TAX SYSTEM**

The tax system should be:

1. Statutory: tax legislation should be enacted by statute and subject to proper democratic scrutiny by Parliament.
2. Certain: in virtually all circumstances the application of the tax rules should be certain. It should not normally be necessary for anyone to resort to the courts in order to resolve how the rules operate in relation to his or her tax affairs.
3. Simple: the tax rules should aim to be simple, understandable and clear in their objectives.
4. Easy to collect and to calculate: a person's tax liability should be easy to calculate and straightforward and cheap to collect.
5. Properly targeted: when anti-avoidance legislation is passed, due regard should be had to maintaining the simplicity and certainty of the tax system by targeting it to close specific loopholes.
6. Constant: Changes to the underlying rules should be kept to a minimum. There should be a justifiable economic and/or social basis for any change to the tax rules and this justification should be made public and the underlying policy made clear.
7. Subject to proper consultation: other than in exceptional circumstances, the Government should allow adequate time for both the drafting of tax legislation and full consultation on it.
8. Regularly reviewed: the tax rules should be subject to a regular public review to determine their continuing relevance and whether their original justification has been realised. If a tax rule is no longer relevant, then it should be repealed.
9. Fair and reasonable: the revenue authorities have a duty to exercise their powers reasonably. There should be a right of appeal to an independent tribunal against all their decisions.
10. Competitive: tax rules and rates should be framed so as to encourage investment, capital and trade in and with the UK.

These are explained in more detail in our discussion document published in October 1999 as TAXGUIDE 4/99 (see <http://www.icaew.com/~media/Files/Technical/Tax/Tax%20news/TaxGuides/taxguide-4-99-towards-a-better-tax-system.ashx> ).