TAG Tax GROUP
A GLOBAL ALLIANCE OF
TAX LAWYERS & ACCOUNTANTS

# TAG Tax
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# FRANCE

## Extension of the tax consolidation rules to cross-border participants

- The 2014 Amending Finance Law contained new provisions allowing French company/permanent establishment to create a French tax consolidated group with horizontal company structures
- Under those new rules, a tax consolidation group may be constituted with two French companies held by a non-French company

Article 63 of the Second Amended Finance Bill for 2014 modified the tax consolidation rules in order to comply with a recent decision rendered by the Court of Justice of the European Union (CJEU[1]).

**Until now, the tax consolidation (hereafter "horizontal consolidation") was not extended to cross-border participations**

Pursuant to the current tax consolidation rules, a company or the French Permanent Establishment (hereafter "**PE**") of a foreign entity may be the head of a consolidation group provided that it is not owned, directly or indirectly, at 95% or more by another entity subject to French corporate income tax. All the subsidiaries have to be owned at least at 95%, directly or indirectly, by the parent company.

Those rules have already been amended in 2009 to comply with a CJEU decision[2] "Papillon", allowing the consolidation with subsidiaries held at 95% or more by a French parent company through a non-French company, being noted that those non-French companies were still excluded from the consolidation group and its tax advantages.

Recently, a CJEU decision judging the Dutch tax consolidation regime (*fiscal eenheid*) and the formal notice issued by the European Commission against France (October 2014) leads the French Government to modify its tax consolidation rules in order to allow the consolidation between companies held by a common foreign parent, so called "horizontal consolidation".

**The 2014 Second Amended Finance Bill created the horizontal consolidation**

Under Article 223 A of the French Tax Code as amended by the Second Amended Finance Bill for 2014, a French company or a French PE is allowed to create a French tax consolidated group with other French companies or PE provided that all subsidiaries are owned at 95% or more by a company or PE that is subject to a tax equivalent to the French corporate income tax in another European Union country or in European Economic Area country.

**Conditions which have to be met in order for two companies held by a non-French company to form a horizontal consolidation**

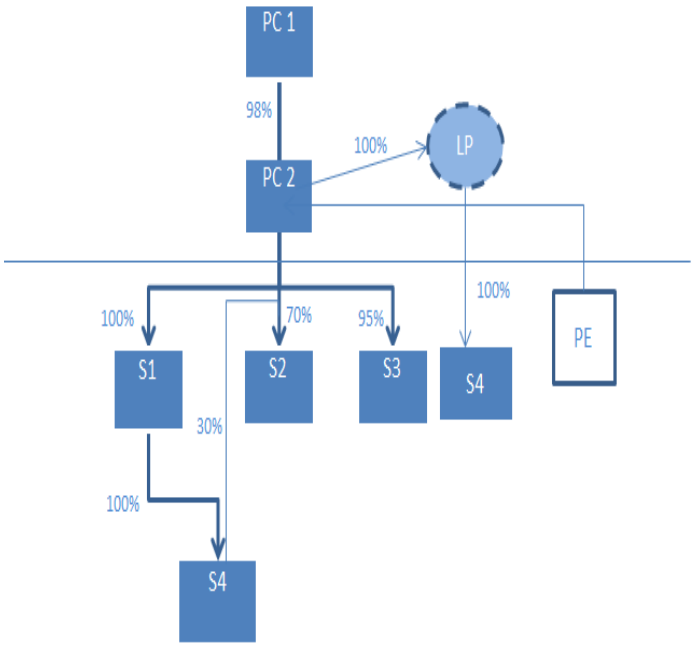
1. The parent company needs to be subject to a tax equivalent to the French corporate income tax in either a Member State of the EU, Iceland, Lichtenstein or Norway;

2. The parent company should not be held at 95% or more, directly or indirectly, by another company subject to French corporate income tax or a tax equivalent to the French corporate income tax located in a Member State of the EU, Iceland, Lichtenstein or Norway;

