



**Premier
Brains**
Audit | Tax | Accounting | Advisory

Transfer Pricing in UAE

September 25, 2022

01 INTRODUCTION

On 31 January 2022, the Ministry of Finance announced that the United Arab Emirates will introduce a Federal Corporate Tax on business profits effective for financial years starting on or after 01 June 2023. On 28th April 2022, a public consultation document ('PCD') was also published with the objective of seeking comments from the stakeholders on the proposed regulations.

When the Ministry of Finance announced that corporate tax would be implemented in the UAE it confirmed that one of the mechanisms underpinning the new tax law would be the introduction of Transfer Pricing, based on Organisation for Economic Co-operation and Development ('OECD') principles. The proposed UAE CT regime will cover the introduction of formal Transfer Pricing (TP) rules and TP documentation requirements in line with the TP Guidelines issued by OECD (OECD TP Guidelines). In addition, other CT aspects (ex: tax grouping, freezone regime, etc.) could have an impact on the applicability of the TP requirements to the businesses.

02 WHO WILL BE AFFECTED?

It is likely that, all businesses will be within the scope of the transfer pricing rules as it seems reasonable that the Federal Tax Authority ('FTA') should be able to invoke the rules in any situation, domestic or international, where the manipulation of transfer pricing appears to impact the amount of corporate tax payable. The principal burden of the rules is likely to fall on multinational enterprises that transfer goods or services between group entities. Groups of this kind, in particular, will probably need to maintain the records stipulated by the OECD and might need to make additional annual reports or declarations to the FTA.



03 INVOLVEMENT OF OECD

For several years, the OECD has been at the forefront of the movement to combat tax avoidance through its 'Base Erosion and Profit Shifting' ('BEPS') action plan. Base erosion and profit shifting (BEPS) refers to tax planning strategies used by multinational enterprises that exploit gaps and mismatches in tax rules to avoid paying tax. Developing countries' higher reliance on corporate income tax means they suffer from BEPS disproportionately. Working together within OECD/G20 Inclusive Framework on BEPS, over 135 countries and jurisdictions are collaborating on the implementation of 15 measures to tackle tax avoidance, improve the coherence of international tax rules and ensure a more transparent tax environment.

Transfer pricing is an integral part of these measures, and the OECD lays down a number of minimal standards, based around standard reports, in order to maintain transfer pricing integrity.

The UAE has stated its support for the BEPS program and the adoption of the OECD rules for transfer pricing was a logical step as part of the introduction of corporate tax.

04 OECD GUIDELINES ON TRANSFER PRICING

The UAE has said that it will follow the OECD guidelines on transfer pricing. Central to the OECD transfer pricing guidelines is the 'arm's length principle', which the OECD says represents an international consensus on the valuation of cross-border transactions between associated enterprises. An arm's length transaction refers to a business deal in which buyers and sellers act independently without one party influencing the other.

The OECD provides detailed guidance on allowable methods to test, analyze and compare the transfer price in order to establish the arm's length valuation. It also prescribes the format of documentation that multinational Enterprises are expected to maintain.

05 TRANSFER PRICING

Transfer pricing concerns the value of transactions between connected parties. Transfer pricing describes all aspects of inter-company pricing arrangements between members of a multinational group, including transfers of tangible goods; services; intellectual property; and loans as well as other financial transactions. The essence of transfer pricing rules for tax purposes is that the transfer price should be at an 'open market' or 'arm's length' value.

06 ARM'S LENGTH PRICE

The arm's length price (ALP) of a transaction between two associated enterprises is the price that would be paid if the transactions had taken place between two comparable independent and unrelated parties, where the consideration is only commercial.

