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HMRC internal manual

Corporate Intangibles Research and Development Manual

From: [HM Revenue & Customs](#)
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Published 11 March 2016

Updated: 10 September 2025 - [See all updates](#)

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CIRD220252 - Patent Box: relevant IP profits: relevant IP income: notional royalties: examples

CTA10/s357BHA (previously s357CD - but unchanged) Patent Box: Notional Royalties: Examples

Example 1 – process patent for in house machinery

Company X manufactures widgets. It holds a patent over a new mechanical process that makes

the widget but the patent does not cover the widget itself. The sale of the widgets does not fall within Head 1 (sales income s357BH) and so the income is not relevant IP income. The company will need to calculate the income received from each widget before and after the patented machinery is first used to manufacture the widgets. This income for the purposes of the notional royalty provision will be 'IP-derived income', to the extent that it is reflected in the company's trading income and is not included in other relevant IP income or excluded income. If only part of the mechanical process has been improved by the addition of a patented part, the IP derived income should only reflect the additional income received as a result of the patented improvements. So the amount of IP derived income will depend on the facts and the way the qualifying IP rights are used in the process. The company must then calculate an appropriate percentage of the IP derived income using transfer pricing principles. This means that Company X must consider what they would (hypothetically) pay a third party if they had licensed the patented machinery part at arm's length in order to exploit that patent in that accounting period. Applying this percentage to the IP derived income is the notional royalty and is deemed to be the relevant IP income for the process sub-stream.

Example 2 – royalty received for patent within service provider

A telecommunications company Y provides broadband and data storage services to customers. Company Y developed a patented device which increases broadband download speeds and this feature generates additional business for the company. The company receives royalty income from providing the broadband and data services out of which it calculates 'IP derived income' which is the amount it receives as a result of exploiting the patented device. It can use any appropriate methodology to do this, which will depend on the nature of the additional business. Company Y is then required to use transfer pricing methodology to calculate an appropriate

percentage of that IP derived income which is the arm's length amount it would be willing to pay another person for a licence to provide the patented broadband service (if it had not patented the device itself). That percentage of IP derived income that company Y calculates is the notional royalty used as deemed relevant IP income for the sub-stream.

Example 3 – simpler method for a company within small claims treatment

If company Z has made a small claims election under S357BNA then although company Z needs to identify and calculate the 'IP derived income' which is the amount it receives as a result of exploiting the qualifying IP rights, it can use using any appropriate methodology to do this. Company Z does not need to then perform a calculation using the OECD transfer pricing principles and instead it calculates the notional royalty as 75% of the 'IP-derived income'. Further details are at [CIRD273100 \(https://www.gov.uk/hmrc-internal-manuals/corporate-intangibles-research-and-development-manual/cird273100\)](https://www.gov.uk/hmrc-internal-manuals/corporate-intangibles-research-and-development-manual/cird273100)

Example 4

Please refer to [CIRD220305 \(https://www.gov.uk/hmrc-internal-manuals/corporate-intangibles-research-and-development-manual/cird220305\)](https://www.gov.uk/hmrc-internal-manuals/corporate-intangibles-research-and-development-manual/cird220305) for a further brief example.

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