CS207 #10, 6 Dec 2013
Gio Wiederhold
Hewlett 102

Bob Zeidman seminar on Protecting Your Software Intellectual Property. Please RSVP to Seminar by Dec 6
info@zeidmanconsulting.com

When Dec 10, 2013
6 - 7 PM
Where LegalForce
323 University Ave.
Palo Alto, CA 94301
1. Why should software be valued?
3. Market value of software companies.
4. Intellectual capital and property (IP).
5. The role of patents, copyrights, and trade secrets.
6. Open source software. Scope. Theory and reality
7. Life and lag of software innovation.
8. Sales expectations and discounting, Licensing.
10. Separation of use rights from the property itself.
11. Risks when outsourcing and offshoring development.
12. Effects of using taxhavens to house IP.
13. Acquisitions and growth
14. Advertising creates IP
15. Drastic Proposal
Class evaluation

• Now open to 18 Dec 2013
  ▪ gives axess to grades
• Especially useful for CS207
  ➢ Novel
  ➢ Experimental – credits, assignments, ...
  ➢ Assign VIC book as reading next year
• likely- can refer to it thenClass
  ➢ VIC book cost/benefit
  ➢ topics: missed advertising this year
  ➢ Time, units, Grading?
Economyths

Sketch from last time

Individual’s view

If big change: downside risk hurts more than upside gain
Economic Models
[Orrell: Economyths+]

• Used to predict effect of policies and tax changes
  use assumptions → based on easy data availability
  miss realistic detail

  ➢ Equilibrium → ignores dynamics and lag: housing
  ➢ Normal distribution → based on additive model $\sum_n = \gamma^2$
    many effects are multiplicative: power-law = $\gamma^{3,4}$
  ➢ Supply cannot always grow as price increases → fish
  ➢ Rational behavior → perfect foresight: X-mas shopping?
  ➢ Symmetric distribution → value S-curve not centered:
    small (infinitesimal change) calculus → symmetric

• Governments get poor advice

12/9/2013 CS207
Topics

• Case used by many: SnapChat
  Allows sending transient pictures (selfies)
  keeps only addresses of senders (and receivers?)

➤ owners did not accept $3B offer from Facebook—wise or foolish
  ✓ Might be worth more later when mature
  ✓ Can it survive standalone – short-term social network
  ✓ Are there other businesses that can monetize SnapChat
  ✓ Does the technical staff have a high value
  ✓ Can the IP be protected
Flow

MNC California

$sales

IP rights

Primary

Palm Island

IP

Conduit

Holland

Semi-taxhaven

IP documents and knowhow

Product for US customers

Product cost

Product for RoW customers

Malaysia, India

Europe

Profit

$sales
Structure

Parent: MNC

Semi-

Set Up

Control

Advice

Service

Own

Primary

Conduit

CFCs: MNC JB MNC MY

CFH: CONCH

CFI: CAAS $₹€£¥

Advisor: ATA

MNC California
Malaysia, India + Holland + Palm Island
Tax law recom’s

R1: Changes in the tax code must commit resources at the IRS.
   *Now laws get passed that are poorly enforced*

R2: Bills passed by Congress should deal with only the topic in the title. *Horse-trading overwhelms intent, 90% of contents not relevant*

R3: Don’t move to territorial [within its boundaries] taxation. *Only adequate for countries that do not create exportable IP*

R4: Write regulations that focus on principles, rather than trying to resolve in advance every possibility of unreasonable tax avoidance. *Don’t expect foresight from politicians and bureaucrats.*

R5: All subsidiary divisions of a corporation should be listed in corporate annual reports, with their actual place of business. *Paperwork reduction act allows omission of most*
R6: The responsible executives and directors of all divisions of a corporation to be shown in consolidated reports. 

*Now often local lawyers*

R7: For each subsidiary, list the financial capital, the size of the workforce, the payroll, and IP rights held.

R8: Show transfers of assets, financial and IP, among divisions.

R9: Report a corporate estimate of the value of IP.

R10: Report and discuss the value of the creative workforce in annual reports.

R11: Investment in development of IP to be capitalized.

R12: Book ongoing maintenance expenses as CoGS/SG&A.

R14: Do not make settlements confidential. *Loss of information how set tax correctly.*

*a prerequisite for action*
R15: Base the allocation of net income on the costs incurred in its creation, *not on sales locality*.

R16: Do not use royalties for reimbursement of IP transfers or acquisitions. *Royalties are meant to deal with uncertainty.*

R17: Link any repatriation incentive for financial capital to a commensurate repatriation of IP, so that future earnings are received in the U.S. as well.

R18: Do not use tax credits to support research.

R19: Do not attempt to support specific categories of research.

