

# IP Tax Valuation & Transfer Pricing



OCEAN TOMO  
INTELLECTUAL CAPITAL EQUITY

# Presenter Bio

---



**Richard M. Conroy** is a Managing Director and Practice Leader at Ocean Tomo. Mr. Conroy's efforts at Ocean Tomo are concentrated in the areas of IP asset valuation and transaction support. He works in the Valuation Services practice assisting clients in valuing their IP, and in developing and implementing strategies and processes for managing or monetizing IP portfolios. He has consulted on a wide variety of engagements involving the valuation of IP in the context of transactions, collateralizations, capital raises, spin-offs and tax strategies, as well as in determining economic damages in commercial litigation. He has also provided corporate finance and analytical support to clients engaged in licensing negotiations and business transactions.

## Presenter Bio

---



**Michael J. Lasinski** is a Managing Director at Ocean Tomo and is responsible for the company's valuation practice. Mr. Lasinski is a recognized expert in the area of intellectual property (IP) centric transactions and valuation. His work has focused on IP-based business transactions, including IP portfolio analysis, target/partner selection, strategic due diligence and other financial advisory services such as negotiations and transaction/deal structuring and closure. Mr. Lasinski has represented his clients in arbitration proceedings, litigation, tax matters as well as other regulatory issues.

In addition to IP valuation matters, Mr. Lasinski has performed appraisals for corporate mergers, acquisitions, tax and financial reporting purposes.

# Summary

---

- IP issues (e.g., valuations) can have significant implications on an organization's taxes (and its financial performance)
- The Internal Revenue Service and other government organizations have become very interested in IP
- IP is challenging to value, but there are existing and developing appraisal standards for IP
- There is a growing body of transactions that are important to consider **APPROPRIATELY** when valuing IP

# IP Tax Value vs. IP Litigation Value

---

- The impact of IP issues on tax-related matters can be far larger than those generally publicized – litigation awards

## Transfer Pricing



\$3.4

GlaxoSmithKline settled a transfer pricing dispute with the IRS for **\$3.4 billion** – the largest tax settlement payment in the history of the agency

## Patent Litigation



\$1.5

Microsoft Corp. was charged by Alcatel-Lucent SA for violating two patents related to digital music. A federal judge ordered Microsoft Corp. to pay **\$1.5 billion** in damages to Alcatel-Lucent SA (Reversed on Appeal)

# IRS Commissioner Comments on Transfer Pricing

---

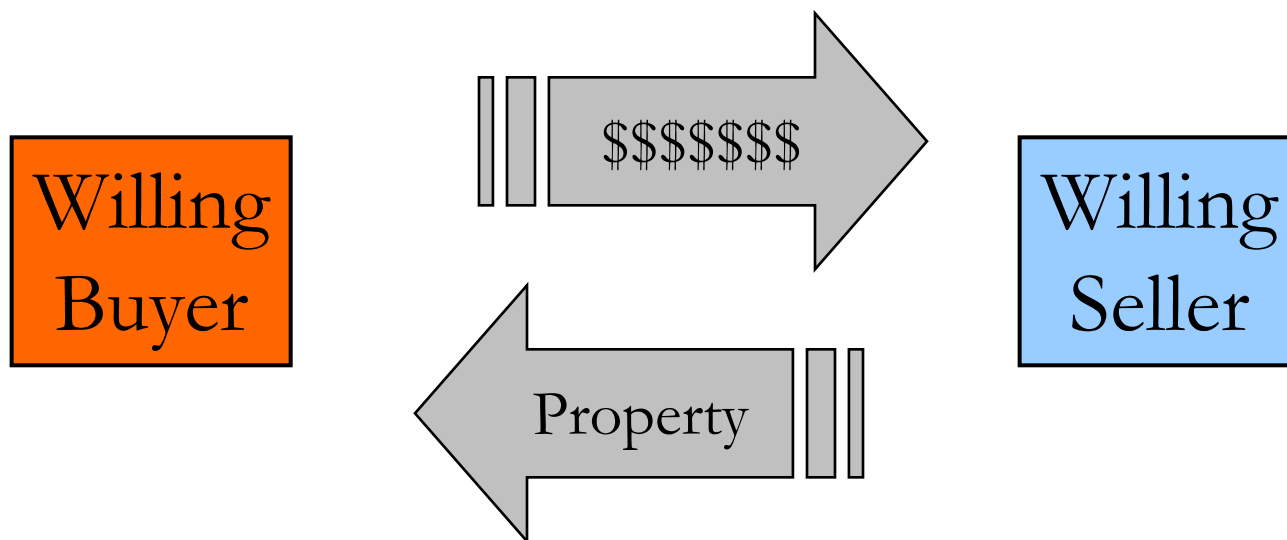
*“Tax issues associated with the transfer of intangibles outside the United States have been a high risk compliance concern for us... Taxpayers... are shifting profits offshore through a variety of arrangements that result in the transfer of valuable intangibles to related foreign entities for inadequate consideration.”*

