

Key Transfer Pricing



Considerations - UAE Landscape

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The UAE's Corporate Tax regime, which was introduced in 2022, has ushered in Transfer pricing regulations for UAE businesses, that are applicable to taxpayers having related party transactions – within UAE or across the borders. The UAE Transfer Pricing regulations clearly cast the onus on the taxpayer to ensure that all related party transactions adhere to arm's length principle. Further, the FTA (Federal Tax Authority) in the UAE Transfer pricing Guide categorically lays down that taxpayers have to maintain contemporaneous transfer pricing documentation for their related party transactions and transactions with connected persons to demonstrate compliance with transfer pricing regulations (Section 6.3 of the UAE TP Guide).

Another key transfer pricing compliance is the filing of Disclosure Form for transactions with Related Parties and Connected Persons. The Disclosure form is part of the Corporate Tax return and is part of the annual tax compliance. For the accounting period / year ending December 2024, the first due date for filing Corporate Tax return is September 30, 2025.

With statutory audits coming to a close for business having accounting period as year ended December 2024, the Statutory Auditors have also been requesting and examining the transfer pricing documentation maintained by the business for determining the arm's length nature of related party transactions.

Therefore, businesses must diligently assess and ensure that all the relevant related party transactions are accurately identified, and arm's length nature of these transactions are appropriately determined and contemporaneously documented.



In this light, some of key aspects and nuances that warrant careful consideration in relation to related party transactions in UAE transfer pricing arena is captured below.

A. Compensation to Key Managerial Personnel ('KMP')

One of the unique aspects of UAE's Transfer pricing regulations is determination of the arm's length nature of payments to connected persons, viz., compensation to Key Management Personnel (KMP).

To be aligned with the UAE TP Guidance issued by the Federal Tax Authority (FTA), which clearly states transfer pricing method should be applied at a transactional level rather than aggregate basis, it is important that the approach for benchmarking the compensation to KMP ought to be based on economic principles and stand the test of transfer pricing.

Some of the key aspects with regard to compensation to KMP are as follows:

1. Remuneration to KMPs in Loss-Making Companies: We often notice that the most common approach for benchmarking KMP compensation which has been adopted in the region is aggregating and testing the profitability of the entity, at the net-level. However, this approach suffers a fundamental flaw viz., if one were to adopt this approach, would one conclude that no compensation is to be paid to KMP if the company incurs losses. And no independent third party will agree on to this proposition.

The transfer pricing approach to benchmark KMP compensation should be 'all-weather' approach – irrespective of profitability of the company, and hence adopting profitability-based approach for benchmarking KMP compensation is not appropriate from a transfer pricing perspective.

Similarly, another approach generally adopted is to understand the salary packages available in public domain for the said position for example CEO / MD. However, the salary paid would also depend on the business that is being managed – for example, the compensation to the CEO managing USD 1 million Company will differ from the compensation paid to CEO heading USD 100 million Company. Hence, use of data from generic salary database may not be used as a comparable information on an as-is basis.

Hence, taxpayers ought to undertake an arm's length analysis at a transactional level and also ensure being correct from a transfer pricing / economic perspective.

2. Compensation to KMP being the only related party transaction: In many instances, taxpayers might only have compensation to KMP as their related party transaction. In such cases, testing the profitability of the company at the entity level would result in subjecting the entire company to transfer pricing – which is not the correct approach. This is in addition to the above-mentioned underlying shortcoming of using profitability-based approach for benchmarking compensation to KMP.



3. KMPs as both related party and connected persons: In many UAE entities especially closely held or family-owned businesses, KMPs may qualify as Related Parties and Connected Persons under transfer pricing regulations. This overlap will require justification of compensation w.r.t. being “wholly and exclusively for business purposes”. The FTA might view some of the activities undertaken as shareholder activities, for which no compensation is required and accordingly a portion of the compensation paid to KMP will be disallowed.

Further there might arise uncertainty in connection with disclosure of such payments in the Disclosure Form (DF) – whether under section for Related Party or Connected Person, especially since there is a difference in the threshold limits for disclosure of such payments for each of the said categories.

B. Arm's Length Analysis Is More Than Just Benchmarking

The UAE TP regulations mandate that all related party transactions must comply with the arm's length principle. Yet, a common misperception persists that undertaking a profitability-based benchmarking analysis is adhering to arm's length analysis.

