Maximizing Brand Value: Top Tax Strategies for Brand Owners

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As brand owners extend the reach of their brands globally, it is increasingly important to recognize how corporate structures and tax arrangements may benefit or disadvantage the brand owner, particularly in the ownership and licensing arenas. Although such structures often are driven by tax and business considerations, the analysis also should focus on the trademark perspective and efficient global brand management. The global IP context also should be considered, taking into account all related and ancillary IP rights. The following summarizes key tax and trademark background to consider in structuring global brand ownership and licensing, to facilitate an interactive discussion of strategies global companies can use to achieve positive results from the business, IP and tax perspectives.

I. Background

Traditionally, tangible assets were regarded as the primary assets of value for creating and enhancing the competitiveness of an enterprise and company valuation was determined by capital assets such as real estate and equipment. Increasingly, intangibles are being viewed as important strategic assets, although systems of accounting and valuation have not fully caught up with this so that intangible assets typically are not fully accounted for unless obtained through an acquisition.

Nevertheless, brands and related intellectual property assets often constitute the cornerstone of a company’s value. Companies may deploy considerable resources to build up, protect, and enforce their IP assets. Strategically used, IP assets reduce costs, bring in revenue through ability to charge higher prices or through licensing, increase share value, and may be used as collateral for loans or other financing.

Intangible assets (including IP) now are estimated to account for more than fifty percent (50%) of the value of many multinational companies. For some companies, the value of their intangibles may be higher than seventy-five percent (75%) of corporate value.

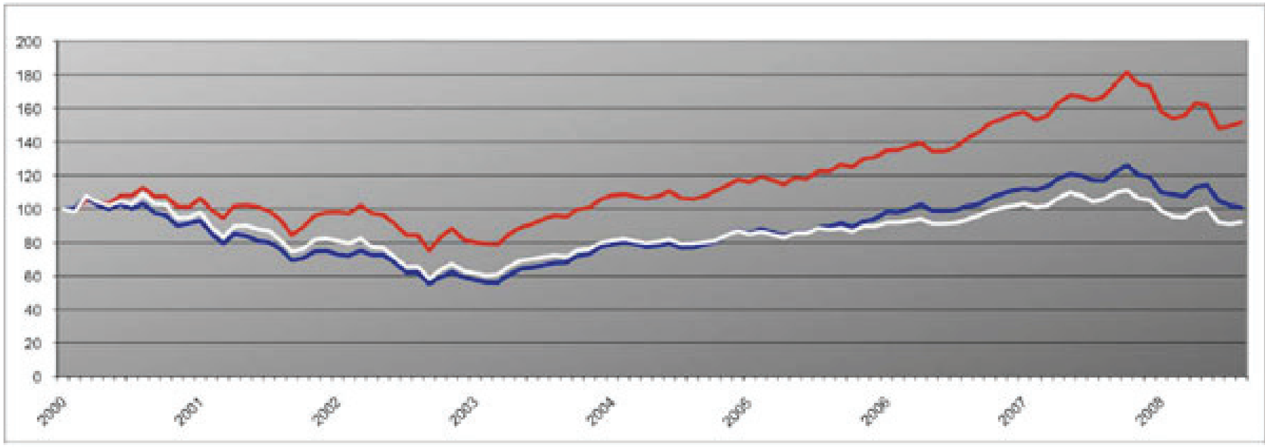
See Figures 1 and 2.

Figure 1—Best Global Brands 2008 (Interbrand)

2008 Rank	2007 Rank	Brand	Country of Origin	Sector	2008 Brand Value ($m)	Change in Brand Value
1	1	Coca-Cola	US	Beverages	66,667	2%
2	3	IBM	US	Computer Services	59,031	3%
3	2	Microsoft	US	Computer Software	59,007	1%
4	4	GE	US	Diversified	53,086	3%
5	5	NOKIA	Finland	Consumer Electronics	35,942	7%
6	6	TOYOTA	Japan	Automotive	34,050	6%
7	7	intel	US	Computer Hardware	31,261	1%
8	8	McDonald's	US	Restaurants	31,049	6%
9	9	Disney	US	Media	29,251	0%
10	20	Google	US	Internet Services	25,590	43%

Source: www.interbrand.com 2008 Interbrand Report

Figure 2—Top 200 Best Global Brands 2007 vs. MSCI World Index and S&P 500 Performance