Former IRS Commissioner Mark W. Everson,  
before the Senate Committee on Finance,  
June 13, 2006

# An IRS Definition of Fair Market Value

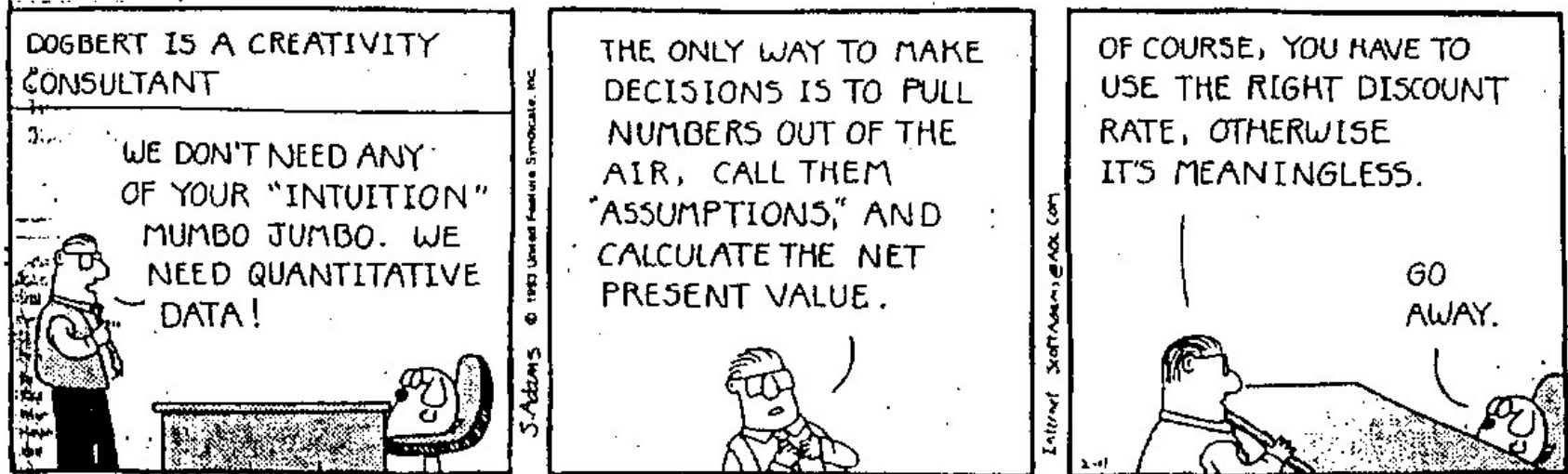
---

- Fair Market Value is defined as the price at which property would change hands between a willing buyer and a willing seller, neither being under any compulsion to buy or to sell, and both having reasonable knowledge of relevant facts (Estate Tax Regs., Sec. 20.2031-1(b); Rev. Rul. 59-60, 1959-1 C.B. 237)



# Dilbert's Definition of Fair Market Value

Dilbert / By Scott Adams

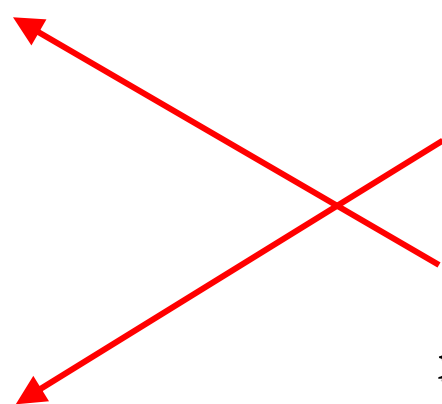


# Tax-Related Valuation Contexts

---

- Section 482 transfer pricing
  - Buy-in payments
- Other transfers of IP
- IP holding company royalty rates
- IP donations (still active)

**Are the tax  
benefits  
directly  
or  
inversely  
related to  
IP value?**



# Valuation Methodologies

---

## Cost Approach

- Theory: Value is determined by the cost to replace or the cost to re-create the IP
- Costs Include: R&D, materials, equip., marketing, advertising, delayed market entry
- Value of Patent = Fair market value of total investment to replace or re-create
  - A prudent licensee/buyer will not pay more for the IP than the amount for which the IP could be re-created
  - By licensing IP from others, the licensee avoids development costs and minimizes risk

