Brand Valuation of Garment Companies for Tax Purposes

Rahmat Heryat Furqon[1], Azhar Affandi[2], Jaja Suteja[3], Dadang Suwanda[4]
[1,2,3]Universitas Pasundan, Bandung, Indonesia
[4]Institut Pemerintahan Dalam Negeri, Indonesia
E-mail : rh.furqon@gmail.com

ABSTRACT

Valuation of intangible assets is carried out to determine a certain value objectively and professionally in accordance with regulatory provisions for non-monetary assets with no identifiable or unidentifiable physical form (goodwill). Many intangible assets will not be recognized in the financial statements because they fail to meet the definition of an asset or the recognition criteria. The transfer of Intangible Assets often uses Book Value so that there is no tax obligation, the purpose of this study is to determine the Fair Market Value of Intangible Assets in the form of Brands for tax purposes with valuation that is to carry out financial statement analysis, macroeconomic analysis, industry analysis and application of Approaches and Methods Selected rating. The approach used is using the Income Approach with the Royalty Savings Method, the results of the valuation obtained the Fair Market Value of Brand X of Rp. 23,978,000,000; (Twenty Three Billion Nine Hundred Seventy Eight Million Rupiah).

Keywords: Brand Valuation, Intangible Assets.

INTRODUCTION

This research is intended to determine the Fair Market Value of Intangible Assets in the form of Brands in Garment companies for taxation purposes. Valuation of intangible assets is carried out to determine a certain value objectively and professionally in accordance with regulatory provisions for non-monetary assets with no identifiable or unidentifiable physical form (goodwill) (Direktorat Jenderal Pajak 2016). Taxpayers should report in their SPT the transfer of brands using the market value when the transfer transaction occurred, so far the transfer of brands uses Book Value so that it does not cause taxation aspects. Meanwhile, the Book Value may not fully reflect the company's resources (one of which is due to the presence of unrecorded intangible assets (Rabier 2018).

Brands represent a very valuable piece of legal property, capable of influencing consumer behavior, being bought and sold, and providing security of sustainable future income to their owners (Keller and Brexendorf 2019). Lennard's explanation (2018) in (Visconti 2020) that many intangible assets will not be recognized in the financial statements because they fail to meet the definition of an asset or the recognition criteria. Examples include staff training, brand building through advertising and developing new business processes. Because there are no assets recognized as a result of expenses for these activities, these assets will be reported as expenses which reduce income and impact on the taxation aspect, even though it is done with the aim of increasing financial returns in the next accounting period.

As a consequence of the Indonesian taxation system which adheres to self-assessment, the Directorate General of Taxes can conduct valuation to test the fairness of the value of the transfer of the mark in order to obtain an objective and professional value for the object of assessment according to valuation standards and tax provisions. (Direktorat Jenderal Pajak 2020).

The valuation is carried out by analyzing financial statements, macroeconomic analysis, industry analysis, SWOT analysis and applying the selected Approach and Valuation Method.

METHOD

This research method is to conduct valuation of a brand by following a predetermined structure or stages, because in this valuation there is a hierarchy that serves as a guide in conducting the valuation, which is sequentially, there are valuation approaches, valuation methods and techniques or models (French and Gabrielli 2018).

The valuation Approach used uses the Income Based Approach with the Royalty Saving Method (Relief from Royalty Method)..

RESULT and DISCUSSION

A. Overview

The object of the valuation is an Intangible Asset in the form of a brand owned by PT A transferred to PT B and is one of the well-known clothing brands in the Mall which is mostly designed for women. Brand X has a fashionable clothing style and always follows the latest fashion trends. The clothes launched by Brand X are blouses, tunics, dresses, shirts, outers, skirts, shirts and so on.

1. Analysis of Financial Statements

The position of the Financial Statements in the Business Circulation account experienced an increase between the 2015 fiscal year and the 2019 fiscal year. The increase in business circulation growth between 2015 and 2019 was 15.26% respectively; 9.79%; and 36.98%.

2. Macroeconomic Analysis

Global economic growth is lower than forecast. The continuing tensions in trade relations and a number of geopolitical risks have pushed the risk of uncertainty on global financial markets to remain high and put pressure on trade volume and world economic growth. In line with this, various monetary authorities responded with loose monetary policies that encouraged continued inflows of foreign capital to emerging market countries.

