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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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CIRD220250 - Patent Box: relevant IP profits: relevant IP income: notional royalties: IP derived income

CTA10/s357BHA (unchanged from CTA10/s357CD)

Patent Box Notional Royalties: IP derived income

This section applies where a company holds qualifying IP rights or an exclusive licence in respect of any rights within a), b) or c) of s357BB(1) and has income (which is not excluded

or finance income) arising from the exploitation of that right, but which is not included in the Heads of Income in [CIRD220160](https://www.gov.uk/hmrc-internal-manuals/corporate-intangibles-research-and-development-manual/cird220160) (<https://www.gov.uk/hmrc-internal-manuals/corporate-intangibles-research-and-development-manual/cird220160>) . The most common example is where a company has a process patent but there are other examples such as income from providing a service or leasing or renting items which incorporate qualifying IP rights. Examples are provided at [CIRD220252](https://www.gov.uk/hmrc-internal-manuals/corporate-intangibles-research-and-development-manual/cird220252). (<https://www.gov.uk/hmrc-internal-manuals/corporate-intangibles-research-and-development-manual/cird220252>)

A patented process or tool may be used to produce a product or service which is subsequently sold to generate sales income of a company. However many products made as a result of a process patent, or as a result of a process that incorporates a patented component or that uses a patented tool, would not be patentable inventions in their own right. Sales of products that have not been patented or are not specifically named in a 'product by process' patent could not qualify under any of the heads of S357BH ([CIRD220160](https://www.gov.uk/hmrc-internal-manuals/corporate-intangibles-research-and-development-manual/cird220160) (<https://www.gov.uk/hmrc-internal-manuals/corporate-intangibles-research-and-development-manual/cird220160>)). In addition, any services supplied by the company that make use of such processes, or that employ patented tools, would not give rise to relevant IP income in their own right.

The key aim of the S357BHA (and previously s357CD) notional royalty provisions is to deliver Patent Box benefits to a company that uses its qualifying IP right or exclusive licence in respect of a qualifying IP right in a way that does not generate relevant IP income under the five Heads of Income defined at S357BH, ([CIRD220160](https://www.gov.uk/hmrc-internal-manuals/corporate-intangibles-research-and-development-manual/cird220160) (<https://www.gov.uk/hmrc-internal-manuals/corporate-intangibles-research-and-development-manual/cird220160>)) but does result in the company deriving income and profits as a result of the exploitation of the IP right (termed 'IP-derived income').

This is achieved by allowing a company to elect that a “notional royalty” is to be treated as if it were relevant IP income.

The notional royalty is an appropriate percentage of the IP-derived income. The method of calculating the appropriate percentage is explained in [CIRD220251](https://www.gov.uk/hmrc-internal-manuals/corporate-intangibles-research-and-development-manual/cird220251) (<https://www.gov.uk/hmrc-internal-manuals/corporate-intangibles-research-and-development-manual/cird220251>) with examples of the combined calculation at [CIRD220252](https://www.gov.uk/hmrc-internal-manuals/corporate-intangibles-research-and-development-manual/cird220252) (<https://www.gov.uk/hmrc-internal-manuals/corporate-intangibles-research-and-development-manual/cird220252>), the summary at [CIRD220260](https://www.gov.uk/hmrc-internal-manuals/corporate-intangibles-research-and-development-manual/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) (<https://www.gov.uk/hmrc-internal-manuals/corporate-intangibles-research-and-development-manual/cird220270>).

The first step in calculating the notional royalty is to establish the IP-derived income.

1. How to calculate IP derived income

The IP-derived income must form part of the company’s trading income and must not be finance income [CIRD220130](https://www.gov.uk/hmrc-internal-manuals/corporate-intangibles-research-and-development-manual/cird220130) (<https://www.gov.uk/hmrc-internal-manuals/corporate-intangibles-research-and-development-manual/cird220130>) or excluded income [CIRD220280](https://www.gov.uk/hmrc-internal-manuals/corporate-intangibles-research-and-development-manual/cird220280) (<https://www.gov.uk/hmrc-internal-manuals/corporate-intangibles-research-and-development-manual/cird220280>).

The same principles apply to calculate the IP derived income in all cases, including where the small claims treatment described in [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>) applies. But a company may calculate IP-derived income using any just and reasonable method, some examples are below:

- (i) By identifying income received by virtue of exploiting the IP in the process or service.
- (ii) By comparing and considering income from a previous year before the IP was included to ascertain the incremental increase due to using the IP;
- (iii) By identifying the profit margin difference between a patented process and a competitor's unpatented process and using these percentages to work back to calculate IP related income
- (iv) By using (for example) cost projections prior to investing in the IP and identifying the subsequent income which has been 'derived' from using the IP.

Note that the calculation of IP Derived Income and the corresponding appropriate percentage of that IP derived income should not be confused with the calculation of normal commercial royalty amounts or rates as the notional royalty itself is the outcome of s 357BHA (previously s357CD) as a whole and requires a second step to calculate.

The second step is explained in [CIRD220251](https://www.gov.uk/hmrc-internal-manuals/cird220251) (<https://www.gov.uk/hmrc-internal-manuals/corporate-intangibles-research-and-development-manual/cird220251>).

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