WHAT IS TRANSFER PRICING?

BACKGROUND

With Corporate Tax in the UAE just around the corner, one of the crucial aspects that cannot be overlooked is Transfer Pricing!

The Organisation of Economic Co-operation and Development (OECD) has published detailed TP guidelines, which are proposed to be adopted in the UAE.

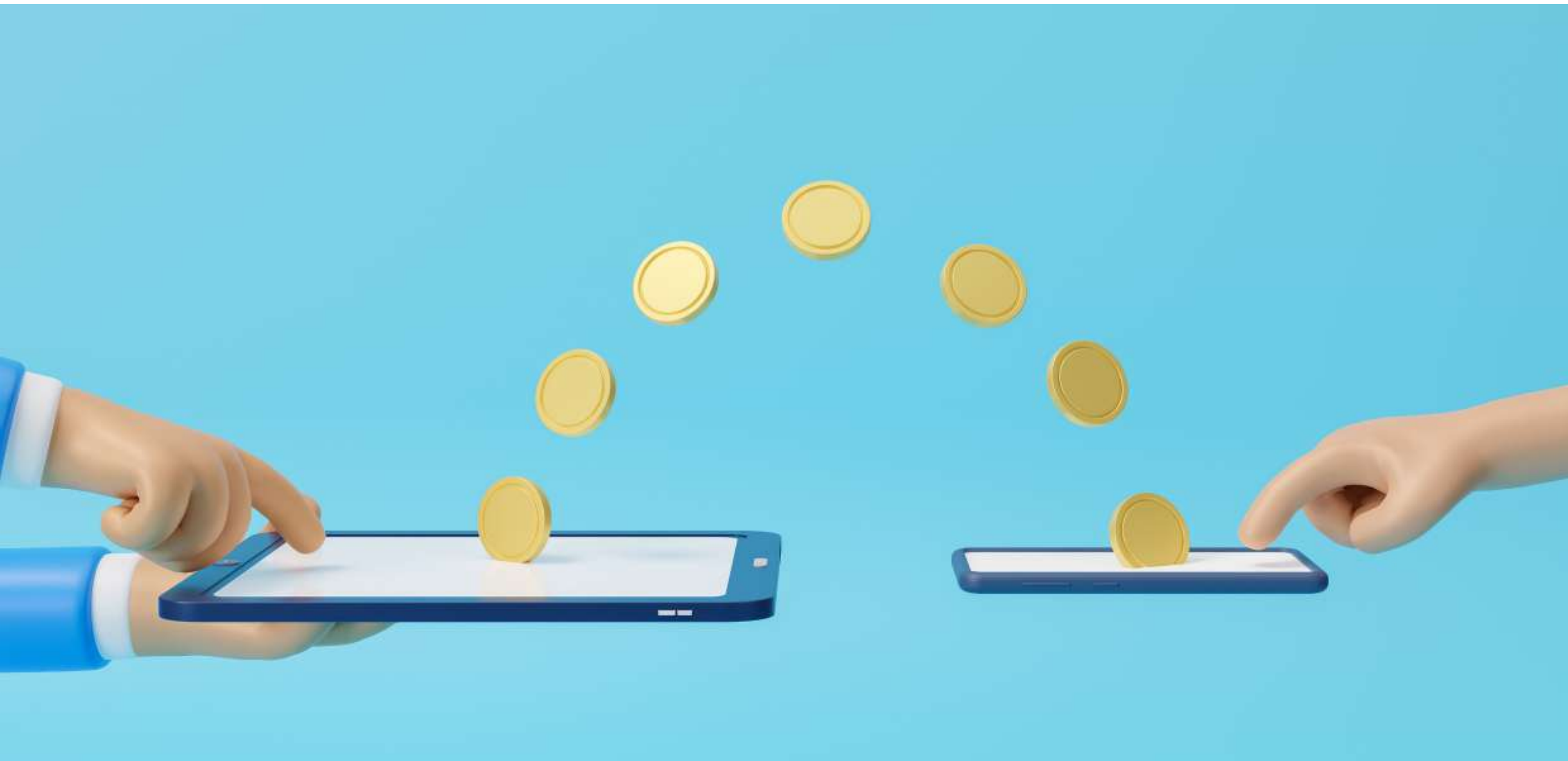
In this series of alerts, we will decode the complexities around TP and the concepts relevant to UAE businesses.

