EU PATENT BOX REGIMES - THE WAY AHEAD

EU WITHDRAWS INVESTIGATION

Many countries in Europe, including the UK, The Netherlands, Belgium, Luxembourg, Spain, France and Hungary have special tax regimes for profits derived from specific types of intellectual property rights. Italy has recently introduced such a regime and the Irish government is currently consulting on its own version.

There has, however, been recent uncertainty over the future of these "patent box" regimes. This uncertainty was initially sparked by the European Commission (EC) concluding in an October 2013 report that the UK Patent Box regime amounted to harmful tax competition.

That uncertainty widened when the December 2013 end of semester report of the EU Economic and Financial Affairs Council (ECOFIN) invited the EU's Code of Conduct Group on business taxation to review all patent boxes in the EU so as to ensure consistency with the principle of equal treatment and against the background of international developments such as the OECD BEPS initiative.

The EC subsequently issued enquiries in March 2014 to several EU member states. The concern was whether their patent box regimes granted a selective advantage to a particular group of companies in breach of EU state aid rules.

But as a way forward for patent box regimes has now received broad multi-lateral support, the EC has announced that it won't pursue these investigations any further.

The UK and Germany Reach a Compromise

In November 2014, government officials from the UK and Germany announced a joint proposal for rules on preferential intellectual property tax regimes within the context of the OECD BEPS project. The proposal was based on a "modified nexus" approach proposed by the OECD, which seeks to ensure that such regimes require substantial economic activities to be undertaken in a given jurisdiction by connecting tax benefits with research and development expenditure in that same jurisdiction. The four key elements of the Anglo-German proposal were as follows:

- *uplift of qualifying expenditure*: where related party outsourcing or acquisition costs are incurred which do not constitute qualifying expenditure, companies will be able to obtain a maximum 30% uplift of their qualifying expenditure (subject to a cap based on actual expenditure) included within the formula;

- *closure and abolition of intellectual property regimes*: all existing regimes will be closed to new entrants (products and patents) in June 2016 and will be abolished by June 2021;

- *grandfathering*: intellectual property within existing regimes will be able to retain the benefits of these until June 2021; and

- *tracking and tracing*: the OECD forum on harmful tax practices (FHTP) should work to reach agreement by June

2015 on a practical and proportionate tracking and tracing approach that can be implemented by companies and tax authorities, which includes transitional mechanisms for intellectual property from existing into new regimes, and special rules for previous expenditure.

The Anglo-German proposal was welcomed by both the OECD FHTP and the Code of Conduct Group on business taxation in meetings held in November and December 2014. Final approval for the proposal was sought last month from the OECD and the G20 at the meeting of the OECD's Committee on Fiscal Affairs. The proposal is now forming the basis of the OECD FHTP's work on how the approach will work in practice.

The EU Stands Down

In light of the support for the Anglo-German proposal from the Code of Conduct Group on business taxation, in December 2014 ECOFIN Ministers effectively endorsed the proposal and invited the Code of Conduct Group to monitor implementation during 2015.

This endorsement has now (as of early February 2015) convinced the EC to withdraw its enquiries into the patent box regimes across the EU. This withdrawal is a sensible and welcome decision given that the process for reform is heading along a widely-accepted path.

What now?

On one level, the withdrawal of the EC investigation and the multi-lateral support for the Anglo-German proposal brings a welcome level of certainty to EU patent box regimes that has not been evident for some time. That certainty is not complete, however, given the legislative reform expected during 2015.

Taxpayers that are already taking advantage of existing EU patent box regimes should be able to continue access the benefit of those regimes until 2021 without fear of losing them (for example had they been found to constitute unlawful state aid). This will no doubt be a welcome boost to companies in sectors such as the pharmaceutical and technology sectors, where adoption of patent box regimes has been greatest.

Taxpayers that have not already opted in to a patent box regime should consider the merits of doing so before the June 2016 deadlines when existing patent boxes will be closed to new entrants. Existing regimes may be more advantageous in certain territories.

Taxpayers and their advisers should also keep a roving eye on reforms as they move forward. The ultimate outcome of the reform process should be the ability of EU countries to retain domestic patent box regimes, albeit with a closer link between patent box benefits and research and development investment.

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