The patent box

The Chancellor has confirmed in this year's annual Budget that the Patent Box will be introduced. The Patent Box is essentially a scheme that will provide a tax break on income generated from patents, such as royalties etc. The scheme is similar to arrangements that have already been introduced in Switzerland, the Netherlands and Belgium, and is aimed at encouraging technically innovative businesses to locate in the UK.

Although media attention has tended to focus on the impact the proposed scheme will have on pharmaceutical giants, it is intended to benefit businesses of all sizes and in all technical fields. Accordingly, SMEs in all fields of technology should seek to take advantage of the scheme in due course. In addition to the usual advantages that patents can provide if managed effectively, the Patent Box will allow more of the financial benefit from these to be kept by the companies owning the patents. In the current times it is even more important that the maximum reward is obtained for R&D investment. The scheme therefore provides a further incentive for smaller and medium sized UK companies to invest in protecting their innovations through patenting.

The basic idea of the Patent Box is to significantly reduce the rate of corporate tax to just 10% for income generated by UK companies which is derived from patents. The tax cut will not apply to patents that have already been granted, but will only apply to those granted after the legislation is passed in 2011. Recently and newly filed patent applications should be able to benefit from the scheme since these will be granted after it commences. Businesses should however review their current patent strategy to determine whether it is worth delaying the grant of patent applications until after the legislation has been passed. Once the scheme has been introduced the tax cut will only apply to income received from 2013.

Details of exactly how the Patent Box will operate are still being worked out and the Government will be seeking input from businesses during a consultation period that starts in the summer of 2010. There are a number of important issues that are still to be ironed out, such as how to identify and evaluate income derived from patents and how to give relief to patents that have been acquired. Value can be derived from patents in a number of different ways including licensing, income from patented products or components of products, and reducing production costs by using patented technologies. Valuing the proportion of the income that is derived from the patents themselves will therefore not be a straight forward matter and the consultation period will hopefully help to find a fair and practical way of calculating this.

A number of other important issues also need to be determined. For example, it needs to be considered if and how the regime will apply to foreign patents held by UK companies. Also, in fields of technology that develop very rapidly much of the income from the technology may arise whilst patents are still pending and prior to grant of the patents, assuming that patents are even granted. It is not currently clear how the new scheme will deal with these issues.

In contrast to equivalent schemes in some other countries, it is not currently intended to widen the UK Patent Box to cover other forms of intellectual property. This may be frustrating for a number of SMEs that rely on other forms of intellectual property to provide some protection and competitive advantage, such as UK software companies. Such industries may therefore consider making the case to extend the scheme to cover other intellectual property rights, especially considering the difficulties in obtaining granted patents for software in Europe.

However, the Patent Box is generally a welcomed scheme and it is hoped that this, in combination with other incentives such as the tax relief system for R&D expenditure, will provide favourable conditions that benefit innovative companies and encourage them to invest in the UK.

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