# Valuation Methodologies

---

## Market Approach

- Theory: Value is based on the transactions of other purchasers & sellers in the marketplace
- Value of Patent = Arm's length price paid in equally desirable & comparable transactions
  - Licensee/Buyer is not willing to pay more than others have paid for similar IP
- Comparables: type of IP, industry, market size, terms, and profitability

# Valuation Methodologies

---

## Income Approach

- Theory: Value is determined by the economic benefit expected from use of the IP
- Value of Patent = Present Value of the expected future income stream
- Three key parameters:
  - Amount of the income stream
  - Duration of the income stream
  - Risk associated with the realization of the income

# Traditional Transfer Pricing Valuation Methodologies

---

- **Comparable Uncontrolled Transaction Method** – evaluates whether the amount charged for a controlled IP transfer is arm's length relative to a comparable uncontrolled transaction.
- **Comparable Profits Method** – evaluates whether amount charged is arm's length based on objective measures of profitability as compared to those derived from uncontrolled taxpayers engaging in similar business activities under similar circumstances.
- **Profit Split Method** – evaluates whether the combined operating profit/loss attributable to a controlled transaction reflects the relative value contributed by each controlled taxpayer.
- **Unspecified Method** – methods not described by the above three may also be used to evaluate whether the amount charged in a controlled transaction was arm's length.

# Transfer Pricing Regulations - Amended

---

## Alternative Method: Investor Model

- Adopted as a fundamental concept when Section 482 was amended in 2005
- Each controlled participant is viewed as making an investment in the form of cost contributions (e.g., IP development costs) and external contributions (e.g., pre-existing advantages each party brings to bear)
- Controlled participants expect to achieve a return appropriate to the risks of the cost sharing arrangement during the development and exploitation of the intangible assets
- Assumes parties at arm's length would not invest in the absence of an appropriate reward

