

Intellectual property

Intellectual property can account for a substantial portion of a business' assets, even in a small enterprise, and in some cases can be the most valuable asset an organisation owns. This brief guide covers some of the more important aspects of identifying, protecting, and leveraging intellectual property' in small and medium-sized businesses.

WHAT IS INTELLECTUAL PROPERTY?

The term 'intellectual property' or 'IP' basically refers to specific creations of the mind for which property rights are recognised. It can include designs, inventions and discoveries as well as literary, artistic and musical works and even symbols words, and phrases, including software.

Your IP will often be an essential element in your business or brand identity, something that distinguishes you from your competitors and a crucial factor in your ability to attract and retain customers. And, of course, it will often play a crucial role in your marketing activities.

The gross value added to the UK economy from IP created by UK businesses is currently estimated to be £54 billion a year!

THE VALUE OF IP

Generally, IP only has value if you can establish ownership rights, or intellectual property rights (IPRs). Once IPRs are established they can be attributed monetary value and traded in the marketplace, thus rendering an intangible assets much more 'tangible'. For example, you can:

- Earn royalties by licensing them
- Leverage them in strategic alliances
- Use them to secure loans
- Sell them separately or as part of a wider business disposal

There are many different ways to value IPRs and no one method is suitable for all situations. Each method has advantages and limitations, and in some cases it might be useful to use more than one method to arrive at a valuation. Three common methods for valuing IPRs are:

The cost method

This method looks at the costs of developing or creating an IPR, or to put it another way, how much it would cost to recreate it. It takes into account factors such as R&D costs and IP protection costs.

The income based method

This method attempts to assess how much income can be generated from licensing or selling the IPR.

The market-based method

This method, which is generally regarded as the most realistic, attempts to arrive at a 'real market value' of an asset by comparing recent sales of similar assets. The weakness of this approach is that it relies on detailed information about such transactions, which is often not available in the public domain.



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WHERE WE CAN HELP WITH VALUATIONS

There are of course, specific times when IP valuations should be conducted or reviewed such as when:

- A purchase, sale, or licensing agreement of a brand or other IP is being considered
- IP is included in negotiations for a joint venture or strategic alliance
- IP needs to be valued for financial reporting purposes
- The market value of IP needs to be determined for tax purposes
- An independent valuation of IP is required for commercial disputes or expert witness reports

Contact us if you need help or advice with any of these.

RULES OF THUMB

It should be noted that according to the Intellectual Property Office (www.ipo.gov.uk), there are some rules of thumb that are often used to estimate royalty rates for patents and trademarks.

In many negotiations the royalty rate for patents is 25-33% of the licensee's anticipated gross profit on sales of products that use the patent. For trademarks the figure is in the region of 10-15%. Usually royalties are paid on net sales, in which case they are commonly around 5%.

Though these are crude averages and circumstances vary considerably from product to product and from industry to industry, they do nevertheless act as benchmarks in the marketplace and any significant departure from them would need to be justified.

PROTECTING IPRS

Often the terms 'intellectual property' (IP) and 'intellectual property right' (IPR) are used interchangeably, but strictly speaking, IP is an intellectual 'product' such as a design, an original piece of writing, some software, or an invention, and the IPR is the legal right covering the ownership and usage of that product.

The most common types of IPR are patents, trademarks, copyrights, database rights and registered designs. Whereas copyright accrues automatically, the others have to be applied for through the appropriate channels.

The process of applying for IP protection can be long and in some cases cumbersome, and we would strongly advise you take appropriate professional advice at every stage.

Failure to adequately protect your IP can make it difficult, though not necessarily impossible, to prevent others infringing your rights by using or selling your IP without your permission. It can also put you at a serious disadvantage when seeking funding or investment in your enterprise.

ESSENTIAL IP MANAGEMENT

- Conduct an IP audit
- Have your IPRs professionally valued
- Ensure your IP is adequately protected
- Introduce compliance and security procedures in the workplace
- Exercise due diligence when dealing with others' IP

PROTECTION IN THE WORKPLACE

Generally employers have the rights to IP created by their employees, but it is always a wise precaution to spell this out in the employment contract. In some cases, where employees work with sensitive material, it might also help to have them sign a confidentiality agreement. Care should be taken to ensure that such material is protected at all times from being wittingly or unwittingly disclosed to others who should not have sight of it. This is especially true of IP in digital format that is stored in systems connected to the Internet.

RESPECT FOR OTHERS' IPRS

Care also needs to be taken not to infringe the IPRs of other businesses because this can prove costly if the other party decides to pursue the matter through the courts. Be sure to carry out appropriate searches of trademarks, patents, registered designs and copyrights before using, selling, or importing others' products. Be clear about where the ownership lies and whether you have permission to use, sell, or import the product.

IP MANAGEMENT

As can be seen from the above, IP is a complex area, but one that is becoming increasingly important. We strongly recommend that you put effective IP management procedures in place to protect your own IP and to ensure due diligence is exercised at all times with respect to others' IP.

Please do not hesitate to contact us if you would like further advice or help with any of the points covered in this guide.

IP AND TAXATION

For corporation tax purposes, any intangible asset created or acquired on or after 1 April 2002 is taxed under a self contained intangible asset regime. In general, the regime attempts to align the tax treatment of intangible fixed assets with the accounting treatment. Consequently, the tax treatment of an intangible asset is fairly simple as the debits, credits or gains recognised in a set of company accounts are also normally allowed for tax purposes.

Debits typically include:

1. Revenue expenditure charged to the profit and loss account
2. Amortisation of expenditure on assets included in the balance sheet, over a period of years in conjunction with the accounts. Alternatively an election can be made to write down the asset on a 4 per cent per annum fixed rate basis.

Credits typically include:

1. Receipts charged to the profit and loss account
2. Profit on the disposal of intellectual property
3. In very limited circumstances the revaluation of intellectual property.

If the debits exceed the credits, then this excess should be available for relief against other profits of the company or it can be surrendered through group relief.

Whilst the accounting treatment is generally followed, it is important that a distinction is made between trading or non-trading assets, as an adjustment is still required in the corporation tax computation. In addition, particular items may still need adjusting for such as non-deductible expenditure (e.g. business entertaining), assets with nil accounting value or where any transfer pricing adjustments are required. Another common situation where the tax cost or value differs to the accounting cost or value is where the gain on the realisation of intellectual property may have been rolled over into the cost of a new intangible asset. This closely follows the provisions to the capital gains rollover relief.

Intangible assets created or acquired before 1 April 2002 are subject to more piece meal provisions. If you require more specific advice on the tax treatment of intellectual property prior to 1 April 2002 or alternatively the tax treatment of intellectual property held by individuals personally, please contact us.

Finally, the new Coalition Government has decided to retain the proposal to introduce a 'Patent Box', which is one of the measures announced by the previous Government. The plan is to introduce a new reduced rate of corporation tax of 10% arising on income from April 2013 on patents registered after the Finance Bill 2011 is enacted, although full details are not currently available. A full review and plan for reform of the taxation of intellectual property is planned for this autumn.