



ICAEW TAX REPRESENTATION

CONSULTATION ON THE PATENT BOX

Comments submitted in August 2011 by the Tax Faculty of the Institute of Chartered Accountants in England & Wales (ICAEW) to HM Treasury in response to the Consultation on the Patent Box issued in June 2011

Contents

	Paragraph
Introduction	1 - 2
Who we are	3 - 5
General Remarks	6 – 7
The Detailed Questions	8 - 34
ICAEW and the Tax Faculty: who we are	Appendix 1
Ten Tenets for a Better Tax System	Appendix 2

CONSULTATION ON THE PATENT BOX

INTRODUCTION

1. We set out below our response to the Consultation on the Patent Box published jointly by HM Treasury and HM Revenue & Customs in June 2011.
2. We responded in February 2011 to the proposals in the consultation document Corporate Tax Reform: delivering a more competitive system concerning, inter alia, proposals in relation to a patent box regime. Our response was published as TAXREP 8/11 and is available on our website www.icaew.com/taxfac

WHO WE ARE

3. 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.
4. 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.
5. 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 REMARKS

6. 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.
7. 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.

THE DETAILED QUESTIONS

Chapter 2 – Qualifying patents

Question 1: Will the requirement for a patent granted by the IPO or EPO cause significant commercial distortion? Do you believe that patents granted by any other EU national patent offices should be included, and if so which jurisdictions?

8. 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.

9. 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.

Question 2: Do the ownership criteria adequately permit on-licensed patents and patents developed or commercialised in commercial cost sharing, partnership and joint venture arrangements to qualify for the Patent Box?

10. The requirement for an exclusive licence needs to be able to cover a group of companies and not be restricted to a single legal entity.
11. When patents are developed under partnerships, joint ventures or cost sharing arrangements then the exclusivity should be applied to all the parties collectively.

Question 3: Do businesses think that the development criteria are workable or are there commercial situations which should be included but would fall outside these rules?

12. As the consultation makes clear there will be problems when a patent has been acquired or developed in collaboration with unrelated parties. A formula creates a cliff edge problem and leaving it to a judgement will create potential uncertainty.

Chapter 3 – Qualifying income

Question 4: Do businesses believe that it is necessary to set out rules to more closely define the circumstances where a composite tangible or intangible product should be considered a single functionally interdependent item? Or can this requirement be tested through a motive test on a case-by-case basis?

13. There clearly needs to be clarity about what is meant by a single functionally interdependent product. One possible approach would be to adopt a general definition specifying appropriate characteristics and leave it to the taxpayer to demonstrate that the treatment as a functionally interdependent item is justified.
14. More detailed guidance containing examples might also be helpful.

Question 5: The Government would welcome views on how the arm's length profit attributable to patents used in processes or to provide services should be calculated.

15. We would urge the government to reconsider its current view on income from services. For many companies the modern approach to IP is to package the services element with the initial sale of the product and it is the income from the total 'package' that represents the return from the patent.

Question 6: Do businesses think that the proposed claim of retrospective benefits for the period while a patent is pending is fair and workable?

16. The proposed arrangements for income arising before grant seem fair and workable.

Chapter 4 – Calculation of patent box profits

Question 7: Do businesses agree that the proposed model will produce an acceptable result in most circumstances, given the flexibility provided by the ability to apply the model to company divisions separately if required?

17. We believe that the model set out is likely to give an acceptable result in most circumstances.

Question 8: Is there any alternative basis of apportioning residual profits between different products which is more appropriate without introducing excessive complexity?

18. Step one of the Patent Box profit calculation seems to be reasonable.

Question 9: Should there be special rules for any one-off items of income or expenditure? If so what form should the rules take?

19. At the moment we cannot see that special rules would be appropriate.

Question 10: Is divisionalisation the most effective and least burdensome way to deal with a wide range of situations in which pro-rata allocation of profits and expenses would produce an inappropriate result? Are the conditions set out above to govern the use of divisionalisation appropriate? The Government would welcome any alternative suggestions, and would appreciate sufficient detail that these can be evaluated by HMT and HMRC.

Question 11: Are there any other circumstances in which divisionalisation should be mandatory?

20. We can appreciate that divisionalisation will be an effective method when the formulaic approach would produce an inappropriate result.

Question 12: The Government would welcome views and evidence on the appropriateness of step 2 in identifying residual profits, as well as on how outsourced functions should be defined and whether there are any other costs which should be excluded from the mark-up.

21. The rate of return of 15% appears quite high particularly for people based businesses. One possibility would be to introduce an option whereby a business could agree to a different return based on the normal return for their particular business.

Question 13: The Government would welcome business' views on an appropriate formula to allocate residual profit to patents, and on what types of expenses should be taken into account in calculating the relative contribution made by the patent and brand to the residual profit.

22. The approach put forward appears reasonable.

Question 14: Can businesses suggest any alternative ways of effectively separating patent profits from those arising from other types of IP? If a relative contribution approach is chosen, is the proposed safe harbour set at an appropriate level to simplify smaller claims?

