The Life of IP: Accounting and Tax Treatments of Trade Marks and Goodwill in New Zealand

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Introduction

This article examines goodwill and trade marks (TMs) from accounting, taxation and intellectual property (IP) law perspectives.

In New Zealand, goodwill is protected as property via the Trade Marks Act (TMA) 2002 and the tort of passing off.¹ That goodwill and TMs are property has legal, accounting and tax implications. From an accounting perspective, goodwill and TMs are intangible assets that comprise unquantifiable factors contributing to value within an entity. From a tax perspective, expenditure on goodwill and TMs may generate taxable income, but it may also result in undesirable “black-hole expenditure”, that is, expenditure that cannot be either expensed (and reduce taxable income) or capitalised (and add value via the balance sheet).²

Goodwill and TMs are becoming increasingly important in an era where the value of organisations is more likely to comprise intangible items. Globally there is a trend away from organisations holding their value primarily in real property (related to land), plant and equipment (tangible personal property), and towards

increased value in intangible assets.³ Companies such as Apple and Amazon hold significant amounts of acquired goodwill on their balance sheets, at US\$5.7 billion and US\$3.7 billion respectively.⁴ In addition, these organisations hold substantial unrecognised value from internally generated goodwill and TMs that does not show on the organisation’s balance sheet. There can be no question that goodwill adds value to organisations.⁵ When organisations have a strong online customer base, an enviable following on social media, or ownership of an attractive colour that only they can use in trade, these all reflect, and can further generate, goodwill in the entity. Furthermore, licensing of TMs and goodwill (whether through franchise agreements or otherwise) is becoming more commonplace, as is the licensing of certification and collective TMs.

This article highlights and contrasts the various outcomes that result from the different disciplinary rules regarding intangible assets. We question whether extant practice, particularly in taxation, results in optimal economic outcomes, and whether it is logical and consistent to treat goodwill and TMs differently from other intangible assets for accounting and tax, because they theoretically have indefinite or potentially infinite lives. We further question whether this treatment reflects the current trading environment, where the value of goodwill and TMs is potentially substantial, while simultaneously being fragile and susceptible to sudden changes in market preferences. The article provides a further contribution in bringing together these disciplines in an integrated format for analytical purposes. While prior studies have compared accounting and tax, or tax and law, the novelty in this article is the inclusion of the three disciplines in the New Zealand context.⁶ New Zealand provides a unique environment in which to examine these three disciplines as, while New Zealand has adopted international accounting standards and the legal rules pertaining to intangibles are not dissimilar to other comparable jurisdictions, the tax rules have the potential to result in different outcomes from other countries.

The second section commences with a contextual summary of the accounting, taxation and legal concepts that we address in the article. Four sections then outline the creation, acquisition and disposal, end of life and

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¹ To the extent that goodwill is attached to something non-reputational or non-communicative, such as a customer list, know-how or trade secret, it is protected by a variety of other laws, such as the equitable doctrine of breach of confidence, and the Crimes Act 1961 ss.230, 249 and 252.

² The balance sheet shows the assets and liabilities of an entity. Where expenditure can be capitalised, it becomes an asset on the balance sheet.

³ e.g. reference to the top 10 companies in the Fortune 500 in 1960 shows that six were oil companies, two were vehicle companies, one was a conglomerate (General Electric) and one was a technology company (IBM). In 2018, three were healthcare companies, a telecommunications company (AT&T), an ecommerce entity (Amazon), a technology company (Apple), a retail company (Wal-Mart) and a conglomerate (Berkshire Hathaway). Two of the original firms remain from the 1960 list (Exxon Mobil and General Motors).

⁴ Nasdaq, “U.S. Stock Quotes, Charts and Research. Company Financials”, <https://www.nasdaq.com/quotes/> [Accessed 9 October 2019].

⁵ In 2018, 20 of the top 100 brands by value were tech giants. The top five were Apple, Google, Microsoft, Facebook and Amazon. See Forbes, “The World’s Most Valuable Brands” (2018), <https://www.forbes.com/powerful-brands/list/> [Accessed 9 October 2019].

⁶ See, e.g., M Walpole, “When is Goodwill not Goodwill?” (1999) 2 *Journal of Australian Taxation* 48; M. Walpole, “The Fate of Goodwill after Ralph” (2006) 3 *Journal of Australian Taxation* 344; M. Walpole, “Goodwill and Taxation Issues” (2008) 3 *The Tax Specialist* 201; M. Walpole, *Proposals for the Reform of Taxation of Goodwill in Australia* (Sydney: Australian Tax Research Foundation, 2009).

licensing, of these assets. We follow this with a discussion in the seventh section, and make concluding comments in the eighth section.

Background

From an accounting perspective, “assets” are “a present economic resource controlled by the entity as a result of past events”.⁷ Intangibles must also be “an identifiable non-monetary asset without physical substance”.⁸ This covers a wide range of items, including computer software, patents, copyrights, motion picture films, customer lists, fishing licences, import quotas, franchises, customer or supplier relationships, customer loyalty, market share and marketing rights.⁹ Goodwill and TMs are further examples.

For taxation, the Income Tax Act 2007 (ITA 2007) does not include a definition of goodwill. Goodwill is mentioned only eight times in the Act with reference to land use,¹⁰ leases¹¹ and financial arrangements.¹² TMs have only two mentions, one with reference to income from royalties¹³ and another with reference to depreciable intangible property.¹⁴ Indeed, the ITA 2007 does not have a substantive definition of “property”, though it appears 2314 times in 430 sections.¹⁵

Property law’s understanding of goodwill comes rather fittingly from a tax-related decision, on stamp duties, *Commissioner of Inland Revenue (CIR) v Muller & Co’s Margarine Ltd*. Lord MacNaghten’s following statement on goodwill has since been adopted into the tort of passing off¹⁶:

“What is goodwill? It is a thing very easy to describe, very difficult to define. *It is the benefit and advantage of a good name, reputation, and connection of business. It is the attractive force which brings in custom.* It is the one thing which

distinguishes an old established business from a new business at its first start. The goodwill of a business must emanate from a particular centre or source. However widely extended or diffused its influence may be, goodwill is worth nothing unless it has a power of attraction sufficient to bring customers home to the source from which it emanates. *Goodwill is composed of a variety of elements.* It differs in its composition in different trades and in different businesses in the same trade.”

