



Demystifying DEMPE

June 12, 2024

Ahead
of the wave

2024 U.S. Cross-Border Tax Conference



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With you today

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Agenda

DEMPE around the world

- OECD Guidelines
- In the U.S.
- Survey of other jurisdictions

Audience Participation

- Survey of DEMPE experience

Key Takeaways

DEMPE Overview

A large, powerful blue wave is crashing, creating a massive white foam curl. The sky above the wave is a vibrant mix of purple and pink, suggesting a sunset or sunrise. The overall scene is dynamic and visually striking.

DEMPE and Risk – OECD guidelines

DEMPE Analytical Framework (Par. 6.34)

1. Identify the intangibles;
2. Identify the full contractual arrangement;
3. Identify the parties performing functions, using assets, and managing risks related to intangibles in relation to DEMPE;
4. **Confirm the consistency between contractual arrangements and conduct of the parties through functional analysis;**
5. Delineate the actual controlled transactions related to the DEMPE of intangibles; and
6. Determine arm's-length prices for the delineated transactions.



Updated Risk Analysis (Par. 1.60)

1. Identify the economically significant risks;
2. Determine how the risks are contractually allocated by the parties;
3. Based on a functional analysis, determine which entities perform risk control and risk-mitigation functions; which entities are exposed to the upside and downside; the consequences of a risk; and which entities have the financial capacity to assume the risk;
4. **Determine whether the contractual allocation of risk is consistent with the parties' conduct by analyzing: (a) whether the parties follow the contractual terms, and (b) whether the party assuming the risk under the contractual terms exercises control over the risk and has the financial capacity to assume the risk;**
5. If, under Step 4, the party assuming the contractual risk lacks the requisite financial capacity or control, apply the OECD Guidelines' risk allocation guidance (paragraphs 1.98-1.99) and allocate the risk to the entity that controls the risk and has the financial capacity to assume it; and
6. Price the transaction in question, taking into account the consequences of risk assumption as appropriately allocated and appropriately compensating risk management functions.

DEMPE in the united states

- **The section 482 regulations have not been amended to reflect the OECD DEMPE or control of risk concepts**
 - U.S. Treasury takes the position that Section 482 is "wholly consistent" with its treaty obligations and the OECD Transfer Pricing Guidelines.
 - IRS position that no updates were needed to incorporate changes from the OECD BEPS guidance.
- **One could argue that the 2015 BEPS deliverables differ in many respects from the Section 482 like treatment of legal ownership of intangibles, treatment of contracts, cost sharing arrangements**
- **2019 memo "Interim Guidance on Mandatory Issue Team Consultations With APMA for Examination of Transfer Pricing Issues Involving Treaty Countries", LB&I exam teams are now required consult with the IRS APMA when auditing transfer-pricing transactions that involve counterparties in jurisdictions that are U.S. treaty partners.**
- **See the U.S. make DEMPE-like arguments – exam, LB&A, APMA**

Outside the U.S. – Different interpretations of DEMPE

 Country	 Key Issue
Austria	Using CbCR to say Swiss HQ doesn't have "enough" DEMPE
Denmark	Movement of R&D leaders to US meant IP transfer and exit charge
Mexico	Disallowing expenses because counter-jurisdiction doesn't have "enough" substance
Germany	Asserting higher returns needed due to 1 senior R&D employee
Netherlands	Dutch APA denied as taxpayer did not have "DEM" of DEMPE in the Netherlands (i.e., only the "PE" functions in the Netherlands), so the IP was not Dutch owned and there's no beneficial ownership (triggering withholding taxes abroad)
Singapore	Claw back of IP-related incentive due to senior people moving to the US
Sweden	Says its decision makers exercise control over Lux entity – so Sweden entitled to all residual
United Kingdom	<ul style="list-style-type: none"> • Key management should be moved from cost plus to earning percentage of system profits • Key R&D leadership to Swiss R&D team is more than a cost plus
United States	Legal and economic ownership considerations in line with DEMPE
Various	Post acquisition argument that reduction in DEMPE means IP Transfer – Sweden, Israel, Denmark

Other key DEMPE issues arising

- **C-suite employed/living outside of the TP operating model**
 - "Hi Sarah, I know our IP is in the US and the C-suite is here, but we want to hire a new COO who lives in Germany, any issues there?"
 - "Hey Joe, CEO wants to go live in Italy for 4 months while her kids are on holiday, is that okay from a tax perspective?"
- **Acquisition where senior leaders are retained post-acquisition in countries outside of future state TP operating model**
- **Misalignment of key value drivers for organization with TP model**
 - E.g., commercial as a value driver (with senior leaders in various markets) where TP is established based on ownership solely of technology and trademark IP
- **Others?**

Wassup with your DEMPE sitch?



