

Intellectual Property Rights - Commercial Exploitation Levy

Constraints

None.

Authoritative Guidance Summary

1. Contracts fully funded by the Ministry of Defence (MOD) under which defence equipment (including software) is designed and developed normally require the contractor to pay an appropriate exploitation levy to MOD for any commercial use of the design and / or jigs and tools (whether by manufacture and sale or in the granting of licences). Levy is also payable in respect of spares or parts, including sale as part of a maintenance agreement.
2. Levy arrangements must be the subject of a formal Agreement with the contractor and / or subcontractor and should be negotiated concurrently with the contract to which they relate. Specimen Agreements are provided under Authoritative Guidance.
3. Commercial officers may sign Levy Agreements, provided that the value of the sale to which they relate is no greater than their delegated powers as defined in their Commercial Licence, subject to all approvals being given at no lower than Band C2 level.
4. Levy may be determined as a fixed percentage of the commercial selling price (generally applicable only to sales below £15M in value); or as a profit-sharing arrangement for sales in excess of £15M in value; or under a levy abatement arrangement providing for profit to be shared to a pre-determined formula. Each arrangement is described in detail under Authoritative Guidance.
5. Director Financial Management, Financial Management Shared Service Centre, Invoicing and Revenue IR IPCM1-13g (DFM-FMSSC-IR-IPCM1-13g) is responsible for administering the Agreements supported by acquisition team commercial officers and Defence Intellectual Property Rights (DIPR).
6. Acquisition teams must:
 - a. maintain records of all levy Agreements for which they are responsible;
 - b. ensure that [DFM-FMSSC-IR-IPCM1-13g](#) receive copies and are advised of any subsequent changes to those Agreements; and

- c. conduct a quarterly review of Agreements that have shown a 'NIL' return for five successive years and consider placing such Agreements in 'abeyance'.

7. Cost Assurance and Analysis Services (CAAS) conduct random verifications of contractor statements and auditors' certificates. Defence Internal Audit (DIA) and National Audit Office (NAO) may audit contractors' as well as acquisition team records relating to levy arrangements and sums due and recovered.

Authoritative Guidance

8. Contracts fully funded by MOD under which defence equipment (including software) is designed and developed normally require the contractor to make an appropriate payment to MOD for any commercial use of the design and / or jigs and tools (whether by manufacture and sale or in the granting of licences). These payments are generally known as 'commercial exploitation levy' or, in context, simply as 'levy'.

9. Levy is not a calculated contribution towards MOD's investment in Research and Development (R&D) or jigs and tools. It is a form of royalty. The general aim of levy arrangements should be to obtain the maximum return possible without harming sales, consistently, with simplicity and speed in operation. There is normally no cut-off point beyond which recovery of levy ceases, but it may be appropriate on some occasions to negotiate a once-for-all payment in commutation of MOD's rights.

10. No levy is payable in respect of:

- a. purchases by MOD;
- b. sales to another UK Government contractor or subcontractor when the contract goods concerned can be clearly identified as being supplied to meet the requirements of MOD; and
- c. substantial individual equipment not developed at United Kingdom (UK) Government expense (i.e. Private Venture).

11. Levy arrangements must be the subject of a formal Agreement with the contractor. A separate Agreement must be established for each contract item. Agreements should extend to all supporting equipment and services covered by a sale (including initial supply of spares). However, it may be necessary to deal with the costs associated with after-sales services on an estimated basis to enable the final settlement of levy to be made at a reasonable time after the delivery of the equipment. Specimen Agreements for hardware and software can be found at [Annex A](#) and [Annex B](#) respectively.

12. Although the relevant Intellectual property Rights (IPR) DEFCONs require the contractor to make an Agreement with MOD before the first sale or licence of leviable items is made, the Agreements should be negotiated concurrently with the contract to which they relate and included by reference in that contract. Where a direct agreement regarding intellectual property rights in the design of some sub-system is entered into with a subcontractor, a direct Agreement with the subcontractor will need to be negotiated, ideally at the same time as the Design Rights and Patents Subcontract Agreement (DEFFORM 177). Any decision to defer the making of an Agreement should be taken by a commercial officer at Band B2 level or above.