	BGB Portfolio	MSCI World	S&P 500
Annual Average Return	4.73%	0.05%	-0.92%
Standard Deviation	14.76%	18.02%	15.36%
Sharpe Ratio	0.07	0.00	-0.06

Source: Interbrand
http://www.interbrand.com/best_global_brands_summary.aspx?langid=1000

II. Good Reasons for Being Proactive and Careful in Strategic Tax Planning for IP Assets

An important part of the IP planning and development process is structuring the tax ownership of brands and related IP assets. A wait-and-see approach to international tax structuring can have significant implications for both established businesses as well as start-ups. In particular, the failure to optimize tax structuring with respect to IP ownership can place a company at a major disadvantage to its competitors. Additionally, sub-optimal tax structuring may limit the company's future international tax structuring options, and if not adequately resolved, it may also unnecessarily impede the value realized from the company's IP in terms of its commercial exploitation or eventual sale.

Although brand owners should consider how to maximize brand value by seeking legitimately to minimize tax exposure, this needs to be handled carefully. Where brands are owned and how they are licensed can have enormous tax consequences and can pose significant trademark validity issues if not structured carefully. From the tax perspective, most major countries are stepping up their efforts to make sure they get their fair share of taxable corporate profits. The consequences of implementing inter-company transactions under terms that the taxing authorities does not initially agree with can result in staggering tax adjustments, as illustrated by the U.S. Internal Revenue Service's (IRS's) $3.4 billion settlement with GlaxoSmithKline. From the trademark perspective, the current economic situation also is making significant trademark enforcement litigation more likely, which may lead to more claims of trademark invalidity in defense. While each company needs to find its place on the spectrum of risk tolerance, no company operating internationally can afford to mismanage these important issues in the current environment.

The best practice for structuring global brand ownership and licensing is to manage tax and IP issues concurrently and consistently, with a particular emphasis on trademarks as being the IP assets that have potentially indefinite life spans. Decisions about brand ownership and licensing—whether arising in connection with acquisitions or proactive tax-planning strategy—involve a multi-factor, cost-benefit analysis. On the one hand, the driver of the analysis is the long-term tax strategy, with a view towards structuring brand ownership and licensing in a way that will result in reduced overall income tax over time. On the other hand, there are a myriad of potential issues and pitfalls to manage from both the tax and trademark perspective, particularly in the areas of transfer pricing and trademark quality control.

III. General Tax and Trademark Principles

1. The U.S. Tax Perspective

The U.S. federal government taxes all sources of income realized by its citizen, regardless of where they reside in the world. Similarly, a U.S. corporation is subject to U.S. taxation with respect to all income directly received by such corporation, regardless of its source.

In contrast, a non-U.S. corporation, including one that is wholly owned by a U.S. parent corporation, is not subject to direct U.S. taxation provided the non-U.S. corporation is not engaged in a U.S. trade or business. The delayed application of U.S. taxation with respect to the income that is earned by a non-U.S. subsidiary of a U.S. corporation is referred to as a "tax deferral" benefit. Provided the earnings of a non-U.S. subsidiary are not required to be remitted back to the U.S. parent, those funds can be left offshore and deployed pre-U.S. tax liability, which can lead to a significant savings, especially because many countries have lower corporate tax rates than the United States.

As a result, the IRS is very focused on transactions that transfer IP rights from a U.S. entity to a related company in a non-U.S. jurisdiction. Indeed, the "transfer of intangibles offshore" is among the top-tier enforcement priorities of the IRS. The IRS and other country taxing authorities are examining legitimate related-party transfers of intangibles, including trademarks. These may include transactions in which a U.S. company transfers ownership of trademarks to a non-U.S. jurisdiction holding company, or in which a U.S. company grants a license to use trademarks to a non-U.S. subsidiary.

2. Licensing Across Borders and Transfer Pricing

Transfer pricing refers to the general idea that companies must choose a price or a royalty rate in order to transfer something to a related company across an international border. For multinational companies, there is an inherent tension in managing transfer pricing risk. The outbound taxing authorities and the inbound taxing authorities both want to ensure that the price or royalty is set so that sufficient income is recognized in their respective countries. This natural tension exists but there can be only one price used on the corporate books.