Indonesia's economy in the second quarter of 2019 compared to the second quarter of 2018 (y-on-y) grew 5.05 percent. Growth was supported by almost all business fields except Mining and Quarrying which decreased by 0.71 percent. The highest growth was achieved by Other Services of 10.73 percent; followed by Corporate Services at 9.94 percent; Information and Communication 9.60 percent; and Health Services and Social Activities of 9.09 percent. Based on the source of Indonesia's economic growth in the second quarter of 2019 (y-on-y), the highest source of growth came from the Processing Industry Business Field by 0.74 percent; followed by Agriculture, Forestry and Fisheries by 0.71 percent; Wholesale Trade - Retail, Car Repair - Motorcycles by 0.61 percent; and Construction by 0.55 percent. Meanwhile, Indonesia's economic growth from other business fields was 2.44 percent.

3. Industry Analysis

In the first quarter of 2019, the growth of the textile and clothing industry was recorded at 18.98 percent. This number increased significantly compared to the same period last year at 7.46 percent and also increased from the 2018 gain of 8.73 percent. Based on data from the Central Statistics Agency (BPS) exceeding 18 percent, the textile and clothing industry grew the most. The production of the large and medium manufacturing industry (IBS) in the first quarter of 2019 rose 4.45 percent compared to the same period last year. The increase in IBS production was supported by the production of the apparel industry sector which rose to 29.19 percent due to an abundance of orders, especially from the export market.

Director of the Textile, Leather and Footwear Industry of the Ministry of Industry (Kemenperin) Muhdori said the textile and textile products (TPT) industry is one of the mainstay sectors because it

makes a major contribution to the national economy. Moreover, he said, the textile industry is a sector that is classified as labor-intensive and export-oriented (Kemeperin 2022).

4. SWOT Analysis

SWOT analysis (strength, weakness, opportunity and threat) consists of internal factors that can be controlled and external or environmental factors that may be difficult to control. Both sides are analyzed so that a strategy can be developed to achieve success and have competitiveness. From internal factors, strengths and weaknesses can be identified, while from external factors, opportunities and threats can be identified.

a. *Strength*
- Brand X has a network spread throughout Indonesia and has collaborated with many well-known fashion e-commerce
- Brand X products are sold at affordable prices but with premium quality.
- Brand X products already have customers who are loyal to that brand.

b. *Weakness*
- Brand X products are more famous for their women's fashion products, while other product lines such as men's fashion and sports are still trying to be introduced.

c. *Opportunity*
- The domestic fashion market in Indonesia is still very potential, this is evident from the entry of foreign fashion products into the Indonesian market.
- Indonesia gets a demographic bonus, namely the number of productive age which can reach 60% of the total population, making it very attractive for the fashion market.

d. *Threat*
- The number of competitors from the local fashion industry continues to grow as the industry grows better.
- Many players from foreign fashion products have also entered the Indonesian market.

Based on the four factors in the SWOT analysis above, IFAS (Internal Factor Analysis Strategy) and EFAS (External Factor Analysis Strategy) were analyzed for Brand X. The results of the analysis obtained an IFAS value of 0.8 and an EFAS value of 0.5, so that based on the SWOT analysis chart the company is in Quadrant 2 with analysis the company can carry out a Diversification Strategy to develop its business to be even better.

B. Valuation Process
The valuation process is carried out as follows:

1. Intangible Assets
According to International Valuation Standards (IVS) 210, as described (Fazzini 2018) that valuation of intangible assets can be carried out for various purposes, such as for taxation purposes.

"*intangible asset valuations are frequently needed for transfer pricing analyses, estate and gift tax planning and reporting, and ad valorem taxation analyses. The role of transfer pricing rules is to provide the fair profit allocation, allowing a state to benefit from the productivity and manufacturing carried out in its territory*". Unquestionably "*things become even more complicated when it is necessary to establish a transfer price for intangible assets, since the price of intangible assets may be included in the price of the goods, or the intangible assets could be the independent objects of contracts*"; "Valuation of intangible assets is often required for transfer pricing analysis, property and gift tax planning

and reporting, and ad valorem taxation analysis. The role of transfer pricing rules is to provide a fair allocation of benefits, enabling the country to benefit from the productivity and manufacturing carried out in its territory". Undoubtedly "things get more complicated when it is necessary to set a transfer price for an intangible asset, because the price of an intangible asset can be included in the price of the goods, or an intangible asset can be an independent contract object.

