October 2023

New Transfer Pricing Guide in UAE

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On October 23, the UAE Ministry of Finance published the Transfer Pricing (hereinafter, "TP") Guide (hereinafter, the "Guide"). It should be noted that the TP rules themselves were introduced in the UAE by Federal Law No. 47 of 2022 (hereinafter, the "Law") and will apply for tax periods beginning June 1, 2023.

The Guide largely copy the provisions of the OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations (hereinafter, the "OECD Guidelines" as amended January 2022) and apply the main provisions of the international practice. At the same time, certain provisions of the Guide characterize the local specifics of TP requirements in the UAE.

Comparative table of TP provisions according to the provisions of the UAE legislation and the OECD Guidelines?

No.	Provision	The UAE legislation	The OECD Guidelines
1	Establishment of amount thresholds for recognizing transactions as controlled transactions	**X**	**X**
2	Application of 5 classical TP methods	**V**	**V**
3	Hierarchy of application of TP methods	**X**	**X**
4	Use of a combination of methods	**V**	**V**
5	Use of "own" TP method	**V**	**V**
6	Preparation of TP reporting (notifications on the Controlled transaction, TP Local Files, three-level reporting)	**V**	**V**
7	Frequency of updating benchmarking studies	Review of sample every 3 years Annual update of financial data on acceptances	
8	The arm's length range	Interquartile range	Interquartile range It is allowed to use the full range from minimum value to maximum value

No.	Provision	The UAE legislation	The OECD Guidelines
9	Approach to the calculation of the arm's length range	Based on weighted average profitability over 3 years	
10	Analysis period for benchmarks	3 years, including the analyzed period	Depending on the local legislation
11	Disclosure of controlled transactions	According to the established format *(in development)*. To be submitted together with the income tax return	Depends on the participating country
12	Provision of Local file	Upon request of tax authorities within 30 days	Depends on the participating country
13	Provision of Master file	Upon request of tax authorities within 30 days	Depends on the participating country
14	Data storage	Within 7 years from the end date of the financial year for which the TP reporting is prepared	Depends on the participating country
15	Burden of proof	On the taxpayer	Depends on the participating country

Peculiarities of TP regulation in the UAE

Perimeter of controlled transactions and applicable TP approaches

All transactions between Related Parties or Connected Persons, **regardless of the amount of turnover** in these transactions, are subject to control.

At the same time, the Guide specifies the requirements for certain types of controlled transactions and restructuring processes:

- Financial transactions
- Intra-group services transactions
- Transactions with intangible assets
- Cost sharing agreements
- Restructuring of business within the group
- Transactions with permanent establishments
- Group synergies, etc.

For the types of transactions listed above, the most applicable approaches to TP analysis are described (including in terms of conducting a functional analysis taking into account the specifics of the transaction, the selection of the TP method, approaches to conducting the arm's length price/profitability studies, and other factors affecting pricing in controlled transactions). For example, the Guide provides for a simplified TP analysis for low value-adding intra-group services: a standard 5% mark-up on the contractor's costs may be applied without conducting a benchmarking study of the arm's length level of profitability.

Forms of TP reporting

The adopted Guide sets out a list of TP reporting to be prepared in transactions subject to TP control. TP reporting can be divided into 2 blocks:

- **Country-by-Country Reporting under the BEPS13 initiative developed by the OECD,** which includes:
  1) **Country-by-Country Report,** which discloses the countries where the group operates with quantitative characteristics of the activities of companies within such a group. The Country-by-Country Report requirements apply only to international groups with a parent company registered in the UAE, provided that the group's consolidated revenue exceeds the established threshold of AED 3,150 million (see details in Resolution No. 44 of the Cabinet of Ministers of 2020).
  2) **Master File,** which discloses top-level information regarding the group's activities and the distribution of profits among group companies.
  3) **Local File,** which discloses detailed information regarding the specific controlled transaction being analyzed, as well as the economic justification of the compliance of the terms of such a transaction with the arm's length level.

