

# ***UK states that OECD agrees on substantial activity level required to benefit from preferential IP regimes***

*December 4, 2014*

## ***In brief***

The UK government released a statement on December 2 that sets out how the OECD plans to move forward with new rules for preferential intellectual property (IP) regimes within the base erosion and profit shifting (BEPS) project.

## ***In detail***

### ***Developments to date***

The OECD BEPS paper on Harmful Tax Practices released in September favored a 'modified nexus approach' to determining an appropriate level of substantial activity in order for a taxpayer to benefit from a preferential IP regime. Not all members agreed with that proposed approach.

On November 11, the UK and German governments issued a joint statement that they had co-developed a compromise proposal to advance negotiations (See [\*PwC Tax Insights, UK - Germany joint proposal for preferential IP regimes: good news for UK patent box?\*](#)). The compromise proposal was presented to both the Forum for Harmful Tax

Practices (FHTP) and the EU Code of Conduct Group.

The December 2 release states that the compromise proposal was broadly welcomed and will form the basis of continued work by the FHTP to determine how the approach will work in practice.

### ***What has been agreed for future IP regimes***

The UK government also released a 'frequently asked questions' paper that provides more detail on the FHTP agreement. Key aspects of this paper include:

- additional details on the planned operation of the modified nexus approach
- a timetable for reaching final agreement on the proposal and finalization of details

- implications for existing IP regimes, including specific commentary on the UK patent box.

### ***Modified nexus approach***

Additional details available on operation of the modified nexus approach include:

- preferential IP regimes apply only to patents (or patent-like assets) and may confer benefits only in line with the modified nexus approach
- under the modified nexus approach, expenditures will qualify for preferential treatment only when directly linked to research and development (R&D) carried out in the territory; outsourced costs and acquisition costs will not be covered

- qualifying expenditures may be increased by up to 30% when groups have acquisition costs or outsourced costs, up to the lesser of those acquisition/outsourced costs or the 30% increase.

#### *Timetable for finalization*

The timetable for final approval of the approach and finalization of details is as follows:

- formal approval of the modified nexus approach by the Committee for Fiscal Affairs in January 2015
- launch of an informal consultation about the regime, including how to track and trace R&D expenditure, to conclude by 2016
- development of legislation to commence in 2015, but final legislation will be informed by the consultation outcome and is not expected until 2016.

#### **Implications for existing IP regimes**

##### *Existing IP regimes generally*

We understand that the Code of Conduct group believes that one implication of these developments is suspension of current investigations into existing IP regimes.

Countries with existing IP regimes must agree to close them to new entrants by June 30, 2016, and abolish them by June 30, 2021.

After June 30, 2021, all IP regimes must comply with the modified nexus approach.

The OECD has agreed to consult informally regarding how a practical tracking and tracing methodology for R&D expenditures should work. The UK government intends to consult with stakeholders to allow them to provide input into this process.

##### *UK patent box specifically*

The UK government highlights in its release that the compromise protects its interests by allowing it to retain a competitive patent box regime. The UK government believes this regime will continue to incentivize innovation and its commercialization in the United Kingdom.

Companies with IP already in the current regime, or that enter into it by June 30, 2016, can continue to benefit from the existing rules until June 30, 2021.

IP submitted after June 30, 2016, will be subject to the new modified nexus approach. Both schemes will run in parallel until June 30, 2021.

The UK government intends to consult on the changes to the UK patent box regime once the FHTP has completed work on the detail of the new rules. Therefore, final legislation is not expected until 2016.

#### **The takeaway**

The FHTP and Code of Conduct groups agreement to the UK-German modified nexus approach creates a clear path forward for existing and future IP regimes.

Companies have until June 30, 2016, to enter into the current generous UK patent box regime. That should secure benefit for existing IP until June 30, 2021, under the proposed grandfathering rules and provides further certainty for US multinational companies.

US multinational companies with significant operations in the United Kingdom may wish to engage in the consultation that is intended to be launched in January 2015 on the further details of the modified nexus approach. This will inform the design of the future UK patent box, as well as other IP regimes.

## ***Let's talk***

For a deeper discussion of how this might affect your business, please contact:

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