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## HMRC internal manual

# Corporate Intangibles Research and Development Manual

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## CIRD220550 - Patent Box: relevant IP profits: profits arising before grant of right: how the relief is given

How the relief is given

The relief is given by adding an amount to the company's relevant IP profits in the accounting period in which the right is granted. That amount is the difference between the aggregate of the relevant IP profit and the aggregate of what the relevant IP profits for that same period would have been if the right had been granted at the date of

application, for accounting periods which ended in the period from the application for grant of the right to the date the right is granted (from 2013 or up to the 6 year limit). A s357A(1) election needs to have been made for each accounting period included.

The amount of relevant IP profit will depend on whether the right is an old or new qualifying IP right.

An application for grant of a right made on or before 30 June 2016 or an exclusive licence in respect of a right which is granted to a company on or before 30 June 2016 (where the right is subsequently granted) are old qualifying IP rights and the grandfathering transitional provisions will apply unless an election is made by the company to treat it as a new entrant ([CIRD271000](https://www.gov.uk/hmrc-internal-manuals/cird271000) (<https://www.gov.uk/hmrc-internal-manuals/corporate-intangibles-research-and-development-manual/cird271000>)). Applications made after 30 June 2016 and licences granted after 30 June 2016 will be treated as new qualifying IP rights, even where the company is not a new entrant (see [CIRD270200](https://www.gov.uk/hmrc-internal-manuals/cird270200) (<https://www.gov.uk/hmrc-internal-manuals/corporate-intangibles-research-and-development-manual/cird270200>)). For an item or process incorporating both old and new qualifying rights the relevant IP profits are determined in accordance with S357BQ(5) as explained in [CIRD271600](https://www.gov.uk/hmrc-internal-manuals/cird271600) (<https://www.gov.uk/hmrc-internal-manuals/corporate-intangibles-research-and-development-manual/cird271600>)).

In order to calculate the relevant IP profits arising between the application for the grant of the right up until the grant of the right itself (so that these can be included in the accounting period in which the right is granted) the company will need to 'track and trace' the qualifying expenditure for each income sub-stream ([CIRD272000](https://www.gov.uk/hmrc-internal-manuals/cird272000) (<https://www.gov.uk/hmrc-internal-manuals/corporate-intangibles-research-and-development-manual/cird272000>)). During these accounting periods prior to the grant of the qualifying IP right

the R&D expenditure in relation to that right will not be included in calculating the R&D fraction.

## Other Considerations

A company with patents pending has to consider the best time to bring the relevant income into the Patent Box including which stream or sub-stream the income may fall into, how best to track and trace the R&D expenditure and also whether the product is making losses (as they will be set against other Patent Box profits within the tax computation once in the Patent Box). The choices will be different for different companies, but remember that there is a two year time limit before the decision has to be made for each accounting period.

Note that once the relevant profit from earlier years has been added to the relevant profit in the year of grant that is the total amount which is included in the calculation to arrive at the Patent Box deduction. Only the main rate of corporation tax and any taper relief rate for the year of grant is applied, so previous rates of corporation tax and taper relief are not brought into this calculation.

## Example

Mr A has an innovative idea that he considers will result in a product that can be patented. Instead of developing the idea and applying for a patent himself, he decides to incorporate a new company, Company A, so that it can develop the idea and potentially claim R&D tax relief as well as meet the development condition (under S357BC) to enable Company A to be a qualifying company (under S357B) for the Patent Box.

On 1 May 2015 Company A applies for a first patent in accordance with the Patents Act 1977 which is granted without modification on 1 December 2018. The company applies for a second patent for a different product on 15 August 2016 which is granted on 31 December 2018. The first patent will be an old qualifying IP right and the second patent will be a new qualifying IP right.

Company A is lossmaking in the year ended 31 December 2015 and therefore, although it could elect into the Patent Box regime for that accounting period, it chooses not to.

However Company A does not wait until 2018 to make an election because the legislation allows a company to take into account profits arising before grant of a patent. It makes an election under S357A and specifies that the first accounting period for which the election is to have effect is the year ended 31 December 2016. Company A will not be a new entrant and the grandfathering provisions will apply to the first patent because there is a s357A election for an accounting period which begins before 1 July 2016

Company A makes an election under S357CQ(2) in relation to the first patent and an additional election under S357BM(2) in relation to the second patent within the time limit. The elections are made within the tax computation for the relevant accounting period.

Company A makes the following relevant IP profits (as defined under S357C(2) and S357BM(2)):

Accounting period ended 31 December 2016

First Patent £30,000

Second Patent £10,000

Total £40,000

Accounting period ended 31 December 2017

First Patent £40,000

Second Patent £20,000

Total £60,000

Accounting period ended 31 December 2018

First Patent £50,000

Second Patent £15,000

Total £65,000

Total for all periods £165,000

Company A would have been a qualifying company for the accounting periods ended 31 December 2016 and 2017 but for the fact that the patents had not been granted. In these circumstances, S357CQ and S357BM allow the company to elect to be treated as if it were a qualifying company for those accounting periods. However, the relevant IP profits for these accounting periods are brought into account only in the accounting period ended 31 December 2018 (the accounting period in which the patent is granted) and not before. So Company A has a total of £165,000 relevant IP profits for the accounting period ended 31 December 2018 and the Patent Box deduction applies the main rate of corporation tax for that period and no taper relief. The company will also have to track the R&D expenditure against each income sub-stream so that the relevant IP profits for the second patent can be calculated and so that the R&D fraction for the first patent can be calculated in future years.

Assume the facts are the same as above but Company A sells the first patent on 1 November 2017. The company can still bring in relevant IP profits for the accounting period ended 31 December 2018 but only in relation to the period from 1 January 2016 to 31 October 2017 for the first patent, so £30,000 plus £33,333 ( $10/12 \times 40,000$ ), making £63,333 of relevant IP profits. In addition, any profit arising on the sale of the patent will also qualify.

Note that the actual taxable profits of the trade for the accounting periods ended 31 December 2016 and 2017 are unaffected. It is just the Patent Box deduction that may be increased in the accounting period ended 31 December 2018.

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