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HMRC internal manual

Corporate Intangibles Research and Development Manual

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CIRD220520 - Patent Box: relevant IP profits: marketing assets return figure: notional marketing royalty: examples

Example 1

Company A develops an innovative concept and patents it. It then grants a 10 year licence to another company (Y) to use the patent to manufacture and sell patented products.

Company A's NMR will be nil throughout the period of the licence as it has no marketing assets within

the statutory definition. Consequently all of its qualifying residual profit will fall within the patent box.

Example 2

Company B develops an innovative concept and patents it. It decides to manufacture and sell products using the patent itself and registers a trademark to do so.

Company B's NMR will be based on the appropriate arm's length royalty it would pay for the marketing assets, within the meaning of the definition given in S357BN, that it possesses. These will include its trademark.

For the accounting period of the year in which the product is first sold the 'appropriate percentage' will be minimal, assuming no marketing activities have yet been carried on, and hence the marketing assets will have little if any value. Assuming the product is successful, the NMR in later periods will be similarly determined by applying the arm's length principle and may be quite significant depending upon the relative impact upon sales of the marketing assets as compared to the other functions and assets of the company including the patent.

At the beginning of Year 4 it is reasonably anticipated that the turnover and profits of Company B from sales of the patented product for the remaining period of the licence will be £100m and £30m respectively.

An analysis undertaken in accordance with the OECD Transfer Pricing Guidelines results in the application of a profit split methodology which concludes that the profit is attributable 60% to the patent and 40% to the goodwill established solely due to the marketing efforts of Company and signified by the trade mark.

Consequently, the appropriate arm's length royalty rate to be used in calculating NMR for the

accounting period will be 12% i.e. $([40\% \times \text{£}30\text{m}]/\text{£}100\text{m}) \times 100$.

If actual sales and profits of Company B in Year 4 are £10m and £3m respectively, NMR will be £1.2m (i.e. $\text{£}10\text{m} \times 12\%$) leaving £1.8m as relevant IP profits (subject to any routine return already deducted) falling within the Patent Box. In practice, the relative contributions of the marketing assets and the patent may not vary significantly once the product has become well-established.

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Example 3

Company X has a well-established electronic goods business which has produced a number of popular products over many years. The company branding is used on all its products. The Company develops a new patented product and commences to manufacture and sell the product under the well known company brand.

Company X's NMR will be based on the appropriate arm's length royalty it would pay for the marketing assets, within the meaning given in S357BN, that it possesses. However, in order to avoid over-stating the NMR, it is only necessary to consider the amount that the company would pay to use the marketing assets on the products that qualify for the Patent Box, not on the company's entire product portfolio. This is because S357BKA(4)(g) provides that the valuation should assume that no income other than RIPI will arise to the company through exploitation of the assets.

For the accounting period of the year in which the product is first sold the appropriate percentage royalty, calculated by applying the arm's length principle, may well be substantial given the established nature of the company brand and its consequently significant impact on the potential sales of the patented product.

For example:

- assume reasonably anticipated sales and profits at the beginning of Year 1 over the patent period were £900m and £400m respectively using the marketing assets and £600m and £250m if the marketing assets were not used;
- the anticipated value of the marketing assets would be £150m (£400m - £250m);
- the appropriate percentage would consequently be 16.7% [$(£150m/£900m)$] of RIPI.

Example 4 Company making Small Claims

Election [CIRD220470](https://www.gov.uk/hmrc-internal-manuals/corporate-intangibles-research-and-development-manual/cird220470) (<https://www.gov.uk/hmrc-internal-manuals/corporate-intangibles-research-and-development-manual/cird220470>)

There is the provision for companies with smaller amounts of Qualifying Residual Profit (QRP) to make a Small Claims Election. Both old and new regimes allow a Small Claims Election to be made in respect of the NMR calculation. When there are marketing assets so it is known that the NMR will not be 0 (example 1) the company may elect to apply a 25% reduction to the QRP as described in [CIRD220480](https://www.gov.uk/hmrc-internal-manuals/corporate-intangibles-research-and-development-manual/cird220480) (<https://www.gov.uk/hmrc-internal-manuals/corporate-intangibles-research-and-development-manual/cird220480>) instead of undertaking the arm's length calculations to ascertain the 'appropriate percentage' of income relating to those marketing assets.

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