

# Discussion forum on Intangible Properties



**Sgatar JTP , Bali , Oct 29th-Nov 02th 2012**



# Intangibles Property

## *Simplified Case*

- Parent Co. (Canada) Establishes a manufacturing subsidiary in Indonesia.
- PT. Subsidiary will manufacture the “ABC” brand of mobile phone which will be sold to :
  - a. Affiliated Distributor in Indonesia for distribution in Indonesia market
  - b. The parent company
  - c. Other Affiliated Distributors in Asia





# Performance of the Subsidiary

## *Simplified Case*

(In US \$)

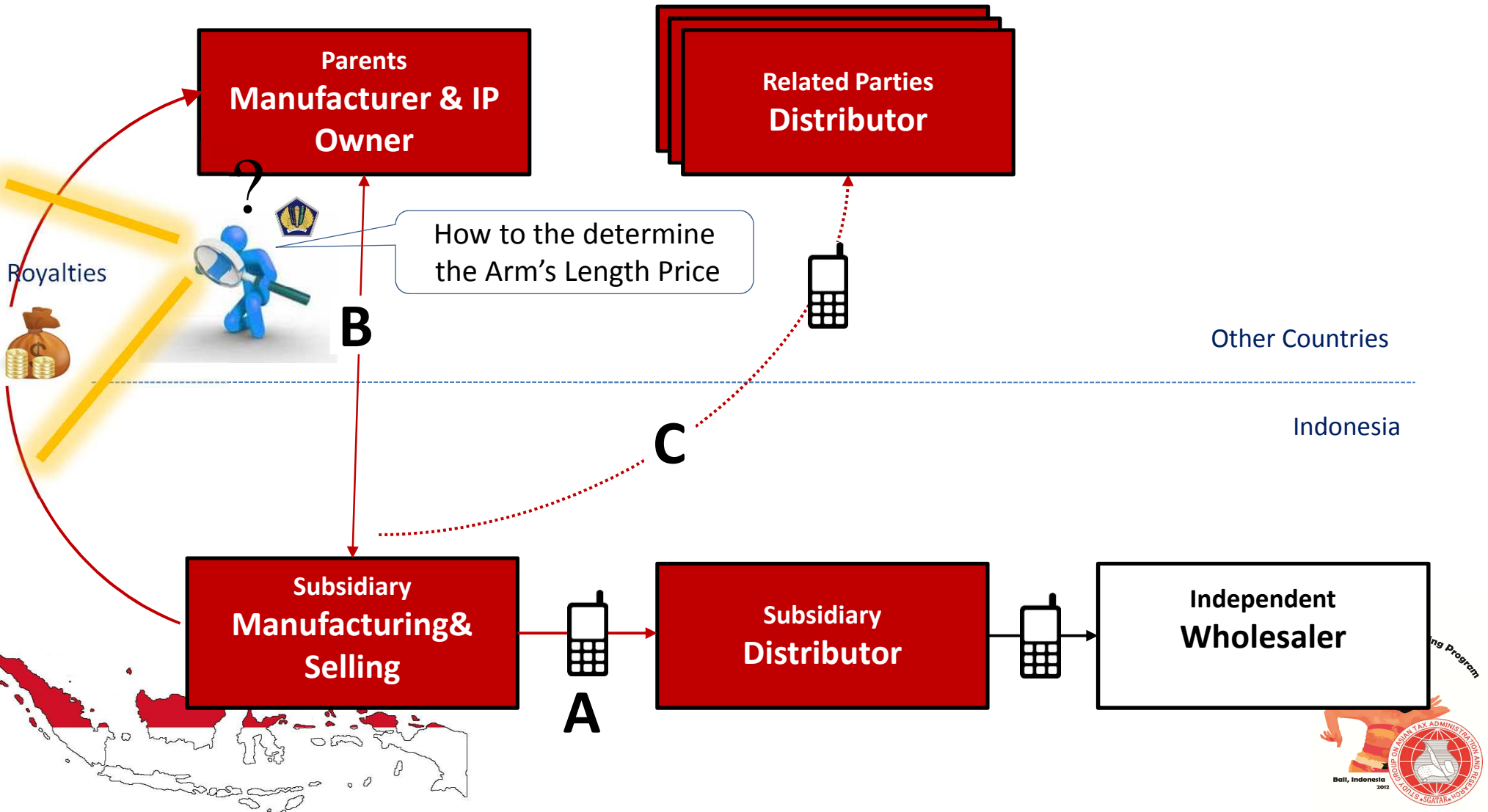
Description	Nominal	
Sales	100.000.000	
Cost of Good Sold	81.000.000	
Gross Profit	19.000.000	
<b>Royalties</b>	<b>5.000.000</b>	<b>5% of sales</b>
Other Expense	13.000.000	
Net Operating Margin	1.000.000	
<b>NCP Ratio</b>	<b>1,01%</b>	





