Transfer Pricing Handbook

Version 1.0

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Audit Division

This document has been prepared based on the OECD TP Guidelines and Public Consultation Document released by MoF on 28 April 2022.

Preface

In today's global economic environment, cross-border taxation and Transfer Pricing issues have become more prominent. The tax authorities around the world are focusing on securing "their share" of the revenue from global trade and business.

Today, almost every major economy has enacted Transfer Pricing legislation and has dedicated significant resources to identify, assess and secure their share of taxes in relation to cross-border taxation.

In line with its commitment to international standards, the G20 and the Organization for Economic Co-operation and Development initiatives on Base Erosion and Profit Shifting (BEPS), the UAE has joined the Inclusive Framework on the BEPS program to become the 116th jurisdiction to join this framework.

Through joining the Inclusive Framework, the UAE has currently committed to implement the following four BEPS Minimum Standards:

- **Action 5:** Countering Harmful Tax Practices
- **Action 6:** Prevention of tax treaty abuse
- **Action 13:** Transfer Pricing Documentation and Country-by-Country Reporting ("CbCR")
- **Action 14:** Mutual Agreement Procedure

With introduction of Corporate Tax Regime in the UAE (effective from June 2023), Transfer Pricing Regulations will also be introduced, which will mandate Related Party transactions to be at arm's length.

Introduction of Transfer Pricing will also have corresponding impact on withholding taxes, customs duties, value added taxes, excise tax and a range of other government charges.

Recognizing the importance of Transfer Pricing Regulation and the fact that such Regulation is a novel addition to the ever evolving tax scenario in the region, this Handbook aims to shed some light on the Basic Concepts of Transfer Pricing and alert readers to take necessary action to mitigate consequences of non-compliance.

We at ECAG are committed to extend complete support to our clients/readers in imparting the knowledge that would be essential for a business in the UAE and sincerely hope this handbook will serve the purpose for which it is released.

We welcome any comments or suggestions for improvement in future.

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Abbreviations and Acronyms

APA	Advance Pricing Agreement
ALP	Arm’s Length Price
BEPS	Base Erosion and Profit Shifting
CCA	Cost Contribution Arrangement
CbCR	Country-by-Country Reporting
CPM	Cost Plus Method
CUP	Comparable Uncontrolled Price
DTAA	Double Taxation Avoidance Agreement
FAR	Functions, Assets and Risks analysis
GCC	Gulf Cooperation Council
HTVI	Hard To Value Intangibles
MAP	Mutual Agreement Procedure
MAP APA	Advance Pricing Arrangement under the Mutual Agreement Procedure
MC	Model Tax Convention
MNE	Multinational Enterprise
MOU	Memorandum of Understanding
OECD	Organisation for Economic Co-operation and Development
OECD TP Guidelines	OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations (Revised on Feb 2022)
PSM	Profit Split Method
RPM	Resale Price Method
TP	Transfer Pricing
TNMM	Transactional Net Margin Method
US	United States of America
UAE	United Arab Emirates

Chapter 1

Transfer Price & Transfer Pricing

When one independent/unrelated party transacts with other independent/unrelated party, the transaction value represents "Transfer Price".

Such Transfer Price is regarded as "Arm's Length Price" as the same is ordinarily driven by open market factors.

In tax environment, such transaction is often referred as "Uncontrolled" transaction.

"Transfer Pricing", as generally understood, refers to price at which two related parties transact. In tax environment, such transaction is regarded as undertaken between two associated enterprises and is often referred to as "Controlled" transaction.

Therefore, we can say that "Transfer Prices" are the prices at which an enterprise transfers-

- Physical goods or
- Intangibles or
- Provides services to associated enterprises.