Quoting from the International Financial Reporting Standards (IFRS) that from an accounting standpoint, intangible assets are "non-monetary assets that can be identified without a physical form", while according to International Accounting Standard (IAS) 38 states that these assets are recognized if and only if, the expected future economic benefits attributable to the asset will flow to the entity; and the cost of the asset can be measured reliably.

Therefore, many intangible assets such as internally generated brands do not meet these requirements for accounting purposes (Legland, Llobet, and Lopez-Balcells 2019). Even though brands, knowledge, innovation, and especially human capital are important parts of intangible assets that play an important role in increasing the competitiveness of companies (Sidharta, Sidik Priadana, and Affandi 2019) and able to increase the value of the company. Although most of these intangible assets are not displayed on the company's balance sheet, they have a dominant impact, especially on the company's market value (Jovanović, Rađenović, and Petrović 2020).

Intangible Assets can be identified or not identified. Intangible Assets can be identified if:

1. Separable i.e. capable of being separated or divided from the entity and sold, licensed, leased or exchanged, either individually or together with a related contract, identified asset or liability, regardless of whether the entity intends to do so, or not.
2. Arise from contractual or legal rights, regardless of whether those rights are transferable or separable from the entity or from other rights and obligations
3. Classification of Intangible Assets or ownership rights to the Intangible Assets

being appraised. Classification must be carried out on Intangible Assets which are the object of valuation, among others:

a. Intangible assets related to marketing (marketing related intangible assets). Intangible Assets related to marketing are primarily used in the marketing or promotion of products or services. Examples include trademarks, trade names, unique trade designs, internet domain names and non-compete agreements, for strict pricing definitions of the transfer of marks, but also for fiscal purposes arising from the introduction of tax benefits on income generated by intangible assets. (Aghaei 2020; Bagna et al. 2017).

b. Intangible assets related to customers (customer related intangible assets). Intangible Assets related to customers or suppliers arise from relationships or knowledge about customers or suppliers. Examples include service or supplier agreements, license or royalty agreements, order lists, labor agreements and customer relations.

c. Intangible assets related to art (artistic related intangible assets). Intangible assets related to art arise from rights to gain benefits such as royalties from works of art such as plays, books, films and music, and also arise from copyright protection that is not contractual in nature.

d. Intangible assets related to company contracts (contract related intangible assets).

e. Intangible assets related to technology (technology related intangible assets). Intangible assets related to technology arise from contractual rights or non-contractual rights to use patented technology, non-patented technology, databases, formulas, designs, software, processes or recipes.

f. Intangible Assets originating from the research and development process (In

Process Research and Development / IPR&D Intangible Assets).

Furthermore (Moro Visconti 2020) explains that economic valuation is carried out in terms of estimated royalty rates that are appropriate to be negotiated in a license agreement (brand license) or franchise or other brand extension methods; determination of appropriate leases from branded companies; impairment test (in assessing financial statements, applying international accounting principles); trademark award (with or without company); merger or demerger exchange with a trademark; performance evaluation of brand managers, directors and sales agents, for awards and bonuses; company liquidation and brand sale; sale and leaseback of brands; valuation of the adequacy of documents for consideration regarding trademarks, to verify the applicability of preferential insolvency and insolvency clauses (in the case of undersold brands); asset value of distressed firms; brand transfer/assignment; fiscal estimates of normal values; liens, mortgages, and usage rights over brands, the entire explanation referred to has an impact on the taxation.