At the same time, the requirements for the preparation of Master File and Local File apply only to large companies. According to Decision No. 97 of May 11, 2023, published earlier by the Ministry of Finance, the taxpayer is obliged to prepare Master File and Local File under at least one of the following conditions[1]:

1. during any time in the tax period, the taxpayer was a member of the MNE Group[2], whose consolidated revenue is equal to or exceeds AED 3,150 million in the relevant tax period.
2. the taxpayer's revenue in the tax period is equal to or exceeds AED 200 million.

The introduced Guide provides detailed comments on the form and content of Master File and Local File, which fully follow the format developed by the OECD.

Thus, **Master File** should disclose information on the following 5 categories:

1) organizational structure of the MNE Group
2) information on the activities/types of activities of the MNE Group
3) description of intangible assets of the MNE Group (according to Section 6 of the OECD Guidelines)
4) information on financial activities of the MNE Group
5) information on the financial and tax position of the MNE Group (reporting).

If Master File provides a general characteristic of the activities of the MNE Group, the taxpayer should describe the company's and counterparty's activities in **Local File** and specify the terms and conditions in relation to specific controlled transactions. In general terms, the information in Local File can be divided into the following blocks:

1) description of the taxpayer's activities (management structure, description of activities, analysis of competitors)
2) description of a specific controlled transaction (type of the transaction, turnover, description of the counterparty, description of the main terms of the transaction, market analysis, selection of the most appropriate TP method, selection of the tested party (if necessary), economic analysis and assessment of compliance of the terms of the controlled transaction with the arm's length level)
3) financial information on the taxpayer and comparable companies on the basis of financial data of which the arm’s length range was calculated (financial statements).

- **Additional supporting information,** provided by the taxpayer upon request of the tax authorities pursuant to Article 55.4 of the UAE Corporate Tax Law.

Regardless of the amount thresholds for Country-by-Country Reporting (Master File and Local File), the Guide requires taxpayers to prepare supporting TP documentation for all completed controlled transactions. Under such TP documentation, the taxpayer should confirm that the terms and conditions of the controlled transactions are at the arm's length (in other words, confirmation that the affiliation does not lead to price manipulation in the transactions). Such TP documentation should be provided by taxpayers upon request of the tax authorities within 30 days.

It seems that such a documentation will be closer to the structure of Local file in terms of the composition and content of the disclosed information, since for the purposes of confirming the arm’s length nature of prices it is required to conduct a full functional analysis, select the most applicable TP method, as well as conduct the economic analysis (a benchmarking study).

Thus, the Guide establishes the obligation of taxpayers to prepare TP documentation for all transactions subject to TP control, regardless of the type of the transaction and its turnover. Taking into account that together with the income tax return the taxpayer will submit the TP disclosure form (see below), the tax authorities will be notified in advance of the perimeter of controlled transactions performed by the taxpayer. Accordingly, it is reasonable, in our opinion, to prepare TP documentation in advance in order to provide it promptly upon request of the tax authorities in the specified period.

- **Transfer Pricing disclosure form, which is analogous to the Russian notification on the controlled transactions,** where the taxpayer should disclose information on all controlled transactions carried out by it during the reporting year

The submission of such a notification is currently provided for at the time of the submission of the income tax return. However, the requirements in terms of the TP disclosure form are not currently established.

The Guide specifies only the approximate composition of the data to be disclosed to the tax authorities:

- Essence of the controlled transaction
- Turnover under the controlled transaction
- Information on related counterparties
- TP methods used.

It is expected that soon additional clarifications on the TP disclosure form will be issued. The type of data provision is also interesting – whether it will be an XML schema or another established format.

[1] However, these clarifications do not introduce controllability thresholds in relation to the preparation of Local File. Therefore, conservatively, Local File should be prepared for all controlled transactions and submitted to the tax authorities upon request within 30 days or together with the income tax return upon request of the tax authorities.

[2] That is, subsidiaries, branches or permanent establishments registered in the Mainland or in Free Trade Zones (hereinafter, "FTZ")

Selection of TP method

The Guide establishes the use of 5 classical methods to confirm that prices/profitability in controlled transactions correspond to the arm's length level:

Group	TP method
Traditional transaction methods	Comparable uncontrolled price method (CUPM)
	Resale price method (RPM)
	Cost plus method
Transactional profit methods	Transactional net margin method (TNMM)
	Profit split method (PSM)

The Guide does not establish a strict hierarchy of TP methods. The method that is the most appropriate for analyzing a specific controlled transaction is selected. If none of the methods above allows to correctly confirm market conditions in transactions between affiliates, it is allowed to use another TP method. In this case, the taxpayer should prove the impossibility of applying the classical TP methods and specify in the TP documentation a detailed approach to the application of the "other" TP method not expressly provided for by the Guide.