Taxing authorities have addressed this natural tension in part by using a universal standard to test results—the arm's length standard. By requiring the results of a transaction (e.g., royalty rate, a trademark valuation or a product price) to be consistent with the results that would have been realized between unrelated parties, taxing authorities are bound to limit their adjustments to replicate what happens in the real world. The IRS expressly requires the arm's length standard to be applied in every case where there are related parties subject to common control.[1]

In most circumstances, no identical transactions are available to test the related-party license. Valuation of IP assets (and thus reasonable royalties) is an art that is strongly influenced by subjective appreciations, and it is not a science. Thus, the rules allow use of inexact comparable transactions so long as appropriate comparability adjustments are considered and made. If it is not possible to make appropriate comparability adjustments, then unrelated party agreements are generally not useful in applying the arm's length standard. Furthermore, ancillary IP rights that were never itemized or given particular attention can suddenly take on renewed importance when a licensing and royalty agreement is being negotiated (e.g., related know-how, trade secrets, databases, domain names and copyrighted materials).

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1 *ee* generally I.R.C. § 482 and Treas. Reg. § 1.482-1.

The IRS generally will respect the taxpayer's actual transactions so long as the transactions reflect "economic substance." This means that an inter-company license that reflects the actual economic transaction occurring between the related parties generally will be respected if it is commensurate with the type of IP assets involved and their terms of use. If the IRS does not believe that the transaction reflects the actual arrangements between the parties, the IRS may re-characterize the transaction or re-adjust the compensation between the parties. If related parties use each other's trademarks without inter-company licenses or other contracts, the IRS will impute agreements that it believes reflect the economic substance of the arrangement.

As an example, the IRS will look at whether the companies have addressed "incremental marketing intangibles" in a trademark license situation. What the IRS has in mind with this is the idea that a trademark licensee will often make expenditures on advertising, sales personnel and other marketing-related items. These expenditures might lead to an enhancement to the value of the trademark that, in turn, might lead to a benefit in the form of a premium profit or, in the words of economics, premium returns. As explained below, enhancement of the trademark is a well-established concept in unrelated-party trademark licenses and the so-called "inure-to" clause is not typically a significant item of dispute or discussion in a trademark license negotiation between third parties. The IRS, however, might perceive tremendous value in the enhancement to the trademark and reject the common notion that the enhancement of the mark inures to the trademark owner. If the licensor benefits from enhanced value based on the activities of the licensee, then the IRS expects the licensor to pay for those benefits either directly or through reimbursement of the licensee. The IRS might attack the overall structure used by the taxpayer or seek to adjust the amounts exchanged between the parties.

In addition to these serious tax consequences, increased enforcement in this area also implicates trademark issues. The IRS's use of its broad latitude in re-characterizing inter-company trademark licensing arrangements and imputing new terms may well be inconsistent with the approach under trademark law. Where the IRS is seeking to challenge a tax structure involving trademark transfers or licensing, the IRS might even take a position calling into question the validity of a trademark. An adverse decision or evidence on these issues in a tax proceeding potentially could be introduced in trademark litigation as well. This is where managing and licensing trademarks together with other IP assets can be particularly important, and a holistic view of the relevant intangible assets is required.

3. The U.S. Trademark Perspective

Under U.S. trademark law, a trademark owner must at all times control the nature and quality of the products sold under its trademarks. A trademark owner can allow another company to use its trademark, and such use will inure to the benefit of the trademark owner, but only if the trademark owner exercises the requisite degree of control.

In other words, if the U.S. trademark owner directs and controls the licensee, then the trademark owner obtains the benefits of the licensee's use. Indeed, the use of the trademark by the licensee is deemed use of the mark by the trademark owner. If the trademark owner does not exercise the requisite control, then the trademark rights can be lost.

Although these legal issues have not been sufficiently litigated in the U.S. to determine with precision what aspects of quality control the trademark owner must exercise, a U.S. court analyzing a challenge to trademark validity would probably examine certain benchmarks of control, including whether the trademark owner makes final decisions, and has ultimate authority concerning matters relating to the use of the trademark and the quality of the goods and/or services provided under the mark.

