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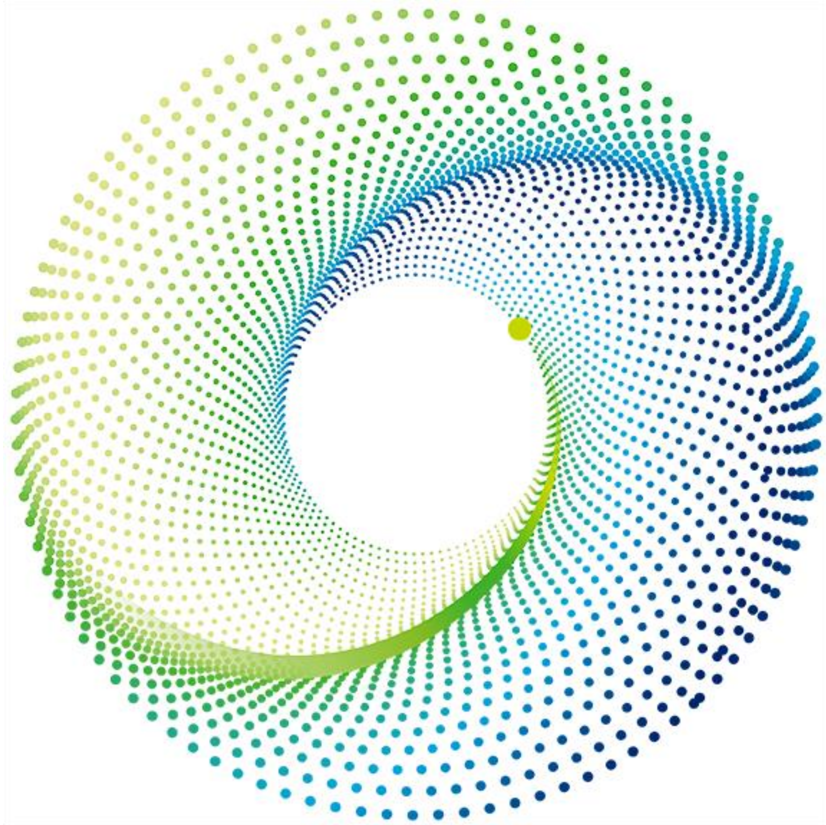

The Transfer Pricing Regime in the United Arab Emirates

November 2023

Foreword

On 31 January 2022, the Ministry of Finance ("MoF") of the United Arab Emirates ("UAE") announced that the UAE will introduce a Federal Corporate Tax ("CT") on business profits that will be effective for financial years starting on or after 1 June 2023.

On 9 December 2022, the MoF released the Federal Decree-Law No. 47 of 2022, issued on 3 October 2022, on the Taxation of Corporations and Businesses ("CT Law"). In addition, the MoF released 353 Frequently Asked Questions ("FAQs")[1] to provide guidance on the UAE CT regime.

The CT Law will be administered by the Federal Tax Authority ("FTA").

The MoF, on 27 April 2023, released the Ministerial Decision No. 97 of 2023 Requirements for Maintaining Transfer Pricing ("TP") Documentation; containing the conditions for maintaining a Master File ("MF") and Local File ("LF") in compliance with the requirements under the UAE CT regime.

On 23 October 2023, the FTA issued a comprehensive Transfer Pricing Guide ("Guide"), bringing much-needed clarity for businesses on the application of the

[1] United Arab Emirates Ministry of Finance, Corporate Tax FAQs. Available at: https://mof.gov.ae/corporate-tax-faq/

arm's length principle. The document provides detailed guidance and multiple examples that help explain complex TP areas.

The Guide provides comprehensive guidance on how to apply the TP regulations, however it is not a legally binding document, therefore taxpayers should primarily rely on the CT Law, the Cabinet Resolution 44 of 2020 in relation to the Country-by-Country Reporting, and Ministerial Decision 97 of 2023 in relation to the TP Documentation requirements as referenced in the Guide.

The Guide is broadly aligned with the Organization for Economic Co-operation and Development (OECD) Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations ("OECD Guidelines"), January 2022 and the FTA encourages taxpayers to refer to the OECD Guidelines if an issue is not specifically addressed in the Guide. It offers a good indication of the FTA's interpretation of key TP issues.

In the next sections, we provide key highlights from the Guide.

Overview of the UAE TP Rules

The CT Law introduced a comprehensive TP regime which broadly aligns with the OECD Guidelines. Specifically, the CT Law expands on the TP rules in the UAE in the following Articles:

- Article 34 – The Arm's Length Principle;
- Article 35 – Related Parties and Control;
- Article 36 – Payments to Connected Persons; and
- Article 55 – Transfer Pricing Documentation.

In addition to the above, the CT Law embedded various references to the TP rules in various Articles to emphasize the application of the arm's length principle, including:

- Article 5 to 8 on exempt activities of certain entities;
- Article 14 - Permanent Establishment;
- Article 18 - Qualifying Free Zone Person;
- Article 20 - General Rules for Determining Taxable Income;
- Article 21 - Small Business Relief;
- Article 23 - Participation Exemption;
- Article 31 - Specific Interest Deduction Limitation Rule;
- Article 42 - Taxable Income of a Tax Group; and
- Article 61 - Transitional Rules.

