

Negative or declining brand values: transfer pricing issues

An idea worth considering | Sept. 10, 2010

Introduction

A brand name is a defined item of intangible property that, if licensed or transferred in certain controlled transactions or controlled transfers, generally is subject to a complex array of U.S. and foreign transfer pricing rules — plus international OECD guidelines.

In general, most of the U.S. transfer pricing regulations are written with the general case presumption that an intangible produces income — not losses. Some might argue that this statement is an oversimplification or an overstatement. However, the current U.S. transfer pricing regulations were originally written and re-written in proposed form during two periods (1992 and 2004–05) when neither the United States nor the worldwide economy were in a state of freefall. Further, in general, the rules neither mention nor imply nor emphasize, by specific provision or example, cases in which an intangible carries a negative value and thus contributes to or proximately causes a periodic or continuing economic or financial loss.

Still, most (if not all) international transfer-pricing regimes apply the arm's-length standard, meaning that multinationals must achieve arm's-length results from their controlled transactions. And in this

connection, the real world marketplace is full of real world evidence and examples of negative intangibles, including negative brands. Indeed, abundant examples exist of declining or diminishing brand values. The causes are multiple: mercury in pet foods, salmonella in eggs, catastrophic hazmat spills, dysfunctional product launches, corporate malfeasance, etc. And in some instances, the diminution in value can be substantial and catastrophic. Take, for example, this well-known case:

Enron is the classic [case study](#) of a complete brand catastrophe. A systematic and well-planned accounting fraud, coupled with massive media coverage and public outrage, doomed the Enron brand. In late 2001, financial transactions that were intended to take unprofitable entities off Enron's books were discovered. The scandal not only destroyed the company, but also accounting giant Arthur Andersen. The negative goodwill created by Enron as shareholders lost everything made the angled 'E' standing outside its corporate headquarters a symbol of corporate fraud and corruption that was too much for the brand to endure.

Not all examples are so dramatic or spectacular. Yet clearly, brands can and do diminish in value. See "[10 Biggest Brand](#)

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[Disasters of 2010](#),” Oct. 8, 2010,
Comcast.net Finance.

Given that intangibles — and brands specifically — can diminish in value, what happens for transfer pricing purposes? Suppose that a multinational establishes a transfer pricing regime in which it transfers or licenses an intangible — a brand name — in a controlled transaction and then the value drops. Or consider a case in which a multinational transfers a diminishing brand in order to develop, revive or resuscitate it (or perhaps even to “kill it”). What happens under the transfer pricing rules, and what if anything can be done to address the issue properly and manage the tax risks appropriately?

Transfer pricing and “brand name”

First, some background... The U.S. Internal Revenue Code (IRC) and the corresponding Treasury regulations both specify that a brand name is an intangible for purposes of IRC Section 482. This means that certain brand name transactions can fall within the provisions of:

- Treas. Reg. Sec. 1.482-4, methods for determining true taxable income in connection with controlled transfers or licenses of intangible property;
- Treas. Reg. Sec. 1.482-7, methods for determining true taxable income for cost sharing arrangements;
- IRC Section 367(d), which governs certain outbound transfers of intangible property from a U.S. corporation to a foreign corporation; and
- IRC Section 936(h), for determining certain intangible property income.

Adding to the complexity is the U.S. statutory rule that the “income with respect

to” a transfer or license of intangible property “shall be commensurate with the income attributable to the intangible.”

Although a complete discussion of this rather insidious legalese is beyond the scope of this publication, it perhaps is sufficient to state (in an admittedly oversimplified fashion) that the IRS requires upward adjustments if a taxpayer understates intangible income, but precludes refunds (e.g., by amended returns) if a taxpayer overstates the intangible income (see generally Treas. Reg. Sec. 1.482-1(a)(3), -4(f)(2), -7).

Neither the IRC nor the Treasury regulations define a brand name.

