



M2K UAE Knowledge Series

Transfer Pricing

ALERT #10



Preface

Tax laws across the world encompass ‘transfer pricing’ requirements, which essentially provide that the transactions between related parties should be carried out at an arm’s length price. i.e., the price at which the transactions would have been entered into with third parties. ‘Transfer Pricing’ provisions in tax laws primarily aim at protecting the tax base of the country and preventing shifting of profits to other jurisdictions.

UAE Corporate Tax law has also embraced the provisions in relation to ‘transfer pricing’ and ‘payments to connected persons’ in their Tax Laws. This alert aims at providing an overview of the said provisions.

Definitions (1/4)

Before we dive into the substantive provisions in relation to transfer pricing in UAE Corporate Tax law, it is important to understand certain key terms.

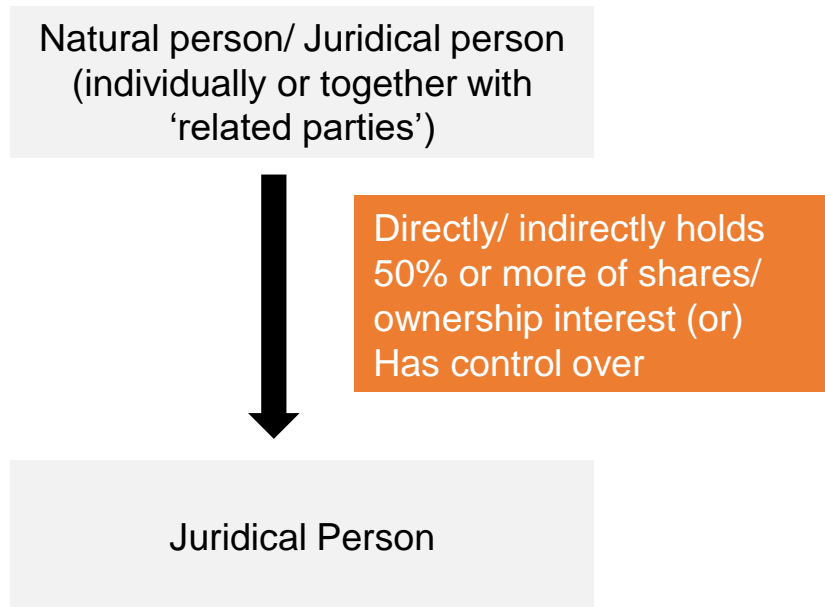
Related Parties: The following are considered to be “Related Parties”:

- Natural persons related within the fourth degree of kinship or affiliation¹ are considered as a related parties. For example, the following relation of self/ spouses (illustrative only) by virtue of birth/ marriage are considered as related parties.
 - Spouse, Parents and Children are part of first degree of kinship.
 - Siblings, grandparents and grand children are part of second degree of kinship.
 - Uncle/ Aunt (i.e., siblings of parents), children of siblings are part of third degree of kinship.
 - Cousins (children of uncle/ aunt) are part of fourth degree of kinship
- A person and its Permanent Establishment (‘PE’²) are considered to be related parties.
- Partners of an unincorporated partnership are considered to be related parties of each other.
- Trustee, founder, settlor or beneficiaries and trust/ foundation (and its related parties, by virtue of aforesaid provisions) are considered to be related parties to each other.

¹ Including adoption and guardianship ² Including Foreign PE

Definitions (2/4)

A natural person/ juridical person and another juridical person are considered as related parties, where,



