

UAE introduces Corporate Tax Law

An insight into Transfer Pricing Regulations

December 2022 Alert 01/2022



Summary

The United Arab Emirates (“UAE”) Ministry of Finance (MoF) issued the Federal Law on the Taxation of Corporations and Businesses by enacting the [Federal Decree Law No.47 of 2022](#) on December 09, 2022 (herein after referred to as the “Decree Law”).

The Decree Law serves as the legislative basis for the introduction and implementation of Federal Corporate Tax (“CT”) in UAE and comes into force with effect from the Financial Year commencing on or after June 01, 2023.

This alert focuses on the transfer pricing regulation embedded in the UAE CT Law. As mentioned by the MoF earlier, that there would be an alignment of the TP rules with the Organization of Economic Cooperation and Development (OECD) Transfer Pricing Guidelines (OECD Guidelines), we have also sought to include certain guidance from the same to make it more comprehensive.



Scope of Taxation

- ▶ CT will be applicable to juridical person incorporated in UAE and juridical persons effectively managed and controlled in the UAE as well as to foreign juridical persons that have permanent establishment (“PE”) in UAE. There are certain categories of entities (Article 4) exempt from UAE CT.
- ▶ Individuals will be subject to CT only if they are engaged in a business or business activity in UAE, either directly or through an unincorporated partnership or sole proprietorship. A Cabinet decision is expected to be issued providing further information on applicability to natural person. Individuals engaged in other activities will fall outside the scope of CT.
- ▶ CT shall be imposed on the Taxable income at the following rates as per the Decree Law (Amount pending Cabinet Confirmation) :-

Taxable Person	Applicable CT Rate
Individuals and Juridical Persons	<ul style="list-style-type: none"> 0% for taxable income upto AED 375,000 9% for taxable income exceeding AED 375,000
Qualifying Free Zone Persons	<ul style="list-style-type: none"> 0% on qualifying income 9% on taxable income that does not meet the qualifying income definition

Transfer Pricing Regulations

Introduction

The Decree Law has introduced a separate Chapter, “*Chapter 10- Transactions with Related Parties and Connected Persons*” containing comprehensive transfer pricing regime to ensure that the transactions between related parties are carried out on arm’s length terms¹. Further in order to prevent manipulation of taxable income, the various Articles in the Decree law require the consideration for transactions with Related Parties and Connected Persons to be determined by reference to the “Market Value.”

Applicability

The Transfer Pricing Provisions apply to UAE businesses that have transactions with Related Parties and Connected Persons, irrespective of whether the Related Parties or Connected Persons are located in UAE mainland, a Free Zone or in a Foreign Jurisdiction. Transfer pricing provisions are not applicable for transactions between entities forming part of the same Tax Group².

Related Party

- ▶ Article 35 of the Decree Law defines the terms “Related Party” and “Control”.
- ▶ Accordingly a related party is an individual or entity who has a pre-existing relationship with a business that is within the scope of the UAE CT regime through Ownership, Control or Kinship (in the case of natural persons). The Decree Law has specified the following situations, where the parties involved would be treated as Related Parties.

					
Two or more individuals related to the fourth degree of kinship (parents, spouse, children, grandchildren, uncles/aunts and cousins) or affiliation, including adoption or guardianship	An individual and a legal entity where alone, or together with a related party, the individual directly or indirectly owns >= 50%, or controls, the legal entity	Two or more legal entities where one legal entity alone, or together with a related party, directly or indirectly owns >=50%, or controls, the other legal entity	Two or more legal entities if a person alone, or with a related party, directly or indirectly owns a 50% share of each or controls them	A person and its Permanent Establishment (PE) or Foreign PE. Partners in the same unincorporated partnership	Trustee, founder, settlor or beneficiary of trust/foundation and its related parties

¹ A transaction or arrangement between Related Parties meets the arm’s length standard if the results of the transaction or arrangement are consistent with the results that would have been realised if Persons who were not Related Parties had engaged in a similar transaction or arrangement under similar circumstances.

