

The background features a dark blue world map with white network lines connecting various points. A hand is visible on the right side, holding a tablet. The overall theme is global connectivity and technology.

FAQs on

Transfer Pricing

in the UAE

A hand is shown holding a tablet. The tablet screen displays a large cargo ship filled with colorful shipping containers. Below the ship, various currency symbols are visible, including the Euro (€), Dollar (\$), Pound (£), and Yen (¥).

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Foreword



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Transfer pricing - I think this term is becoming familiar to many of us in the UAE now.

Globally, transfer pricing is one of the leading tax risk issues and relates to the competing objectives of three parties i.e., the revenue-maximizing objective of the domestic tax authority, the revenue-maximizing objective of the foreign tax authority, and the tax-minimizing objective of the taxpayer.

The introduction of the transfer pricing regulations under the UAE's Corporate tax law is now in the spotlight and is an important matter for all UAE businesses. These regulations indicate that it will have an extensive tax and non-tax operational implications for all affected UAE businesses. Also, failure to adequately address transfer pricing could result in lengthy transfer pricing audits, significant tax exposures, double taxation, reputational damage, and significant penalties being imposed on the taxpayers.

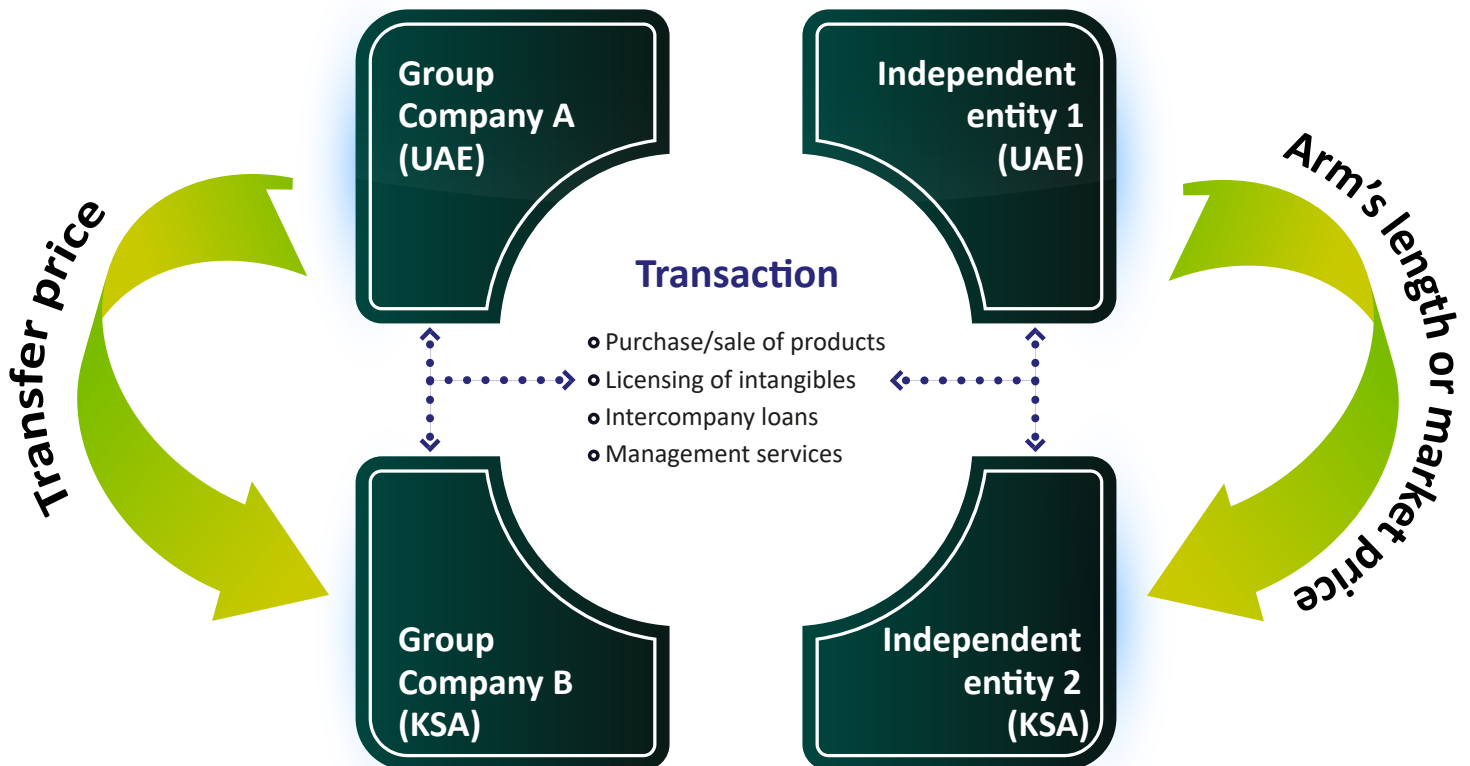
At UHY James, we believe that sharing knowledge is essential. So, considering the complexity, technicality, and subjectivity of Transfer Pricing we have prepared a list of Frequently Asked Questions (FAQ) covering basic principles of transfer pricing and specific technical questions on the UAE Transfer Pricing Regulations. This FAQ intends to act as a quick guide on how businesses in the UAE can address their TP framework going forward.