23. The safe harbour proposal seems reasonable for smaller businesses.

Question 15: Are the proposed rules for the carry-forward of Patent Box losses appropriate? Should Patent Box losses also have to be set against Patent Box profits of other group companies in the same accounting period, in order to achieve a symmetrical treatment of Patent Box profits and losses?

24. We consider that the rules for the carry-forward of patent box losses are appropriate.

Question 16: Do businesses consider that taking pre-commercialisation expenses into account in these circumstances is proportionate and fair, or are there better ways of ensuring that the benefit accrues to total net patent profits?

25. The approach looks reasonable.

Chapter 5 – Computational issues

Question 17: Do respondents see any practical or technical problems with the approach of implementing the 10% Patent Box rate through a computational tax deduction?

26. We cannot foresee any practical or technical problems but like other commentators we favour an above the line recoverable credit as is currently being discussed in the context of R&D tax credits. It is felt that this alternative treatment would make the impact of the patent box regime more transparent and self evident and would lead to additional expenditure on development activities in the UK.

Question 18: Do respondents have any initial comments about interaction with double tax relief rules or have any views on the Government's stated aims for giving relief?

27. The intention to give relief up to the level of UK tax payable on patent box profits seems reasonable.

Question 19: Would having to comply with transfer pricing rules for transactions with associated companies in cases of tax avoidance be an unreasonable burden for smaller companies?

28. We would be anxious to ensure that the provisions are suitably targeted and only likely to be in point when there is blatant manipulation of prices.

Question 20: Can respondents suggest any alternative ways to prevent artificial tax avoidance abuse of the Patent Box?

29. It is going to be in the interests of all genuine claimants that the patent box regime is not abused. Purposive legislation is one approach to ensuring that the relief 'hits' the intended target.

Question 21: Do respondents consider that other aspects of the formula apart from divisionalisation and step 3 will give rise to clearance applications? Will the current non-statutory clearance system be sufficient to respond to the range of enquiries that the Patent Box is likely to generate?

30. There should be a clearance process similar to that for R&D. Large companies will expect to work in real time with their CRMs to establish suitable processes to arrive at patent box profits.

Chapter 6 – Commencement of the patent box

Question 22: The replacement of a cut-off date with a phase-in approach will have different effects for each company. The Government would welcome comments on the impact of this proposal on different sectors as well as views on whether businesses prefer a cut-off date as originally announced or would favour the proposed phase-in approach.

31. We support the phased introduction rather than the cut-off date that was originally proposed. We do not have any data on the likely impact of the new proposal on different sectors.

Chapter 7 - Tax Impact Assessment

Question 23: The Government would welcome comments or evidence to support the assessment of the impacts of the regime.

32. Our members in business have indicated that they believe the introduction of a patent box will have a positive impact on the perception that the UK has a competitive tax regime which will encourage increased development activity in the UK.

Question 24: The Government would welcome comments on the best forum for dealing with emerging issues once the Patent Box is introduced

33. In the initial introductory phase we believe that the HMT Business Forum on Tax and Competitiveness should have the patent box on its Agenda to monitor that the patent box is working as intended. We think it will then be important to establish an HMT/HMRC taxpayer forum to meet on a regular basis to discuss all aspects of the operation of the patent box. This should be along the lines of the Research and Development Consultative Committee.

Further contact

34. For any further enquiries please contact:

Frank Haskew Head of the ICAEW Tax Faculty Email: frank.haskew@icaew.co.uk Tel: +44 (0)20 7920 8618	Ian Young International Tax Manager, ICAEW Tax Faculty Email: ian.young@icaew.com Tel: +44 (0)207 7920 8652
--	---

Copyright © ICAEW 2011
All rights reserved.

This document may be reproduced without specific permission, in whole or part, free of charge and in any format or medium, subject to the conditions that:

- it is appropriately attributed, replicated accurately and is not used in a misleading context
- the source of the extract or document is acknowledged and the reference number and title are quoted.

Where third-party copyright material has been identified application for permission must be made to the copyright holder.

www.icaew.com/taxfac

ICAEW AND THE TAX FACULTY: WHO WE ARE

1. ICAEW is a world-leading professional accountancy body. We operate under a Royal Charter which obliges us to work in the public interest. ICAEW's regulation of its members, in particular its responsibilities in respect of auditors, is overseen by the UK Financial Reporting Council. We provide leadership and practical support to over 136,000 member chartered accountants in more than 160 countries, working with governments, regulators and industry in order to ensure that the highest standards are maintained.
2. ICAEW members operate across a wide range of areas in business, practice and the public sector. They provide financial expertise and guidance based on the highest professional, technical and ethical standards. They are trained to provide clarity and apply rigour, and so help create long-term sustainable economic value.
3. The Tax Faculty is the voice of tax within ICAEW and is a leading authority on taxation. Internationally recognised as a source of expertise, the faculty is responsible for submissions to tax authorities on behalf of ICAEW as a whole. It also provides a range of tax services, including *TAXline*, a monthly journal sent to more than 8,000 members, a weekly newswire and a referral scheme.

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>).