13. Commercial officers may sign Levy Agreements, provided that the value of the sale to which they relate is no greater than their delegated powers as defined in their Commercial Licence, subject to all approvals being given at no lower than Band C2 level.

14. The arrangements described below should be applied unless there is already an agreement with the contractor as to the levy payable in respect of the sale or other transaction concerned. Under these arrangements, levy is to be determined in one of three ways:

- a. as basic **Percentage Levy** arrangement, that is a fixed percentage of the commercial selling price (generally applicable only to sales below £15M in value); or
- b. as a **Profit-Sharing** arrangement in substitution of the fixed percentage payable under a) in all individual sales in excess of £15M in value (for which purpose contemporaneous sales of the same equipment to the same customer will be treated as one sale); or
- c. under a levy **Abatement** arrangement providing for profit to be shared to a pre-determined formula (which a contractor can seek to apply to any sale in substitution for the fixed percentage payable under a) where he contends that the fixed percentage arrangement could frustrate a potential sale or result in an unreasonably low profit).

15. In March 1990 the profit sharing threshold was increased to £15m from £5m. A threshold of £15m should be applied in respect of all appropriate individual sales agreed from March 1990 onwards, even when the associated commercial exploitation main Agreements were in existence prior to March 1990 (provided that such agreements contain provision for the adjustment of the profit sharing threshold as described in clause 2 of the specimen Agreements at [Annex A](#) and [Annex B](#)). The £15m threshold is not to be applied retrospectively to individual sales concluded prior to March 1990.

16. MOD's approval of any arrangement is dependent upon the following:
- a. the agreement of the accounting conventions between CAAS and the contractor prior to signature of the Agreement, so that the contractor and the auditors are in no doubt as to the basis on which the required financial statements are to be prepared and the terms in which the auditor's certificate is to be submitted; and
 - b. in the case of the profit-sharing and abatement arrangements, confirmation from the contractor that allowable costs can and will be allocated to the sale on the basis prescribed by MOD, and that records of such costs will be made readily available to MOD in adequate form, if required, for examination.
17. Levy Agreements relating to international collaborative contracts or contracts placed on behalf of other Government Departments will need to reflect the views of the partner nation(s) or relevant Department. In the latter case the relevant Department should assume responsibility for recovery of levy due.

Percentage Levy Arrangement

18. Levy is expressed as a percentage of the 'Contractor's selling price' and this term is defined in the specimen Agreements at [Annex A](#) and [Annex B](#). Nor should any deduction be made from the 'Contractor's selling price' in respect of any contingency or mark-up (including profit) on any of the elements of cost. Any settlement under a variation of price provision in the sale contract becomes part of the 'Contractor's selling price' for levy purposes. In all cases, the costs concerned are those incurred by the contractor and not any different value at which the contractor may claim to recover them in his invoice price.

19. For use of the design, levy is derived from one of three standard rates, namely:
- a. 5% for the broad ranges of electrical and mechanical equipment listed at [Annex C](#).
 - b. 10% for guns; main battle tanks and Her Majesty's Government (HMG)-funded derivatives (e.g. bridge layers on the tank chassis); ammunition and explosives; torpedoes; major (non-electronic) equipment for ships; and main machinery and machinery controls for ships.
 - c. 7.5% for all other items.

20. For use of Government-funded jigs and tools, levy is derived from a single standard rate of 2.5% of the 'Contractor's selling price'. This rate may require adjustment where:

- a. a substantial part of the jigs and tools used in connection with a sale or other transaction has not been provided or paid for by the Government and this can be demonstrated to the acquisition team; or
- b. MOD has not paid directly for R&D, but has paid for production tooling.

21. The levy rate appropriate will be as stated above unless the rate needs to be adjusted for specific reasons as described in paragraphs 40 to 56 below.