Our tax professionals including Subject Matter Experts (SMEs) with solid experience from UK/ Netherlands wield a wide breadth of experience, local knowledge and provide a range of transfer pricing services to help stakeholders plan, manage, document, and defend domestic/-cross-border transactions.

Transfer pricing and its importance?

Transfer pricing (“TP”) is the pricing of transactions between associated enterprises/related parties and connected persons. These related party transactions could be tangible property, services, intangible property, and financing transactions. Ideally, the transfer price should not differ from the prevailing market price, which would be reflected in a transaction between independent enterprises – which is the arm’s length principle.

Please see below a schematic overview of the transfer pricing concept:



As a process, it is required to determine arm’s-length prices using one or a combination of the following internationally recognized TP methods:

- Comparable Uncontrolled Price method (“CUP”);
- Resale Price method (“RPM”);
- Cost-Plus method (“CPM”);
- Transactional Profit Split method (“PSM”); and
- Transactional Net Margin method (“TNMM”)

Important to note that, the UAE TP rules does not specify the order of preference for determining the application of a TP method.

Considering the technicality and subjectivity of transfer pricing, its a leading tax risk issue and failure to adequately address transfer pricing could result in lengthy tax audits focused on transfer pricing issues, significant tax exposures, double taxation, reputational damage, and significant penalties being imposed on the taxpayers.

Related parties and connected persons as per the UAE transfer pricing law?

Any natural or juridical person who has, directly or indirectly, associated for business arrangements through ownership of 50%, control, kinship or affiliation, which is established by the relationship of two or more individuals who are related to the fourth degree by birth, marriage, adoption, or guardianship and,

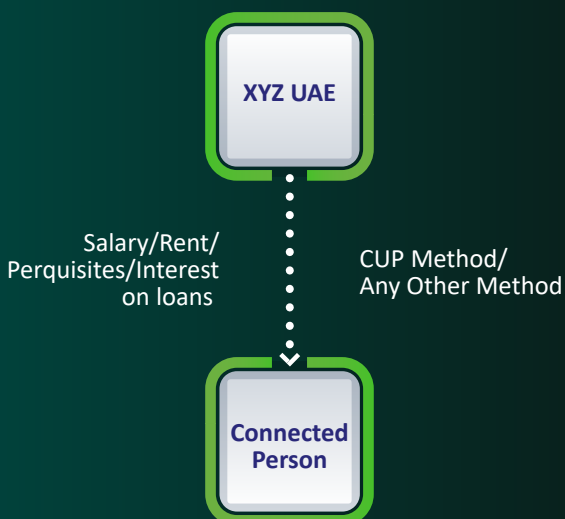
A Connected Person is an individual who directly or indirectly has an ownership interest in or controls the taxable person. A director or officer of the taxable person is also considered as a connected person.

It is key for the UAE businesses to start identifying their related parties and connected persons in view of the UAE transfer pricing legislative framework.

Please see below an example depicting transfer pricing for the related party transactions in relation to sales of products and payments to connected persons.

