

The newsletter of the Life Sciences Group



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Welcome to the Summer issue of BioBrief. In this edition we discuss the Patent Box regime and the cost of protecting patents once they have been obtained. Manches are also offering a free Will review service, which is detailed on page 4.

BOXED IN?

In November 2010 the Government announced a review of taxation in the R&D sector: As part of this review it introduced a Patent Box regime. In summary, the Patent Box promotes a reduction in corporation tax to 10% on profits derived from patents. Profit from patents has been chosen because patents are strongly linked to research and development effort. By increasing benefits in relation to patents, the Government hopes to persuade companies to leave R&D and other high technology jobs within the UK. The new regime is intended to come into force in April 2013.

The Government claims that it wants to achieve the most competitive tax system in the G20, supporting growth and innovation and encouraging investment in the UK. However, given other countries (Netherlands, Belgium, Luxembourg) have also implemented similar tax-saving regimes and the details of the UK Patent Box regime remains unclear, it is difficult to say whether the Government will achieve its ambitious aims. In addition, the Patent Box will clearly impact on Government tax receipts and it remains to be seen whether such an impact can be sustained over a long period of time.

The Government has recently published a consultation document in relation to the Patent Box regime. The foreword to this document reinforces the Government's stated aim of removing barriers to business and encouraging businesses across a wide range of sectors to invest in the UK. The Government recognises that to achieve its aims it is necessary that the Patent Box covers a wide range of patent income and any uncertainty and complexity is minimised. That

said, identifying relevant profits may increase the burden on companies and the system will have to be sustainable. The consultation is therefore aimed at seeking the right balance between wide coverage and long-term sustainability.

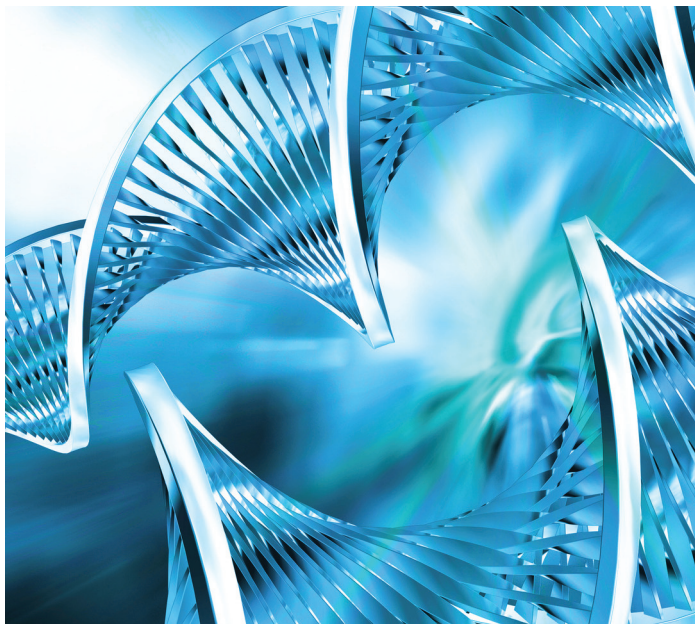
The consultation takes the high level principles identified in the November 2010 review and expands on them, whilst seeking to address some of the earlier criticisms.

IP Scope

Any company with qualifying IP will be entitled to take advantage of the Patent Box. The relief will extend widely to a large range of industries and company types. It will also extend to a wide variety of qualifying IP 'users'. Hence patent owners and exclusive licensees will be entitled to use the Patent Box, as will joint ventures, partnerships and other similar arrangements. The test is whether the 'entity' is performing a 'significant' activity and whether the entity remains involved. The exact test for what will constitute 'significant' activity and how this will be monitored is unclear, though the government is looking beyond merely R&D activity as a means of assessing 'significant' activity.

Although the Patent Box is clearly aimed at patents, the consultation extends it to cover regulatory data protection/'data exclusivity' and plant variety rights, (of course, data exclusivity is not strictly an intellectual property right). The relief is predicated on the fact that the covered rights are only granted following some form of verification by an independent authority. Only UK and European Patent Office (EPO) patents are proposed to be covered at this time, although the Government is considering whether to extend the scope wider to include other European Member State patents or equivalent IP rights.