Polling question 1

Q: Has your group taken action to address risks arising from the revised OECD guidelines on intangibles and DEMPE?



No, our transfer pricing aligns with DEMPE



Yes, we changed DEMPE pricing



Yes, we changed DEMPE substance



Yes, we moved intangibles for DEMPE



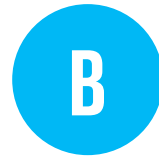
KPMG participant

Polling question 2

Q: In your experience which of these business changes has caused the biggest headache from a DEMPE perspective?



Integrating new acquisitions



Increasingly dispersed senior management



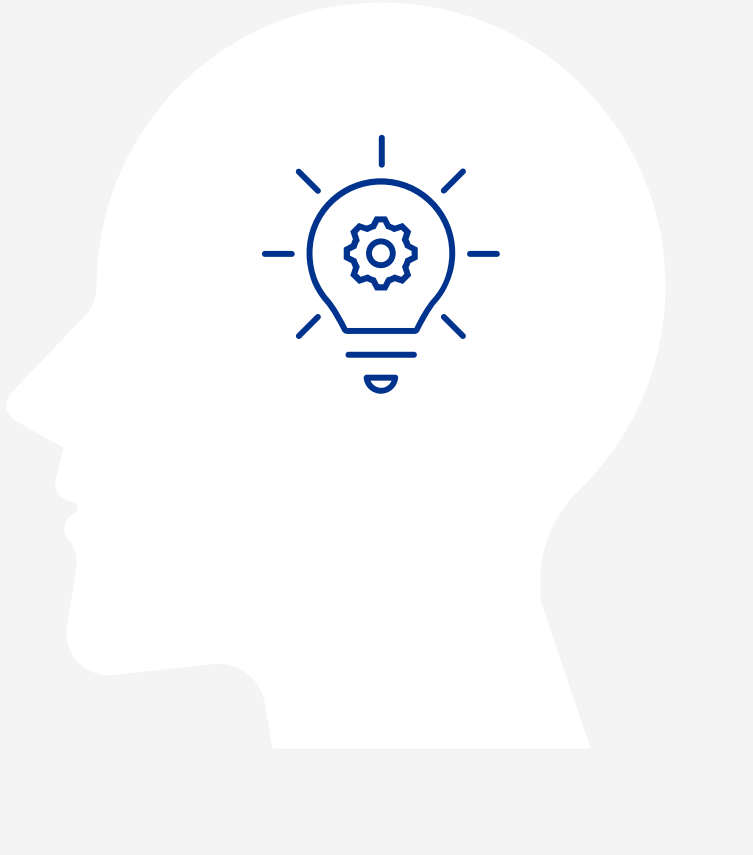
Development of new categories of intangibles



Increased collaboration with third parties



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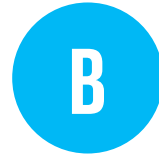


Polling question 3

Q: What tools and techniques do you use to identify DEMPE risks? (select all that apply)



Analysis of headcount data



Real time data gathering on decision making for key intangibles



Detailed process mapping and RACI analysis for DEMPE activities



CbCR data and transaction level functional analysis



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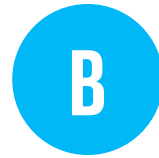


Polling question 4

Q: Have you experienced a transfer pricing audit where a tax authority asserted DEMPE functions were under-rewarded?