3. All subsidiaries have to be owned, directly or indirectly, at 95% or more by the parent company.

[1] CJEU 12-6-2014 aff. 40/13
[2] CJEU 27-11-2008 aff. 418/07

**Exemple**




- S1 and S4 may constitute a "vertical" consolidation
- S1, S2, S3 and S4 may constitute a horizontal consolidation since they are held, directly for S1, S4 and S3 and indirectly for S2 at more than 95% by a non-French parent company: PC1
- PC2 cannot be the non-French parent company since its shares are owned at more than 95% by PC1
- PC2 cannot be part of a consolidation existing between S1 and S4, while PE, which is its permanent establishment subject to French corporate income tax, may be
- S4 cannot be part of any consolidation created between S1, S2 and S4, due to the fact that its shares are held by a Limited partnership

**The non-French Parent company may hold the French Parent company through a non-French entity**

Attention must be paid to the fact that the non-French parent company may be held at 95% or more, directly or indirectly, by another company which is subject to a tax equivalent to the French corporate income tax but not located in a Member State of the EU, Iceland, Lichtenstein or Norway.

Indeed, entities located outside of EU or EEE cannot constitute themselves as non-French parent company, but they may have PE in EU or EEE which can be the non-French Parent company, held by companies located outside of EU or EEE.

**The horizontal consolidation may be formed either by sisters or cousins**

Under the new rules, group entities jointly held at 95% or more by other members of the group may be a member of the horizontal consolidation.

**Advantages or disadvantages of the consolidation**

It should be noted that the French consolidation has consequences on corporate income tax only. Indeed, consolidation allows the companies to aggregate the adjusted profit and losses realized by the individual group companies in determining a tax-consolidated result. The parent company then pays tax on behalf of the group. Other advantages are neutralization of capital gains realized on a group transaction or neutralization of intra-group dividends. Such dividends are furthermore exempted from the 3% tax surcharge on distributed profits. However, tax consolidation may trigger some disadvantages (i.e. the global limitation of financial expenses system is appreciated at the level of the group and not at the level of the subsidiaries, the turnover taken into account to determine whether the exceptional contribution on corporate income tax should be levied or not is appreciated at the level of the group). Accordingly, the business decision under which it is decided to create a French consolidation or not or the decision under which it is decided to include one or another entity in the consolidation should be subject to a specific analysis in order to take into account each benefit and/or pitfall of such a tax treatment.

**Formalities**

The horizontal consolidation is optional: the parent company may choose to apply the classic tax consolidation rules instead of the horizontal one.

To constitute the horizontal consolidation, the Parent company has to elect to be the only entity of the group liable for the payment of the corporate income tax.

The election has to be filed within the corporate income tax filing deadline of the tax year preceding the start of the consolidation (i.e. 1st of May for financial years

ending on 31 December). It needs to include the written approval from:

- the French Parent Company;
- its French Subsidiaries;
- the Foreign Parent Company; and
- the Foreign intermediate companies.

**Entry into Force**

The new provisions apply to tax years ended as from December 31, 2014. Relevant horizontal structures that could have benefited from those rules before that may nevertheless claim a refund of the relevant taxes paid in respect of tax years 2012 to 2014 on the basis of the EUCJ decision.

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# FRANCE

## French social security contributions for non-French tax resident: potential tax refund

- In a judgment dated 26 February 2015, the Court of Justice of the European Union (hereafter the "**CJEU**") ruled that French CSG/CRDS (i.e. *Contribution Sociale Généralisée* and *Contribution Sociale pour le Remboursement de la Dette Sociale*) are falling within the scope of the EU regulation, stated their perception as incompatible with EU principles

- Based on this decision, France should not be allowed to levy these taxes for EU workers who are not affiliated to the French social security scheme

By principle, French tax residents are subject to social security contributions on real estate income (capital gain on the disposal of a real estate property in France or French rental income). The second finance bill for 2012 came to include real estate income realized by non-French tax residents to French social security contributions (including CSG/CRDS).