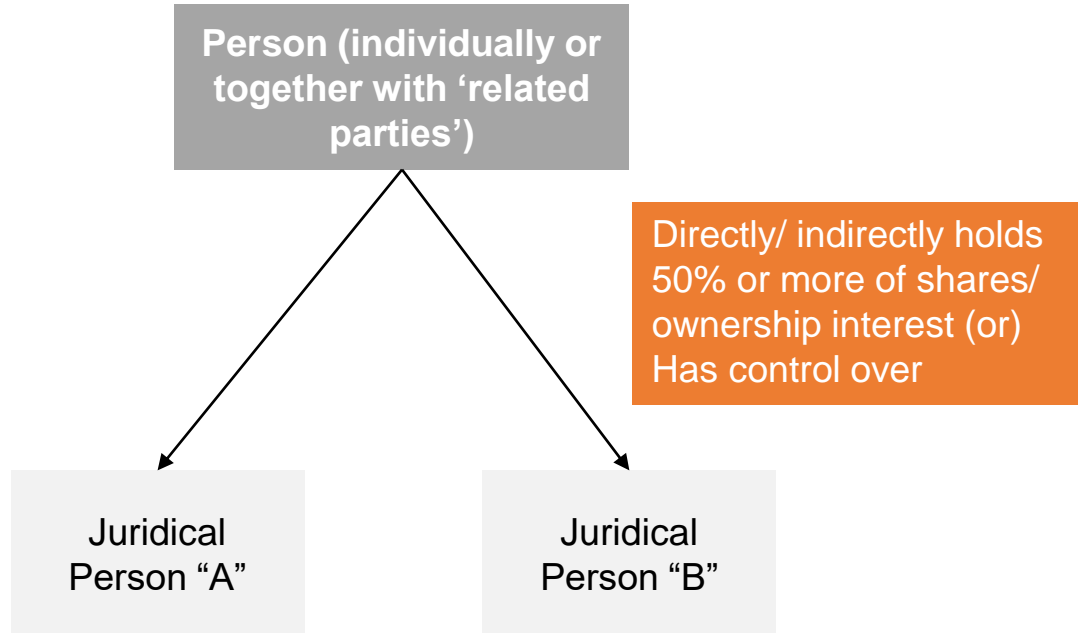
Let us look at certain examples to understand the above provision:

- Where Mr. X holds $\geq 50\%$ of shares in A Ltd., Mr. X and A Ltd. are considered as related parties
- Where Mr. X and Mrs. X³ hold 25% of shares each (together own 50%), Mr. X and A Ltd., and Mrs. X and A Ltd., are considered as related parties.
- Where Mr. X and Mrs. X hold 25% of shares each (together own 50%) in B Ltd., (intermediary) which in turn owns 100% in A Ltd., Mr. X and A & B Ltd., and Mrs. X and A & B Ltd., are considered as related parties.

³ Spouse is a 'related party' by virtue of affiliation, as discussed above

Definitions (3/4)

Further, Two are more juridical person are considered as related parties, where,



Juridical persons "A" & "B" are considered to be related parties.

Let us look at certain examples to understand the above provision:

- a) Where Mr. X holds $\geq 50\%$ of shares both in A Ltd., and B Ltd., A Ltd. and B Ltd., are considered as related parties
- b) Where Mr. X and Mrs. X⁴ hold 25% of shares each (together own 50%) in both A Ltd., and B Ltd., Mr. X and A Ltd., A Ltd. and B Ltd., are considered as related parties

⁴ Spouse is a 'related party' by virtue of affiliation, as discussed above

Definitions (4/4)

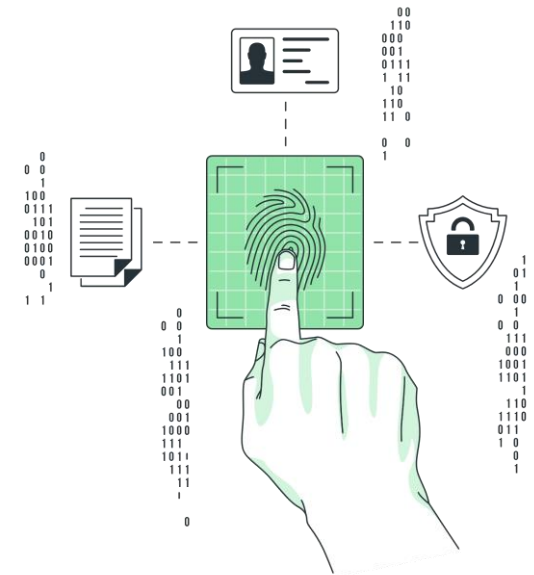
In the above definition of ‘related parties’, the important criteria of determining the related parties relationship are shareholding or ownership interest and control. While shareholding or ownership interest is a straightforward, it is important to understand, when it is said that one person has control over the other.

Control: “Control” is defined as the ability of a person⁵ for the following in relation to another person: (a) Exercise 50% or more of voting rights (b) Determine the composition of board of directors by 50% or more (c) Receive 50% or more of profits (d) Exercise significant control over business affairs (e) Determine or exercise significant influence over the conduct of the business and affairs

Connected Persons: A person is considered to be a “connected person” of the taxable person in the following cases:

- An owner⁶ of the taxable person
- A director or officer of the taxable person
- A related party of any of the above persons

In case of an unincorporated partnership, any partner or any related party to the partner are considered to be connected persons.



