

UAE- Public Clarification-Downward Adjustment

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Summary

UAE Federal Tax Authority (“FTA”) has recently issued a public clarification¹ focusing on downward adjustment made by a Taxable Person to meet the arm’s length standard and the corresponding disclosure requirement in the Corporate Tax Return. The alert covers the key aspects of the clarification issued and the documentation requirements to be considered by Taxable Person to ensure sufficient defense during tax audit.



Background

Article 34(1) of the Federal Decree-Law No. 47 of 2022 requires that all transactions and arrangements between Related Parties must meet the arm’s length standard. In the instances where the transactions / arrangements with related parties are not concluded at arm’s length and the Taxable person has reasons to believe so, based on an appropriate arm’s length analysis, then one must make appropriate transfer pricing adjustments to comply with the arm’s length principle. Adjustments can be carried out in any of the below ways:

1. Adjustment in the books of accounts, prior to finalisation of the Financial statements; or
2. Adjustment in the Tax Return

Such adjustment may either increase the Taxable Income (upward adjustment) or decrease the Taxable Income (downward adjustment).

In case of related party transactions exceeding the materiality threshold², necessary disclosures were required to be made in the disclosure form alongside the corporate tax return.

As per the Corporate Tax Guide (CTGTXR1) dated November 2024³, downward adjustment will be allowed only in the Tax return upon a successful application to the FTA (i.e., prior approval). Accordingly, prior to the release of this clarification, if the downward adjustment is not approved by the FTA, the Taxable Persons were asked to enter the amount as ‘NIL’ in their tax returns.

¹ CTP011 - Downward adjustments made by a Taxable Person in the Tax Return to comply with the Corporate Tax Law

² Aggregate value of related party transactions exceeding AED 40 million / AED 4 million per category as specified