As per the PCD, UAE will apply arm's length principle to the transactions and arrangements between related parties and with connected persons



07 RELATED PARTIES DEFINITION AS PER PCD

There are different rules for determining whether parties involved in a transaction are considered "Related Parties" for UAE CT purposes. These are summarized below:

- Two or more individuals related to the fourth degree of kinship or affiliation, including by birth, marriage, adoption or guardianship
- An individual and a legal entity where alone, or together with a related party, the individual directly or indirectly owns a 50% or greater share in, or controls, the legal entity;
- Two or more legal entities where one legal entity alone, or together with a related party, directly or indirectly owns a 50% or greater share in, or controls, the other legal entity;
- Two or more legal entities if a taxpayer alone, or with a related party, directly or indirectly owns a 50% share of each or controls them;
- A taxpayer and its branch or permanent establishment;
- Partners in the same unincorporated partnership;
- Exempt and non-exempt business activities of the same person

08 CONNECTED PERSONS DEFINITION AS PER PCD

A person will be considered as 'connected' to a business that is within the scope of the UAE CT regime if he or she is:

- An individual who directly or indirectly has an ownership interest in, or controls, the taxable person;
- A director or officer of the taxable person;
- An individual related to the owner, director or officer of the taxable person to the fourth degree of kinship or affiliation, including by birth, marriage, adoption or guardianship;
- Where the taxable person is a partner in an unincorporated partnership, any other partner in the same partnership;
- A Related Party of any of the above.

09 TRANSFER PRICING PROCESS

OECD Transfer pricing guidelines includes a 9 steps process for comparability analysis:

- 01** Determination of the years to be covered.
- 02** Broad-based analysis of the taxpayer's circumstances (sector, competition, economic and regulatory environment etc).
- 03** Understanding the controlled transactions, based on functional and risk analysis. This is used to define the tested party, the transfer pricing method most appropriate to the circumstances of the case, financial indicators to be tested and to identify significant comparability actors that should be taken into account.
- 04** Review of existing internal comparables, if any, (i.e. the taxpayer's own transaction prices, mark-up percentages, net margins etc.) with independent persons comparable to the transactions conducted between the controlled related parties.
- 05** Determination of available sources of information on external comparables, taking into account their relative reliability (i.e. comparable transaction prices, mark-up rates and net margins between unconnected parties in market conditions).
- 06** Selection of the most appropriate transfer pricing method and, depending on the method, determination of the relevant financial indicator (e.g. determination of the relevant net profit indicator in case of the transactional net margin method).
- 07** Identification of potential comparables: determining the key characteristics to be met by any uncontrolled transaction in order to make a comparison to determine an arm's length price for the controlled transaction in accordance with step 3 and in accordance with the comparability factors)
- 08** Determination and application of the comparability adjustments where appropriate.
- 09** Interpretation and use of data collected, determination of the arm's length remuneration.



10 OECD - TRANSFER PRICING METHODS

There are 5 methods which consist of three traditional transaction methods and two transactional profit methods.

11 TRADITIONAL TRANSACTION METHODS

Are regarded as the most direct means of establishing whether conditions in the commercial and financial relations between associated enterprises are at arm's length. They are:

- Comparable Uncontrolled Price Method (CUP Method) :** The CUP method compares the price charged for property or services transferred in a controlled transaction to the price charged for property or services transferred in a comparable uncontrolled transaction in similar circumstances.
 This method would generally be an appropriate transfer pricing method for establishing the arm's length price for the transfer of commodities between associated enterprises.
- Resale Price Method :** This method begins with the price at which a product that has been purchased from an Associated Enterprise is resold to an independent enterprise. The Resale Price is then reduced by an appropriate gross margin on this price representing the amount out of which the reseller would seek to cover its selling and other operating expenses and in the light of functions performed make an appropriate profit. What is left after subtracting the gross margin can be regarded, after adjustments for other costs associated with the purchase of the product, as an arm's length for the original transfer between the Associated Enterprise.
 This method is probably most useful to marketing operations such as those carried out by a distributor.
- Cost Plus Method :** This method begins with the costs incurred by the supplier of property in a controlled transaction for property transferred or services provided to an associated purchaser. An appropriate cost-plus markup is added to this cost, to make an appropriate profit in light of the functions performed and the market conditions. What is arrived at after adding the cost-plus mark up to the above costs may be regarded as an arm's length price of the original controlled transaction.
 This method probably is most useful where semi-finished goods are sold between Associated parties, where associated parties have concluded joint facility arrangements, or where the controlled transaction is the provision of services.

