INTRODUCTION

IP Australia is the Australian Government agency that administers IP rights and legislation relating to patents, trademarks, designs and plant breeders rights.

CPA Australia and IP Australia have recently held webinars on intellectual property issues, addressing why intellectual property matters to accountants, the tax treatment of intellectual property, and helping accountants to better understand how they need to compile their intellectual property valuation solutions in association with multi-disciplinary professionals.

This online chat was an opportunity to ask follow up questions that may have arisen from those events or to ask questions that may have arisen after reading our joint fact sheet on intellectual property for accountants.

The experts responding to member questions were:
- John Kenny, Legal Practitioner, Director, Kenny & Co Solicitors
- Brian Richards, Richards Advisory
- Professor Andrew Christie, Chair of Intellectual Property, Melbourne Law School

RESOURCES

- Fact sheet: Intellectual property for SME firms and their accountants
- Video recording: What is intellectual property and why it matters to accountants
- Video recording: The accountant’s role in a multi-disciplinary team
- Video recording: Tax treatment of intellectual property
- IP Australia website
QUESTIONS AND ANSWERS

Why are accountants critical to the client’s participation in IP solutions??

Most clients do not understand the importance or production of financial models. Financial models are critical in determining the rate of likely return on a new project. Financial modelling will also determine the financial value proposition for investors. It is accountants who manage the inclusion of intellectual property on the balance sheet.

I sometimes hear of a “common law trade mark” – what does that mean?

It refers to a trade mark that has not been registered but which has a strong reputation in the public’s mind, such that use of the same or similar trade mark by someone else could be stopped on the ground it would mislead or deceive consumers.

Given that unregistered trade mark rights exist, why go to the effort and expense of registering a trade mark?

To enforce rights in an unregistered trade mark, it is necessary to prove reputation, which requires evidence. Getting evidence of reputation is costly, and can be very difficult for smaller traders. Proving a reputation is not required for a registered trade mark – this is the main reason why we have a trade mark registration system.

I know that copyright material does not need to be registered to get protection, but are there any other requirements that need to be satisfied for protection to arise?

No – simply creating the material is all that is required. However, it can be of practical benefit to put “Copyright” or “©”, and the name of the creator, on copyright material – so as to alert others that rights exist in the material.

Is there such a thing as an “international patent” that covers all countries? What role does the Patent Cooperation Treaty (PCT) play?

No - there is “European patent” that covers most European countries, but not one that covers all countries in the world. To get a patent in non-European countries you need to obtain one in each country separately. The PCT allows you to file one application for multiple countries, but to get a patent in those countries the application has to be examined and granted in each of those countries separately.

How is the sale of a trade mark taxed if it is owned by a small business?

A trade mark is a capital asset and any gain generated by the sale of the trade mark will be subject to the CGT concessions.

If the trade mark is inherently linked to the taxpayer’s business the gain will be an active asset for the purposes of Division 152 ITAA 1997.

Are there any structuring strategies that should be adopted to provide a small business with the option to access the small business CGT concessions if the assets, including a patent, of a business are sold?

If the client’s objectives include the sale of their business, including all the assets and Division 40 intellectual property, it is essential to ensure that what is ultimately sold is a CGT asset subject to CGT assessment.

This can be achieved if the CGT asset sold is, for example a share in a company which “houses” all of the business assets.

In accordance with the Division 152 provisions, a share will be an active asset if 80% of the market value of the assets of the company are active. Even though the assets might include depreciating assets they are still active.
assets. Further there is a special inclusion of IP assets that are used for passive income, if the value in the asset has been developed by the taxpayer.

If the owner of a patent grants a licence in relation to the patent and receives a lump sum amount for granting the licence, how is the amount taxed?

The receipt of a lump sum amount is assessable pursuant to Division 40. In particular, in circumstances where the taxpayer grants or assigns an interest in an item of intellectual property, for example a licence, the taxpayer is treated as having stopped holding part of the item (subsection 40-115(3)).

Then as a consequence of that there is a balancing adjustment event (Section 40-295) and the consideration received is the amount relating to the balancing adjustment.

From a taxation perspective is there any differences in tax treatment on the sale of a patent and some unregistered innovation?

A patent is a depreciating asset for the purposes of Division 40 ITAA 1997. Whereas a patent is a CGT asset, on the sale of a patent, any gain is assessed pursuant to subdivision 40-D. Accordingly, there are no CGT concessions applicable to the gain.

An unregistered innovation, (e.g. confidential information) to the extent that the taxpayer has any legal or equitable rights to protect the innovation, is a CGT asset and any gain generated by the ‘sale’ of the innovation will be a capital gain and eligible to the relevant CGT concessions.

What specialist skills do accountants contribute to IP projects?

They contribute communication / collaboration skills with other professionals on the project team. They also develop a Project Plan for the nature / priority of the accountant’s contribution.

How does an accountant source other professionals to join the business team?