² UAE companies can apply to form a Tax Group and be treated as a single taxable person if the UAE parent company (directly or indirectly) holds at least 95% of the share capital and voting rights of each of the companies

Control



“Control” for determining Related Party is as follows:-

The ability to

- ▶ Exercise 50% or more of the voting rights of another Person.
- ▶ Determine the composition of 50% or more of the Board of directors of another Person.
- ▶ Receive 50% or more of the profits of another Person.
- ▶ Determine, or exercise significant influence over, the conduct of the Business and affairs of another Person.

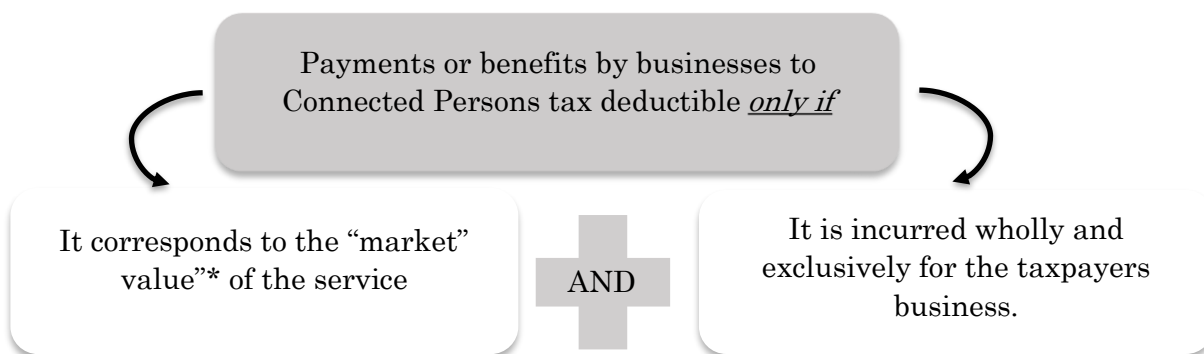
Connected Persons



- ▶ The concept of Connected Person is very new and specific to UAE.
- ▶ In the absence of personal income tax in the UAE, excessive payments to individual owners of Taxable Business either to themselves or person connected to them are likely to erode the tax base for UAE CT
- ▶ Article 36 of the Decree Law defines the terms Connected Person. The term is different from Related party and means:-

An individual who directly or indirectly has an ownership interest in, or controls, the taxable person	A Related Party of any of the three
A director or officer of the taxable person	
Where the taxable person is a partner in an unincorporated partnership, any other partner in the same partnership	

- ▶ Tax deductibility criteria



* Market value of services shall be determined having regard to the arm's length principle as defined in Article 34 of the Decree law.

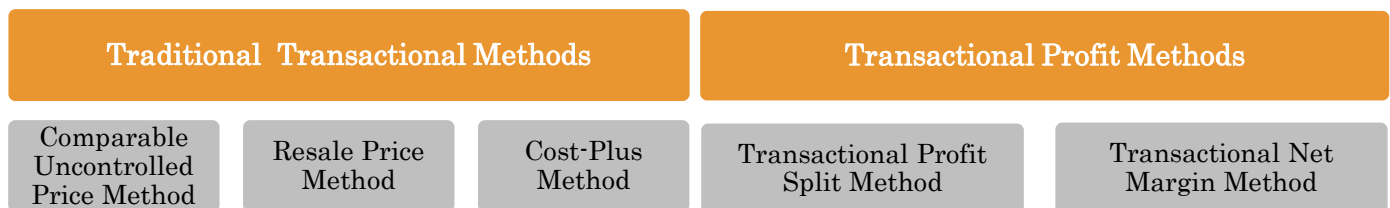
- ▶ From the above it looks like one needs to evaluate only the expense transactions with connected person and not all transactions from a TP perspective.

