



PATENT BOX - WHAT IS *RELEVANT IP* INCOME?

Summary

We discuss here issues relating to which income streams can qualify for the Patent Box. The Patent Box legislation defines what income streams count as *relevant IP income*. The calculation of *relevant IP income* is used in determining an amount deductible from the profits of the trade for the calculation of UK Corporation Tax liability. Determining the amount deductible from the profits of the trade will ultimately lead to the amount of UK Corporation Tax due being equivalent to paying a rate of 10% on the *relevant IP income* (following certain deductions as explained in our separate Briefing “Patent Box - How to calculate the Patent Box Benefit”).

Relevant IP Income

Relevant IP income is defined in the legislation under five main categories, each of which is dealt with below.

1 *Income by sale of item protected by a qualifying IP right*

Relevant IP income includes worldwide income from the sale by a *qualifying company* of:

- a) items in respect of which a *qualifying IP right* held by the company has been granted (“*qualifying items*”)
- b) items incorporating one or more *qualifying items* and
- c) items that are wholly or mainly designed to be incorporated into such items

Thus, a single *qualifying IP right* (for example a UK patent) brings all worldwide profits relating to sales of a *qualifying item* into the Patent Box. This includes profits relating to sales in any territory (even a major market such as the USA) in which there is no equivalent IP right.

For Patent Box purposes, an item is not considered to be protected by a *qualifying IP right* by virtue of being made by a method protected by the *qualifying IP right*. Therefore, if the invention relates to a method, it is important, if at all possible, to obtain a claim relating to the product itself, for example using a “product by process” claim format. It is often problematic to obtain such “product by process” claims. If a “product by process” claim cannot be obtained, this may be a disadvantage in terms of Corporation Tax saving because it will then only be possible to claim as *relevant IP income* a notional royalty (discussed below) for use of the *qualifying IP right*.

It is significant that income relating to the sale of items incorporating one or more qualifying items is also counted as *relevant IP income*. This means, for example, that the whole income from the sale of a car may be considered as *relevant IP income* for the sole reason that the engine management system is covered by *qualifying IP rights*. HMRC is expected to interpret the term “incorporating” as referring to an item that is physically part of a larger item and intended to be so for its operating life. For a printer and a printer cartridge sold together, the income from the sale of the printer and cartridge is *relevant IP income* even if only the cartridge is protected by *qualifying IP rights* (under heads a) and b) above). If the company has *qualifying IP rights* only in respect of the printer, sale of the cartridge on its own qualifies as *relevant IP income* under head c) as an item wholly or mainly designed to be incorporated into the printer.

There is an anti-avoidance provision which states that income arising from the sale of any item that incorporates a *qualifying item* is not *relevant IP income* if the main purpose, or one of the main purposes, of incorporating the *qualifying item* is to secure income arising from any such sale as *relevant IP income*. It is to be seen how HMRC interprets this provision. An example which would fall foul of the provision is a case where a company produces speakers which include no patented part but the company decides to incorporate a patented computer chip into the speakers, even though the chip performs no useful function and is not connected to the internal electrics of the speaker itself. If in practice a novel and inventive component is to be sold incorporated into a larger product it would be sound patent practice to include where possible a patent claim to the commercial product incorporating the component (a downstream claim). In patent terms the downstream claim can be said to protect the commercial product as such and it should not therefore be necessary to consider the provisions relating to items incorporating a qualifying items including this anti-avoidance provision.

For the purposes of determining *relevant IP income*, packaging is not considered to be part of an item unless the packaging performs a function that is essential for the use of the item for the purposes for which it is intended to be used (e.g. an inhaler).

It may be the case that two or more items are sold together, but none of the items can be regarded as being incorporated in any of the other items, yet at least one of the items is protected by a *qualifying IP right* and at least one of the items is not protected. In such a situation it will be necessary to attribute the income on the basis of a “just and reasonable apportionment” between *relevant IP income* and non-relevant IP income, unless the proportion of income not attributable to non-relevant IP income is trivial.

2 *Income from a Licence of a Relevant IP Right*

Relevant IP income includes any licence fee or royalty which the company receives under an agreement granting to another person a right in respect of any *qualifying IP right* held by the company.

Significantly, the *relevant IP income* also includes any licence fee or royalty for any other right in respect of a *qualifying item* or process, if the right is granted in the same agreement as a *qualifying IP right* and for the same purpose. Thus, if the right to a design or trade mark (which is not a *qualifying IP right*) is included in an agreement which grants the right to a *qualifying IP right* such as a patent, the income from the agreement related to the right to the design or trade mark also counts as *relevant IP income*.

3 *Income by Sale of a Relevant IP Right*

Income arising from a sale or other disposal of a *qualifying IP right* or an exclusive licence of such a right is also deemed *relevant IP income*.

In the case of a company selling *qualifying IP rights* and receiving income in an accounting period different from the period in which the ownership of the *qualifying IP right* transferred, it is necessary to have *elected in* to the Patent Box for the period when the sale was made, not just for the period when income is received.

4 *Income as Damages for Infringement*

Any amount of damages received by a company in respect of an infringement, or alleged infringement, of a *qualifying IP right* held by the company at the time of the infringement or alleged infringement counts as *relevant IP income*.

5 *Other Income in Respect of Use of a Relevant IP Right*

A company may elect to treat as *relevant IP income* a notional royalty in respect of use of a *qualifying IP right* to bring in otherwise non-qualifying parts of the company's gross income. Therefore it is possible to make use of the Patent Box even if the company only holds a *qualifying IP right* relating (a) to a method and not to an item or (b) to items used only in providing a service. However calculating *relevant IP income* on the basis of a notional royalty rather than on the basis of sale of a whole product is likely to be less beneficial to a company. Therefore all efforts should be made to obtain *qualifying IP rights* related to the item to be sold.

12 May 2016

14 South Square
Gray's Inn
London WC1R 5JJ

Telephone: +44 20 3077 8600
e-mail: mjackson@jakemp.com