22. If the negotiations are protracted an Agreement levy may become due and payable before an Agreement has been reached and signed. If an Agreement has not been reached three months before levy is expected to become payable an interim levy arrangement should be considered. If no Agreement is likely to be reached in the following three months, arrangements should be made for levy to be paid on an interim basis. The levy should be calculated by applying half the standard percentage rate to the gross selling price, unless the commercial officer has reason to think that this would lead to a payment in excess of that finally likely to be payable. In that event the commercial officer may modify the arrangement appropriately.

Profit-Sharing Arrangement

23. For a commercial sale exceeding £15M in value (for which purpose contemporaneous sales of the same equipment to the same customer will be treated as one sale), levy should be dealt with on a profit-sharing basis appropriate to the circumstances where this is considered to be worthwhile and practicable. The specimen Agreements at [Annex A](#) and [Annex B](#) reserve the position accordingly at clause 2, and require the contractor to notify MOD when he is contemplating a sale valued in excess of the threshold.

24. The precise terms of the profit-sharing arrangement will be a matter for negotiation in each case. DIPR must be involved in these negotiations from the outset. They will advise on the amount and liability date for a provisional payment and validate MOD's final profit share. The profit-sharing arrangements should provide as follows:

- a. For the contractor to retain a first slice of emergent profit in recognition of his need to service his capital. In considering what is reasonable, MOD will need to take account of the likely incidence of down payments and any other payments under the sale in question in relation to the length of the contract. The advice of DIPR should be sought as to what is reasonable in the circumstances.

- b. For a second slice of emergent profit to be shared between the contractor and MOD in such a way that MOD gets a return approximately equal to that which it would have obtained had the standard percentage levy rates (including that for the use of jigs and tools, where appropriate) been applied. The contractor for his part gets an overall retained return of between 15% and 20% on costs.
- c. For the sharing of any further profit in the ratio of the aggregate shares accruing to each party under 23.a. and b. above.

This arrangement is illustrated at [Annex D](#).

25. Profit should normally be determined by setting allowable costs against the gross selling price (**not** the 'Contractor's selling price' as defined in [Annex A](#) and [Annex B](#)). In general, allowable costs may include all normal production costs and any special costs appropriate to the sale, but not the cost of servicing capital. Account should be taken of inter-divisional or inter-group profits so that they are normally included in the sum to be shared between MOD and the contractor.

26. A specimen Agreement for a profit-sharing arrangement is at [Annex E](#). The percentage to be included in paragraph 3.d), for interim payment of levy, should be the normal standard rate of levy (including that for jigs and tools where appropriate) but adjusted, where requested by the contractor, to take account of the fact that it is expressed as a percentage on the gross selling price without any deductions that would be appropriate under the definition of the 'Contractor's selling price' in Annexes A and B. (An interim levy arrangement is necessary in all profit-sharing arrangements because the actual levy payable cannot be calculated until some time after the sale has been completed.)

27. If it is proposed either not to seek a profit-sharing arrangement for a sale exceeding £15M, or to abandon the attempt to negotiate an acceptable profit-sharing arrangement the case must be referred to the Director Commercial, as appropriate. They will consider the case further before an approach is made to Treasury who must be consulted in such circumstances.

Abatement or Waiver of Levy Arrangement

28. There is no delegation provided by HM Treasury to MOD to waive levy entirely. The only exception appertains to purchases from the United States Department of Defense where the 'Gast / Harding Arrangement' allows, under certain circumstances, waiver of levy. In any other case where an entire waiver is sought and considered worthy of investigation, the Director Commercial as appropriate must be consulted before an approach to Treasury is considered.

29. Requests for abatement or waiver of levy are governed by the standard abatement scheme described in the specimen Agreements at Annexes A and B and are subject to the rules set out in paragraphs 30 to 36 below. Some existing commercial exploitation agreements do not specify the basis on which abatement of levy may be approved. In such circumstances, any request for abatement of levy should be considered only on the basis of the arrangements set out below.

30. MOD's approval of any application for the abatement scheme must normally be sought and given, or refused, in advance of the signing of the sale contract.

Approval:

- a. should not be unreasonably withheld;
- b. should relate only to the sale in question; and
- c. once given, may not be revoked by either party.

