

# The management of intangible assets is challenged by transfer pricing controls: a question of legal ownership and economic ownership

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FashionFR SAS is a French company specialized in the manufacturing and selling of prêt-à-porter clothing. The company has internally developed an exclusive and very successful clothing brand, for which it has several registered French trademarks. In 2020, as part of a company restructuring, FashionFR sold all of its French trademarks to its Luxembourg subsidiary, FashionLux Holding, for a total of €5 million. Since this disposal of its French trademarks, FashionFR has been paying FashionLux an annual royalty of 4% of its turnover for the commercial use of these same trademarks. While this practice is legally sound from an intellectual property rights perspective, the question remains, is it compliant with existing OECD transfer pricing guidelines and French transfer pricing legislation?

## I. Legal mapping: The first step in the analysis

### A. The OECD conceptual framework

According to the OECD Transfer Pricing Guidelines of 2022, (hereinafter “**OECD Principles**”), the determination of legal ownership is a fundamental step in transfer pricing analysis. As set out in paragraph 6.42: *“Determining the legal ownership and contractual arrangements of the assets in question is an important first step in the analysis.”*

Like many legal systems, the French civil law also recognizes a close relation between legal ownership and the right to enjoy the fruits of property. Article 544 of the French Civil Code states that *“ownership is the right to enjoy and dispose of things in the most absolute manner.”*

In the present case we are studying, FashionLux Holding indisputably holds the legal ownership of the trademarks following their transfer in 2020. The transfer agreements were formalized, and the new registrations were made with the relevant industrial property offices, with the Luxembourg company listed as the legal owner of the rights.

### B. The French legal framework

French tax law addresses this question in particular through Article 57 of the French General Tax Code.

This provision, reinforced by the French Finance Act of 2024, gives the tax authorities the legal power to adjust transfer prices that deviate from the arm's length principle.

The documentary obligation in France, specified in Article L. 13 AA of the Tax Procedures Code, requires companies to submit a file which includes "a list of the main intangible assets held (patents, trademarks, trade names, know-how, etc.) in relation to the company being assessed" (BOFiP BOI-BIC-BASE-80-10-20 §160). Similarly, for the annual transfer pricing declaration (form 2257-SD), it is specifically stipulated that the taxpayer is required to disclose the intangible assets related to the reporting entity's activity and to identify the legal owner of these assets. (BOFiP BOI-BIC-BASE-80-10-20 §450).

In the case of FashionFR, the company would have to declare the registered trademark (and therefore its change of legal owner) and provide detailed documentation on the terms of the 2020 disposal and the subsequent licensing agreements, as well as providing justification for the pricing applied. This legal mapping constitutes the basis for analyzing the validity of the royalties in principle, although it is not in itself sufficient to justify the arm's length nature of the agreed amount of compensation.

### C. The limitations of a purely legal approach

Experience shows that a traditional legal analysis presents significant limitations in the context of multinational groups. The potential to easily separate legal ownership from economic substance has sometimes resulted in artificially constructed tax optimization schemes. This is why the OECD has developed an economic ownership approach, which is set out in the latest versions of its Principles.

## II. An analysis of economic ownership and a comparison with legal ownership

### A. The framework of a DEMPE analysis

The OECD Principles have introduced a new approach which is that of the concept of

economic ownership which is determined on the basis of a DEMPE analysis (Development, Enhancement, Maintenance, Protection, Exploitation). **Simply holding the legal title to industrial property rights is therefore no longer sufficient to warrant the recognition of all income derived from the exploitation of the asset in question.**

Paragraph 6.48 states that "it is therefore necessary to determine [...] which party or parties are engaged in the development, enhancement, maintenance, protection, and exploitation of the intangible assets or which exercise control over these functions."

If we apply this framework to the analysis of the case in point:

- **Development:** The brand FashionFR was created entirely by French design and marketing teams. The company has invested €12 million over four years in developing and promoting the brand and has employed a team of 15 specialized designers and marketing managers.
- **Enhancement:** Since the disposal, FashionFR has continued to enhance the brand by investing €2 million annually in its marketing and design. FashionLux has no actual technical team and does not participate in the brand's ongoing enhancements.
- **Maintenance:** The protection of the brand's intellectual property rights is ensured by FashionFR, which manages the renewals and oppositions of these. FashionLux simply approves the proposed budgets.
- **Protection:** Although FashionLux is the legal owner of the brand, it is FashionFR that oversees the intellectual property protection strategy, takes action against infringements and negotiates licensing agreements with third parties.
- **Exploitation:** FashionFR markets the products directly under the exclusive brand name / trademark and generates the group's entire revenue under this brand.

## B. The consequences on remuneration

Paragraph 6.54 of the OECD Principles draws the following conclusions from this analysis: "If the legal owner does not control and perform the functions related to the development, improvement, maintenance, protection, and exploitation of the intangible asset in question, **it should not be entitled to any ordinary benefits attributed to the outsourced functions.** Depending on the specific case, the arm's length remuneration to be paid by the legal owner to other associated entities that perform, or control functions related to the development, improvement, maintenance, protection, or exploitation of the intangible assets in question is equivalent to any proportion of the total income derived from the exploitation of those intangible assets."

The application of this principle may lead to the reallocation of all or part of the income derived from the licensing of trademarks owned by the legal owner to the associated entity or entities which directly or indirectly perform the different DEMPE functions.

In our case study, an analysis of the DEMPE functions shows that FashionFR performs practically all of the brand's value-creating functions. Consequently, all or part of the royalties received by FashionLux should be reallocated to the former as remuneration for the DEMPE functions performed.

## C. The approach based on French case law

The *Conseil d'État* (CE, 9th-10th chambers combined, Nov. 23, 2020, No. 425577) has progressively adopted this approach in its case law. In the 2020 ruling, the high administrative court affirmed, if not explicitly stated, that a company that bears the costs of a flagship store (the company's main store and showcase) should be entitled to remuneration for this function i.e. enhancing the brand.

The mere fact of having legal ownership of an intangible asset no longer gives an entity the exclusive right to receive all the proceeds from the exploitation of the asset. **From now on, the**

**economic owner is recognized as being entitled to receive all or part of the underlying royalties based on the findings of the DEMPE functional analysis.**

## D. The practical challenges of tax audits

In the event of a tax audit conducted in France on transfer pricing related to the use of intangible assets, it is incumbent upon the taxpayer to prove to the tax authorities that the DEMPE functions are actually performed by the entity that is the legal owner and beneficiary of the royalties.

For this purpose, it is necessary to:

**Document the different development functions:** organization charts of the design and marketing teams, job descriptions of the product designers, the planning of brand creation projects, etc.

**Provide evidence of the enhancement functions:** historical records of marketing and rebranding campaigns, investments made in marketing and design, the dedicated teams, satisfaction surveys performed, etc.

**Provide justification for the functions of maintaining and adapting intellectual property rights:** procedures for the renewal of rights, additional forms of protection, etc.

**Demonstrate the defense functions being used:** the strategy for defending intellectual property rights, identification of infringements, oppositions and infringement proceedings, etc.

**Perform an analysis of the exploitation functions:** identification of revenue-generating elements, mapping of license or sublicense agreements, etc.

Our unique approach combines both the legal and tax aspects of the client issues at hand, ensuring full compliance and providing optimal solutions that are tailored to each situation.

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