# Scheme of the Transaction

## *Simplified Case*





# What is your view ?

## ➤ Facts :

- ✓ Net Cost Plus (NCP) ratio 1.01%
- ✓ Legal Owner of the Manufacturing Intangibles is the Parent
- ✓ The Subsidiary use the Manufacturing Intangibles belongs to the Parent
- ✓ The product is branded





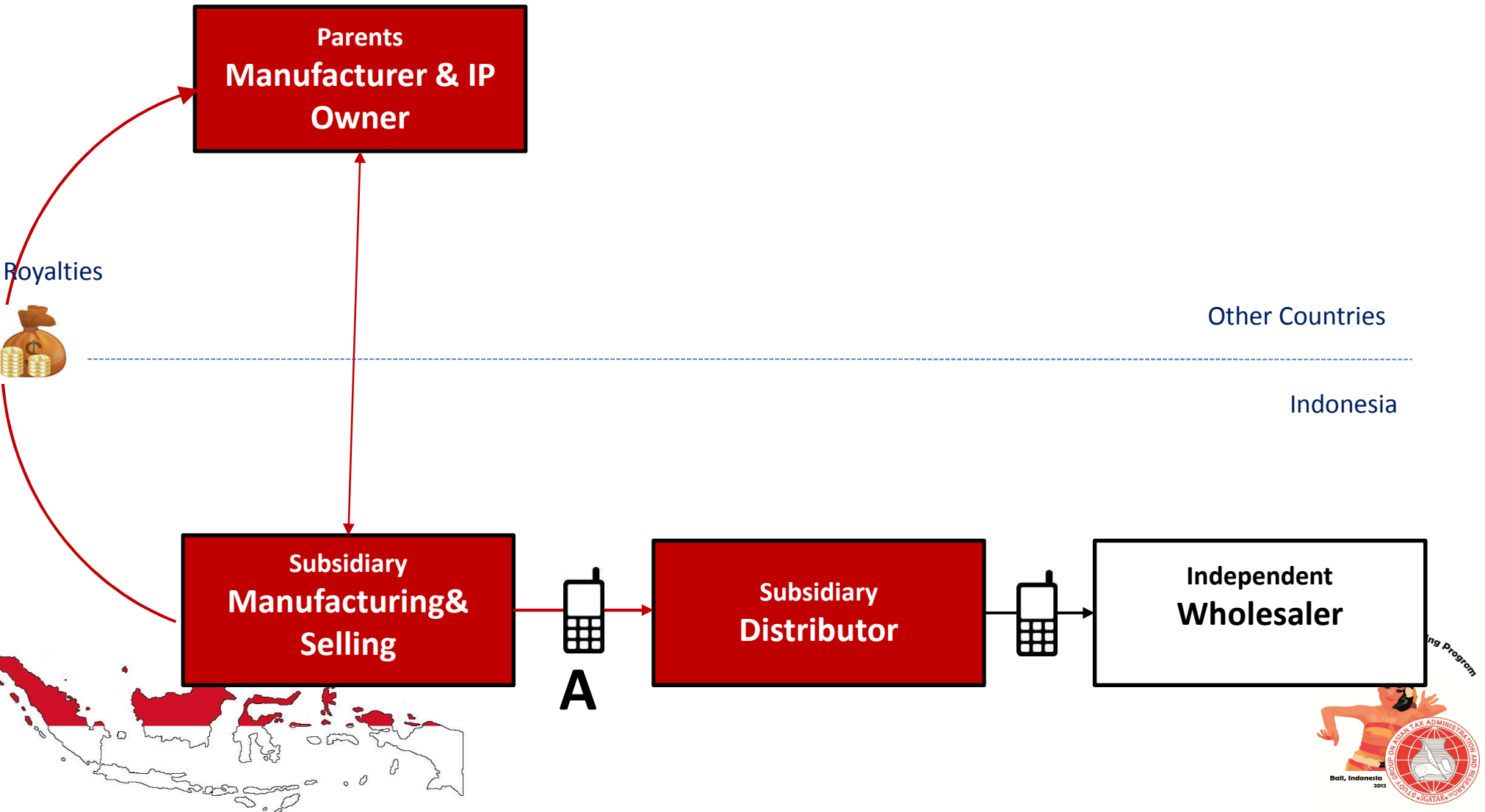
# What is your view ?

➤ Issue : Can taxpayer provide the segmented financial statement?