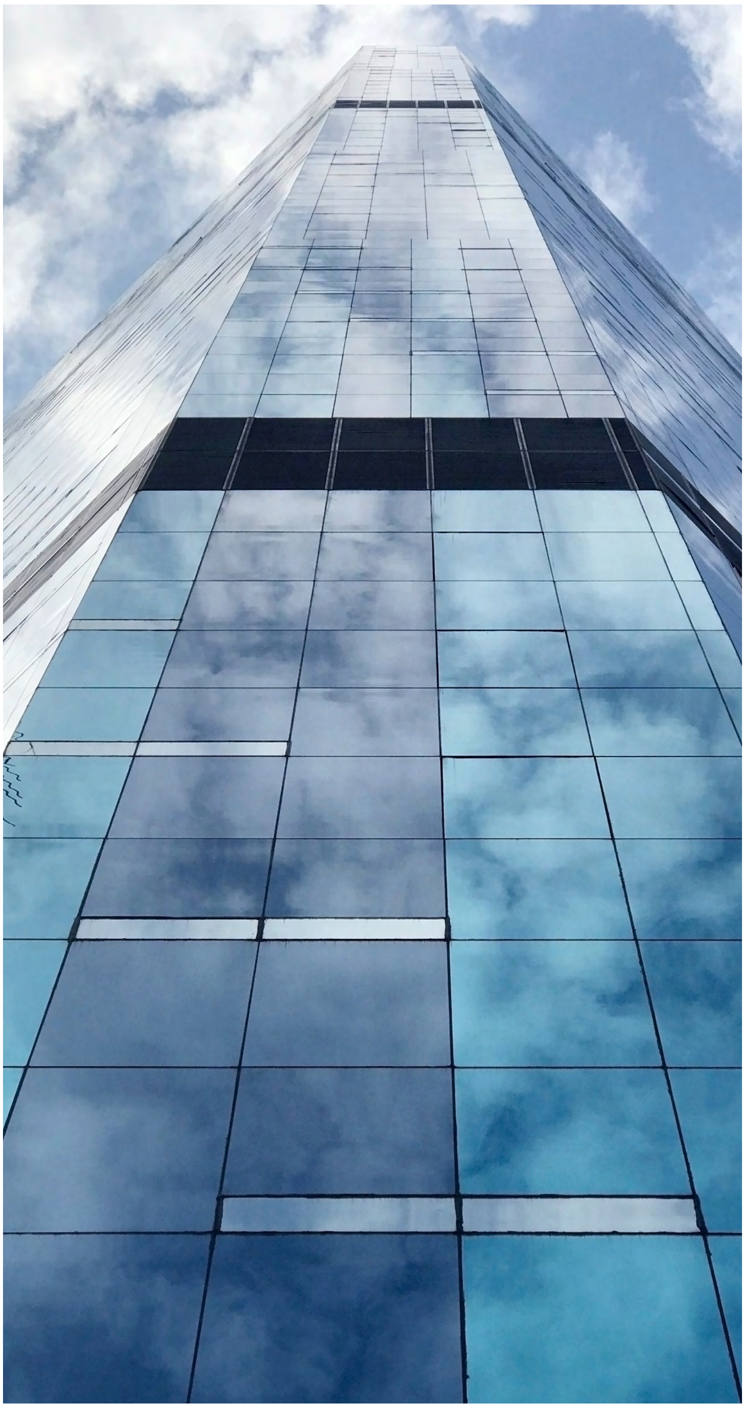
Transfer pricing is a term used to bench-mark all inter-company pricing arrangements.

"Arm's Length Price" is the CORE of TP and plethora of materials and guidelines have been released in this regard.

Importance of Transfer Pricing:

For Business: To determine price for inter-group transactions to measure fair profitability of each division or the group entity.

For Tax Authorities: Controlled transaction, may take place under conditions differing from those under Uncontrolled transaction on account of relationship influence. Hence, the apprehension of shifting of profits from high tax to low tax jurisdiction.



Relevance of Transfer Pricing

Transfer pricing has linkages with Global Stability, revenue generation, economic growth,trans border activities and international trade in the following manner:

a. Promote stable flow of labour, capital, goods and services across national borders of the world;
b. Promote economic growth at unilateral, bi-lateral and multi-lateral levels;
c. There is over-arching issue of the right of each country to generate the right amount of tax revenue from the economic activities performed across the boundaries and help eliminating double taxation.

Interplay with OECD Model Tax Convention

Article 9 of the OECD MC deals with adjustments of profits that may be made for tax purposes where transactions have been entered into between associated enterprises on other than arm's length terms.

Separately, Article 7 dealing with PE profit attribution requires a PE to be treated as an independent enterprise and thereby triggering Transfer Pricing implications even for transactions undertaken with the Head Office.

"Transfer Pricing" by itself does not necessarily involve tax avoidance. It is where the pricing does not accord with applicable norms (international or domestic) that it tantamount to "mispricing", "incorrect pricing", "unjustified pricing" or similar, and issues of tax avoidance and evasion may arise.

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Chapter 2

Transfer Pricing Global Scenario

The US and the OECD have been instrumental in the evolution of Transfer Pricing practices around the world.

The history of development of Transfer Pricing Regulations is outlined hereunder:-

1968	US, first country to adopt a comprehensive Transfer Pricing legislation
1979	OECD report on “Transfer Pricing and Multinational Enterprises”
1984	OECD report on “Transfer Pricing and Multinational Enterprises - Three Taxation Issues”
1987	OECD report on “Thin Capitalization”
1994	US releases its final Transfer Pricing regulations under section 482 of the Internal Revenue Code
1995	OECD releases TP Guidelines (Rework of 1979 Report)
2013	OECD launches BEPS Action Plan
2015	OECD releases solutions to BEPS
2016	OECD releases standardised electronic format for the exchange of BEPS Country-by-Country Reports
2017	OECD releases updates to TP Guidelines
2018	The UAE joins the Inclusive Framework on BEPS
2019	International community agrees on a road map for resolving the tax challenges arising from digitalisation of the economy
2022	OECD’s latest update to Transfer Pricing Guidelines

The OECD Guidelines are regarded as the most important document in drafting Transfer Pricing legislation as well as in interpreting the provisions.