Yes, audit is ongoing



Yes, audit was resolved with no adjustment to remuneration for DEMPE functions



Yes, audit resulted in adjustment to remuneration for DEMPE functions



No



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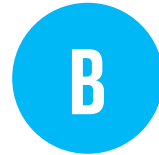


Polling question 5

Q: What dispute prevention approaches has your group used to manage risks related to DEMPE challenges? (select all that apply)



Enhanced defense files & audit readiness



Unilateral APA



Bilateral APA



ICAP



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Key takeaways

Three key points

1

Understand the DEMPE history of your key intangible assets

..... You need a clear view of what is driving value creation in your company and what functions are responsible for that. This needs to be clearly articulated as it's the basis of any DEMPE analysis/discussion/defense.

2

Understand DEMPE governance for next gen intangibles

..... You need to have a clear view on what roles and decision points are critical and whether value creation is impacted by next gen intangibles. It is advisable to have a clear view that you can articulate internally & externally, e.g. by enforcing certain rules related to DEMPE and risk control functions.

3

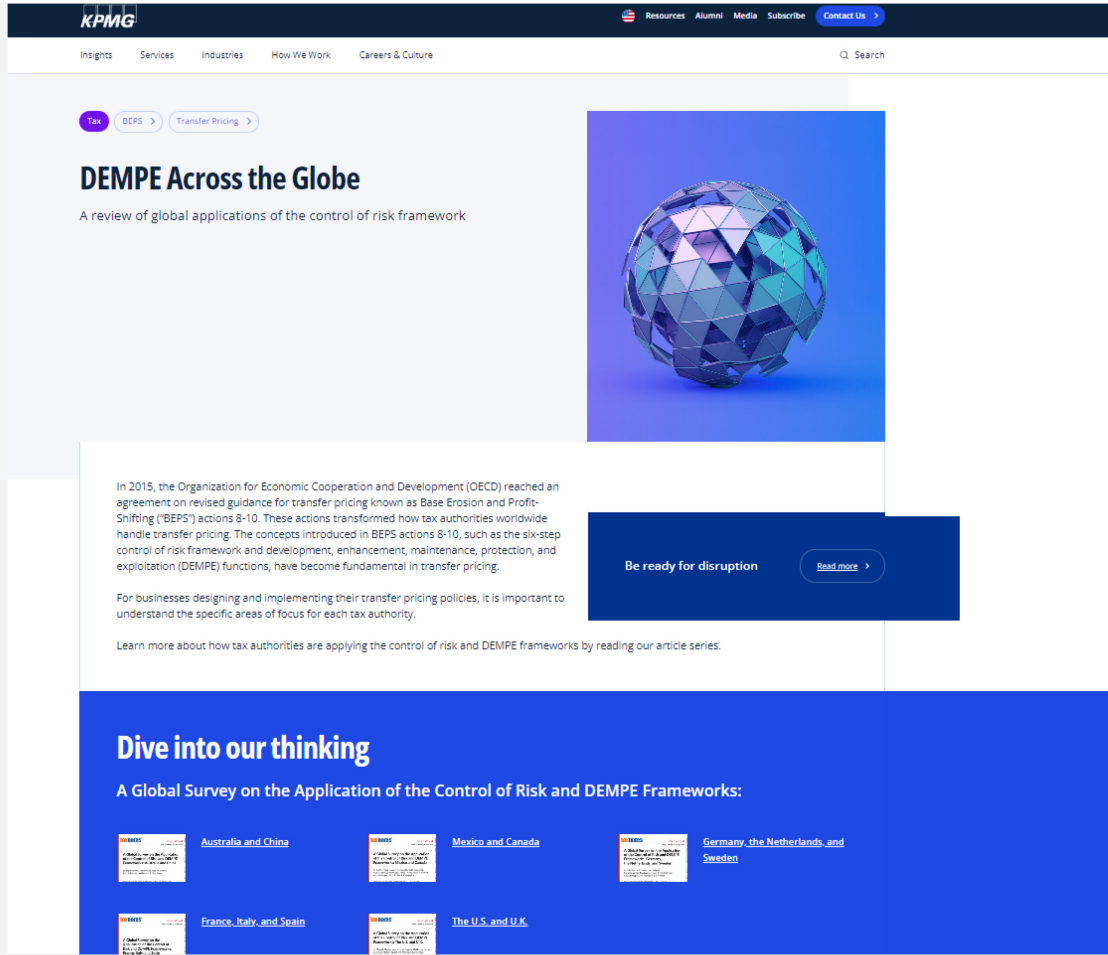
Tax authority engagement strategy

..... A clear tax authority strategy is not observable as it currently is rather a case-by-case course of action to ensure tax income in each jurisdiction. It is advisable to at least prepare enhanced defense files to ensure tax audit readiness.