2. Commonly Used Valuation Approaches

Three recognized and commonly used approaches are market, revenue and cost. All of these are based on economic principles that underlie pricing and the choice of approach will vary depending on the purpose and nature of the valuation (French and Gabrielli 2018; Lisi 2019).

a. Market Based Approach

With the Market Approach, the value of an Intangible Asset is determined by referring to market activities, for example bid transactions involving identical or similar assets. The heterogeneous nature of Intangible Assets means that it is difficult to find market data from transactions involving identical assets. If anything, this usually relates to assets that are similar, but not identical. As an alternative, or in addition, price comparisons in relevant transactions involving identical or similar assets through analysis of sales transactions may provide comparative data in valuations, for example it may be possible to determine the price to profit ratio or rate of return for a group of Assets Intangible Similar in shape.

b. Cost Based Approach

In applying the Cost Approach, the cost of each component in the creation of an asset, including the developer's profit, must be estimated using existing knowledge at the valuation date. The estimated cost to be used is the New Reproduction Cost (New Reproduction Cost) or the New Replacement Cost (New Replacement Cost) after deducting depreciation.

c. Income Based Approach

The Income Approach is used to determine the value of Intangible Assets, by discounting and/or capitalizing actual or hypothetical income, cash flow, or cost savings that will be generated by Intangible Assets that are the object of valuation using a certain discount rate and/or capitalization .

The methods that can be used in the Revenue Approach to value brands are as follows:

1. Royalty Savings Method (Relief-From-Royalty Method/Royalty Savings Method); The Royalty Saving Method is used to generate value for Intangible Assets by capitalizing the value savings obtained from hypothetical royalty payments by owning or renting. With this method, the value of Intangible Assets is determined by referring to the value of royalty payments hypothetically that can be saved by owning Intangible Assets, compared to paying a license for Intangible Assets to a third party. Hypothetical royalty payments over the life of the Intangible Asset are adjusted for tax and discounted to their present value as of the valuation date. In some cases, royalty payments may include an initial payment in addition to being based on a percentage of revenue or some other financial parameter.

2. Premium Profit Method (Incremental Income Method); The Premium Profit Method is used to generate the value of Intangible Assets by capitalizing the income stream or incremental

cash flow resulting from a comparison of businesses that use Intangible Assets with businesses that do not use Intangible Assets using a certain discount rate or capitalization rate.

3. Excess Earnings Method The excess income. method is used to estimate the value of Intangible Assets by determining the present value of cash flows to be received in the future associated with Intangible Assets using the discount rate or capitalization rate according to the risk of Intangible Assets.

3. Selection of Valuation Approach

Of the several approaches commonly used in valuation as described above, the approach and method chosen by considering the availability of data is the Income Approach and the method chosen is the Relief from Royalty Method.

4. Revenue Approach

The income approach was chosen to be used to assess Brand X with the Royalty Savings Method to generate Intangible Asset value by capitalizing the value savings obtained from hypothetical royalty payments by owning or renting.

With this method, the value of the Intangible Asset is determined by referring to the hypothetical value of royalty payments that can be saved by owning the Intangible Asset, compared to paying a license for the Intangible Asset to a third party. Hypothetical royalty payments over the life of the Intangible Asset are adjusted for tax and discounted to their present value as of the valuation date. In some cases, royalty payments may include an initial payment as well as a percentage of revenue or some other financial parameter.

The technique that can be used to determine the royalty rate hypothetically is based on the market royalty rate for comparable or similar transactions. A prerequisite for this technique is the existence of a comparable Intangible Asset licensed on an arm's length basis and on a regular basis.

5. Determination of the Discount Rate

The discount rate in assessing brand X is using the cost of equity (Ke).

Cost of Equity (Ke)

The discount rate for equity is obtained by applying the Capital Asset Pricing Model (CAPM), namely that the cost of equity is risk-free interest plus a premium to cover the systematic risk of stock securities with the formula:

$$Ke = Rf + \beta (Rm - Rf) \qquad (1)$$

$$Ke = Rf + \beta. Rpm \qquad (2)$$

Where :
Ke = cost of equity
Rf = risk-free rate of return on investment
Rm = expected rate of return
       equity market
Rpm = the difference between Rm and Rf
Taking into account the Rating Based Default Spread (RBDS), the formula becomes:

$$Ke = Rf + (\beta. Rpm) - RBDS \qquad (3)$$

Rf (*Risk free rate*) is the interest rate for instruments deemed to have no possibility of default. In the case of Indonesia, the risk-free instrument to choose from is the long-term government bond interest rate.
In this study, the chosen risk-free instrument is based on government bonds with fixed interest issued by the government, namely the yield rate on Indonesian bonds denominated in Rupiah with a tenor of 10 years, the weighted yield is 8.25% and this figure will be used as the rate of return. risk free (Rf) (KSEI 2022).