Since 2017, OECD has released Transfer Pricing guidance notes on application of PSM, various typical transactions, like Financial Transactions, Hard to Value Intangibles, etc., which have been incorporated in OECD's latest updated TP Guidelines released in January 2022.

OECD Transfer Pricing Country Profiles

Albania	Finland	Liechtenstein	Senegal	Egypt
Angola	France	Lithuania	Seychelles	Saudi Arabia
Argentina	Georgia	Luxembourg	Singapore	Latvia
Australia	Germany	Maldives	Slovak Republic	Russian Federation
Austria	Greece	Malaysia	Slovenia	Liberia
Belgium	Honduras	Malta	South Africa	Korea
Brazil	Hungary	Mexico	Spain	Romania
Bulgaria	Iceland	Netherlands	Sri Lanka	Estonia
Canada	India	New Zealand	Sweden	Uruguay
Chile	Indonesia	Nigeria	Switzerland	
China **[People's Republic of China]**	Ireland	Norway	Tunisia	
Colombia	Israel	Panama	Turkiye	
Costa Rica	Italy	Papua New Guinea	Ukraine	
Croatia	Jamaica	Peru	United Kingdom	
Czech Republic	Japan	Poland	United States	

Transfer Pricing Rules and Regulations around the world continue to grow in number and complexity. Around 125 Countries have adopted BEPS – Action 13 requirements i.e.Transfer Pricing methods, benchmarking requirements, penalties on non-compliance, assessments and opportunities for Advance Pricing Agreements.

Though some countries have been more successful than others in administering Transfer Pricing legislation, which depends mainly on the human and material resources available with the tax administrations, capitalized experience, the characteristics of the regulations, the political will to address the issues, and their ability to address tax planning, among other aspects.Most of them have accepted the fact that some action is required.

The latest in the race is Cyprus, which has passed a law to introduce Transfer Pricing rules and documentation requirements in accordance with recommendations of the OECD TP Guidelines.

" Transfer Pricing Rules and Regulations around the world continue to grow in number and complexity. "

Chapter 3

Transfer Pricing in GCC

Tax dynamics in GCC countries have significantly changed in the last decade due to economic challenges. Topic of TP has gained a significant momentum over the past few years especially after the GCC countries in the region (except Kuwait) have joined the Base Erosion and Profit Shifting (BEPS) framework.

Saudi Arabia

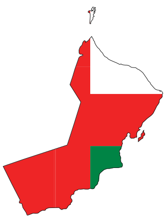
CbCR since 2018

- Maintain Local File & Master File
- TP disclosure in the Tax Return

Qatar

CbCR since 2018

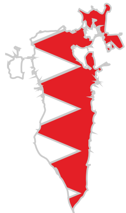
- Local File & Master File to be Submitted
- TP disclosure in the Tax Return



Oman

CbCR since 2020

- TP Documentation Recommended
- Reference of Related Party Pricing in the IT Law



Bahrain

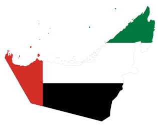
CbCR since 2021

- No Specific TP Regulations

Kuwait

CbCR - NA

- Documentation of Contracts with Related Party to be Maintained
- Deemed Profits in Specified Ranges of %



UAE

CbCR since 2019

- TP Regulations from June 1, 2023

This document has been prepared based on the OECD TP Guidelines and Public Consultation Document released by MoF on 28 April 2022.

Further, a detailed analysis of TP Regulations in each of the GCC countries is tabulated hereunder:

Country	Applicability	Permissible Pricing Methods	Documentation	Advance ruling or Pricing Agreements	Penalties for non-compliance
KSA	All juridical persons, including mixed companies	As per the OECD Guidelines	Controlled transaction disclosure form General documentation Maintain - Local and Master file	Permissible	As per IT Law
Qatar	Transactions between a Qatar resident entity and an unrelated foreign entity if in preferential tax regime or residing in non-cooperative country.	Preferred CUP method Alternatively, as per the OECD Guidelines	TP declaration be submitted along with the annual income tax return Submission of Local and Master file	Permissible	As per IT Law
Oman	Measures of Related party Transaction through IT Law, no specific TP Regulation	No specific mention The OECD Guidelines Recommended	No specific Regulations Recommend maintaining Documents to be made available on request	Permissible	Imposed
Bahrain	No TP Regulations or measures to monitor related party transactions	NA, as no TP Regime	NA, as no TP Regime	NA, as no TP Regime	NA, as no TP Regime
Kuwait	Transactions between domestic and a foreign entity	Covered Transactions to be as Arm's Length Price	Declared costs and expenses from the head office or related parties must be fully documented for the tax inspection. Except in cases where a tax treaty applies, deemed profits are determined by the Tax Authorities based on documentary inspection	NA	NA
UAE*	All transactions (domestic / International) subject to a threshold limit	As per the OECD Guidelines	Disclosure form alongwith Return Maintain - Local and Master file	Details Awaited	

* Indicated in Public Consultation Document

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Chapter 4
Applicability of Transfer Pricing in the UAE

The proposed Corporate Tax Regime in the UAE vide release of Public Consultation Document inter-alia introduces TP rules to ensure that the price of a transaction is not influenced by the relationship between the parties involved.

