

INTELLECTUAL PROPERTY PORTFOLIO MANAGEMENT

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Welcome friends, in IP portfolio management In many videos, sessions we have discussed that we have to generate value from our IP. And when we say value generation from IP, we have discussed that we need to increase income. IP can be a source of extra income for us. It is possible by getting some kind of exclusive rights, some kind of competitive advantage.

It is possible to generate some kind of extra goodwill for you. through which also your income may increase. You may charge a premium price because of higher goodwill. It is always possible that you can use IP as a good negotiating power in your business dealings. As a startup, you can raise funds from your IP.

So, there are different types of uses of your IP portfolio. But when you are making income from your IP which is sometime not clear that income is coming from IP because it may be income from your business operations you have a particular IP with you and now you are using that IP in making a product you are selling that product to the market. So, you are not very clear that how much of this income is coming from your IP because you are having a better quality camera in your mobile phone. And because of that better quality camera in your mobile phone, your phones are having bigger market size or you are able to charge a higher premium price from your better quality camera.

It is not income from IP. But as we have discussed in our earlier videos, there may be some direct streams of income generation from your IP. For example, if you are giving your IP in terms of franchisee mode, in terms of licensing, where there is a clear stream of revenue which is coming from IP. So, this is income from IP and when you have income from anything, anything that country's taxation laws will also be applicable on that.

So, in this particular session we will be discussing about how taxation related to IP related incomes are going to be applicable and what type of issues are involved when we are talking of taxation in IP incomes. So, we are going to have IP taxation under the Income Tax Act also that is particularly more relevant from India's point of view that how Indian IT Tax, Income Tax Act and it may vary, it may vary from country to country. Then there are some international IP taxation essentials also we are going to discuss in this particular case. The issues related to transfer pricing.

Because lot of IP related incomes are generated when we are doing the technology transfer and when we are doing the technology transfer the amount of transfer of technology the price which we are giving to that how it is affecting our taxation related matters. Then, we are also going to discuss a very important arm's length principle which is applicable in taxation purpose. So, all these things we are going to discuss in this particular session. Now, taxation is a very important you can subject matter of any particular government and generally governments are very much concerned about the taxation because it is a the most important source of revenue generation for any government whether the

income or the tax is coming directly or indirectly. But governments are very much concerned you understand and many countries are becoming quite friendly because of the low tax rates. They want to promote business in their countries and they try to keep the tax so low that it becomes attractive to do business in those countries. So, taxation is a very important business decision across the globe. Governments are keen on assets R&D within their territories to boost revenue creation jobs and improving the R&D activities.

Intellectual property is increasingly valuable for tax optimization for governments and firms. Because of inherent nature of intangibility both company as well as government they both want to take. maximum benefit of this intangible aspect of intellectual property for optimizing their tax structure. Every company and every government tax is a broad term, but within tax indirect direct who is going to be paying the tax like in our case there may be income tax also there may be GST also there may be other type of taxes also excise tax also.

So, you optimize that overall this much is expected earning from the government's point that this much is the expected earning I want to have for my country from tax. So, how much of that will come from the direct tax. How much of that will come from the indirect tax? So there will become a complete you can say portfolio of taxable incomes and so

that is the optimization from the government side. From the firm side also interesting thing is that.

government wants to maximize its revenue from the tax and as an individual or as a firm I want to minimize my tax liabilities. So, it is very interesting thing government to maximize tax collection firm or individual to minimize tax liabilities. So, both have their own purpose or their own objectives and accordingly optimization of tax structure becomes a very interesting problem. Now, in some cases where IP is

very much, though entire IP is intangible, but within that also there are few IPs which are more visible than other types of IPs, like trade secret, know-how, these are known as non-codified IPs, because you have no idea, you have no documentation related to trade secrets and know-how. While in case of patents, trademarks, copyrights, design, etc., you have proper documents available that is why these are known as codified IPs. So, when I am saying the taxation related matters these are more pertinent or more related to codified IPs where you have proper documentation where documentations are not available this income from IP is not visible income. Now, generally tax related structures are very complicated things.