31. Exceptionally, with the approval of the Director Commercial (DC) and the drafting of an appropriate provision in, the specimen Agreements at Annexes A and B, the contractor may be permitted to opt for the abatement arrangement after the signing of a sale contract, subject to:

- a. the application being irrevocable and being made not later than one month after the signing of the contract;
- b. the decision whether to approve the application resting with MOD;
- c. MOD's decision on the abatement being final; and
- d. the standard rate of levy being payable if approval of abatement is not notified within three months from the date of application.

32. The abatement arrangement is essentially another profit-sharing scheme since it involves determining the emergent profit on the sale and sharing it between MOD and the contractor in accordance with the formula set out in Annexes A and B.

33. An [example of an abatement sharing scheme calculation](#) can be found at Annex F. Where it is clear that such a calculation would lead to an arrangement unfair to MOD more equitable arrangements should be proposed after consultation with the policy sponsor, via the [Commercial Policy Help Desk](#), and DIPR as necessary.

34. Profit is assessed under the abatement scheme by setting off the allowable costs of a sale against the 'Contractor's selling price'. For this purpose, allowable costs may include all normal production costs and any special costs applicable to the sale excluding the cost of servicing capital, but net of the costs of those elements

excluded from the 'Contractor's selling price'. Account should be taken of inter-divisional or inter-group profits, so that they are normally included in the sum to be shared between MOD and the contractor. For example:

Invoice Price	£1.0M
Costs	£0.8M
Deductions (Clause 1f)	£0.2M £0.2M
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Net Costs	£0.6M
'Selling Price'	£0.8M
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Profit	= £0.2M on costs of £0.6M = 33% on costs

35. The abatement arrangements should form the subject of an Agreement with the contractor based on the [specimen Agreement at Annex G](#). The percentage rate to be inserted in paragraph 3d for interim payment of levy, should be calculated on the basis of one half of the unabated percentage rate of levy unless a commercial officer at Band B2 level or above is satisfied that some other basis would be appropriate. (An interim levy arrangement is necessary in any profit-sharing style arrangement because the actual levy payable cannot be calculated until some time after the sale has been completed.)

36. Where the value of a sale is less than £500K, an abatement in the rate of levy may be settled, at the discretion of a commercial officer at Band C2 level or above before the sale is concluded, on the basis of the expected out-turn profitability, provided the request for abatement is supported by adequate evidence and reasonable notice is given to MOD.

Special Considerations

37. Special considerations arise in relation to the negotiation of any of the above arrangements in the circumstances described in paragraphs 38 to 54 below.

Private Venture Research and Development (PV R&D)

38. Where contractors draw substantially upon their PV R&D, adjustments to the standard rates of levy set out above, or other special arrangements, may be appropriate. To justify the agreement of an adjusted rate, however, the contractor's PV R&D must be substantial because MOD will already have given consideration to PV elements in agreeing the price for the contract. Any losses incurred by contractors in performing R&D contracts may be considered as an allowable cost for levy purposes and excluded from the 'Contractor's selling price' or the gross selling price in profit-sharing arrangements, but must not otherwise be taken into account in establishing levy arrangements. An example of an acceptable

arrangement in the context of a Basic Percentage Levy arrangement is as follows:

Development Cost £M

Contract Value £900K

Loss (treated as PV contribution and therefore an allowable cost) £100K

Normal Levies 2.5% (Tooling) + 7.5% (Design) = 10%

Levy Rate Adjustment: $(10\% \times £900K) / £1M = 9\%$

39. Where an Agreement is concluded concurrently with the placing of the development contract or exceptionally, shortly afterwards, provision may be made for revision of the rate of levy at the end of the development contract (clause 2a of the specimen Agreements at Annexes A and B refer). If such revision is considered, commercial officers should seek assistance from CAAS if verification of some aspect of the contractor's submission would help in determining whether the rate of levy should be modified and / or the extent of such modification.

Potential Double Recovery of Levy

40. Contract goods may incorporate items procured from subcontractors and suppliers that are themselves already subject to levy and in establishing the new levy arrangements acquisition teams must ensure that levy is not claimed on the items from both the subcontractor or supplier and from the prime contractor.