Rpm (Equity Risk Premium - ERP) is the difference between the risk-free investment interest rate and the return on investment in the form of investments. The determination of the equity market risk premium includes premiums for country-specific risk premiums such as share price volatility to generate a base equity market risk premium. By taking these risks into account, a discount rate is generated that accommodates changes in short-term sentiment in securities in emerging markets. The Rpm used in this study is

8.60% as of January 1 2019 and the Rating Based Default Spread (RBDS) is 2.15% (Damodaran 2022b).

The Unleverage Beta is 0.65 and the Debt to Equity Ratio (DER) is 34.26% for the apparel industry as of January 2019 (Damodaran 2022a) and the tax rate used is 25% referring to the corporate income tax rate.

To calculate Beta Leverage, the formula used is

$$= Bu \times (1+((1-tax)*DER)) \qquad (4)$$

Where :
Bu = Unleverage Beta
Tax = Tax rate
DER = Debt to Equity Ratio Industry
Based on the calculation above, the Unleverage Beta is 0.82.

To calculate the Cost of Equity using the formula:

$$Ke = (Rf+(BL*Rpm)+Rs)–CDS \qquad (5)$$

Where :
Rf = risk-free rate of return on investment
BL = Beta Leverage
Rpm = Equity Risk Premium
Rs = Specific Company Risk Premium
CDS = Credit Default Spread
Based on the calculation above, the Cost of Equity is 13.13%.

On the basis of the Financial Report the object of the valuation is that the capital structure consists of 74.48% coming from own capital and the remaining 25.52% coming from Government Bank loans with an average interest rate for June 2019 Government Bank investment loans of 10.03%.

To calculate the discount rate (discount factor), the formula used is:

$$= (Kd \times Wd (1-T)) + (Ke \times We) \qquad (6)$$

Where :
Kd = Average interest rate on loans
    Investment Bank Government June 2019
We = Own capital structure
Wd = Loan capital structure
T = Tax rate
Ke = Cost of Equity

Based on the calculation of the formula above, the discount rate / discount factor of 11.70% is obtained.

In table 1 it can be explained that the growth of business circulation is projected at 5.05% per year and revenue is projected over the useful life of the brand, namely for 10 years with a brand obsolescence factor of 10% per year. A 3% pre-tax selling cost savings minus 25% income tax resulting in an after-tax selling cost savings. The discount factor used is 11.70% so that the selling cost savings of the Present Value (PV) after tax are obtained which are then added together. After obtaining the Present Value (PV) multiplied by a tax rate of 25% or tax benefit amortization. The Present Value (PV) of the tax benefit amortization is multiplied by the discount factor for each year to obtain the Present Value. Present Value After tax selling expenses savings added to Present Value of tax benefit amortization, the Brand Value X is obtained.

Table 1. Calculation of Intangible Asset Value in the form of Brand X

(In million rupiah)

Description		Jul-Des 2019	2020	2021	2022	2023	2024	2025	2026	2027	2028	2029
							Year					
Income		62,717	131,768	138,422	145,412	152,756	160,470	168,573	177,086	186,029	195,424	205,293
X brand Economic age	10 10%	100%	95%	85%	75%	65%	55%	45%	35%	25%	15%	5%
obsolescence factor	3%	1,881	3,953	4,153	4,362	4,583	4,814	5,057	5,313	5,581	5,863	6,159
Pre-tax selling expense savings	25%	470	988	1,038	1,091	1,146	1,204	1,264	1,328	1,395	1,466	1,540

Less income tax (25%) After tax selling expenses savings		1,411	2,965	3,114	3,272	3,437	3,611	3,793	3,984	4,186	4,397	4,619
Factor Discount	11.70%	0.946	0.847	0.758	0.679	0.608	0.544	0.487	0.436	0.391	0.35	0.313
PV After tax selling expenses savings Total Present Value (PV)	20,689	1,335	2,512	2,362	2,222	2,089	1,965	1,848	1,738	1,635	1,537	1,446
Tax benefit amortization	25%	517	517	517	517	517	517	517	517	517	517	517
PV of tax benefit amortization		489	438	392	351	314	281	252	226	202	181	162
Number of PVs	3,289											
	23,978											

CONCLUSION

Based on the results of analysis of data and information on the object of valuation and after considering various factors that affect value, the Fair Market Value of the object of valuation of Intangible Assets in the form of Brand X for Garment companies as of June 2019 is Rp. 23,978,000,000; (Twenty Three Billion Nine Hundred Seventy Eight Million Rupiah).