Notwithstanding substantial non-tax legal and policy arguments in favor of treating all members of a corporate family as a single economic unit, there is no U.S. statute or case law stating that the control requirement does not apply when the trademark owner and the entity that uses the trademark are affiliates. In one U.S. case outside the IRS context, the control requirement was violated in the case of a wholly owned subsidiary, where control generally would be presumed. In that case, a holding company was found to have forfeited its trademark rights by failing to exercise quality control over its wholly owned subsidiary that used its trademarks.[2]

This means that the licensor in any U.S. trademark license—by the terms of the license and by its actions—should exercise at least minimal quality control.

Although to avoid invalidity the trademark owner should be required to exercise only minimal quality control, the IRS could be less likely to impute alternative arrangements allocating value enhancements to the licensee where there is greater level of quality control by the trademark owner. Accordingly, it is now more important than ever to ensure that any structure for global brand ownership and licensing take into account the longer-term costs of maintaining staffing and procedures to exercise trademark quality control, and ensure that there will be commitment to such operations over time.

[2] *NA Financial Corp. v. Brown*, 162 F.3d 1334 (11th Cir. 1998).

4. Switzerland— A Top Location for Brands

There are many different considerations to balance in selecting the locations to be involved in any global brand ownership and licensing structure. Each company will have its own particular requirements and needs to make its own judgment as to the proper locations for its companies and operations. For the purpose of illustration in this paper, we will use Switzerland as an example to explain some of the factors that make a location beneficial with respect to brand ownership.

Switzerland has become one of the favored locations for involvement in global brand ownership and licensing structures. In a context where multinational companies are rediscovering the value of intellectual property they have developed and acquired over the years, many of them already have moved research and development, licensing or trademark operations to Switzerland. The fast-moving consumer goods industry has been driving this trend. More recently, companies in the fields of biopharma and life sciences have been setting up substantial intellectual property operations in Switzerland.

As an international intellectual property champion (with companies like Novartis and Nestle), Switzerland provides for top-notch intellectual property protection and offers an infrastructure and service industry meeting the highest standards. The country respects privity of contract and although it only recognizes legal ownership when it comes to enforcement and validity issues, it recognizes equitable ownership when it comes to fiscal issues.

Pro-IP courts, adherence to all major international IP treaties, and a strong tradition of international alternative dispute resolution mechanisms, combined with relatively low tax rates and a stable tax climate, Switzerland is probably the preferred on-shore location to hold, own and exploit IP.

From a tax perspective, the favorable features of Switzerland include an ability to obtain advance rulings from the Swiss tax authorities regarding potential tax positions and advantages, pricing arrangements between related companies across borders, and valuation of IP being transferred or licensed.

In a situation where a U.S. company, as an example, is considering the creation of a new subsidiary in another country, a Swiss licensing branch typically combines a company in an excellent treaty jurisdiction with Swiss corporate tax (and IP recognition) benefits.

See Figure 3.

4. Switzerland's Tax Treaty Network

	Withholding Tax Rates		
Country	**Dividend**	**Interest**	**Royalty**
Albania	15/5%	5%	5%
Algeria[a]	15/5%	10/0%	10%
Argentina[b]	15/10%	12/0%	15/10/5/3%
Armenia	15/5%	10/0%	5%
Australia	15%	10%	10%
Austria	15/0%	0%	0%
Azerbaijan	15/5%	10/5/0%	10/5%
Bangladesh	15/10%	10/0%	10%
Belarus	15/5%	8/5/0%	10/5/3%
Belgium	15/10%	10/0%	0%
Bulgaria	15/5%	10/0%	0%
Canada	15/5%	10/0%	10/0%
Chile[i]	15%	15/5%	10/5%
China	10%	10/0%	10%
Colombia[i]	15/0%	10/0%	10%
Croatia	15/5%	5%	0%
Czech Republic	15/5%	0%	5%
Denmark	0%	0%	0%
Ecuador	15%	10/0%	10%
Egypt	15/5%	15/0%	12.5%
Estonia	15/5%	10/0%	10/5%
Finland	10/0%	0%	0%
France	15/0%	0%	5%
Germany	15/0%	30/0%	0%
Ghanai	15/5%	10%	8%
Greece	35/15/5%	10%	5%
Hungary	10%	10%	0%
Iceland	15/10/5%	0%	0%
India	10%	10/0%	10%
Indonesia[c]	15/10%	10%	12.5/5%
Iran	15/5%	10/0%	5%
Ireland	15/10/5/0%	0%	0%
Israel	15/10/5%	10/5/0%	5%
Italy	15%	12.5%	5%
Ivory Coast	15%	15/0%	10%
Jamaica	15/10%	10/5%	10/6/5%
Japan	15/10%	10/0%	10%
Kazakhstan	15/5%	10/0%	10%
Kuwait	15%	10%	0%

a The treaty with Algeria was signed on June 3, 2006. The treaty has been ratified by the Swiss parliament, but ratification by Algeria has not yet occurred.