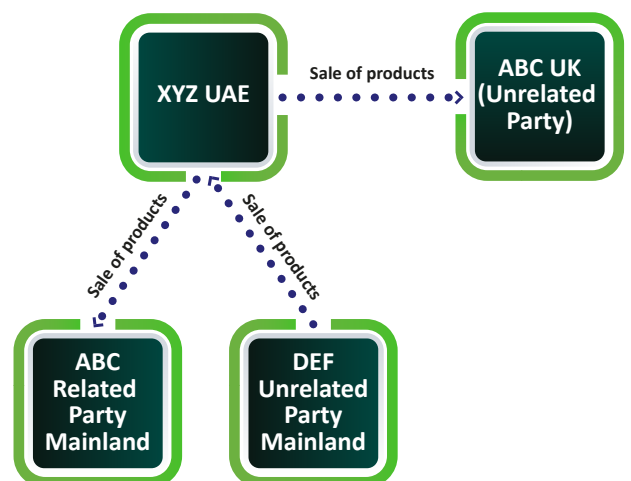


Payments to connected persons



- Salaries/Perquisites to be substantiated using business and rationale. We can use any other method or CUP Method i.e., approaching recruitment agencies for conducting salary benchmarks;
- Rent payments – CUP Method;
- Interest rate benchmarking – CUP Method

Related party transaction – Sale/Distribution of products



- Compare the prices of sales and margins earned between related parties Vs. unrelated parties using application of CUP method and TNMM method using Return on Sales (“RoS”) as profit level indicator in respective scenarios; and
- Maintain necessary transfer pricing documentation to depict the functional characterization/profile

Are the related parties same as provided in the Audited financial statements?

The meaning of a related party under the UAE Transfer Pricing (“UAE TP”) regulations vs. the definition under the audited financial statements following IAS24 is broadly similar.

The differentiating factors among two are as follows:

- The UAE TP Regulations (Article 35) follow a threshold of 50% for determining ownership and there is no such threshold under IAS 24; and
- The UAE TP Regulation (Article 36) mentions the concept of “connected persons” vs. “key management personnel and shareholders” under IAS 24.

Related party as per the UAE TP Regulations

Generally, Related Parties of an individual refer to the individual’s relatives (who are related within the fourth degree of kinship or affiliation, including by way of adoption or guardianship) as well as companies in which the individual, alone or together with their Related Parties, has a controlling ownership interest (typically 50% or more of shares of the company).

Similarly, Related Parties of a company refers to any other companies in which the company, alone or together with their Related Parties, has a controlling ownership interest (typically 50% or more of shares of the company), or that are under greater than 50% common ownership.

In addition, the UAE TP Regulations defines Connected Persons i.e., A person will be considered “connected” to a business that is within the scope of UAE CT if they are:

- The owner of the business;
- A director or officer of the business; or
- A Related Party of either of the above.

Related Party as per IFRS (IAS 24)

As per the IAS 24, the related parties comprise companies and entities under common ownership and/or common management and control, key management personnel and shareholders. The management decides on the terms and conditions of the transactions and services received/rendered from/to related parties as well as on other charges



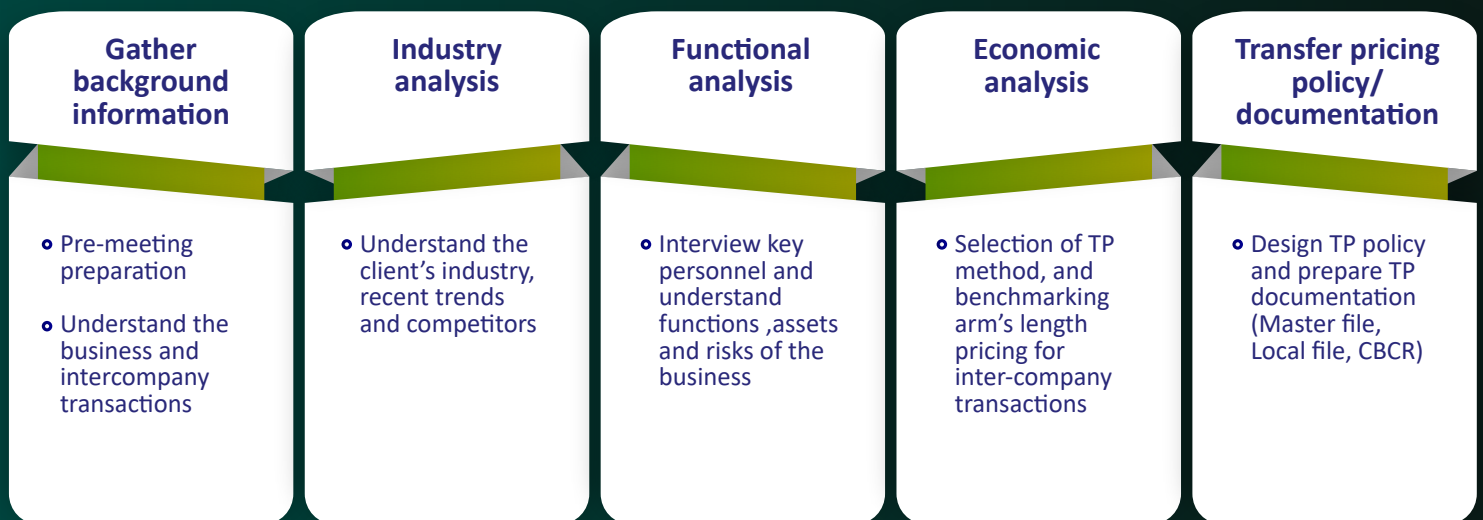
Process for TP adaptation?