The Guide provides practical guidance on the UAE TP regulations to taxpayers and focuses primarily on the key TP provisions. It does not cover any other Articles of the CT Law that have references to the TP rules. The primary focus of the Guide is on the following:

- Fundamentals of TP;
- Application of Arm's Length Principle;
- TP Documentation;
- Special considerations for specific cases; and
- TP Audit and risk assessment.

TP Principles and Fundamentals

In continuation to Article 34 of the CT Law, the Guide introduces the concept of TP and clarifies in-scope entities for application of the arm's length principle in the UAE.

What is Transfer Pricing?

Section 3 of the Guide defines TP at a glance and defines how TP refers to pricing of transactions or arrangements, between Related Parties or Connected Persons, which are influenced by the relationship between the entities. These transactions include trade of services, tangible goods, intangibles, financial transactions as well as certain transactions involving a permanent establishment. The primary objective is to ensure that the pricing of such controlled transactions reflect market forces, prevent profit shifting and ensuring a fair allocation of taxable profits among countries.

The arm's length principle

The arm's length principle is the cornerstone of TP. It requires that transactions between related entities should be priced as if they were between independent entities under similar circumstances. Article 34(2) of the CT Law states that:

> *"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 realized if Persons who were not Related Parties had engaged in a similar transaction or arrangement under similar circumstances."*

The Guide elaborates that the arm's length principle treats related party entities as separate entities rather than as inseparable parts of a single unified business, ensuring that related entities earn their fair share of profits, corresponding to their respective functional profile and contribution in the value chain. The Guide also explains this principle with the help of a simplified example.

Scope of the TP Rules

The scope of the TP rules is extensive and applies to all taxpayers in the UAE. The Guide clarifies that entities that are exempt or have elected for small business relief are not required to prepare and maintain TP Documentation but are subject to TP rules and must abide by the arm's length principle where they enter into Controlled Transactions.

In addition to Article 35 of the CT Law, the Guide provides certain criteria for determining the association between related parties, with the help of practical examples from the perspective of ownership and control by exercising considerable influence.

The initial focus of the Guide on TP as a concept and TP principles and Fundamentals highlights the complexity of the topic and demonstrates the need for UAE taxpayers to have a robust understanding of the topic.

With the increasing globalization of businesses and the ongoing efforts of tax authorities worldwide to ensure fair taxation, adhering to the TP Guide is not just a matter of compliance, but also a strategic imperative. By understanding the impact of these provisions, UAE businesses can navigate the complex world of TP with confidence. As most UAE taxpayers come to their first taxable period starting on 1 January 2024, it is critical to identify controlled transactions that would fall within the scope of the UAE TP regulations and assess their alignment with the arm's length principle.

Application of the arm's length principle

Article 34 (8) of the CT Law provides the FTA with the ability to adjust the taxable income of taxpayers to achieve the arm's length results, where the results of the controlled transactions do not fall within the arm's length range.

The FTA will determine the taxable income through an analysis of whether the taxpayer has dealt at arm's length with its related parties and connected persons.

In theory, the "Arm's Length Principle" is intuitive and reasonable. However, most taxpayers face challenges in the application of arm's length principle. The Guide now provides a detailed overview of the principle and how businesses operating in the UAE should apply these principles in practice.

The importance for UAE Taxpayers

The Guide reassures the UAE's position on aligning of the TP provisions with international standards considering circumstances relevant from a UAE perspective.

In addition to the TP regulations covered under the CT Law, the implementing decisions and other relevant guidance published by the FTA, taxpayers now have clarity to navigate the complexities of TP, the arm's length principle and related parties, for their first taxable year.

Objectives of the TP documentation requirements

The key objectives of TP documentation, as specified in the Guide, are as follows:

- Ensuring that TP requirements are appropriately considered when setting prices and other terms for transactions between Related Parties and Connected Persons – the outcomes of which are accurately reported in the Tax Return;
- Providing necessary data to perform TP risk assessments and arrive at an informed decision to conduct an audit; and
- Providing necessary information to facilitate a comprehensive audit of the Taxable Person's TP practices subject to Corporate Tax in the UAE and recognizing the need for additional information as the audit progresses.

TP Documentation

Section 6 of the Guide expands on the TP documentation obligation as stipulated in Article 55 of the CT Law, which are applicable to Taxable Persons entering into transactions with their Related Parties and Connected Persons.

The purpose of TP documentation is to provide FTA with a clear and comprehensive understanding of the Taxable Person's TP policies and their application to evaluate the TP outcome for the year under review.

Contemporaneous TP documentation

Taxable Persons must maintain contemporaneous TP documentation to demonstrate compliance with the TP rules and preserve their corporate tax integrity.

The FTA expects that TP documentation be maintained either at the time of the transaction or when the Tax Return for that period is submitted. This helps ensure that TP policies adhere to the arm's length principle and should be regularly updated to reflect any business changes and the regulatory environment.

