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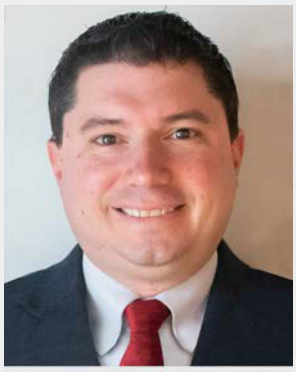

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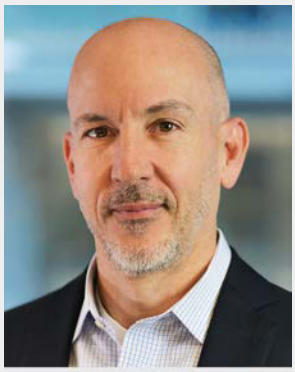

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In this article, the authors highlight examples of the digital transformation that is creating transfer pricing issues for multinational enterprises unique to the transfer or licensing of digital intangible property, and explain how investments in digital can address these issues and create value.

This article represents the views of the authors only and does not necessarily represent the views or professional advice of KPMG LLP.

Introduction

In today's rapidly evolving business landscape, digital initiatives have become paramount for organizations aiming to capture new opportunities and maintain a competitive edge. By leveraging advanced technologies and data-driven strategies, businesses can streamline operations, enhance customer experiences, and unlock new revenue streams. As industries become increasingly interconnected and reliant on digital solutions, the ability to effectively harness these tools is essential for sustainable growth and long-term success.

Nearly every company is — or seems to be — digital these days, and the tax world is not immune from this change. Tax issues of the digital economy are a driving force behind tax initiatives such as the OECD's base erosion and profit-shifting project and potential digital services taxes. At the same time, technology innovates at a faster pace than tax administrations can respond. These trends, combined with an increased focus by tax authorities on the contributions of intangible property (IP) to business profits, create tax and transfer pricing challenges for taxpayers with businesses undergoing a digital transformation (or evolution).

The complexities of transfer pricing for digital intangibles are numerous. As companies that are not traditionally technology companies — for example, tractor manufacturers, insurance companies, wholesale distributors, life science companies — incorporate digital technology in their business, they face complex transfer pricing issues related to digital that a mere decade ago were largely limited to Silicon Valley.

For many companies, merely identifying digital intangibles and assessing their effect on the business is challenging. Today's tractors or refrigerators may look strikingly like they did 10 years ago, but today a significant component of

what a customer may pay for is the digital IP within the physical product. Valuing and establishing arm's-length transfer pricing for these digital intangibles is complex, especially for software used inside a business. Indeed, digital intangibles may be the most difficult of the intangible assets that a business has to value.

This article is a transfer pricing primer for taxpayers that are facing digital transformation within their organizations. We begin by highlighting examples of the digital transformation that is affecting businesses and is the ultimate source of the transfer pricing issues addressed. We then discuss how investments in digital are creating value at companies, and the issues and challenges unique to the transfer or license of digital IP. We close with the ongoing challenges in pricing of everyday transactions involving digital IP as well as nondigital transactions that have embedded digital value.

Digital Transformation

The past few decades have seen rapid innovation in consumer technology. The relative lag in corporate technology innovation is changing as we observe significant transformation across the corporate technology ecosystem. Innovations and (importantly) adoption of technology that had been steadily rising in the 2010s has now accelerated because of the COVID-19 pandemic and associated remote work policies. Private fixed investment in information processing equipment and software exceeded $1.2 trillion[1] on a seasonally adjusted annual rate in 2024 and is expected to continue to increase as businesses modernize their IT infrastructure and build systems that improve operational efficiency, employee experience, and sustainability.

