

CAPITAL ALLOWANCES ACT 2001

EXPLANATORY NOTES

COMMENTARY ON SECTIONS

Glossary

Part 8: Patent allowances

Overview

1636. This Part provides for patent allowances. The allowances are available to persons who incur qualifying expenditure on patent rights for the purposes of a trade or who are taxable on any income receivable from those patent rights. Qualifying expenditure is pooled for the purpose of calculating entitlement to allowances and liability to charges.
1637. [Chapter 1](#) introduces the Part. It requires a person to have incurred qualifying expenditure on purchasing patent rights to get allowances. It defines “patent rights” and provides for the application of the Part to:
- rights to acquire future patent rights; and
 - the grant and acquisition of licences.
1638. [Chapter 2](#) defines “qualifying expenditure” for the purposes of patent allowances. This may be qualifying trade expenditure or qualifying non-trade expenditure.
1639. [Chapter 3](#) deals with determining entitlement to allowances or liability to charges and calculating the amounts involved. Qualifying expenditure is pooled. There is a separate pool for each trade for which there is qualifying trade expenditure and one pool for qualifying non-trade expenditure. Disposal receipts can arise in relation to qualifying expenditure. Disposal receipts come out of the pool and effectively reduce entitlement to allowances or result in balancing charges. The disposal receipt (or total disposal receipts if there are part disposals of the patent rights) in relation to an item of qualifying expenditure is limited to that qualifying expenditure.
1640. [Chapter 4](#) contains the rules about how allowances and charges are given effect for the chargeable period:
- allowances and charges for qualifying trade expenditure are treated as trading expenses or receipts of the trade; and
 - allowances for qualifying non-trade expenditure are deducted from patent income and there are provisions for carry forward of excess allowances. Charges for qualifying non-trade expenditure are treated as Case VI income for income tax and as patent income for corporation tax.
1641. [Chapter 5](#) contains supplementary provisions. These include a rule limiting qualifying expenditure in cases of purchases between connected parties or for avoidance.
1642. Provisions for expenditure incurred before 1 April 1986 are in paragraphs 92 to 102 of Schedule 3.

History

1643. Income Tax Act 1945 introduced capital allowances for patent rights. It also introduced provisions dealing with the “revenue treatment” of capital profits from the sale of patent rights.
1644. Allowances were originally given for each separate item of capital expenditure on the purchase of patent rights. Those allowances were given on a straight line basis over, broadly, the life of the patent rights that had been bought. A balancing allowance was available on the disposal of the whole of the patent rights if the sale proceeds were less than the unrelieved cost of the patent rights at the time of the sale. Balancing charges were made if patent rights were sold for more than the unrelieved cost of the patent rights at the time of the sale.
1645. FA 1986 changed the way allowances are given. Capital expenditure on the purchase of patent rights incurred after 31 March 1986 is pooled. Allowances are given on the balance in the pool. There are also balancing allowances and charges similar to, but not identical with, those for plant and machinery.
1646. Both sets of provisions – for expenditure before and after the changes in 1986 – were consolidated in Chapter I of Part XIII of ICTA together with provisions about the “revenue treatment” of capital profits. These are sections 520 to 529 and 532 and 533 of ICTA.

Structure of this Part

1647. This Part:
- brings the legislation dealing with capital allowances (broadly all or parts of sections 520 to 523, 528, 532 and 533 of ICTA) into this Act in order to make it more accessible; and
 - splits that material into separate Chapters having regard to both the structure of patent allowances and the structure used for other allowances.

Chapter 1: Introduction

Overview

1648. This Chapter introduces patent allowances. They are given to persons incurring qualifying expenditure on the purchase of patent rights. The Chapter defines “patent rights”. It contains extensions to deal with licences and cases if a patent has not yet been granted for an invention. “Qualifying expenditure” is defined in Chapter 2.
1649. [Section 464](#) requires qualifying expenditure on purchasing patent rights in order for allowances to be given and defines “patent rights”.
1650. [Section 465](#) extends this Part to deal with certain cases concerning rights in respect of an invention if a patent has not yet been granted.
1651. [Section 466](#) extends this Part to deal with grants of licences in respect of patents.

