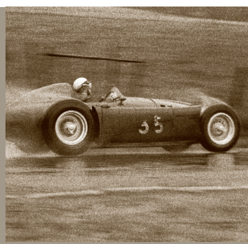
Editorial



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Intangibles such as patents/know-how/workforce, customer relationships and unique organisational designs accounted for some three-quarters of the Fortune 500's total market capitalisation in the late 1990s[1]. According to Leonard Nakamura, a US Federal Reserve economist, they absorb USD 1 trillion of investment funds every year – roughly the same as total corporate investment in physical assets[2]. The reasons are easy to grasp, as numerous recent publications show that IP investments often offer the 'keys to the kingdom' of stakeholder wealth. Academics preach correlation between 'intangible capital' and company performance[3] and thus plead for increasing management awareness of intellectual capital. Further, as you will see in this book, the authors consulted renowned publications, including the *Harvard Business Review, MIT Sloan Management Review* and various other well-known journals and found evidence of how innovation as a management process has turned multinational groups such as GE, P&G, Google, Nokia, 3M, Toyota and Honda into 'ideas factories' or 'innovation machines'[4]. New challenges are put to provide legal frameworks to protect the fruits of their brainpower.

An often heard criticism is, however, that investors systematically misprice enterprises that are intangible-intensive. In established sectors – the argument runs – intangibles tend to be undervalued. This burdens firms with an excessively high cost of capital, which in turn leads them to underinvest in intangibles, thereby losing out on opportunities for the earnings and growth investors seek. Indeed, undervaluation prevents intangible-intensive companies from raising funds in capital markets – a situation familiar to managers of science-based and high-tech companies during the post-bubble years.

From a tax point of view, intangible assets offer significant opportunities through a legitimate modular approach when planning results. Particular transfer pricing techniques can be applied to achieve tax optimisation, based on a fair allocation of profit potential, according to the economic risk profiles and functions of group entities. It is precisely these functions that can more easily be re-located in the case of intangible assets, thus giving rise to what are known as 'portable profits'. This is in contrast to generating profits from business activities within a physical infrastructure, which is hard to dismantle, such as production facilities. Ideally, these portable profits can be allocated to an entity sustainably located in a favourable tax jurisdiction.

As the impact of intellectual property rights on world trade is now more than ever on the increase, it is crucial to pay attention to the legal protection, tax impact and planning possibilities for these rights.

One relevant question is whether tax authorities will pass up the opportunity to tax the (potential) income made from intangibles. And, if not, how should one proceed, given the uncertainties that will be identified as to ownership and value?

The answer, as will be seen below, is that tax authorities around the world are stepping up their efforts to avoid missing out on additional tax revenues. These efforts are fraught with difficulty for taxpayers for precisely the reasons investors find it hard to evaluate the same questions. For taxpayers and investors, the central problem is that transactions involving intangibles in the natural course of events only occur in 'imperfect markets', i.e. those marked by a lack of information for the players.

In any case, one needs to take into consideration the fact that the information rational people need to make better decisions is hard to get. Generalisations about intangibles are easy to find. But, for intangibles like brands and patents to be productive, they have to be unique. Moreover, intangibles are not traded in active and transparent markets, as many physical and financial assets are. Markets are aggregators of information: oil prices enable investors to predict the performance of energy companies; commodities futures tell investors about the performance of the agribusiness. Unfortunately, there are no markets generating visible prices for intellectual capital.

This book, the foundations of which were laid in 2001 in *Intellectual Property Rights from a Transfer Pricing Perspective*, is constructed around the 'life cycle' of intellectual property rights, seen from tax, accounting, and legal planning and defence perspectives. In this way, the emphasis from a legal viewpoint is especially laid on copyright, trade marks, know-how and patents. After introducing and describing these rights, we look at their development (either individually or by means of collaboration) and application (i.e. own use, licensing or transferring property rights, and combating infringement); we also look at the valuation, migration and extinction of such rights.

These various phases are illustrated throughout using specific examples. The relevant international case law is also referred to, together with administrative practice. In this third edition, the authors have also been able more extensively to leverage on the expertise of the worldwide network of tax and legal experts within PricewaterhouseCoopers. The forty five country chapters are the result of our colleagues' enthusiasm in making this publication one of PricewaterhouseCoopers' key initiatives in profiling its highly skilled teams of professionals *vis-à-vis* today's and tomorrow's clients and contacts.

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1 REITZIG, M., 'Strategic Management of Intellectual Property', MIT Sloan Management Review, Spring 2004, 35.

2 LEV, B., 'Sharpening the Intangibles Edge', Harvard Business Review, June 2004, 109.

3 BOLLEN, L.H.H., VERGAUWEN, P. AND SCHNIEDERS, S., 'Intellectual Capital, Intellectual Property and Company Performance', Management Decision, 2005, vol. 43, n° 8, (accepted January 2005), 33.

4 LYER, B. and DAVENPORT, T.H., 'Google's Innovation Machine', Harvard Business Review, April 2008, 59.