A **brand** is a name or symbol used to identify the source of a product. It can add significant value when it is well recognized and has positive associations in the mind of the consumer. This concept is referred to as **brand equity**. Further, brand equity is an intangible asset that depends on associations made by the consumer. Strong brand equity can:

- facilitate a more predictable income stream;
- increase cash flow by increasing market share, reducing promotional costs and allowing premium pricing; and
- act as an asset to be sold or leased.

However, brand equity is not always positive in value. Some brands acquire a bad reputation that results in negative brand equity, which can be measured by surveys in which consumers indicate that a discount is needed to purchase the brand over a generic product. (Source: [NetMBA Business Knowledge Center](#).)

The perfect storm

The foregoing lays the groundwork for identifying the perfect storm. First, we operate with complex transfer pricing rules that presume (or at a minimum, start from the general case assumption) that all intangibles generate income. Second, those rules generally preclude (at least from the U.S. perspective) downward adjustments, e.g., refunds, when intangible values (and therefore, income from those intangibles) diminish. Third, the rules require that a multinational achieve arm's-length results, i.e., the results that uncontrolled taxpayers would achieve in similar transactions under similar circumstances. As discussed above, because the real world contains multiple examples of loss generating (or loss complicit) intangibles, the result is the perfect storm: a multinational with controlled transactions in IP must achieve arm's-length results by working with multiple sets of often conflicting rules that do not seem to contemplate, recognize or arguably allow for the fact that in the real world, companies can (and do) lose money.

What to do

The issues surrounding negative intangibles (negative brands, etc.) are extremely complex. And they are relatively cutting edge in the world of transfer pricing, where governments do not typically update or modify their transfer pricing rules and regulations with every passing or lingering economic cycle. Fortunately, Grant Thornton's transfer pricing professionals have given a great deal of recent thought to negative intangibles and diminishing intangible values. They have developed a series of recommendations for proactively managing the associated tax risks.

Has your company or client been experiencing a diminution in brand equity or has your company otherwise been experiencing a negative intangible? If so, please contact your local Grant Thornton transfer pricing professional to discuss how best to address your specific situation.

Examples: diminishing brand value

Using brand valuation data from BrandZ and Interbrand, *DailyFinance* and *24/7 Wall Street* chose 10 big-name brands operating in the United States that have lost substantial chunks of their brand valuations in the first half of this year.

1 **BP**

Brand value Jan. 1, 2010: \$20 billion
Brand value June 30, 2010: \$0
Change: -100 percent

2 **Dell**

Brand value Jan. 1, 2010: \$16 billion
Brand value June 30, 2010: \$9 billion
Change: -44 percent

3 **Adobe**

Brand value Jan. 1, 2010: \$7 billion
Brand value June 30, 2010: \$4 billion
Change: -43 percent

4 **Sony**

Brand value Jan. 1, 2010: \$12 billion
Brand value June 30, 2010: \$7 billion
Change: -42 percent

5 **Goldman Sachs**

Brand value Jan. 1, 2010: \$16 billion
Brand value June 30, 2010: \$10 billion
Change: -38 percent

6 Research in Motion

Brand value Jan. 1, 2010: \$25 billion
Brand value June 30, 2010: \$16 billion
Change: -36 percent

7 Nokia

Brand value Jan. 1, 2010: \$40 billion
Brand value June 30, 2010: \$27 billion
Change: -33 percent

8 Johnson & Johnson

Brand value Jan. 1, 2010: \$45 billion
Brand value June 30, 2010: \$33 billion
Percent change: -27 percent

9 Google

Brand value Jan. 1, 2010: \$100 billion
Brand value June 30, 2010: \$74 billion
Change: -26 percent

10 Toyota

Brand value Jan. 1, 2010: \$30 billion
Brand value June 30, 2010: \$24 billion
Change: -20 percent

Source: "[10 Biggest Brand Disasters of 2010](#)," Oct. 8, 2010, *Comcast.net Finance*.

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