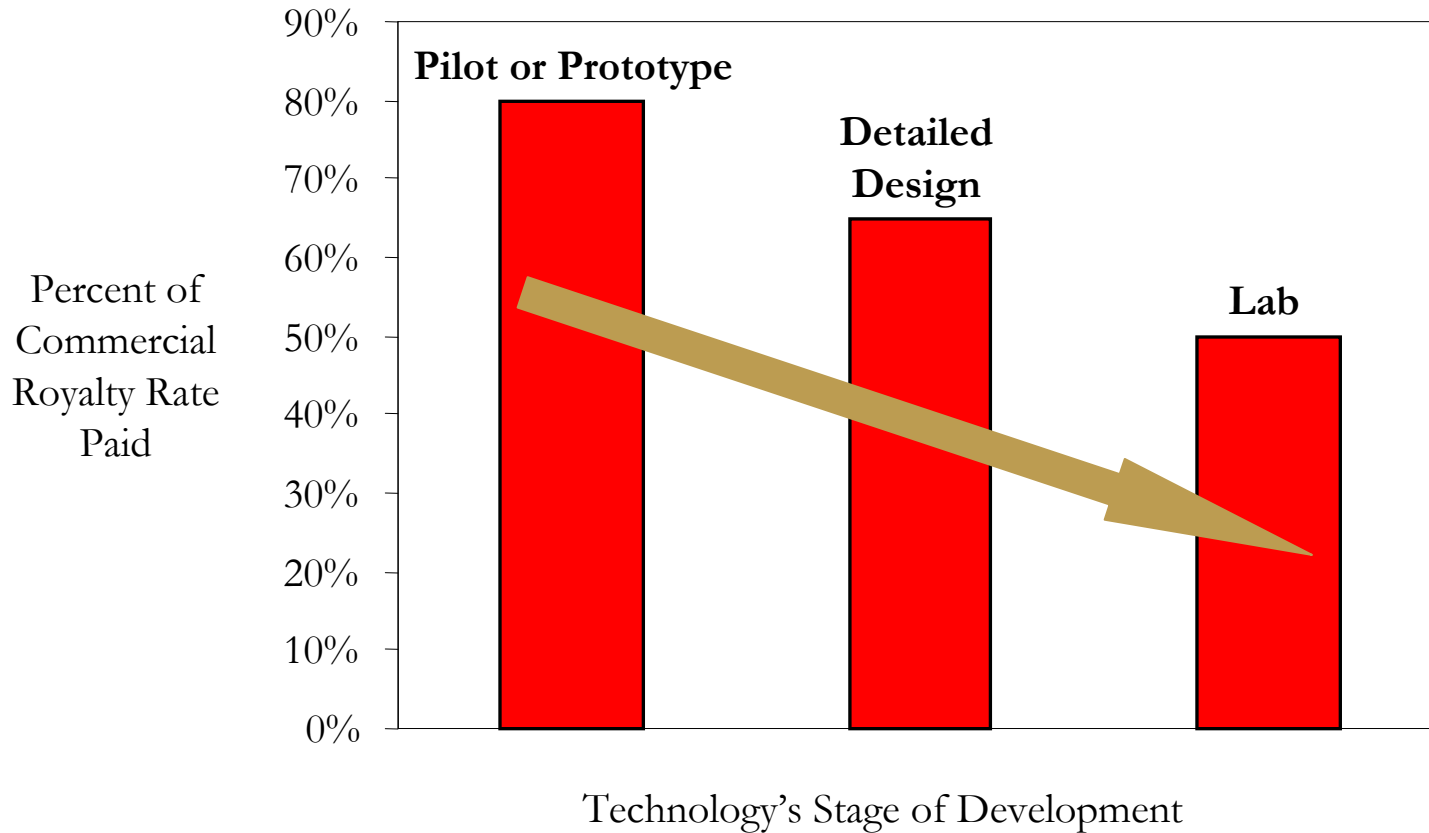
# IP Valuation Data Sources

---

1. IP sale, acquisition and auction results
2. Public Patent Licensing and Enforcement Companies (P-LECs)
3. Financial filings (SEC)
4. Recombinant Capital (Recap.com)
5. Royaltysource.com
6. Windhover Information (Windhover.com)
7. Court records
8. Licensing Economics Review (LER)
9. Licensing Executives Society publications (les Nouvelles)
10. Industry presentations
11. Licensing experts

# Market Approach: Adjusting Comparables

## Discount Increases for Early Stage IP



Source: A Survey of Licensed Royalty Rates, les Nouvelles, June 1997, Stephen A. Degnan and Corwin Horton

# IP Sale Information Is Available – You Have to Dig for It

---

- NeoMagic® Sells Embedded DRAM patents and applications to Faust Communications Holdings, LLC for \$12.5M
- Kronos receives \$3.5M from Tessera for patents related to micro-cooling
- Broadcom buys \$18M of patents from Cirrus Logic
- Commerce One sells patent portfolio out of bankruptcy for \$15.5M to JGR Acquisition, Inc.
- Numerous Bio-tech examples of IP asset/company sales for IP assets