DEMPE next steps

- **Perform a DEMPE/VCA analysis to determine and confirm where key leadership sits and where key decision making is performed**
- **Assess opportunities to align with DEMPE and IP profile, or establish risk management steps to alleviate potential DEMPE challenges/risks**
 - Cost plus is not always the answer!
- **Determine opportunities, if possible, to pursue APAs to alleviate potential DEMPE challenges under audit (proactive approach to TP strategy)**
- **Re-assess current Master File and Local File Documentation to assess how DEMPE is presented alongside organizational profile**

For additional background



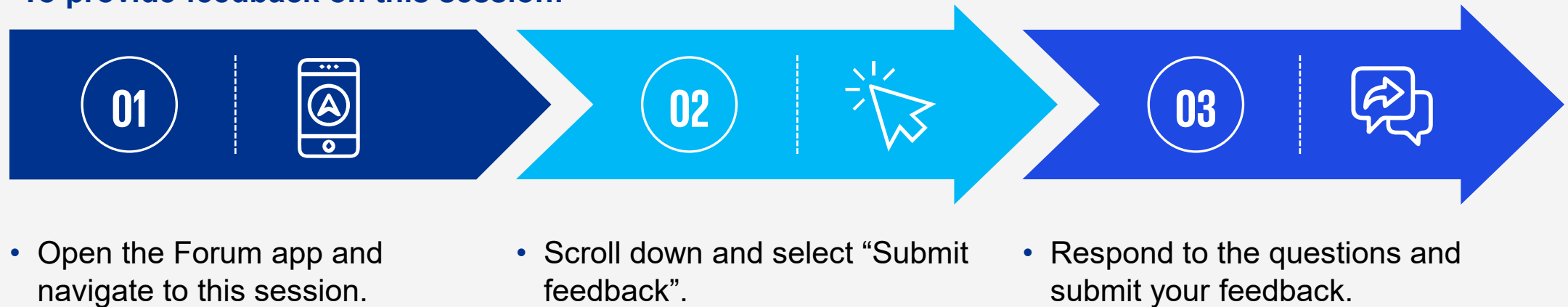
The screenshot displays the KPMG website's content for the article "DEMPE Across the Globe". At the top, the KPMG logo is on the left, and navigation links for "Resources", "Alumni", "Media", "Subscribe", and "Contact Us" are on the right. Below this, a secondary navigation bar includes "Insights", "Services", "Industries", "How We Work", "Careers & Culture", and a "Search" icon. The article is categorized under "Tax" > "BEPS" > "Transfer Pricing". The title "DEMPE Across the Globe" is prominently displayed, followed by the subtitle "A review of global applications of the control of risk framework". To the right of the text is a 3D geometric sphere graphic. The main text block begins with: "In 2015, the Organization for Economic Cooperation and Development (OECD) reached an agreement on revised guidance for transfer pricing known as Base Erosion and Profit-Shifting ("BEPS") actions 8-10. These actions transformed how tax authorities worldwide handle transfer pricing. The concepts introduced in BEPS actions 8-10, such as the six-step control of risk framework and development, enhancement, maintenance, protection, and exploitation (DEMPE) functions, have become fundamental in transfer pricing." It continues with: "For businesses designing and implementing their transfer pricing policies, it is important to understand the specific areas of focus for each tax authority." and concludes with: "Learn more about how tax authorities are applying the control of risk and DEMPE frameworks by reading our article series." A dark blue button with the text "Be ready for disruption" and a "Read more" link is positioned to the right of the text. Below the article is a section titled "Dive into our thinking" with the subtitle "A Global Survey on the Application of the Control of Risk and DEMPE Frameworks:". This section features five thumbnail images representing different regions: "Australia and China", "Mexico and Canada", "Germany, the Netherlands, and Sweden", "France, Italy, and Spain", and "The U.S. and U.K."

DEMPE Across the
Globe (kpmg.com)

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