Parker Russell UAE

The UAE Strengthens Tax Regulations with New Transfer Pricing Requirements

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The United Arab Emirates (UAE) has taken a significant stride in enhancing its tax regulations with the issuance of Ministerial Decision No. 97 of 2023. This decision, enacted by the Minister of State for Financial Affairs, introduces vital requirements for maintaining transfer pricing documentation in accordance with Federal Decree-Law No. 47 of 2022 on the Taxation of Corporations and Businesses. These new regulations carry substantial implications for taxpayers operating in the UAE.

Defining the Landscape

Before delving into the specifics of the decision, it's crucial to understand the context. The UAE government has been proactive in aligning its tax policies with international standards, especially those related to transfer pricing – the prices at which companies trade goods, services, or intellectual property across borders within a multinational group. The aim is to ensure fairness, transparency, and compliance with the arm's length principle, where transactions between related entities should mirror those between unrelated parties in the open market.

Key Provisions of Ministerial Decision No. 97 of 2023

1. **Definitions**: The decision begins by affirming that words and expressions will have the same meanings as specified in the Corporate Tax Law unless otherwise indicated.

2. **Maintaining Master File and Local File**: Perhaps the most significant aspect of this decision is the requirement for taxpayers meeting certain conditions to maintain both a master file and a local file during the relevant tax period. These conditions include being a Constituent Company of a Multinational Enterprises Group with a consolidated group revenue of AED 3,150,000,000 or more, or having a revenue of AED 200,000,000 or more.

3. **Inclusion of Transactions with Related Parties**: Taxable persons must include transactions or arrangements with specific related parties and connected persons in the local file. This includes non-resident persons, exempt persons, resident persons that have made an election under the Corporate Tax Law, and resident persons subject to a different corporate tax rate. However, certain entities and transactions, such as resident persons not falling into the specified categories, natural persons, and partnerships in unincorporated partnerships, are excluded from this requirement.

4. **Independence Criteria**: The decision provides criteria to determine if parties in a transaction are acting independently of each other. Transactions must occur in the ordinary course of business, and parties should not exclusively or almost exclusively transact with each other. Parties that subject one another to detailed instruction or comprehensive control are not considered independent.

5. **Guidelines and Documentation**: The Federal Tax Authority will issue guidelines to clarify the application of these provisions and provide guidance on maintaining transfer pricing documentation.

OECD Methods

The Organisation for Economic Co-operation and Development (OECD) Model Convention deals with international taxation and transfer pricing rules for multinational enterprises. It outlines that if an enterprise from one contracting state (State A) exerts influence over another enterprise in another contracting state (State B), and this leads to commercial or financial conditions that differ from those of independent enterprises, any resulting profits that would have otherwise accrued to one of the enterprises can be included in that enterprise's taxable income.

Article 9 of the OECD Model Convention addresses transfer pricing in situations where associated persons set prices differently from what unrelated entities would typically agree upon due to undue influence or circumstances. Importantly, it specifies that State B should only make adjustments to profits if it believes that the adjusted figures accurately reflect what the profits would have been under arm's length conditions.

The OECD provides two categories of transfer pricing methods:

Traditional Transaction Methods

These include the Comparable Uncontrolled Price (CUP) method, Resale Price method, and Cost Plus method. For instance, the CUP method involves comparing the price of goods or services in a controlled transaction to a similar uncontrolled transaction in comparable circumstances.

Comparable Uncontrolled Price (CUP) Method: This method compares the price of property or services in controlled transactions to the price in comparable uncontrolled transactions. If, for instance, a company sells cocoa from different countries under similar conditions, adjustments may be needed to account for differences in the cocoa's origin or quality.

Resale Price Method: This method starts with the price at which a product purchased from an associated enterprise is resold to an independent entity, reducing it by a suitable gross margin. For instance, if a company resells books through independent distributors but has a subsidiary in a different market, adjustments may be needed for comparability.

Cost Plus Method: This method begins with the costs incurred by the supplier in a controlled transaction, considering factors like research expenses. For example, if one subsidiary conducts research for another and bears the associated risks, the cost-plus method can determine a suitable profit margin.

Transactional Profit Methods

These methods involve analyzing the net profit relative to an appropriate base, such as costs, sales, or assets. The Transactional Net Margin Method and Transactional Profit Split Method fall under this category. For example, the Transactional Net Margin Method evaluates the net profit realized from a controlled transaction and compares it to what would be expected under arm's length conditions.

Transactional Net Margin Method: This method evaluates the net profit relative to an appropriate base (e.g., costs, sales, assets) from a controlled transaction. It operates similarly to the cost-plus and resale price methods.

Transactional Profit Split Method: This method identifies profits to be split from controlled transactions and allocates them between associated enterprises based on an economically valid basis approximating arm's length agreements.

Choosing the right method is essential, and the OECD highlights three main objectives:

- Ensuring that taxpayers consider transfer pricing consequences when establishing prices and reporting them in tax returns for associated enterprise transactions.
- Informing tax administrations with relevant information when conducting inquiries.
- Providing tax auditors with useful information for reviewing transfer pricing practices, potentially supplementing documentation with additional details during the audit process.

Implications and Conclusion

Ministerial Decision No. 97 of 2023 underscores the UAE government's commitment to fostering transparent and equitable taxation practices. While it places additional compliance responsibilities on taxpayers, especially those meeting the specified revenue thresholds or having transactions with particular entities, it aligns the UAE's tax regulations with global standards.

Taxpayers operating in the UAE should promptly review the decision, seeking professional advice if necessary, to ensure compliance and avoid potential penalties. The decision's long-term benefits, including improved fairness in taxation and international alignment, make it a necessary step in the evolution of the UAE's tax landscape.

In conclusion, the decision is a testament to the UAE's dedication to creating a fair and transparent tax environment. It encourages businesses to embrace the principles of arm's length pricing, ultimately fostering trust and credibility in the UAE's tax regime. As with any significant regulatory change, awareness and proactive compliance are key to navigating this evolving landscape successfully.

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