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Transfer Pricing in the New Global Tax Era

A. Background

The Transfer Pricing provisions imbuing the arm's length principle for related party transactions were adopted by UAE through the Federal Decree-Law No.47 of 2022 issued by the Federal Tax Authority ('FTA'). Later, in October 2023, a detailed TP Guide was issued by the FTA to provide more clarity on the transfer pricing provisions. For the companies in UAE following the Gregorian calendar, the first Corporate Tax Return was due on 30th September 2025.

The first Corporate Tax filing season in UAE highlighted the importance of transfer pricing compliance for Multinationals Enterprises ('MNE's') to align themselves with the global transfer pricing environment and directed maintenance of robust transfer pricing documentation for each of the related party transactions to help reduce tax audit risks. Given that the TP Guide and the FTA regulations are largely aligned with the OECD transfer pricing regulations, it is vital for the UAE businesses to adopt international best practices and stay updated with the global developments.

The FTA's commitment to stay ahead in the TP arena is evident from the following initiatives:

- Recent Cabinet decision outlining the Advance Pricing Agreement ('APA') Fee structures in line with the FTA directives on Unilateral APA.
- Cabinet Decision No. 142 of 2024 for implementation of Domestic Minimum Top-Up tax ('DMTT') effective 1st January 2025 in line with the Pillar 2 based Global Anti-Base Erosion ('GloBE') Rules recommended by the OECD.

B. What does the implementation of APA mean to the UAE enterprises?

APA is a formal binding agreement entered into between a taxpayer and the tax authorities for determining the appropriate transfer pricing methodology for specific related party transactions. APA can be Unilateral, Bilateral or Multilateral. UAE has proposed to accept Unilateral APA's (i.e. agreement between FTA and the taxpayer in UAE) initially.

Given that the APA related directions are being released in a phased manner in UAE, it is anticipated that the APA implementation framework would also be formally notified in the coming months. It is expected that the framework would be in line with the OECD recommendations similar to the general transfer pricing guidance.

APA aims to provide tax certainty to taxpayers and is likely to reduce tax disputes. The possibility to apply for Unilateral APA before the FTA was envisaged through the decision issued in June 2024 which indicated the tentative start date for acceptance of APA applications.

It is imperative that the MNEs in UAE stay prepared to defend their intra-group pricing policies, as the regulatory framework is marching towards maturity and the FTA is expected to intensify its audit and risk assessment activities. Since APA's are intended to give tax certainty, UAE enterprises may consider APA as a proactive measure to avoid disputes.

Companies who would want to enter into APA will have the following advantages:

- Low/Nil chances of tax disputes since the pricing would



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have been agreed in advance with the tax authorities

- The likelihood of agreeing to unique pricing approaches for related party transactions with the FTA is significantly high under an APA
- Loss-making companies while applying for APA can submit their functional profile & actual business facts and mutually agree to an arm's length transaction price with the FTA
- When the related party pricing is agreed by the APA, it provides a positive indication to the stakeholders, especially in case of listed companies
- Though costs relating to APA application and related efforts in the initial years may be high, the companies can save on long-term litigation costs
- Given that, APAs are being concluded for various transactions in other developed/developing countries across the world, similar approach would help in adoption of uniform practices across the Group
- Considering that this is the first year of filing and litigation with respect to Transfer pricing is yet to begin, it would be an added advantage for the companies entering into APA from the year 1 of implementation, to secure their intra-group transactions and agree to arm's length pricing
- Since APA would typically be entered into for a period of 3 – 5 years and the possibility of rollback would also be made available in line with the global best practices, the companies can thrive in a litigation free environment during the APA agreed period.

In light of the latest directions on the APA fee structure, it is pertinent to note that in addition to APA application/renewal fees, charges are also proposed for amendments to the APA. Accordingly, it would be prudent for the UAE enterprises to undertake feasibility analysis and evaluate the impact of entering into APA.