The Proposed CT regime requires 'Arm's Length' principle to be followed while undertaking transactions between "Related Parties" and with "Connected Persons".

Related Parties

As per Public Consultation Document, 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 Corporate Tax regime through ownership, control or kinship (in the case of natural persons).

The following rules are prescribed to determine whether parties involved in the transaction would be considered as "Related Parties" for the purpose of UAE Corporate Tax:

1. Two or more individuals	Related to the fourth degree of kinship or affiliation, including by birth, marriage, adoption or guardianship
2. An individual and a legal entity	Individual alone or together with a related party, **directly or indirectly** owns a **50%** or greater share in, or controls the legal entity
3. Two or more legal entities	• Legal entity alone, or together with a Related Party, directly or indirectly owns a 50% or greater share in, or controls the other legal entity. • Taxpayer alone, or with a related party, directly or indirectly owns a 50% share of each or controls them.
4. Taxpayer	Its branch or permanent establishment
5. Unincorporated partnership	All partners
6. Exempt and non-exempt business	Activities of the same person

Connected Persons

Payments or benefits provided by a business to its "Connected Persons" will be deductible only if the business can demonstrate that the payment or benefit:

- corresponds with the market value of the service provided; and
- is incurred wholly and exclusively for the purposes of the taxpayer's business.

A person will be considered as 'connected' to a business that is within the scope of the UAE Corporate Tax regime under following circumstances:

- Individual, who has direct or indirect ownership / control in the taxable person
- Director / Officer of taxable person
- An individual related to owner, director or officer
- Any other partner of the unincorporated partnership
- Related party of any of the above

Covered Transactions

On the basis of plain reading of the proposed Corporate Tax Regulations and as also generally understood, all kinds of transactions (whether oral or written, enforceable or unenforceable), domestic and international, between related parties would be subject matter of TP Regulations.

However, it is indicated that certain threshold limit would be set for maintenance of documentation to facilitate ease of doing business.

Simply put, purchase and sale of tangible and intangible assets, goods, provision and availing of services, cost sharing arrangements, reimbursements, support services, management charges, financial transactions (loans, guarantees, etc.) would get covered.

> More importantly, covered transactions would also include transactions with or without consideration.

Chapter 5

Arm's length Principle

As mentioned earlier, in case of uncontrolled transactions market forces normally determine the terms of the commercial and financial relationships. The price in such transactions is called 'Uncontrolled Price' and in a tax terminology it is called 'Arm's Length Price'.

The Arm's Length Principle is agreed upon by all the OECD member countries and adopted as an objective guideline for use by multinational companies and tax administrators in cross border taxation.

The principle is embodied under Article 9 of the OECD MC. It's objective is to avoid erosion of the tax base or the transfer of profits to low tax jurisdictions.

Therefore, all transactions between Related Parties would need to be evaluated from an economic and commercial point of view (Comparability analysis) to verify whether the TP between the related parties (Controlled transactions) is equivalent to TP of same/similar transaction undertaken between independent parties (Uncontrolled transactions) in the same/similar circumstances.

As per the proposed Corporate Tax Regime in the UAE, all Related Party transactions and transactions with Connected Persons will need to comply with TP rules and the arm's length principle as set out in the OECD TP Guidelines.

The 'Arm's Length' principle states that the price agreed in a transaction between two related parties must be the same as the price agreed in a comparable transaction between two unrelated parties.

Guidelines for applying the Arm's-length principle

The OECD provides guidance for applying the arm's-length principle. These guidelines summarised herein below, provide a good understanding on how OECD expects each Person to determine the ALP of the covered transaction. It is recommended to identify the commercial or financial relations between the associated enterprises and the conditions and economically relevant circumstances attached to those, viz:

- The contractual terms of the transaction;
- The functions performed by each of the parties to the transaction, taking into account assets used and risks assumed, including how those functions relate to the wider generation of value by the MNE group to which the parties belong, the circumstances surrounding the transaction, and industry practices (FAR Analysis);
- The characteristics of property transferred or services provided;
- The economic circumstances of the parties and of the market in which the parties operate;
- The business strategies pursued by the parties

Further, OECD prescribes steps for analysing risk in a controlled transaction, in order to accurately delineate the actual transaction in respect to that risk. The same can be summarised as follows:

Step 1: Identify economically significant risks with specificity

- Strategic risks or marketplace risks
- Infrastructure or operational risks
- Financial risks
- Transactional risks
- Hazard risks

