



# IP planning and the creation of value

It is possible, with careful portfolio management and creative commercial structuring, to realise greater value from intellectual property (IP) assets. In some cases, this can attract the additional benefit of increased tax efficiency says McDermott Will & Emery's **Rohan Massey** and **Peter Nias**

IP rights are flexible; they can be assigned permanently or temporarily and they can be licensed in whole, or in part, on a territorial or field of use basis. Licences can be granted exclusively, non-exclusively or solely. This flexibility and the ease with which IP can be transferred internationally means it is relatively easy to restructure and relocate IP assets.

## Intellectual property structuring

IP ownership can become fragmented. Acquired entities may begin using a group trademark, or they may even apply for local trademark registration, thereby fragmenting IP ownership by jurisdiction. Operating entities may continue to develop know-how and register patents and trademarks for their own products, thereby

fragmenting know-how and creating tension in competing markets as different parties own similar rights.

IP ownership fragmented across a group suppresses value, as no single party has the power to exploit the IP globally. Without global rights there is always the risk of another party asserting rights against operating companies.

## Maximising value

There are two simple ways to maximise the value of IP assets. The first is to create IP centrally, the second is to consolidate existing IP in a single entity. There are a number of factors, however, that should be considered carefully in relation to any IP structuring: the commercial rationale for the project, specific IP issues and fiscal efficiency.

## Structure

The commercial rationale must be set out clearly and be well documented. This may include hosting IP auditing workshops with the management of the operating companies to discuss legal considerations surrounding the exploitation of IP, and educating management on the benefits of the proposal. Often operations management sees a proposed licence fee for the use of new group IP as a wasteful expense, but this expense may be looked on more favourably once the advantages of the proposal are explained. These may include the leveraging of services and skills across business units, group-level procurement savings, reduced human capital costs, resulting from better attraction and retention rates; and cross-branding opportunities.



Once the commercial rationale has been established, the new structure can take shape. This will usually involve the following basic steps:

- Conducting an audit to identify the group's IP assets. A group-wide audit of the IP will give an overview of the rights held and their current ownership. Performing the audit has a number of additional advantages, such as presenting an opportunity to consolidate the progress of research and development companies in different jurisdictions. The audit may also reveal further gaps in ownership or protection.
- Consolidating ownership. Having established the current ownership structure, IP rights can be transferred to a new group company (IPHoldCo) from other group entities. Rights applied for after this transfer should be applied for in the name of IPHoldCo.
- Licensing by the IPHoldCo of the IP to operating companies (OPCOs). The licence should be a non-exclusive, royalty-bearing licence (calculated on an arm's length basis) with a fixed-term agreement, enabling the OPCO to use the consolidated IP for the operation of their business. By having a limited, fixed term, IPHoldCo can refresh the IP periodically or link the licence to the term of the IP protection.

A significant factor in any structuring will be the location of the IPHoldCo. Apart from the commercial considerations already discussed, fiscal efficiencies can legitimately play a part in planning, producing savings that can assist a group in managing its effective tax rate. Tax authorities and international organisations such as the Organisation for Economic Co-operation and Development (OECD) recognises tax planning can play a part in any business decision-making process, provided the arrangements have the requisite commercial substance.

The OECD accepts that a restructuring can be carried out to obtain tax savings if functions, assets and/or risks are actually transferred. In other words, it can be tax motivated provided there is a commercial, non-tax purpose present.

Any transfer of IP between jurisdictions is likely to be a taxable event. The United Kingdom (as in other jurisdictions) is keen to avoid the artificial diversion of profits that could result from such a transfer, whilst at the same time acknowledging that its current controlled foreign company (CFC) rules (in place since 1984) are in need of modernisation. It is proposing a more territorial approach to better reflect the global reality of modern business. In the context of IP ownership, management and exploitation, the intention is to make the CFC rules more competitive by not inhibiting how a group manages commercial operations overseas and its foreign IP, whilst protecting the UK tax base.

