



Interplay between Intangibles and the DEMPE Framework: A Transfer Pricing Guide for MNEs in the UAE and KSA

This article explores the critical aspects of Intangible Property (IP) through a tax and transfer pricing (TP) lens, focusing on the statutory definitions and commercial utilization within the United Arab Emirates (UAE) and Kingdom of Saudi Arabia (KSA). As these countries transition into more mature tax environments, understanding the interplay between asset ownership and the development, enhancement, maintenance, protection, and exploitation (DEMPE) framework is vital for managing group-wide tax risks.

In practice, tax authorities in the UAE and KSA are increasingly focusing on DEMPE alignment during TP reviews, particularly in relation to marketing intangibles and centralized IP structures. The article has been drafted in accordance with the relevant guidelines issued by the:

- Federal Tax Authority Transfer Pricing Guide (Guide) of UAE and
- ZATCA Transfer Pricing Guidelines (ZATCA Guidelines) of KSA

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DEFINITION AND MEANING

As per para 6.6 of Chapter VI of the Organisation for Economic Co-operation and Development Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations (OECD Guidelines), para 7.3.2. of the Guide and para 8.1 of the ZATCA Guidelines, intangibles are defined as “something which is not a physical asset or a financial asset, which 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.” It is important to note that the OECD recognises that intangibles considered for TP purposes are not always recognised as intangible assets from an accounting perspective. For example, costs borne to develop intangibles such as expenditure for research & development and advertisement, are usually charged as an expense in profit & loss account and will not be reflected in the balance sheet. Such intangibles may however be required to be considered for purposes as they generate significant economic returns. Therefore, an item’s accounting treatment is not the sole determinant of whether it qualifies as an intangible for TP analysis.

The OECD Guidelines, the Guide and the ZATCA Guidelines give illustrative examples of what can be considered as intangibles, such as patents, know-how, trade secrets, trademarks, trade names, brands, rights under contracts and government license, licenses and similar limited rights in intangibles.

While legal registration of intangibles such as patents, designs, copyrights, or trademarks provide an economic advantage, all the above mentioned guidelines clarify that legal ownership is not the only factor in identifying these intangibles. In practice, a multinational enterprise (MNE) may derive significant economic value from unregistered assets, such as proprietary technical know-how or valuable customer relationships, which function as unique and valuable intangibles despite the lack of formal legal titles.

DEMPE

The introduction of DEMPE via Base Erosion and Profit Shifting (BEPS) Action Plans 8-10 shifted the focus of TP from legal ownership to value creation. Under these guidelines, the compensation of an MNE entity is determined by its active role in the development, enhancement, maintenance, protection, and exploitation of intangibles. If an entity bears the risks or provides the assets necessary for these functions, it is entitled to an arm's length return that exceeds its routine service fees.

The OECD TP Guidelines, the Guide and the ZATCA Guidelines also clearly support the concept of substance over form, by focusing and remunerating based on the actual functions carried out and risks undertaken, rather than being guided only by the terms of inter-company contracts.

The OECD has provided guidance on the important functions that can be considered as value adding functions, since they contribute to intangibles and need to be identified and analysed for DEMPE. These include design of research and marketing programmes, controlling the strategic decisions regarding intangible development programs, management and control of budgets, important decisions regarding defence and protection of intangibles, etc. The emphasis is on looking beyond legal ownership of intangibles and contractual arrangements and instead focusing on allocation of economic return, costs and economic burdens associated with intangibles to the entities that factually perform and control the important value creating functions of intangibles. All the above mentioned guidelines emphasize the need to accurately delineate transaction and to ensure that the actual conduct of parties is reflected in the contractual arrangements.

A six-step framework has been provided for analysing transactions involving intangibles.

- Identify the intangibles used or transferred;
- Identify the full contractual arrangements with specific emphasis on determining their legal owner and contractual rights and obligations;
- Identify parties performing functions using assets and managing risk related to the DEMPE of intangibles;
- Confirm consistency between agreements and conduct;
- Delineate the actual control transactions in light of legal ownership, contractual relations, and conduct of the parties; and
- Determine arm's length price (ALP) for relevant transactions.