The key steps to follow the process for adaptation of the UAE transfer pricing rules by UAE businesses are:

- Identify the related parties/connected persons.
- Understand the intercompany transactions undertaken by the related parties/connected persons.
- If there is a current transfer pricing framework to determine arm's length results for intercompany transactions, such framework should be reviewed in view of the current international tax and transfer pricing landscape in the UAE. Further, if the transfer pricing framework is non-existent, a transfer pricing policy should be designed to determine the arm's length price for the intercompany transactions.
- Prepare intercompany agreements to provide the key terms and conditions of the related party transactions.
- Prepare a Transfer Pricing Disclosure Form, Group Master file and a Local Country file to manage transfer pricing compliance. Please note that the contents of the Transfer Pricing Disclosure Form, Master file and Local file are yet to be clarified by the FTA.



Please see below a snapshot of the transfer pricing process:



From when transfer pricing rules need to be complied?

As per Federal Decree Law 47 of 2022, the UAE corporate tax and transfer pricing law will be effective considering the financial year beginning on or after 1 June 2023. For instance, if the UAE business has a financial year ending 31 December, the first year of corporate tax and transfer pricing applicability for the respective business would be from 1 January 2024. However, understanding the clause 2 of Article 61 (Transitional Rules), the opening balances of tax year must be driven considering the Arm's Length Principle and consequently, the transfer pricing principles must be adopted and implemented in the previous year to first tax year and accordingly the closing balance sheet balance of the UAE businesses from the previous year (e.g., FY23) would be the opening balance sheet balance for the next year (e.g., FY24) must be at arm's length.

UAE transfer pricing rules comparable to the global standards?

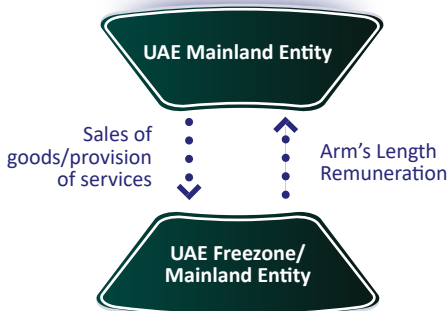
The UAE transfer regime is broadly in line with the global transfer pricing standards which are incorporated in the 2022 OECD Transfer Pricing Guidelines and the transfer pricing principles which are followed by the UK, Netherlands, Germany etc. However, there are some key distinguishers in the UAE's transfer pricing regime which provides for the applicability of transfer pricing rules to a) connected persons and b) domestic intercompany transactions.

UAE transfer pricing rules applicability on Domestic and Cross Border Business?

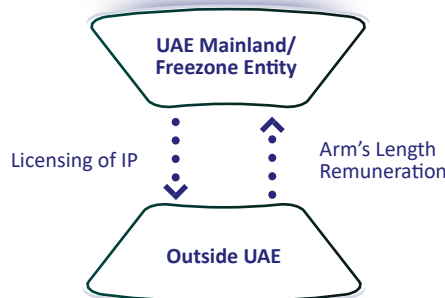
The UAE transfer pricing regime would be applicable to both domestic and international/cross-border related party transactions. That said, the UAE transfer regime would be applicable to the domestic and international intercompany transactions undertaken by UAE mainland entities and free zone entities.

Please see below a schematic overview of UAE transfer pricing rules on domestic and international related party/connected person transactions undertaken by UAE businesses is provided below.