Digitalization today affects all aspects of most businesses. Some common examples include:

- **Digital marketing.** The use of data combined with myriad digital touchpoints with consumers — email, pop-ups, social media, and other direct forms of advertising — allow companies to reach target customers faster and with less cost per view, minimize costs, and be more agile in their strategies.
- **Business-to-customer and business-to-business e-commerce.** E-commerce allows companies to expand their reach and achieve global commercial markets. More advanced commerce models (including, importantly, B2B) provide detailed information on products, testimonials, recommendations, and replacements and ancillary upsell suggestions. Such advanced models create a better customer experience (which increases stickiness) and can also increase the margin generated from recommendations and upselling.
- **Digitized products.** Today, tangible products — from refrigerators to cars to medical devices to farm equipment — incorporate digital as an increasingly important component of what the product is and does. In many cases something as simple as a coffee maker or a tractor would not be commercially viable without the internal digital technology.
- **Connected products.** Not only is value being created by the software embedded within digitized products, but there is value being created because of connected devices (products and devices that have sensors and connectivity to other technology hardware, the internet, or both). By one measure, it was estimated that there were 18.8 billion connected devices at the end of 2024, with that number doubling by 2028.[2] Connected devices talk to each other, increasing functionality but also sharing data that can provide expanded service and other monetization opportunities.
- **Internal use software.** One of the most impactful, and in the context of transfer pricing most often overlooked, value-creating digital intangible class is related to technology and software a company uses internally to operate. Technology plays an important role across most functions in an

[1] U.S. Bureau of Economic Analysis, Private Fixed Investment in Information Processing Equipment and Software [A679RC1Q027SBEA], Federal Reserve Bank of St. Louis, last accessed Feb. 11, 2025.

[2] Satyajit Sinha, "State of IoT 2024: Number of Connected IoT Devices Growing 13 Percent to 18.8 Billion Globally," IoT Analytics (Sept. 3, 2024).

organization, including inventory management, demand planning, and functions like resource management, assets management, and most other functions. For example, companies use data and technology to predict when a machine or a delivery truck needs a particular repair before it happens, reducing downtime and increasing profit. Data-driven tools can predict trends that drive cost-saving decisions in demand planning or enhance the cost savings in their supply chain management.

- **Automation and artificial intelligence.** Automation increases productivity on the factory floor, as well as in the warehouse, shipping, and distribution functions. AI describes computer programs that perform tasks that are usually performed by humans. Robotic process automation (RPA) is a type of automation focused on replacing human tasks like reconciling accounts, reviewing legal contracts, or processing bank loans. The savings comes not just from reducing labor but by increasing throughput (for example, in a factory setting), avoiding errors, and reducing workplace injuries. Indeed, in the context of RPA, one study found that average return on investment achieved by businesses on implementing RPA was about 250 percent.[3]
- **Generative AI.** GenAI is a form of AI in which the technology learns from what it is asked to do and can evolve not only its analysis but what it does and how it does it to the point that in some cases it can begin to determine what to do on its own. GenAI has become ubiquitous. In a recent survey, over half of CEOs say that GenAI is their top technology investment priority.[4]
- **Digital twins.** A digital twin is a virtual simulation of one or more things that exist in the real world that can be used for a variety of functions. For example, using a digital twin of a virus can help significantly reduce the time it takes to create a vaccine and get it through the approval process. Digital twins also allow companies to predict pipeline damage, design a better baseball bat, and manage supply chain risk.

Digital Value Creation

> Businesses with high levels of digital maturity have a competitive advantage along multiple performance indicators, including revenue growth, time to market, cost efficiency, product quality, and customer satisfaction. Businesses with low levels of digital maturity struggle to achieve these benefits.
>
> — Boston Consulting Group, "Digital Maturity"

Digital investments — like the examples provided above and a wide range of others — create value for a company, in many cases significantly. Indeed, for more digitally mature businesses, digitization can be a competitive advantage. Value can come in the form of increased revenue from new products or delivery models, or from creating incremental customer stickiness. Value creation from digitalization also often comes in the form of operational effectiveness and cost reductions. For example, the use of data and digital tools could allow a company to reduce days of inventory on hand, costs to deliver or warehouse products, or production costs.