C. What measures need to be taken by UAE enterprises pursuant to implementation of DMTT?

Pillar 2, also known as the Global Anti-Base Erosion (GloBE) Rules is a global minimum tax framework developed by the OECD to stabilize the international corporate tax system, discourage profit shifting to low-tax jurisdictions and promote fair distribution of tax revenues among jurisdictions. Though UAE has not adopted the Income Inclusion Rules (IIR) and Under Tax Profits Rule (UTPR) of Pillar 2 suggested by the OECD, FTA has proposed to implement DMTT rules and tax the MNE's whose Effective Tax Rates ('ETR') are lower than 15%. The provisions are aligned to OECD Pillar 2 model rules and is applicable for MNE's whose consolidated annual revenue exceeds 750 million Euros in two of the

last four fiscal years. DMTT is applicable from financial year starting 1st January 2025. The UAE DMTT rules are closely aligned with the GloBE Model Rules, however it is yet to attain the 'Qualified' status, which is expected to be received before 1st January 2026.

Based on the UAE DMTT rules, all the constituent entities of MNE Group who meet the consolidated revenue threshold must register with FTA and file the GloBE Information Return ('GIR'). In light of the same, as the financial year 2025 comes to a close this December, the UAE enterprises ought to focus on the following aspects:

- The constituent entities of MNE groups which are held under Joint-venture structures (non-wholly owned entities) are also subject to UAE DMTT rules, therefore the JV entities in UAE would be required to review the thresholds and applicability based on the same
- MNE's need to undertake an impact assessment and decide whether the transitional CbCR safe harbour is applicable for them. In case the MNE's do not meet the transitional safe harbour requirements, the impact of top-up taxes needs to be evaluated
- The transitional safe-harbour offers relief to MNEs in the initial years by easing compliance with GloBE rules. It allows eligible companies to rely on existing CbCR data and qualified financial information to avoid detailed GloBE computations until 30th June 2028. Entities that meet the safe-harbour criteria are exempt from top-up tax in UAE and may continue paying UAE corporate tax during this period
- CbCR filed assumes greater significance since it serves as a bases to be eligible to apply transitional safe harbour rules. Since only 'qualified CbCRs' are eligible to claim transitional relief, aligning the entity-level financials with consolidated financials in terms of the generally accepted accounting standards such as IFRS is required
- Entities for whom transitional safe harbour is not applicable, need to determine the top-up tax liability before the closure of audit for the relevant year to ensure compliance with statutory reporting obligations and maintain smoother cash flows
- Given that the computation of taxes is being done jurisdiction-wise, in cases where there are more than one constituent entity of the Group operating in a country, one entity undertakes all the activities relating to pillar 2 compliance including computation and payment of additional taxes, if any. The cost related to those activities including the taxes paid by such entity on behalf of the other constituent entities must then be appropriately allocated to the respective entities
- For UAE head-quartered MNE's, if any jurisdiction in



which their constituent entities have top-up tax liability via IIR, then the top-up tax will be collected by the other intermediary group entities who have IIR rules, owing to UAE's non-adoption of IIR

- Owing to introduction of DMTT rules in UAE, DMTT liability will be triggered to all the entities which were earlier in low-tax or no tax zones, if their Group falls under the scope. Therefore, all the MNEs, though their intra-group transactions are within the arm's length range, may review their existing transaction structures to ensure optimal pricing policy after considering the impact of Pillar 2
- Since transfer pricing outcomes have a direct impact on tax outflow, and consequently on the ETR, the entities must adhere strictly to the arm's length requirement with respect to transactions with related parties.

D. Key Takeaways for MNEs:

- ✓ Documentation is the key. Be it an application for APA or preparedness for Pillar 2, strengthen the documentation
- ✓ Align/Re-assess the inter-company transfer pricing policies within and outside UAE to withstand transfer pricing scrutiny, promote consistency and align with Pillar 2 requirements across jurisdictions!
- ✓ Co-ordinate globally since DMTT interacts with Pillar 2 rules, consistency in the intra-group pricing policy across jurisdictions is critical
- ✓ Reassess free-zone structures and relevant transfer pricing strategies in light of DMTT
- ✓ Leverage CoCr data and transitional safe-harbour provisions.

(The article is contributed by Nithya Srinivasan CEO of VSTN consultancy LLC, Global transfer pricing firm with inputs from Saranya Nagarajan. She can be reached at snithya@vstnconsultancy.com.)