These elements can include a business’ reputation,¹⁷ customer loyalty or the quality of employees, all of which are difficult to value separately from the organisation. A business’ TM carries a significant amount of that business’ goodwill. Typically, goodwill accumulates and/or deteriorates over time in patterns that are difficult to forecast.

There has been considerable debate on the potential problems arising from the accounting treatment of intangible assets, highlighting many of the technical issues in attempting either to value intangible assets or to achieve a fair assessment of their value in financial statements.¹⁸ The problems commence at the point of definition, with research showing inconsistencies in how firms define goodwill.¹⁹

In contrast, tax and its relationship with IP have received little interest in the academic literature.²⁰ This is puzzling, given the importance of IP to many organisations. Moreover, as discussed further in this article, the tax treatment of some IP can result in black-hole expenditure. Thus, the potentially inequitable outcome of IP for tax purposes would appear to be a research topic of pertinence.

⁷ New Zealand Accounting Standards Board, New Zealand Equivalent to the IASB Conceptual Framework for Financial Reporting (2018 NZ Conceptual Framework), External Reporting Board, Wellington, para.4.3.

⁸ New Zealand Accounting Standards Board, New Zealand Equivalent to International Accounting Standard 38 Intangible Assets (NZ IAS 38), 2018, External Reporting Board, Wellington, para.8.

⁹ NZ IAS 38, para.9.

¹⁰ ITA 2007 s.CC 1.

¹¹ ITA 2007 s.EI 7 and s.EZ 68.

¹² ITA 2007. s.FE 5(1BB)(d), s.FE 19(2)(a)(iii), s.FE 21(7)(a).

¹³ ITA 2007 s.CC 9(2)(a).

¹⁴ ITA 2007, Sch.14. The reference to TM in Sch.14 relates to the right to use a TM, rather than the TM itself. In accounting, depreciation provides for the systematic decline in the value of a tangible asset. Amortisation is the term used when the asset losing value is an intangible asset. Throughout the article we use the terms used in the relevant standards or legislation.

¹⁵ ITA 2007 s.YA1.

¹⁶ *CIR v Muller & Co’s Margarine Ltd* [1901] A.C. 217 HL at 223–224 (emphasis added).

¹⁷ Reputation and goodwill are two very related, but distinct, concepts. English case law has held that reputation alone is not enough to bring a case of passing off. There must be established goodwill, meaning trade presence in the jurisdiction. See *Starbucks (HK) Ltd v British Sky Broadcasting Group Plc* [2015] UKSC 31, [2015] 1 W.L.R. 2628 at [23] and [51]–[52]; *Star Industrial Co Ltd v Yap Kwee Kor* [1976] F.S.R. 256 PC at 259; and *Bhayani & BLL v Taylor Bracewell LLP* [2016] EWHC 3360, [2017] E.T.M.R. 14 at [26]–[28] (IPEC). Notably, New Zealand courts have not taken such a strict approach. See *Dominion Rent A Car Ltd v Budget Rent A Car Systems (1970) Ltd* [1987] 2 N.Z.L.R. 395 CA; *Cyclone Hardware Pty Ltd v Patience & Nicholson (NZ) Ltd* [2001] 3 N.Z.L.R. 490 CA; *Gallaher Ltd v International Brands Ltd* (1976) 1 N.Z.I.P.R. 43 SC; *Esanda Ltd v Esanda Finance Ltd* [1984] 2 N.Z.L.R. 748 HC; and *Crusader Oil NL v Crusader Minerals New Zealand Ltd* (1984) 1 T.C.L.R. 211 HC.

¹⁸ G. Wines, R. Dagwell and C. Windsor, “Implications of the IFRS Goodwill Accounting Treatment” (2007) 22 *Managerial Auditing Journal* 862; A. Verriest and A. Gaeremynck, “What Determines Goodwill Impairment?” (2009) 54 *Review of Business and Economics* 1; T.M. Carlin and N. Finch, “Resisting Compliance with IFRS Goodwill Accounting and Reporting Disclosures: Evidence from Australia” (2010) 6 *Journal of Accounting and Organizational Change* 260; T.M. Carlin and N. Finch, “Goodwill Impairment Testing under IFRS: A False Impossible Shore?” (2011) 23 *Pacific Accounting Review* 368; K.G. Chalmers, J.M. Godfrey and J.C. Webster, “Does a Goodwill Impairment Regime Better Reflect the Underlying Economic Attributes of Goodwill?” (2010) 51 *Accounting and Finance* 634; J. Guthrie and T. Pang, “Disclosure of Goodwill Impairment under AASB 126 from 2005–2010” (2013) 66 *Australian Accounting Review* 216.

¹⁹ M. Giuliani and D. Brännström, “Defining Goodwill: A Practice Perspective” (2011) 9 *Journal of Financial Reporting and Accounting* 161.

²⁰ Walpole has also addressed a number of issues relating to goodwill and tax in the Australian context: M. Walpole, *Proposals for the Reform of the Taxation of Goodwill in Australia* (Doctoral Thesis in Law, University of New South Wales, 2006); Walpole “Goodwill and Taxation Issues” (2008) 3 *The Tax Specialist* 201.

Creation

TMs offer statutory protection for goodwill as embodied in “signs” used in trade.²¹ TMs are personal property,²² obtained through application, examination and registration. To enforce the property, the existence of goodwill is presumed. TM protection is potentially perpetual (renewable every 10 years). In contrast, most forms of IP are time-limited. For example, patents run for 20 years,²³ plant variety rights (PVRs) can go on for 20 or 23 years,²⁴ and designs last for 15 years.²⁵ Copyright is also restricted in duration, but an indeterminate and relatively long duration, as it is based on the life of the author plus an additional 50 years.²⁶

TMs are a statutory child of tort law (as well as other laws), including the tort of passing off.²⁷ However, while one can get a TM for a sign that has never been used in trade and, thus, has no associated goodwill, passing off only protects “get-up” (trade dress)²⁸ with established goodwill. The trader must prove the existence of the goodwill, which is protected as property.²⁹

For accounting purposes, there are two primary concerns regarding how goodwill and TMs are treated: (1) whether outgoings constitute an expense on the income statement³⁰; and (2) whether the outgoings create an asset, recognised on the balance sheet.

