**SEPARATELY INCORPORATING YOUR BRAND: THE CASE FOR AN INTELLECTUAL PROPERTY HOLDING COMPANY**

*This is the second-post in a multi-part series dealing with the income tax imposed on professional athlete earnings. This post reveals potential benefits of using an Intellectual Property Holding Company to manage the brand of an athlete.*

Hypothetical:I am an athlete. I have spent my life training and building my brand. I recognize endorsement and advertising opportunities as well as franchising will likely account for a substantial portion of my future earnings. Without my brand, my current and future economic potential diminish. I need a way to market myself and at the same time, protect my brand from infringement, fraud, lawsuits and maybe even save a little tax money in the process?

Greg Norman’s “Shark” is an iconic logo and part of the Greg Norman Company which he leads as the Chairman and CEO. I will admit, I do not know how his various product lines and services are structured, but each division of his company from his clothing line, eyewear brand, luxury estates, golf course design firm or restaurant (the Australian Grille) uses the “Greg Norman” name, the term “The Shark” or his “Shark” logo to promote, advertise and endorse their products or services. It is absolutely clear: his endorsement can make a business thrive -- to the tune of hundreds of millions of dollars in fact. In his case, and in many others, using an Intellectual Property Holding Company (IPHC) to manage the brand, could procure a number of potential benefits.

To use an IPHC, an athlete incorporates their intellectual property into a subsidiary, separate and apart from themselves. Then the IP is managed as its own business. For example, one would create a Delaware (or a jurisdiction with no corporate tax) Limited Liability Company (LL.C.) and make that entity the owner of the intangibles. Using the example above, “Greg Norman”, the term “The Shark” and the actual “Shark” logo would be the intangibles. There are more than a few non-tax related reasons to do this, and the reasons are important when it comes to justifying the tax benefits that happen to result from protecting the brand – I’ll briefly touch on two of the top non-tax considerations below: limited liability and franchising. Then, we will talk state & local tax.

Limited Liability: A properly formed limited-liability structure is a separate entity from its owners and employees which serves to limit the liability of their personal assets, when sued. In the event the athlete is sued, the IPHC insulates the intellectual property, protecting the IP (and perhaps, investors) from the claims of creditors.

A modern trend in professional sports is to use the morals clause to void contracts when a professional athlete behaves in a way which is deemed inappropriate.[[1]](#footnote-1) Entertainers and all public figures are facing the same threat, as their choice of endorsements or perhaps their Tweets get the better of them. In 2003, Kobe Bryant’s sexual assault accusations didn’t lose him a spot on Nike’s roster and Nike waited a month before Michael Vick was indicted for running a dog-fighting ring before terminating his contract. These days, a wayward tweet or a mere accusation of sexual assault can have immediate and devastating effects. The effects do not necessarily destroy the value of the intellectual property, as even after certain events and lawsuits, athletes and entertainers sign book-deals, make movies and find other outlets to capitalize from their celebrity status. But like it or not, lawsuits for outrageous, inappropriate or harmful behavior have become the norm. It goes without saying that protecting the brand and the investors has to be a consideration in this climate. But wait, there’s more…

Investors & Franchising: For athletes seeking to expand their brand, they may seek investors, who would also benefit from the limited liability structure because lawsuits against the athlete or her company, separate from the IPHC, would be sued directly, with the effect of shielding the IP from the lawsuit. Investors may simply invest capital, or they may want to pick-up a franchise using the famous mark as the foundation for a successful business venture. For example, athletes wishing to franchise like Greg Norman’s Australian Grille or Hines Ward’s 86 can license their intellectual property to a third-party seeking to open a franchise in another state.

State & Local Tax: Advertisement and endorsement contracts frequently require that the players travel both nationally and internationally to make appearances, engage in promotional activities and even wear a particular logo during practice, preseason, regular season and post season activities. When the athlete is traveling and performing duties under their advertising or endorsement contract, athletes must be mindful that this income is also fair-game for states and municipalities with an income tax levied on activities within their jurisdiction. Franchises like Greg Norman’s Australian Grille may also be subject to an income or franchise tax in the jurisdiction where they are situated.

When an IPHC licenses the use of their intellectual property the licensee pays a royalty to the IPHC in exchange for the right to use the license. IPHC is typically established in a state that does not tax royalty income or does not have a corporate income tax (Delaware was our example above),so the IPHC pays no tax on the royalty income it receives. But when an athlete or business pays to use a license, it is an ordinary and necessary cost of doing business, which is deductible both on the state and federal level. Generally, this allows for a state tax deduction in the amount paid for the use of the mark; effectively offsetting an athlete’s state income tax liability generating from their promotional activities in the state.

States have historically seen this in a poor light and some have challenged the legitimacy of these deductions, arguing that the deductions were manufactured and constitute a sham transaction under the economic substance doctrine. They also force combined reporting, subject the taxpayers to add-back statutes, and assert economic nexus. Other states accept the royalty deduction, and to be sure, the facts of each situation will establish whether the deduction is accepted or challenged, and if challenged, whether it can be overcome.[[2]](#footnote-2) Some states even provided cases that are like roadmaps, which guide tax professionals through the factors that matter.

The well-known cases such as Sherwin Williams, Geoffrey (Toys ‘R’ Us) and WalMart provide a backdrop for anyone to understand how different courts have treated IPHCs and what the outcome historically might have been.

The considerations are also vastly different when considering setting up an IPHC for an individual versus a huge multi-national corporation. Although there is likely overlap in the reasoning behind setting up an IPHC, the concerns Amazon has with protecting their intellectually property are different than the concerns of an athlete, and each must be considered independently to determine how best to affect the business purpose underlying creating and employing an IPHC.

There are more non-tax reasons than ever to consider splitting up the IP from the professional athlete. Knowledge of each states relevant tax code sections, regulations, and recent rulings with regard to both successful and unsuccessful attempts at IPHC use are key in understanding the likelihood of being challenged by a state tax authority on the royalty payment deduction.

*© 2018 gary k. heald, jr. ALL RIGHTS RESERVED*

1. https://www.newyorker.com/business/currency/ryan-lochte-and-the-impatience-of-corporate-sponsors [↑](#footnote-ref-1)
2. [↑](#footnote-ref-2)