Only IP that has been developed in the UK and transferred to a low-tax jurisdiction would

be taxed. Along with IP held offshore, which is effectively managed in the UK, or where UK financing is used to invest in IP held offshore as an investment (although possibly in this latter case only at an effective rate of 8%).

These rules would not be introduced until 2012 to take effect in 2013, together with an onshore patent tax regime taxing royalty income and "embedded" income included in the price of patented products at the rate of 10%.

In the interim, an exemption would be introduced for any CFC with their main business of IP exploitation where the IP and the CFC have "minimal connections with the UK".

Although the principles described above have some attraction, the draft legislation published to date on the interim measures introduces a complex set of tests and definitions which leave a number of issues unclear. As a result, any UK-based multi-national having a range of IP interests cannot be confident, as a practical matter, that it will not be caught by the new regime where it decides to own and manage its IP through an IPHoldCo located outside the UK, unless all its IP so owned and managed can clearly be shown to have no "UK connection". This could well require the very fragmentation in ownership which conflicts with the commercial requirements of the business.

Representations have been made to expand the patent box regime to include all IP, and in that way introduce an on shore IP holding company regime that could compete favourably with other jurisdictions eg, Switzerland, the Netherlands and Luxembourg. However, the reaction to date to this proposal has been that such a general relief would be very expensive given the amount of IP in the UK.

### IP-specific issues

There are a number of IP-specific issues that need to be considered in any relocation that could adversely impact the value of the IP. For example, where the benefit of a structure results in the creation of a patent holding company generating revenue streams from licensing the patents in its portfolio to others, this may affect the value of the patents when asserted. In the US, only a patent owner has "legal standing" to prosecute an infringement claim in court. Whereas an exclusive licensee has the right to be joined as a co-plaintiff to such an action, a non-exclusive licensee has no such right, regardless of the level of economic harm it suffers. Even if the parent may have a claim of equitable ownership of the patent, this is generally not sufficient for the purpose of establishing legal standing in the US, and the parent will be unlikely to succeed in claims to either injunctive relief or monetary damages.

If applied to the example structure, IPHoldCo will not be able to seek a recovery of

OPCO's profits due to the infringement. Instead, as a non-manufacturing licensor, IPHoldCo's damage recovery will be limited to a reasonable royalty, which may be relatively small (20 to 25% of a lost-profits calculation). Additionally, attempts to circumvent such restrictions by re-assigning the patent to the party actually using it prior to bringing suit will have limited success, as the period for any claim for loss of profits will be calculated from the date of the assignment. Such legal limitations can have a serious impact on the value of the patent.

### Summary

Depending on the investment made in IP consolidation and its ongoing implementation, in our experience, the royalty may range from 0.5% to 10% of turnover.

Structures are flexible and, as such, can accommodate different attitudes to risk from an aggressive stance (in which rights are disposed of at an arm's length value and then licensed) to more conservative structures (in which any existing rights are licensed to the consolidating company, avoiding a taxable event on disposal, in return for an offset of the royalty paid by the owning company to use the IP globally).

Finally, it is critical that the commercial justification behind the proposed consolidation of the currently fragmented IP rights is well documented with contemporary evidence. That evidence will be needed to satisfy any tax authority that the structure has the requisite substance and meets any "genuine economic activity" test.

### Authors



Rohan Massey is a partner based in the London office of McDermott Will & Emery, and leads the non-contentious IP practice. Rohan focuses on the commercialisation of IP both nationally and internationally. His client base is international in scope, as he works extensively across Europe and the US. Rohan can be contacted at [rmassey@mwe.com](mailto:rmassey@mwe.com)

Peter Nias is based in the London office of McDermott Will & Emery and is head of the London Tax Department, where his practice focuses on direct and indirect tax advice on a broad range of corporate and commercial business activities for multi-national organisations. He can be contacted at [pnias@mwe.com](mailto:pnias@mwe.com)