⁵in his own right or by agreement or otherwise to influence a person ⁶A natural person who directly or indirectly owns an ownership interest or has control over the taxable person

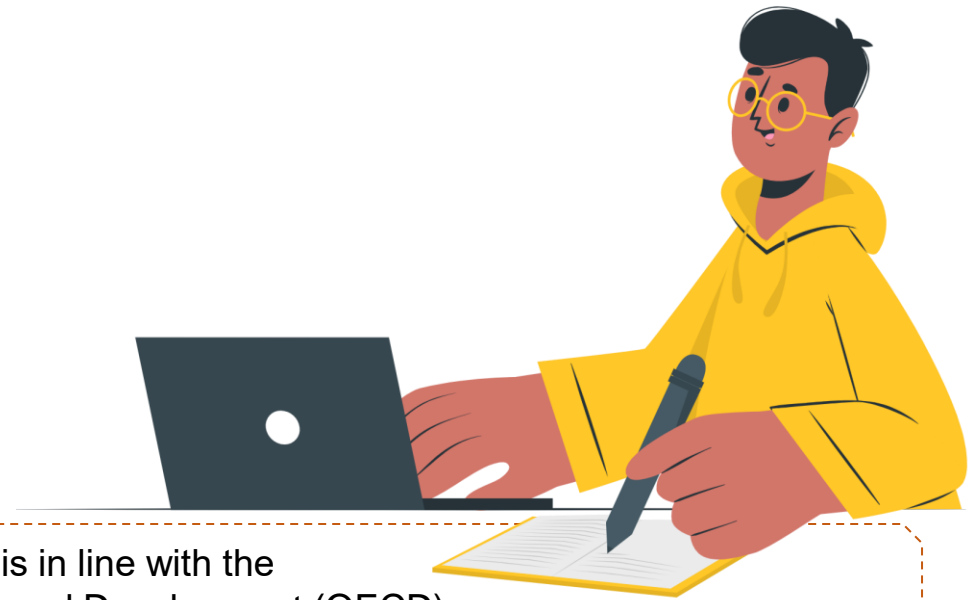
Transfer Pricing (1/2)

The provisions of the Corporate Tax law in relation to Transfer Pricing are discussed below:

The transactions or arrangements between related parties must be at arm's length, in computation of taxable income. Where the results of the transactions or arrangements between related parties are consistent with the results of transactions between third parties in similar transactions or arrangements under similar circumstances, the transaction can be said to be meeting arm's length standard.

The arm's length result of a transaction or arrangement between related parties are to be determined using one or a combination of the below methods:

- The comparable uncontrolled price method
- The resale price method
- The cost-plus method
- The transactional net margin method



The transfer pricing methods prescribed for determination of arm's length price is in line with the international practice prescribed by the Organization for Economic Cooperation and Development (OECD).

Transfer Pricing (2/2)

Where none of the above methods can be reasonably applied to determine an arm's length result in respect of any transaction or arrangement, any other transfer pricing method can be applied.

Generally, in the absence of uncontrolled comparables publicly, transfer pricing method, other than those listed above is used in certain transactions. For example, Unique transactions like transfer or licensing of intangibles, Business Transfer, Transfer of unlisted shares, Long-term buying and selling arrangements, Sale of assets, Guarantee provided/ received

The following are the examples for other methods used:

- Valuation of business
- Valuation of assets (both tangible and intangible)
- Market price (quoted) of the commodities
- Statistical average prices or Standard rate cards or reference values

The choice of the “most reliable” transfer pricing method should be made, duly considering the following factors in connection with the transactions/ arrangements with related parties:

- The contractual terms and characteristics
- The economic circumstances
- Functions performed, Assets employed and Risks assumed (FAR) by each of the parties
- The business strategies of each of the parties
- Availability of comparable data



Procedures to be followed by the Tax Authorities (1/2)



- The tax authorities may examine as to whether the transactions or arrangements entered into between related parties meet arm's length standard. Such examination should be based on the transfer pricing method used by the taxable person, where the same is appropriate duly taking into account the above factors.
- The application of transfer pricing method as explained above may result in arm's length range of financial results or indicators.
- Where the results of the transactions or arrangements between related parties do not fall within arm's length range, the Authorities shall make adjustments to taxable income. The information relied on by the tax authorities in determining the arm's length adjustment should be made available to the taxpayers.
- Where the authority or the taxable person makes adjustments to its taxable income to meet arm's length standard in respect of transactions or arrangements with related parties, the tax authorities shall also make **corresponding adjustment to the taxable income of the related party.**
- Further, where a foreign tax authorities make transfer pricing adjustment in respect of a taxable income of a related party in respect of a transaction or arrangement with a taxable person in UAE, such taxable person in UAE can make an application to the tax authorities requesting corresponding adjustment to be made to its taxable income.

