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Decoding Transfer Pricing with GT UAE

Intangibles & Transfer Pricing considerations

February 2025

Intangible assets may be among the most valuable assets a company owns. For most multinationals, they are a major source of sustainable competitive advantage. Intangibles play a key role and can significantly impact the allocation of income / expenses among different entities within a MNE group.

By accurately structuring the intangibles, businesses can ensure regulatory compliance, optimize financial performance, and maintain equitable profit distribution across their operations.

What are intangible assets?

- Intangible Asset is an asset that is not physical or financial but is capable of being owned or controlled for use in commercial activities and whose use or transfer would be compensated had it occurred in a transaction between independent parties in comparable circumstances.
- Legal, contractual, and other forms of protection may affect the value of an intangible, and the returns attributed to it, but the existence of such protection is not a necessary condition for being characterized as an intangible for transfer pricing purposes.
- It is not necessarily that intangible for transfer pricing purposes is always recognised for accounting purpose. The classification and examples of intangible assets are covered below:

Marketing Intangible

An intangible that relates to the marketing activities, aids in the commercial exploitation of a product or service, and / or has an important promotional value for the product concerned. Depending on the context, marketing intangibles may include, trademarks, trade names, customer lists, customer relationships, and proprietary market and customer data that is used in marketing and distribution of goods or services.

Trade Intangibles

Intangibles other than marketing intangibles are referred to as trade intangibles such as know-how, trade secret, patents, copyrights etc.

Exclusions: Group synergies and local market features (such as location savings) are not considered as intangibles for transfer pricing purposes as they are not owned and /or controlled.

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6 step framework

- It is crucial to determine the entity or entities within a Multinational (MNE) Group which will be entitled to the returns from exploiting the Intangible.
- Legal owner of an intangible may receive the proceeds from exploitation of the intangible, however other entities within an MNE group may also perform functions, use assets, or assume risks that contributes to the value of the intangible. These members (economic owners) should also be adequately compensated.
- In this regard, UAE TP Guidelines and OECD TP Guidelines have prescribed a six-step framework to identify commercial or financial relations in the context of intangibles.

STEP 6

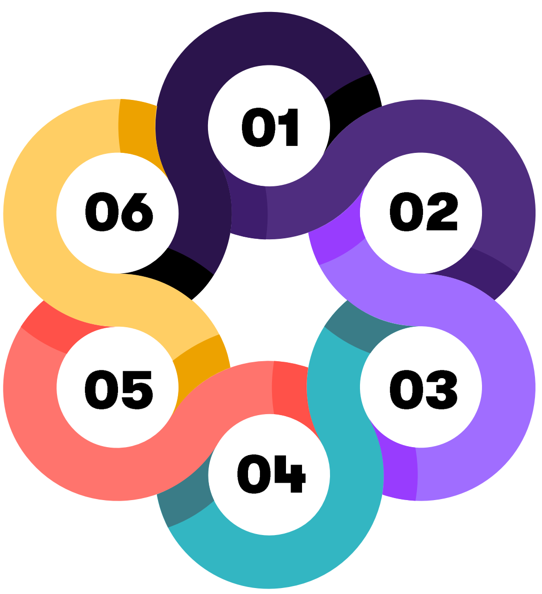
'Where possible' determine arm's length prices for contributions; 'In exceptional circumstances' re-characterise transactions to achieve arm's length conditions

STEP 5

Accurately delineate the actual controlled transaction based on above

STEP 4

Confirming consistency between contractual arrangement and actual conduct (i.e., party assuming risks actually controls the risk and has the financial capacity to assume it)



STEP 1

Identify the intangible

STEP 2

Identify the contractual arrangement (risks and obligations), including legal ownership

STEP 3

Detailed functional analysis to determine parties performing DEMPE related activities

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DEMPE Analysis

- In the context of transfer pricing, DEMPE functions – Development, Enhancement, Maintenance, Protection, and Exploitation (DEMPE) are critical in determining which entity within an MNE group should be entitled to the returns from intangibles. Properly attributing these functions helps ensure that profits are allocated in line with value creation.
- Understanding and accurately attributing DEMPE functions is essential for compliance with the UAE TP regulations. By ensuring that each function is properly compensated, businesses can align their transfer pricing practices with the arm's length principle and avoid disputes with tax authorities.

D Development	E Enhancement	M Maintenance	P Protection	E Exploitation
Everything associated with introducing new ideas for intangibles and putting plans and strategies in place for their creation. This includes activities such as research and development (R&D), product design, and software development.	Continuing to work on aspects of intangibles to make sure they can perform well at all times and continue to be improved. This can include upgrades, modifications, and improvements to existing products or technologies.	Actions that ensure intangibles continue to perform well and generate revenue. This includes routine updates, bug fixes, and ongoing support.	Ensuring that the value of the intangible remains strong. This includes legal actions, securing patents, and implementing security measures.	Refers to the way in which intangibles are used to generate profits. This includes licensing, sales, and marketing activities.

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Ownership of intangibles

- Intangibles involve two types of ownership: **legal** and **economic**. Typically, the legal owner is also the economic owner. However, it's increasingly important to consider the actual substance of transactions and the actions of the parties involved. This ensures that profit allocation from intangibles is based on each party's relative contribution.
- A key consideration is the requirement to directly perform or control the performance of DEMPE functions and associated risks. Returns on intangibles should be allocated to entities carrying out these functions, rather than necessarily to the legal owner.
- If the legal owner is economically responsible for all DEMPE functions, they are likely to expect all profits derived from the intangible. However, if the legal owner does not perform key functions, they should receive arm's length compensation for their role, such as holding the title or providing funding.
- The allocation of profits from the exploitation of an intangible should be made between the legal owner, the licensee or economic owner, and any other entity involved in its development. This should be based on robust Functional Analysis (FAR) of DEMPE functions performed by each entity.

