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## HMRC internal manual

# Corporate Intangibles Research and Development Manual

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## CIRD271600 - Patent Box: patent pending calculation: Products containing both old and new qualifying IP rights CTA10/s357BQ

S357BQ CTA10 -This section now only applies to certain calculations relating to patents pending.

All qualifying IP rights will have entered the 'new regime' by 1 July 2021. This means that the 'nexus requirements' of streaming relevant IP income and applying an R&D Fraction to those

streams and sub-streams are now a required part of the Patent Box calculation.

However, it may still be the case that companies which elected into the Patent Box prior to 1 July 2016 have patents granted which were applied for before 1 July 2016. Relevant IP profits from the patent pending years are included in the computation in the year of grant, but the calculation of those profits follow the old rules applicable in those years.

When the level of streaming is at product or product family level, or the notional royalty sub-stream includes several qualifying IP rights, the relevant income in that sub-stream could arise from a mixture of old and new qualifying IP rights, for example when new IP is introduced into the product. There needs to be an inclusive methodology because of the wide range of qualifying IP rights which can be included within the Patent Box. The test should be applied every time a new qualifying IP right is incorporated into a sub-stream containing more than one qualifying IP right.

These are 2 alternative methods, the choice lies with the company. Either of the following two methods can be used to decide whether the product should be treated as old or new or split proportionately as long as the IP item or IP process incorporates at least one old qualifying IP right and at least one new qualifying IP right and the computation uses product, process or product family streaming. If it is decided that the product can be considered as part of the old regime, the relevant IP income should be included as part of the old regime sub-stream.

### **First method : Core value**

Consider whether the value of the item is wholly or mainly attributable to the old or new qualifying IP right(s) contained within it. If the core value of the IP relates mainly to the new qualifying IP right incorporated within it, then all relevant income from that product or process should be treated as

being from new qualifying IP. Conversely, if the new qualifying IP does not add significantly to the value of the item, the relevant income from the entire item can be included within the old stream.

### Examples:

With real products and processes there are likely to be specific factors within different businesses which completely change the scenario. However some examples are included to outline the thinking behind the idea of Core Value.

1. An established mechanical process is used in producing quality goods due to old IP contained within it. In previous years an additional margin of 5% has been treated as a notional royalty to reflect the exploitation of that old IP. Additional new IP is incorporated into the machinery which speeds up production, but does not change the quality. Commercial analysis considers that the margin should remain at 5% over competitors without the patented technology. The new IP contributes to more goods being sold, so the relevant income increases. The mechanical process clearly benefits from both new and old IP incorporated within it. There are different ways that core value could be considered and the company should use the one which fits their own business and particular IP right, and be prepared to back up their methodology should they be asked by HMRC to do so.

If sales figures had been analysed sufficiently to identify the percentage of increased profits from the additional volume compared to the existing 5% margin these could be compared to identify the greater value. However, the core value of the process could also be regarded to be producing the same quality goods, whatever the volume, so the patented process could still be regarded as being within the old regime.

2. An electronic product is on the market with several old qualifying patents within it. A new model is produced which upgrades the core value, allowing significant improvements, such as

reception speed, quality or other features. Although the new model now contains both old and new qualifying IP, it can be seen to be significantly different from the previous model commercially because the new model increases in price whilst the older version is marked down. The commercial value rests in having the new patent included. So despite still containing some old qualifying IP the product would therefore be regarded as being entirely in the new regime using this method.

3. A medical device used to deliver drugs in a certain way contains one old qualifying IP right. The device is improved to prevent the mechanism from wearing out so quickly and this involves incorporating three patented elements. The company believes that the core value of the device is that it delivers the medicine in the correct dosage. The improvement that it lasts longer is ancillary to the core value. Would the analysis change if it subsequently won awards and acclaim in the relevant press, leading to greater sales? Possibly not as the core value itself hasn't changed. However, include other commercial considerations such as whether the value of the stock would change to make a considered judgement in the light of the facts each year.

## **Second method : Numeric value**

Take the total number of qualifying IP rights within the product or process. Treat rights relating to the same IP (but in relation to different territories for example) as one. If the percentage of old IP is 80% or more of the total number of qualifying IP rights the relevant income may be entirely attributed to old qualifying rights only.

If the percentage of old IP is less than 20% the relevant income may be entirely attributed to new qualifying rights only.

If the percentage of old IP is between 20% and 79% that percentage of the income may be taken to be attributable to old qualifying rights and the

remainder attributable to new qualifying rights and allocated to the relevant sub-stream. In this case, the R&D fraction would be based only on R&D expenditure underlying the new IP.

## Examples

1. A vehicle contains many thousands of patents. As time passes more new patents are introduced into the vehicle. In the accounts year ended 31/12/19 there are 12500 qualifying IP rights incorporated into the vehicle and 1500 of these are classified as new qualifying IP. As this is 12% of the total ( 1500/ 12500) the entire relevant profits can be included as old IP.

2. A new gaming device contains 80 patents, of which 60 are new IP. 75% (60/80) are new IP which means that 25% are old. The relevant profit should be split so that 25% is placed in the old stream and 75% placed in a suitable new sub stream

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