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ARTICLE from MEMBER

UAE Transfer Pricing – Key aspects

The first Corporate Tax return due date for taxpayers with YE December 2024 is fast approaching viz., 30 September 2025. As taxpayers finalise their financials, TP compliances have to be borne in mind. Even though certain taxpayers have not crossed the threshold for the local file and master file, they will need to maintain documentation to defend the arm's length nature of all the related party transactions / transactions with connected person (RPT). This article summarizes some of the pointers that taxpayers will have to bear in mind regarding certain areas.

A. Compensation to Key Managerial Personnel (KMP)

In UAE CT Law, KMP is included among "Connected Persons." – through "any director or officer of a taxable person,". Since "officer" is not defined, even Head of Department or other senior executives with control over strategic or operational matters may fall under the definition. It is therefore crucial for businesses to clearly identify and document who qualifies as KMP to ensure compliance.

TP regulations require KMP compensation should be at market value, viz., the Arm's Length Price (ALP) and be determined in accordance with the prescribed transfer pricing methods under the TP regulations.

Key aspects w.r.t. KMP.

• Consider Company A, due to business / economic reasons has a net margin of negative 5% and KMP is only transaction. Adopting TNMM may be unrealistic, as a loss-making position might suggest that no payment should be made to the director, which is commercially unrealistic. Transfer pricing principles require assessing what independent parties would do, and in practice, no unrelated party in a similar role would agree to work without remuneration solely because the company is incurring losses.

• Company B in trading of electronics has annual revenues of AED 10 million and adopts a generic market salary guide (e.g., Glassdoor, Naukri Gulf) to set the KMP's pay. This cannot be compared to the salary paid to personnel in say a leading player in the electronics field with more than AED 1000 million of revenue

Such an approach ignores the scale of operations, the complexity of business, and the actual responsibilities, leading to a misalignment between the KMP's remuneration and the company's operational size.

A more appropriate approach is to undertake either:

(1) Bespoke, company-specific HR compensation benchmarking exercise reflecting the actual size, industry, and complexity of business; or

(2) Assessment of KMP's contribution to top line and aligning compensation with the measurable value they bring to the business.

Under UAE TP provisions, KMP compensation should align with Arm's Length Principle and be determined using the most appropriate recognised TP method, thereby ensuring the pay is market-aligned, substantiated with evidence, and compliant with tax requirements & commercial reality.

B. Net Funding Transactions

Taxpayers commonly settle expenses on behalf of its related parties, for example, paying an amount to a supplier for raw materials ordered by RP. If RP does not reimburse this amount within a reasonable credit period—say, within 60-90 days from the date of payment—this extended receivable is treated as a form of financing. Even though no formal loan agreement exists, TP Guide indicates that interest should be computed on the outstanding amount at an arm's length rate and included as taxable income - as if the company had advanced a loan to an unrelated third party.

Further there is a free-flow movement of funds within the group entities. However, based on the actual substance and other factors such as credit rating and debt capacity, the arm's length interest rate on a loan must be determined. There are two aspects that require analysis: (a) whether the loan itself is at arm's length—since, if a comparable third-party loan could not be obtained due to business or economic circumstances, the money lent may need to be recharacterized as equity; and (b) whether the interest payments are at arm's length.

Although loans do not require disclosure in TP Disclosure Form, the interest is to be disclosed after the ALP analysis.

Loans are always required to be tested at the time the loan is granted. Consider a UAE entity lending AED 2 million to RP in January 2024 for three years. The arm's length interest rate should be determined at the time the loan is granted, based on comparable market conditions and the borrower's credit profile. The rate determined will be applied to the loan outstanding over the period of loan. Let us say in July 2025 the lender provides an additional AED 1 million to the same RP, it is a new loan and must be separately benchmarked during that year.

C. Year-end adjustment

Let us take a case where the UAE entity operating margin is 2%, and the lower quartile (LQ) of the arm's length range is 5%, the shortfall is 3% even to the LQ. An adjustment will have to be affected to bring the results of UAE entity within the arm's length range. Some key aspects on such adjustments in two scenarios is provided:

1. Financial statements are finalised

Where financial statements are finalised, no accounting adjustment can be made. Under the TP framework, if the result falls anywhere within the interquartile range (IQR), it is considered arm's length—no explicit guidance requiring an adjustment to median or to exact lower quartile.

However, the FTA may not accept a downward adjustment (reducing taxable income), without getting the written approval from FTA. So practically it may not be preferable to pursue such a claim. For upward adjustments (increasing taxable income), the adjustment can be made in the corporate tax return itself, with the TP justification and workings for the same may be uploaded as part of the disclosure form.

2. Financial statements are not finalised

Where the audit is not yet complete, there is flexibility to record the TP adjustment directly in the financial statements before they are signed. This ensures the operating margins are within the arm's length range and aligns with TP regulations. In such cases, a corresponding adjustment can also be recorded in RPs accounts, ensuring both sides reflect the revised transaction value consistently.

To conclude, it is important that taxpayers have to analyse the transactions with related party & connected people accurately to ensure arm's length nature of such transactions by having a robust documentation for determination of arm's length nature of related party transactions, since this would set a precedent for the following years.