Considerations for Second Transfer Pricing Season in UAE

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Nithya Srinivasan

Founder, VSTN Consultancy

E Rajesh

Senior Director, VSTN Consultancy

UAE introduced transfer pricing regulations effective from financial year starting on or after 1st June 2023, along with its corporate tax regime. For companies following the calendar year, the upcoming compliance in September 2026 will be the second season for transfer pricing.

Some of the key points to be considered in regard to transfer pricing compliance in UAE for CY 2025 are:

1. **Thresholds**

Under UAE TP regulations an entity is expected to maintain a local and master file if it meets either of the following criteria

1. Where a taxable person is a member of an MNE group that has a total consolidated group revenue of AED 3.15 billion dollars or more in the relevant tax period, or
2. Where the taxable person's revenue in the relevant Tax Period is AED 200 Million or more.

Entities must submit a related party schedule along with the corporate tax return if the aggregate market value of all transactions with all related party exceeds AED 40 Million. As the threshold for disclosure is based on the arm's length price of the transaction. ALP analysis is required to determine if the transaction has crossed the threshold.

The threshold for documentation and disclosure does not eliminate the requirement for all related party transactions to be at arm's length.

As per the TP laws issued by the FTA all transactions entered into between related parties and connected persons are subject to arm's length analysis. Accordingly, even if a taxpayer is below the discourse form/local file related thresholds, they should carry out the TP analysis to prove that transactions are conducted on arm's length basis. A TP study and documentation are crucial to avoid upward adjustment and penalties being imposed by FTA in such scenarios.

2. **Requirement to update the arm's length analysis**

The UAE regulations provide for leveraging the comparables from a benchmarking search for up to three years. However, the margins of the comparables and the tested party must be updated each year i.e., for the comparable companies selected through benchmarking in 2024, the margins for 2025 will have to be undertaken. **Hence the arm's length analysis has to be carried out annually and the taxpayer is not alleviated from this requirement.**

Further for the said companies, taxpayers will have to ensure data availability for 2 or more years, in case where the comparable companies do not satisfy these criteria, the respective company will have to be omitted from the final set of companies, and the revised margins will have to be computed.

The provision for relying on the past year's benchmarking and not carrying out a fresh search is only available if the fact pattern and related parties' transactions have not changed in this year over the past years. If there has been changes then reliance on the past years arm's length analysis is incorrect.

In terms of the local file, this preparation is an annual exercise as the requirement to maintain depend on the turnover of the taxpayer/or MNC Group in the particular year, and updates should be carried out for the current year.

3. **Downward Adjustment in the Tax Return**

Taxpayers will now be able to make downward adjustments in the tax return without prior approval from FTA. However, FTA has imposed the following requirements if a downward adjustment is made:

- All downward adjustment and the connected related party transactions should be disclosed in the Disclosure Form
- Documentation explaining the rationale and the reason for making a downward adjustment to be maintained.
- Reconciliation between the corporate tax return and the financial statements
- A corresponding upward adjustment by the related party.

The FTA has indicated that downward adjustments will have a higher probability of scrutiny. Hence, taxpayers may consider effecting adjustments during the finalization of the books of accounts.

4. **Implications for Qualifying Free Zone Persons (QFZP)**

QFZP are expected to maintain arm's length pricing for related party transactions. Failure to maintain and justify arm's length price may lead to the QFZP status of the entity being revoked and the entity can be disqualified from claiming Free Zone benefits such as 0% corporate tax for a period of five years.

Federal Tax Authority (FTA) considers related party transactions of QFZP with a mainland enterprise to be high risk and has focused significant resources on auditing QFZP due to risk of profit shifting from mainland entities to QFZP entities.

FTA has clarified that QFZP enterprises whose related party transactions are not at arm's length can maintain QFZP status if downward transfer pricing adjustment is made even in the corporate tax return. QFZP are also expected to maintain significant substance in the free zone it is incorporated in.

Hence, it is crucial that taxpayers in Free Zone maintain transfer pricing documentation and the underlying documents - capturing in detail the activities that are carried out, and the substance being maintained in the free zone. Hence, the arm's length vetting has to happen every year for the entity to claim the free zone benefit for that year. Any documentation of the past year, if not updated for the results of the comparables companies and the taxpayer for the year under consideration, is insufficient for the purpose of claiming the Zero tax benefit.

5. **Safe Harbour**

For low value-added intra-group services, UAE has provided for a safe harbour of Cost plus 5% markup. Entities pricing low value-added service at this stated margin do not have to conduct benchmarking study however this does not exempt a taxpayer from preparing TP documentation.

A transaction can be considered to be low value add only if it is supportive service that are not part of the core business of the MNE group, and where the service provider is not using or creating valuable Intangible assets and the risk assumed by the service provider is not significant.

Entities availing the safe harbour should provide adequate justification that the services it received or provided meet the criteria for using the safe harbour.

Taxpayer cannot adopt the low value-added services safe harbour for other transactions which are not part of the eligible transactions, and benchmarking analysis will be required for the non-qualifying transactions.

Certain services that the FTA has explicitly ruled out from the ambit of safe harbour include R&D, Manufacturing and production services, financial transactions, sales, marketing and distributing activities, etc. Hence adopting a 5% mark-up relying on the safe harbour is an incorrect way of substantiating ALP for the ineligible transactions.

6. **Compensation to KMPs**

UAE TP regulations require the compensation paid to connected persons to be at arm’s length. During the first TP season there was some uncertainty about who exactly qualifies as a director and officer of an entity.