When a TM or goodwill is internally generated, there is usually no impact on the balance sheet for accounting purposes. Expenditure towards their development may be reflected on the income statement and expenses. Notwithstanding this default position, there are some expenditure items that contribute to goodwill or TMs that

may be capitalised, such as research and development (R & D).³¹ In the research phase, no intangible asset is generated, and all expenditure is expensed when incurred.³² In the development phase, an intangible asset is recognised when a number of criteria are met, such as the technical feasibility of completion, demonstration of ability and intent to complete the intangible asset, and demonstration of probable future economic benefits.³³ Where the R & D phases cannot be distinguished, all the expenditure is treated as research and expensed as incurred.³⁴ Goodwill or TMs are unlikely to meet the high standard required to constitute development expenditure. Therefore, the costs are likely to be expenses.

Regarding taxation, R & D expenditure incurred in deriving assessable income or derived in the course of carrying on a business for the purpose of deriving assessable income, is an allowed deduction.³⁵ There are limitations,³⁶ the most relevant of which is the capital limitation.³⁷

Under the capital limitation, expenditure that contributes to the cost of an asset is not deductible, unless s.DB34 applies. This allows a deduction for expenditure incurred on R & D where either the expenditure: is immaterial or less than \$10,000 and it is written off for accounting purposes³⁸; or is recognised as an expense for financial reporting purposes.³⁹ Section DB34 is voluntary.⁴⁰

Like the accounting treatment, development expenditure that only contributes to goodwill or TMs is unlikely to meet the criteria for recognition as an asset. However, also like accounting, a number of other common business expenses are likely to impact on the goodwill or value of a TM of an organisation (e.g. legal

²¹ L. Bently, “From Communication to Thing: Historical Aspects of the Conceptualisation of Trade Marks as Property” in G.B. Dinwoodie and M.D. Janis (eds), *Trade Mark Law and Theory: A Handbook of Contemporary Research* (Cheltenham: Edward Elgar, 2008), p.3.

²² TMA 2002 s 9(1). On the historical development of TMs as “property”, see Bently, “From Communication to Thing” in *Trade Mark Law and Theory* (2008), p.3.

²³ Patents Act 2013 s.20.

²⁴ Plant Variety Rights Act 1987 s.14(2).

²⁵ Design Rights Act 1953 s.12.

²⁶ Copyright Act 1994 s.22(1). Some forms of copyright or copyright works are of specified limited duration. These are industrial artistic copyright (16 years; Copyright Act 1994 s.75), computer-generated work (50 years from their making; Copyright Act 1994 s.22(2)), sound recordings and films (50 years from their making; Copyright Act 1994 s.23(1)). Notably, Sch.14 of the ITA 2007 (listing depreciable intangible property) includes the first three of these. It is unclear why Sch.14 does not include copyright in films.

²⁷ Signs used in trade were initially protected under the tort of deceit, supported by the law of equity and its ability to grant injunctions, against misrepresentation in trade. These two mechanisms developed from protecting against fraudulent trading to protecting property in the mark itself (see Bently, “From Communication to Thing” in *Trade Mark Law and Theory* (2008), p.3; G.B. Dinwoodie and M.D. Janis, “Confusion over Use: Contextualism in Trademark Law” (2007) 92 *Iowa Law Review* 1597; A. Chronopoulos, “Goodwill Appropriation as a Distinct Theory of Trademark Liability: A Study on the Misappropriation Rationale in Trademark and Unfair Competition Law” (2014) 22 *Texas Intellectual Property Law Journal* 253. The Fair Trading Act 1986 protects against misleading or deceptive conduct in trade.

²⁸ Trade dress refers to the characteristics that help to identify a product, e.g., the shape of a product that makes it distinctive.

²⁹ *AG Spalding & Bros v AW* (1915) 32 R.P.C. 273 HL; and *Star Industrial v Yap Kwee Kor* [1976] F.S.R. 256 at 269.

³⁰ The income statement shows the revenue and expenditure of an entity for a specified period.

³¹ Note that, in early May 2019, the New Zealand Parliament passed the Taxation (Research and Development Tax Credits) Act 2019. This gives a tax credit of 15% (up to \$120 million). R & D is defined as activity that “(i) is conducted using a systematic approach; and (ii) has a material purpose of creating new knowledge, or new or improved processes, services, or goods; and (iii) has a material purpose of resolving scientific or technological uncertainty” (s.LY 2). This potentially covers expenditure made towards patentable inventions and copyright works, but not trade marks (or goodwill).

³² IAS 38, para.54.

³³ IAS 38, para.57(a)–(f).

³⁴ IAS 38, para.53.

³⁵ ITA 2007 s.DA1.

³⁶ The General Limitations are found in ITA 2007 s.DA2.

³⁷ ITA 2007 s.DA2(1). See also specific rules per s.DB33 (scientific research), and ss.DB34–DB35 (other R & D). Inland Revenue, Interpretation Statement IS 17/05 Income Tax – Treatment of New Zealand Patents.

³⁸ ITA 2007 s.DB34(1)–(5).

³⁹ Under NZ IAS 38, para.68(a) (“expenditure on an intangible item shall be recognised as an expense when it is incurred unless it forms part of the cost of an intangible asset that meets the recognition criteria”), or NZ IAS 38, paras 54–67 (criteria under which development expenditure can be capitalised).

⁴⁰ Inland Revenue, Interpretation Statement IS 17/05 Income Tax – Treatment of New Zealand Patents, para.77.

fees,⁴¹ marketing and communications, or entertainment),⁴² which may be allowable as deductions. Furthermore, direct costs associated with protecting the reputation of a business, which also protect goodwill and TM value, is deductible.⁴³

In contrast, expenditure to develop patents and designs (or applications) can be capitalised and depreciated as part of the depreciable intangible property.⁴⁴ In addition, if one fails to obtain patent or design, because the application is not lodged or is withdrawn, or because the grant is refused, the expenditure is an allowable deduction under s.DB37.⁴⁵ Note that one can also capitalise and depreciate expenditure made towards PVRs (or application) or industrial artistic copyright.⁴⁶ However, if one fails to obtain the PVR, one cannot deduct the expenditure.⁴⁷ It is not clear why PVRs are treated differently from patent and design rights, as all are registered and finite kinds of IP. Industrial artistic copyright also does not come under s.DB37, though it is finite in duration. However, this makes sense, as one does not register industrial artistic copyright—it simply exists when a certain set of criteria subsists,⁴⁸ one of which is industrial application (defined as the production of 50 copies for the purpose of sale or hire), such that the mere existence of industrial artistic copyright means that the expenditure for development resulted in a marketed product.