- ▶ The above tax deductibility criteria however does not apply to:
 - a. Listed Entity;
 - b. Taxable person subject to the regulatory oversight of a competent authority;
 - c. Any other person determined by a decision of the cabinet.

Transfer Pricing Methods



- ▶ All transactions and arrangements with Related Parties or with Connected Persons will need to comply with transfer pricing rules and the arm's length principle
- ▶ For determination of the arm's length result of a transaction or arrangement between Related Parties the Decree law prescribes the application of **one or combination** of the following methods which are in line with the OECD TP Guidelines:-



- ▶ The Decree law also allows a Taxable person to apply a different method where the business can demonstrate that the specified methods cannot be reasonably applied to determine an arm's length result. This is akin to the 'Other method' concept present in the OECD guidelines.
- ▶ Hence there is no priority of methods and one can select the most appropriate method(s) even a combination of methods can be adopted to prove arm's length.
- ▶ Choice of methods to be decided having regard to the factors of comparability being - contractual terms, characteristics of the transaction, economic circumstances, functions, assets and risks, business strategies.
- ▶ The application of one or more transfer pricing methods may result in an arm's length range of financial results, subject to any conditions specified in a decision issued by the Authority. The arm' length range is yet to be notified by the MoF. Most of the countries follow the interquartile range (or its variation) or any point in the range (minimum to maximum).
- ▶ In case if the transfer price falls outside the arm's length price then an adjustment would be carried out by the tax authority to the taxable income.
- ▶ Whenever there is an adjustment to the taxpayer's taxable income the benefit of corresponding adjustment is granted to the other related party(includes foreign entities)

Documentation Requirements

- ▶ With the introduction of local file and Masterfile, UAE is aligning itself with the 3 tier documentation approach of the OECD as Country by Country reporting(CbC) regulations are already implemented in UAE.
- ▶ There is also a Disclosure form which is prescribed which contains information regarding their transactions with Related Parties and Connected Persons, and this needs to be filed along with their tax return (due date is 9 months from the end of the year)
- ▶ Businesses that claim small business relief are not required to comply with the transfer pricing documentation rules.
- ▶ There is a requirement to maintain master file and local file, the thresholds and the conditions for applicability are yet to be prescribed.
- ▶ Though the contents of the Master File and the Local File are yet to be specified by the MoF but is expected to be consistent with the requirement prescribed under OECD guidelines. The contents of the Master File and Local File as per OECD guidelines is as below:

Master File Contents	Local File Contents
As per the OECD guidelines, a Master file should provide an overview of the MNE Group business, including nature of its global business operations, its overall transfer pricing policies etc. The information to be documented in the Master file can be categorized into the following groups:	The Local file provides more detailed information relating to specific intercompany transactions pertaining to a particular jurisdiction. The important information to be included in the Local file are:
1. Organisation Structure	1. Details of Related Party Transactions
2. Description of MNE group's business(es)	2. Group Overview
3. MNE group's intangibles	3. Industry Overview
4. MNE group's intercompany financial activities	4. Functional, Assets and Risk Analysis
5. MNE group's financial and tax positions	5. Economic Analysis

- ▶ Taxable Person need to submit the Documentation within 30 days from the date of request from the tax authority or such other later date as may be directed by the Authority.

Advance Pricing Agreement (APA)

There is a reference to APAs in Article 59 where it states that the person can make an application for conclusion of APA with respect to a transaction/arrangement entered or proposed to be entered by the person and hence it appears that UAE is bringing in the APA regime as well for tax certainty.

Applicability of arm's length principle in other CT sections

- ▶ **Article 18- Free Zones** – For a Free zone to be treated as a Qualifying Free Zone Person apart from other conditions, the entity must comply with transfer pricing rules and maintain the relevant transfer

pricing documentation. Hence compliance with transfer pricing rules is a precursor for Qualifying free zones to claim 0% CT.