TP documentation requirements

As stipulated by Article 55 of the CT Law and Cabinet Resolution No. 44 of 2020, there are five TP documentation requirements for certain Taxable Persons for each Taxable Period. These requirements are set out below.

TP Disclosure Form

According to Article 55(1) of the CT Law, Taxable Persons undertaking domestic or cross-border transactions with Related Parties or Connected Persons must complete and submit a TP Disclosure Form.

The TP Disclosure Form must be submitted along with their Tax Return (i.e., within nine months from the end of the relevant Tax Period).

The Guide clarifies that Taxable Persons that undertake Controlled Transactions above a materiality threshold need to prepare and submit the Disclosure Form. While the threshold is to be announced, the information to be disclosed in the TP Disclosure Form will include:

- Broad categories of transactions and arrangements undertaken by the Taxable Person with its Related Parties or Connected Persons;
- Nature and value of the Controlled Transactions;
- Details of the Related Parties; and
- TP method(s) used to determine the arm’s length value of the Controlled Transactions; and
- A sample of the disclosure form will be made available on the FTAs website in due course.

Master File and Local File

The MF and LF are two of the TP documentation requirements stipulated in the three-tiered approach of the OECD BEPS Action 13.

In accordance with Article 55(2) of the CT Law, Taxable Persons undertaking domestic transactions (subject to conditions outlined in Ministerial Decision No. 97) or cross-border transactions with its Related Parties/Connected Persons, during a Tax Period and meeting any of the following threshold, must maintain MF and LF:

- At any time during the relevant tax period, the taxpayer is a constituent entity of a multinational enterprise (“MNE”) group with a total consolidated group turnover in the relevant tax period of AED 3.15 billion or more; or
- The taxpayer's turnover in the relevant tax period is at least AED 200 million.

The announced revenue threshold of AED 200 million allows Taxable Persons who do not meet the above criteria relief from maintaining a full-fledged TP documentation, thereby reducing compliance burden on small taxpayers.

However, if the Taxable Person is considered a constituent entity of an MNE group at any time during the Tax Period, it would be required to maintain TP documentation, regardless of whether the revenue threshold is met.

The information required to be disclosed in the MF, as described in Section 6.6.1.1 of the Guide, broadly follows Annex I to Chapter V of the OECD Guidelines. The information required to be disclosed in the LF as described in Section 6.6.2.1 of the Guide, broadly follows Annex II to Chapter V of the OECD Guidelines.

It is important to note that Taxable Persons in a UAE-based group, which is not an MNE Group (i.e., without business establishments outside UAE), are exempt from maintaining a MF. Such entities should, however, maintain a LF as per the specified thresholds.

A Taxable Person not meeting the conditions for a MF, or a LF, is still obligated to maintain records supporting the arm's length nature of their transactions with Related Parties/Connected Persons, and the FTA may request supporting information from all taxpayers. Such information may include functional analysis, benchmarking studies, intercompany agreements, meeting minutes, evidence of decisions taken, emails, invoices, workpapers computing the transfer prices, among others.

The FTA can request this information within 30 days or as directed by the FTA.

Country-by-Country Report

The Guide expands on the Country-by-Country (“CbC”) report being the third requirement stipulated in the three-tiered approach of the BEPS Action 13. It is a standardized report providing information about global income allocation, taxes paid, and economic activity indicators of the MNE Group across tax jurisdictions. It also lists the MNE Group’s Constituent Entities for which financial information is reported, including the tax jurisdiction of incorporation as well as details of the main business activities carried out by the Constituent Entity.

The UAE CbC reporting rules apply to UAE-headquartered MNE Groups with over AED 3.15 billion (about EUR 750 million) in consolidated revenue in the previous fiscal year.

The Ultimate Parent Entity must submit a CbC notification for each reporting Fiscal Year, due by the end of that year.

The notification designates the Ultimate Parent Entity as the reporting Entity for CbC reporting. The CbC report must be filed within 12 months after the end of the UAE MNE Group's reporting year. Cabinet Resolution No. 44 of 2020 provides guidance on CbC reporting requirements, preparation, and submission, which Taxable Persons should consult for practical guidance.

The information required to be disclosed in the CbC report follows Annex III to Chapter V of the OECD Guidelines.

Under Section 7, the Guide provides special considerations for complex TP topics and provides practical insights for determining arm’s length pricing in these areas. This includes financial transactions, intra-group services, intangibles, cost contribution arrangements, business restructuring, permanent establishment, group synergies, and other cases.

Financial Transactions

For UAE taxpayers, navigating the realm of financial transactions in transfer pricing can seem daunting. However, with the guidance provided in Section 7.1 of the UAE's Guide, businesses can tread with confidence, ensuring that their financial dealings align with both local regulations and international best practices.

As the UAE continues to solidify its position on the global economic stage, understanding and adhering to these guidelines will be instrumental in fostering a transparent and robust business environment.