b The treaty is expected to be applicable as of January 1, 2009, and has been applied on a provisional basis since January 1, 2001.

c A protocol signed on February 8, 2007, will reduce the high withholding tax rate on royalties from 12.5 percent to 10 percent.

d The new treaty, waiting ratification by Pakistan, provides for the following rates: 20 percent/10 percent (dividend), 10 percent/0 percent (interest), and 10 percent/6 percent (royalty).

e After the independence of Montenegro on June 3, 2006, the 2005 Swiss treaty with Serbia and Montenegro will be applied to both Serbia and Montenegroseparately, and both as

	Withholding Tax Rates		
Country	Dividend	Interest	Royalty
Kyrgyzstan	15/5%	5%	5%
Latvia	15/5%	10/0%	10/5%
Lithuania	15/5%	10/0%	10/5%
Luxembourg	15/5/0%	10/0%	0%
Macedonia	15/5%	10/0%	0%
Malaysia	15/5%	10/0%	10/0%
Mexico	15/5%	15/10%	10%
Moldova	15/5%	10/0%	0%
Mongolia	15/5%	10/0%	0%
Montenegro[e]	15/5%	10%	10%
Morocco	15/7%	10%	10%
Netherlands	15/0%	5%	0%
New Zealand	15%	10%	10%
Norway	15/0%	0%	0%
Pakistan[d]	10/15/20%	30/15/0%	0%
Philippines	15/10%	10%	15%
Poland	15/5%	10%	0%
Portugal	15/10%	10%	5%
Romania	10%	10/0%	0%
Russia	15/5%	10/5/0%	0%
Serbia[e]	15/5%	10%	10%
Singapore	15/10%	10/0%	5/0%
Slovak Republic	15/5%	10/0%	5/0%
Slovenia	15/5%	5%	5%
South Africa[f]	7.5%	10/0%	0%
South Korea	15/10%	10/0%	10%
Spaing	15/0%	0%	5%
Sri Lanka	15/10%	10/5%	10/5%
Sweden	15/0%	5%	0%
Thailand	15/10%	15/10/0%	10/5%
Trinidad and Tobago	20/10%	10%	10/5%
Tunisia	10%	10%	10%
Turkey[i]	15/5%	15/10/5/0%	10%
Ukraine	15/5%	10/0%	10/0%
United Kingdom[h]	15/5%	0%	0%
United States	15/5%	0%	0%
Uzbekistan	15/5%	5/0%	5%
Venezuela	10/0%	5%	5%
Vietnam	15/10/7%	10/0%	10%

of January 1, 2007, based on an exchange of notes between the countries ' respective foreign affairs departments.

f A new treaty signed in Pretoria on May 8, 2007, provides for a 5 percent withholding tax rate on parent-subsidiary dividends and a 5 percent maximum rate on interest. The new treaty is awaiting ratification and will likely enter into force as early as January 1, 2009.

g The withholding tax on royalties will be lowered to 0 percent as of July 1, 2011.

h Zero percent on parent-subsidiary dividends, most likely applicable as of January 1, 2009.

i First-time treaty signed and submitted to the Swiss parliament for ratification; possibly applied as of January 1, 2009.

Source: Swiss Federal Tax Administration, Aug. 1, 2008.

IV. The U.S. Taxation of International Structures—In Practice

1. Base Case U.S. Parent Structure

Consider the following fact pattern as a Base Case for purposes of comparison to the other alternative structures discussed. Assume, for purposes of the Base Case, that the U.S. corporation at issue, SuperBev, is incorporated under the law of the U.S. and is subject to a U.S. federal income tax rate of 35% with respect to its taxable income.