REFERENCES

Aghaei, M. 2020. "Valuation of the Hamrah-e-Aval Brand Based on Brand Valuation Models Using Topsis Multi-Criteria Decision-Making Model." *Journal of Revenue and Pricing Management*.

Bagna, Emanuel, Grazia Dicuonzo, Andrea Perrone, and Vittorio Dell'Atti. 2017. "The Value Relevance of Brand Valuation." *Applied Economics* 49(58):5865–76. doi: 10.1080/00036846.2017.1352078.

Damodaran, Aswath. 2022a. "Levered and Unlevered Betas by Industry." *Https://Pages.Stern.Nyu.Edu/~adamodar*.

Damodaran, Aswath. 2022b. "Risk Premiumfor Other Markets." *Https://Pages.Stern.Nyu.Edu/~adamodar*.

Direktorat Jenderal Pajak. 2016. *SE-54/PJ/2016 Tentang Petunjuk Teknis Penilaian Properti, Bisnis, ATB Untuk Tujuan Perpajakan*.

Direktorat Jenderal Pajak. 2020. "SE-05/PJ/2020 Prosedur Pelaksanaan Penilaian Untuk Tujuan Perpajakan."

Fazzini, Marco. 2018. *Business Valuation : Theory And Practice*. Switzerland: Springer International Publishing;Switzerland.

French, Nick, and Laura Gabrielli. 2018. "Pricing to Market: Property Valuation Revisited: The Hierarchy of Valuation Approaches, Methods and Models." *Journal of Property Investment and Finance* 36(4):391–96. doi: 10.1108/JPIF-05-2018-0033.

Jovanović, Milica, Tamara Rađenović, and Bojan Petrović. 2020. "Brand Valuation as Intangible Asset of Company." *Naucne Publikacije Drzavnog Univerziteta u Novom Pazaru. Serija B, Drustvene & Humanisticke Nauke* 3(1):46–57. doi: 10.5937/npdunp2001046j.

Keller, Kevin Lane, and Tim Oliver Brexendorf. 2019. *Measuring Brand Equity*. Hanover,NH,USA: Springer Fachmedien Wiesbaden GmbH, ein Teil von Springer Nature 2019.

Kemeperin. 2022. "Https://Kemenperin.Go.Id." *Https://Kemenperin.Go.Id*.

KSEI. 2022. "Obligasi Negara Republik Indonesia." *Https://Www.Ksei.Co.Id/Services/Registered-Securities/Government-Bonds/Lc/FR0078*.

Legland, Patrick, Daniel Llobet, and Alejo Lopez-Balcells. 2019. "Brand Valuation A Case Study on Lindt & Sprungli." *SSRN Electronic Journal* (June). doi: 10.2139/ssrn.1496300.

Lisi, Gaetano. 2019. "Property Valuation: The Hedonic Pricing Model – Location and Housing Submarkets." *Journal of Property Investment and Finance* 37(6):589–96. doi: 10.1108/JPIF-

07-2019-0093.

Moro Visconti, Roberto. 2020. *The Valuation of Digital Intangibles*. Switzerland.: Springer Nature; Switzerland.

Rabier, Maryjane R. 2018. "Value Is in the Eye of the Beholder: The Relative Valuation Roles of Earnings and Book Value in Merger Pricing." *Accounting Review* 93(1):335–62. doi: 10.2308/accr-51785.

Sidharta, Iwan, M. Sidik Priadana, and Azhar Affandi. 2019. "Innovative Behavior: The Study of Intellectual Capital Effect on Creative Fashion Industry in Bandung, Indonesia." *Problems and Perspectives in Management* 17(4):404–15. doi: 10.21511/ppm.17(4).2019.33.

Visconti, Roberto Moro. 2020. *Patent Valuation*.