🛈 Here is a breakdown of what UAE taxpayers need to consider:

Treasury Function

At the heart of MNE Groups lies the treasury function, a centralized hub responsible for managing a group's financial resources, cash flows, and associated risks. It ensures that funds are readily available where and when they are needed within the group, all the while navigating the financial risks that come with such management.

To ensure that the arm’s length principle is followed, it is key to delineate the transactions and actual activities (and risks assumed) performed in relation to the treasury function.

In general, the treasury function may be considered more supportive in nature and a service fee will be determined in line with the provisions for intra-group services detailed in later sections of this Article. More complex functions would require further analysis and alternate pricing methods may be considered.

Intra-group loans

A common practice among related entities within a corporate group, intra-group loans refer to the lending of funds from one entity to another.

The crux is to determine an interest rate that mirrors what would be charged between independent entities operating under similar circumstances, i.e., at arm’s length. This usually entails:

1. Understanding the economically relevant factors around the loan such as the purpose, duration of loan, functional currency used, value of loan, and the borrower's credit rating plays a pivotal role in arriving at an arm’s length interest rate.
2. The options for the appropriate credit rating to be used includes: the overall credit rating of the group; or the credit rating of the specific borrower. Factors such as the availability of financial information, industry and jurisdiction should be considered.
3. Benchmarking the appropriate credit rating and applying the comparability factors outlined in Chapter 5.2.1.1 of the Guide to publicly available third-party loans.
4. Comparable adjustments permissible on third party loans to enhance comparability and reliability of data.

Cash Pooling

A strategic tool for liquidity management, cash pooling allows for the consolidation of funds from various entities within a group into a singular account. This pooling can lead to a myriad of benefits, including reduced external borrowing costs and an uptick in interest income on the pooled cash.

In general, the cash pooling group entity usually performs routine coordination functions which may be considered an intra-group service and a service fee will be determined in line with the provisions for intra-group services as detailed in later sections of this Article. The Guide outlines that more complex functions would require further analysis and alternate TP methods may be considered.

Hedging

In the volatile world of finance, hedging serves as a protective shield, offering strategies to offset potential losses that might arise from adverse price movements, be it in commodities, currencies, or securities. It is an initiative-taking approach to managing the financial risks linked with market price fluctuations.

In instances where the group treasury team performs functions such as arranging the hedging contract on behalf of other group entities, it may be considered an intra-group service and a service fee will be determined in line with the provisions for intra-group services as detailed in later sections of this Article. More complex functions would require further analysis and alternate TP methods may be considered.

Financial Guarantees

Sometimes, one entity within a group might step in to assure the meeting of financial obligations of another group entity in case of default to third parties, offering what is known as a financial guarantee. Determining an arm's length fee for providing such guarantees is crucial to ensure fairness and compliance.

In order to determine the appropriate TP method to arrive at an arm's length guarantee fee, the purpose of the guarantee should be determined. This includes the following:

1. Whether the guarantee allowed the guaranteed party to obtain better terms and conditions in relation to the third-party loan; or
2. Whether the guarantee enabled the guaranteed party to actually obtain such loan.

An arm's length guarantee fee is typically arrived at by estimating the benefit recognized by the guaranteed party in receiving a lower interest rate on its borrowings as a result of the guarantee. This approach is referred to as the "interest savings approach" and is done by calculating the difference in the guaranteed party's cost of borrowing without the guarantee as compared to its actual cost of borrowing with the guarantee.

Captive Insurance

A unique risk management strategy, captive insurance refers to an insurance or reinsurance entity set up primarily to cover the risks of the group. Instead of relying on external insurance providers, groups can manage certain risks internally, often leading to cost savings and customized coverage.

Accurate delineation of the transactions and activities are key to determining the appropriate arms' length compensation for the captive insurers.

Key points to consider

While both the UAE's Guide on TP and the OECD Guidelines provide comprehensive guidance on financial transactions, there are nuances:

Depth of Guidance: Chapter 10 of the OECD Guidelines offers a more in-depth analysis, especially on the accurate delineation of financial transactions, the importance of understanding the actual transaction and considerations for determining the arm's length compensation. It is therefore important to consider the OECD Guidelines when certain aspects are not covered or provide high level guidance in the Guide.

Intra-group Services

The Guide, under Section 7.2 discusses services provided by one member of a Group (to other members and the arm's length consideration for such services.

The extent of intra-group services varies among the members of the Group, depending on the structure of the group. In a decentralized group, the parent entity may limit its intra-group activity to monitoring its investments in its subsidiaries in its capacity as a shareholder.

In contrast, in an integrated group, management of the parent entity may make all the important decisions concerning the affairs of the subsidiaries and may conduct all relevant functions. In this regard, intra-group services play a pivotal role in facilitating seamless operations and fostering synergies across entities. With this in mind, we set out below the key areas that taxpayers will be required to consider in the context of intra-group services from a UAE perspective.

Understanding intra-group services

At its core, intra-group services refer to services rendered between entities within the same corporate group. These can span a wide spectrum, from administrative and management services to technical support, marketing, and beyond. Given their internal nature, it is crucial to ascertain that these services are priced fairly and transparently, adhering to the arm's length principle.