Section 464: Patent allowances

1652. This section is based on section 533(1) of ICTA. It explains that allowances under this Part are only available to persons who incur qualifying expenditure on purchasing patent rights and defines “patent rights”.

Section 465: Future patent rights

1653. This section is based on section 533(5) and (6) of ICTA. It treats expenditure by a person on the right to acquire future patent rights as if it was on the purchase of patent rights

– even if a patent has not yet been granted in respect of the invention. Relief would not be available to the payer without this provision.

1654. *Subsection (2)* treats the expenditure on the right to acquire future patent rights as if it were expenditure on the patent rights if that person subsequently acquires those rights.
1655. *Subsection (4)* gives corresponding treatment to the recipient of the payment. It treats the recipient as receiving the sum for a sale of patent rights even if a patent has not yet been granted for the invention.

Section 466: Grant of licences

1656. This section is based on section 533(2) and (3) of ICTA. It enables:
- section 468 or 469 to apply to licence acquisitions. They would not otherwise as they require a *purchase* of patent rights; and
 - section 476(2) to apply to the grant of a licence. Section 476(2) requires a *sale* of patent rights.

Chapter 2: Qualifying expenditure

Overview

1657. This Chapter defines “qualifying expenditure”. There are two types of qualifying expenditure. The way in which allowances are given in respect of the two types is different.
1658. *Section 467* sets out the two types of qualifying expenditure.
1659. *Section 468* deals with qualifying trade expenditure.
1660. *Section 469* deals with non-trade qualifying expenditure.

Section 467: Qualifying expenditure

1661. This section introduces the two types of qualifying expenditure. The main difference between them is in the way allowances and charges are given effect in Chapter 4.

Section 468: Qualifying trade expenditure

1662. This section is based on sections 520(1), (2)(a) and (3), 528(1) and 532(1) of ICTA and section 161(3) of CAA 1990. It defines “qualifying trade expenditure”.
1663. *Subsection (1)* incorporates the effect of section 161(3) of CAA 1990. See *Note 74* in Annex 2.
1664. *Subsection (2)* prevents capital allowances being given more than once on the same qualifying expenditure. This is to make the point explicit. See *Note 59* in Annex 2.
1665. *Subsection (3)* treats qualifying expenditure incurred before the trade starts as if it was incurred when the trade starts.
1666. *Subsection (4)* prevents subsection (3) applying if a person sells all of the patent rights before the trade starts.

Section 469: Qualifying non-trade expenditure

1667. This section is based on section 520(2)(b) of ICTA. It defines “qualifying non-trade expenditure”.

Chapter 3: Allowances and charges

Overview

1668. This Chapter deals with allowances and charges on qualifying expenditure. Qualifying expenditure is pooled. There is a separate pool for each trade for which a person has qualifying trade expenditure and a single pool for a person's qualifying non-trade expenditure. Disposal receipts can arise in relation to qualifying expenditure. Disposal receipts effectively reduce allowances or lead to balancing charges.
1669. [Section 470](#) requires pooling and sets out the separate pools.
1670. [Section 471](#) sets out whether there is an allowance or a charge for a chargeable period.
1671. [Section 472](#) deals with the amount of the allowance or charge.
1672. [Sections 473 to 475](#) set out how to find "AQE" which is a term used in the earlier sections.
1673. [Section 476](#) and [477](#) deal with when a disposal receipt is to be brought into account in respect of qualifying expenditure and its amount.

Section 470: Pooling of expenditure

1674. This section is drafted to introduce pooling explicitly.
1675. *Subsection (2)* provides that there is a separate pool for each trade for which a person has qualifying trade expenditure and a single pool for any qualifying non-trade expenditure of that person. As with plant and machinery and know-how, this Act refers explicitly to these separate pools rather than, as in CAA 1990, leaving them to be deduced.