Now, in terms of IP related income, the most common word which will be used again and again in this particular session that is the royalty income. How this royalty income comes because we have already understood that how things are happening in terms of IP commercialization. Let me tell you that you are a company based in USA. Now, you have done some kind of FDI foreign direct investment and you open your India branch. Now, India branch wants to manufacture the same products which you are manufacturing in USA and for that purpose this India branch

requests you for transfer of technology. So, you have transferred some know-how, some technologies to your India branch so that India branch can manufacture those product that you are manufacturing in USA. Now, because you have transferred technology to your India branch, this India branch will pay royalty to you. And now this royalty income is one such simple example which is purely IP based income. Technology means IP, knowledge.

So, since American company is giving knowledge to Indian company and in lieu of that Indian company will pay royalty to the American company. That is the royalty income system. Now, this royalty income system the income which is coming because of royalty it has to be appropriately taxed it has to be appropriately taxed that is one thing. Second is

since Indian company is a part of American company. So, the income from this operations whatever business Indian company is doing that income from business

will also be going to American company, will go to its parent company. So, business income will also go to the American company. So, there will be two streams of revenue for the American company. One because of transfer of technology and the second is because of the business operations in India. and there are different types of taxes systems.

For example, generally tax on royalty income is much less as compared to tax on business income. So, most of the companies they try to give in this kind of arrangement which is there on your screen, you see that both companies are having same ownership, same management. So, generally as I say the tax on royalty is less as compared to tax on business income the Indian company will like to give most of the money to American company through royalty payments to take advantage of low tax payments. But this is not going to benefit this is rather not acceptable to the national governments because it is actually

hampering their interest of more tax realization. So, that is a kind of debate discussions which are happening at multiple levels that how do we streamline all these issues. So, I hope this one point is clear about royalty income that is income because of IP. I gave you example of technology transfer. Similarly, royalty incomes are also possible in trademark, in copyrights.

I have given you rights of my book. I authored a book. You are a publishing house. Now, you want to publish my book. I have given you entire manuscript of my book.

And in lieu of that, you are saying that you will get annually 10% of whatever income is generated from the sale of these books. So, that is royalty income for authors. Similarly, you are a big chain of fast food. I want to open a fast food outlet in this city.

I approach you. You said, okay, you can use my name. You have to put this type of signboard and you can use my name. But for using your name, I have to pay royalty to you.

So, there are royalty payments in all forms of IP, not limited to patent, but it is in the field of trademark also, it is in the field of copyright also, it is in the field of design also. That is why I said that royalty income is the most commonly used word whenever we are talking of tax systems on IP income. Then, these days, lot of IP commercialization is

happening through online systems. In that online system sometime it is still not very concrete in black and white.

It is still a complex phenomena, tricky phenomena to actually categorize your income and whether it is part of IP related income or some other kind of business operation related income. That is yet not concretized. It is in the pipeline to have more clarity on these things. Now, coming to specific to Indian scenario where Indian Income Tax Act is applicable. So, we all know that taxation on IP related income.

is a global phenomena these days and particularly as our science technology etcetera is improving more IP creation is happening almost all national governments they are trying to make laws related to IP income taxation. In India's Income Tax Act, there is no specific definition of intellectual property, income and tax on that intellectual property. But however, this word royalty is there and it is actually taxed under the system of royalty and IP is taxed through various indirect legislation in India's case and because of these indirect legislation, it is actually creating a challenge about entire process of IP creation, development, acquisition, utilization etcetera because of I will say that Income Tax Act is not so clear with respect to IP related income. Now, the indirect categories through which IP intellectual property can be taxed in India are deductions, income

goods and sales tax GST. So, in the deductions, it is the pre-existing stage of an IP. The cost which is incurred, since it is a matter of law, so we have to go word by word, it is the cost which is incurred on analysis and manufacturing, capital expenditure on R&D, is treated as an expense and it is to be deducted from the gross income received from the calculation of income tax. So, it is a kind of a relief whatever expenses you are incurring in R and D for generating the IP that can be deducted as such from your gross income and it is considered as an expenses.

And therefore, you will have lesser income for calculation of income tax. So, all the expenses as part of your R and D activity and it is more important for individuals that if I have a particular level of income let us say rupees X year I got one IP in And I say that for developing this IP the kind of raw material lab etcetera which I developed I spent about rupees 10 lakh. So, from my gross income of XCR I can deduct this 10 lakh and then whatever is left that will be my taxable income. Though there are various other provisions of deductions also, I am not going into the income tax class, but R&D expenses can be deductible from my gross income.