Every company's digital journey is unique. It often involves an evolution and rethinking of the overall business strategy. Many companies start from no digital strategy, or more accurately, from a basic strategy in which digital tools facilitate only routine activities and communication. As companies become more digitally mature, they invest more but, more importantly, they tend to invest more strategically.

From a transfer pricing perspective, an important first step to understanding, and ultimately quantifying, the benefit of these investments is to map the value chain of digital IP. The value chain is an enterprise's conceptual framework that describes the series of functions and activities through which it creates and delivers a product or services to the market. It

[3] Catherine Calarco, "'Now & Next: The State of RPA' — Your Guide to the Cloud-Native Era," Automation Anywhere blog, Aug. 2, 2021.

[4] KPMG 2023 Global Technology CEO Outlook, last accessed Feb. 12, 2025.

includes all the steps involved, from design to sourcing of raw materials, production, sales, and distribution, as well as supporting functions. A value chain analysis (VCA) is an assessment of the value chain that involves identifying and mapping its components (for example, functions and activities), as well as the people, assets, and controlled risks associated with value chain components. By combining a VCA and a financial analysis, multinational enterprises can better identify where value is created, and which functions and assets are expected to create the greatest future profit. A digitally focused VCA (often referred to as a digital value chain), identifies digital functions and digital IP assets (see figure for an example of a digital value chain). It provides deeper insights into where, and in what ways, digital IP and data create or enhance value. Also, a VCA provides visibility to key components of governance that exist or are needed. It is often used as a tool to develop a governance model framework. This is helpful in establishing a decision-making process, tracking compliance, and offering protection to valuable IP.

Quantifying the value of digital IP can be a challenging exercise. For one, we are only at the beginning stages of unlocking the potential that it will provide to business. Also, many technologies are built on the premise that new technologies can augment existing capabilities. However, it is becoming increasingly difficult to determine when a release of a piece of software is a derivative work enhancing an existing software copyright, or instead a unique and stand-alone asset. For large-scale digital transformations, there is a significant level of risk associated with achieving success. A recent study suggests that 70 percent of these types of projects failed.[5] What failure ultimately looks like depends on how objectives are measured. There are plenty of concrete examples of large investments in IT infrastructure that impair MNE value. In addition to these examples, we find that in large businesses, venture capital provides a window into return on investment on key technology initiatives. Many portfolio companies of venture capital firms fail, but those that succeed provide an outsized return that more than compensates for failures.

DEMPE in a Digital World

As a foundational issue, taxpayers must consider the functions related to development, enhancement, maintenance, protection, and exploitation (DEMPE)[6] of IP in the context of digital IP. DEMPE is a complex and nuanced concept. For many taxpayers, the complexity is exacerbated in their digital intangibles because tax departments in many nontechnology companies simply have not had the same experience dealing with digital IP as they have with other, more traditional classes of IP. The OECD's BEPS 1.0 initiative and the resultant Transfer Pricing Guidelines made clear that it is no longer sufficient to look solely at legal ownership and funding contributions to attribute profits related to IP. Instead, an IP owner is permitted to earn nonroutine returns from its intangibles only if the IP owner also performs some (undefined) quantum of DEMPE functions regarding its IP.

Control of the IP, in the form of DEMPE functions, is considered an essential predicate for profit attributed to the IP owner to exceed a routine investor return. In addition to this requirement, the transfer pricing guidance provides that the functions — including DEMPE functions — performed by persons other than the IP owner be appropriately compensated. Specifically, the portion of the nonroutine return that the IP owner retains is reduced by the appropriate remuneration of other related parties that perform DEMPE using the IP. What constitutes appropriate remuneration is fact-specific and, in some cases, may mean a share of the residual profit. In others it could mean simply a cost-plus return.

When it comes to digital IP, DEMPE doesn't require that an entity perform coding activities.

[5] "Common Pitfalls in Transformations: A Conversation With Jon Garcia," McKinsey & Co. (Mar. 29, 2022).

