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## HMRC internal manual

# Corporate Intangibles Research and Development Manual

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## CIRD220251 - CTA10/s357BHA Patent Box: Notional Royalties: How to calculate the 'appropriate percentage'

The notional royalty is an appropriate percentage of the IP-derived income. The method of calculating the IP derived income is explained in [CIRD220250](#) (<https://www.gov.uk/hmrc-internal-manuals/corporate-intangibles-research-and-development-manual/cird220250>) (which needs to be read before this page), with examples of the combined calculation at [CIRD220252](#) (<https://www.gov.uk/hmrc-internal-manuals/corporate-intangibles-research-and-development-manual/cird220252>)

[intangibles-research-and-development-manual/cird220252](#)), the notional royalty summary at [CIRD220260](#) (<https://www.gov.uk/hmrc-internal-manuals/corporate-intangibles-research-and-development-manual/cird220260>) and Transfer Pricing assumptions at [CIRD220270](#) (<https://www.gov.uk/hmrc-internal-manuals/corporate-intangibles-research-and-development-manual/cird220270>).

Having identified IP derived income as described in [CIRD220250](#) (<https://www.gov.uk/hmrc-internal-manuals/corporate-intangibles-research-and-development-manual/cird220250>) (the first step), the second step is to calculate the 'appropriate percentage' of the derived IP income. The 'appropriate percentage' is the proportion of the IP derived income which the company would pay another person (P in the legislation) for the right to exploit the qualifying IP right in the accounting period concerned if the company were not otherwise able to exploit it.

The legislation requires the appropriate percentage to be an arm's length calculation in accordance with Article 9 of the OECD Model Tax Convention and the OECD Transfer Pricing guidelines. See [CIRD220270](#) (<https://www.gov.uk/hmrc-internal-manuals/corporate-intangibles-research-and-development-manual/cird220270>) for assumptions to be made or not to be made.

Transfer pricing has a number of methodologies available but the profit-split methodology is likely to be the appropriate Transfer Pricing methodology to determine the "appropriate percentage" of IP derived income which relates to having been able to exploit the qualifying IP right.

Where a small claims election is applicable, and a valid election made, the legislation allows the small claims election (under S357BNA) to treat the appropriate percentage as 75%, so the notional royalty is 75% of the IP-derived income (see [CIRD273100](#) (<https://www.gov.uk/hmrc-internal-manuals/corporate-intangibles-research-and-development-manual/cird273100>)).

[development-manual/cird273100](#) ), but in all other cases the facts will need to be considered in accordance with OECD transfer pricing principles to reach an appropriate percentage of IP derived income which would be paid to hypothetical IP Owner P, based on the scoping of the IP derived income, facts about how the qualifying IP right is used within the business , and commercial considerations. The appropriate percentage cannot be assumed to be 75% and must have supporting methodology.

Examples are provided at [CIRD220252](#)  
(<https://www.gov.uk/hmrc-internal-manuals/corporate-intangibles-research-and-development-manual/cird220252>)

### Streaming note

Relevant IP income is separated into sub-streams. The notional royalty calculated according to S357BHA and described above is likely to be treated as the relevant IP income for a single sub-stream in accordance with Step 2(c) of S357BF(2) , the calculation steps are shown at [CIRD275200](#) (<https://www.gov.uk/hmrc-internal-manuals/corporate-intangibles-research-and-development-manual/cird275200>). If there are several qualifying IP rights which combine to form the process or service, they can be combined into the same sub-stream.

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