Procedures To Be Followed By The Tax Authorities (2/2)

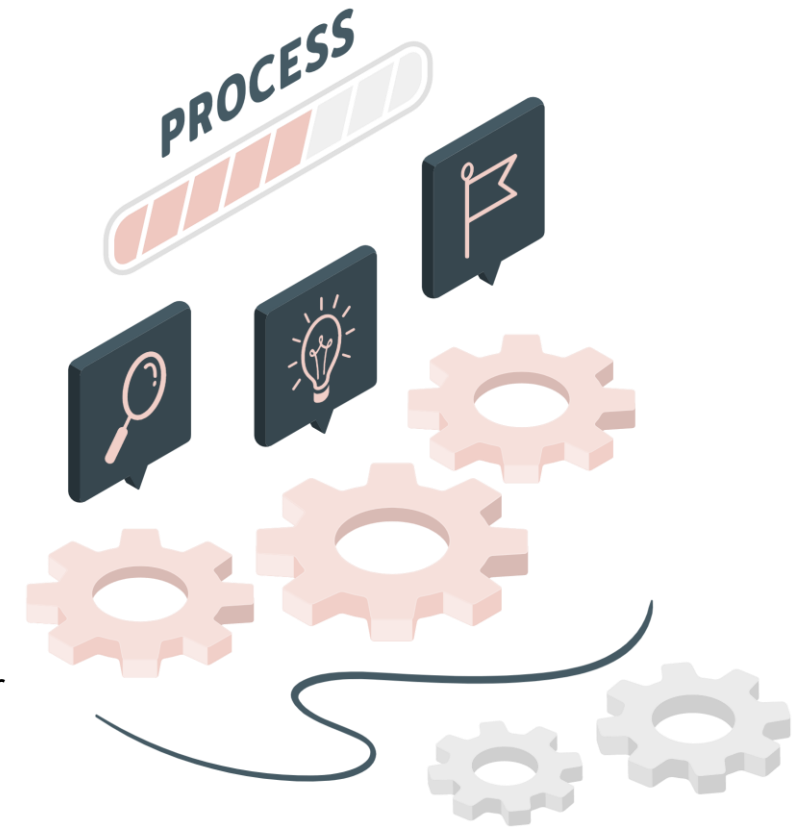
Allowing corresponding adjustment in the hands of other party to the transaction is a welcome step, as the same ensures equitable approach and avoids double taxation in the hands of both the parties of the transaction.

It would be interesting to watch the modalities to be followed in allowing corresponding adjustment in the hands of UAE tax payer, where UAE tax authorities are not in agreement with the transfer pricing adjustment made in the hands of other party to the transaction by the foreign tax authorities. Mutual Agreement Procedures (MAP) may be invoked in terms of tax treaties between UAE and other countries in such cases.

The following aspects have been clarified:

- Transfer pricing provisions are applicable in respect of transactions or arrangements with related parties and connected persons, irrespective of whether such related parties or connected persons are located in UAE mainland or free zone or a foreign jurisdiction.
- Transactions between the members of the tax group, which are eliminated in the consolidation of the Group's financial results/ financial position are not subject to transfer pricing requirements.

However, where the tax group is required to compute the standalone taxable income of any of its member (for example, a subsidiary utilizing the tax losses incurred before joining the group), such standalone taxable income should be determined duly taking into account the provisions of the transfer pricing.



Payment to Connected Persons

Payment or benefit provided to a connected person would be considered as deductible expenditure, only if and to the extent the same corresponds to the market value of services or benefits provided by the connected person and such expenditure is incurred wholly and exclusively for the business of the taxable person.

In order to determine whether the payment or benefit provided to a connected person corresponds to its market value, the transfer pricing provisions discussed above should be applied.

These provisions do not apply in the following cases:

- A. The shares of the taxable person is traded on a recognized stock exchange (in UAE or outside UAE, subject to regulations)
- B. The taxable person is subject to regulatory oversight of a competent authority of the UAE

Any other cases to which these provisions would not be applicable may be specified in Cabinet Decision.