FTA has clarified that director is any person who holds a position in the company’s board including non-executive director. Officer is any individual who has the authority to plan, direct and control the business activities of an entity. An individual can be considered to be an officer based on their role and conduct even if they are not holding a high-level job title.

It is possible that general manager, divisional head can be considered to be an officer. Detailed study of the functions and roles performed must be conducted to ensure that the compensation paid to all connected persons is documented and disclosed to FTA in the connected persons schedules. Connected Person’s schedule has to be filed if the payment to a connected person or their relatives exceeds AED 500,000.

The clarification also stated that in case a person is both a related party and a connected person they must be considered to be related party.

It should be noted that the entity must maintain arm’s length price analysis for all transactions with connected persons even if it is below this threshold. Entities must have evidence on the actual services received and benefits provided by the connected persons and payment to namesake individuals without active contribution in the company’s operations would be questioned by the FTA.

7. **Intellectual Property**

All intellectual property transactions should be conducted at arm’s length. UAE TP regulations require a DEMPE analysis to be conducted in terms of intangibles. Each entity performing the relevant DEMPE functions must be compensated for the functions they have performed irrespective of the legal ownership of the Intellectual Property.

In certain instances, where the seller of IP continues to perform DEMPE functions post sale and the new IP owner only legally holds the IP then the seller will be entitled to the residual profits arising from the intangibles, while the buyer will be compensated for the limited activities undertaken.

However, it is not necessary all the DEMPE functions are performed by the legal owner if the related party performing the services are compensated at arm’s length for the services they provided and the control over the risk w.r.t. such IP is with the legal owner.

8. **Loans**

It is common practice for some groups to have fluid flow of funds between the group entities based on requirement of fund. These transfers are usually undertaken without any formal arrangement for the said financial transaction and / or interest being charged. Movement of funds / financing arrangements between group companies are related party transactions and thus these arrangements should be conducted at arm’s length, and all intra-group financing arrangement should be included in the related party disclosure schedule.

The first step in a loan benchmarking is to arrive at the credit rating of the borrower. Carrying a loan search without knowing/estimating the credit rating is a futile exercise, and this kind of loan benchmarking analysis will not withstand the test of the FTA scrutiny.

Taxpayer may however note that loan benchmarking is a onetime exercise – at the time of entering into financial transaction, and this documentation can be leveraged for the entire tenure of the loan – where the terms and conditions of the loan remain unaltered.

9. **Management Charges**

UAE headquartered groups providing management services to other group entities should ensure that all the services provided are adequately documented and ensure that the HQ is compensated at arm’s length from its members for the service provided.

Any entity who has been cross charged with management charges should maintain robust documentation to prove the following points.

1. The need for the services being provided by related party
2. Proof of service being actually rendered
3. The benefits derived from the services received.
4. Non-duplicity of the services rendered i.e., in case the entity is already performing similar services similar to those being received from related party then an analysis on why the services is not duplicative in nature may be required.
5. In case of charges to multiple entities the cost pool allocation workings

Management charges may be disallowed by FTA if the taxpayer is unable to adequately justify them.

10. **Outstanding Receivables**

In case of related party transactions, it may not be adequate for just the price and terms of the transaction to be at arm’s length. As per the law, FTA will also look at the receivables arising from the transactions.

FTA considers long overdue receivables from a related party to be an implicit loan and can make upward adjustments on income for the arm’s length interest on the loan.

Entities must justify their credit period and lending terms according to the industry norms and practices to ensure the receivables are not recharacterized as a loan.

11. **Consistency**

TP documentation prepared for the current compliance season should be consistent with the TP documentation prepared for last year. If the TP documentation was properly positioned during the first year there should not be a sudden change in the characterisation of the entity unless there is a significant change in the FAR.

For instance, if the entity is continuing to be characterized as a limited risk distributor, then there must not be a significant difference in the FAR analysis. Significant differences between the positions taken by the entity may undermine the evidentiary value of the TP documentation.

Conclusion

The compliance cycle for CY 2025 will require heightened attention, as strengthening and ensuring tax compliance continues to be a key focus area for the FTA, consistent with the evolution of any country's tax regime.

Taxpayers must evaluate their current business circumstance to understand if updating TP documentation would be appropriate or if a fresh benchmarking search is required.

While clients and consultants continue to focus on 2025 from a transfer pricing compliance perspective, the “elephant in the room” is evaluating the change in the facts and circumstances for 2026 – due to the current geopolitical crisis in the middle east impacting the business and its effect on Transfer pricing. It would be prudent to proactively relook at the intercompany transactions, during the 2026 and undertake required actions to align from a transfer pricing perspective. This would include:

- Ascertaining the impact of supply chain and disruptions on the business,
- Relook at the existing inter-company agreements
- Understand the transfer pricing risk profile / characterization between the related parties / within the group entities.
- Alignment of transfer pricing outcomes based on the above.

Another key aspect that taxpayers would have to consider is any change in the characterization of the entities and transfer pricing implications of the same. Change in characterization would not only change the base transfer pricing policy but would also have far reaching implications including payment / receipt of exit charge for change in the functional analysis.

Therefore, it would be ideal to proactively review the related party transactions during the year and streamline transfer pricing outcome based on the economic activities undertaken as well as the risks borne by the respective entities within the group. This would ensure that the taxpayers have a better footing from a TP compliance perspective and be ready for the filing.

With inputs and contribution from Vinayak D Kumar, Assistant Manager, VSTN Consultancy Pvt Ltd.