*R20: Abolish corporate taxation entirely.*
Abolish Corporate Taxation

• Immediate problem: Loss to the US Treasury

But Now: no double taxation

• No reason for lower rate on
  - Dividends
  - Capital gains

• When taxed at personal rates the effect is substantially offset
Proposal: eliminate corporate taxation and tax personal income fully

No corporate taxation and full personal rates on dividend and capital gains income

- Removing a component of US tax revenues is worrisome
- But now no `double taxation’ Corporate + Shareholders
  - Revenues from corporate taxation are decreasing,
  - Its contribution to the US economy in 1994 was already less than 2.5% of GDP.
  - The 2008 recession lowers the amount of corporate income tax collected

A linear extrapolation of the trend in corporate tax rates makes the revenues from corporations zero by 2050!
<table>
<thead>
<tr>
<th>Taxed item</th>
<th>Action</th>
<th>Change</th>
<th>see</th>
<th>Motivation and result</th>
</tr>
</thead>
<tbody>
<tr>
<td>Corporate income tax (CIT)</td>
<td>Abolish</td>
<td>($228.5B)</td>
<td>F10.20</td>
<td>Cannot be administered fairly</td>
</tr>
<tr>
<td>Dividends to individuals</td>
<td>Tax as income</td>
<td>$30.4B</td>
<td>F10.19</td>
<td>Treat all sources of individual income identically</td>
</tr>
<tr>
<td>Capital gains by individuals</td>
<td></td>
<td>$69.0B</td>
<td>F10.18</td>
<td></td>
</tr>
<tr>
<td>Effect of taxation of greater dividend payouts</td>
<td>Corporate</td>
<td>$9.6B</td>
<td>F10.21</td>
<td>Compensate shareholders for their increased taxes, collect taxes on those</td>
</tr>
<tr>
<td>Research credit and similar corporate tax expenditures, corporate AMT, deductions</td>
<td>No $ change, no tax negates tax credit</td>
<td>No $ change, no tax negates tax credit</td>
<td>F10.22</td>
<td>If incentives are still desired, they must be replaced by explicit grants</td>
</tr>
<tr>
<td>Non-corporate business incentives</td>
<td></td>
<td>$5.0B</td>
<td>F10.22</td>
<td></td>
</tr>
<tr>
<td>Total estimated effect</td>
<td></td>
<td>($114.5B)</td>
<td>F10.23</td>
<td>50.2% of CIT, 3.6% of US tax rev.</td>
</tr>
</tbody>
</table>

Table Ch10.1  Direct annual US revenue effects of abolishing the corporate income tax
G1: Corporations get all the benefits individuals get, and should pay for them.

**C1:** *In the end it is their owners who benefit from corporate activities.*

G2: Corporations count on the government to offload their problems: *risks, pollution.*

**C2:** *Insurance schemes exist* (up to the PBGC).

*All businesses affect the environment.*

G3: Pay for the liability protection given owners!

**C3:** *C-corporations are not unique in that respect. LLPs, LLCs, and S-corporations also insulate owners*
G4: Corporations have similar legal rights as individuals

C4: Current laws and tax codes already treat corporate persons differently

G5: Corporations have fewer constraints, for instance: people can’t be owned.

C5: Any businesses can be owned

G6: Natural persons have residency constraints imposed, so should pay less.

C6: That corporations can have multiple domiciles enabled the tax avoidance that goes away with Recom. 20.
Multinationals and individuals

G7: Abolishing all corporate taxation is extreme.
C7: Don’t further disadvantage domestic businesses.

G8: Closing loopholes will solve the problems.
C8: Closing current loopholes as tax incentives effects multinationals little. Most have taxhavens already.

G9: Not taxing corporations enables more personal tax evasion.
C9: Other business forms exist enabling evasion.

G10: Individuals can use corporations to shelter earnings in taxhavens.
C10 Individuals must move offshore to get tax-free $. Much easier for corporate subsidiaries
Money Flow

G11: Not taxing corporations enables indefinite deferral of paying taxes.  
C11: Holding capital internally is already available to any business entity. It’s better for business to invest.

G12: Current tax deductions already take care of double taxation of dividends and capital gains.  
C12: Not the motivation for Recommendation 20

G13: Investors taking risks deserve lower taxes.  
C13: Investors get higher returns if there is risk.

G15: The role and value of banks is reduced.  
C15: Investors are now equal in taxation.
G16: The U.S. should just fix the problems with international taxation.

C16: Tax havens are in sovereign nations. Just getting the G20 to agree is not enough.

G17: There will be no US taxes to offset foreign taxes.

C17: Foreign taxes just become expenses of doing business, just as sales and other taxes.

Other countries may well follow, but it will be harder for counties that rely more heavily on corporate taxation, and may have inadequate systems for control of individual tax evasion.
G18: If corporate taxation is changed, all other taxes need updating as well.

C18: False, corporate taxation is quite distinct. Many pages regulations just become irrelevant

G19: Making a transition is impossible.

C19: Change is needed, and this is simple, focused.

G20: Why concede such an important issue and let corporations win?

C20: Don’t continue fighting a battle that is lost already.
Two technological drivers of change

1. Internet for rapid, low cost, invisible transfer of intellectual property and its products.
2. Containerization enabling low cost transport of tangible products, with airfreight backup.

Geographic limitations have become irrelevant. It’s no longer Portugal for wine and Scotland for wool.