From an overall management perspective, there are advantages in concentrating specific and common services in a group service center, either as a separate entity or as a department of a parent company. Commercially it may ensure the MNE can achieve economies of scale, synergy, efficient use of resources, and a high degree of specialization.

Determining the legitimacy of services

Not all services exchanged between related entities qualify as intra-group services from a TP perspective. The Guide underscores the importance of determining whether an intra-group service has indeed been rendered. This involves assessing if the service provides economic or commercial value, enhancing the recipient's commercial position.

The yardstick is whether an independent enterprise, in comparable circumstances, would have been willing to pay for the activity concerned (or to perform it in-house for itself). If not, such activity should not be considered as an intra-group service under the arm's length principle.

Establishing an Arm's Length Charge

Once the legitimacy of the service is established, the next step is to determine an appropriate charge for it. This charge should reflect what would be agreed upon between independent entities for a comparable service under similar conditions. Factors such as the nature of the service, the benefits derived, and market comparables play a crucial role in this determination.

Potential challenges and considerations

As we have seen globally, intra-group services are a major target of tax audits. Depending on the origin of a service, tax authorities may question whether a charge had to be made, whether a charge was allowed or whether a charge was sufficient from an arm's length perspective.

Intra-group services can sometimes be intertwined with group synergies, leading to complexities in determining charges. It is essential to differentiate between services that lead to synergistic benefits and those that do not. Additionally, taxpayers should be wary of duplicate services, ensuring that charges are not levied for services that do not offer additional value beyond what has already been provided.

For UAE taxpayers, understanding the intricacies of intra-group services in TP is not just a matter of regulatory compliance, it is about ensuring fairness, transparency, and fostering trust in the UAE's business ecosystem. As the nation continues to evolve as a global business hub, adhering to the Guide, set out in Section 7.2, will be instrumental in navigating the complex waters of intra-group transactions with clarity and confidence.

On this basis, for UAE taxpayers, the issues for further consideration in this context are, in particular, (i) to mitigate non-deductibility of service costs; (ii) to reduce cross-border tax leakage; and (iii) to prepare adequate documentation.

Comparison with the OECD Guidelines

According to the Guide, the UAE follows the OECD Guidelines in relation to intra-group services, however certain modifications have been made to suit the UAE domestic requirements and views of the FTA.

On this basis, when considering the depth of guidance, while both the UAE Guide and the OECD Guidelines provide comprehensive insights into intra-group services, the OECD offers a more granular level of information and analysis.

Similarly, in relation to the benefit test, both the UAE Guide and the OECD Guidelines emphasize the importance of the service conferring a benefit on the recipient.

The OECD's "benefit test" provides a more structured framework for this assessment. With respect to reporting requirements, it is clear that the UAE will adopt a practical and detailed approach regarding intra-group services and the associated documentation requirements to be adhered to.

Where service-type activities are conducted by group members that may benefit other group members, the Guide specifically requires adequate documentation to be prepared, for both provider and recipient(s) of a service. As set out in section 7.2.4 of the Guide, service-related documentation may be structured to include:

- A clear explanation of the intra-group services provided and the identity of the beneficiaries;
- A summary of the benefits received;
- The approach adopted to determine and calculate the charges together with the justification for the choice of allocation key(s) used;
- An explanation of how the underlying costs relate to the service provided; and
- Supporting rationale for any mark-up applied.

In summary, the guidance on intra-group services has been prepared to provide a general direction on the key matters relating to service arrangements in the UAE and to ensure ease of reference and applicability. In doing so, this addresses typical or common questions that may arise in relation to intra-group services in the context of the emerging UAE TP regime.

Therefore, while the UAE's Guide on TP offers valuable insights tailored to the UAE context, the OECD Guidelines provide a more detailed and structured framework for understanding and navigating intra-group services. UAE taxpayers should consider both sets of guidelines to ensure a holistic understanding and compliance and ensure any analysis conducted is in conjunction with the OECD Guidelines.

Intangibles

In the ever-evolving landscape of global business, intangible assets have become extremely important and significant.

As a consequence, it is common to witness some complex intangible arrangements / transactions within MNE groups – which pose a number of challenges when applying the arm's length principle, as envisaged in the transfer pricing regulations globally. Needless to say, transfer pricing aspects of intangibles are extremely important and overly complex.

The UAE's Guide on TP, under Section 7.3 titled "Intangibles", delves into the intricacies of dealing with such assets in the realm of TP. Broadly, the sections follow the guidance of Chapter VI of the OECD Guidelines. This article aims to provide UAE taxpayers with a concise overview of this section, ensuring clarity and understanding.

Identifying intangibles

Intangibles are defined as something that is not a physical asset or a financial asset, which is capable of being owned or controlled for use in commercial activities.

Simply put, there are various categories of assets under the concept of intangibles. At a high-level, distinctions can be made between trade intangibles and marketing intangibles, between routine and non-routine intangibles, and between other classes of intangibles. Besides this, some intangibles may be considered to be unique and valuable i.e., classified as hard-to-value intangible ("HTVI").