Acquisition and disposal

A TM owner may “assign or transmit the registered TM (either in connection with the goodwill of a business or not)”. While a TM can technically be sold independently from the goodwill of a business, this is not the case with goodwill, which is inseparable from the business that it is attached to.⁴⁹ In practice, this means that it might not be possible to sell certain TMs without also selling the attached goodwill and associated business.⁵⁰ To illustrate, if Nike decided that it wished to sell its “Swoosh” TMs, it is unfathomable that Nike would do so without both the goodwill attached to the marks and the business of sportswear. Not only would this cause consumer confusion, it would create a legal paradox if the purchaser

could sue for TM infringement, but Nike would have to bring the action of passing off because it retains the goodwill.⁵¹ The paradox is deepened by the presumption that TMs embody goodwill.

As noted in the previous section, internally generated goodwill and TMs do not create any impact on the balance sheet from either an accounting or tax perspective. However, this changes when they are purchased or disposed of.

For accounting, it is only when an item meets both the definition of an intangible asset and the recognition criteria as outlined in accounting standards that it can be classified as an intangible asset on the balance sheet of the entity.⁵² Otherwise, the expenditure to acquire is expensed through the income statement when incurred.

The accounting standard that deals with intangible assets does not provide a definition for goodwill.⁵³ A definition can be found in NZ International Financial Reporting Standards (IFRS) 3, Business Combinations, which defines goodwill as “[a]n asset representing the future economic benefits arising from other assets acquired in a business combination that are not individually identified and separately recognised”.⁵⁴ Purchased goodwill is recognised as the difference between the consideration paid for the entity and the net assets of the entity. Thus, it attempts to capture some of the intangible value of the entity that is acquired. When a value associated with a purchased intangible asset is not identifiable, it is subsumed into goodwill, as is any value attributed to items that do not qualify as assets, such as potential contracts.⁵⁵

An intangible asset will be recognised separately from goodwill if it meets the identifiability criteria, which require that “it meets either the separability criterion or the contractual-legal criterion”.⁵⁶ An intangible asset also meets the separability criterion if it is separable in combination with a related contract, identifiable asset or liability. An example is when an entity owns goodwill that is attached to a registered TM as well as the trade dress of its product. In order to transfer ownership of the goodwill, it has to transfer everything else that the purchaser requires to produce that product in the same

⁴¹ See, e.g., *CIR v Murray Equipment Ltd* [1966] N.Z.L.R. 360, which held that expenditure paid by the taxpayer to contest a third party’s patent application, as being non-patentable owing to the taxpayer’s patent, was revenue in nature per the Land and Income Tax Act 1954, despite the fact that the legal costs were incurred to protect a capital asset.

⁴² Marketing and communication expenses are deductible under ITA 2007 s.DA1(1)(b). While the entertainment expenditure regime acts to limit some entertainment expenditure items, s.DD5 allows for a deduction for expenditure on entertainment where that entertainment is mainly to advertise or promote a business to the public.

⁴³ *Federal Commissioner of Taxation v Snowden and Willson Pty Ltd* [1958] HCA 23.

⁴⁴ ITA 2007 s.EE18B.

⁴⁵ ITA 2007 s.DB37.

⁴⁶ ITA 2007 s.EE18B.

⁴⁷ Under ITA 2007 s.DB37.

⁴⁸ See Copyright Act 1994 ss.14 and 75.

⁴⁹ See *Starbucks v British Sky Broadcasting Group* [2015] UKSC 31, [2015] 1 W.L.R. 2628 at [23] and [51]–[52]; *Star Industrial v Yap Kwee Kor* [1976] F.S.R. 256 at 259; and *Bhayani & BLL v Taylor Bracewell LLP* [2017] E.T.M.R. 14 at [26]–[28].

⁵⁰ See B. Sherman and M. Power, “Law, Accounting and the Emergent Positivity of Intangible Property” (1994) 3 Social and Legal Studies 477, 483 and 485.

⁵¹ In contrast, see G.B. Ramello, “What’s in a Sign? Trademark Law and Economic Theory” (2006) 20 *Journal of Economic Surveys* 547, 559, on brand loyalty and the unbundling of the sign from the product.

⁵² The definition and recognition criteria can be found in NZ IAS 38, paras 11, 13, 17 and 21.

⁵³ International Accounting Standards (IAS) 38.

⁵⁴ NZ IFRS 3, Appendix A.

⁵⁵ NZ IAS 38, para.B 38.

⁵⁶ NZ IFRS 3, para.B31. Separable means capable of being separated or divided from the entity and sold, transferred, licensed, rented or exchanged regardless of whether the entity intends to do so. A TM is an example of something arising from contractual or legal rights.

way. As the TM and rights in the trade dress must be separated from the seller and, if the goodwill is sold, this also meets the separability criterion.

For tax purposes, the definition of allowable R & D expenditure excludes expenditure on the acquisition of intangible property, as it creates a capital asset. For the purchaser, the amount paid becomes the cost of the asset for tax purposes. Parallel to this, when an intangible asset is sold, this remains on capital account of the seller. As New Zealand does not have a comprehensive capital gains tax, any capital gains made on disposal of an asset are not taxable. Similarly, tax losses are not deductible expenditure.

The ITA 2007 lists certain “depreciable intangible property” in Sch.14 (discussed in detail below), including patents, PVRs and design rights. In relation to TMs, it is only the right to use the TM, rather than the TM itself that is explicitly included in Sch.14. Therefore, a TM cannot be depreciated. As noted previously, the rationale behind this different treatment is that a patents, PVRs and design rights have finite lives, whereas a TM is indefinite. This distinction is critiqued in the following Sections.

End of life

TMs and goodwill can be protected indefinitely. So long as the business thrives, so will its goodwill in the business and its TMs. Renewal of TMs every 10 years keeps the register “clean” of signs not being used and prevents traders from stockpiling signs to prevent competitors from using them. One can also lose a TM registration through “abandonment” (non-use of the mark in trade),⁵⁷ or “genericide” (when a TM becomes “a common name in general public use”).⁵⁸ To avoid genericide, TM owners have to ensure that the goodwill associated with the mark stays with their businesses and does not diffuse out to all traders of the related goods or services.