- Network in the area
- Digital searches
- Ask other team members
- Ask the client with whom they are working

I work across a broad range of business development and financial strategic planning, including many of my own designs for workbooks and diagrams to demonstrate various points to clients and workshop attendees, and have often thought that I should have some IP ‘protection’, but have shied away from this due to simply not knowing what is relevant or where to begin! I’m interested to hear your views, as the would be many other advisers who have similar approaches, I would imagine.

To the extent that your material is either text (writing) or diagrams (drawings), then it is protected by copyright without you needing to take any steps such as registration. Be aware, however, that the copyright protection stops others from using your text or diagrams without permission, but it does not stop others from using the ideas contained in the text or diagrams. If you want protection for your ideas as such, you need to consider patent protection (which may or may not be possible).

You may be interested in reasserting either your practice name or another brand as the source of this material. If you wish to protect your practice name or the other brand, you will need to consider a trade mark application. Trade marks are the highest form of name protection - and the only element of intellectual property without a defined time frame. there are rules for trade marks, and they must be the subject of an application through IP
Australia. You need to check that no one else has registered your brand prior to your application, by undertaking searches.

Structuring for IP for tax planning and asset protection is a developing area for some of our clients - particularly those developing applications/software for mobiles. Is there any recommended structures that will provide benefits to the client for asset protection plus also tax efficiency?

To achieve appropriate asset protection it is preferable to isolate the IP with different ownership to the entity conducting the business.

Using a company structure to hold the IP with a licensing arrangement to the trading entity is advisable.

Ensure that you have dealt with the IP ownership issues.

From the perspective of ultimate sale of the business + IP selling the shares in the IP entity potentially allows access to the small business CGT concessions, whereas if the IP was directly sold there would be no CGT concessions.

I follow on from the query regarding advice we provide to clients in our day-to-day business (documents, training plans and information, emails, etc.). Should we be adding a copyright to these as a standard practice? From your previous answer I would presume no copyright symbol is needed?

You are correct that no copyright symbol is needed. It is useful, as a practical matter, to add a copyright notice (such as "Copyright or © [your name] [year of creation]"), but it is not necessary as a matter of law. There is no downside to adding such a notice, and it can have the practical benefit of alerting others to the fact that you own rights in the material.

If a completing trade mark has recently expired and its status is "renewal possible", and I want to register a similar trade mark, how long do I have to wait before that trade mark has permanently lapsed?

To register a trade mark you must be first to use and first to register as a trade mark. The name cannot be geographic, descriptive, or laudatory. The mere fact that a trade mark has lapsed doesn't overcome your obligation to be the first to use it. Accordingly, a lapsed trade mark does not necessarily afford you any great advantage in the registration process, because your predecessor was the first to use it. Of course, this outcome will depend on whether in fact the previous lapsed mark is in fact confusingly similar to the mark you wish to use.

Trade marks can be renewed up to six months after expiry. If the trade mark is not renewed, it will be removed from the register. However, there is still a risk that the trade mark owner might still be using the trade mark, which could give rise to other risks such as passing off or misleading and deceptive conduct under the Australian Consumer Law.

Holding Co (Co A) undertakes a research project and incurred A$50,000. Outcome of the project is a partially developed intellect property. This IP needs further enhancement before it could be marketed. Co A decided to sell the project and IP to it subsidiary registered in Australia (Co B) at cost A$50,000. Can Co B claim the A$50,000 as expenses for accounting and tax purposes?

The deduction for IP is limited to what is a depreciating asset. The ITAA defines a depreciating asset as copyright, patents or registered designs or an interest therein.

If the IP does not constitute any of the above there is no Div 40 deductions unless the costs come within 40-880. This will only be the case if the expenditure does not constitute the acquisition of an asset.
If I am wanting to use principles, procedures, manuals and other work created by others that I have read about via their books, magazines, emails, blogs, procedure manuals etc… can I create a procedure manual or program using some of the principles they give to generate income? Do I only need to quote where I received the information and from who or do I need to get permission from the writer? Is there a difference between just writing about these via a blog or article vs creating a procedure manual base? These ideas have come from all over the world.

This is a tough one – it is difficult to give a certain answer in the abstract. The material you are accessing is almost certainly protected by copyright, and the creator of it will thus have rights to it. (The fact that it was created overseas doesn’t change this – it is still protected in Australia under international treaties.) The protection is limited to reproduction of the actual text or drawings – it does not cover the ideas that the text or drawings disclose. The problem, however, is to distinguish between a reproduction of the ideas only contrasted with the text or drawing expressing it. If you can express the same idea without using the text or drawing then most likely you aren’t infringing rights (and so don’t need any permission). As a courtesy, and possibly as a means of ensuring the original creator doesn’t complain, you should acknowledge the source of the ideas (preferably giving a link to them). Whether there is a difference between writing on a blog and creating a manual is also hard one to give a certain answer to – but, basically, the more directly your use is generating income, the more careful you need to be to use only the ideas and not the expression of the original creator.

Although our trade mark was spelt differently, it was declined on the basis that it had a similar pronunciation. Is there any thing we can do?

The trade marks office considers trade marks on a phonetic basis. If the trade marks are phonetically similar (e.g. "Kola" vs "Cola") then the prior mark will be cited against the application. There are a number of ways to respond to an examiner’s report under the Trade Marks Act, including providing evidence of your use of the trade mark, or arguing that the goods/services claimed are sufficiently different such that consumers would not be confused between the two.