[6] The concept of DEMPE, as stated in the OECD Guidelines, refers to the functions related to the development, enhancement, maintenance, protection, and exploitation of intangibles. This framework is crucial for determining the allocation of returns derived from intangibles within MNEs. The DEMPE framework was introduced as part of the OECD's BEPS action plan, specifically under actions 8-10, to address the artificial shifting of profits to low-tax jurisdictions.

Digital Value Chain

1 PLAN	2 CODE	3 RELEASE	4 DEPLOY	5 RUN/ OPERATE	6 MONITOR	7 LEGAL	8 DATA
1.1 Digital Strategy	2.1 Developer Toolset	3.1 Release Planning	4.1 Deployment Strategy	5.1 Infrastructure (including Cloud) Strategy	6.1 Event Detection, Logging and Reporting	7.1 IP Protection	8.1 Data Strategy
1.2 Budgeting	2.2 User Stories and Sprint Planning	3.2 Build	4.2 Deploy Environment Provisioning	5.2 Cloud Enablement	6.2 Diagnosis, Feedback	7.2 Contracting (internal/external)	8.2 Data Acquisition (source, collect)
1.3 Product Vision, Goals, Success Criteria	2.3 Source Code Management	3.3 Pipeline Management	4.3 Configuration Management	5.3 Infrastructure Management	6.3 Usage Metrics, Analytics and Telemetry		8.3 Data Cleansing
1.4 Selection and Prioritization	2.4 Local Environment Provisioning	3.4 Testing	4.4 Deployment Automation	5.4 Service Resiliency	6.4 Incident Management		8.4 Data Enhancement
1.5 Portfolio/ Product Management	2.5 Code Creation	3.5 Release Management	4.5 Continuous Deployment	5.5 System Delivery	6.5 Cyber and Data Security Strategy		8.5 Data Management
1.6 Requirements Management	2.6 System Architecture	3.6 Release Approval	4.6 Health Check & Rollback	5.6 Service Operations			8.6 Data Privacy and Security
1.7 Resource Management	2.7 Code Approval	3.7 Manage Artifacts		5.7 Service Management			8.7 Data-as-an-asset
	2.8 Cybersecurity Requirements						8.8 Data Delivery/ Exploitation

Coding is the development of software, and the underlying copyright and other intangible — in fact, another word for coding is software development. While this is development, it is doubtful that basic coding activity — which for many companies is performed by employees numbering in the thousands — is DEMPE, notwithstanding its nomenclature. If these employees are not driving decisions, controlling the risks, or both, it is highly unlikely their activities will be considered DEMPE. Indeed, coding is a common activity for which numerous benchmarks are available and is generally a routine function compensated using a cost-plus method.

Many of the common DEMPE functions involving digital intangibles are not surprising when compared with DEMPE for other intangibles. For example, the strategic investment decisions are perhaps the most important DEMPE functions. In the context of digital, these decisions include "epic"[7] level budget and project approval. Also, pipeline management, product prioritization, release and deployment scheduling, and product ownership are functions that often comprise significant components of a company's DEMPE related to digital intangibles. Where digital IP is delivered through a cloud transaction, additional DEMPE may include making decisions concerning the development and delivery of the software-as-a-service (SaaS) infrastructure and cloud enablement, in addition to the software and data deployed on the cloud platform.

Corporate functions such as supply chain management and procurement rely heavily on digitalization and data. As a result, these functions may now need to have both digital IP and DEMPE functions to support allocation of functional profits. Similarly, companies whose physical products are being digitalized — for example, cars, medical devices, home appliances — are often surprised to find how new value drivers have been created by different areas within the organization. Imagine a Swiss manufacturer that owns all the IP related to its medical devices, and which historically had a strong DEMPE profile regarding its physical products because the chief medical officer and other top executives with oversight over the physical product were all located in Switzerland. As an increasing portion of the devices' value is attributable to the digital IP embedded in the devices, such a company can no longer justify earning all of the residual profits from the devices based solely on the DEMPE associated with product and manufacturing patents. Rather, to have a claim to the full residual profits on the devices, it must perform the DEMPE functions related to the digital IP.