From the accounting perspective, an intangible asset can decline in value over time, or suddenly. With traditional tangible assets, depreciation accounts for the first decline in value and writing-off accounts for the second.

The default is that goodwill and intangible assets with indefinite lives (e.g. TMs) are annually reviewed for impairment, defined as when an asset is carried at more than its recoverable amount,⁵⁹ or shows on an entity’s balance sheet at more than its likely market value. Testing takes place more frequently if there is an indication that the goodwill or TM is impaired. The value of the “impairment loss” is reflected on the balance sheet and

a corresponding amount is written-off in the income statement. For example, if a TM was purchased and therefore held as an intangible asset on the balance sheet, and subsequently struck off the register, this would be considered as impaired. Research suggests “delayed and avoided goodwill impairment” among firms, which reflects the subjectivity inherent in impairment testing.⁶⁰ This is amplified when goodwill cannot be separately distinguished and must instead be valued as part of a “cash generating unit”. The inherent subjectivity in the accounting rules, including with respect to “goodwill”, is well established.⁶¹

For tax purposes, “depreciable property” is property that is likely to decline in value while being used to generate income.⁶² For an intangible item, it must also be “depreciable intangible property”,⁶³ and not included in s.EE7 of the ITA 2007 as something that is not depreciable property. Schedule 14 to the ITA 2007 lists depreciable intangible property.⁶⁴ The criteria for property to be listed in Sch.14 is twofold: it must be intangible; and it must have a finite useful life that can be estimated with a reasonable degree of certainty on the date of its acquisition.⁶⁵ This list includes:

- the right to use a TM;
- the copyright in a sound recording under certain conditions;
- the copyright in software, the right to use the copyright in software, or the right to use software;
- industrial artistic copyright⁶⁶;
- the right to use a copyright;
- a design registration or a design registration application;
- the right to use a design or model, plan, secret formula or process, or other like property or right;
- a patent, the right to use a patent or a patent application;
- PVRs and the right to use PVRs.

TMs are not listed. As they are an indefinite kind of IP, the owner of a TM (and/or goodwill) could not expect the value of a TM to decline in value while it is used or available for use, in deriving assessable income, or in carrying on a business for the purpose of deriving assessable income (per s.EE6(1)).⁶⁷ Impairment loss vis-à-vis an intangible asset is not an allowable deduction, but a black-hole expenditure. Overall, goodwill and TMs

⁵⁷ TMA 2002 s.66(1)(a). See, e.g., *Crocodile Int'l Pte Ltd v Lacoste* [2017] NZSC 14.

⁵⁸ TMA 2002 s.66(1)(c).

⁵⁹ NZ IAS 36, paras 6 and 10.

⁶⁰ K. Ji, “Better Late than Never, the Timing of Goodwill Impairment Testing in Australia” (2013) 23 *Australian Accounting Review* 36.

⁶¹ See, e.g., C. Carvalho, A. Maria Rodrigues and C. Ferreira “Goodwill and Mandatory Disclosure Compliance: A Critical Review of the Literature (2016) 26(4) *Australian Accounting Review* 376.

⁶² ITA 2007 s.EE6(1).

⁶³ ITA 2007 s.EE6(3).

⁶⁴ ITA 2007 s.EE62(1).

⁶⁵ ITA 2007 s.EE62(2).

⁶⁶ ITA 2007, Sch.14.

⁶⁷ *Trustees of the Simkin Trust v CIR* [2003] 2 N.Z.L.R. 315 CA at [18]–[20] at [25].

are seen as not depreciating, and there are no tax consequences of a TM being struck off the register or a business losing all its goodwill.

Licensing

As property, TM and goodwill can be licensed to third parties,⁶⁸ with consideration typically be in the form of lump-sum payments and/or royalties calculated relative to use or sales.

Accounting standards outline the recognition and measurement criteria associated with revenue from licences over IP.⁶⁹ Goodwill is not specifically named, but the list is not exhaustive and it could be included where it meets the recognition criteria. However, as goodwill, by its very nature, cannot be separately identified, it is unlikely that goodwill could be licensed, other than when “attached” to other assets, e.g. TMs.⁷⁰

The licensor recognises licensing revenue in the income statement.⁷¹ The asset that is recognised in the balance sheet is depreciated on a systematic basis that is consistent with the transfer to the customer of the goods/services to which the asset relates.⁷² Impairment losses are recognised where the value of the intangible asset in the balance sheet is greater than the remaining consideration under the contract.⁷³ Regarding the licensee, a contract liability is shown in the balance sheet and a corresponding expenditure item is charged to the income statement. A licence to use a TM is likely to be amortised⁷⁴ over the length of the licence.

For tax purposes, the ITA 2007 lists the “right to use” a TM as “depreciable intangible property”. When Sch. 14 refers to rights to use certain kinds of IP, this is with reference to licensees or lessees. If this were not the case, it would not be necessary to refer to the IP and to the right to use the IP separately, as is done in Sch. 14.⁷⁵

The Privy Council confirmed this to be correct in *Trustees in the CB Simkin Trust v CIR*.⁷⁶ In this case, the plaintiffs had purchased two TMs from two businesses that used the marks in trade. They granted exclusive licences back to the vendors to use the TMs, for seven years. The plaintiffs sought to depreciate the TMs. Discussing the Schedule of “depreciable intangible

property”,⁷⁷ their Lordships noted that the kinds of IP that were not listed were those without a “finite useful life”, whereas the right to use a trade mark is finite as it “will last only for as long as the trademark owner has granted that right”.⁷⁸

Regarding the right to use, the Privy Council upheld the Court of Appeal, which had stated that this must be a right of someone other than the owner, i.e. a licensee, as “[i]f the right to use were merely that inherent in the ownership ... there would be no need to specify it separately”.⁷⁹

Furthermore, the Privy Council held that the owners in the case at hand could not depreciate the right to use because they had granted exclusive licences to the licensees, meaning that they no longer had the right to use the TMs⁸⁰; to hold otherwise would “offend commonsense”.⁸¹ The court stated that, for the licence period, the TM owner did not own any depreciable intangible property, as they did not own the right to use the TMs—“[t]hat right belonged to the exclusive licensees.”⁸² The Privy Council essentially held that to grant an exclusive licence to a certain property right for a certain period of time is to give up ownership of that right for that period. While this might make sense from the tax perspective,⁸³ it is inconsistent with property law. As per property law, an owner of a thing does not give up ownership of a right just because he/she grants an exclusive licence/lease over it.

