Transfer Pricing Compliance

Transfer pricing compliance in the UAE involves adhering to the regulations set by the UAE Ministry of Finance (MoF) and the Federal Tax Authority (FTA). The UAE introduced transfer pricing rules aligned with the OECD Transfer Pricing Guidelines, as part of its broader corporate tax framework. Some key points to consider for compliance are as follows:

1. **Transfer Pricing Documentation**: Companies need to maintain proper transfer pricing documentation, including a Master File and a Local File, to justify their pricing arrangements for transactions between related entities.
2. **Arm's Length Principle**: Transactions between related parties must be conducted at arm's length, meaning that the terms and conditions should be comparable to those agreed upon by unrelated parties.
3. **Country-by-Country Reporting (CbCR)**: For multinational enterprises (MNEs) with consolidated group revenue above a certain threshold, Country-by-Country Reporting is mandatory. This requires filing a CbCR with the MoF of the UAE.
4. **Annual Disclosure Requirements**: Companies may need to disclose related-party transactions and transfer pricing policies in their annual corporate tax returns.
5. **Compliance Deadlines**: Ensure the timely submission of required documents and reports to avoid penalties.
6. **Penalties for noncompliance**: Noncompliance with transfer pricing regulations can result in substantial penalties.

Method for Calculating Transfer Pricing

Calculating the arm's length price involves several methods, as outlined in the OECD Transfer Pricing Guidelines. These methods ensure that transactions between related parties are conducted as if they were between unrelated parties. Commonly used methods are as follows.

1. **Comparable Uncontrolled Price (CUP) method**
   - **Description**: Compares the price charged in a controlled transaction to the price charged in an uncontrolled transaction under comparable circumstances.
   - **Application**: Identify a comparable transaction between unrelated parties and use that price as a benchmark.

   Example:

- **Related Party Price**: 100,000 AED
- **Comparable Transaction Price**: 95,000 AED
- **Adjustments**: 5,000 AED
- **Adjusted Comparable Price**: 100,000 AED

Calculation:

Transaction ID	Related Party Price	Comparable Transaction Price	Adjustments	Adjusted Comparable Price	Result
1	100,000	95,000	5000	100,000	Arm’s Length

2. **Resale Price Method (RPM)**:
   - **Description**: Starts with the price at which a product is resold to an independent party and then subtracts an appropriate gross margin to arrive at the arm's length price.
   - **Application**: Typically used when a product is purchased from a related party and then resold to an independent party.

   Example:

- **Resale Price to Independent Party**: 125,000 AED
- **Reseller’s Gross Margin**: 20%

- **Cost of Goods Sold**: 100,000 AED

Calculation:

Arm's Length Price=Resale Price−(Resale Price×Reseller's Gross Margin)

=125,000−(125,000×0.20)

=125,000−25,000=100,000

Transaction ID	Resale Price to Independent Party	Reseller's Gross Margin	Cost of Goods Sold	Arm's Length Price
1	125,000	0.20	100,000	100,000

3. **Cost Plus Method (CPM)**:
    - **Description**: Starts with the costs incurred by the supplier in a controlled transaction, then adds an appropriate mark-up to arrive at the arm's length price.
    - **Application**: Suitable for transactions involving the provision of services or manufacturing where value-added functions are involved.

Example:

- **Cost of Goods Sold**: 100,000 AED
- **Mark-up Percentage**: 15%

Calculation:

Arm's Length Price=Cost of Goods Sold + (Cost of Goods Sold × Mark-up Percentage)

=100,000+(100,000×0.15)

=100,000+15,000=115,000

Transaction ID	Cost of Goods Sold	Mark-up Percentage	Arm's Length Price
1	100,000	0.15	115,000

4. **Transactional Net Margin Method (TNMM)**:
    - **Description**: Examine the net profit margin relative to an appropriate base (e.g., costs, sales, assets) that a taxpayer realizes from a controlled transaction.
    - **Application**: Often used when traditional transaction methods are not applicable or when dealing with complex transactions.

Example:

- **Net Profit**: 20,000 AED
- **Appropriate Base (e.g., Sales)**: 100,000 AED
- **Net Profit Margin**: 20%
- **Arm's Length Range (Low)**: 15%
- **Arm's Length Range (High)**: 25%

Calculation:

Net Profit Margin=Net Profit/Sales

=20,000/100,000=0.20

Since the net profit margin of 20% falls within the range of 15% to 25%, the transaction is arm's length.

Transaction ID	Net Profit	Appropriate Base (e.g. Sales)	Net Profit Margin	Arm's Length Range (Low)	Arm's Length Range (High)	Result
1	20,000	100,000	0.20	0.15	0.25	Arm's Length

5. **Profit Split Method (PSM)**
   - **Description**: Allocate the combined profits from a controlled transaction in proportion to the relative contribution of each party involved.
   - **Application**: Suitable for highly integrated operations or transactions in which both parties make unique and valuable contributions.

Example:

- **Combined Profits**: 200,000 AED
- **Contribution Percentage (Party A)**: 60%
- **Contribution Percentage (Party B)**: 40%

Calculation:

Profits Split (Party A) = Combined Profits × Contribution Percentage (Party A)

=200,000×0.60=120,000

Profits Split (Party B) = Combined Profits × Contribution Percentage (Party B)

=200,000×0.40=80,000

Transaction ID	Combines Profits	Contribution % (Party A)	Contribution % (Party B)	Profit Split (Party A)	Profit Split (Party B)
1	200,000	0.60	0.40	120,000	80,000

Steps to Calculate Arm's Length Price

1. **Select the Appropriate Method**: Choose the most suitable method based on the nature of the transaction and available data.
2. **Identify Comparables**: Find similar transactions between unrelated parties (comparables). This can involve internal (transactions within the same company with unrelated parties) or external comparables (industry data and databases).
3. **Adjust for differences**: The comparables are adjusted for any differences that may affect comparability, such as market conditions, contractual terms, and geographic location.
4. **Determine the Arm's Length Range**: Calculate the range of prices or profit margins for comparables. The interquartile range (IQR) is often used to exclude extreme values.
5. **Test the Controlled Transaction**: Compare the price or margin of the controlled transaction with the arm's length range. If it falls within this range, the arm's length is considered.
6. **Document and Report**: Maintain detailed documentation of the method, comparables, adjustments, and calculations to support the arm's length nature of the transaction.