SuperBev developed Beverage X via innovation performed in the U.S. and is now moving to launch Beverage X. SuperBev is considered the sole owner of the trademarks and other IP associated with Beverage X. SuperBev manufactures Beverage X at its facilities in the U.S. Beverage X is sold to customers both within and outside the U.S. Assume that SuperBev realizes a pretax profit of $100 per case on all sales of Beverage X.

Because SuperBev is incorporated under the laws of the U.S., its U.S. and non-U.S. profits are subject to direct taxation by the U.S. Thus, regardless of whether the sale is to a U.S. or non-U.S. patient, SuperBev incurs a $35 U.S. federal tax liability with respect to the sale of each case of Beverage X, resulting in an after tax profit of $65 per case.

2. Base Deferral Platform

U.S. companies with profiles similar to that outlined in the Base Case may be able to reduce U.S. tax exposure with respect to non-U.S. sales by deploying a basic deferral planning structure.

Working with the facts outlined in the Base Case, assume for purposes of illustrating the application of a deferral planning strategy, Basic Deferral Platform, that Beverage X develops a fairly substantial non-U.S. market. To better serve the non-U.S. markets, SuperBev decides to form a wholly owned subsidiary in Switzerland, Swiss Sub. Swiss Sub is incorporated under the laws of Switzerland, and pursuant to an advance ruling with the Swiss federal and cantonal officials, Swiss Sub secures a tax ruling resulting in a 10% effective tax rate.

Swiss Sub enters into a nonexclusive license with SuperBev to manufacture and sell Beverage X in all markets outside the U.S. Due to the U.S. transfer pricing rules, the license allowing Swiss Sub to manufacture and sell Beverage X must be made at a market rate—or at arm's length.

As explained above, under the U.S. transfer pricing rules, the arm's length standard, which is the test typically applied in transfer pricing, provides that the terms of a transaction between related parties will satisfy the arm's length standard if the results arising from the transaction are consistent with the results that would have been realized if unrelated taxpayers had engaged in the same transaction under the same circumstances.

Assume, for purposes of illustration, that under the Basic Deferral Platform it is determined that the arm's length pricing on a nonexclusive manufacturing and distribution arrangement (including a trademark license) with respect to Beverage X should be $10 per case. Employees of Swiss Sub, based in Switzerland, perform all manufacturing, testing, packaging, labeling, and storage of Beverage X for the non-U.S. markets. Further Swiss Sub supervises and incurs all marketing and distribution of Beverage X to non-U.S. customers.

Assuming Swiss Sub also realizes a pretax and preroyalty profit of $100 per case under the Basic Deferral Platform, its net profit after the royalty and Swiss taxes are considered would be $81 per case ($100 profit per case, less the royalty of $10, less Swiss tax of $9 on the after-royalty profit). Provided the activities and investments of Swiss Sub are properly structured to avoid triggering the U.S.'s antideferral provisions, the profit of $81 may enjoy deferral from U.S. federal income tax until a later date when such profits are distributed by Swiss Sub as a dividend to SuperBev.

The $10 royalty per case paid to SuperBev under the Deferral Platform would give rise to a U.S. federal income tax of $3.50. Thus, the net profit after taxes to SuperBev with respect to the royalty income would be approximately $7.50 per case.

Under the Base Case, SuperBev realized an after tax profit of $65 per case on all non-U.S. sales. In contrast, the after tax profit realized on the non-U.S. sales under the Deferral Platform would be closer to $88 per case (Swiss Sub's after tax profit of $81, plus SuperBev's after tax profit of $7.50). As illustrated by this simple example, basic deferral planning can give rise to substantial tax savings for a U.S. company with respect to its non-U.S. sales. Those savings can then be utilized by the non-U.S. sub in a myriad of ways such as funding further innovation, the expansion of the non-U.S. business, or a non-U.S. acquisition.

From a trademark perspective, these savings would be offset to some extent by increased costs of administering the trademark license to ensure compliance. Because trademark rights are territorial, the license would need to be drafted consistent with requirements for trademark licenses in any of the applicable non-U.S. countries where the license is in effect. In most European countries, the requirements for trademark licensing require less overall control by the trademark owner than the rights in the U.S. As a result, this structure would be relatively low risk and cost from the trademark perspective.

3. Deferral Platform with Cost-sharing

While there are substantial tax savings to be realized from basic deferral planning, there are increased savings available to the extent the IP associated with the product is not exclusively owned by a U.S. company. Unfortunately, once IP is developed, there are limited planning opportunities available for transferring any portion of such IP to an off-shore entity.

