May/June 2018 iam
www.IAM-media.com

Identifying the IP impact of the US tax act

The effect of the sweeping US Tax Cuts and Jobs Act of 2017 on IP rights is unclear but early indications are that not all of the news is good

By Bruce Berman

The Tax Cuts and Jobs Act of 2017 – a complex overhaul of US laws – could place some rights holders squarely in the crosshairs of government. The act encourages patent, trademark and copyright owners of all sizes to revisit the nature and tax implications of their transactions, including direct patent sales, as well as where their IP assets are best located.

The new law is partly a response to businesses that hold massive amounts of revenue-producing intellectual property outside the United States in so-called 'patent boxes' – devices which allow revenue on assets held within them to escape most local and all domestic taxes derived from IP-related revenue.

Patent boxes have encouraged some companies to conduct their R&D (or, at least, locate the fruits of it) in tax havens. The United States, along with several other nations, has for years been losing tax revenue associated with these devices. The concept was first introduced in Ireland in 2000 and adopted in 2001 by the French tax authorities as a means of reducing the rate of tax on revenue derived from IP licensing or the transfer of qualified intangibles. In Europe, similar IP-box schemes have been introduced in Belgium, Hungary, Luxembourg, Netherlands, Spain and the United Kingdom. The Irish patent box is scheduled to expire in 2020.

Like wildfire

"Patent boxes have spread like wildfire," argues Edward Kleinbard, former chief of staff of the US Congress's Joint Committee on Taxation, now a law professor at the University of Southern California. "Their success was doomed from the start. The international environment for intangibles and tax has evolved. With more products to license from sources worldwide, and more revenue derived from them, these devices, which originally were restricted to a handful of nations, have become diffuse."

The most famous (or infamous) product of the IP asset tax avoidance schemes, known as the 'double Irish', has been used by large corporations, including Facebook Inc, Google parent Alphabet, Inc and drug maker Allergan PLC.

The double Irish, reports the *Wall Street Journal*, is a structure that allows companies to reduce taxable income by setting up two entities – an Irish-registered parent based in a tax haven such as Bermuda that houses a company's foreign IP rights and an Irish subsidiary, which licenses the intellectual property and pays royalties in turn. "Since Ireland doesn't tax the royalties paid, the company's tax bill is effectively reduced." Determining what is in fact 'royalty generating' intellectual property is part of the challenge.

This structure has proved particularly attractive to US companies, which can stockpile foreign profits abroad without paying US taxes – something they may no longer be able to do under the new code because it includes a set of minimum taxes on foreign income. Tax advisers estimate that hundreds of companies have used the double Irish to move tens of billions of dollars a year to low or no-tax jurisdictions.

"The new law may encourage more out-licensing and equity transfers than outright IP sales – perhaps a good thing for the tepid IP monetisation market"

The Tax Cuts and Jobs Act targets US owners of sheltered intellectual property but gives them an opportunity to move assets if they wish to, at a cost. However, the new law's treatment of self-created intellectual property (eg, inventions, songs or designs) is different from those assigned to, say, a multinational corporation.

"For those US companies producing the bulk of their intangibles domestically and licensing them abroad, the act is a likely windfall," notes Kleinbard. "For others, the question is are the reduced rates afforded by the new law attractive enough to move intangibles back to the United States? For most, the likely answer is 'no'."

Patent sales

The American Enterprise Institute reports that the tax reform package may have fundamentally transformed the tax treatment of patent sales.

"Under the previous tax regime, patents and unpatented inventions created by an individual taxpayer were considered capital assets, and proceeds of their sales were deemed capital gains, which are generally taxed at a much lower rate than ordinary income," Kleinbard points out. "But under the Tax Cuts and Jobs Act, proceeds from the sale of patents and other self-created inventions will no longer be treated as capital gains."

The new law removes capital gains treatment on the license or sale of self-created intellectual property, including patents, and treats these transactions as ordinary income – a blow to inventors.

Apple has been shifting foreign IP profits overseas for decades and the practice has become a cornerstone of its tax practices. "In effect," observes *Fortune*, "the company attributes a large portion of the value of its products to patents and other intellectual property, such as trademarks. Apple then assigns some of that IP, proportional to overseas sales, to subsidiaries in countries with low tax rates and assesses substantial patent royalties on sales. Those royalties then flow back to those low-tax locations, like Ireland."

The act has a provision designed to make this manoeuvre less attractive by levying a minimum tax on foreign patent income. This is expected to come to about 13%.

Capital assets no more

Exactly what the Tax Cuts and Jobs Act means for rights holders will depend on several key variables. Independent inventors who monetise their patents need to revisit whether long-term capital gains treatment still applies to their transactions. In the end, the new law may encourage more out-licensing and equity transfers than outright IP sales – perhaps a good thing for the tepid IP monetisation market. For now, the best advice is to stay tuned and to ask plenty of questions. iam

Bruce Berman is CEO of Brody Berman Associates and chair of the Center for Intellectual Property Understanding, New York, United States