

Stuffing a balance sheet with self-generated, synthetically acquired Intellectual Property will generally not help an entity to become an Active NFE if one follows the International Financial Reporting Standard (IFRS) treatment

CRS non-reportable Active NFE

of intangible assets.

The term "Active NFE" means a NFE with:

1) less than 50% of it's gross income being passive income

AND

2) less than 50% of the assets held by the NFE are assets that produce passive income (or potentially can produce such as cash)

Business or trade entity - Passive or Active NFE?

• An entity that has mostly non-passive income, such as from business or trade income will be a **reportable passive NFE** if its cash average balance is more than 50% of total assets.



• If the assets were predominantly (> 50%) of the type that cannot generate passive income (or the potential to produce passive income) then the entity would be an Active

• Those are assets such as buildings, computer equipment, vehicles, precious metals, and Intellectual Property.

Using Intellectual Property to convert a Passive NFE into a nonreportable Active NFE

 Intangible assets cannot generate passive income or have the potential to produce passive income (Passive income is generated from financial assets such as stock dividends, interest, equity capital gains, etc.)

• Therefore, if an entity's balance sheet has predominantly intangible assets, and income is predominantly (> 50%) not passive, then the entity will be a non-reportable Active NFE. • The Active Non-Financial Entity is reported to its place of management, but not its

controlling persons.

OECD on intangible assets

• Intangible assets are assets that do not have a physical or financial embodiment. • Termed 'intellectual assets' in previous OECD work, intangible assets have also been

referred to as knowledge assets or intellectual capital. • Much of the focus on intangibles has been on Research and Development, key personnel, and software.

• BEPS Action 8 Implementation Guidance on Hard-to-Value Intangibles deals with OECD on intangible assets transfer pricing and payments for intangibles from one entity to a low-taxed entity.

 However, the exploitation of intangible assets for CRS mostly concerns valuing fake intangibles for the asset test of an Active NFE, assuming the entity genuinely earns mostly non-financial income.

Intellectual Property on brands is difficult to place on a balance

• Many ill-informed practitioners erroneously advise their business or trading client to generate or procure an intangible asset such as Intellectual Property about say their

brand/logo to be classified as a non-reportable Active NFE. • As long as income is mostly business or trade in nature, the generated IP asset will ensure the entity is an Active NFE (type A - business or trade) if intangible assets account for

most of the balance sheet asset value.

International Financial Reporting Standards says to hold your horses on IP, not so fast

"Internally generated IP cannot be an asset"

• Internally generated IP assets: The International Financial Reporting Standards – IAS 38 on internally generated intangible assets such as Intellectual Property opines costs to generate such type of intangible asset cannot be an asset and must be expensed in the year of incursion as it is impossible to distinguish these costs from operational costs. The only costs that may be amortized are developmental costs such as a laboratory.

"Externally acquired IP must be amortised over a realistic short term"

• Externally acquired IP assets: Can be amortized in a balance sheet and amortized over a realistic short term. The intangible asset cannot appreciate in value unless it can be shown there is an active market and demonstrable price for the intangible asset.

The patent - ideally acceptable IP for CRS

• A patent is an exclusive right granted for an invention, which is a product or a process that provides, in general, a new way of doing something, or offers a new technical

solution to a problem. To get a patent, technical information about the invention must be disclosed to the public in a patent application • Patent law defines the limits of what can be patented. For example, the laws of nature,

physical phenomena, and abstract ideas cannot be patented, nor can only an idea or suggestion. • Patents can be for specific territories or cover many countries (then costs an arm and a

• Software-related inventions are patentable, but to qualify as an invention, however, there must be a creation of technical ideas utilizing a law of nature although this requirement is typically met by concretely realising the information processing performed by the software by using hardware resources.

 Patents valid generally 20 years from the date of filing the patent application. Apply for a patent on some new technology idea, eg. RFID plastic capsule chip that gun manufacturers can embed in new guns, for tracking purposes. RFID caopsules are usually

made from glass which would shatter inside a gun. • The more countries you duplicate the patent the more valuable. The valuation method can be:

1. Market method: (meh, boring) Market-based methods value patents through comparison with prices achieved in recent comparable transactions. These methods require an active market, a comparable exchange of IP between two independent parties, and sufficient access to transaction price information.

2. Cost method: (meh, even more boring) Cost theory looks at the costs which would be necessary to develop and patent a similar invention, either in-house or externally. This

approach is generally used in accounting and bookkeeping. 3. **Income method**: (yipee de doo) Income-based methods measure the potential income that can be derived from a patent; the calculation of the present value of the patent on

The income method to value patents can be a long-term substantial value as the income could be as long as patent is valid, viz 20 years

Summary

the basis of anticipated future income.

More articles for you

(ITES)

Masum Gazi ACA

CC♥ 36 · 8 comments · 3 reposts

• .A patent is the ideal intellectual property asset to place into an entity's balance sheet to convert Passive NFE to non-reporting long term Active NFE if > 50% of income is from non-passive income (ie generated by financial assets)



Non Deduction Certificate in case of Information Technology Enabled Services

The Best Practices Trap. Don't Fall In! Joël Collin-Demers  $\bigcirc$  15 · 3 comments

 $\bullet$  0 0 0

IFRS 16 | Future of Lease Lalit Chadha **4** 