41. Where this arises, suitable arrangements should be made either:

- a. to charge a reduced rate of levy on the 'Contractor's selling price' for the goods and delete point 1(f)(7) from the definition of the 'Contractor's selling price' in the Agreements at Annexes A and B; or
- b. to charge levy at the appropriate standard rate (plus tooling rate where appropriate) on an adjusted selling price in accordance with point 1(f)(7).

42. It has been the practice with sales of military aircraft to charge a levy of 5% on the full selling price, instead of 7.5%, to take account of the fact that levy is recovered separately from the suppliers of the engines and certain other items which together have been regarded as accounting for one-third of the selling price. This ratio should be reviewed for individual aircraft types.

Computer Software Levy

43. [DEFCON 91 \(Intellectual Property Rights in Software\)](#) only provides for payment of a levy on software, not hardware. The [relevant specimen Agreement is at Annex B](#).

44. Under the Basic Percentage Levy arrangement it is not easy to assess a common 'average' levy for computer software but it is generally much higher than for hardware and 50% is a good starting point. This is a reflection of the high development costs of computer software but its relative ease of production. The appropriate percentage should be assessed case by case and account taken of how much PV R&D money has already been spent on the computer software product and what financial and technical contribution has been or is to be made by MOD.

Post Design Services (PDS)

45. PDS contracts can relate to equipment:

- a. developed under contract at HMG expense by the PDS contractor;
- b. developed under contract at HMG expense by some other MOD contractor;
- c. developed by a MOD establishment or other Government Department;
- d. developed on a PV basis by the PDS contractor; and
- e. developed on a PV basis by some other party.

46. Frequently there will be equipment with a mixture of such origins in one PDS contract.

47. The disposition of rights between MOD and the PDS contractor relate only to the results of any further development work that will arise under the PDS contract. Normally, the pre-existing Agreement for development of the equipment will cover derivatives from the original design and this should be included by reference in the new PDS contract. Current rates of levy applicable to the PDS work may differ from those obtaining on the original equipment. Where this is so, some pro-rata rate of levy may need to be negotiated.

48. Similar considerations will apply to cases falling under paragraph 45.b. except that neither contractor will be free to exploit the further developed item without the agreement of the other. Where such sales arise, it is important that MOD receives from one or other contractor (or jointly from both) the full normal amount of levy.

49. In respect of paragraph 45.c. cases, the standard levy percentage rates above are deemed to include the relevant contribution for any MOD-owned intellectual property rights (see clause 4 of specimen Agreements at Annexes A and B). In the event of a sale by the PDS contractor, a normal Annex A or B Agreement is appropriate. However, as DIPR normally have the responsibility for recovery of levy in respect of MOD-owned rights, it will be necessary to liaise with that Support Group to avoid any duplication of claims.

50. Cases under paragraphs 45.d. and e. are likely to arise only rarely. Having due regard for the individual circumstances, it should be the general aim to agree a percentage rate of levy (roughly pro-rated down from the appropriate standard rate) which recognises the proportion that the content of the item deriving from the PDS work represents of the item as a whole.

51. Where commercial exploitation agreements have been satisfactorily included in PDS contracts in the past, these may continue to be used. Similar agreements in new cases should reflect the advice given above and include the appropriate terms from Annex A (e.g. in the definition of the 'Contractor's selling price').

Militarised Proprietary Items

52. When several proprietary items are 'militarised' to varying degrees, it may be appropriate to enter into a single Agreement operative for a number of years with the application of a single rate of levy based on an agreed average (actual or estimated).

Consortia

53. For a contract where a consortium of companies is supplying equipment or software to an overseas customer:

- a. written evidence should be obtained that any 'spokesman' company has the authority to speak and act for all members of the consortium;
- b. each member should normally remain responsible for the determination and payment of levy in respect of his share of the sale; and
- c. only exceptionally and after consultation with the policy sponsor, via the [Commercial Policy Help Desk](#), should a consortium be treated as an entity for levy purposes.