# Ocean Tomo's Live IP Auction Results

---

**Spring 2006  
San Francisco**

On-Floor Patent Lot Sales  
**\$3,026,100**

Average Patent Lot Sale  
**\$116,388**

**Fall 2006  
New York**

On-Floor Patent Lot Sales  
**\$6,066,500**

Average Patent Lot Sale  
**\$275,750**

**Spring 2007  
Chicago**

On-Floor Patent Lot Sales  
**\$11,429,000**

Average Patent Lot Sale  
**\$336,148**

**Summer 2007  
London**

On-Floor Patent Lot Sales  
**\$8,084,184**

Average Patent Lot Sale  
**\$621,860**

**Fall 2007  
Chicago**

On-Floor Patent Lot Sales  
**\$11,599,500**

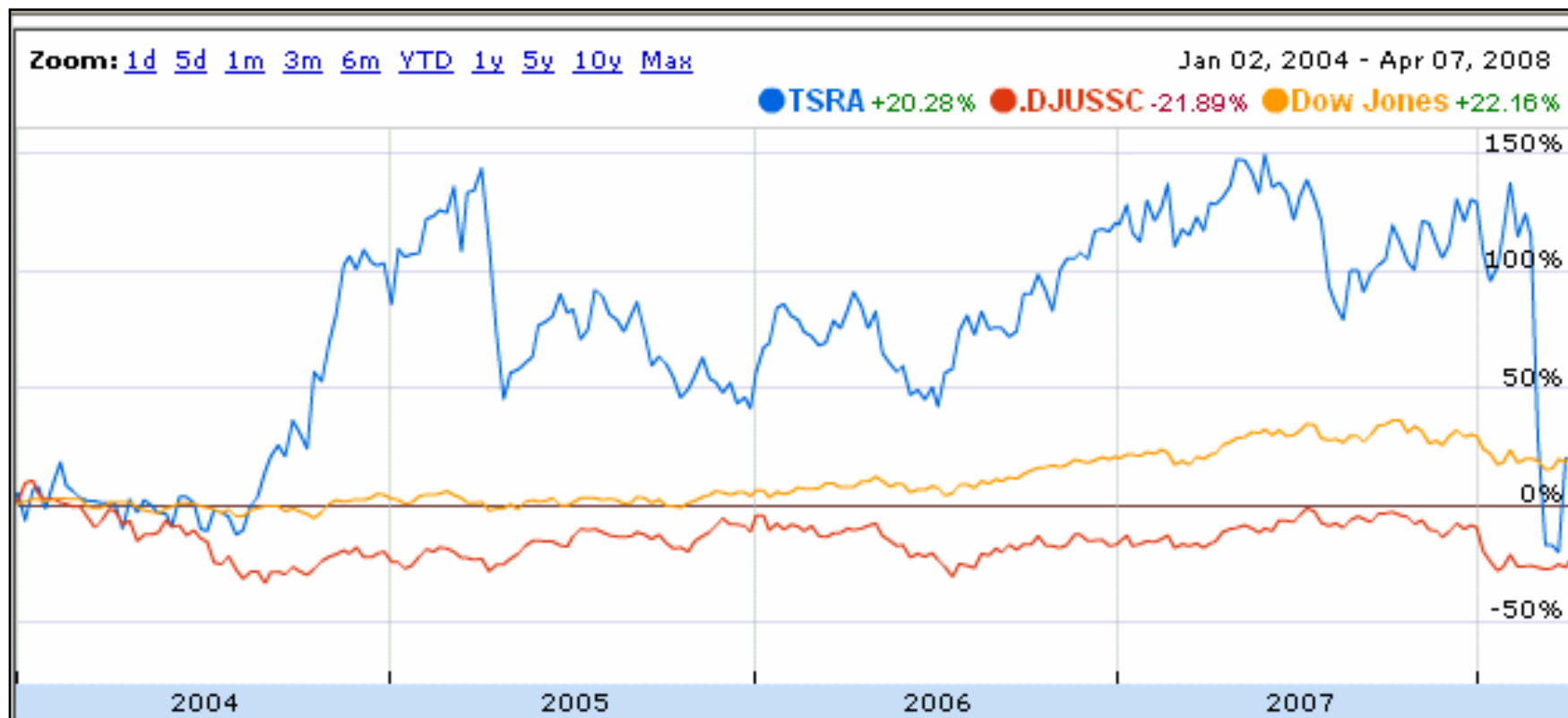
Average Patent Lot Sale  
**\$305,250**

**Spring 2008  
San Francisco**

On-Floor Patent Lot Sales  
**\$19,629,500**

Average Patent Lot Sale  
**\$370,368**

# Companies That Employ IP As a Business Are Public



*Tessera shares plunge on unfavorable ruling in ITC Case*

# Disclaimer

---

The concepts and theories covered by this presentation are for discussion purposes only and are not intended to be all-inclusive on the topic of intellectual property or valuation. Many of the concepts are illustrative only and do not necessarily represent the approaches that the author would recommend in any particular case.

# Contact Information

---



**OCEAN TOMO™**  
INTELLECTUAL CAPITAL EQUITY®

Michael J. Lasinski  
200 West Madison  
37<sup>th</sup> Floor  
Chicago, IL 60606  
(312) 377-4836 Ph  
(312) 327-4401 Fx  
[mlasinski@oceantomo.com](mailto:mlasinski@oceantomo.com)

Richard Conroy  
200 West Madison  
37<sup>th</sup> Floor  
Chicago, IL 60606  
(312) 327-4402 Ph  
(312) 327-4401 Fx  
[rconroy@oceantomo.com](mailto:rconroy@oceantomo.com)

**CHICAGO**  
200 West Madison  
37<sup>th</sup> Floor  
Chicago, IL 60606  
(312) 327-4400 Ph  
(312) 327-4401 Fx

**DC METRO**  
7475 Wisconsin Avenue  
Suite 525  
Bethesda, MD 20814  
(240) 482-8200 Ph  
(301) 652-2885 Fx

**ORANGE COUNTY**  
19200 Von Karman Ave.,  
Suite 600  
Irvine, CA 92612  
(949) 222-1264 Ph  
[www.patentratings.com](http://www.patentratings.com)

**PALM BEACH**  
235 S. County Road  
Suite 1  
Palm Beach, FL 33480  
(561) 309-0011 Ph  
(561) 805-8765 Fx

**SAN FRANCISCO**  
101 Montgomery Street  
Suite 2100  
San Francisco, CA 94104  
(415) 946-2600 Ph  
(415) 946-2601 Fx