IP management: Brand royalties for a fuel company

In the sixth in a series of 10 articles on tax-effective intellectual property (IP) management, Bastian Gottschling, Philip de Homont, and Alexander Voegele of NERA Frankfurt present a case study on brand royalties for a fuel company.

How do you prove that motorists are willing to pay not just for fuel, but also for a brand? This question arose for a large multinational fuel company when tax authorities in one major country denied the deductibility of brand royalties that the company was charging to its downstream subsidiaries worldwide.

The tax authorities argued that motorists would not pay one cent for the brand and only cared about the location of fuel stations, the price of the fuel, the friendliness of service staff, and the presence of convenient stores – but not about the brand.

In turn the fuel company asked NERA to find out if motorists would pay extra for the brand. Our approach was based on a simple principle that was carried out rigorously: We directly asked motorists how much more they would pay through a consumer survey.

The survey was conducted at the company's fuel stations on several sites across the country. Interviewees were presented with a hypothetical alternative fuel station of an unfamiliar brand, but otherwise equal characteristics. They were asked how often they would refuel there and what discounts would be needed to make them switch to the alternative station.

Various characteristics of both the fuel stations and the interviewees needed to be taken into account to eliminate the effects of location, the time of day (due to commuting routes), and the presence of convenience stores, among others, and to ensure a good sample. An appropriate spread of interviewees encompassing potentially relevant demographic factors, such as gender, age, and occupation, was ensured.

We found that the brand was in fact important to motorists, and that considerable discounts would be needed to compel them switch to other stations. The implication is that they were indeed willing to pay more for the branded fuel. More importantly even, motorists were not only willing to pay more at the branded stations, but they also refuelled there more frequently.

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Brand royalty

In economic theory these effects relate to the concepts of price- and quantity-premiums that firms enjoy as a brand changes the demand curve for their products. NERA calculated the ensuing benefit to the local fuel stations, controlling for respondents' consumption patterns, such as average commuting or travel distances and the type of fuel purchased in a random sample. Variable costs had to be subtracted from the additional sales volume, while the price-premium could be directly translated into a commercial benefit.

In a final step we analysed the different contributions to the estimated brand value and distinguished between global branding by the HQ, local branding and research and development to identify the benefit of global branding.

The consumer survey and economic analysis revealed the substantial benefit that the global brand brought for the local subsidiary in its market. This was translated into a brand royalty.

The identified brand royalty is fair and based on real-world data, gathered directly in the market. It was proven that the charged royalty was within a reasonable range. Sales entities continue royalty payments to the principal in a tax efficient country, and as a result, taxes are reduced significantly.

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Alexander Voegele has more than 25 years of experience in transfer pricing. He has led hundreds of transfer pricing projects and provided economic advice on numerous defense cases for a variety of clients in a wide range of industries.

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