Transfer Pricing Documentation (1/2)

- The taxable persons are required to maintain the information regarding their transactions with the related parties and connected persons.
- The authorities may require a taxable person to file the above information along with the tax return, by notice or through decision to be issued by the tax authority.

Master file and Local file⁷

- A taxable person, who has been a constituent company of a multinational group at any time during the relevant tax period, whose **total consolidated group revenue is AED 3 Billion and 150 Million or more or taxable person's revenue is AED 200 Million or more** are required to maintain both **master file and a local file**.
- The transactions or arrangements with the following related parties or connected persons should be included in the local file: A non-resident person, An exempt person, A resident person who has elected for small business relief and meets prescribed conditions, A resident person whose income is charged to tax at a different tax rate (as compared to the taxable person⁸).
- The transactions or arrangements with the following related parties or connected persons should NOT be included in the local file:
 - Resident person other than those specified above
 - A natural person, where the transactions were entered into as if they were third parties*
 - A juridical person considered to be related party/ connected person solely by virtue of being a partner in the unincorporated partnership, where the transactions were entered into as if they were third parties*
 - A UAE PE of a non-resident person, whose income is subject to same corporate tax as that of the taxable person.

⁷ Ministerial decision No. 97 of 2023 ⁸ Transaction entered into by a taxable person in mainland (whose income is subject to tax @ 9%) and a related party who is a qualifying free zone person (whose income is subject to tax @ 0%) could be covered under this Clause.

Transfer Pricing Documentation (2/2)

*Notes:

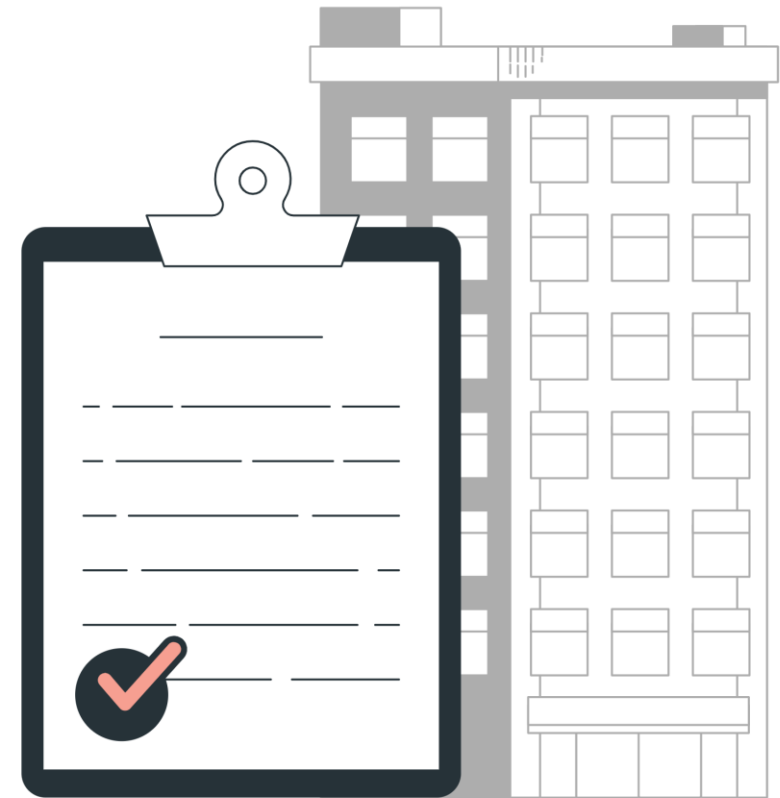
Transactions or arrangements are considered to have been entered into as if they were with third parties, if both of the below conditions are met.

- a) The transaction or arrangement is entered into in the ordinary course of business
- b) The parties are not exclusively or almost exclusively transacting with each other.

Further, where activities of one of the persons are subject to detailed instructions or comprehensive control of the other person (involved in the transaction or arrangement), it shall not be regarded that they were acting independently. All the relevant facts and circumstances shall be taken into account by the tax authorities in determining if they were acting independently.

The Ministerial Decision has introduced additional test like 'ordinary course of business' and 'exclusively' or 'almost exclusively'.

- The tax authorities may require the taxable persons to furnish the above documentation within 30 days following the request or a later date as may be directed.
- It has been clarified that the businesses that claim 'small business relief' will not have to comply with the transfer pricing documentation rules.



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