UAE Corporate Tax

Transfer pricing guide

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UAE CT - Transfer pricing guide

On 23 October 2023, the Federal Tax Authority (FTA) issued the Transfer Pricing Guide (TP Guide), which provides insights and practical guidance to taxpayers on the Transfer Pricing (TP) rules and regulations per the Corporate Tax Law of the United Arab Emirates (UAE CT Law).

The TP Guide is broadly aligned with the Transfer Pricing Guidelines issued by the Organisation for Economic Co-operation and Development (OECD Guidelines)[1] and provides general guidance on the TP regime in the UAE, and practical examples on, for instance: how to identify Related Parties and Connected Persons; how to undertake a functional analysis; and how to price intra-group financing transactions.

Summarised in this alert are some of the key points contained within the TP Guide which provide additional guidance and clarifications as compared to the OECD Guidelines. This alert is not intended to provide a full summary of the TP Guide.

1. Related Parties

The TP Guide provides examples as to when a Person can exercise control over another person, and hence may be considered Related Parties for TP purposes. These examples are as follows:

- **Significant influence based on debt:** when a third party provides debt to a borrower, that constitutes 50% of the total capital of the borrower;
- **Exercising key management and strategic functions:** when a minority shareholder (or shareholder with less than 50% of the shares), plays a key role in the management of day-to-day operations, development of strategies, and formulation of key market decisions in decision making.

The examples further expand the scope of the Related Party definition in the UAE CT Law.

Furthermore, the UAE has entered into agreements with other jurisdictions for the avoidance of double taxation, which refer to the term “Associated Enterprises”. The TP Guide clarifies that in the event that there are differences between the Related Party definition in the UAE TP regulations and an international agreement in force in the UAE, the provisions of the international agreement will prevail for cross border transactions.[2]

2. Substance over Form

The TP Guide clarifies that the economic conduct between the parties prevails over the written contracts, as the latter may not provide all the information necessary to perform a TP analysis. The functions performed, characteristics, economic circumstances and business strategies will provide an important understanding of the actual conduct of the parties involved in relation to the Controlled Transaction.

Whilst there is no obligation to prepare written contracts from a TP perspective, taxpayers may consider adopting a simplified approach of maintaining written contracts based on certain materiality thresholds, criticality of transactions and arrangements, etc. and ensure these contracts are aligned with the actual conduct. It is highly recommended that taxpayers conclude written contracts for more material transactions as these will define the parameters of a transaction, they will be used as a starting point in TP audits, and hence, will form the first line of defence for taxpayers. However, it is also critical that economic reality is aligned with the content of the contracts as, on their own, they are insufficient to conclude on the economic conduct of the parties involved.

Furthermore, in case of business restructurings (per Chapter IX of the OECD Guidelines and Section 7 of the TP Guide) legal agreements are essential to evaluate the arm’s length nature of the termination clause.

[1] The 2022 version of the OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations
[2] Considering the absence of a double taxation between the UAE and the United States of America, for example, the complex Related Party definition in the UAE CT Law will require many companies to do a detailed analysis of their position.

3. Aggregation of Transactions

In line with the OECD Guidelines, the TP Guide provides for the preference to apply the TNMM on a transactional basis and not on a company-wide basis as this becomes less reliable when the Taxable Person is engaged in various different Controlled Transactions. However, TNMM on an aggregate basis may be applied when the aggregate activities / transactions are sufficiently interlinked from an economical or commercial standpoint, for example, when similar sales functions are conducted for products in similar product lines.

Taxable Persons may also opt to apply the TNMM, or any other method, on a company-wide basis to corroborate the results obtained from the separate analyses performed on a transactional basis.

As such, whilst aggregation may offer the possibility of simplification of the TP documentation, careful consideration of the comparability factors is required before an aggregated approach may be adopted.

4. Arm's length range

The FTA endorses the use of the interquartile range as an appropriate approach to ascertain an arm’s length range as it provides more a reliable measure of central tendency.

Any point in the arm’s length range is acceptable in establishing an arm's length price for the controlled transaction, however the functional profile of the taxpayer will be considered in determining the most appropriate point in the range.

For example, a point closer to the lower quartile may be appropriate for a company with a very simple functional profile, whilst a point closer to the upper quartile may be suitable for a company with more complicated functional profile.

The TP Guide is silent on whether the FTA will make an adjustment to a specific point in the arm’s length range (interquartile or full range) when results are not within the range, so taxpayers will have to wait to see how the FTA’s position develops through their conduct of TP audits.

5. Extreme results in comparables

The TP Guide highlights the importance of reviewing extreme results in a comparability analysis, particularly loss-making entities and when they should be retained or otherwise removed from the list of comparables.

Generally, a loss-making uncontrolled transaction or loss-making company should trigger further investigation in order to establish whether or not it can be comparable to the Controlled Transaction. Circumstances in which loss-making transactions/ enterprises should be excluded from the list of comparables include cases where losses do not reflect normal business conditions, and where the losses incurred by third parties reflect a level of risk that is not comparable to the one assumed by the Taxable Person in its Controlled Transactions.

[1] The 2022 version of the OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations.

6. TP disclosure form

The UAE CT Law states that the FTA may require all Taxable Persons who undertake transactions with Related Parties or Connected Persons (domestic or foreign) to prepare and submit a TP disclosure form. The TP Guide has now introduced a materiality threshold for this TP disclosure form, but the threshold has not been determined as of yet.

The TP Guide also states that a sample TP disclosure form will be published on the FTA website shortly.