The second is the income related component. Income from an IPR either by assignment or licensing is treated as capital gain. So, we have a provision of tax on capital gain or income received from royalties. under the Income Tax Act of 1961. So, capital gain or royalty that is mentioned.

So, income from IP is taxed either of these two. Then GST, tax on the sale of IP. So, if it is properly invoiced, so there will be a GST component that will also come on that value of IP. Transfer of IP, licensing of IP, assignment of IP all these are covered under GST because all these things are services. So, all these service activities are taxed under GST system.

So, that is also one type of taxing system which is applicable in case of IP. Under 1961 Income Tax Act in India. Intangible assets are considered as depreciable assets for the computation of income. These days there is a very popular term EBITDA and in EBITDA also the last word A that is amortization. So, that amortization is basically how you are depreciating your IP assets that is included in this accounting terms also.

Intellectual property and accounting treatment when IP is created and acquired, the money flow will be shown as an asset. Expenses incurred on R&D are written off under the concept of materiality. An asset will be acquired for the direct purchase of IP. The plant machinery acquired along with the know-how, design, drawing are subject to levy the different types of tax or charges. So, the meaning is

when you are procuring any kind of IP, when you are creating any kind of IP, in our accounting term it is shown as an asset. And all the expenses on R and D are shown as, all these expenses on R and D activities are written off under the concept of materiality means whatever equipments, whatever tools, whatever raw material etcetera that is actually consumed for the development of IP. So, there is no need of including them in your balance sheets and the payments which you are making as part of royalty will go under the heading of liabilities in your balance sheet.

So, the payments which you are making under the royalty are part of section 9 1 part 6 where the transfer is made for lump sum consideration once for all will result in capital gain accessible to the tax. So, as we just saw that royalty payments are subject to capital gain charges. Capital gain just to give you an example whenever you are doing sale and purchase of land for example. So, when you are doing sale and purchase of land it is subjected to capital gain.

Another example is shares of the companies. So, if you are buying, selling the shares of the companies And if you are holding the share for more than one year, the gain which you are getting on that particular sale proceed is charged as capital gains. not only the IP related income but in majority of other cases also capital gain is applicable. So, that is why we said in the beginning that there is no separate mention of IP but it is possible to include IP related income through various other provisions which are there in our Income Tax Act.

Now, whether the transfer is made for a limited period as a recurring payment based on the trading results of the user intellectual property is revenue receipts. Then, after this section 9, another section 32, 1 part 2 in respect of depreciation of assets. Depreciation means the value is declining over a period of time. We all know that patent is only for 20 years. which is the most popular type of IP and a patent will have more value in the beginning and slowly and slowly once your technology is still alive and you will see that there will be more competing technologies available with other competitors also or competitors may have a better technology.

So, your technology will depreciate its value will decline over a period of time. So, depreciations are allowed in know-how, patents, copyrights, trademarks, license, franchises all these things because of the very fast nature of business. And that is possible to include in your IP thing that what is the depreciation you are charging on your intangible assets. Generally, we charge depreciation on the tangible assets, for example, car, machines, your building, plant, machinery, all these things, but depreciation as per our Income Tax Act can also be possible on your intangible assets. Section 35 is on deduction on expenditure on any know-how for use for the purpose of business

one sixth of the amount so paid shall be deducted in computing the profits and gains of the business for that previous year and the balance amount shall be deducted in equal installments for each of the five immediately succeeding previous years. So, how this depreciation will be charged in terms of IP assets that is mentioned in the section 35 AB. Section 80QQA, it is about income from copyrights. The IP right which is available to you for the longest period that is the copyright. So, any lump sum consideration for the assignment or grant of any of his interest in the copyright of any book or royalties or copyright fee.

In respect of such book, there shall in accordance with the subject to the provisions of this section be allowed in computing the total income of the SSC, a deduction from such

income of an amount equal to 25 percent thereof. So, whatever income you are receiving in lump sum as a result of your copyright transfer or copyright income that will be added to your income, income of SSC. and maximum amount equal to 25% can be deducted as part of the expenditure incurred in that particular copyright that is section 80 QQA. Section 80 RRB royalties for patent deduction is allowed equal to the whole of such income or 3 lakh rupees whichever is less. So, in case of

you have income from royalty for patents. So, you are getting royalty for patents because you are able to maintain the patent and therefore, there is some expenses on the patent related activities. And for that purpose, you can reduce maximum up to 3 lakh rupees. If 3 lakh is the maximum income, so the entire income can be reduced. Otherwise, upper cap is 3 lakh rupees, you can have deduction on this ground.