It is arguable that the outcome would be the same even had the licence been non-exclusive. This is because the exclusivity or lack thereof does not change the nature of TMs, and “the right to use the trademark sourced from the ownership of the trademark itself would not decline over time”.⁸⁴ That is, TMs do not decline in value over a finite period, thus, neither does the right to use them, and so neither constitutes depreciable property.⁸⁵

While the Privy Council held that the right to use belonged to the exclusive licensees, it found that the licensees could not depreciate the exclusive right to use the TM, as “[t]hey had no capital asset to depreciate”.⁸⁶

It appears impossible to depreciate the right to use a TM. Either:

⁶⁸ TMA 2002 ss.10 and 89.

⁶⁹ NZ IFRS 15, para.B52.

⁷⁰ NZ IFRS 15, para.27.

⁷¹ NZ IFRS 15, para.46.

⁷² NZ IFRS 15, para.99.

⁷³ NZ IFRS 15, para.101.

⁷⁴ See above fn.14.

⁷⁵ See *Simkin Trust v CIR* [2003] 2 N.Z.L.R. 315 CA at [18]–[20]; upheld in *Trustees in the CB Simkin Trust v CIR* [*Simkin Trust v CIR (PC)*] [2004] UKPC 55, [2005] F.S.R. 18.

⁷⁶ *Simkin Trust v CIR* [2004] UKPC 55; [2005] F.S.R. 18.

⁷⁷ This case was brought under the 1994 Act, wherein “depreciable intangible property” was listed in Sch.17.

⁷⁸ *Simkin Trust v CIR* [2004] UKPC 55; [2005] F.S.R. 18 at [8].

⁷⁹ *Simkin Trust v CIR* [2003] 2 N.Z.L.R. 315 at [18] and [24] (emphasis added).

⁸⁰ *Simkin Trust v CIR* [2004] UKPC 55; [2005] F.S.R. 18 at [17].

⁸¹ *Simkin Trust v CIR* [2004] UKPC 55; [2005] F.S.R. 18 at [17].

⁸² *Simkin Trust v CIR* [2004] UKPC 55; [2005] F.S.R. 18 at [19] (emphasis added).

⁸³ ITA 2007 s.EE6(1): the grant of an exclusive licence means that the owner cannot use the mark to derive assessable income, such that cannot constitute depreciable property.

⁸⁴ *Anzco Foods Ltd v CIR* [2016] NZHC 1015 at [92].

⁸⁵ ITA 2007 s.EE 6(1).

⁸⁶ *Simkin Trust v CIR* [2004] UKPC 55; [2005] F.S.R. 18 at [18].

- (a) you are the owner of property that does not have a “finite useful life”; or
- (b) you are the licensee (whether exclusive or not) and you pay royalties for the right to use, which are then deductible expenditures, but you do not own a capital asset to depreciate.

However, the Privy Council further stated that had the transaction been set up as with consideration in the form of a premium rather than royalties, the licence would have been depreciable.⁸⁷ Their Lordships favoured form over substance. This is in contrast to s.CC9 of the ITA 2007, which states that, for the purposes of determining income, consideration for

“the use of, or right to use, a copyright, patent, plant variety rights, trademark, design or model, plan, secret formula or process, or other similar property or right is a royalty, regardless of “how the payment is described or computed””,

or “whether the payment is periodical or otherwise”. Overall, on the TM owner’s side, any consideration paid by third parties to use the TM is revenue, regardless of the structure of the transaction. However, on the licensee’s side, the consideration could be a royalty and thus revenue, or a premium and thus capital, depending on how the transaction is structured.

Discussion

This section commences with a summary of the different accounting, tax and property law perspectives of goodwill and TMs in Table 1. We follow this by outlining and challenging four propositions that arise from the analysis undertaken in prior sections.

Table 1: Summary of the life cycle of TMs and goodwill

	Accounting	Taxation	Property Law
<i>Law, regulation and other guidance</i>	NZ IAS and NZ IFRS	ITA 2007	TMA 2002
<i>Creation</i>	Recognised only when purchased not internally created; indirect “costs” of creation allowed as expenditure (e.g. advertising).	Capital in nature, but not recognised when internally generated; expenses are not deductible unless nexus to income earning process can be demonstrated.	The tort of passing off The statutory regime protects registered TMs and goodwill is presumed. The tort of passing off requires the plaintiff to prove the existence of goodwill.
<i>Acquisition and disposal</i>	Recognised as an intangible asset by purchaser if definition and recognition criteria are met.	Capital in nature – gain on sale is not taxable, expenses are not deductible.	TMs can be sold, as they are personal property.
<i>Licensing</i>	No impact on seller if internally generated.	Potentially black-hole expenditure.	Goodwill can also be sold, but only with the business to which it is attached.
	Licensor recognises income and depreciation.	The right to use a TM is listed in Sch.14 as a depreciable intangible asset; however, see <i>Trustees in the CB Simkin Trust v CIR</i> .	The owner of a TM and/or goodwill embodied in trade dress can license it, either exclusively or non-exclusively.
	Licensee recognises expense and liability.	Royalties received by the licensor are income.	
<i>End of life</i>	If impaired, write off	No provision for impairment or depreciation / amortisation, instead is black-hole expenditure	Registered TMs can lose registration if not renewed, not used or owing to genericide.
	No allowance for gradual decline (i.e. no amortisation/ depreciation).		Goodwill can also be lost, e.g. via loss of reputation.

Proposition 1—TMs and goodwill are less valuable than patents and copyright

Most forms of IP are statutorily limited in duration, but TMs and goodwill are not. One of the reasons for the potentially perpetual protection of TMs and also goodwill is that these are closely tied to a trader. It does not make sense for them to fall into the public domain after a set

amount of time.⁸⁸ Furthermore, TMs and goodwill are considered to be a “weaker” and less valuable form of property compared with other kinds of IP, because of their comparatively limited effect on competition. While patents and copyright can form the basis for market monopolies, this is not generally true for TMs and goodwill, the existence of which alone rarely constitutes

⁸⁷ *Simkin Trust v CIR* [2004] UKPC 55; [2005] F.S.R. 18 at [18].

