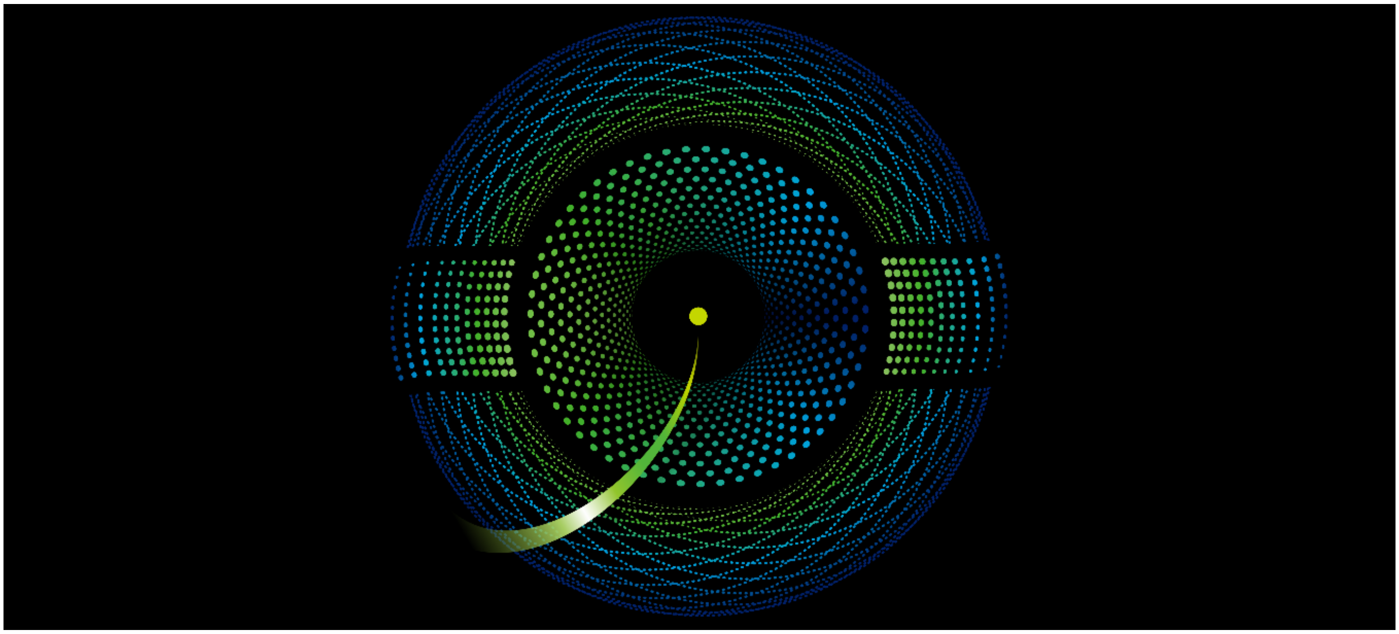

Tax Newsletter

Timely news and information on national tax issues

Intangible assets and their treatment from a Transfer Pricing perspective.

What is understood to be an intangible asset?

For Transfer Pricing (TP) purposes, the definition of "Intangible Asset" is something that is not a physical and/or 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. According to that established in Chapter VI – Intangibles, of the OECD Guidelines,[1] from a TP perspective, the definition transcends the accounting and legal definitions and the essence of a TP analysis involving these assets is based on the determination of the conditions that independent parties would have agreed upon for the transfer, use or exploitation of the asset.

Intangible assets that are important to consider for transfer pricing purposes are not always accounted for as intangible assets for accounting purposes. For example, costs disbursed in the internal development of intangible assets through investment, such as in research and development (R&D) and advertising are sometimes expensed rather than capitalized, and thus the intangible assets resulting from the investment are not always reflected on the balance sheet. However, such intangible assets may be used to generate significant economic value and may need to be considered for transfer pricing purposes. On the other hand, not all investment in R&D will produce or enhance an intangible asset.

Through a functional analysis (as will be explained below) the intangible assets in question should be identified, according to their contribution to the creation of value in the company's transactions, reviewing the most important functions performed and risks incurred by the members of a multinational

[1] OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations.

group in relation to the development, enhancement, maintenance, protection and exploitation of the intangible assets.

Therefore, it is important to first determine whether or not a transaction involving an intangible asset exists, and subsequently define whether an intangible asset has been used or transferred between related parties.

While not an exhaustive or comprehensive list, the OECD Guidelines provide some examples of intangible assets that tend to be analyzed for TP purposes:

- Patents,
- Know-how and trade secrets,
- Trademarks, trade names and brands,
- Rights and licenses granted,
- Licenses and similar limited rights in intangible assets, among others.

Analysis and determination of the consideration in transactions involving intangible assets

Once it is determined that a transaction between related parties involving an intangible asset exists, it is necessary to proceed to its analysis from a TP perspective. Based on the "Action Plan on Base Erosion and Profit Shifting" (BEPS) developed by the OECD, specifically in Actions 8, 9 and 10 of such plan, considerations regarding the analysis of transactions with intangible assets were incorporated into the OECD Guidelines, seeking to align transfer pricing outcomes with value creation and develop rules that impede base erosion and profit shifting through the movement of intangibles among members of a group.

<u>DEMPE Analysis</u>

The rules established by the OECD consist of the performance of a detailed functional analysis to determine which of the parties involved in a transaction with intangible assets performs the important functions in connection with the **development, enhancement, maintenance, protection and exploitation** (DEMPE) of such intangible asset, so that each of the parties involved can share in the returns obtained from the exploitation of the intangible assets in their respective jurisdictions, in line with the investment made by each of the parties, as well as the value creation of the intangible asset.