Transfers of Digital IP

Chapter VI of the OECD Guidelines highlights the special considerations that need to be placed on transfers of intangible assets.[8] Because of its inherently unique nature, digital IP is often in the category of so-called Hard to Value Intangibles (OECD Guideline 6.189). Therefore, extra scrutiny is warranted, and it is often advisable to apply both a primary and secondary method to substantiate an arm's-length value. In the following paragraphs we discuss the transfer pricing methods often used to price a transfer of digital IP.

Comparable Uncontrolled Price Method

The first transfer pricing method often considered by taxpayers when considering the transfer of a digital intangible is the comparable uncontrolled price method. As part of a "build vs. buy" analysis, there may already be research performed to understand the cost associated with licensing or buying technologies from third parties to achieve the desired benefit. In some cases, companies may acquire digital IP directly from third parties giving rise to an internal CUP

[7] Components of software (especially in modern, agile development models) are typically organized into a hierarchy in which a particular project or initiative is segmented and decomposed into its component parts. While there are multiple terminologies, in one of the most widely used taxonomies many small pieces of release software called "Stories" or "User Stories," comprise a Feature. Multiple Features constitute an Epic. Epics are generally large segments of software. Typically budgeting and project approval at the Epic level is in the form of MNE-wide, annual budget and project approval of a type that is consistent with DEMPE-type management and oversight.

[8] Chapter VI focuses on transfers of assets that occur in business restructurings. Such transfers typically include both make-sell and development rights.

for subsequent intercompany transfers of acquired digital IP.

In other instances, an external CUP may exist that is similar to the tool the company is considering developing. The reliability of the CUP could be high if the functionality of the proprietary tool is similar, or if there is good information available to make appropriate comparability adjustments to the CUP for functionality held by the proprietary tool but that the third-party vendor does not have, or vice versa. However, a CUP may lack reliable comparability if the proprietary software created is unique and therefore dissimilar to commercially available software. In fact, a common reason a company decides to develop its own capabilities rather than buying an external solution is its belief that it can develop unique IP that allows it to capture a market advantage.

Investor Return Method

The IRS initially developed the concept of the investor model to determine what the owner of existing hard-to-value IP would charge an affiliate for access to its IP as a platform for developing new IP.[9] The theory is that the affiliate would only be willing to pay a price that at least allowed it to earn an appropriate risk-weighted rate of return on that price plus its expected future investment. The owner of the existing IP, on the other hand, would be unwilling to charge a price that permitted the affiliate to earn more than an appropriate risk-weighted return on its investment. Therefore, the arm's-length price for the existing IP platform would be equal to the excess of the net present value of the enhanced IP over the amount necessary to allow the affiliate to recover its anticipated additional investment plus an appropriate risk-weighted return on its total investment — the upfront transfer price plus the additional investment. Of course, the affiliate might earn more (or less) than the anticipated profit used to determine the transfer price if it did better (or worse) than the ex ante projections.

The investor model as described above determines the price for existing intangibles based on the prospective expected returns from the time of the transfer. However it can also be applied to the value of past investments when that value is difficult to ascertain, either because of the technical or commercial uncertainties of the past investment, or because it is not possible to attribute revenues to digital IP. This would preclude the use of transfer pricing methods that rely on estimates of future cash flows.

The primary benefit of applying the investor model to past investment is simplicity. All that is required to perform this valuation are a few items of largely objective data, such as historical spending and cost of capital. Because it is based on the amount of investment rather than realized historical and projected profit, this analysis can be performed before any software is created so long as the amount of the investment amount is known.

On the other hand, the application of this model has several challenges. Unless the total transfer price is paid in a lump sum or fixed installments, the return will have to be stated as a percentage of future revenue. However, how the digital IP will translate to cash flows may be uncertain. If the company is making investments to increase market share in the future, it may not show up on the income statement right away. However, investments might still be valuable to the organization today and investors will consider a premium on the enterprise today if the investment is expected to enhance future cash flows.