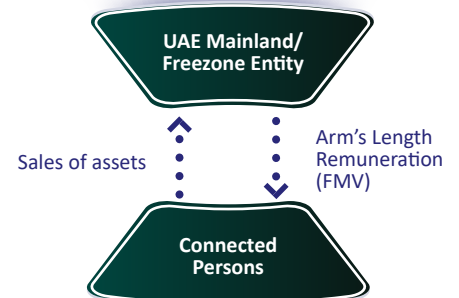
Domestic Transfer Pricing in the UAE



International Transfer Pricing in the UAE



Transfer Pricing for the Connected Persons



Applicability of transfer pricing on freezone entities?

The UAE transfer pricing regime would impact both Qualified freezone person ("QFZP") and other freezone businesses. More specifically, the UAE corporate tax law introduces the concept of Qualifying Free Zone Person which is defined as a company or branch registered in a free zone that satisfy Arm's length principle and Transfer pricing compliances along with other conditions of maintains adequate substance, deriving qualifying income and any other requirements to be prescribed through a Ministerial Decision would be eligible to claim benefit from a 0% corporate tax rate on its qualifying income. Accordingly, for QFZP it is mandatory to comply to avail 0% tax benefit.

Further, the freezone entity (other than QFZP) either a company or a branch of mainland, need to comply with the provisions for the business transactions with related parties.

Transfer pricing compliance requirements for UAE businesses?

The UAE transfer pricing law requires the taxpayers to submit a Transfer Pricing Disclosure Form together with the Corporate Income Tax Return (which is due within 9 months after the accounting/financial year end of the UAE taxpayer). Further, the UAE businesses would be required to maintain a Group Master file and a Local Country file, subject to meeting certain thresholds which are yet to be clarified by the FTA.

Whilst the exact contents of the Transfer Pricing Disclosure Form, Master file and Local file are yet to be clarified by the FTA, our initial expectation is that the Transfer Pricing Disclosure Form would require the taxpayer to disclose the list of domestic and international related party transactions, amounts and transfer pricing methodology applied to test each related party transaction.

The Master file should provide an overview of the group's business, including the nature of its global business operations, its overall transfer pricing policies, and its global allocation of income and economic activity and whereas, the Local file should contain information that is relevant for the transfer pricing analysis relating to the intercompany transactions where the (UAE) local taxpayer is involved in.

Coverage of Local File and its importance without a Benchmark Analysis?

Local file is an important part of the transfer pricing documentation. Local file is prepared at the company or country level and it provides a more detailed overview of the related party transactions that are entered into by this specific entity.

- Detailed information and overview of the local entity.
- Types of intercompany transactions involving the local entity.
- Analyses about the arm's length prices including a functional analysis, economic analysis (including a transfer pricing benchmarking analysis) and a financial analysis.

Benchmarking analysis as part of the transfer pricing Local file: A local file without a transfer pricing benchmarking analysis could be a starting point to address transfer pricing compliance requirements.

Benchmarking analysis is the **backbone of the transfer pricing documentation** i.e., Local File as they support with reliable economic data the taxpayer's positions outlined in the transfer pricing documentation by comparing the related party transaction that is being tested with transactions entered between third parties in same or similar circumstances. In essence, the transfer pricing benchmark analysis is used to set and test transfer pricing policy. Therefore, getting it done and right will mean **minimizing** the risk of a transfer pricing adjustment as the data contained in the benchmarking analysis provides a robust first line of defense if the transfer pricing arrangements are questioned by the tax authorities in the event of a tax/transfer pricing audit.

Therefore, a transfer pricing benchmarking analysis should be performed to support the arm's length nature of the intercompany transactions undertaken by the local taxpayer.



Significance of Intercompany agreement and Transfer pricing policy?

Intercompany agreements are an essential part of transfer pricing documentation. An intercompany agreement reflects arrangements which make commercial sense from the perspective of each participating company of a group. Taxpayers are exposed to unnecessary tax audits, fines, and penalties if the intercompany agreements are missing, or are defective.

A transfer pricing policy sets out how the related party business generates profit and in which country or countries it should be taxed. It also states how a group's prices are set. To be certain that you fulfil the transfer pricing documentation requirements, no matter how large or small your company is, it is sensible to draw up a transfer pricing policy. You can then make sure nothing is overlooked. By meeting the documentation requirements, you ensure transparency about the allocation of profit between the various entities in the group.

How arm's length results are determined?