⁸⁸ The other main reason is that copyright and patents are more anti-competitive. TMs should not prevent competitors from offering similar or even identical products or services. In contrast, third parties want to be able to copy copyright works and patented inventions, which IP prevents.

a barrier to market entry or limits market competition.⁸⁹ In contrast to copyright, design and patents, TMs generally do not offer exclusivity for goods and service themselves, but the signs used on them to denote source.⁹⁰

If TMs and goodwill are less valuable than other kinds of IP, one might conclude that there is, thus, no issue that: (1) internally created goodwill and TMs are not reflected on an entity's balance sheet; and (2) for tax purposes, it is neither possible to deduct the costs of creating TMs and goodwill, nor is it possible to depreciate them once created or acquired. However, the characterisation of TMs and goodwill as a lesser IP is unrealistic in today's world, where a business's brand and reputation (often embodied in TMs) can be worth billions.⁹¹ The franchising business model exemplifies this, as does the ever-growing importance of, and investment in, brand development.

Ensuring investors can assess the value held within an entity is vital for efficient capital markets. A potentially significant component of value being invisible to investors could distort investment behaviour, away from entities rich in "invisible" assets such as TMs and goodwill, in favour of entities with visible patents and copyright assets. This issue is particularly acute when one considers the rationales behind protecting TMs and goodwill as property, discussed in the following.

Proposition 2—TMs and goodwill are static in value

We give property protection to TMs and goodwill to incentivise traders to invest in their goodwill and brands. This is in part for consumer protection. TMs and get-up allow consumers to distinguish between products. In New Zealand, "the essential function of a TM is as a badge of origin",⁹² indicating source of manufacture. TMs and get-up allow consumers to efficiently differentiate between the goods and services of different traders. This mitigates consumer confusion and lowers search costs.⁹³ TMs and get-up can also signify non-source characteristics, such as quality or social standards.⁹⁴ Thus, they allow consumers to make informed decisions. Furthermore, brands can have a lot of value and traders will not invest in them if they are not protected from "unfair competition" and diversion of trade.⁹⁵

A newer phenomenon is to protect certain TMs from "dilution". This protects famous marks from being used in a way that could "dilute" their uniqueness, either by "blurring" their ability to act as a badge of origin,⁹⁶ or "tarnishing" their reputation.⁹⁷ There does not need to be any consumer confusion. The extension of TM protection essentially protects the goodwill itself embodied in famous marks.⁹⁸ It represents a step away from theorising TMs around consumer welfare.

Unsurprisingly, the tort of passing off is similarly justified, and the expansion of the statutory protection to dilution is consistent with passing off.⁹⁹ The tort prevents misrepresentations made in trade (consumer protection), which causes either diversion of trade (unfair competition) or damage to goodwill (dilution).

Overall, both registered TMs and the tort of passing off protect goodwill as property that can be damaged. This is similarly the case in accounting, with impairment testing of goodwill and TMs that are on an entity's balance sheet. Both property law and accounting ignore increases in value to goodwill. In contrast, tax appears to understand the property as being static; there is neither a means to recognise its growth in value, nor can its value shrink and one cannot depreciate it.

Of course, the three regimes have different objectives. There is no reason for property law to consider increases in value of TMs/goodwill. Taxation is primarily focused on calculating tax obligations vis-à-vis income; therefore, changes in value of intangibles have little impact for tax purposes. In comparison, accounting aims to give a true and fair view of: (1) the performance and position of an entity over, and at, a specified time period; and (2) the value of the assets within the organisation in order to provide useful information to shareholders. This being the case, accounting should then be able to take into account increases in value of TMs/goodwill. Historically this was possible, but the new international accounting standards do not allow this. This approach is conservative, but reflects the considerable difficulty with, and subjectivity of, valuation of these intangible assets.

A question that arises from our interdisciplinary examination is why there are different levels of engagement in the literature between the disciplines, namely, more in accounting than in taxation. We suggest

⁸⁹ Economists theorise TMs as being pro-competitive because they lower search costs: W. Landes and R. Posner, "Trademark Law: An Economic Perspective" (1987) 30 *Journal of Law and Economics* 265.

⁹⁰ There are exceptions, such as when TMs protect functional shapes, e.g., *Fredco Trading Ltd v Miller* (2006) 8 N.Z.B.L.C. 101,761 CA.

⁹¹ See, e.g., Kurt Badenhausen, "The World's Most Valuable Brands 2018: By The Numbers" (23 May 2018), <https://www.forbes.com/sites/kurtbadenhausen/2018/05/23/the-worlds-most-valuable-brands-2018-by-the-numbers/#565a4f6a2eed>, referring to Forbes, "The World's Most Valuable Brands" (2018), <https://www.forbes.com/powerful-brands/list/> [Both accessed 10 October 2019], which values the Apple brand as the most valuable in the world, worth US\$182.8 billion, and the 100th most valuable brand, KFC, is worth US\$24.5 billion.

⁹² *Intercity Group (NZ) Ltd v Nakedbus NZ Ltd* [2014] 3 N.Z.L.R. 177 at [98].

⁹³ Landes and Posner, "Trademark Law: An Economic Perspective" (1987) 30 *Journal of Law and Economics* 265. On the centrality of preventing consumer confusion in TM law, see Dinwoodie and Janis, "Confusion over Use" (2007) 92 *Iowa Law Review* 1597. See also M.P. McKenna, "A Consumer Decision-Making Theory of Trademark Law" (2012) 98 *Virginia Law Review* 67, who argues for an even narrower focus on consumer confusion that affects decision-making.

⁹⁴ Sherman and Power, "Law, Accounting and the Emergent Positivity of Intangible Property" (1994) 3 *Social and Legal Studies* 477; B Beebe, "The Semiotic Analysis of Trademark Law" (2004) 51 *UCLA Law Review* 621; Ramello, "What's in a Sign?" (2006) 20 *Journal of Economic Surveys* 547, 559.

⁹⁵ M.P. McKenna, "The Normative Foundations of Trademark Law" (2013) 82 *Notre Dame Law Review* 1839; Chronopoulos, "Goodwill Appropriation as a Distinct Theory of Trademark Liability" (2014) 22 *Texas Intellectual Property Law Journal* 253.