Financial metrics may be difficult to track, but key performance indicators may be used to estimate how tangible metrics translate to profit and loss effects. That is helpful information to collect to measure the effectiveness of the digital strategy as the implementation plays out.

Profit Split Method

A profit split approach is commonly applied when multiple parties make valuable contributions to the development of IP as part of a business arrangement. To illustrate the point with a nondigital example, MNEs in the pharmaceutical sector enter into co-development arrangements that allow for IP owners of preclinical compounds or biologics to unlock value by finding a partner with expertise to

[9] Reg. section 1.482-7T. The 2008 regulations were preceded by proposed regulations in 2005, which was the first formal articulation of the investor model. REG-144615-02.

achieve marketing authorization and produce at scale. A profit split may often make sense in the context of digital IP given that companies often operate their IT functions through a globally distributed workforce model in which (often more than in the other functions of the organization) there are important contributions to the development of IP provided by personnel in multiple affiliated entities. In this transfer pricing method, a taxpayer first benchmarks business returns for which available third-party information permits reliable pricing — sometimes referred to as "routine returns." After excluding these routine returns from total profit (including any benchmarkable intangible returns such as trademark royalties) what remains is the profit associated with nonroutine intangibles, including digital IP. This residual profit is then split between the parties contributing to its development, often, but not always, on the basis of their relative expenditures on, or contribution to, development activities.

The residual profit split method is most reliable when the bulk of the profits can be ascribed to routine functions that can be benchmarked through the transactional net margin method. In that case, the residual profit to be split is relatively smaller, placing less stress on whether the measures used to split the residual profit are reasonably verifiable.

Ongoing Transactions With Digital

As noted above, transfer pricing for the sale or transfer of existing digital intangibles carries with it many challenges, including comparability issues inherent to digital intangibles. Likewise, digital IP is uniquely challenging when it comes to transfer pricing for ongoing use of such intangibles in a make-sell arrangement.

Pricing Digital Transactions

CUP Method

When companies are delivering software via an on-demand hosted model, a CUP for similar SaaS delivered services might be available. This is particularly true in cases in which the business can monetize the asset to third-party customers as well as internal users. CUPs work well because often pricing on SaaS or other subscription-type services offered digitally are comparable. However, CUPs can be challenging to apply in cases in which the technologies being delivered as SaaS are bespoke to the organization. In such a case, the in-house technologies are not likely to be highly similar in form or function to third-party SaaS transactions for which comparable data exists. Data for off-the-shelf software offerings may be available in some cases, but they are not likely to be strong comparables for bespoke internal software. Using them as CUPs would require thoughtful analysis to identify the nature and quantum of adjustments that are required to increase reliability. In many cases, those adjustments may not be practical.

Residual Profit Method

The residual profit split method is also commonly used to determine appropriate pricing for internal digital transactions. In many cases, a taxpayer may have already used transfer pricing to quantify the contribution to profit from nondigital intangibles. For everything that remains, the taxpayer must determine a method for splitting this profit that is most appropriate to the type of intangibles while considering all the facts. Affiliates that benefit from the use of digital technologies may have functional, asset, and risk profiles that are more routine. A distributor, for example, may already be earning a return on sales for reselling products to third-party customers. Since the investment in digital will be expected to increase sales or operating margins, while taking on no funding costs associated with the digital initiatives, the distributor could be willing to pay for use of the Digital IP to increase its returns.

Profit split methods may be useful when there are multiple contributions to DEMPE. One might be tempted to allocate these residual profits under some measure of formulary apportionment. However, digital IP investments aren't intended to be people-heavy. In fact, many investments by MNEs today are predicated on using AI to reduce the number of people needed to perform certain functions. As a result of this trend, strategic decision-makers that are able to capture the capabilities of technology to grow the business are critical to the organization — and the allocation of business profits should reflect their contribution. In many situations that involve digital intangibles, allocation keys commonly used in

other contexts — for example, the number of people or amount costs incurred — are unreliable.