Applying the arm's length principle to intangibles

The core of TP revolves around the arm's length principle, ensuring that transactions between related entities are priced as if they were between independent entities. When it comes to intangibles, applying this principle can be complex due to the unique nature of these assets, lack of clarity on the nature of related party transactions, and the inherent challenge to find comparable arrangements.

Accordingly, it is imperative to understand the nature of transactions, involving intangibles the transactions between related entities involve: (a) transfer of intangibles or rights in intangibles; (b) use of intangibles in connection with the sale of goods or the provision of services. The Guide underscores the importance of analyzing the functions performed, assets used, and risks assumed by parties involved in the transaction. Simply put, a detailed functional analysis helps in ascertaining the contributions of each entity involved in the development, enhancement, maintenance, protection, and exploitation ("DEMPE") of intangibles. This aids in determining the appropriate return for each entity, derived from the exploitation of intangibles. Furthermore, the Guide provides insights into the methods suitable for determining the arm's length price for transactions involving intangibles.

Key takeaways for UAE taxpayers

As the global business environment leans more towards a knowledge-based economy, intangibles will continue to play a pivotal role. UAE taxpayers must equip themselves with the knowledge and tools to navigate the complexities of TP for intangibles, ensuring compliance and optimizing their tax strategies.

It is imperative for the UAE taxpayers to have a granular understanding of the TP principles relating to intangibles, as outlined by OECD Guidelines (Chapter VI); this would enable the taxpayer to understand, appreciate and apply the principles outlined in the Guide, as well (Section 7.3).

Comparison with the OECD Guidelines

- **Definition:** Whilst, both UAE and OECD Guidelines are broadly aligned on this aspect; the OECD additionally refers to "soft" and "hard" intangibles.
- **Identifying intangibles:** The OECD Guidelines clearly states that focus is not on categorization of intangibles; in contrast, the Guide does not mention this.

Cost Contribution Arrangements (CCAs)

A CCA is a contractual arrangement among business enterprises to share the contributions and risks involved in the joint development, production or the obtaining of intangibles, tangible assets, or services with the understanding that such intangibles, tangible assets, or services are expected to create benefits for the individual businesses of each of the participants.

The UAE's Guide on TP, Section 7.4 titled "Cost Contribution Arrangements," provides an insight into CCAs, ensuring that taxpayers are well-equipped to navigate this complex area.

Introduction to CCAs

As per the Guide, CCAs are contractual agreements entered into by related parties or connected persons within an MNE Group. The objective of CCAs is to share the contributions and risks of joint projects involving the development, production, or acquisition of intangible or tangible assets, or the performance of services, with the anticipated benefits derived from contributions shared equitably among the parties.

A CCA is neither a distinct legal entity nor a fixed business location for all participants.

Type of CCAs

Broadly, there are two major categories of CCAs:

- **Development CCAs:** These pertain to the joint development, production or acquisition of intangibles or tangible assets. Participants contribute resources towards the development phase and, in return, obtain entitlement to rights in the resulting assets.
- **Services CCAs**: These revolve around the acquisition of services. Participants contribute resources to collectively receive services, ensuring that costs are shared equitably.

The development CCAs are more complex, uncertain, and involve significant risks, in comparison to service CCAs.

Applying the arm's length principle to CCAs

A fundamental aspect of any CCA arrangement is that CCA participants expect mutual and proportionate benefits from pooling resources and abilities. Participants also agree to share the risks and benefits of accomplishing CCA results. From an arm's length perspective, CCA participants' contribution should match what independent enterprises would have agreed to contribute under comparable circumstances, given the proportionate share of the total anticipated benefits expected from the arrangement.

Accordingly, the key steps in applying the arm's length principle in a CCA involve: (a) calculation of the value of each participant's contribution to the joint activity; and (b) determination of whether the allocation of CCA contribution (post adjustments, if any) align with the respective share of expected benefits, for the participants.

CCA entry, withdrawal, and termination

The dynamic nature of business means that entities might enter or exit CCAs. The Guide (in line with the OECD Guidelines) provides clarity on how to manage such scenarios. Any change in CCA membership – e.g., entry of a new participant (in an existing CCA), exit or withdrawal of a participant - will result in a re-evaluation of the proportionate share of participants' contribution and anticipated benefits. From an arm's length standpoint, this change would entail a compensation i.e., buy-in payment (in case of new entrant) or, buy-out payment (in case of participant leaving the CCA).

Balancing payments

In some instances, balancing payments between participants in a CCA might be necessary to ensure that the division of contributions and benefits remain at arm's length.

Key takeaways for UAE taxpayers

In conclusion, the UAE's guidelines on CCAs offer a structured approach, ensuring that these arrangements are both equitable and compliant with the arm's length principle. Taxpayers in the UAE should familiarize themselves with these provisions, ensuring that their CCAs stand up to scrutiny and align with best practices.