Usually, the related party that has the right to the benefits deriving from the intangible asset is the one that has legal ownership of the intangible in each of the countries where it is exploited. However, mere legal ownership does not imply that only this company should be compensated or, on the contrary, it is probable that the entity that has legal ownership performs all of the functions involved.

Therefore, it is important to determine through the functional analysis which member or members of the group perform and control the functions mentioned above, which member(s) contribute financing and other assets, and which member(s) assume the various risks associated with the intangible asset, with the purpose of compensating each party in their jurisdiction in accordance with the arm's length principle.

Once the functions, risks, resources and assets that each party contributes for the exploitation or transfer of an intangible asset are determined, it will be easier to determine the arm's length consideration with which each party should be compensated, according to such functions, risks and assets. For such purpose, an analysis should be performed of the comparability between each related party and transactions performed between independent parties, in order to determine the arm's length range that can be agreed in order to compensate each activity.

In summary, a complete analysis of the transactions between related parties involving intangible assets should consider the following:

- Specifically identifying the intangible assets used or transferred in the transaction and the specific, economically significant risks associated with the development, enhancement, maintenance, protection, and exploitation of the intangible assets;

- Identifying the full contractual arrangements, with special emphasis on determining legal ownership of the intangible assets based on the terms and conditions of the legal arrangements;

- Identifying the parties performing functions, using assets, and managing risks related to developing, enhancing, maintaining, protecting, and exploiting the intangible assets through the functional analysis (DEMPE analysis);

- Confirming the consistency between the terms of the relevant contractual arrangements and the conduct of the parties;

- Where possible, determining arm's length prices for these transactions consistent with each party's contributions of functions performed, assets used, and risks assumed.

Final considerations

To determine the arm's length principle in transactions involving the use or transfer of intangible assets between related parties, it is necessary to perform an exhaustive analysis regarding the functions, risks, resources and assets contributed by each of the parties, and consequently compensate each party according to their contribution in each of its jurisdictions, seeking proper taxation aligned with value creation.

Although El Salvador is not a member of the OECD, the Salvadorian Transfer Pricing regulations and orientation guides are based on the OECD Guidelines, and thus for the analysis of transactions involving intangible assets, the OECD Guidelines mentioned above should also be considered.

We suggest to our clients and friends that they apply the previous considerations in order to appropriately value their transactions involving intangible assets.

Mario Coyoy
Transfer Pricing Partner
mcoyoy@deloitte.com

Alvaro Miranda
Transfer Pricing Senior Manager

ajmiranda@deloitte.com

Tax Calendar December 2022

The updated 2022 tax calendar is now available on the Tax Administration's website, which includes public holidays and deadlines for all tax obligations.

S	M	T	W	T	F	S
				1	2	3
4	5	6	7	8	9	10
11	12	13	14	15	16	17
18	19	20	21	22	23	24
25	26	27	28	29	30	31

Download the 2022 Obligations Calendar

December 14

VAT

Declaration and payment of the Tax on the Transfer of Movable Goods and the Rendering of Services (F-07).

Financial Income and Transactions

Monthly declaration of Payment on Account, and Tax Withheld on Income, Financial Transactions, and the Special Contribution for Citizen Security and Coexistence (F-14).

Specific and Ad Valorem Taxes

Declaration and payment of Specific Taxes, Ad Valorem Taxes and Special Contribution (F-06).

Other Obligations

- Report on donations (F-960)
- Report on Specific and Ad Valorem Taxes on Producers and Importers of Alcoholic Beverages, Potable Ethyl Alcohol and Beer, Carbonated Beverages, Isotonic Beverages, Fortified Beverages or Energy Drinks, Juices, Nectars, Soft Drinks and Concentrated or Powder Mixtures for the Preparation of Drinks (F-955).
- Report on Specific and Ad Valorem Taxes on Producers and Importers of Firearms, Ammunitions, Explosives and Similar Items, Producers of Tobacco and Producers, Importers and those that clear fuels through customs (F-988).
- Monthly Report of Sales to Producers, Distributors or Retailers of Tobacco and Tobacco Products (F-956).

December 21

VAT

- Monthly Report on Withholdings, Collections, or Payments on Account of VAT (F-930).

Printing Presses

- Monthly Report on Documents Printed for Taxpayers Registered under the VAT (F-945).

December 25, 27, 28,29, 30

Christmas and New Year holidays

Contacts

Federico Paz
Tax Partner
fepaz@deloitte.com

Ghendrex García
Tax and BPS Partner
ggarciaq@deloitte.com

Mario Coyoy
Transfer Pricing Partner
mcoyoy@deloitte.com

Henry Aguirre
BPS Senior Manager
haguirre@deloitte.com

Cosette Fuentes
Legal Services Senior Manager
cg.fuentes@deloitte.com

Jhonny Flores
Tax Consulting Manager
jflores@deloitte.com

Alvaro Miranda
Transfer Pricing Senior Manager
ajmiranda@deloitte.com

Wilmer García
Transfer Pricing Senior Manager
wsgarcia@deloitte.com

Bryan Antillón
Transfer Pricing Manager
bantillon@deloitte.com

Cristina Hernández
Tax Manager
roshernandez@deloitte.com

Emerson Inocente
Tax Manager
einocente@deloitte.com

José Ángel Lopez
Transfer Pricing Manager
joselopez@deloitte.com