Section 471: Determination of entitlement or liability

1676. This section is based on section 520(4) to (6) of ICTA. It determines if a person is entitled to an allowance or liable to a charge. It applies to each pool separately for each chargeable period.
1677. [Section 473](#) defines "AQE" in the pool for a chargeable period. [Section 476](#) defines the "disposal receipts" which contribute to the calculation of TDR to come out of the pool for a chargeable period.
1678. There is a minor change. *Subsections (4) to (6)* determine if an entitlement to an allowance is to a writing-down allowance or a balancing allowance. In the case of qualifying non-trade expenditure, subsection (6) provides for a balancing allowance when all of the patent rights, on which such expenditure was incurred, have been wholly disposed of or come to an end. Section 520(4)(c) and (5) of ICTA might be read as denying a balancing allowance if the last of the relevant patent rights does not come to an end but is wholly disposed of. See *Change 56* in Annex 1.

Section 472: Amount of allowances and charges

1679. This section is based on section 520(4) and (6) of ICTA. It determines the amount of a writing-down allowance.
1680. *Subsections (1) to (3)* set out the calculation of a writing-down allowance for a chargeable period. The rate at which writing-down allowances are given is 25% per year on a reducing-balance basis. The amount of a writing-down allowance is adjusted if the length of the chargeable period is more or less than a year and if the trade was carried on for only part of the chargeable period.

1681. There is a minor change. *Subsection (4)* allows a person to claim a writing-down allowance of less than the full entitlement for the chargeable period. There is nothing for this in CAA 1990. See *Change 38* in Annex 1.
1682. *Subsections (5) and (6)* set out the calculation of a balancing charge or allowance for a chargeable period.

Section 473: Available qualifying expenditure

1683. This section is based on section 521(1) of ICTA. It defines “available qualifying expenditure” in a pool for a chargeable period.

Section 474: Allocation of qualifying expenditure to pools

1684. This section is based on sections 520(2), 521(1)(a) and 528(1) of ICTA. It allows qualifying expenditure to be put into the pool either in the chargeable period in which it is incurred or in a later chargeable period.
1685. There is a minor change. This section allows qualifying expenditure to be allocated to a pool for any chargeable period subject to the specific provisions in subsections (2) to (4). So it allows qualifying expenditure to be added to a pool for a chargeable period after that in which it is incurred. It is unlikely that taxpayers will in practice wish to do so. But this flexibility is consistent with the approach taken for plant and machinery allowances in Part 2. See *Change 54* in Annex 1.

Section 475: Unrelieved qualifying expenditure

1686. This section is based on section 521(1)(b) of ICTA. It sets out the amount that is carried forward in a pool from one chargeable period to the next chargeable period.
1687. *Subsection (3)* stops any amount being carried forward after the trade is permanently discontinued. There would only be unrelieved qualifying expenditure if the taxpayer were to choose for some reason not to claim all of a balancing allowance that is available in those circumstances. See *Note 60* in Annex 2.

Section 476: Disposal value of patent rights

1688. This section is based on section 521(2) of ICTA. It defines “disposal receipt”. It is the disposal value under this section or (in rare circumstances) under Schedule 12 to FA 1997 or any other enactment.
1689. *Subsection (2)* sets out when disposal values are to be brought into account.
1690. *Subsection (3)* sets out the amount of a disposal value under this section. But this is subject to section 477. That ensures the disposal values in relation to particular patent rights do not exceed the qualifying expenditure incurred on the purchase of those patent rights.
1691. There is a minor change. This section limits the amounts to capital sums. This makes clear that proceeds that are income are not *both* taxed as income and brought into account as disposal receipts. ICTA does not limit the disposal value to capital sums. See *Change 55* in Annex 1.