Because of these challenges, some taxpayers use a profit split based on a VCA, with a profit contribution analysis as a primary or corroborating method. A profit contribution analysis takes all an enterprise's profits, routine and nonroutine, and allocates them to each function or activity presented in the enterprise's VCA.

The benefits of this approach include the ability to capture nuanced effects that are not sufficiently comparable to publicly available benchmarks and for which allocation keys are impractical because of the unique ways in which people functions and intangibles drive value and synergy. Contemporaneously prepared documents (such as business use cases) that were used to approve investments as a normal business process are fantastic evidence of expected value contribution. A strong governance framework can arise from a VCA, which can also allow parties to work together to manage people and risks to achieve successful outcomes. This could quantify the level of benefit contributed by each party to digital IP, which can be remunerated through set and agreed-to arm's-length transfer pricing policies. One of the biggest benefits of this model is that it relies, in part, on the expertise and observations of the people who have the most realistic perspective on the potential and actual effect on the business and its profits of the digital IP. However, the very same reliance on the expertise and insights of employees could introduce the risk of subjectivity, adversely affecting reliability. In addition, because it is based on understanding the nuanced cause and effect of functions and intangibles, some tax authorities might be reluctant to do the work required to understand the analyses.

Digital's Effect on Common Nondigital Transactions

As digital becomes more pervasive, the underlying digital IP becomes an important asset and value driver associated with many functions of a business. Increasingly, functions across an organization rely in varying degrees on digital intangibles and data. For example, loan processing services in the past were a largely human function. Today, it is largely a digital process. Selling a car, designing and building a dam, and providing warehousing services today typically have a digital component. In many cases digital IP is an important component and becomes an essential asset for considering comparability for related-party sales or service transactions.

Consider strategic sourcing. A U.S. MNE established a team in Singapore under controlled foreign corporation Proco to handle procurement and vendor management. CFC Proco charges U.S. MNE and its affiliates a fee based on 7 percent of the goods they manage or acquire. This fee structure was established 10 years ago using comparable companies that relied heavily on human functions and relationships.

However, today, these comparable companies supporting that 7 percent benchmark price rely heavily on assets, including digital technology and data, as primary value drivers. If CFC Proco lacks similar digital IP, the companies in the old benchmark list may no longer be comparable.

A similar dynamic may exist in the context of factories. Suppose a U.S.-parented company operates three manufacturing plants, each producing 100,000 units at a cost of $100 million, earning $20 million in profit on revenue of $120 million ($1,200 per unit). After modernizing Plant A into a "Smart Factory" with advanced technology, its output increased to 140,000 units, and costs dropped to $80 million, creating an additional $68 million in profit for the U.S.-parented manufacturer.

Because of these changes, Plant A can no longer use the same benchmarks as plants B and C. The new profit distribution needs to consider who owns the digital IP, who funded and managed the conversion, and associated risks.

Conclusions

Rapid digital transformation across industries has fundamentally altered the business landscape, requiring companies to adapt and innovate continuously. As digital initiatives become integral to corporate strategy, the valuation and management of digital IP present complex challenges, particularly in the realms of transfer pricing and compliance with international tax standards such as the OECD's

BEPS framework. Value is created, which ultimately results in profits. Tax departments often have limited visibility into where this value is created, and where this value creation is identified, many tax departments have less practical experience dealing with digital IP than more traditional types of IP.

Dealing with digital IP requires a comprehensive understanding of the digital value chain, the application of appropriate transfer pricing methods, and the significance of DEMPE functions in attributing profits to digital IP. Companies that strategically invest in digital transformation can achieve significant competitive advantages, drive operational efficiencies, enhance customer experience, and increase enterprise value. This should play a role in how profits are allocated and subsequently taxed within the group. However, these benefits come with the necessity of navigating the intricate landscape of digital IP valuation and transfer pricing, ensuring that all contributions are fairly compensated and aligned with regulatory requirements.[10] ■

[10]