Legal Ownership

Legal ownership refers to the entity that holds the legal title to the IP, typically through registration with relevant authorities. The legal owner has the formal right to use, license, or sell the IP. However, merely holding the legal title does not automatically entitle the entity to all the returns from the IP. The returns to the legal owner are often limited to a routine return for holding the title, unless they also perform significant functions related to the IP.

Economic Ownership

Economic ownership is attributed to the entity that performs the key functions related to the IP, bears the associated risks, and uses the assets necessary for the DEMPE of the IP. The economic owner is entitled to the residual returns from the IP, reflecting the value created through their contributions. This includes returns from the exploitation of the IP, such as licensing revenues, sales, and other commercial uses.

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Key considerations

MNEs should analyze the arrangements in detail and accordingly align their transfer pricing policy for intangible assets. Furthermore, they should establish whether their policy correctly reflects comparability factors like market specific characteristics, DEMPE functions and so on. It would be pertinent to ensure that the profits are aligned to the value-creating functions. MNEs that have separated the DEMPE functions that contribute to value creation from the entities that are legal owners of intangibles need to realign the profits considering the relevant contributions of each entity. Key considerations to be focused in this respect include:

Functional Analysis:

Conduct a detailed functional analysis to identify which entities within the multinational enterprise (MNE) group perform the DEMPE functions. This analysis helps in determining the economic owner of the IP.

Alignment with value creation:

Ensure that the allocation of profits aligns with the value creation activities. The entities that contribute to the development and exploitation of the IP should receive appropriate returns, reflecting their economic ownership.

Documentation and compliance:

Maintain comprehensive documentation to support the allocation of profits based on economic ownership. This includes detailed records of the functions performed, risks assumed, and assets used by each entity involved in the IP-related activities.

Intercompany Agreements:

Draft clear intercompany agreements that outline the roles and responsibilities of each entity concerning the IP. These agreements should reflect the economic reality of the transactions and support the transfer pricing policies.

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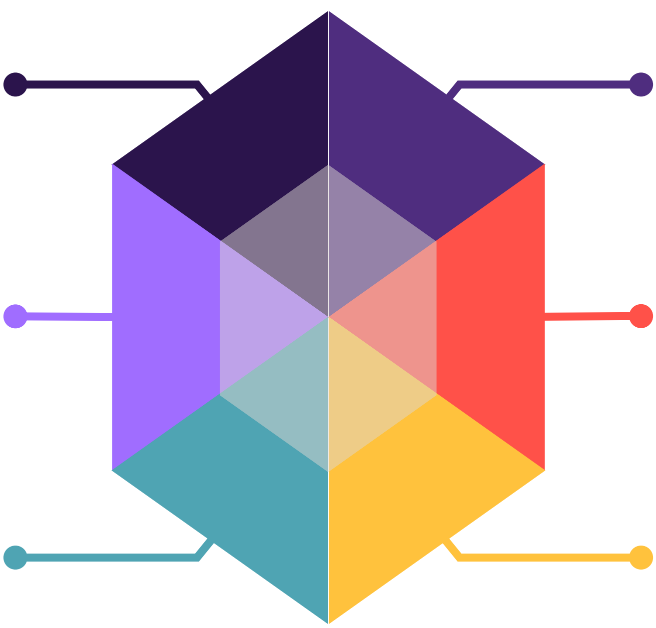
Challenges

- Some common challenges and solutions in regarding intangibles are:
  - **Valuation Difficulties:** Intangibles are often hard to value due to their unique and non-physical nature. Solutions include using robust valuation methods and maintaining thorough documentation to support the chosen approach.
  - **Compliance and Documentation:** Ensuring compliance with transfer pricing regulations requires detailed documentation. This includes explaining the valuation methods used, the rationale behind pricing decisions, and how DEMPE functions are attributed.
  - **Disputes with Tax Authorities:** Disputes can arise due to differing interpretations of regulations or valuation methods. Proactive measures include engaging with tax authorities early, seeking advance pricing agreements (APAs), and maintaining transparent documentation.
- Some challenges regarding intangibles highlighted by OECD are provided below.



1
A lack of comparability between intangible related party transactions and independent enterprises

2
Level of functions performed within the MNE Group in relation to development, enhancement, maintenance, protection, exploitation of intangible

3
A lack of comparability between intangibles in question

4
Difficulty of isolating the impact of any particular intangible on the MNE Group's income

5
Contributions of various members of the MNE Group to intangible value may take place in different years than the years in which any associated returns are realised

6
Ownership and/or use of different intangibles by different AEs within the MNE group

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Ensure an appropriate business model is in place for intangible assets to distribute the profits effectively within the group.

Align the positioning of the intangibles and return based on DEMPE functions performed.

Ensure correct identification of legal v/s economic owner of the IP.

Ensure compliance and maintain documentation as transfer pricing regulations continue to evolve.

Undertake thorough benchmarking analysis to identify the comparable arrangements for arm's length pricing.

Plan and optimize the supply chain to effectively mitigate tax risks within business operations.

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Contact our Transfer Pricing team

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For more details regarding this topic or other Tax issues, reach out to our team of experts on the latest Tax developments within the UAE and the Middle East region.

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