

Organization for Economic Cooperation and Development
Paris,
France

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**Request Concerning the Revised Discussion Draft on
Transfer Pricing Aspects of Intangibles**

I, Thangadurai V.P, am pleased to provide the following response to OECD's invitation to public comments regarding the "Revised Discussion Draft on Transfer Pricing Aspects of Intangibles". I am a practicing Tax Advocate based out of India.

I would like to provide my comments to the Discussion Draft on Intangibles in the context of '**Brand**' from the perspective of Indian Transfer pricing which in my opinion would be the view of all the developing countries. I would also like to quote the decisions of Indian Courts of law for the sake of brevity.

Synopsis of my comments:

- Economic Ownership Vs Legal Ownership of the Intangible
- Creating an Intangible value to the Brand Vs Creating an Intangible value to the product of the Brand

My Comments:

1. Economic Ownership Vs Legal Ownership of the Intangible

The Discussion Draft on Transfer Pricing Aspects of Intangibles proposes to evaluate the intangibles by first (i) *Identifying the Intangibles and then by (ii) **identifying the parties which are entitled to Intangible related return**, (iii) Nature of controlled transactions and (iv) remuneration that would be paid between the independent parties for use or transfer of intangibles.*

A perusal of the Discussion Draft of the OECD on TP Aspects of Intangibles would lead us to a conclusion that '**ECONOMIC CONTROL**' plays the pivotal role in determining the parties which are entitled to intangible related return. The OECD seems to have played down on the legal ownership of the intangibles by stating that the legal ownership can at best help us to arrive at a conclusion about the existence of the intangibles but certainly cannot be decisive factor in determining the parties which are entitled to intangible related return.

As per OECD Discussion draft [Para 54 of the Discussion Draft on the Transfer Pricing Aspects of Intangibles], a party can be determined to be a party who is entitled to intangible related return it should be in substance

- ***“Perform and control important functions related to the development, enhancement, maintenance and protection of the intangibles and control other related functions performed by independent enterprises or associated enterprises that are compensated on an arm’s length basis;***
- ***Bear and control the risks and costs related to developing and enhancing the intangible;***
- ***[Inserted by Para 89 of the Revised Discussion draft]Provides all assets necessary to the development, enhancement, maintenance, and protection of the intangibles; and,***
- ***Bear and control risks and costs associated with maintaining and protecting its entitlement to intangible related returns.”***

From the above, it is clear that the OECD makes the party who undertakes most of the functions, who bears most of the risk and the party who provides all the assets necessary to the development of intangibles- a party who is entitled to intangible related return. In other words, a party who undertakes functions, bears risks and provides assets to the development of an intangible will be considered as the owner of that intangible.

Whereas the Indian Courts have categorically held that the ***legal ownership of the intangible*** is the only criteria for determining the ownership of the intangible ***and not the economic ownership of the intangible.***

It was first decided in the case of **L.G.Electronics India Pvt. Ltd Vs Assistant Commissioner of Income Tax [Reported in ((2013) 140 ITD 41 (Delhi)(Special Bench)]** and was later followed in as many as 20 odd cases. The back ground of the case is as follows:

LG India Pvt. Ltd is a wholly owned subsidiary of the Foreign AE. It has a manufacturing unit in India where it manufactures the patented products of the foreign AE and was allowed to sell the manufactured products to Indian customers alone. During the year under consideration, the LG India incurred considerable amount of expenditure towards Advertising, Marketing and Promotional activities (AMP Expenditure). The Indian Transfer Pricing Officer scrutinized the expenditure made by LG India and held that LG India has incurred the AMP expenditure beyond the arm’s length range which ought to be reimbursed by the foreign AE of LG India. During the appeal proceedings, LG India took a stand that LG India became the economic owner of the brand ‘LG’ in India since it has exclusive manufacturing rights in India and also that the AMP expenditure was incurred to increase the brand value of ‘LG’ in India which is ultimately going to benefit LG India. Moreover, LG India bears almost all the risks undertakes all the functions with respect to promoting the brand of LG in India and hence, LG India is the economic

owner of the brand. However, the appellate court has dismissed the contentions of economic ownership and held as follows:

*“10.2. We do not find any weight in the contention put forth about the economic ownership and legal ownership of a brand. **It is not denied that there can be no economic ownership of a brand, but that exists only in a commercial sense. When it comes in the context of the Act, it is only the legal ownership of the brand that is recognized.** If we accept the contention of the Id. AR that it be held as an economic owner of the brand or logo of its foreign AE for the purposes of the Act and hence expenses incurred for brand building, which is legally owned by the foreign AE, should be allowed as deduction in its hands, then incongruous results will follow. It is patent that a manufacturer does not ordinarily sell its goods directly to the ultimate customers. There is normally a chain of middlemen ending with retailer. Going by that logic and descending in the line, the distributors or wholesalers to whom the assessee sells its goods, also become economic owners of the brand on the parity of reasoning that they also exploit the brand for the purpose of selling the goods to retailers. Similarly the retailers also become the economic owners of the brand on the premise that on the basis of such brand they are selling the goods to the ultimate customers. All these middlemen and the assessee can be considered as economic owners of the brand only in a commercial sense for the limited purpose of exploiting it for the business purpose, which is otherwise legally owned by the foreign AE. **Such economic ownership is nothing more than that. Suppose the foreign company, who is legal owner of the brand, sells its brand to a third party for a particular consideration, can it be said that the Indian assessee or for that purpose the wholesalers or retailers should also get share in the total consideration towards the sale of brand because they were also economic owners of such brand to some extent? The answer is obviously in negative.** It is only the foreign enterprise who will recover the entire sale consideration for the sale of brand and will be subjected to tax as per the relevant taxing provisions. There can be no tax liability in the hands of the Indian AE or the wholesalers or the retailers for parting with the economic ownership of such brand under the Act. In that view of the matter we are of the considered opinion that the concept of economic ownership of a brand, albeit relevant in commercial sense, is not recognized for the purposes of the Act.”*

Thus, according to the Indian Courts it is only the legal ownership that matters when it comes to the determination of the owner of the brand and concept of economic ownership could be used only in the commercial sense and not in the legal sense.

In my view, the Indian tax administrators or any developing country's tax administrators will never accept to the concept of economic ownership of the intangibles because there will be major revenue loss to the tax department. The reason being, the developing countries like India will have a lot of *wholly owned subsidiaries* of the foreign AE and as per the OECD's discussion draft most of those wholly owned subsidiaries will become the economic owner of the brand of the foreign AE and the extraordinary (or above arm's length range) marketing expenditure incurred by the Indian AE to promote the brand of the foreign AE need not be reimbursed by the foreign AE. In other words, those extraordinary expenditures will not be brought under the ambit of taxation but can be claimed as legitimate expenditure as per OECD discussion draft which no developing country's tax administrator will accept.

2. Creating an Intangible value to the Brand Vs Creating an Intangible value to the product of the Brand:

In my view, there could be multiple 'brand' intangibles to a single party which were neither discussed by the OECD nor by the Indian TP regulations. The concept of multiple 'brand' intangibles can be best explained by providing practical examples.

Example1: Ford, India is a wholly owned subsidiary of Ford USA. Every year, Ford India incurs certain amount of expenditure towards advertisement in media, etc. During one particular year, Ford India introduces new product called 'Ford Fiesta' in to the market and incurs heavy expenditure to boost the sales of the product 'Ford Fiesta'. The expenditure incurred should be considered as expenditure incurred for the promotion of the brand 'Ford Fiesta' and should not be considered as expenditure incurred for the promotion of the brand 'Ford' (or only some portion of the expenditure incurred for the promotion of brand 'Ford Fiesta' should be considered as expenditure incurred for the promotion of brand of 'Ford'). The reason being, assume a situation where the product 'Ford Fiesta' becomes a failure in the market, the failure of the product 'Ford Fiesta' is not going to affect the sales of other products of the brand 'ford' unless there is a series of flop products by Ford India. Hence in my view, the marketing expenditure incurred on 'ford fiesta' might not develop the brand 'ford'.

Example 2: Similarly, assume a situation where the product 'Ford Fiesta' becomes a hit in the market, over a period of time (say 4-8 years) Ford India will eventually abandon the product 'Ford Fiesta' and introduce a new product with enhanced facilities to thrive in the market. In this case also, the marketing expenditure incurred to promote the sales of the product 'Ford Fiesta' is not directly going to enhance or develop the brand 'Ford' but only the sales of the product 'Ford Fiesta' and when a new product is being introduced by the tax payer, it again has to incur heavy marketing expenditure to boost the new product.

Hence, the ascertainment of which marketing expenditure develops which 'brand' is crucial. However, it cannot be denied that success of the product of the brand develops the value of entire

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brand itself. In the same way, marketing expenditure incurred by the tax payer to promote the 'SUV segment car' may be higher when compared to the marketing expenditure incurred to promote the 'sedan segment car' owing to difference in the competition for the products. In my view, it should also be taken in to account while identifying and valuating the intangibles.