Establishing a robust functional, asset and risk (FAR) analysis is the foundational requirement for any credible economic and arm's length evaluation. The OECD Guidelines further reinforced this by mandating a detailed FAR assessment with a specific emphasis on DEMPE functions to accurately identify the value-adding contributions of each entity within a MNE group. A critical insight from this framework is that simply assuming risks related to DEMPE functions is insufficient; one must also evaluate the actual control over those risks and the financial capacity to bear them. This necessitates an analysis of who holds the decision-making authority regarding the intangible assets and who possesses the financial strength to absorb any losses resulting from those strategic choices.

The core of this debate centers on whether a legal owner of an intangible should receive residual returns from its exploitation if they do not contribute to the actual value-creation functions. According to current guidance, the residual profits derived from intangible assets should be allocated proportionately to the group entities that perform the DEMPE functions and actively manage and control the associated risks.

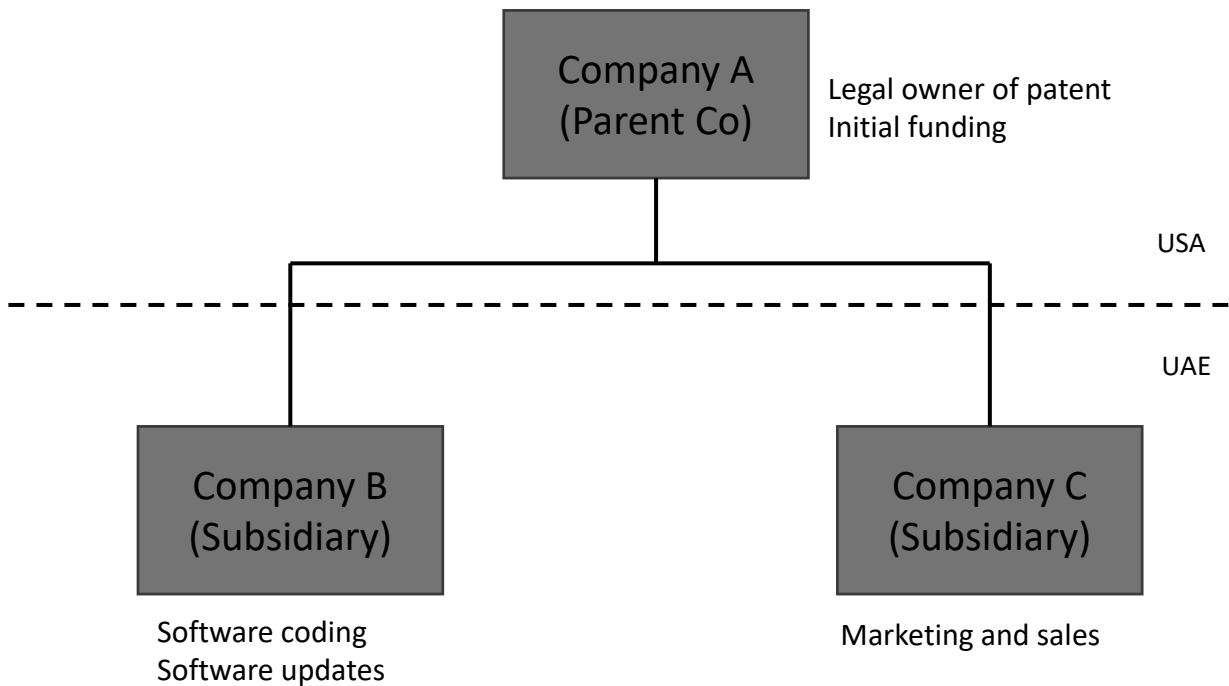
Consider the TP model for Limited Risk Distributors (LRDs). While these entities are generally compensated with a fixed return for low-risk activities, their actual conduct must match their limited risk status. If a detailed DEMPE analysis reveals that an LRD is performing strategic functions, such as developing intangible marketing assets or high-value customer lists, it may no longer qualify for a routine return. In such cases, the LRD may be entitled to a share of the residual profits commensurate with its contribution to the business's key value drivers.