Description	Total	A	B	C
Sales	100.000.000			
Cost of Good Sold	81.000.000			
Gross Profit	19.000.000			
<b>Royalties</b>	<b>5.000.000</b>	?	?	?
Other Expense	13.000.000			
Net Operating Margin	1.000.000	?	?	?
<b>NCP Ratio</b>	<b>1,01%</b>			



# Understanding the transaction *transaction A*



- ❑ Patents are of various type-patents on formulas or design, use patents, etc
- ❑ It is necessary to determine what type of patent is involved in the analysis
- ❑ More importantly to determine the degree to which the patent provides its owner with market power







# How to determine the ALP?

Identify the existency of the IP

**A**

Determine the parties develop the value of the IP

**B**

Determine how transfer would be handle in arm's length situation

**C**

Determine the arm's length compensation for each of the IP

**D**

**Arm's Length Price of the Royalties?**



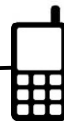


# How to Identify Intangible Properties



Any Manufacturing and Marketing Intangibles ?

Subsidiary  
Manufacturer



Subsidiary  
Manufacturer



Independent  
Whole Saler





# How to Identify Intangible Properties-type of IP

1

## Manufacturing Intangibles

Developed by R&D or  
manufacturing Activity

Patents, trade secrets or  
unpatented technical know-  
how, etc

2

## Marketing Intangibles

Developed by Marketing  
Activities and/or Sales  
Personel of Company

Trade Marks, Trade names,  
Distribution Networks, etc





# How to Identify Manufacturing Intangibles

- Analysts must understand the industry as well as the company itself

## Step-1

- ✓ Begins with a tour of manufacturing plants involved
- ✓ Questions should be addressed to plant managers and/or manufacturing engineers to determine what know-how exists within the plant
- ✓ Sometime difficult to obtain those information since the plant managers didn't realize his activities are intangible development





# How to Identify Manufacturing Intangibles

- ✓ Techniques which can be helpful :
  - Identifying unique production equipment or modifications to existing equipment which either improves quality or reduces costs of production;
  - Identifying changes in plant layout which reduces the operating costs of production; and
  - Examination of capital cost approval form or engineering change orders to see what changes were made in the plant.





# How to Identify Manufacturing Intangibles

## Step 2 :

- Obtain a list of patents or other type of manufacturing intangibles
- Discuss with R&D personnel and other knowledgeable employees to find out which are practised and valuable
- Significant discussion should be conducted with those who familiar with the patents to determine what degree of market power each provides the company
- Discuss with industry expert outside the company





# How to Identify Marketing Intangibles

- It is usually easier to identify marketing intangibles than manufacturing intangibles
- Techniques that can be helpful :
  - ✓ Discussion with marketing/sales personnel who are responsible for the product lines in question.
  - ✓ These people can identify the reasons for the success of the product in its various market.
  - ✓ Discussion with industry experts who routinely study the product and its market





# How to Identify *the Intangible Properties-Simplified Case*

- After conducting the technics above, it is found that the mobile phones sales are strong in Indonesia because
  - the product is very high quality,
  - customers identify the advertising message, i.e “we make things simple”
  - The product is easily available in a variety of retail outlets.







# How to Identify *the Intangible Properties-Simplified Case*

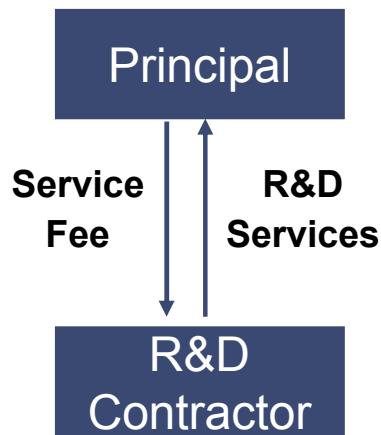
- In this simplified case , the existency of the intangibles identified are :
  - Manufacturing intangibles which produce the high quality –more analysis is necessary to determine what produced the high quality
  - Marketing intangibles :
    - Trademark value created by advertising
    - The distribution network





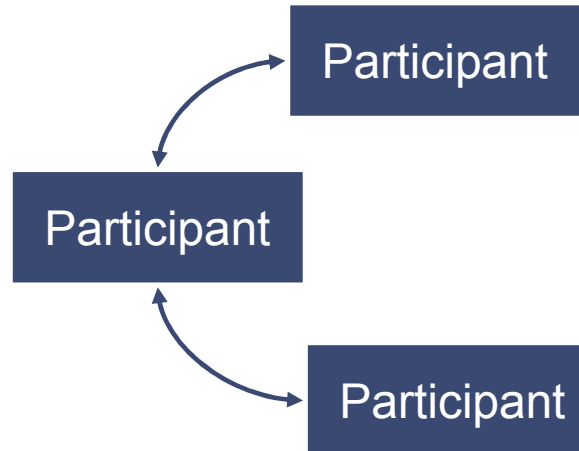
# Who Contribute? Manufacturing intangibles

