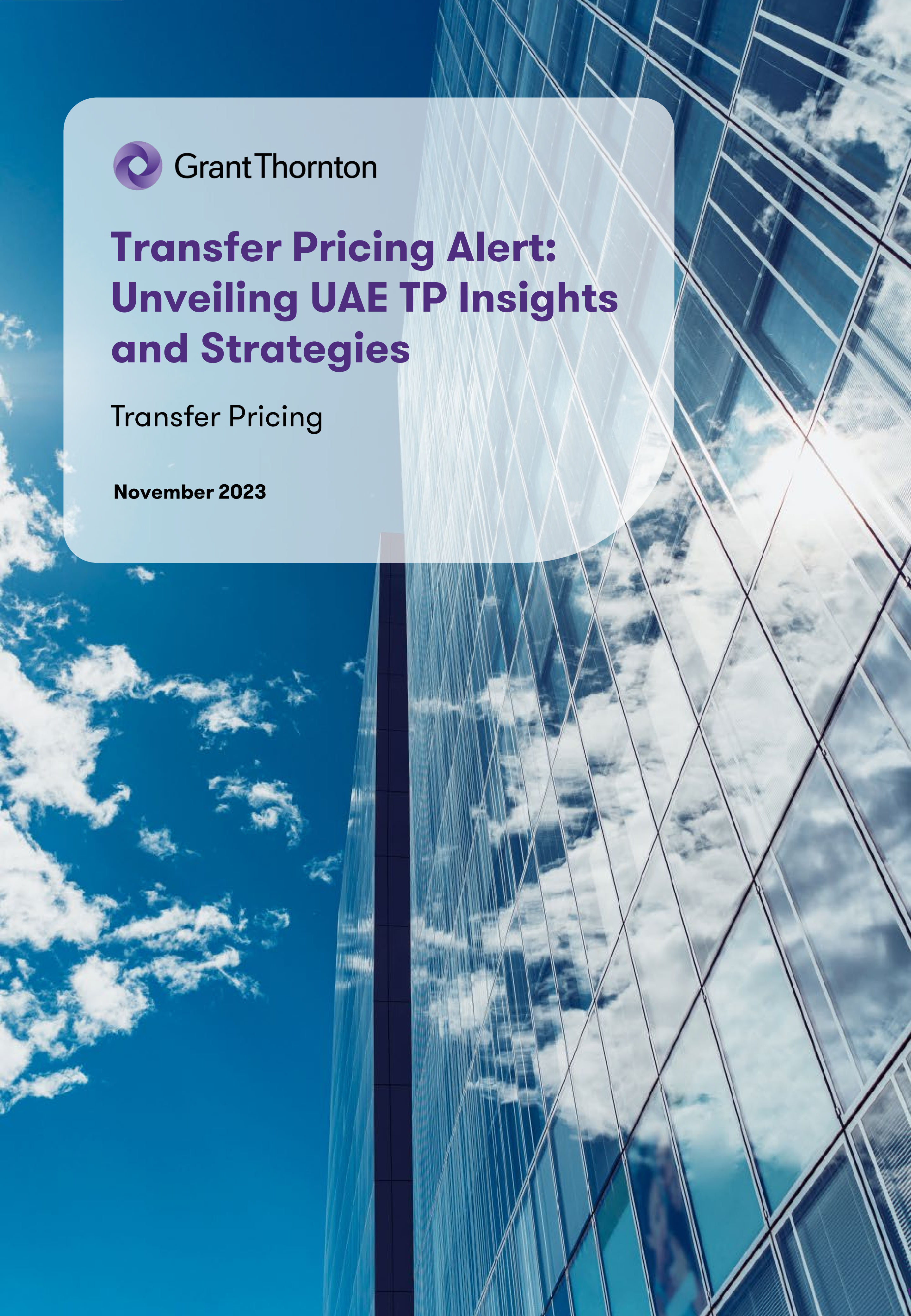

Grant Thornton

Transfer Pricing Alert: Unveiling UAE TP Insights and Strategies

Transfer Pricing

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The UAE announces detailed Guidelines for application of Transfer Pricing (TP) regulations

On 23 October 2023, the UAE Ministry of Finance (MoF) released a Transfer Pricing Guide ('TP Guide') which provides clarifications, as well as simple examples to help businesses understand complex TP regulations outlined in Corporate Tax Law (CTL).

This TP Guide is not a binding legal document; however, it should be the primary source of guidance for TP, even taking precedence over international standards. However, if a certain aspect is not covered in the TP Guide, taxpayers can refer to the TP Guidelines published by Organisation of Economic Cooperation and Development (OECD) [also referred herein as OECD TP Guidelines].