Step 2: Identify contractual assumption of the specific risk

- Determine whether the contractual assumption of risk is consistent with the conduct and other facts and
- whether the party assuming the risk is exercising control over the risk and has the financial capacity to assume the risk

Step 3: Functional analysis in relation to risk

- Perform functional analysis identifying risks and other facts, including conduct of the parties, control functions and risk mitigation functions and financial capacity to bear risks

Step 4: Interpreting steps 1-3

- Whether the associated enterprises follow the contractual terms
- Whether the party assuming risk, exercises control over the risk and has the financial capacity to assume risk

Step 5: Allocation of risk

- If the party assuming the risk does not control the risk or does not have the financial capacity to assume the risk, allocate the risk to the group company having the most control and having the financial capacity to assume the risk

Step 6: Pricing of the transaction, taking account of consequences of risk allocation

- The actual transaction as accurately delineated by considering the evidence of all the economically relevant characteristics of the transaction, should then be priced taking into account the financial and other consequences of risk assumption, as appropriately allocated, and appropriately compensating risk management functions.

Computing an arm's-length price is a complex task; it requires lot of groundwork and research. There are variety of exceptions and set-offs which necessarily have to be applied to the system to provide useful results.

Chapter 6

Transfer Pricing Methods

The OECD TP Guidelines provide five major TP methods to ensure compliance with the arm's length principle. Usually the appropriate method has to be applied to arrive at the appropriate arm's length.

These methods fall into two categories, namely, Traditional Transaction Methods (CUP, RPM & CPM) and Transactional Profit Methods (TPSM/PSM & TNMM).

Comparable Uncontrolled Price (CUP) Method

The CUP method compares the price charged for a property or services transferred in a controlled transaction to the price charged for property or services transferred in a comparable uncontrolled transaction in comparable circumstances.

This method is reliable where an independent enterprise sells the same product as that sold between two associated enterprises.

Cost-Plus Method (CPM)

The cost-plus method is used to determine the price to be charged by a supplier of property or services to a related purchaser.

The price is determined by adding to costs the supplier incurred, an appropriate gross margin so that the supplier will make an appropriate profit in the light of market conditions and functions he performed. Value obtained after adding markup to costs may be regarded as arm's-length price of the original controlled transactions.

This method is used when semi-finished goods are sold between related parties on the basis of joint agreements or for the provision of services in controlled transactions value.

This method is also used in resources/cost sharing arrangements among group entities.

Resale Price Method (RPM)

The resale-price method is used to determine price to be paid by reseller for a product purchased from an associated enterprise and resold to an independent enterprise.

The purchase price is set so that the margin earned by reseller is sufficient to allow it to cover its selling and operating expenses and make an appropriate profit. Value arrived after subtracting the gross margins can be regarded, after adjustments for other costs associated with the purchase of the product, like custom duties, as an arm's-length price for the original transfer of property between the associated enterprises. This method is usually applied to marketing operations.

Profit Split Method (PSM)

Profit-split method takes the combined profits earned by two related parties from one or a series of transactions and then divide the profits using a defined basis that is aimed at replicating the division of profits that would have been anticipated in an agreement made at arm's length.

Arm's-length pricing is derived from both parties by working back from profit to price.

Both the OECD and US allow for profit-split methods and the main ways of applying profit split are as follows:

(i) Contribution profit-split

Under the contribution profit split method, the relative contribution of each member of a controlled group to the profits derived from integrated transactions is valued on the basis of the activities and risks undertaken by each member. The combined profits are then allocated among the members of the controlled group on a pro-rata basis according to their contributions.To determine their relative contributions the transactional methods may be used.

(ii) Residual profit-split

The **residual profit split method** looks at total profits, removes the profits made by the routine functions of both parties, computed using the comparable profits method, and residual profits are split, generally based on each party's investments and relative spending.

This method involves 2 stages: first each member of the controlled group is allocated sufficient profit to provide it with a basic return appropriate to type of transactions it undertook (primarily measured by traditional methods). Then next stage is calculating residual profits based on analysis of how it might have been allocated among

Transactional Net Margin Method (TNMM)

This method seek to determine the level of profits that would have resulted from controlled transactions if return realized on the transaction had been equal to the return realized by the comparable independent enterprise.

The TNMM under OECD guidelines compares the net profit margin of controlled transactions with the net profit margins of uncontrolled transactions.

The OECD does not recommend this method because it allows only comparison of net margins on a transactional basis and only in last-resort situations i.e places where "transaction methods cannot be reliably applied alone or exceptionally cannot be applied at all".

This method is used when semi-finished goods are sold between related parties on the basis of joint agreements or for the provision of services in controlled transactions.

