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Corporate Intangibles Research and Development Manual

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CIRD220260 - Patent Box: relevant IP profits: relevant IP income: notional royalties: summary of calculations

CTA10/s357BHA (previously s357CD, but unchanged)

Patent Box: Notional Royalty: Summary of calculations

The company must hold relevant 'qualifying IP rights' which means patent rights within (a), (b) or (c) of S357BB(1) (CIRD210150

(https://www.gov.uk/hmrc-internal-manuals/corporate-intangibles-research-and-development-manual/cird210150)). Notional royalties cannot be calculated in respect of any other rights to which the legislation applies.

A company may elect that the notional royalty is to be treated as if it were relevant IP income. The notional royalty is the royalty that would be paid to an independent owner of the relevant qualifying IP rights for the company's exclusive use of those rights to generate the IP-derived income.

The notional royalty is an appropriate percentage (CIRD220251 (https://www.gov.uk/hmrc-internal-manuals/corporate-intangibles-research-and-development-manual/cird220251)) of the IP-derived income (CIRD220250 (https://www.gov.uk/hmrc-internal-manuals/corporate-intangibles-research-and-development-manual/cird220250))

The IP derived income may be identified by any methodology appropriate to the case facts, as there are many different ways that qualifying IP rights may be incorporated within a company's trade and not produce direct income which can be included as Relevant IP income (RIPI).

The appropriate percentage of the IP-derived income is the arm's length amount the company would be willing to pay another person (P) for a licence to use the IP (if it had not patented the device itself). It must be calculated in accordance with Article 9 of the July 2010 OECD Model Tax Convention and the OECD's Transfer Pricing Guidelines, or any successor documents.

The notional royalty is for the right to exploit qualifying IP rights and does not include amounts payable for any associated IP rights such as know-how, market forecasts, research data that the company holds from which in practice it obtains additional value. It does include such technical detail which is necessary for the company to exploit the patents. One approach may be to assume that P owns only that which is to be included within the Patent Box. In an arm's length

situation, the bargaining range between the parties is determined by the minimum the seller/ licensor is prepared to accept and the maximum that the buyer/ licensee is prepared to pay, but the starting point is to ascertain exactly what the company is paying for.

If the qualifying IP rights function holistically to create added value over and above the value of each individual patent (because the company's trade exploits the patents as a single interrelated set of rights), then the notional royalty is that for the whole portfolio.

This approach prevents the following incorrect outcomes:

- The aggregate notional royalty is treated as nil or negligible because each patent in isolation has little value even though the combined portfolio is extremely valuable.

- The aggregate notional royalty is excessive because each patent in isolation is said to have a high value even though the package as a whole has a limited value.

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