Business restructuring

Section 7.5 of the Guide provides specific guidance for the UAE taxpayers on cross-border and domestic restructuring of business from an arm's length perspective.

What is Business Restructuring?

Business restructuring refers to the reorganization of the commercial and financial relations between Related Parties or Connected Persons including termination or substantial renegotiation of existing arrangements.

It often involves change in the functional characterization of the entity(ies), transfer of something of value (tangible / intangible assets or a going concern) typically accompanied by a reallocation of the profit potential for various commercial reasons.

The Guide highlights that sound commercial reasons behind restructuring may not necessarily mean that it is arm's length from the perspective of each of the restructured entity(ies).

Key considerations

One of the major objectives of Section 7.5 is to discuss the extent to which reallocation of profit potential is consistent with the arm's length principle and how it applies to cross-border as well as domestic business restructurings; broadly in line with the OECD Guidelines.

The Guide explains following key considerations in this regard:

- Accurately delineating the transactions comprising the restructuring by performing a functional analysis before and after the restructuring through:
  - understanding the commercial or financial relations
  - conditions and economically relevant circumstances
- Justifying commercial sense of restructuring by determining options realistically available to Related Parties and Connected Persons; since in an arm's length scenario, persons acting at arm's length would only enter into a transaction if it does not make them worse off than their next best option.
- Expected benefits following the restructuring including the role of synergies.
- Reallocation of profit potential i.e., expected future profits (losses).
- Indemnification of restructured person for the detriments suffered (such as restructuring costs, re-conversion costs, and/or loss of profit potential) by undertaking a detailed functional analysis pre and post restructuring to see how the profit potential is impacted.

The Guide notes that where an agreeable range of values for transfer of assets or going concerns cannot be determined, it may indicate a need for termination payment or potentially disregarding the transaction.

Further, the Guide does not intend to set out valuation techniques but highlights that valuation of assets being transferred should be in line with international valuation standards that is consistent with the arm's length principle; and the nature of valuation parameter and assumptions should be explicitly documented when creating the valuation model.

Key takeaways for UAE taxpayers

The Guide not only covers situation of cross-border restructuring arrangements but also covers domestic restructuring. With the introduction of the CT Law, this is one of the key areas of consideration for many businesses in the UAE in view of the differences in tax rates and various exemptions provided under the CT law keeping in mind the relief provided to the taxpayers under Article 27 of the CT Law i.e., "Business Restructuring Relief".

Permanent Establishments

The concept of Permanent Establishment ("PE") plays a pivotal role in the taxation landscape, especially in the context of international business operations. For UAE taxpayers, understanding the concept of PE is crucial to ensure compliance with the FTA.

This section provides a concise overview of the PE section from the Guide. Additional details can be found in Article 14 of the CT Law.

What is a Permanent Establishment?

The Guide defines a PE as fixed or permanent place of business through which the business activities of an enterprise are wholly or partly conducted. A PE can include branches, offices, factories, workshops, land, buildings and other real property, a building site, a construction project, and other fixed locations where business is conducted.

Key considerations

- **Headlines:** The Guide emphasizes the significance of understanding the PE concept, especially in the context of TP. The presence or absence of a PE can influence how business profits are taxed in the UAE and other jurisdictions.

- **TP applicability:** The scope of TP applies to Taxable Persons who continue business activities through a PE. Hence, transactions between related parties and connected persons where one of the parties is characterized as a PE would need to be conducted in line with the arm's length principle.
- **Separate entity approach:** The Guide emphasizes on treating PEs as if they are distinct and separate entities from the head office to whom the PE belongs (i.e., with its own assets and liabilities). The FTA expects Taxable Persons to attribute the appropriate number of profits (or losses) and associated costs to the PE in respect to its dealings with the rest of the enterprise in line with the arm's length principle.
- **Attribution of profits between the PE and its head office:** To accurately attribute profits to the PE and its head office, a two-step analysis is required: (i) a functional analysis to identify the activities performed by the PE and the head office, treating each other separate to the other, and (ii) determining the compensation of any transactions through a comparability analysis and determining the most appropriate method to arrive at an arm's length compensation.
- Reference to guidance from OECD: The Guide encourages Taxable Persons to refer to the 2010 report and the 2018 report issued by the OECD on the attribution of profits to PEs in situations where an issue is not addressed within the Guide.

Key takeaways for UAE taxpayers

The concept of PEs holds important implications for taxpayers, particularly as the domestic tax landscape in the UAE is increasingly aligned with global tax standard. Determining a PE within the UAE is a key factor in establishing tax liabilities as it gives rise to taxable presence which in turn dictates where profits should be taxed.

Taxpayers need to analyze their operations against the FTA's guidance to avoid the risk of disputes and penalties. In addition, the requirements for documenting the dealings between a PE and its head office, in accordance with the arm's length principle, needs a sophisticated approach to TP as taxpayers must ensure that profit (and loss) attribution is reflective of the economic activities and the value creation of the PE.