The arm's length results are determined by conducting a transfer pricing benchmarking analysis. The benchmark study is a very important tool and used to set and test the transfer pricing policy by comparing with the records of companies that perform an activity similar to the activity performed by the tested party.

How a Transfer Pricing Benchmarking Analysis is done and its validity?

With the introduction of the UAE Transfer Pricing Regulations, a benchmarking analysis that is reliable and defensible, is key when preparing transfer pricing documentation. The benchmarking process starts after the analysis of identifying and characterizing the related party transaction has already been performed.

The preparation of a benchmarking study is often a structured process that requires to go through a set of steps, which are not necessarily standard i.e., performing a benchmarking study through a process that requires examining public information sources and databases or commercial databases and substantiating the adjustments are all steps that require effort on the part of taxpayers and their consultants alike.

For the benchmarking study to be valid, each step must be critically analyzed and justified from a legal and economic point of view, and finally the whole process must be thoroughly documented in a benchmarking study report. Further, the transfer pricing benchmark is accepted by the Authorities for up to three years, however financial/light update is advised every year.

Are there any transfer pricing penalties linked to non-compliance with the UAE transfer pricing rules?

The Federal decree Law No. 47 of 2022 has indicated that there would be potential penalties for non-compliance of transfer pricing rules or partial/inaccurate transfer pricing compliance. However, the exact details on applicable penalties are expected to be announced by the Authority in due course.



Way forward

The transfer pricing rules will have significant implications for the UAE businesses. The businesses should start looking into the identification of their related parties/connected persons and business transaction with them, understand the impact of transfer pricing rules on their business operating model and whether the pricing of related party/connected person transactions is in line with the arm's length standard. Further, the businesses should understand the impact on free zone structures and the applicability of the conditions that must be satisfied to be eligible for a 0% corporate income tax rate. The businesses must understand their transfer pricing compliance obligations and impact on historical positions with respect to the economic substance regulations. At the outset, it is key for UAE businesses to closely follow any other developments or guidance from the FTA on transfer pricing in the coming months.

How UHY James can help

UHY James assists your company in setting up a well-documented transfer pricing policy, by performing a full-fledged transfer pricing analysis. Or we can help you update the current policy (please keep in mind that benchmark analyses are only valid for three years).

The policy we set up will contain a recommend at arm's length remuneration, to prevent disputes with tax authorities. The transfer pricing benchmark will be used to substantiate the transfer pricing policy applied. If you would like to discuss how we can be of service to you, please reach our tax and transfer pricing team.



Overview of services



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- Information System Audits
- RERA Regulatory & Compliance Audits
- Retail Sales Audit



Internal Audit

- Risk Assurance
- Forensic Audits
- Standard Operating procedures
- Business Efficiency Reviews



Corporate Finance

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- Valuation and Pricing
- Purchase Price Allocation
- Business Modelling
- Fund Raising



Technology & Cybersecurity

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- Cybersecurity Assessment
- Data Protection
- Automation
- ERP Consulting



Strategy & Transformation

- Strategic Consulting
- Profitability Enhancement
- Organizational Transformation



Company Incorporation

- Business Setup
- Company Liquidations
- Tax Residency Certificate
- Trademark Registration
- Visa Assistance



Direct Tax

- Corporate Tax Advisory and Compliances
- Transfer Pricing Advisory and Compliances
- ESR Advisory



Indirect Tax

- VAT Advisory and Compliances
- Tax Audit Assistance
- Excise Tax Advisory and Compliances



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- Independent Director & Secretarial Services



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One of the most recognized financial practitioners in the audit, accounting & advisory space in the UAE James is known for sustaining excellent client relationships, and exhibiting a strong adversity quotient. James has built immense credibility & has played key roles at various professional organizations and international forums.

James Mathew
FCA, CPA
CEO & Managing Partner



35+ yrs exp.

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- Risk Management
- SOP Development
- Operational Due Diligence
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S. Unnikrishnan
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- Highly experienced in FMCG, Real Estate & Hospitality sectors
- Internal Financial Controls

Tushar Jesrani
Partner
Audit & Assurance



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- Strategic insight in cross border transactions/engagements across India, Middle East and abroad
- Experienced in advising on setup of business entities globally

Priyesh Kapadia
Partner
Advisory Services



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- Diverse experience in direct and indirect taxation services covering Corporate Tax and VAT across wide range of industries
- ICV Certification and improvement plan advisory
- Adept at strategic planning, operational management and on the technical advisory front

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