



PATENT BOX: SUBSTANTIAL ACTIVITIES

ICAEW welcomes the opportunity to comment on the consultation document *Patent Box: substantial activities*

https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/469969/Patent_Box_substantial_activities.pdf published by HM Treasury and HM Revenue & Customs on 22 October 2015.

This response of 4 December 2015 has been prepared on behalf of ICAEW by the Tax Faculty. Internationally recognised as a source of expertise, the Faculty is a leading authority on taxation. It is responsible for making submissions to tax authorities on behalf of ICAEW and does this with support from over 130 volunteers, many of whom are well-known names in the tax world. Appendix 1 sets out the ICAEW Tax Faculty's Ten Tenets for a Better Tax System, by which we benchmark proposals for changes to the tax system.

We should be happy to discuss any aspect of our comments and to take part in all further consultations on this area.

We attended a meeting on 2 December 2015 with HM Treasury / HM Revenue & Customs jointly with ICAS at which we were able to discuss some key features of the current proposals.

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GENERAL COMMENTS

1. We welcome the opportunity to comment on the proposed changes to the UK Patent Box regime.
2. There is a need to make the UK regime compliant with the recommendations contained in the OECD BEPS Action Plan, Action 5.
3. There is also a need to maintain a Patent Box regime in the UK which is attractive as a tool to incentivise R&D in the UK.
4. Our detailed comments below are made in the context of those overarching objectives.

RESPONSES TO SPECIFIC QUESTIONS

Q1: The Government would be grateful for any wider comments, beyond responses to the specific questions below.

5. We appreciate that the UK government wishes to make the necessary changes, and introduce a replacement Patent Box regime, so that the new regime is compliant with the OECD recommendations in relation to Action 5 of the BEPS (Base Erosion Profit Shifting) Action Plan to counter harmful tax practices.
6. A Patent Box regime is an important fiscal tool to ensure that R&D activity is incentivised in the UK.
7. The change from the existing UK regime to a replacement regime, based on the OECD modified nexus approach, is going to be less advantageous to some UK companies for which there could be a significant reduction in the relief currently available, in particular for those companies which outsource R&D within their corporate group.
8. We suggest that the review of the new arrangements should include consideration as to whether the tax rate applicable to the Patent profit should be reduced below the existing 10% to ensure the competitiveness of future UK arrangements.

Q2. The Government would be grateful for views on whether the current approach to defining profits should be retained, including any evidence supporting the retention of a small claims election.

9. We believe that to maintain as much as possible of the mechanics of the existing regime will be beneficial for both HMRC and taxpayers. This would allow the new parameters to fit over the existing framework of the current regime which is well understood.

Q3. The Government would be grateful for views on requiring streaming in all cases.

10. We are concerned that streaming is going to put an unreasonable burden on some businesses and while the requirements of the OECD nexus approach must be met, and will need to be seen to be met when reviewed by OECD, nevertheless the arrangements need to be as practical and flexible as they can be permitted to be.

Q4. The Government would be grateful for views on the suggested approach to the rebuttable presumption, especially on what circumstances should be considered exceptional and justify its use, and what examples should be included in guidance.

11. We agree that guidance and examples of circumstances where the rebuttable presumption would apply are the best way forward.
12. We do not have practical examples of where this presumption should apply in practice.

Q5. The Government would be grateful for comments on the suggested approach to co-development.

- 13.** We are pleased that the government believes that co-development arrangements should not be disadvantaged.
- 14.** We think the current proposals need to be fine tuned so that funding or other non R&D contributions are not automatically treated as acquisition or related party subcontracting costs. So if one of the co-developers has spent less than the percentage required under the co-development arrangements and makes a cash top up that should not reduce their nexus fraction.

Q6. Do respondents agree that

- the same definition of R&D should be used for nexus as for R&D tax credits?
 - expenditure for the nexus fraction should be relevant R&D of the company?
 - the definitions of and rules for calculating direct and subcontracted expenditure should be aligned with the R&D tax credits, as set out above?
- 15.** We support the alignment of costs to the existing R&D definitions.

Q7. Do respondents agree with the suggested approach to the timing of expenditure for the nexus fraction?

- 16.** We agree with the suggested approach.

Q8. The Government would be grateful for

- views on the merits of the suggested approach to tracking and tracing, in contrast to defining “product” and “product family” more precisely; and,
 - suggestions as to what factors might be relevant in judging the conditions set out in paragraph 4.03.
- 17.** In the light of the complexity of many businesses which have multiple patents applying to a range of products and product families we welcome the government’s decision to offer companies the choice to track at the level of IP asset, product or product family.

Q9. The Government would be grateful for views on the alternative approaches suggested for dealing with pre-merger costs, including, under option (i), how long this treatment ought to last. The Government would also welcome suggestions for any alternative options which respondents feel may better address the issue raised at 4.09.

Q10. The Government would also welcome information about any other circumstances in which a company may come to own IP and which may not be clearly addressed by the proposed rules.

- 18.** We do not have any strong preferences between the options set out in paragraph 4.10 but we do note that a purpose test would create uncertainty and would be best accompanied by a clearance arrangement.

Q11. The Government would be grateful for views on the suggested approach to retiring expenditure from the nexus fraction, including other suggestions for addressing the issue without introducing undue complexity.

- 19.** We think there may be some merit in using the 15 year period as the default position but then allow companies to agree a different time period with HMRC if that is more appropriate for them.

Q12. The Government would be grateful for views on the suggested rules for calculating the nexus fraction, including the lengths of the time periods to be used (with evidence if possible showing why these are appropriate).

20. We do not have any views on this at the present time.

Q13. The Government would be grateful for evidence about the length of time likely to be needed for companies to adapt systems, reorganise their affairs, and begin collecting the information they will need to calculate the nexus fraction to inform the length of the grandfathering period.

21. We think that a five year period is appropriate but note that non grandfathered IP will need to apply nexus from 1 July 2016 so there is only a 6 month period in which to make system changes for information collection in respect of this particular IP.

Q14. The Government would be grateful for views on the suggested transitional rules.

22. We accept that the transitional arrangements are complex but we welcome the opportunity for companies to transition to nexus over time.

Q15. The Government would be grateful for views from business as to the likely impact on amounts of relief they may claim under the new rules.

23. The new nexus approach is going to provide less relief for those groups where, for instance, the UK is the global IP holder but significant R&D functions are outsourced which will include to UK related parties. There will also be an adverse impact in relation to acquired IP

Q16. The Government would be grateful for views from business as to the likely impacts on administration and compliance costs, and how these can be kept to a minimum.

24. The new regime is going to be complex and it will need good quality guidance and help and assistance from HMRC, particularly in the Large Business Directorate, to provide pragmatic and commercially minded advice in relation to Patent Box issues and claims.

Q17. The Government would welcome views on other possible impacts arising from these changes, including the equalities impact, impacts on additional administrative burdens and compliance costs and on small businesses.

25. No comments.

APPENDIX 1

ICAEW 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 via <http://www.icaew.com/en/about-icaew/what-we-do/technical-releases/tax>).