Benchmarking is only one phase of a comprehensive arm's length analysis. A robust TP assessment begins with understanding the commercial and economic context of the transaction, followed by a detailed Functional, Asset, and Risk (FAR) analysis to characterize the role of each party whether as an entrepreneur, limited risk entity, or routine service provider. This also involves mapping the broader value chain to identify value creation points and strategic contributions. Only after this can the most appropriate method (MAM) such as TNMM, CUP, RPM, Cost Plus, or Profit Split be selected – based on the taxpayer's specific facts and functions.

Benchmarking then becomes relevant to test the selected method using third-party comparables. Additionally, the analysis must go beyond contractual form and consider actual conduct and delineate the transaction.

A classic example is where UAE taxpayer / entity makes payments to related parties for “management services”. Merely testing the mark-up applied would not suffice, as the FTA might question the arm's length nature of the cost base itself and require documentation on Need-benefit test, actual rendition test and that the services are not duplicative in nature. If the FTA deems that the cost base itself is not appropriate, even the most robust benchmarking w.r.t. mark-up cannot be used to defend the arm's length nature of the cost base.

Therefore, one will have to ensure that a wholistic arm's length analysis of the related party transactions will have to be undertaken, as against a mere benchmarking analysis.

C. Deputation of employees within group entities



In the Middle east region at large, and more specifically for UAE, there are many instances where one of the group entities obtains the required work permits(visas) / license for the entire group. This company usually onboards all the employees on behalf of all the group entities manages their payroll and deutes these employees to the premises of the other group entities, as may be required. The related party transaction consists of a cost-to-cost recharge of such deputed employees to the respective group entities.

A mere cost-to-cost recharge to the other group entities might not be appropriate since obtaining the work permits is a critical part of undertaking the overall operations of the company / group entities, and a mark-up would be warranted. Hence, it is necessary that the accurate delineation of the transaction is undertaken, and considering the same as a "salary recharge" and reimbursing on a cost-to-cost basis would not suffice from a transfer pricing perspective.

In certain instances, the taxpayers consider opting under the Low value adding services Safe Harbour, which states that for low value adding intragroup services mark-up of 5% would be considered arm's length in nature. However, taxpayer may have to evaluate if these services qualify as low value adding in nature, considering the role of employees deputed.

Therefore, taxpayer will have to undertake a detailed and robust analysis to ensure that the transaction is accurately delineated and analysed and an appropriate transfer pricing method is adopted, supported by relevant benchmarking analysis.

D. Cash Pooling: Centralised Liquidity Management

In many UAE groups, funds often move freely between related entities as part of centralised treasury operations, without formal agreements or defined interest terms. While this free flow of funds aids liquidity management, the UAE TP Regulations require each of such movement to be assessed independently based on its economic substance, rather than being justified solely by informal group policy.

To ensure compliance, businesses must carefully analyse the nature, purpose, and duration of each transfer to determine its true character - whether it qualifies as short-term operational funding, a loan, or another financial arrangement. Even in the absence of formal agreement, the conduct of the parties, frequency of fund movements, and any implicit expectation of repayment must be evaluated. Clear documentation, alignment with arm's length principles, and having an appropriate arm's length interest is essential to avoid any Transfer Pricing adjustment by the FTA.

Another key aspect with regard to these fund movements is that in case the credit rating of the borrower is at one of the lowest at the rating scale or there is no intention of the borrower to repay such amounts received, inability of the borrower to obtain funds from third party lenders due to high debt levels etc., the fund



transfer can be recharacterized as equity in nature and any consideration for such funds would be treated as dividend rather than interest. Accordingly, the deductibility of such payment made lieu of the 'interest' will be disallowed. Therefore, it is imperative that movement of funds accurately characterised both in form as well as in substance to ensure that such recharacterization does not take place and does not result in payment of additional taxes.

Among others, these free flow of funds can partake the character of loan or cash pooling, based on the facts and circumstances.

1. Intercompany Loans:

Where the arrangement is not very short-term or is medium-term or long-term in nature, the fund transaction may be recharacterized as a loan. In such cases, the TP considerations include:

- Understanding terms of fund / loan transaction
- Supporting documentation demonstrating the rationale and commercial substance of the transaction – including a robust debt capacity analysis.
- Credit risk assessment of the borrower
- Interest rates, benchmarked against comparable third - party loans

In groups where the requirement of funds is dynamic and involves multiple loans transactions, the group can enter into an agreement for borrowing of funds based on a loan matrix – which captures the arm's length interest spread for various credit ratings across various maturities. This approach would be efficient for Groups considering intragroup loans within the same currency. Through this the group entities will have visibility on the borrowing costs and can take an informed decision.