In addition, the recent OECD Guidance Notes provides guidance on specific transactions like:

- Hard to Value Intangibles – BEPS Action Plan 8
- Financial Transactions - Risks and Capital Transactions – BEPS Action Plan 9
- High Risk Transactions - controlled transactions which are not commercially rational (e.g. management fee, HO expenses, etc.) – BEPS Action Plan 10 intergroup
- Business Restructuring

Chapter 7
Transfer Pricing Documentation

"Documentation is the key for any organisation that comes under the ambit of Transfer Pricing Regulations."

Documentation is a key element of TP as it serves as indispensable evidence for demonstrating the arm's length nature of the Controlled Transactions.

Countries with TP Regulations have their own set of rules as regards maintenance and provision of documentation to the tax authorities. In addition, the OECD too has included the same as part of its guidance, which has been incorporated by individual countries in their legislation.The BEPS project has devoted considerable effort on TP Documentation. Specifically, it has replaced the earlier chapter on TP Documentation in the OECD TP Guidelines.

BEPS Action Plan 13 has suggested a three- tiered approach to TP Documentation with a view to provide relevant and reliable information to tax administrations to assess the TP risks involved.

The three-tiered approach consists of:

A Master File

Providing an overview of the business activities of the MNE, viz. description of business and its important services/ business drivers, ownership of intangibles, financing activities and consolidated financials.

In other words, the Master file will provide revenue authorities with high-level global information regarding the global business and TP policies that are adopted by the Group for each category of the Related Party transaction.

A Local File

Providing information on material inter-group transactions of the local entity and its business activities.

In other words, the Local file is akin to more transactional TP documentation where information on related party transactions, the TP method adopted and related party transactions are included.

Country-by–Country Report ("CbCR")

Providing information on tax juris-diction wise allocation of income, taxes paid, economic activity and taxes accrued.

These three documents will provide tax administrators with useful information to assess TP risks and determine where audit resources can be deployed effectively.

As stated earlier, there are Country specific documentation Rules and OECD recommended documentation. Most of the countries require documentation to be maintained on a contemporaneous basis to the extent feasible.

Generally, TP Documentation would include:

- **Enterprise-wise documents** (Ownership, Group profile, transacting parties business activities, industry profile, etc.)
- **Transaction-specific documents** (details of relevant transactions, transacting parties, transaction-wise FAR analysis, Group TP Policy/transaction pricing policy, generally available market reports, record of comparable/uncontrolled transaction and the most important one being the economic analysis undertaken to test the arm's length principle.)
- **ALP computation documentation** (Method applied, critical assumptions, adjustments carried out to align with ALP, etc.)

> "Most of the countries require documentation to be maintained on a contemporaneous basis to the extent feasible."

Chapter 8

FAR and Comparability Analysis

FAR Analysis

Another key element of any TP analysis is undertaking FAR analysis of the controlled transaction vis-a-vis the transacting entities.

To put it simply, FAR analysis identifies the functions performed, assets employed, and risks undertaken by the respective transacting entities. FAR analysis is the key aspect of any TP component.

FAR analysis can be said to be the first step in analysing each transacting party's relative contribution so as to set the foundation for determining the pricing policy. A well conducted FAR analysis can assist in clear understanding of the controlled transaction, the role played by each party, determination of reward/return to each party, identifying the tested party (whose pricing/margin is to be tested vis-s-vis testing the arm's length principle), determining the most appropriate TP methodology and basis of comparability analysis, including identifying right comparables (internal/external).

The importance of FAR analysis forms part of country-wise TP regulations. Further, both, the OECD TP Guidelines and the United Nations Practice Manual on TP lay specific emphasis on the same.

Comparability Analysis

As one would observe from the above, comparability analysis emerges as the most important aspect of determining/testing the ALP principle.

While undertaking the above, FAR plays the critical role as it assists in determining the tested party, identification of comparables, selection of the most appropriate TP method and finally determination of the ALP.

Having determined the tested party, TP method, etc. the next step is to undertake comparability analysis and the key typical steps of the same are as under:

- **Identifying potential comparables (internal/external).** In case of external comparables, the process is exhaustive. It begins with a wide set of entities operating in same/similar activity. Generally, such entities are sourced from reputed well accepted databases.
- Following the above, one would need to initiate screening process involving qualitative and quantitative screening.

- Qualitative screening involves identifying entities using industry/business activity codes eg. HSN code, which will assist in excluding entities who are not engaged in similar activity/business. Also, absence of information of the relevant period could be a criterion for elimination.

- Quantitative screening involves a more stringent process whereby entities not meeting the economic characteristics of the controlled transaction gets eliminated. For eg. an entity whose turnover is just 5% of the controlled transaction value would have to be disregarded.

- Having identified the comparables under above step, one would now need to identify material differences between the tested party and the comparables in terms of other parameters. For eg. Differences in accounting methodology, capacity utilisation, extraordinary events, etc. Once such differences are identified, the next step would be to evaluate whether such differences can be quantified so as to carry appropriate adjustments to remove the impact of such differences. If it is not possible to quantify the differences, in which case one would not be able to carry out the adjustments and the identified comparable would have to be eliminated. In this regard, adjustments can be carried in either of the party's hands.