Some tax payers were arguing that France should not be allowed to levy these taxes where individuals are not working in France. To support their argumentation: the EU Regulation on the application of social security schemes to employed persons, to self-employed persons and to members of their families moving within the Community[3] (hereafter the "Regulation") which prohibits overlapping social security legislation. Accordingly, the French Supreme Court requested a ruling from the CJEU in order to determine whether these contributions fall within the scope of the Regulation or not.

In a decision dated 26 February 2015, the CJEU holds that the above-mentioned prohibition applies irrespective of the source of the income received by the person concerned: either from an employment relationship or from his assets. In the case at hand, the claimant was an immigrant worker French tax resident subject to the social security scheme of the Member state of employment (the Netherlands) and saw its revenues subject to French social security contributions.

[3] Regulation No 1408/71 of the Council of 14 June 1971

At first the CJUE specifies that these contributions, have, since they contribute to the financing of compulsory social security schemes, a direct and relevant link with the Regulation and therefore fall within its scope.

Since this Regulation (i) does not allow overlapping social security legislation and (ii) states that a tax payer should be subject to the legislation established by the State in which he is employed: France should not be allowed to levy these taxes in cases where the individual is resident in France but is working in the Netherlands and therefore is subject to the social security scheme of the Member State of employment.
Otherwise, the individual would be subject to a different treatment from the one applied to individuals resident in France who are required to contribute only to the French social security scheme.

Based on this decision, individuals subject to French social security contributions and depending from a social security scheme provided by another EU state member might then file a claim as soon as possible in order to obtain a refund of social contributions unduly paid, being noted that such tax claim may only concern taxes paid within the last two years.

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# NORTHERN IRELAND

## Devolution of corporation tax rate setting powers

- On 8 January 2015 the UK Secretary of State for Northern Ireland, Theresa Villiers, announced the publication of the Corporation Tax (Northern Ireland) Bill

- This Bill has been introduced against a backdrop of current devolution of various tax powers to regional jurisdictions within the UK, and as part of the plan to rebalance the economy in Northern Ireland which has historically been dependent disproportionately on its public sector and has a land border with the Republic of Ireland which has a corporation tax rate of 12.5%.

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The rate currently applied in Northern Ireland is the UK corporation tax rate (20% from April 2015 under current legislation).

This Bill, the passing of which is reliant on the Northern Ireland Executive parties in parallel fulfilling their commitments under the Stormont House Agreement signed in December 2014, provides for the devolution of Corporation Tax rate setting powers to the Northern Ireland Assembly, to apply to companies carrying on certain trades and activities in Northern Ireland. The Bill is scheduled to reach its final stages in March 2015 with the Bill passed before dissolution of Parliament on 30 March 2015 and the UK general election in May 2015.

There is a drive locally in Northern Ireland to reduce the rate to at least 12.5%, giving parity with the corporation tax rate of 12.5% which has been in existence in the Republic of Ireland for many years. The Bill is comprehensive and complex, but the main provisions relating to eligibility and reliefs are summarized below.

***Northern Ireland Rate***

The Corporation Tax (Northern Ireland) Bill provides for the creation of a *'Northern Ireland rate'* of corporation tax. The Bill does not set the Northern Ireland rate nor the date for any change in rate; rather it will devolve the power and decision on the actual rate to the

Northern Ireland Assembly. Given the border with the low corporation tax jurisdiction of the Republic of Ireland means that the case for reducing the rate is strong for Northern Ireland. Once the Bill is enacted the Northern Ireland rate would simply be set by resolution of the Assembly at any time before the start of the financial year and it is anticipated this may be as early as from April 2017. If a rate is not set, the UK mainstream rate continues to apply as normal.