7. Master File and Local File requirements

Taxable Persons are required to maintain contemporaneous TP documentation of their controlled transactions to demonstrate compliance with TP regulations and maintain the integrity of their Corporate Tax positions.

Furthermore, Taxable Persons meeting a certain threshold are required to prepare a Master File and a Local File.

However, a Taxable Person that is part of a UAE headquartered group that is not an MNE Group (i.e. a group that does not have business establishments outside the UAE) is not required to maintain a Master File, but will still be required to maintain a Local File if it is engaged in any Controlled Transactions.

Furthermore, the TP Guide explicitly permits the preparation of a Master File presentation by each line of business where justified by facts, e.g. if significant business lines in the MNE group operate largely independently or are newly acquired. However, centralised group functions and transactions between business lines should be adequately described in the Master File. Regardless of the choice of a business line presentation, the taxpayer must maintain a Master File that encompasses all business lines to provide a comprehensive overview of the group's global operations.

8. Additional Guidance on financial transactions

While the TP Guide follows Chapter X of the OECD Guidelines for financial transactions, additional guidance on pricing of financial transactions is provided with further examples. The TP Guide covers various aspects of intra-group financing arrangements with illustrative examples demonstrating how the arm's length principle is applied to intra-group financing arrangements and how comparability adjustments are performed where there is a lack of sufficient comparables.

9. Intra-group services

To reduce the compliance burden on taxpayers, a simplified approach under Chapter VII of the OECD Guidelines is provided, whereby certain low value-adding intra-group services may be charged out at a cost-plus 5% mark-up without the need for a detailed benchmarking analysis. The TP Guide has explicitly adopted the use of this simplified approach in the UAE, if the intra-group services provided meet the criteria for low value-adding services.

Also the Taxable Person must maintain and submit to the FTA (upon request), supporting documents that provide information on the intra-group services rendered, recipients' identity, benefits accrued, methodology and computation of the service charges along with the rationale for the selection of allocation key, This should be incorporated in the TP documentation for each pertinent Tax Period.

Whilst the use of a simplified approach reduces the compliance burden, services provided should be carefully analysed to assess whether these can indeed be characterised as low value adding considering the overall business activities of the service provider and service recipients. Furthermore, the acceptability of the simplified approach from the perspective of the counter-party to the transaction (i.e. foreign jurisdiction) should be evaluated.

10. Use of Domestic Comparables

The TP Guide emphasizes the importance of using local and/or regional comparables in the taxpayers' TP policy and benchmarking study. However, when such comparables are not available then other geographies should be considered. If an MNE Group has a Group-wide TP policy for common transactions and arrangements consistent with arm's length standards, this TP policy may be used for UAE TP purposes. However, this TP policy should be evaluated from the UAE context based on two parameters:

- whether the Taxable Person is carrying out similar transactions and arrangements with Related Parties and Connected Persons; and
- whether the arm's length result of the Group-wide TP policy takes into account local and/or regional comparables in order to meet the arm's length standard.

In reality, it is practically difficult to find suitable local and/or regional comparables for the UAE and Middle East, and hence typically searches in the Middle East are expanded to include companies from North Africa and Eastern Europe regions, whilst carefully considering the comparability factors.

11. Business Restructurings

To assess whether a business restructuring would give rise to a compensation, Chapter IX of the OECD Guidelines should be followed. However, certain modifications have been made in the TP Guide to suit the domestic requirements and views of the FTA. The TP Guide does not refer to mere cross-border business restructurings and, therefore, covers domestic business restructurings as well.

12. Cash/ bank settlement

The TP Guide indicates that the arm's length principle requires that there should be a reasonable mechanism and governance between Related Parties or Connected Persons on raising intercompany invoices and the time period for the settlement process. If the actual settlement period exceeds what the Related Parties or Connected Persons agree upon on a regular basis, the extended credit period could be regarded as an advancement of loan, for which an arm's length fee or interest could be charged.

13. Burden of Proof

The TP Guide further highlights the taxpayer's burden of proof to maintain sufficient supporting documentation as well as to make timely submissions to the FTA in order to support the position taken in the tax return as it relates to the Controlled Transactions that are in scope for each Tax Period.

Hence, robust TP documentation is an important first line of defence to help support taxpayers' positions. The benefit of maintaining TP documentation is that it pushes the burden of proof onto the FTA.

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Key takeaways and next steps

Taxpayers should consider the TP Guide when designing TP policies and preparing their compliance strategies for financial years starting on or after 1 June 2023. Global group-wide TP policies should be reviewed and adapted to the local TP requirements in order to be prepared for the first compliance year. There are still critical areas that remain unclear, of which some are included below:

- The threshold to determine which taxpayers will be required to prepare and file a TP disclosure form;
- With reference to the Ministerial Decision No. 97 of 2023, whether transactions between Taxable Persons falling under the same corporate tax rate, can also be excluded from the TP disclosure form;
- With reference to the Ministerial Decision No. 97 of 2023, whether transactions that occur in the ordinary course of the business, can also be excluded from the TP disclosure form;
- Whether a benchmarking study supporting a different mark-up than 5%, can be used for low value adding intra-group services rather than using the simplified approach;
- What valuation techniques could be used in case of a transfer of intangibles or in case of a business restructuring of a business;
- How to characterise intra-group funding, based on a debt capacity analysis.

Please reach out to us through your PwC contact or the TP specialist contacts below for further guidance and questions. You can also reach us by emailing CT.UAE@pwc.com.

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