Ships

54. Ships' hulls and, in certain circumstances, ships' main machinery, where fixed sum design fees for the use of MOD designs will continue to be charged.

Applicability of Levy Requirements

55. In addition to levy payable in respect of the manufacture and sale of goods to the complete design, levy is payable in respect of any other use of a design, any other use of Government-funded tooling and any grant of licence to manufacture the design or parts thereof.

Spares, Derivatives and Refurbished Goods

56. The sale of spares or parts, including sale as part of a maintenance agreement, attracts levy in the same way and at the same rates as would the complete item. No levy should be charged on private venture spares / parts. If a leviable sale includes such spares / parts and making a distinction between spares / parts gives rise to accounting problems, acquisition teams should be prepared to consider a special rate, lower than the standard rate, to apply equally to all spares for specified items of equipment in a particular sale. The contractor may propose such an approach.

57. As above, it is open to a contractor to make reasonable proposals for an appropriate reduction in the rate of levy on the sale of any PV derivatives from the design goods. In calculating the levy in such cases, account should be taken of the relative value of each party's involvement when adjusted to a common economic base date.

58. Where a contractor sells refurbished or reconditioned goods, levy is payable only on replacement parts incorporated and on the use of Government-funded jigs and tools.

Items for Contractor's Own Use

59. Unless the design item is subsequently sold, no levy is due where a contractor makes an item for his own research or development purposes, or for his own demonstration or sales promotional purposes except that, where appropriate, levy should be recovered for the use of any Government-funded jigs and tools.

Licence to Manufacture

60. Where a contractor licences the manufacture of the design item, the levy is, subject to certain provisions (see [Annex A](#) and [Annex B](#), clause 3), normally one-third of the gross receipts. In cases where the design was not fully funded by MOD, the one-third levy should be reduced pro-rata to MOD's funding share.

Cancelled Orders

61. Tooling levy is due on a reasonable basis where a sale is cancelled after the contractor has undertaken some work. Where the contractor has received some payment, which he is entitled to retain, whether from his customer or otherwise (e.g. from Export Credit Guarantee Department), in respect of work done or in hand, or in respect of any claim arising out of cancellation, a fair and reasonable levy should be calculated having regard to costs and claims (but not redundancy payments) which the contractor may have to meet. Should the item or derivative, manufactured or in course of manufacture prior to cancellation, subsequently be re-sold, levy will again be due on the normal basis.

Hiring Out Goods

62. If goods are hired out, rather than sold, levy will normally be due on the gross receipts of the contractor.

Acquisition Team Responsibilities

63. In order to help internal administration, control and monitoring all MOD levy Agreements must be allocated a number from the Discrete Numbering System (DNS). The Discrete Number (DN) allocated will form the prime reference number and must be quoted in all correspondence regarding the Agreement. The commercial officer must complete the proforma at [Annex H](#) and forward it to [DGDCCS-2D-1](#) who will allocate a DN and return the completed proforma. The DN allocated to the levy Agreement must be detailed in the space provided ('CEL Agreement No.') on the specimen Agreements at [Annex A](#) and [Annex B](#), prior to dispatch to the contractor.

64. Acquisition teams must maintain records of all levy Agreements for which they are responsible, so that the effectiveness of the arrangements can be kept under review, especially the adequacy of the standard rates, the extent of abatement requests and the operation of abatement and profit sharing schemes, including contractors' out-turn profitability on export sales. This information will inform the handling of future Agreements with the contractor, or requests for abatement. Records should include the following information in convenient form for each sale:

- a. Contractor details.
- b. Goods / Equipment.
- c. Details and selling price of sale.
- d. Levy assessment methodology and rates applicable.

- e. Abatement arrangement requests and details.
- f. Levy receipts.
- g. Comparison of actual levy receipts against those that the standard rates proposed in the guidance above would have given.
- h. Contractor's out-turn profitability as a percentage on allowable costs.
- i. Any other relevant details (e.g. arrangements in respect of spares or derivatives).