Preparation of benchmarking studies under methods based on profitability analysis

The Guide establishes relief in terms of the preparation of benchmarking studies by taxpayers: it is sufficient to search for comparable companies/agreements once every 3 years, provided that there have been no significant changes in the controlled transactions being analyzed. At the same time, in order to obtain the most accurate results it is necessary to update financial data of the companies accepted in the final sample on an annual basis in order to obtain the representative arm's length range.

It should be noted that to calculate the arm's length range, the approach of analyzing data for several years, namely 3 years, including the reporting year, is used. The weighted average approach is used in the calculation.

TP adjustments to the tax base

The Guide considers the following cases of TP adjustments to the tax base:

1) **Voluntary adjustment by the taxpayer**. The adjustment to the tax base depends on its timing: before or after submission of the tax return:

   - **Before submission of the tax return**, the taxpayer has the right to adjust the tax base if it is discovered that the conditions of the controlled transaction do not correspond to the market. The tax base may be adjusted to any value within the arm's length range (minimum or maximum depending on the deviation identified).
   - **After submission of the tax return**, only upward adjustments are allowed, i.e., the taxpayer may adjust the tax base by (1) increasing the amount of profit or (2) decreasing the amount of loss. TP adjustments resulting in a decrease in the amount of taxable income or an increase in the amount of loss are not allowed.
   - **A symmetrical adjustment** is possible where the competent authority of a foreign state of which the taxpayer's counterparty is a tax resident has made an adjustment to the tax base. In this case, a UAE resident taxpayer may apply to the tax authority with a request for a symmetrical adjustment (if Double Taxation Agreement is in force with the state of the taxpayer's counterparty).

2) Adjustment by the tax authority.

Where the terms of the controlled transaction do not correspond to market practice, the tax authority has the right to make its own adjustments to the tax base and charge additional income tax. Adjustments to the tax base should be made taking into account the specifics of the transaction and the functional risk profile of the taxpayer. In addition, the tax authority may dispute, in principle, the fulfillment of the controlled transaction if it is found that there is no commercial purpose of the transaction between affiliates.

TP audits

TP audits as a separate form of tax control are not stipulated by the Guide.

However, the Guide states that the tax authorities have the right to request supporting TP documentation for all transactions of the taxpayer subject to TP control.

If the UAE tax authorities identify a deviation of prices in controlled transactions from the arm's length level, they have the right to adjust the tax base accordingly and charge additional income tax.

What needs to be paid attention to

The MNE groups with a substance in the UAE should analyze the necessity of preparing TP reporting in accordance with the requirements of the local UAE legislation.

Moreover, given the stricter requirements for the preparation of TP reporting in the UAE, the scope of controlled transactions for which the documentation will be required will be broader for the UAE purposes compared to the requirements in Russia.

In connection with the publication of the new clarifications, we propose to take the following measures:

- to analyze the actual structure of intra-group transactions (domestic and cross-border transactions) and identify potential risk areas;
- to analyze the applicable TP methods for potentially controlled transactions;
- to develop a TP methodology for key intra-group transactions;
- to analyze TP risks and modify the pricing mechanism for intra-group transactions;
- to determine a sufficient level of economic substance for qualified FTZ residents, taking into account the types of activities carried out;
- to conduct a benchmarking study of the arm's length level of salaries of management personnel, taking into account the type of industry to which the company belongs;
- to prepare Master File and Local File for intra-group transactions.

How can we help?

Our team has experience in analyzing various types of intra-group transactions and developing TP methodologies for planning and preparing Master File and Local File purposes in accordance with the OECD Recommendations and the requirements of various local legislations, as well as experience in advising on the economic substance of companies from various industries.

We would be glad to discuss all these aspects in detail with you, share our practical experience, and answer any questions you might have.

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