⁹⁶ The blurring argument to dilution is consistent with the economic theory behind TM protection (B. Beebe, "The Semiotic Account of Trademark Doctrine and Trademark Culture" in *Trade Mark Law and Theory* (2008), pp.42, 58.

⁹⁷ TMA 2002 s.89(1)(d).

⁹⁸ Chronopoulos, "Goodwill Appropriation as a Distinct Theory of Trademark Liability" (2014) 22 *Texas Intellectual Property Law Journal* 253.

⁹⁹ S. Todd, "Interference with Intellectual Property" in S. Todd (ed.), *The Law of Torts in New Zealand*, 6th edn (New Zealand: Thomson Reuters, 2013).

that this is driven by the different implications from asset values in the balance sheet for financial accounting and tax purposes. Financial accounting valuations of intangibles can impact on the value of an entity, whereas in most situations the value of intangible assets will not impact on tax obligations.¹⁰⁰

Proposition 3—a core distinction between TMs and goodwill and other IP is that the former are indefinite while the latter are finite

Accounting standards require an entity to assess whether the useful life of an intangible asset is finite or indefinite.¹⁰¹ Because TMs can be perpetually renewed and goodwill will exist so long as a business does, both can potentially have infinite existences. However, in reality, businesses fail. More still, businesses refresh their brands on a periodic basis, acquiring new TMs, and goodwill fluctuates. It is thus correct that accounting treats TMs and goodwill as having indefinite lives, as we do not know exactly how long they will last. However, perhaps a more nuanced view is that TMs or goodwill are reasonably expected to decline in value under normal circumstances. If we recognise that goodwill/TMs can lose value (and, indeed, most do), then the inability to depreciate the subject-matter is illogical.

The reason why goodwill and TMs are not depreciable, but patents, design rights and PVRs are, is that the former are theoretically indefinite in duration, whereas the latter have finite lives. This distinction is arbitrary. Patents have to be renewed annually in New Zealand (many are not and lapse well before the maximum 20-year term is over). Designs have to be renewed every five years, twice to achieve the maximum 15-year period of protection. Both kinds of IP can be challenged and revoked, as can PVRs. It is, thus, incorrect to say that these kinds of property have predetermined finite lives. The actual empirical life span of the different kinds of IP is unclear, regardless of whether some have statutorily delineated maximum terms or not.

Business expenditure that results in an asset, the economic value of which will decline in value, should either be immediately deductible or depreciable. Economic distortions result when the tax system does not provide for such treatment.¹⁰² Yet, expenditure towards creating TMs/goodwill is generally not deductible and these assets are often not depreciable, creating black-hole expenditure.

Proposition 4—the potential for black-hole expenditure will not impact investment in intangible assets

Aligning the tax and accounting treatments for certain expenditures would reduce black-hole expenditure. To create efficient tax systems, most jurisdictions attempt to minimise exploratory investment decisions constituting black-hole expenditure. For example, recommendations from an Australian tax review include that black-hole expenditures should be either expensed, amortised or capitalised, alongside specific write-off provisions for certain types of expenditure that would otherwise be black-hole expenditure.¹⁰³ Moreover, expenditure giving rise to assets of indeterminate, but finite, lives should be accorded statutory write-off.¹⁰⁴

Calls have been made for New Zealand to address the issue.¹⁰⁵ Lui and Elliffe observe the potential for expenditures that cannot be deducted or depreciated resulting in taxpayer reluctance to invest in capital projects or new product development, where there is the potential for black-hole expenditure.¹⁰⁶ They further acknowledge the possibility that New Zealand's low levels of R & D expenditure might result from the tax treatment that allows some expenditures on intangible assets to fall into black-hole expenditure.

Conclusion

From a tax perspective, TMs and goodwill receive little attention. This is probably because, as capital assets, they have little impact on tax revenue, with the exception of when revenue is generated when the intangibles are licensed. In contrast, accounting has invested considerable effort in negotiating a universally accepted accounting treatment of TMs and goodwill. Accounting standards allow for greater expensing of costs associated with TMs and goodwill than tax. Accounting standards also recognise that the value of TMs and goodwill may decline and thus may be impaired through the income statement. No similar provision exists for tax. We also note the inconsistency in allowing the depreciation of some intangibles, such as patents, but the absence of depreciation provisions for TMs and goodwill.

To a certain extent, TMs and goodwill are the least controversial form of IP, compared with copyright and patents. Civil society does not resent that they are legally protected. Stronger protections pushed in international trade agreements do not create much fanfare. Much of this laissez-faire attitude to TM and goodwill protection can be attributed to the four propositions discussed in this

¹⁰⁰ We acknowledge that there are some circumstances in which changes in the value in intangibles will impact on tax obligations, such as in relation to development expenditure.

¹⁰¹ NZ IAS 38, para.88.

¹⁰² Inland Revenue, *Black Hole and Feasibility Expenditure: A Government Discussion Document* (Wellington: Inland Revenue Policy and Strategy, 2017).

¹⁰³ G. Cooper, "Black Holes: More than Science Fiction" (2001) 36 *Taxation in Australia* 93.

¹⁰⁴ See Cooper, "Black Holes" (2001) 36 *Taxation in Australia* 93 for examples of black-hole expenditure and their potential tax treatment.

¹⁰⁵ P. Lui and C.M. Elliffe, "The Problem with 'Black Hole' and Feasibility Expenditure: Some suggestions for reform" (2011) 17 *New Zealand Journal of Taxation Law and Policy* 1.

¹⁰⁶ Lui and Elliffe, "The Problem with 'Black Hole' and Feasibility Expenditure" (2011) 17 *New Zealand Journal of Taxation Law and Policy* 1.

article. While the propositions can be challenged from a purely property law perspective, we have shown that they have consequences beyond this.

We challenge the extant treatment that appears to suggest that TMs and goodwill are less valuable than patents and copyright, and that they are static in their value and less predictable in their lifespan. We suggest

that TMs and goodwill might be more visible and receive more investment if they received the same treatment as other intangible assets. Finally, we recommend alignment of the tax and accounting treatments for intangible assets, in order to minimise black-hole expenditure for intangible assets and encourage investment in them.