

Transfer Pricing News

The fundamental component in the payment of royalties from a Transfer Pricing perspective

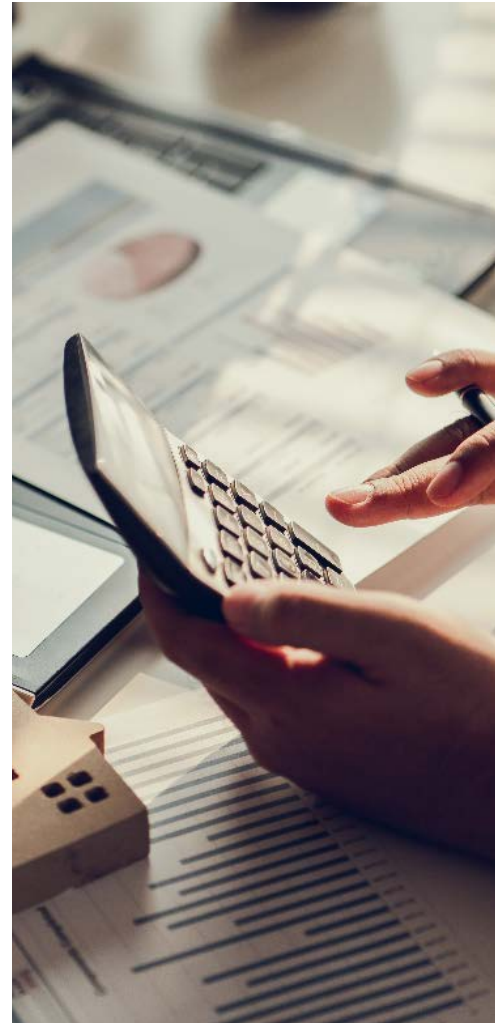
Common Transfer Pricing practice focuses the importance of the payment of royalties on essential and logical aspects that comply with the arm's length principle, such as the existence of a contract, agreeing upon a royalty rate at a market rate, the maximum deduction for such payment, the applicable withholding, the invoice issued, etc. However, there is one fundamental factor that requires special attention in a transaction for the payment of royalties to a foreign related company.

This factor can be summarized in the “substance” that is behind the payment of the royalties, as a result of the “value” of an intangible asset. Let’s remember that BEPS (Base Erosion and Profit Shifting) actions 8, 9 and 10, published by the OECD, seek to align transfer pricing outcomes with the creation of “value.”

This creation of value is measurable based on the DEMPE (Development, Enhancement, Maintenance, Protection and Exploitation) analysis of intangibles. This analysis allows for determining the parties to which the right to a payment for the value of an asset can be allocated. That is, the entity or entities that have performed the DEMPE functions indicated above are the entities that would have the right to charge a royalty for the intangible.

Therefore, royalty payments made to non-resident related companies should comply with the common formalities for transactions such as this one, without failing to consider the fundamental factor of allocating the existing right to the entities that have invested in the DEMPE functions. In other words, there would be little support for thinking that a company that has not invested in the development, enhancement, maintenance, protection and exploitation of an intangible asset, could charge a royalty solely because they are the owner.

We recommend performing a timely DEMPE analysis on royalty payment transactions with foreign related parties in order to avoid possible tax contingencies in these types of transactions.



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