The Patent Box relief applies to granted patents rather than applications. However, following consultation, the Government recognises that getting a patent can take a significant amount of time and expense. It is therefore proposing an ability to claim back relief for the four years prior to grant, but only once the patent has been granted (and therefore is verified by the independent party).



Eligible Profit

In summary the following position is proposed:

Eligible	Not eligible
Royalties/license fees	Income from products made in a patented process
Income from sale of products incorporating invention plus spare parts	Service income
Licensing of intangible assets	Income from financial arrangements/ financial income
Damages paid re infringement	North Sea ring fence regime
Income from sale of patents	

Direct patent income (for example royalties or licence fees) will clearly be easier to assess than, for example, income from sales of products incorporating the invention. The latter category also raises the potential for avoidance strategies, with companies labelling or combining products in order to achieve Patent Box relief.

To make assessment of attributable profit easier; the Government is proposing a formulaic approach which can be summarised as follows:

1. Identify qualifying income i.e. that relating to qualifying IP – the starting point for identification is taxable rather than accounting profit. R&D tax credit enhancement and interest receipts are excluded. Apportionment is then on a pro-rata basis according to proportion of total trading income which is qualifying.
2. Deduct routine profit/return (i.e. standard trading return) – the Government is proposing a cost-plus method for calculating routine profit. Certain costs will be excluded and remaining costs will be marked up at a fixed rate of 15%. This proposal seeks to avoid complexity.
3. Eliminate profit derived from other forms of IP (for example trade marks) – the Government is proposing to apportion by looking at the ratio between 'patent' expenses (e.g. R&D expenses) and 'brand' expenses (e.g. marketing costs).

Whilst the above approach may well lead to less complexity in terms of calculation, it remains to be seen whether it reflects reality or leads to inappropriate allocation of, for example, profit related to brands. It also may disadvantage certain markets, where additional or high marketing spend is required in order to bring a product to market.

In certain circumstances 'divisionalisation' will replace step 1 above. This enables companies to apportion expenses and profits separately into suitable 'divisions' of the company. Profit is then assessed in relation to a notional royalty calculated at arm's length. The approach may be mandatory in certain cases. It will be interesting to see whether companies choose to adopt this divisionalisation approach as a way of improving their Patent Box relief.

Anti-avoidance rules

Given the scope of the Patent Box relief, the Government has made it clear that anti-avoidance measures will have to be considered for the relief to have any chance of long-term sustainability. One area of particular concern is the sale of combined products, where companies may combine products purely with the intent of obtaining Patent Box relief, where the patented product was not truly necessary to the combined product.

Other points to note

It will be possible to opt out of the Patent Box. This opt-out right is given in the context of the relief calculation giving rise to Patent Box losses. These losses will be ignored in terms of calculating corporation tax but will be carried forward and therefore reduce future Patent Box relief. To prevent use of the opt-out to avoid tax, the Government is proposing that if a company opts out it will not be allowed to opt-in again for a period of five years.

The Patent Box will apply to all qualifying patents rather than just those first commercialised after 29 November 2010, as suggested in the November 2010 review. However, benefits will be phased in over five years to manage the impact on tax receipts. The proposed phase-in goes from 60% proportion of full benefit available in 2013/14, to 100% of relief by 2017/18.

Conclusions

The consultation period will finish on 2 September 2011, with the Government aiming to publish draft legislation in Autumn 2011. Clearly, feedback on the existing proposals will be important in influencing how the Government decides to legislate for the Patent Box. It will be interesting to see whether the current broad measures survive into the draft legislation.



CAN YOU AFFORD TO PROTECT THE PATENTS YOU HAVE OBTAINED?

For many years, the Patents Court of the English High Court has been world-renowned, as one whose decisions are well considered, well presented and result in 'good law'. Decisions from that court, and indeed from former judges of that court who have progressed to the Court of Appeal and on to the House of Lords, are highly regarded by the courts on the continent and throughout the common law countries of the world.