I have a small business client in a start up company who during the last 14 months has spent a total of close to $500k which includes the employment of programmers to convert a human resources evaluation system into an online digital program. What is the appropriate write off rate for this intellectual property creation? Does a 25% straight line write off rate for accounting purposes seem reasonable and consistent with relevant accounting standards?

In the first instance it is necessary to characterise the IP - the IP you refer to is most probably copyright.

The determination of the effective life of an item of IP is specific and related to the period of statutory protection afforded to the IP.

Div 40 specifically deals with IP effective life and application of depreciation methods. Refer to ATO guide on effective life.

Regarding the recent expansion of the regime for Personal Property Securities for the efforts of knowledge workers/professionals - is this considered part of the IP under discussion today?

The PPSR covers intellectual property. The scope of what is covered under a PPSR Security Interest registration would be determined by the underlying security document. If intellectual property is generated by an organisation, then it can be subject to a security interest.
In a software development environment, is it best to maintain a register of deemed IP assets to ensure that they can be appropriately identified and valued if a business should be offered for sale? Who ultimately decides if IP exists in an organisation such as a software developer? Is it restricted to the normal tangible type assets or is there latitude for the more intangible type of assets that may not be immediately recognisable as being IP until sometime later in the business cycle?

With respect to software, the most likely IP it gives rights to is copyright. Copyright will exist in the software itself (i.e. in the computer program) as if it was a literary work. There is no need for anyone to determine if those rights exist - they just do.

It is prudent to maintain a register of IP Assets for existing IP and research & development work. Future IP Rights (e.g. IP that has not yet been developed) can be assigned or licensed. There is a finite spectrum of IP for software - certainly copyright, but possibly patents and trade marks if the brand is commercially important.

What is the tax consequence of licensing the IP with royalty free, and with the condition that the licensee pays for all the IP related expenses? Does it imply that the amount of royalty is the amount of IP expenses paid by the licensee?

There is no implied royalty. In those circumstances where the licence agreement has no specific consideration provided for the grant and use of the IP, but the agreement stipulates that the licensee is to pay the costs, the non-cash benefits provisions apply and if the costs are of a revenue nature the otherwise taxable rule apply and there are no tax consequences.

Just be careful to get the ownership of IP improvements correct!

What is the distinction between Patent, IP and Goodwill with respect to CGT and Depreciation?

Patents, copyright and registered designs are depreciable assets and subject to Division 40 and not CGT (see section 118-24 ITAA 1997). Therefore any gain made on these assets will not attract the CGT concessions. Goodwill trade marks are CGT assets and their gains are subject to CGT concessions.

Do you depreciate trademark?

No, trade marks are a capital asset.

Why do accountants need to work with a multi-disciplinary team in IP projects?

Innovation projects need a series of Innovation skills:

- Modeler
- Lawyer
- Patent Attorney
- Brand Consultant

Innovation has discrete Governance requirements often sourced with complementary professionals:

- Patent Attorney
- Solicitor

Accountants need to mix their discrete professional skills with the contribution of other professionals.

BE HEARD.
BE RECOGNISED.
Why are business models so critical?

Once complete, business models become the source of subsequent Governance tasks:

- Identify stakeholders
- Legal Model
- Tax Model
- IP Requirements
- Value Proposition for New Brand.

What is the tax consequence of assigning trademarks with royalty free? Do we need to look at the market substitution rule to calculate CGT?

Yes, the issue to consider is what constitutes the market value of the IP and then applying that market value as the capital proceeds (section 116-30 ITAA 1997)

If you are granting a right in the trade mark, you need to consider the CGT D1 consequences where again the market value substitution rules are applicable.

If the licence is royalty-free because the licensee is paying the IP related expenses, what would be some examples of these expenses?

For example, improvement costs - such as labour costs, registration fees, renewal fees, legal fees re advices re nature of IP and some administration allocations.

If the IP expenses are paid by licensee, not licensor; how do the licensor account for the IP expenses which should be capitalised and depreciate through years?

The licensor will not capitalise the expenses paid by the licensee since the Tax requirements is that the owner has paid for the costs, unless there is some exchange of property.

The licensee would claim the expenses incurred as presumably the incurring of the costs would be consistent with the requirements under the licence agreement.

Given that copyright subsists in a drawing and copyright does not require registration, why would anyone register a design for a product? Why not just rely on the copyright in the design drawing of the product?

Copyright law removes protection from a design drawing of a product where more than 50 of the products have been made for sale by the owner of copyright in the drawing. The protection that is removed is the right to stop others making a product that reproduces the design shown in the drawing. Once that protection is removed, others are allowed to make a product to that design. To be able to stop others making a product to the design, it is necessary to register the design. This is the reason for having a design registration system.

Re IP related expenses, would labour costs to improve the copyright fall under the non cash business benefits rule?

Yes they would. That being the case the effect of the non-cash benefit section would negate the tax consequences.

FOR HELP

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