TP METHODS

Regarding the selection of TP methods, while one-sided methods such as Transactional Net Margin Method and Resale Price Method may be appropriate for routine entities, they may not fully capture value creation in highly integrated intangible arrangements. These methods often fail to capture the economic reality because they tend to disproportionately allocate residual profits to the legal owner while granting only a routine return to the performing entities. Instead, the OECD advocates for the Comparable Uncontrolled Price method or the Transactional Profit Split Method and acknowledges valuation-based techniques like Discounted Cash Flow as reliable alternatives when facts and data availability permit.

CHALLENGES

MNEs operating in the Middle East region face several issues that relate to the development and use of intangible assets, especially given the introduction of new regimes and increasing TP interest of tax authorities in the region. Let us consider the following example to understand how the profits should be distributed:



Company A (Parent Co) based in USA is the legal owner of ABC trademark and patent. It provides the initial funding to develop the software. Company A has 2 subsidiaries, Company B and Company C based in UAE. Company B employs all the software engineers who coded the product and continue to provide software updates. Company C launched a localized branding campaign and built a proprietary database of high-value enterprise clients in its region. To determine how the profits from ABC should be shared, we look at the DEMPE functions:

Pillars	Entity responsible
Development	Company B - created the code and improved it based on user feedback
Enhancement	
Maintenance	Company B – identifies the technical bugs that need fixing. Company A pays the legal fees for patent renewals.
Protection	
Exploitation	Company C – manages actual sales and uses its local expertise to capture market

Historically, Company A might have kept 90% of the profits as the owner of the software, paying Company B and Company C a small, fixed fee for their services.

Under OECD guidelines, Company A is only entitled to a routine return for its financing. The residual profits must be split between Company B and Company C because they performed the functions and controlled the risks that actually created the wealth.

BEST PRACTICES

In light of the above cases and the importance of an appropriate TP policy for intangible assets, it is essential for MNEs operating in the region to anticipate important considerations related to intangible assets at group level in order to manage their group wide tax risk.

Below are three key steps MNEs in the region should strongly consider in respect of intangible assets:

❖ Identify

- The intangible assets within the group (developed/ acquired, used, etc.)
- The key parties involved in the creation of the intangibles assets;
- The functions performed, assets utilized and risks assumed on intangibles through a full DEMPE analysis.

❖ Analyze

- The scope and consistency of the contractual framework;
- The consistency of economic returns derived from the intangible assets;
- The accuracy of the allocation method used to split the economic returns from the intangible assets.

❖ Implement

- Benchmarking studies to justify the level of economic returns to intangible asset owners;
- TP documentation supporting the TP policy related to the intangible assets;
- Intra-group agreements that are aligned with the DEMPE analysis and the supporting economic analysis.

CONCLUSION

As we have seen, the unique nature of intangible assets makes them as difficult to measure as they are vital to business success. For too long, MNEs in the Middle East have overlooked the tax implications of their intangible property. With the UAE and KSA implementing rigorous Corporate Tax regimes, the wait and see approach to transfer pricing for intangibles is no longer viable.

The 3-tier documentation has been introduced under the BEPS regime, whereby the tax authorities across the globe have access to particulars such as details of global transactions, TP policy framework, and distribution of economic substance. The Master File also contains specific details related to intangibles such as description of the overall strategy of the group for ownership, development and exploitation of intangibles, list of important intangibles with ownership, and important IP agreements. In case of transfer of intangibles, an extra-cautious approach needs to be adopted by maintaining robust documentation, including laying out critical assumptions used for preparation of projections and valuation of intangibles. Businesses must act now to document and defend their value chains to stay ahead of impending regulatory challenges.