The fact that IP is the central value driver in the U.S. economy has not been lost on the U.S. government, which obviously has a vested interest in protecting the U.S. ownership of such IP. As such, the U.S. government, like most governments throughout the world, has established laws that effectively prohibit the tax-free transfer of IP outside the U.S. A taxable sale of fully developed IP between related entities can be prohibitively expensive, in terms of the tax liability generated from such sales.

Further, any such sale by a U.S. company to a related party will be scrutinized in hindsight by the IRS to determine whether the sale produced an arm's length result. Thus, once IP has been developed, transferring all or a portion of the ownership from a tax perspective can be problematic.

"Cost-sharing" is an alternative structuring technique that can be employed to allow a non-U.S. subsidiary to participate in the development of any IP, and therefore, own, for tax purposes, a portion of the rights associated with such IP. A cost-sharing arrangement is a contractual agreement between two or more related parties to share the costs and risks of the development and use of intellectual property in exchange for a specified ownership interest in the resulting IP.

For U.S. tax purposes, the parties to a cost-sharing agreement are considered to jointly own the IP that is developed pursuant to the agreement—the members obtain "beneficial ownership" as opposed to title ownership which continues to be held by the original owner of the IP. The non-U.S. ownership of the IP is generally only applicable for tax purposes. From an IP law perspective, the IP could be owned exclusively by the U.S. entity, if desired, which is typically the case.

The use and anticipated benefits from a cost-sharing structure can be illustrated using the same basic fact pattern discussed above. Assume for purposes of this example the same facts as set forth in the Basic Deferral Platform example, with the exception that there is no license of IP from SuperBev to Swiss Sub. Instead, SuperBev and Swiss Sub enter into a qualified cost-sharing agreement, pursuant to which SuperBev and Swiss Sub agree to share all the costs associated with the development of Beverage X.

Under the Cost-Sharing Platform, there is no royalty due from Swiss Sub to SuperBev. As such, Swiss Sub will realize a pre-tax profit of $100 per case, which will trigger a Swiss tax liability of $10 per case under the assumed facts. As such, Swiss Sub's after-tax profit would be $90 per case. Provided the activities and investments of Swiss Sub are properly structured to avoid structured to avoid triggering the U.S. antideferral provisions, the after-tax profit of $90 per case may enjoy deferral from U.S. federal income tax until distributed by Swiss Sub as a divided to SuperBev. The Cost-Sharing Platform provides a significant savings when compared to the after-tax profits realized from non-U.S. sales under the Base Case ($65 per case) and the Deferral Platform ($88 per case).

Cost sharing generally is most effective from a tax-planning standpoint when deployed early in the development of newly created IP because the non-U.S. subsidiary does not have to compensate the U.S. parent company (in the form of either a royalty or buy-in payment) for the use of any preexisting IP. Nonetheless, cost sharing can also be effectively deployed with respect to future refinements of existing IP.

From a trademark perspective, however, this sort of arrangement is associated with a higher level of risk. The concept of "sharing ownership" for fiscal purposes needs to be squared with the trademark law principles discussed above. As with the prior scenario, license agreements consistent with relevant local law would need to be addressed and, in this scenario, the offsetting costs of administering the arrangement can be expected to be higher. In addition, the ability to amend any such agreement, or modify the participants as a result of corporate restructuring exercises or other changes, can be rather limited. As with any ownership structure, the relative costs and benefits should be carefully considered.

Conclusion

Multinational brand-centric companies have unique risks and opportunities for minimizing the worldwide tax burden. Every time a brand crosses an international border from one affiliated entity to another, whether attached to a product, a license, or a transfer of ownership to another country, international transfer pricing rules apply.

As companies have expanded globally, most major countries have stepped up their efforts to make sure they are getting their fair share of taxable profits allocated to their tax system. Multinational corporations often have significant flexibility to structure their affairs from both a tax and trademark law perspective. Although tax planning regarding brand ownership or licenses of intangibles are can arise in a number of different scenarios, taxing authorities will be most interested in situations where ownership or licenses of intangibles are granted to an affiliate in a non-U.S. jurisdiction. Concurrent and consistent management of tax and trademark issues reduce risk and provide economic benefit to the multinational enterprise.