***Northern Ireland Company***

The Northern Ireland rate will apply to Northern Ireland profits. The Bill provides for the Northern Ireland Assembly to set the Northern Ireland rate of corporation tax charged in respect of certain trading profits of a company deemed to be a *'Northern Ireland Company'.*

A Northern Ireland Company is one that is carrying on *a 'qualifying trade' and passes either the 'SME' or the 'large company' test.*

***Qualifying Trade Condition***

A *'qualifying trade'* excludes non-trading activities and defined excluded trades (banking, insurance, lending, investment and investment management, insurance/re-insurance and oil and gas ring fenced trades). Certain 'back-office activities' of excluded trades will however be eligible for the Northern Ireland rate and the UK Treasury is to be given the power to issue regulations to define "back office activities".

***SME Condition***

The SME Condition is that the company is a micro, small or medium sized enterprise (*'SME')* and is a *'Northern Ireland Employer'* for the relevant period. An SME is a company that meets the SME definition under EU regulations (less than 250 employees, and either turnover < Euro 50m, or Balance Sheet < Euro 43m) (* subject to group rules). A Northern Ireland Employer is a company where at least 75% of its staff working time in the UK and related costs relate to work carried out in Northern Ireland. This will give rise to an 'in/out' test.

***Large Company Condition***

*A 'large company'* is a company that is not an SME and has a *'NI Regional Establishment'* (NIRE) for the relevant period.

The Bill provides rules which require large companies to determine whether they have a regional establishment in Northern Ireland; broadly, similar to the UK permanent establishment rules. These companies must then also as required apply rules similar to those governing the allocation of profits to a permanent establishment, apportioning their profits between those arising in Northern Ireland and those arising elsewhere in the UK. A NIRE exists if the large company *either* has a fixed place of business in Northern Ireland through with the business is wholly or partly carried on, *or* has an agent who has the authority to conclude business in Northern Ireland on behalf of the large company.

***Profits & Reliefs***

A Northern Ireland company will be required to split its profits and losses into 'Northern Ireland profits/losses' and 'mainstream profits/losses'. The existing rules on loss reliefs are modified to accommodate the existence of different tax rates and loss carry forward and group/consortium relief rules.

Capital allowance claims will be streamed between activities subject to the Northern Ireland rate and those subject to the main UK rate. There are complex rules for dealing with intangible assets held for the purpose of a Northern Ireland trade. There are additional rules in relation to the calculation of R&D tax relief, contaminated land relief, film tax relief, and various other reliefs; with the broad objective of preserving the value of those reliefs. The UK Patent Box regime is to be amended to provide for a mainstream deduction and a Northern Ireland deduction in calculating the patent box profits. There are further rules governing the treatment of corporate partnerships.

***Summary***

This is a broad summary of the provisions of the Bill as initially proposed and is subject to any changes during its passage through Parliament or amendments or new

legislation following its enactment, together with any guidance issued by HM Revenue & Customs in due course. There will be various practical implications for companies that do business in Northern Ireland and elsewhere to implement and deal with the complexities of the proposed legislation once enacted and any reduction in the Northern Ireland rate.

This is a significant piece of legislation for Northern Ireland to complement an existing skilled workforce and competitive cost base for local businesses and for attracting inward investment and which is acknowledged requires to be coupled with further investment in areas such as skills and infrastructure that a growing private sector and foreign direct investment needs. Under EU law in accordance with the European Court of Justice decision on the "Azores case" (Commission v Portugal C88/03), Northern Ireland will also be required to fund any reduced taxation by a reduction in Northern Ireland's own block funding via the UK government.

As a panel member of the break out session "Doing Business in the British Isles" at the Spring 2015 International Conference in Edinburgh, I look forward to discussing further the various tax implications of doing business in the various jurisdictions throughout the UK and Ireland.