Now, these are some of the subsections, sections which are relevant to know with respect to income from IP and the taxation system. But you see that there are still very much possibility. There are grey areas where you have that some IP may not follow very strict ownership rules. Then brand values where lot of emotional issues are also involved and it is very difficult to have write valuation or write money related calculations on which you can have your taxation system.

And in licensing agreements also, it is quite possible that your income from license may not be correctly reflected and you may create some kind of via media for minimizing your tax liabilities. And in comparison to tangible assets, where you have more or less fixed to a particular assets. Intangible assets are generally shifted to those places where you have low taxation because fixed asset you cannot move, but you can easily move your intangible assets to a different location. The meaning is you cannot move your plant from India to another country, but it is always possible

that I register my patent in a country where taxation is very very low with respect to income on IP. So, that is a very important challenge for national governments that because of higher taxation many of us who can expect high income from their IP, they may register their IPs in those countries where taxations are low because of the easy movement of the, that is a very interesting characteristic of which we need to see from IP portfolio management point of view that are we registering our IP in high tax countries or we are registering IP in low tax countries. they are therefore, there are good number of agencies, there are vigilances which are continuously watching the IP assets, their transferring policies and they are seeing that what type of practices corporates are

adopting for minimizing their tax liabilities with respect to IP incomes. So, IP related activities are surely generating income

But companies are continuously trying to use some of the unique features of intangible assets to minimize their IP related tax liabilities. And particularly whenever we are talking of international IP taxation it becomes even more complex. Because, IP can easily be transferred across the boundaries as we just discussed in the beginning of this particular session that how USA and India are involved in IP transfer. It is very important that there has to be some kind of treaties between the countries so that any kind of violation of income rules, taxation rules can be minimized and here So, the understanding of arm's length principle is very very crucial and that we are going to see that what is this arm's length principle in our transfer pricing.

So, this principle says that price which is agreed in a transaction between two related parties must be the same as the price agreed in a comparable transaction between two unrelated parties. For example, as I said in the beginning of the session that you have a parent company and its subsidiary in a different country. So, these are two related parties where parent company is doing some kind of investment to start a subsidiary in a different country and it is quite possible their pricing is very high. Subsidiary may say that okay I will pay you 50% royalty that is quite possible because subsidiary and parent are same but can there be a 50% royalty payment if these two companies are unrelated. It is not the subsidiary of the parent company but they are two unknown companies A and B.

Maybe if it is only 10 percent payment of royalty which will be maximum in this case then this arm's length principle is helping us that the price between parent and subsidiary should be somewhere closer to 10 percent. It may be 11 percent, it may be 9 percent but it must be similar to the if it is 10 percent here and it is 50 percent here. It creates a lot of question and there will be issues related to fairness in this particular transaction. So, this arm's length principle is very important and the tax agencies continuously keep watch on these things that whether whenever there is a transfer pricing arm's length principle is followed or not followed because there will not be any case of any kind of hidden agenda or lack of fairness when two unrelated parties are there.

This issue happens only when two related parties and generally in terms of FDI when a parent company is making a subsidiary in some other country. So, that arm's length principle is also very important to know and you need to do lot of search so that you know what is the comparable pricing when two unrelated parties are coming for this kind

of technology transfer. So, with this We understood that taxation has different objectives for different parties. countries want to maximize their taxation, countries also want that more and more technology inflow should happen but their payment for income should be properly under the tax regime.

There may be possibility of some kind of let us say exaggerated pricing of the technology transfer. So, in that case this arm's length principle is very handy which will give you a comparable idea about the pricing and IP related Taxing is more dependent on country to country system. We presented some of the important considerations which are available in India's Income Tax Act. But for a global phenomena, you need to see that wherever more FDI is happening in India.

Across the globe, it can be a good project activity. What is the taxation system in those countries on IP-related matters? Whether low tax on IP matters is a reason for more FDI in those countries or not? So, with this, we come to end of this particular session. Thank you very much.