³ Para 9.3.4 and Para 16.1.9

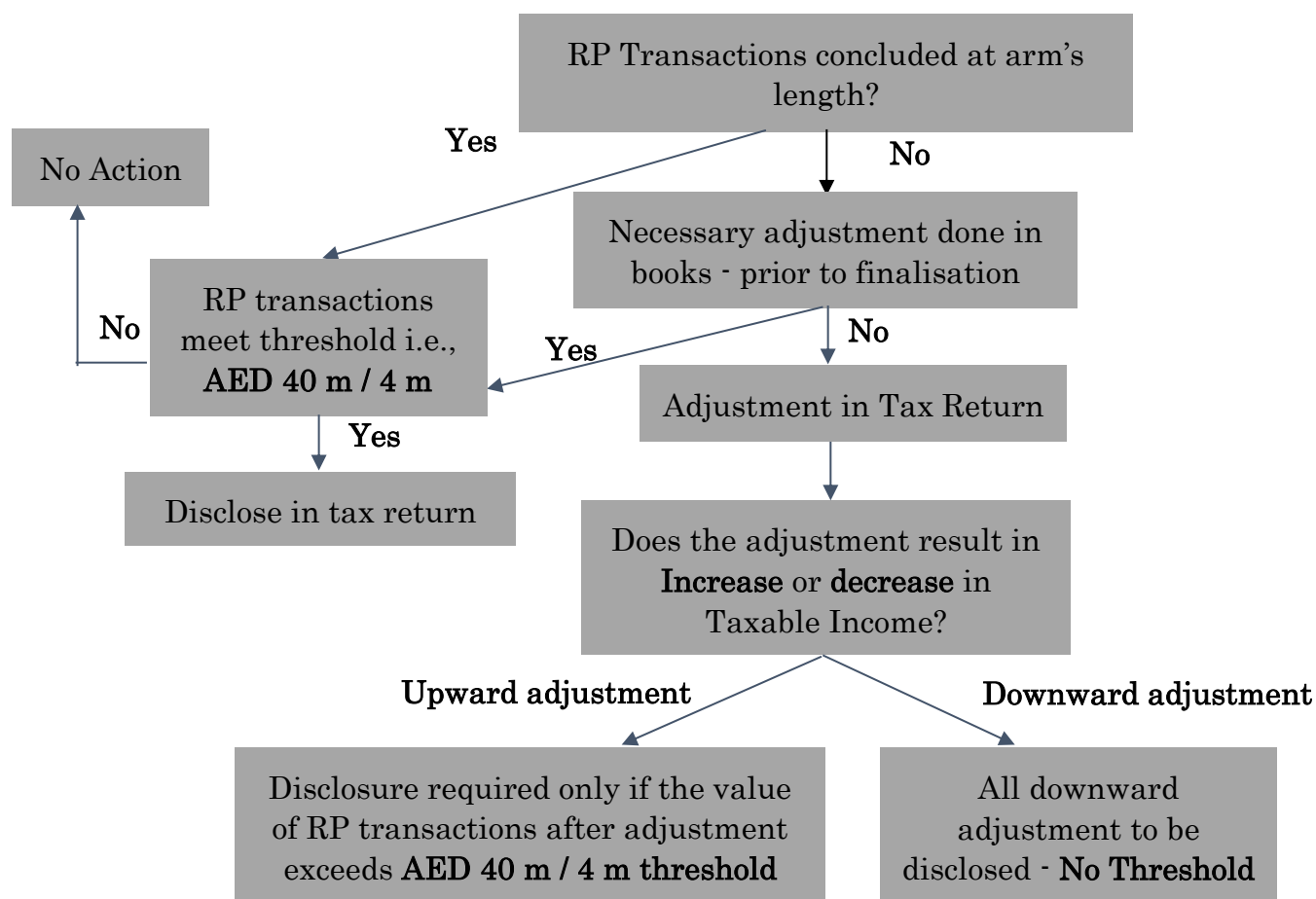


Clarification

The Corporate Tax system of UAE operates on a self-assessment basis. On the contrary, in instances where a downward adjustment is made, there was no automatic route prevalent to disclose the said adjustment in the corporate tax return of the taxable person which caused hardship to the tax payers.

In this public clarification issued by FTA, it is now clarified that no approval is required from FTA in order to disclose downward adjustment in the tax return.

The below chart depicts the transfer pricing adjustment process going forward:



Having said that, it is specifically mentioned in the clarification that any transfer pricing adjustment made by a Taxable Person in the Tax Return may be subject to a Tax Audit.

Further FTA has imposed certain key mandates to the Taxable Persons in this regard, which requires strict adherence.

Key considerations:

- **No threshold** - Disclosure of downward adjustment in tax return irrespective of value / nature;
- **Maintaining Robust documentation** – covering rationale for making downward adjustment, benchmarking analysis;
- **Supporting workings** - Reconciliation of values as per financials and as per tax return;
- **Corresponding adjustments** – Taxable person to ensure that symmetrical corresponding adjustments are made by the Related Parties to the transactions

This Public Clarification applies solely to adjustments required under Article 34(1) of the Corporate Tax Law and does not extend to the following:

- a. Corresponding adjustments made by the FTA to the taxable income of related party(ies) [as per Article 34(10)]; and
- b. Taxable person making an application to FTA to make corresponding adjustment pursuant to an adjustment made by foreign competent authority to the transaction. [Article 34(11)]



Key Takeaways

While prima facie this clarification brings in operational convenience to the Taxable Persons, it is indeed an indication of a strong review mechanism being built underneath by the FTA to closely monitor and scrutinize the downward adjustments irrespective of the volume.

Considering that FTA has lifted the approval mandate for disclosure of downward adjustment, the burden of proof entirely rests on the taxable person and hence it is imperative to build a comprehensive defense mechanism well in advance.

The specific mandate on maintenance of a proper benchmarking analysis and the requirement to ensure symmetrical corresponding adjustments signify that the taxable persons cannot merely plug-in an adhoc number in their tax return, whereas it should be supported by a robust defense documentation prior to the filing of tax returns and to ensure that the Related parties also treat the adjustment consistently.

About us



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