## Contract R&D



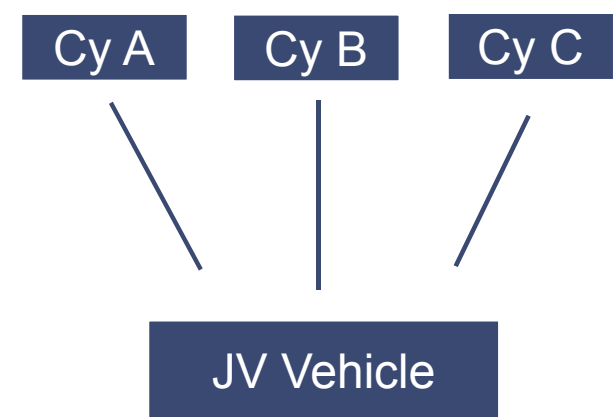
- Principal has funding cost and economic risk
- Principal = IP owner
- R&D contractor gets service fee

## Cost Contribution



- Shared funding cost and economic risk
- Shared IP ownership (choice)
- Buy-in/buy-out premiums upon access or leave of participants

## Corporate Partnering



- Companies A, B and C are independent entities
- Between them, no controlled transaction will occur
- Towards JV vehicle however: controlled transactions





# Who Contributes?

## *Marketing Intangibles*

- Who conducting the marketing activities?
- Who borne the cost?
- Who bear the risk?
- Legal versus economic?





## How the treatment *in Arms Length Situation*

- No transfer of IP in case of Contract Manufacturing ?
- No Royalty payment should be paid in Contract Manufacturing?
- Distributor should not pay royalties related to manufacturing intangibles?





# How to value the Compensation

*Use of and outright sale*

- Use of IP
  - CUP method
  - Resale Price
  - TnMM
  - Profit Split
- Outright Sale
  - Income Approach
  - Cost approach
  - Market approach





Parents  
Manufacturer



185

Other Countries

Indonesia

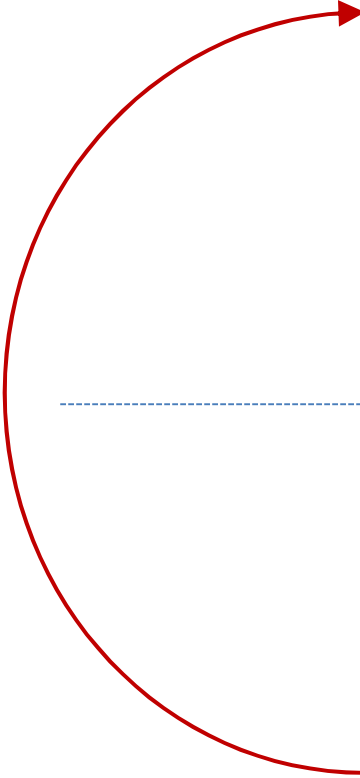
**B**

Subsidiary  
Distributor

210

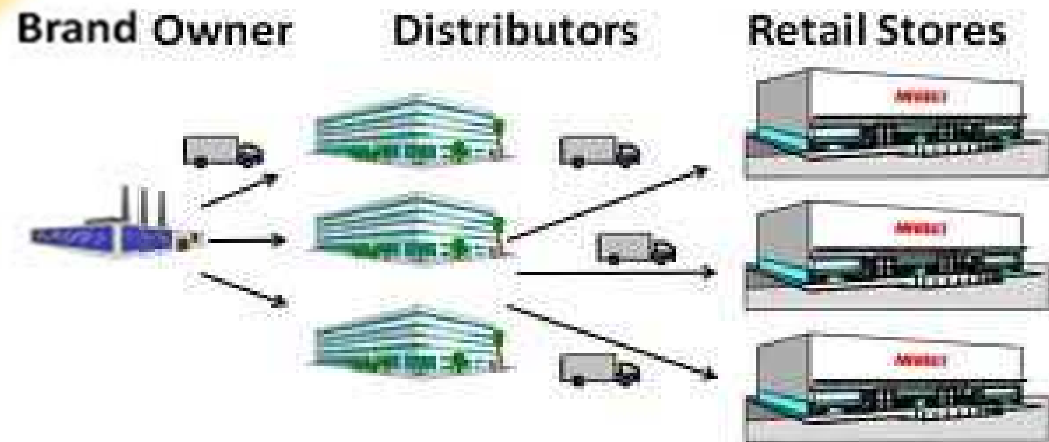


Independent  
Whole Saler



# Distribution Network?

## 3-Tier DSD Network



Identification the  
Existence of  
Distribution  
Network

Distribution  
Networks