65. Copies of levy Agreements, including international collaborative project Agreements and any subsequent amendments must be sent direct to [DFM-FMSSC-IR-IPCM1-13g](#) under cover of the proforma at [Annex I](#). Any levy Agreements forwarded without a DN will be returned to the originator. To help keep the DFM-FMSSC database current, details of transfers of Agreements between acquisition teams, changes in team titles or changes to Unique Identification Number (UINs) and Resource Account Codes (RACs) should also be reported by means of the proforma at [Annex J](#).

66. In order to ensure that the DFM-FMSSC database of levy Agreements does not retain an excessive number of effectively 'dormant' Agreements, acquisition teams are required by DFM-FMSSC to review a quarterly printout that highlights Agreements that have shown a 'NIL' return for five successive years. If the commercial officer is satisfied, on the contractor's evidence and after consulting their acquisition team colleagues and the relevant Regional Marketing Director Defence Exports and Sales Organisation (DESO), that there is no evident prospect of a future leviable activity or receipt, then they should consider placing such Agreements in 'abeyance' through an exchange of letters with the contractor in which it is made clear that:

- a. the contractor's liability to pay levy will continue for a further five years before it is to be considered extinguished;
- b. the contractor is required to report any leviable transaction or receipt arising during that period;
- c. any leviable transaction arising in that period will overturn the date at which it had been previously agreed that the contractor's levy liability would be considered extinguished; and
- d. a new five year period may be specified at MOD's discretion.

67. Where agreement cannot be given to the omission of an Agreement from future returns, a once-for-all commutation payment may be considered.

Collection of Levy Arrangements

Liability Date for Levy

68. Clauses 18 - 20 of the specimen Agreements at Annexes A and B describe when levy becomes payable on sales, cancelled sales, licences and other transactions where levy is based on gross receipts by the contractor, use of Government-funded jigs and tools, Variation of Price (VOP) settlements, and interim payments. It should be noted that the liability date relates to the dates of individual deliveries and not the last delivery in any sale.

69. Where levy is to be assessed on a profit-sharing basis, and so cannot be calculated until some time after the sale has been completed, an interim payment of levy should be required at the time levy would otherwise be due. The interim payment should be reviewed at quarterly intervals and, additionally, if the contractor represents that circumstances warrant a review.

Notification of Leviable Transactions

70. Clause 16 of the specimen Agreements at Annexes A and B require contractors to notify leviable transactions. It is important that a contractor should not be allowed to overlook his obligations and acquisition teams should be alert to all possible sources of information relating to export sales of equipment (or licences) developed at MOD expense. Such information should be reported to DFM-FMSSC-IR-IPCM1-13g and recorded in a manner that enables it to be taken into account when examining contractors' returns of accrued levy.

71. Unless it is positively known that a contractor has not held a MOD R&D contract, DFM-FMSSC-IR-IPCM1-13g will remind all MOD contractors, in April each year, of contractors' obligations to pay levy utilising the form of letter at [Annex K](#). DFM-FMSSC-IR-IPCM1-13g will ensure that replies are received to these annual reminders.

Accounting

72. Clause 21 of the specimen Agreements at Annexes A and B require contractors to submit a return to DFM-FMSSC-IR-IPCM1-13g in accordance with the interval to be specified by the acquisition team in clause 21 of each Agreement. All statements of accrued levy are to be returned to DFM-FMSSC-IR-IPCM1-13g and any existing levy arrangements reflecting different arrangements should be modified accordingly.

73. DFM-FMSSC-IR-IPCM1-13g is responsible for:

- a. maintaining formal claims registers and for progressing and hastening receipt of statements and auditors' certificates;

- b. ensuring that the correct levy is applied to sales (except that commercial officers will determine the levy due under abatement or other profit-sharing arrangements);
- c. issuing invoices; and
- d. obtaining payment where contractors fail to forward payment with their statement.

74. In order to speed up the receipt of levy payments, clause 24 of the specimen Agreements at Annexes A and B provide for payments to be made by contractors concurrently with each periodic statement. If payments are inadvertently received by acquisition teams they should be transferred immediately to DFM-FMSSC-IR-IPCM1-13g in a sealed envelope under cover of an appropriate minute, together with a copy of the relevant paperwork that accompanied the payment when it was received.