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# POLAND

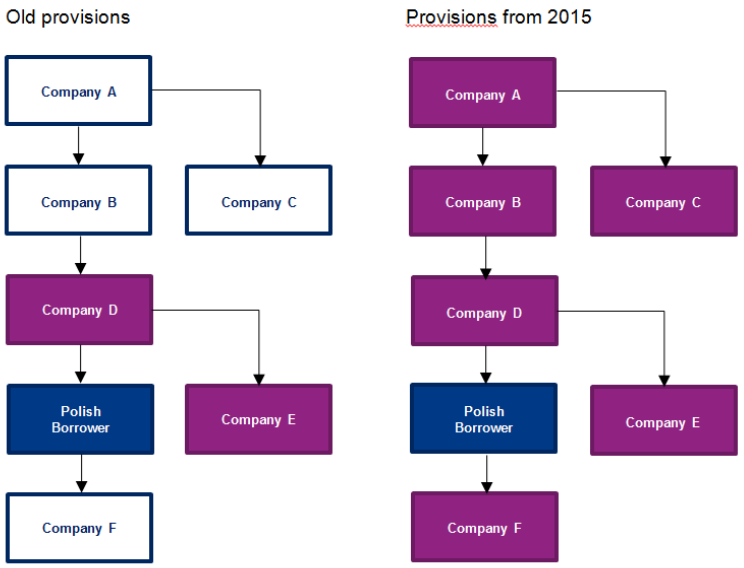
## New Polish tax rules applicable from January 2015

- The Polish tax system is subject to constant changes. As of 1st January 2015, the Income Tax Acts were significantly amended.

- Below we present details of the significant practical impact had by the entry into force of two new regulations.

### 1. More stringent thin capitalization regime

In recent years, it was relatively easy to structure transactions around the Polish legal provisions governing thin capitalization rules. Restrictions on the deductibility of interest paid on group financing could be avoided if loans were granted from grandparent companies, as opposed to coming from direct shareholders or sister companies. As of January 2015, such financing is now subject to new, more stringent thin capitalization rules which extend their applicability and limit the deductibility of interest on most loans granted within the framework of a single capital group.




✓ The amended thin capitalization provisions extend the group of borrowers covered by the thin capitalization rules, so as to also include **indirect relations.**

Entities covered by thin capitalization

- ✓ The new provisions envisage the modification of **debt-to-equity ratio** from 3:1 to **1:1**.

- ✓ The new restrictions extend the definition of a **"loan"** to include the provision of a credit facility (in addition to the pre-existing categories of loans, debt securities, irregular deposits or savings accounts) and extend the definition of a **"qualifying equity"** to cover not only the company's registered capital but also to supplementary capital (subject to a few exceptions expressly listed in the laws).

**An alternative to thin capitalization rules**

Instead of the thin capitalization regime, a company may now opt for an alternative method of calculating the limit of tax-deductible interest, which is also applicable to interest paid on financing received from non-related parties.

- ✓ Pursuant to this new method, the amount of interest deemed to constitute a tax deductible cost is calculated on the basis of the tax value of assets (within the meaning of accounting law provisions) and the reference rate of the National Bank of Poland from the last day of the year preceding the relevant tax year, increased by 1.25 percentage points.

- ✓ The amount of tax deductible interest may not exceed 50% of the company's operating profits (EBITA). This condition does not apply, however, to banks, credit institutions and financial institutions whose revenue from leasing transactions constitutes at least 80% of their revenue derived in a given tax year, or if the revenue from the purchase and sale of receivables constitutes at least 90% of their revenue for that tax year.

- ✓ This method must be notified to the tax authorities within the first month of the tax year in which it is utilized and this method must be applied for a minimum period of three years.

The thin capitalization amendments primarily affect most Polish entities utilizing intra-group financing, as well as those at the initial stages of their development. For some companies, the new provisions may necessitate extremely diligent planning to eliminate any potentially adverse tax consequences flowing from group financing. In some cases, however, it may force companies to seek external financing.