- Having completed all of the above, the last step in the process would be to determine the ALP basis comparable entities data. Here, mostly the country specific regulations, OECD and UN Guidelines provide for use of multiple data range.

Having conducted the comparability analysis, the same would have to be documented as part of documentation requirements. Such documentation would have to be step-wise (as stated above).

"comparability analysis emerges as the most important aspect of determining/testing the ALP principle."

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Chapter 9

Interplay with other Regulations

As one can observe and agree, for Revenue authorities it is imperative that there is correct allocation of profits, which further adds to the jurisdiction-wise challenge of ensuring fair share of taxes.

The issue gets more challenging when you have more than one tax and particularly when the objectives of the two tax regimes are inherently conflicting. For eg. TP regulations under direct tax regime and Customs law under indirect tax regime.

Both the Regulations are based on two key pillars – Allocation and Valuation. Allocation of correct profits, itself is based on business value drivers. Therefore, the two authorities, albeit part of the Revenue Department, work to ensure that related party transactions take place on arm's length basis. However, in this regard, the authorities do not follow same rules of valuation.

The inherent conflict of the two Regulations leaves MNEs at crossroads. To illustrate, customs authorities would examine any lower transaction price declaration; whereas the TP authorities would test the same transaction for any higher price (influenced by the relationship). Similar challenge also surfaces when Countries impose anti-dumping laws.

Similarly, as per the VAT regulations in the UAE, the Value of Supply of goods or services shall be determined based on the value of supply rules provided in chapter 4 of VAT Decree Law No. 8 of 2017. The valuation rules as per this regulation shall assert different taxable value than the actual value or book value of the Goods or Services that were rendered. For instance, in case of a supply to a related party, the value of supply may be considered as the market value provided such market value is more than actual value of the supply or in cases of a deemed supply, the total cost incurred for making the supply might be considered as its supply value.

There are different challenges when Countries have Exchange Control Regulations. In such situations there may exist prohibition, caps, etc. on payment to foreign entities.

The above conflict will continue till such time Countries agree to converge; atleast with respect to valuation methods under different regulations/ regimes. This subject is being debated at the highest levels, including by large countries like Canada, UK, Australia, France, US, etc. Further, there is increased interaction between the two authorities. The OECD has also been active in the matter. In May 2007 meeting of World Customs Organization/OECD Conference on TP and Customs Valuation was held in Brussels followed by meeting of the Focus Group on TP on 26 October 2007 and the efforts to solve the conflict continues thereafter as well.

Despite the efforts, there is no internationally agreed approach. TP policies may be a useful information source, and the related mandatory disclosure requirements (e.g., country-by- country (CbC) reports, documents attached to tax return filings, etc.) provide increased access to information by various governmental administrations (including customs authorities).

Chapter 10

Unique/Typical Transactions

Each Industry has its unique way of doing business, which inherently gives rise to unique transactions.There are few key transactions between associate enterprises which are not industry specific and are subject matter of high importance for both, taxpayers and revenue authorities.

Some examples of such transactions are as under:

Intra-group/centralised services

These are performed at Group Headquarters/by Centralised entity on behalf of Group entities eg. Accounting, legal, payroll, procurements etc.

Cash Pooling

These are jointly undertaken to achieve better liquidity management.

Cost Contribution Arrangements

Here the entities come together to jointly develop, produce or procure assets, sevices or rights.

Transfer/Right to use intangibles

These are generally the ones relating to transfer/use of know-how, brand name, marketing intangibles, etc. At times, valuable intangibles include self-generated ones eg. Customer/Client list.

Business Restructuring

These again arise on account of change in business models. For eg. A full-fledged manufacturer may convert itself to a group contract manufacturer or vice-versa.

Group synergies/implicit support

Here the Group entities enjoy implicit support of the parent entity in various forms e.g. Parent credit rating.

Secondment

These are unique as they may lead to taxing rights to the seconded jurisdiction and thereby triggering TP implications.

From TP perspective each of the above needs to be addressed in its own way. For eg., generally payments for intra-group services are disallowed if the same fall within the Parental support category.

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Chapter 11
Dispute Resolution

It is said that the TP disputes lead the international tax dispute arena. Nearly 60% of the international tax disputes are in connection with TP. Landmark disputes relates to reputed MNEs like – Coca Cola, A/S Norske Shell, Phillips, DHL, P&G, GSK, etc.

Generally, Country regulations provide for the traditional dispute resolution mechanism. These include normal appellate route, safe harbour, etc. However, such mechanism resolves country specific disputes and therefore leaving transacting entity level double taxation issues unanswered. Further, the traditional mechanisms are time consuming and usually time takes multiple years for an amicable resolution.