However, the quality of such decisions comes with a hefty price tag. This is most remarkably illustrated in the BlackBerry patent litigation some years ago, where it was reported that the parties spent around £5 million and £1 million respectively. Clearly there is a need for a much lower cost venue.

The answer has been found in the (now re-constituted) Patents County Court (PCC).

Following submissions to the Lord Chancellor's Department over several years, with effect from 1 October 2010, the Patents County Court was the subject of some fundamental changes, designed to make the court an affordable forum for intellectual property litigation for small and medium enterprises and for individuals.

The factors that create the most cost in litigation in the High Court include the need for extensive documentary disclosure and also the preparation and exchange of extensive written evidence, both from witnesses of fact and from experts. These factors have been largely removed in the revised procedure in the PCC.

To balance this absence, parties to litigation in the PCC need to prepare and serve full (but concise) statements of their case or defence, which set out the facts and arguments on which they are relying. A copy of any document mentioned in a statement needs to be appended. Each party is entitled to serve a reply to the other parties' statement, especially if the Defendant raises a counterclaim (which would usually be the case where a Defendant wishes to challenge the validity of registered rights). All of the documents together make up the bulk of what amounts to disclosure under the PCC rules.

In contrast to the process in the High Court, in the PCC, any additional evidence that might be helpful can only be used or prepared at the Judge's discretion, and then on the basis that the cost of preparing and dealing with the evidence does not outweigh its benefit. The same test applies to witness statements, experts' reports, and cross-examination at trial, among others. Another feature is the limitation of trials to a maximum of two days in the PCC.

The reduction in the number of procedural steps and the robust control of other variables by the PCC Judge will play a significant role in driving down litigation costs. However, the main driver in reducing the cost of litigation is the imposition of a cap on the costs the losing party will be ordered to pay. These are limited to a maximum of £50,000 to determine liability but £25,000 to assess how much damages ought to be paid. Additionally, every step of the case has a costs cap, so even

£50,000 might be at the upper limit of what might be expected to be recovered.

In all, the new PCC should become the preferred venue for SMEs or individual inventors and designers who want to protect their IP. The costs of preparing a case should be significantly lower than equivalent cases in the High Court, and the cost exposure should a claim be unsuccessful, is capped to a moderate level (in comparison to the cost of a High Court action).

MANCHES' FREE WILL REVIEW SERVICE

Many people do not realise that it is wise to review a Will every three years or so. This is especially important if there has been a change in personal circumstances or where there have been changes to the tax rules.

We are happy to review your Will free of charge or, where you don't have a Will, provide you with free advice on putting a Will in place.

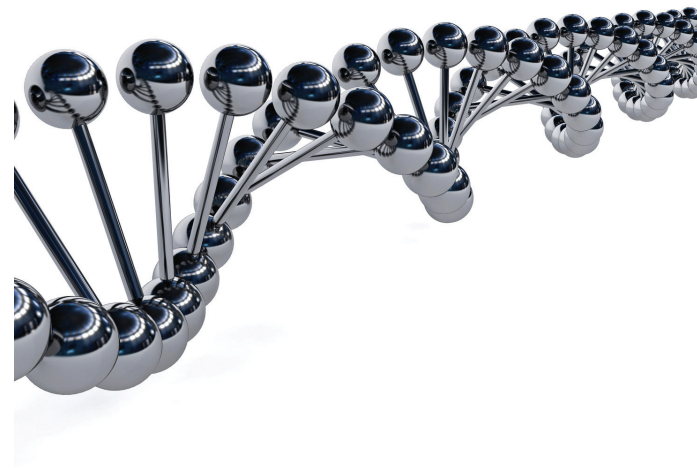
Our review also includes the following:

- Free inheritance tax advice
- Free advice on powers of attorney
- Free advice on protecting the value of the family home from care home costs

If you are interested then please contact Anna Burnside at anna.burnside@manches.com or call Anna on 01865 722106 quoting "free review".

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