**2. New CFC rules**

The CFC regime represents a novel legal solution, which has never previously existed within the Polish tax system. The general objective of the CFC regime is to tax income generated by so-called controlled foreign corporations (CFCs) to a 19% Polish tax, in order to prevent Polish taxpayers from transferring their profits to other jurisdictions with low tax levels.

- ✓ Generally, any company having its registered seat (or management) in a territory formally blacklisted as a tax haven by the Polish Minister of Finance, or in a country with which no ratified double tax treaty and/or no treaty governing the exchange of tax information has been signed by Poland or the EU, shall be deemed to constitute a CFC.

- ✓ Companies having their seats within the EU, or countries with which Poland or the EU have signed a tax treaty, will also fall within the definition of a CFC if they meet the following criteria:

  (i) non-Polish entities in which a Polish taxpayer holds, directly or indirectly, at least 25% of the share capital, voting rights or profit share for a minimum period of 30 days, and;

  (ii) at least 50% of that entity's revenue in the given tax year is derived from passive income (such as dividends, interest, income from intellectual property rights, capital gains, or income from the sale or exercise of financial instruments), and;

  (iii) at least one source of such passive income is subject to either a tax rate equal to or lower than 14.25% or is exempt or excluded from tax, unless such income is exempt from tax pursuant to the EU Parent-Subsidiary Directive.

- ✓ A foreign company, subject to tax on its worldwide income within the EU or the EEA, is not recognized

as a CFC provided that it conducts genuine business activity.

- ✓ Also entities registered outside the EU or EEA fall outside the scope of the CFC rules if they conduct genuine business activity and their income does not exceed 10% of the revenue resulting from conducting business activity in that state.

- ✓ CFC rules do not apply to entities having annual revenue which falls below Euro 250.000 (or its equivalent in other currencies).

- ✓ Polish taxpayers who own CFCs are now subject to certain reporting obligations consisting *inter alia* of keeping a separate register of CFCs to enable the calculation of the CFC's income and the tax payable in Poland. They must also file a specific tax return and pay any additional tax due on this CFC sourced income by no later than the end of the 9th month of every tax year.

The new Polish CFC rules may prove problematic for capital groups operating worldwide, since they will be required to verify whether a given entity within a group conducts genuine business activity or falls within the scope of the Polish CFC regime. In practice, this may also necessitate the reorganization of the most commonly encountered optimization structures, based on the utilization of foreign companies (e.g. for IP regimes).

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# UNITED-KINGDOM

## Non-Residents to pay capital gain tax on residential property from April 2015: Details announced

- As from April 2015, non-UK residents who own UK residential property should be subject to a tax levied on gains realized on the sale of their UK residential property

- According to the UK Government, the new regime is being put in place to counter the perceived "unfairness of the current situation" and to bring the UK into line with "many other countries around the world that charge capital gains tax on the basis of where a property is located". The unfairness is due to the fact that UK resident individuals are subject to capital gain tax on the sale of residential property which is not their main home. The Government believes this should be the case for non-residents as well.

Until now, non-UK residents have generally been able to dispose of UK property without incurring a liability to Capital Gains Tax (CGT) but from 6 April this will change and non-residents will be subject to CGT on disposals of UK residential property. The term "disposal" includes not only a sale but also a gift, so those considering gifts to say, children also need to take note of this change. The proposals were originally announced in the 2013 Autumn Statement but following publication of the draft legislation for inclusion in the Finance Bill 2015, full details are now available.

Individuals will pay CGT on any gain at the usual CGT rates, either 18% or 28%, and any losses can be offset against other gains on the disposal of UK residential

property and against any gains if they subsequently become UK resident. The charge applies to disposals of any interest in UK property used or suitable for use as a dwelling including let property, although communal dwellings such as student accommodation and nursing homes are excluded. Non-residents will continue to be exempt from CGT on disposals of commercial property and other assets.

There are provisions for rebasing so that by default only the rise in value between the market value as at 6 April 2015 and sale will be subject to the charge.