The answer to resolving large TP disputes in timely and cost effective manner and more importantly addressing largely the double taxation issue, there is international consensus to alternative dispute resolution mechanism viz. Advance Pricing Agreement and invoking the Mutual Agreement Procedure (MAP) available in tax treaties.

Advance Pricing Agreement

APA refers to an agreement between Taxpayer and Tax Authorities confirming the arm's length pricing thus ensuring certainty in the TP matters. It started with Japan introducing a system called Pre confirmation System in 1987, which was akin to unilateral APA process.

USA followed it in 1988 and thereafter several other countries have introduced the programme, which include, Canada, Australia, Mexico, New Zealand, Korea, China, UK, Germany, India, KSA, Qatar, Oman etc., and Egypt too. As per information available, more than 95 countries have APA provisions in place at present.

Unilateral APA refers to country specific arrangement i.e it does not involve the transacting entities and the respective country authorities. Therefore, the inherent nature of such APA does not address the double taxation issue.

Bi-lateral (involving two countries authorities) and Multi-lateral (involving multiple jurisdictions) APAs can address the said issue by providing for corresponding adjustments.

APA is also a useful tool in addressing the diverse regulatory provisions (TP vs Customs, discussed earlier). However, the proposed UAE CT Regulations do not indicate any provision for APA. We would have to wait for the final print to confirm whether the UAE would have APA provisons.

MAP

On the other hand, MAP is an alternate dispute resolution available under tax treaties. Article 9 and 25 of the MC provides for such mechanism. As a process, the dispute is referred and attempted to be resolved between the Competent Authorities of the two countries.

Chapter 12

Solutions for TP Risk Mitigation

In the face of numerous transactions of multi-national enterprises and their subsidiaries in the present day business scenario, a lot needs to be done in form of tax reforms, both at domestic level and the international sphere, to ensure proper transfer prices and its application in international taxation.

Some measures that can be taken to ensure compliance with the TP regulations are as follows:

1. Documentation:

It is the responsibility of tax payers to maintain contemporaneous records that are considered adequate for the purpose of proving that transfer prices confirm to arm's length principles. Such records must be kept for a prescribed minimum period. The burden of proof of compliance with arm's length principle is on the tax payer. However, same is discharged upon by the provision of relevant documents.

2. The efficient use of technology:

The use of modern technology seems a veritable tool to managing transfer price systems for efficacious disposal and determination of genuine transfer prices.

3. Standard TP regimes and regulations:

TP regulations on multi-national enterprises should work on the following issues for effective pricing standards.

I. Establish group TP Policy
II. Align group TP Policies with regulations
III. Set up internal structures to handle TP policies, documentation and reporting.
IV. Design internal control and reporting system for controlled transaction.
V. Secure services of TP Professionals to handle negotiation, documentation, analysis and filing activities.
VI. Ensure that the contracts for intra-group transfers are properly documented.
VII. Secure TP Compliance personnel.

4. Reduced Tax Liabilities through effective legislations:

APAs are effective way to mitigate the tax uncertainty, especially when the skates involved are significant.

Our Services for your TP needs

01 Preliminary Assessment on Applicability

02 Understanding transactions to Review/Draft Agreements

03 Performing; FAR Analysis & Benchmarking Study

04 Tax Efficient Restructuring of Supply Chain/IP

05 Documentation and Reporting

Should you have any questions on transfer pricing or tax issues, please feel free to contact us. We will be happy to assist you.

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This document has been prepared based on the OECD TP Guidelines and Public Consultation Document released by MoF on 28 April 2022.

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TAX Direct Tax

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  - » First Time Adoption
  - » Tax Compliance
  - » Tax Advisory
  - » Tax Training
- Transfer Pricing [TP]
  - » Country by Country Reporting [CbCR]
  - » TP Local File and Master File
  - » TP Advisory
  - » International Tax
  - » Review of International Transaction
  - » Economic Substance Regulation
  - » Tax Residency Certificate
  - » Ultimate Beneficial Owner Regulation [UBO]

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- Value Added Tax [VAT]
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- Pre- Tax Audit
- VAT Return Filing & Refund
- Registration/De-registration
- Representation to FTA
- Excise Tax
- Customs Tax

Company Incorporation

- Company Formation
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  - » Free Zone
  - » Offshore
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- Offshore Registered Agent –JAFZA
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Disclaimer:

This document has been prepared on the basis of the OECD Transfer Pricing Guidelines and the Public Consultation Document released by the Ministry of Finance, UAE on 28 April 2022, in relation to proposed Corporate Tax regime. The intent of this document is to have a broad information on Transfer Pricing concepts and does not purport to be a legal document. The information contained in this document is confidential. It is intended solely for use by the recipient and others authorized to receive it. If you are not the recipient, you are hereby notified that any disclosure, copying, distribution or taking action in relation of the contents of this information is strictly prohibited and may be unlawful.

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