In brief

- Key highlights of the TP Guide
- Insights on benchmarking analysis to be maintained by businesses
- TP Audit essentials
- Special Considerations
- Key Takeaways

In detail

I. Distinctive approach of UAE

- Guidance on 'Significant Influence'

  Article 35 of the CTL, one of the definition of Related Party includes ability to determine or exercise "significant influence" over the conduct of the business and affairs of another person.

  This may require considering different factors and circumstances specific to the situation.

  The TP Guidelines illustrates few examples to establish 'significant influence':

  a. **Debt-based influence:** A person contributing significant amount of funds (e.g., equivalent to 50% or more of the total capital) to another person's business through a loan.

  b. **Entitlement of profits:** royalty arrangement that entitles 50% or more of profits

  c. **Key business decisions / majority interest:** A person who undertakes important decisions about another person's business, such as developing the business strategy and other core business activities.

  Hence, each arrangement needs to be evaluated and examined on case-to-case basis.

  Based on our experience, reference of 'significant influence' may also be drawn from other legislations such as International Financial Reporting Standards (IAS 28).

- Materiality Threshold

  The TP Guide requires transactions above a certain threshold to be disclosed in both TP Disclosure Form and the TP Documentation (which is yet to be released).

  We expect this threshold to apply to each class of transaction with a Related Party / Connected Person.

  This will reduce the compliance burden for small businesses and other entities that are required to maintain TP documentation, even though very few controlled transactions may occur during the tax period.

- Clarification on applicability of Master File to UAE headquartered groups

  The TP Guide specifically carves out UAE-headquartered groups that do not have any business establishment outside the UAE, they are therefore not required to maintain a Master File.

- Substance over form

  When the actions of related parties or connected persons differ from the terms of a contract, the actual transaction should be judged based on their conduct, even in cases where there is no formal agreement between them. Accordingly, it is crucial to revise or prepare the contractual agreements (wherever required) to align them with actual circumstances.

- Comprehensive sample of functional interview questionnaire

  The TP Guide provides a detailed list of functional questions for businesses that are typically engaged in manufacturing. This list may be used as a reference tool for evaluating their business operations. Additionally, the TP Guide also outlines contents of Local File and Master File based on OECD TP Guidelines.

II. Insights on benchmarking analysis

- Adoption of foreign comparables

  While domestic comparables are preferred, regional (Middle East) or global comparables may be considered when domestic data is insufficient.

  Based on our experience, the Middle East region has limited published data on public databases. Accordingly, adoption of foreign comparables is a welcome news for all UAE based groups.

- Multiple year analysis

  Using three years of data to compare companies is acceptable, but at least two years of data are required to accept a company as comparable.

- Interquartile range

  Interquartile range (lower, median and upper quartile) is considered acceptable for arriving at arm's length price. The TP Guide also outlines methodology to compute the arm's length range by way of case study. Any extreme results published by comparables (such as abnormal profits or losses) should be revisited and maybe excluded.

- Contemporaneous documentation

  In order to reflect actual economic environment, it is recommended to maintain information relating to the controlled transaction at the time it was undertaken

- Frequency of benchmarking analysis

  If the terms and conditions of the controlled transaction remains unchanged, a fresh benchmarking analysis can be performed once in every three years. However, for the interim years, a financial update of comparables is mandatory.

- Timing of arm's length testing

  Taxpayers should demonstrate arm's length pricing by conducting arm's length testing either at the time of undertaking the transaction or at the end of tax period. Such approach should be consistently followed for controlled transactions.

III. TP Audit essentials

- Burden of proof

  The burden of proof to substantiate the arm's length nature of controlled transactions lies with the taxpayers.

- Commercial rationality / Benefit test

  The TP Guide emphasises the importance of meeting the benefit test to prove that the arrangement was not solely motivated by corporate tax advantages.

  It is important to note that all controlled transactions must have a valid commercial purpose, and respective substantiation/ documentation that supports this economic rationality.

  These practices are recommended for all businesses, specially, in case of loss-making entities and availing intercompany services which is always under the tax authorities' radar.

- Maintain records to support arm's length price

  Taxable persons that do not meet the thresholds or entities that are exempt from maintaining TP documentation are still required to maintain reasonable records to substantiate the arm's length nature of the controlled transactions. The Federal Tax Authority (FTA) has the power to request such information to be produced within 30 days of request.

- TP adjustment by the Taxable Person

  Taxpayers have an option to make suo-moto adjustment (post filing of return) which results in increased taxable profits / reduced allowable losses. However, in case of a suo-moto adjustment that results in reduction of taxable profits / increased allowable losses, such adjustment can be implemented only during audits conducted by FTA.