Alternatively the vendor can elect for the gain to be taxed on a time apportionment basis e.g. if the property was owned for 50% of the time prior to 6 April 2015 and 50% after, 50% of the gain will be taxable under the new rules. This option is not available where part of the gain falls within the ATED rules - see below. Another alternative is that an election can be made to use the normal method of calculating CGT and so effectively to ignore rebasing, which may be helpful where the property has made a loss since purchase. Advice will therefore be required prior to disposal on the most tax efficient method of calculating the gain. If the vendor already files UK tax returns, any tax due should be included in the return for the tax year in which the gain arises. Otherwise payment is due within 30 days of completion.

Principle Private Residence Relief (PPR) is a valuable relief which often prevents any CGT charge arising on the sale of an individual's main home. PPR will be available to non-residents, but the qualifying criteria is being narrowed from 6 April 2015 so that, in addition to meeting the existing criteria, the taxpayer either has to be resident in the territory in which their house is situated or meet the day count test i.e. they or their spouse must spend at least 90 nights in the property in any tax year. (If the house is only owned for part of the year, the day count test is reduced proportionately and where there is more than one property in a territory, the 90 day test can be spread across all or both of those properties.) In many cases spending 90 days in the UK each year will make an individual UK resident anyway, in which case although they may be entitled to PPR on any disposal of their UK home, they will be within the UK tax net for all other income tax and CGT purposes. Careful consideration will therefore need to be given as to whether it is desirable for a particular non-resident individual to attempt to preserve a PPR claim, possibly at the expense of abandoning their non-UK resident status, bearing in mind that there is not a one-off test for PPR at the date of sale – for every tax year after April 2015 that either the residence criteria or day count test is not met, a proportion of PPR will be lost.

The new CGT charge will also apply to non-resident trusts, companies and partnerships. Non-resident trusts will pay CGT on the disposal of UK residential property as it arises at the trustees' rate of 28% and the gain will not therefore be taxed on any UK resident and domiciled settlor with an interest in the trust, nor go into the tax pool to be matched against any benefits received by UK resident beneficiaries. PPR may be available where a beneficiary occupies a trust property as their main residence under the terms of the trust provided they are either UK resident or meet the day count test.

The application of the new CGT charge to non-resident companies and the interaction with existing anti-avoidance provisions is particularly complicated. Where a company is within the scope of the new CGT charge the rate will be 20%, the same as the corporation tax rate. Diversely held companies and institutional investors are specifically excluded from the charge but residential property let out by other companies even on a commercial basis is not. This creates a mismatch with the Annual Tax on Enveloped Dwellings (ATED) legislation which imposes an annual charge on "high value" residential properties owned by companies and a special CGT charge on gains arising on the disposal of such property, whereby let residential property is generally excluded both from payment of the annual charge and the ATED related CGT charge. (Currently ATED applies to properties worth £2million or over but this limit will be reduced to £1million from April 2015 and £500,000 from April 2016. In addition it was announced in the recent Autumn Statement that the annual levies will increase by 50% from this April.)

Where a company does pay the annual charge, the ATED related CGT charge, which is levied at 28%, will take priority over the new CGT charge. Equally the new CGT charge will take priority over the anti-avoidance provisions in section 13 of the Taxation of Chargeable Gains Act (s13) whereby gains arising to offshore companies sometimes fall to be taxed on a UK resident shareholder. The scope of s13 has in any event substantially narrowed in recent years as it no longer applies where CGT or Corporation tax avoidance was not a motive and late last year the ECJ held that the unamended provisions of s13 were contrary to EU law.

Partnerships will be treated as transparent meaning that each partner (be it a company, trust or an individual) will be taxed at the relevant rate on its proportion of the gain.

Although the final proposals are broadly as expected, the introduction of the CGT charge on non-residents disposing of UK residential property is going to change the tax planning landscape for both non-residents and short term UK residents who own property in the UK.