75. DFM-FMSSC-IR-IPCM1-13g will send one copy of each statement received from a contractor to the appropriate acquisition team seeking advice on:

- a. the accuracy of the return or certificate;
- b. whether all known sales are covered in the return or certificate;
- c. whether any selling prices appear to have been understated; and
- d. any apparent errors in the contractors levy calculations prior to implementing any retrospective recovery or refund action.

76. Commercial officers receiving statements for scrutiny will also advise other appropriate acquisition teams of any items whose cost has been deducted from the selling price under the provisions of clause 1.f)(7) of the Agreements on the grounds that they are subject of separate levy agreements with the subcontractors or suppliers concerned. Commercial officers notified of such deductions will be responsible for checking that the items are included in the returns from the relevant subcontractors or suppliers or (when applicable) for advising the original acquisition team that the items are not leviable at source, as claimed by the contractor.

77. Clause 25 of the specimen Agreements at Annexes A and B require the contractor to submit an auditor's annual certificate. If this is three months overdue and DFM-FMSSC-IR-IPCM1-13g receives an unsatisfactory reply (or no reply) to a reminder issued at that time, the matter will be reported by them to the appropriate CAAS officer. CAAS will seek the contractor's consent to an approach to the statutory auditors to establish the cause of the delay. If CAAS is refused access, or is not satisfied that an auditor's certificate will be available within a reasonable period, the contractor will be informed of CAAS's intention to inspect the books of

account and records in accordance with rights conferred by clause 26 of the specimen Agreements. If CAAS is then satisfied that the correctness and completeness of the statements to which the required certificate relates can be established, they will consult with the commercial officer concerned about relieving the contractor from the obligation to submit an auditor's certificate for the period in question. The general objective, however, is to secure auditors' certificates rather than to substitute with a CAAS audit.

Audit

78. Notwithstanding the requirement for contractors' periodic statements to be supported by annual certificates of correctness and completeness from statutory auditors, CAAS will exercise the rights conferred on MOD to conduct random verifications of contractor' statements and auditors' certificates. Such checks will include, but not be confined to, 'NIL' returns and will be decided upon in consultation with commercial officers.

79. Defence Internal Audit (DIA) and National Audit Office (NAO) also have access to, and may inspect contractors' books of account and records as well as acquisition team files and records relating to levy arrangements and sums due and recovered. Normally, DIA will visit to scrutinise records but may occasionally call for files to be sent to them. Local (minor) observations will be made by the auditor to the appropriate commercial officer, but not copied to NAO. Formal (major) observations will be addressed to the appropriate Director Commercial and will be copied to NAO. Directors Commercial should copy their replies to formal observations to the policy sponsor and, where an observation raises a point of general interest, should refer the case to the policy sponsor before a reply is sent.

List of Annexes

Annex A	Specimen Agreement for Hardware Where Percentage Levy Rates Apply
Annex B	Specimen Agreement for Software Where Percentage Levy Rates Apply
Annex C	Broad Range of Equipment to Which a Standard Rate of Levy of 5% of Selling Price Applies
Annex D	Examples of Profit-Sharing Arrangements
Annex E	Specimen Profit Sharing Agreement
Annex F	Example of Abatement Sharing Arrangement
Annex G	Specimen Abatement Agreement
Annex H	Application for a Discrete Number for a Commercial Exploitation Levy
Annex I	Proforma Covering Copy of Agreement Sent to Director Financial Management – Financial Management Shared Service Centre – Invoicing and Revenue

Annex J	Reporting of Transfer of Agreements Between Acquisition Teams / or Title Changes
Annex K	Reminder Letter to Contractors

Essential Reading

- [IPR - Conditions topic](#)
- [IPR - Overview and Policy topic](#)
- [JSP462 – Financial Management Policy Manual](#) (Chapter 42)

Further Reading

- [Financial Management Shared Service Centre website](#)
- [Overseas Procurement topic](#)
- [Procurement From The USA topic](#)
- [Commercial Delegations and Mentoring topic](#)
- [Guide To Intellectual Property](#)