- TP adjustment by the FTA

  The FTA has the power to adjust the taxable profits of the taxpayer to achieve arm's length results that reflects actual economic circumstances of the arrangement. The FTA will also reflect the corresponding adjustment in the taxable income of the local entity that is a party to this arrangement.

- Cross-border corresponding TP adjustment

  The FTA has the power to adjust a taxpayer's taxable income to ensure that it reflects the true economic value of controlled transactions. The FTA will share the information used to make these adjustments

  In summary, the FTA can ensure that taxpayers pay the correct amount of tax, this is important to prevent tax avoidance and to ensure that all taxpayers are treated fairly.

IV. Special Considerations

- ### Financial transactions

  Guidance on determining arm's length prices for special cases such as intragroup loans, treasury services, cash pooling, hedging, guarantees and captive insurance has been included in the TP Guide. These guidelines are in line with OECD TP Guidelines.

- ### Safe Harbour on intragroup services

  Routine/low value-added support services (non-core services), such as centralised services (administrative, information technology support, etc.), may choose to use a safe harbor margin of cost plus 5% markup to arrive at arm's length compensation.

  This will reduce the compliance burden on multiple businesses that have internal low value-added support functions.

- ### Intangibles

  A detailed analysis involving intangibles will be required to be undertaken to identify entities involved in Development, Enhancement, Protection, and Exploitation (DEMPE) of intangibles. The legal owner need not physically perform all these functions, related to an intangible, however, the overall control of these functions needs to be tested.

  Additionally, if none of the five methods can be applied, the TP Guide gives an option to apply other alternative methods such as valuation, market appraisal, etc.

- ### Cost contribution arrangements

  Value of each participant's contribution needs to be evaluated under this arrangement. Accordingly, the TP Guide provides steps to delineate such arrangements and calculate arm's length price.

- ### Business restructurings

  Organisation restructuring may lead to transfer of ownerships, transfer of intangibles, etc. Accordingly, the TP Guide provides guidelines to determine reallocation of potential profits under arm's length conditions.

- ### Permanent Establishments

  In order to arrive at profit attributable to a Permanent Establishment (PE), it is recommended to undertake a detailed Functions, Assets and Risk analysis since a PE is treated as a separate entity for TP purposes.

Key Takeaways

- The TP Guide is largely based on the principles of the OECD TP Guidelines, with some specific modifications to apply to the UAE region.
- Tax authorities around the world are increasingly scrutinising TP arrangements. This is because transfer pricing is a common way for multinational companies to shift profits to low-tax jurisdictions. Accordingly, maintaining adequate documentary evidences to substantiate all controlled transactions and its commercial rationality will make the businesses prepared for TP audits.
- Taxpayers should adopt a risk-based approach and prioritise areas where there is greater risk of tax avoidance.
- Specific guidelines for determining arm's length prices for payments to Connected Persons are still awaited amongst the other open decisions such as materiality thresholds, etc.

Tax Team

Want to know more? The Tax Team at Grant Thornton UAE aims to provide you with updates regarding the latest developments in Tax within both the UAE and the Middle East region.

For more details with respect to this alert or queries on other Tax issues please contact the following GT Tax leaders, whose details are given below.

Steve Kitching
Partner
Head of Tax

T +971 58 550 9064
E steve.kitching@ae.gt.com

Anuj Kapoor
Partner
Tax Advisory

T +971 56 369 8944
E anuj.kapoor@ae.gt.com

Anna Nikolayko
Director
Transfer Pricing

T +971 56 500 1940
E anna.nikolayko@ae.gt.com

Nimesh Malik
Associate Director
Transfer Pricing

T +971 52 797 91584
E Nimesh.malik@ae.gt.com

Abu Dhabi

Al Kamala Tower
Office 1101, 11th Floor
Zayed the 1st Street
Abu Dhabi, UAE

T +971 2 666 9750
F +971 2 666 9816

Dubai

The Offices 5
Level 3, Office 303
One Central, DWTC
PO Box 1620
Dubai, UAE

T +971 4 388 9925
F +971 4 388 9915

Abu Dhabi

Unit 2, Floor 14
Sila Tower
ADGM Square
Al Maryah Island
Abu Dhabi, UAE

T +971 2 666 9750
F +971 2 666 9816

Sharjah

Al Bakr Tower
Office 305
7/9 Al Khan Street
Sharjah, UAE

T +971 6 525 9691
F +971 6 525 9690

Grant Thornton