2. Cash Pooling:

The UAE TP guidelines recognize cash pooling as a treasury management strategy aimed at optimizing group liquidity. Cash Pooling arrangement is typically where there is two-way movement between cash participants and for a very short term. However, these arrangements can pose significant challenges due to their inherent complexity—such as the use of multiple currencies, daily balance fluctuations, etc.

Some of the key Considerations w.r.t. cash pooling include:

- **Accurate delineation of the arrangement:** The true nature of the transaction must be identified based on the functions performed, risks assumed, and assets used—not merely the contractual terms. This determines whether the setup qualifies as a cash pool or another type of financial transaction such as loan.
- **Remuneration to the Cash Pool Leader (CPL):** The CPL should be compensated based on its role. If its role is limited to coordination of funds, limited remuneration may suffice. However, if it bears significant financial risks, a larger share of the interest spread between depositors and borrowers may be justified.



- **Compensation to cash pool participants:** Cash pool participants should earn a return equivalent to what they could obtain from an independent party, and borrowing entities should be charged an interest rate in line with comparable market rates.
- **Compliance** – Entities must first identify the existence and type of cash pooling in their group. A thorough functional and risk analysis must follow to accurately delineate the transaction. Based on this, an arm's length policy should be established for benefit allocation and CPL remuneration. This must be supported by robust intercompany agreements and benchmarking analyses.

When cash pooling is considered across various geographies, it is important that the group has robust cash pooling agreement in place to ensure compliance and acceptability of the said arrangement from a legal and foreign exchange regulatory perspective of the respective jurisdictions.

E. Introduction of new transaction:

In certain MNE groups operating in the UAE, certain intercompany transactions are either not formally recognised, not documented, or are implemented without clear contractual arrangements. While such transactions may not appear on the books as standalone transactions, they still have transfer pricing implications, and the absence of a formal arrangement does not exempt these transactions from remaining compliant from a UAE Transfer pricing perspective.

1. Royalty or Brand Usage Without Formal Agreement

For UAE-headquartered groups owning intellectual property (IP), such as trademarks, brand, or proprietary know-how, the group entities in other jurisdictions or even entities within the UAE might use these IPs in their operations. However, no formal agreement might be in place for payment of royalty for use of such IP. In such cases the FTA can impute royalty income to the UAE HQ parent.

Therefore, groups will have to reassess their intangible related group policies and in absence of the same ensure a transfer pricing framework is set for the use of intangible assets by the group entities.

2. Guarantees

There are instances where UAE parent or group company provides a financial guarantee for a subsidiary's borrowing, through a guarantee to the banks of the group entity borrowing funds. Certain Groups treat the guarantee that is provided as shareholding activity and do not make any payment. Where the financial statements are audited, there would be disclosure of the same, based on which the FTA can impute guarantee fee to be charged and effect transfer pricing adjustment.

The UAE parent entity or the UAE entity providing guarantee will have to ensure that the transaction is delineated and analysed to identify if any arm's length consideration will have to be received or not. For example, the guarantee given is



by virtue of being a shareholder or there might be no additional liability that would be arise to the guaranteeing entity, since the loan is capped to assets of the borrower and the banks will have recourse to the assets of the borrower. However, one will have to evaluate the benefit that the borrower that would have received due to the guarantee provided, and any opportunity cost for provision of such guarantee to the guarantor.

Therefore, in either of the cases – guarantee fees received or not, the UAE entity will have to maintain robust documentation on the facts & circumstances as well as on arm's length nature of the guarantee fees.

F. Free zone vs Mainland:

UAE has several Free Zones where taxpayers enjoy preferential tax rates on qualifying income, and hence transactions between related parties in Free zone and Mainland needs to be ensured to be at arm's length to claim free zone benefits. The transactions involving movement of goods would be easily identifiable and disclosed / reported in the financial statements, there might be certain transactions which might not be separately identified and compensated between related parties – such as provision of services by the Mainland, charges incurred by the mainland entity on behalf of the Free zone entity, etc.

These transactions will have to be identified, and appropriate compensation will have paid by the Free zone entity to its Mainland related party, else it will be viewed by the FTA as a means of increasing the profits of the Free Zone entity to claim the benefit of preferential tax rates.

To conclude, considering that 2025 is the first tax filing season for business, since the implementation of the Corporate Tax in UAE it is critical that business have their transfer pricing framework and policy set in place, also since the first year would set the tone for the future years and act as a frame of reference. Any gaps or weaknesses in year one could have compounding effects, exposing businesses to adjustments / penalties, and embroiling the business into transfer pricing litigation. Companies that adopt a proactive approach, supported by robust documentation and commercial clarity, will be better positioned to defend their transfer pricing positions.

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