Section 477: Limit on amount of disposal value

1692. This section is based on section 521(3) and (4) of ICTA. It limits a person’s disposal value, or disposal values, from a sale of patent rights to the qualifying expenditure incurred by that person on purchasing the rights.
1693. *Subsections (2) and (3)* increase the limit of a person’s disposal value, or disposal values, if the patent rights were acquired from a connected person.

Chapter 4: Giving effect to allowances and charges

Overview

1694. This Chapter deals with the way in which allowances and charges are made. They are treated as trading expenses and receipts if qualifying trade expenditure is involved. They are treated as deductions from patent income or, broadly, as patent income if qualifying non-trade expenditure is involved.
1695. **Section 478** deals with allowances and charges for a pool of qualifying trade expenditure.
1696. **Section 479** deals, for income tax, with allowances and charges for a pool of qualifying non-trade expenditure.
1697. **Section 480** deals, for corporation tax, with allowances and charges for a pool of qualifying non-trade expenditure.

Section 478: Persons having qualifying trade expenditure

1698. This section is based on sections 528(1) and 532(1) of ICTA and sections 140(2), 144(2), and 161(2) and (5) of CAA 1990. It gives effect to allowances and charges in respect of qualifying trade expenditure as trading expenses or receipts. This treatment is what one would expect but the path to it in CAA 1990 is not straightforward. See *Note 61* in Annex 2.

Section 479: Persons having qualifying non-trade expenditure: income tax

1699. This section is based on sections 528(2) and (4) of ICTA. It gives effect to allowances and charges for non-trade qualifying expenditure for income tax.
1700. It does not reproduce the words at the end of section 528(2)(b) of ICTA about tax being discharged or repaid accordingly. Nor does it reproduce the closing words of section 528(2) which require a claim for relief to be made under that subsection. See *Note 63* in Annex 2.
1701. The second half of section 532(1) of ICTA is not rewritten. See *Note 62* in Annex 2.
1702. *Subsection (4)* treats charges in respect of qualifying non-trade expenditure as income taxable under Case VI of Schedule D. Such charges are treated as income from patents by section 483, which allows the charges to be reduced by allowances in respect of qualifying non-trade expenditure.

Section 480: Persons having qualifying non-trade expenditure: corporation tax

1703. This section is based on sections 528(3) and (4) of ICTA. It gives effect to allowances and charges for non-trade qualifying expenditure for corporation tax.
1704. *Subsection (3)* provides that excess allowances can be carried forward and deducted from patent income of later accounting periods so long as the company remains within the charge to tax. The second half of section 532(1) of ICTA does not allow a more generous offset of such excess allowances. See *Note 62* in Annex 2.
1705. *Subsection (4)* treats charges in respect of qualifying non-trade expenditure as income from patents. This treatment allows charges to be reduced by allowances in respect of qualifying non-trade expenditure.

Chapter 5: Supplementary provisions

Overview

1706. This Chapter deals with limits on qualifying expenditure in certain cases and minor provisions that do not naturally fit into earlier Chapters.
1707. **Section 481** deals with limits on qualifying expenditure if:
- the purchase of patent rights is from a connected person; or
 - a main benefit is to get patent allowances.
1708. **Section 482** deals with certain payments by a government if the payments may not be under a licence of patent rights.
1709. **Section 483** defines “patent income”.

Section 481: Anti-avoidance: limit on qualifying expenditure

1710. This section is based on section 521(5) and (6) of ICTA. It puts limits on the amount of qualifying expenditure if a person purchases patent rights from a connected person or as part of a transaction that has as a main benefit the obtaining of allowances.

Section 482: Sums paid for Crown use etc. treated as paid under licence

1711. This section is based on section 533(4) of ICTA. It treats certain sums paid by a government in relation to a patented invention as if the payments were made under a licence. This allows the sections in this Part referring to sales of patent rights to operate on such payments.

Section 483: Meaning of “income from patents”

1712. This section is based on section 533(1). It defines “income from patents”. That term is used in sections 479 and 480 to describe the amount against which allowances in respect of qualifying non-trade expenditure can be offset.