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# UNITED-KINGDOM

## Patent box regime

- UK Patent Box allows 10% corporation tax for sales of patented products and patent royalties; existing regime to be closed for new companies in June 2016 but available for five more years to those who have opted in.

**Background**

Companies that own or have an exclusive license over patents granted by the UK Intellectual Property Office or the European Patent Office can elect into a scheme known as the Patent Box regime. This regime allows companies to apply a rate of corporation tax of 10%, instead of the normal rate, 20% from April 2015, on profits attributable to patents. The income received from the patents to be taxed at the lower rate can be derived from sales of products which incorporate at least one patented component or from royalties from patents. Income from products which only have copyright protection are excluded.

The patent box regime was introduced from 1 April 2013 to provide an incentive to companies to maintain, develop and manufacture their patents in the UK. In common with many territories, the UK Government is keen to encourage the development and exploitation of original ideas and to promote the UK as being an excellent location for technology based businesses. It was part of a range of measures introduced at the time to increase the UK's competitiveness from a corporation tax point of view, including a relaxation of the CFC rules and a dividend exemption system.

To qualify for eligibility into the regime, various criteria must be met. These are:

- A company must own qualifying intellectual property rights to the patent and must have performed qualifying development expenditure in relation to it.

- If a company owns the patent but licenses it to another company for development purposes, it can still qualify for the scheme provided it plays an active role in managing the intellectual property rights.

- If the company is a member of a group, it can enter the scheme provided that it has either developed its own intellectual property rights or undertakes a significant active role in managing the rights.

The above criteria prevent groups from transferring their intellectual property rights to 'passive' companies and thus benefiting from the lowered and advantageous corporation tax rate. However, they do allow for a range of possible ownership and exploitation arrangements within a group that is worthy of careful consideration for groups of companies with appropriate registered patents.

It is necessary to elect into the regime within two years of the end of the accounting period to which the regime

is to apply. There are a series of calculations to be performed in order to ascertain exactly how much of a company's total profits in the period will be subject to the lower rate of taxation. These involve removing some element of profits that are deemed to be associated with a 'normal rate of return' on overhead expenditure and also a 'normal' marketing return. The regime is intended to benefit the super-profits that derive to an organization as a result of its innovation.

The reduced rate of taxation is being phased in over four years, with the full reduction to 10% only becoming available in the year commencing April 2017.

**Recent changes**

The original proposal for the UK patent box regime came under fire from Germany and a number of other EU member states. It was argued that the regime was too generous and was encouraging companies to artificially shift their profits to the UK thereby resulting in a negative impact on the tax positions and collections of these states. As a result, the UK has agreed to a compromise agreement with regard to its new regime.

The UK regime will close to new entrants by 30 June 2016, and the existing arrangements will be phased out completely by 30 June 2021. Companies who have elected into the regime by June 2016 will therefore be able to continue to benefit from the existing arrangements for five years. After this time, it seems likely that all countries will be required to operate regimes based on the modified nexus approach as part of the work being done by the OECD. This approach considers where the research and development expenditure is incurred in developing the patent and is unlikely to be as beneficial as the existing UK scheme.

Work by the OECD on the modified nexus approach to Intellectual Property tax reliefs is progressing and will be included in the 2015 progress report from the Forum on Harmful Tax Practices.

**Advice for companies**

The existing UK Patent Box regime now carries a time limit. A number of groups have not yet fully explored the possibilities of the regime, partly because it is not yet available at the best rate of relief. The take up from SME companies in particular has been low.

For standalone UK companies and for parent companies with subsidiaries in the UK who sell patented products, now is the time to review whether they can and should elect their business into the regime. The answer is not always clear cut and the best approach is to conduct a feasibility analysis to determine to what extent the regime will be beneficial.

Doing nothing however, risks missing the opportunity. However, the revised regime ends up being legislated it will almost certainly be less beneficial than that which currently exists.

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