12 TRANSACTIONAL PROFIT METHODS

examine the profits that arise from particular transactions among associated enterprise. Profits arising from a controlled transaction can be a relevant indicator of whether the transaction was affected by conditions that differ from those that would have been made by independent enterprises in otherwise comparable circumstances. They are:

- Transactional Profit Split Method:** This method first identifies the profits to be split from the controlled transactions- the relevant profits and then split them between associated enterprises on an economically valid basis that approximates the division of profits that would have been agreed at arm's length. This method can be considered where each party makes unique and valuable contributions, or business operations are highly integrated such that the contributions of the parties cannot be evaluated in isolation.
- Transactional Net Margin Method:** This method examines the net profit relative to an appropriate base that a tax payer realizes from a controlled transaction with the net profit earned in comparable uncontrolled transactions. This is the most commonly used method for justifying the transfer pricing of a company

A case-by-case analysis would have to be undertaken to determine the most appropriate method to evaluate the correct application of arm's length principle for every related party transaction.



13 TRANSFER PRICING DOCUMENTATION

Transfer pricing documentation is defined as all the documents that taxpayers are obliged to prepare in order to prove their related party transactions were performed under arm's length conditions and at arm's length prices. In addition to being a legal requirement, TP documentation is a proactive instrument of defence in a tax inspection, and keeps taxpayers prepared for retrospective examinations of related party transactions that could create time and cost burdens, and supports the transfer pricing policy being applied consistently

OECD guidelines recommend that individual jurisdictions adopt a three-tier structure to transfer pricing documentation consisting of:

- A Master File containing standardized information relevant for all MNE group members;
- A local File referring specifically to material transactions of the local tax payer; and
- A Country-by-Country report containing certain information relating to the global allocation of the MNE group's income and taxes paid together with certain indicators of the location of the economic activity within the MNE group.

It seems likely that groups that fall within the scope of UAE transfer pricing will need to maintain the Master and Local Files where the arm's length value of their related party transaction exceeds a certain threshold in the relevant tax period.

Country-by-Country Reporting has already been introduced to the UAE.

MASTER FILE

The Master File should include an overview of an MNE's group business, including the nature of its global business operations, its overall transfer pricing policies, and its global allocation of income and economic activity in order to assist tax administrations in evaluating the presence of significant transfer pricing risk.

The information required in the master file provides a "blue print" of the MNE group and contains relevant information that can be broken down into five categories:

- The MNE group's organizational structure;
- A description of the MNE group's business or businesses;
- The MNE group's intangibles;
- The MNE group's intercompany financial activities;
- The MNE group's financial and tax positions.



LOCAL FILE

In contrast to the Master File, which provides a high-level overview, the local file provides more detailed information related to the specific intercompany transactions. The local file focuses on information relevant to the transfer pricing analysis related to transactions taking place between a local affiliate and associated enterprises in different jurisdictions and which are material in the context of the jurisdiction's tax system.

The local file is required to contain:

- Information regarding the local entity, organizational structure, description of the local business, business strategy and key competitors;
- Detailed analysis of material related party transactions, including copies of material intercompany agreements, functional and comparability analyses, selection and application the most appropriate transfer pricing methodology;
- The amount of intra-group payments and receipts for each category of controlled transactions involving the local entity, broken down by tax jurisdiction of the foreign payor or recipient; and
- Local entity financial information including financial accounts for the financial year.



14 WHAT NEXT TO DO FOR BUSINESSES REGARDING IMPLEMENTATION OF TRANSFER PRICING IN UAE?

It is believed that the Transfer Pricing rules may be published within and as a part of the detailed UAE CT legislation. The CT regime will come into effect from 01 June 2023 and it is expected that Transfer pricing rules associated with CT will also come into effect for financial years from this date.

The OECD Transfer Pricing Rules shall now be applicable in the UAE and all companies will have to comply with the Transfer Pricing rules and documentation requirements. These transfer pricing rules will now become mandatory and may also be applicable to domestic transactions.

The expected Transfer Pricing rules in the UAE will be applicable to related party and connected persons transactions for entities subject to CT in the UAE. Multinational groups with entities in the UAE should start making an assessment of their transfer pricing policy and also understand any TP risks and exposures related to the pricing of related party transactions.

“Always Doing The Right Thing”

ADDRESS

 Office 805, 8th Floor,
The Exchange Tower
Business Bay, UAE

CONTACT US

 04 354 2959
 info@premier-brains.com
 www.premier-brains.com

FOLLOW US