- ▶ **Article 61- Transitional Provisions** - Opening balance sheet shall be the closing balance sheet prepared for financial reporting purposes on the day immediately before the first tax period. The Opening balance sheet so prepared shall be after considering the arm's length principle. In essence, though the Decree Law specifies that the CT law will be effective from June 01, 2023, it appears that the businesses will however need to ensure transactions are at arm's length in order to draw up the opening balance sheet appropriately.
- ▶ **Article 50: General Anti abuse rules** – For the purpose of invoking GAAR one of the provisions includes evaluating whether the transaction or arrangement has created rights or obligations which would not normally be created between Persons dealing with each other at arm's length in respect of the relevant transaction or arrangement. Further this provision comes into force with immediate effect
- ▶ **Article 15- Investment Manager Exemption**- Article 15 provides certain preconditions for an Investment Manager acting on behalf of a Non- Resident Person to be treated as an independent agent. One of the conditions is that the Investment manager should transact on an arm's length basis with the Non-Resident Person and receive due compensation for the provision of services,
- ▶ **Article 24- Foreign PE** - Any transfer of assets or liabilities between a Resident Person and its Foreign Permanent Establishment shall be treated as having taken place at "Market Value" at the date of the transfer. Market value as per the Decree is equivalent to arm's length
- ▶ **Article 31- Interest Deduction** – Interest expense incurred on a loan obtained directly or indirectly from a related party will not be allowed if it is for the following transactions:
 - a) Dividend or profit distribution to related party;
 - b) Redemption, repurchase, reduction or return of share capital to a Related Party;
 - c) Capital contribution to a Related Party;
 - d) Acquisition of an ownership interest in a Person who is or becomes a Related party following the acquisition.

The taxable person needs to demonstrate that main purpose of obtaining the loan and carrying out the above transaction(s) is not to gain a corporate tax advantage. Where the interest expense is subject to corporate tax in UAE or taxed in foreign jurisdiction at a rate not less than UAE tax rate, no Corporate Tax advantage shall be deemed to arise.



Conclusion

The transfer pricing provisions provided are more or less aligned to the generally global accepted practices laid down in the OECD Guidelines. There are areas where the MoF may need to clarify and provide guidance for application of the provisions in its true sense.

**Transfer Pricing Compliances**

- Identification of Related parties and Connected persons
- Analysis of transactions that would be covered under the UAE TP regime
- Undertake TP benchmarking analysis for the covered transactions to be in line with the arm's length principle.
- Assist with regular TP compliances – Disclosure form, Master file, Local file, CbC report

Transfer Pricing Advisory

- Price Setting- Advice on suitable pricing model and transfer pricing policy
- Assistance in implementation of TP policy and periodic review of margins earned
- Review/Drafting of intercompany agreements for the covered transactions
- Supply chain Re-Structuring
- Possible Advance Pricing Agreement assistance, once rules are notified
- Advice on Intra-Group Services, Management Charges, royalty, Cost Contribution Arrangements and financing transactions
- Support on estimating the profit attribution to Permanent Establishments

About us

VSTN Consultancy Private Ltd is a boutique Transfer pricing firm with extensive expertise in the field of international taxation and transfer pricing.

Our offering spans the end-to-end Transfer Pricing value chain, including design of intercompany policy and drafting of Interco agreement, ensuring effective implementation of the Transfer Pricing policy, year-end documentation and certification, BEPS related compliances (including advisory, Masterfile, Country by Country report), safe harbour filing, audit defense before all forums and dispute prevention mechanisms such as Advance Pricing agreement.

We are structured as an inverse pyramid where leadership get involved in all client matters, enabling clients to receive the highest quality of service.

Being a specialized firm, we offer advice that is independent of an audit practice, and deliver it with an uncompromising integrity.

Our expert team bring in cumulative experience of over four decades in the transfer pricing space with Big4s spanning clients, industries and have cutting edge knowledge and capabilities in handling complex TP engagements.



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