In conclusion, a thorough comprehension of the PE section within the Guide provides UAE taxpayers with valuable insights, ensuring they navigate the complexities of tax compliance. As international business operations become more intertwined, the ability to navigate the PE landscape becomes crucial for decision-making and compliance. The initiative-taking management of PE risks and a clear understanding of the UAE's tax treaty network can help mitigate exposure to tax audits and disputes.

Authorized OECD Approach for the attribution of profits to permanent establishments

The Authorized OECD Approach ("AOA") for attributing profits to PEs aligns with the UAE's approach, addressing the importance of PEs in international tax treaties. The OECD's definition of a PE is in line of the UAE, highlighting the role of PEs in the global taxation framework.

In line with the AOA, profits are attributed to PEs through a two-step process that begins with treating the PE as if it were a separate and independent entity. This involves a functional analysis to understand the PE's activities, assets, and risks. The second step is to apply the arm's length principle to determine an appropriate remuneration for these activities, based on what would be expected between independent enterprises under similar circumstances (i.e., on an arm's length basis). This principle is also expanded on the Guide.

In summary, while the UAE's Guide and the AOA both advocate for treating PEs as separate entities and applying the arm's length principle, the AOA offers a more detailed blueprint, particularly regarding functional analysis and capital attribution.

Group synergies

The Guide touches upon the topic of group synergies, which can arise from being part of a group where entities may benefit from interactions or synergies between each other. Synergies can lead to benefits for the Group as a whole, and it is essential to determine whether these benefits are attributable to passive association or active synergies resulting from concerted action of group members. In cases where material synergies can be allocated to group members by way of advantages or disadvantages, any resulting benefit or detriment should be allocated between members commensurate with their role in generating the synergy on an arm's length basis supported through documentation.

Other cases

The Guide also delves into two specific scenarios i.e., (i) the reliance on the arm's length standard conducted by members of a MNE Group in multiple countries given rise to various transactions and arrangements with a focus from the UAE perspective, and (ii) the nuances of cash/bank settlements between Related Parties and Connected Persons that are not settled on time without compensation.

TP audit and risk assessments

Section 8 of the Guide delves into the intricacies of the audit and risk assessment processes related to transfer pricing. The primary objective of such audits is to ensure that transactions between related parties or connected persons are conducted at arm's length, meaning they are consistent with what would have been charged between independent entities under similar circumstances.

This is crucial for ensuring that the right amount of tax is paid and that there is no manipulation of prices to shift profits to low-tax jurisdictions.

The FTA reserves the right to raise inquiries and request information and data for examination in order to reach a determination concerning the arm's length prices of a taxable entity.

Burden of proof and adjustments

The section emphasizes on the "burden of proof" which refers to the responsibility of the Taxable Person to provide sufficient evidence and documentation to support existing TP practices. Taxable Person should continually review their controlled transactions, both existing and new, to ensure that these adhere to arm's length principle.

If a Taxable Person fails to meet this burden, the entity may be subject to TP adjustment.

Such TP adjustments can be initiated by both Taxable Persons and the FTA in cases where it is believed that a transaction has not been conducted in an arm's length manner.

Where the FTA adjusts the Taxable Income to achieve the arm's length result; FTA will also make available to the Taxable Person the information relied on to make TP adjustment. Furthermore, the FTA will reflect this adjustment in the Taxable Income of local Taxpayer i.e., the party to the relevant transaction or arrangement. Where TP adjustment is made by a foreign competent authority; the Taxable Person can request the FTA to make a corresponding adjustment under the applicable provisions of the relevant Double Taxation Agreement.

In case of TP adjustments by the Taxable Person – the same could be before or post submitting of Tax Return. If this results in a decrease in the taxable profits or increase in allowable losses, it may only be affected through the operation of FTA procedures. Taxable Person also has the option to seek clarification on a point of law from the FTA.

Non-recognition

Another critical aspect covered in this section is "non-recognition." This pertains to instances where tax authorities may not recognize a particular controlled transaction, believing that independent entities, operating under comparable circumstances, would not have entered into such a transaction. In such cases, the tax authorities might disregard the transaction for tax purposes and consider an alternative transaction that reflects the substance of the actual transaction and ensures that the taxable profits are consistent with the economic activities undertaken.

Next steps

The UAE's introduction of TP regulations is a clear signal of its commitment to international tax standards and reflects its dedication to creating a fair and transparent business environment for both local and international groups which are operating in the market.

Taxpayers must now undertake a critical evaluation of their transactions with related parties and connected persons to ensure compliance with the arm's length principle. This will involve a detailed analysis of their legal structures, business models, and contracting practices. The preparation of TP documentation is essential to demonstrate compliance with the new regulations. These requirements will need to provide a comprehensive overview of the business and its TP policies, as well as detailed information on specific intercompany transactions captured under the scope of TP in the UAE.

Given the complexity of these new TP rules, taxpayers should move to assess their impact and prepare for these changes. This preparation is not merely about compliance, but also about optimizing business practices to take advantage of the competitive benefits offered by the UAE's economy. The implementation of TP regulations as part of the CT Law is a significant milestone for the UAE, positioning it for continued growth and success in the global marketplace.

Contact us

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