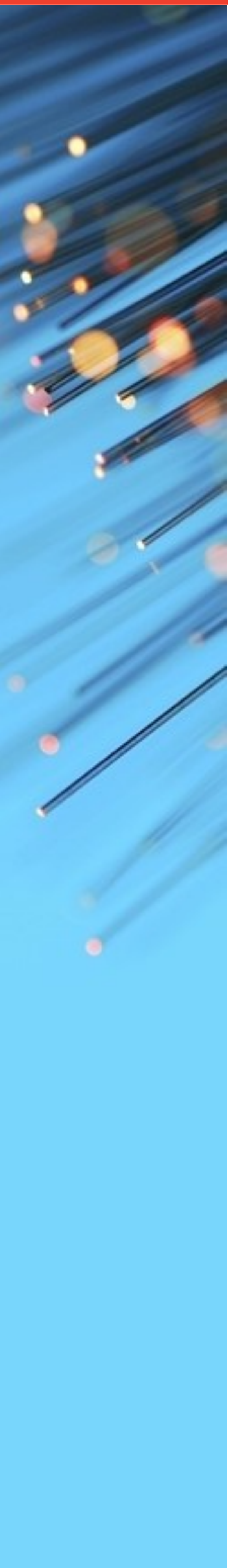

# The patent box: a boon for R&D or accountants?

The "patent box" was originally announced in the 2009 Pre-Budget Report, with the stated aims of strengthening the incentives to invest in innovative industry and ensuring the UK remains an attractive location for innovation. Under the patent box, a reduced rate of corporation tax would apply from April 2013 to income from newly-granted patents.

Chancellor George Osborne confirmed in this year's Budget that "a reduced 10 per cent rate of corporation tax for profits arising from patents" would be introduced effective from 1 April 2013, but the Chancellor did not put much meat on the bones of the original announcement, presumably because the details of the patent box are far from being finalized.

In November 2010, HM Treasury issued a consultation document on the taxation of innovation and intellectual property, which inter alia discussed the patent box proposals, and invited views on several aspects of the patent box. In particular, HM Treasury sought comments on their suggestion that all patents first commercialized after 29 November 2010 should qualify for inclusion, instead of the originally proposed limitation to patents granted after the passing of the appropriate legislation. They also made it clear that the reduced tax rate was intended to apply not only to easily-quantifiable royalty income, but also to "embedded" income included in the price of patented products. In accordance with the Chancellor's preference for rules and regulations to be simple (if occasionally unfair), the intention was to apply a formulaic strategy to valuation of this "embedded" income, which would provide certainty and ease of administration at the cost of accuracy; however, no details of the proposed formulae were given in the consultation document.

According to this year's Budget announcement, a further consultation document is to be published in May 2011, and draft legislation is expected to follow in autumn 2011. It is to be hoped that by that point, decisions will have been reached on which patents will actually qualify for the patent box, and on how the profits arising from them will be assessed.

Regardless of this uncertainty, according to the figures in this year's Budget, the Government are estimating that the patent box measures will cost £500 million in the 2013-14 financial year, rising to £900 million in 2015-16. The Institute for Fiscal Studies suggested an annual cost of £1.1 billion. So what are the Government expecting in return for this largesse?

It is hard to see how the patent box provisions, at least in their currently proposed incarnation, can dissuade major companies from relocating high-tech R&D jobs out of the United Kingdom. The current R&D tax credit scheme, to which the Government reaffirmed its commitment in this year's Budget, appears to be aimed more at SMEs.

It is not even clear at the moment whether the qualification requirements will specify that patents must cover the United Kingdom in order to benefit from the reduced rate, or whether non-UK patents held by UK-based companies will qualify. Further, as European law would apparently prevent the patent box provisions from being limited to patented technologies created in the United Kingdom, there appears to be no reason why a United Kingdom company could not move its R&D jobs to a cheaper country and still obtain the benefit of a lower tax rate for any patents resulting from such research.

Pfizer's recent decision to close their technical centre in Sandwich with the expected loss of up to 2,400 jobs is an unfortunate hint that the patent box provisions may not fulfil their aims. Pfizer stated that their decision did not reflect any unhappiness with government policy, and since a company of Pfizer's stature is surely aware of the patent box provisions, the proposed tax cut plainly was not enough to persuade Pfizer to protect UK jobs. It is hard to see how the patent box can be viewed as specifically protecting UK-based R&D jobs, as opposed to encouraging global R&D in general.

When the patent box provisions were first announced in the 2009 Pre-Budget Report, the Institute of Fiscal Studies attacked them as being "poorly targeted" at research, since they were aimed at income resulting from patented technologies, rather than the research leading to such technologies. The IFS also suggested that it was not clear that any additional research arising from the patent box provisions would take place in the United Kingdom, and the Government's latest announcements do little to suggest that these criticisms have been heeded.

Several other European countries already have patent box provisions, with that of the Netherlands in particular offering a lower tax rate than proposed in the UK on profits from a wider range of intellectual property. Despite the fine words, it is hard not to think that the Government's proposals are less concerned with stimulating innovation, and more concerned with keeping at least some of the available tax revenues instead of losing all of them as companies relocate their patents to even more generous jurisdictions.

At the moment, it looks as if the patent box provisions will provide more of a boost to British jobs in accountancy than in R&D.

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