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Corporate Intangibles Research and Development Manual

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CIRD240160 - Patent Box: relevant IP losses and inheritance of R&D fraction: transfer of a trade or part trade

CTA10/S357EE and s357GCA

There are special rules when there has been a transfer of a trade or a part trade. These have been gathered into one section for convenience.

Note that whilst the Loss rules refer to group members, inheriting an R&D Fraction can apply to

the transfer of a trade between any companies meeting the relevant conditions.

1. For relevant IP losses when a trade has been transferred between group members :

Where a company:

- has a set-off amount in relation to a trade of the company for an accounting period,
- is a member of a group, and
- ceases to carry on the trade,

then where another company ('the transferee') that is a member of the group begins to carry on that trade, then an amount equal to the set-off amount is to become, or be added to, the set-off amount in relation to the trade of the transferee for the accounting period in which the transferee begins to carry on the trade.

2. Inheriting an R&D Fraction following the transfer of a trade or part trade.

This is not restricted to connected parties.

A trade which exploits a qualifying IP right is regarded as having been transferred (for the purposes of this section only) when the transferor has ceased to carry on that trade, assigned the relevant qualifying IP rights or grants; or transferred the exclusive licence in respect of them and the company receiving these rights begins to carry on that trade.

NOTE:

This will include a trade within a business where there is more than one trade and those other trades are continuing. It also includes part of a trade. However, because patents pending and nascent IP are not defined as qualifying IP rights in s357BB, companies which have no qualifying IP rights will not be able to take advantage of the transfer of trade provisions. As long as there is at least one qualifying IP right, the provisions can

apply to the transfer of the trade or part trade in its entirety and any nascent IP or patents pending will be included.

The legislation requires that the transferor assigns the relevant qualifying IP right, or grants or transfers an exclusive licence in respect of it, to the transferee. However, where a company exploits qualifying IP rights as the holder of an exclusive licence it will be necessary to consider the contractual arrangements and rights of the exclusive licensee because if it is not possible for the licence to be transferred by the exclusive licensee then s357GCA cannot apply. That would be the case if the licence holder instead reassigned or transferred the licence, or extinguished that licence and provided a new licence to the company which takes over the trade. These actions would not meet the requirements of the legislation. The 'transfer of trade' provisions in this section will only apply in these circumstances if the transferor did actually grant or transfer the exclusive licence to the new licensee. If an equivalent sub licence was created by the transferor this would be regarded as new qualifying IP, within the new Patent Box regime, but the other transfer of trade provisions (inheriting the R&D fraction components instead of using acquisition costs from the transfer) could still apply.

2. What happens to the R&D fraction for transferred IP rights within transferred trades?

The transferee 'inherits' the R&D expenditure from the transferor without the transferor having to have been elected into the Patent Box.

The status of being a qualifying company holding qualifying IP rights is independent of making a s357A(1) election. The implication of this is that the transferee will have to use the transferor's R&D/acquisition expenditure to inform their own fraction, whether or not the transferor had themselves elected into the Patent Box.

As it is a transfer of trade, rather than an acquisition or purchase of the qualifying IP rights there is an expectation that the relevant records detailing the type of R&D expenditure and any acquisition costs made by the transferor will form part of that transfer. Even if the transferor has not elected into the Patent Box and therefore not undertaken any formal tracking and tracing exercises it is expected that available records will allow the transferee company to be able to obtain figures to identify an initial fraction to use.

The tracking and tracing of R&D expenditure and acquisition costs from the relevant date which has been obtained will feed into the transferee's fraction, but this could relate to a qualifying IP right, a product or a product family level and to that extent the transferee themselves may choose to stream at a different level.

In cases where even this element of record keeping has not happened there should be some evidence of whether the R&D took place within the company or whether the R&D had been acquired or subcontracted out to a related party and this should be used to ascertain an estimate of the fraction.

Should there be no information at all, despite undertaking due diligence exercises required in a transfer or merger of trades from one company to another the supposition has to be that the inherited fraction should be 0, explaining why this is so, and the transferee is in effect starting from scratch.

What is included in the components of the inherited R&D fraction for transferred IP rights within transferred trades?

D: Direct R&D expenditure

The R&D Fraction will include the transferor's direct R&D costs, as their own (ie what has been included as D will be inherited by as D)
(s357GCA(4))

S1/S2: connected and unconnected party subcontracted R&D expenditure

Amounts included as S1 and S2 by the transferor are treated as being inherited by the transferee as if it were their own payment. That means that the amount could possibly change from S1 to S2 (or vice versa) if that sub contractor has a different connection with the transferee. If the transferee had been one of the transferor's sub contractors those costs would be S1/S2 for the transferor, but the transferee can treat them as D. (s357GCA(5))

Acquisition payment for the trade

Acquisition costs (s357(6) and (7)): acquisition costs incurred by the transferor will be inherited by the transferee as their own acquisition costs, if they took place after the start of tracking and tracing (so after 1/7/16 or earlier if elected to use an earlier date)

Expenditure incurred by the transferee in making a payment to the transferor in respect of the assignment, grant or transfer is to be ignored and excluded from A even though the payment for the transfer of the trade will incorporate the acquisition of the qualifying IP rights.

Example

Company A had been working on a project and held a variety of qualifying IP rights. When the project funding ceased Company A ceased work on that particular project. Company B regarded the project as having potential so company A sold that part of its trade to company B including qualifying IP rights, the scientists employed by company A moved to B to stay with their project and the lab rental and project management were transferred to company B. Because the whole project has been taken over, and company A has ceased to work on this project, this can be regarded as a transfer of all or part of company A's trade.

Company B will not include the amount it pays for the project as an acquisition cost, as the IP rights

are an intrinsic part of the purchase.

Company B will however need details of the R&D expenditure incurred by company A relating to each term of the R&D fraction for the qualifying IP rights in order to commence its own R&D fraction in preparation for entry into the Patent Box. This information should be obtained at the time of transfer.

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