TP – CONCEPT

TP refers to the prices of goods and services that are exchanged between companies under common ownership or control (related parties).

Given the varied tax rates across the globe, MNEs may structure transactions in a manner that shifts profits out of high-tax jurisdictions into tax havens or low-tax jurisdictions.

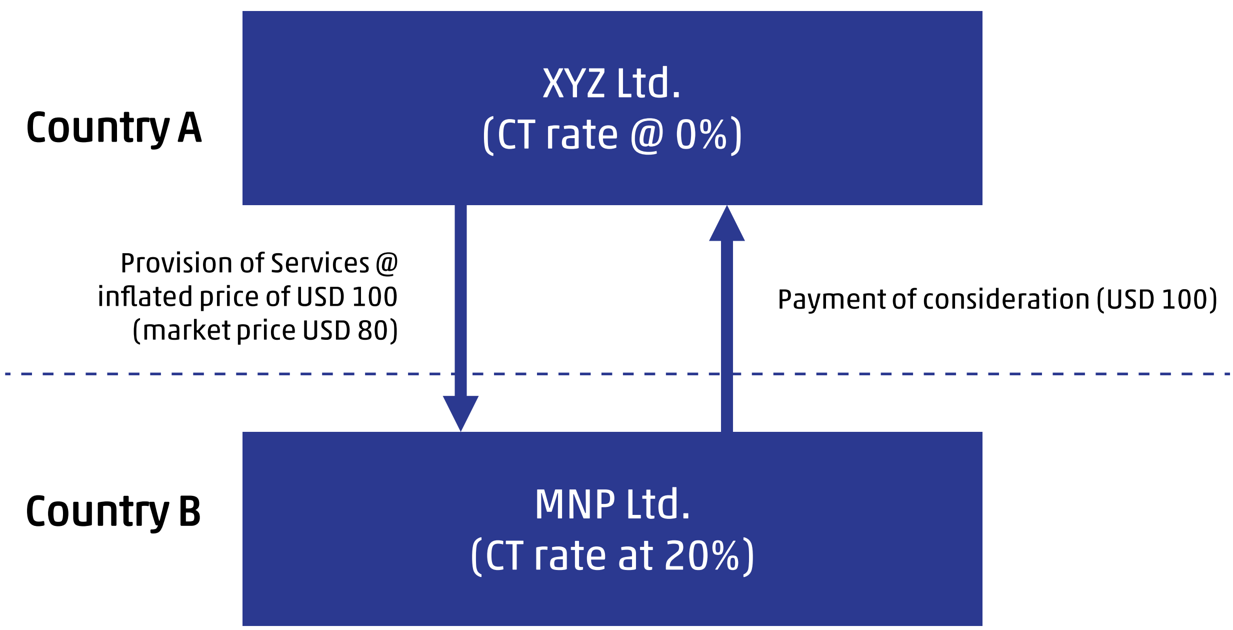
TP, as a mechanism, is a check to counter these harmful tax practices.



WHAT IS THE PROBLEM?

Let us take an example of an MNE that operates as follows:

- ✓ Through XYZ Ltd. in Country A – CT rate @ 0%
- ✓ Through MNP Ltd. in Country B – CT rate @ 20%
- ✓ Price charged for services by XYZ Ltd. – USD 100
- ✓ Actual market price for services – USD 80
- ✓ Artificial inflation of USD 20 to 'shift' profits from high-tax jurisdiction to low-tax jurisdiction



TP IS THE SOLUTION!

TP regulations would ensure that MNP Ltd. and XYZ Ltd. transact at an ‘arm’s length price’

Outcome of our example:

- ✓ Country B loses on taxes as services prices are inflated by USD 20 – Tax loss of USD 4
- ✓ Failure to demonstrate arm’s length nature - Country B to tax MNP Ltd for the inflated price of services

WHY IS THIS AN ISSUE?

Imagine this practice being followed at a much larger scale by numerous MNEs across the globe! This would lead to a significant loss of taxes to Governments.

Recently, large companies like Apple, Google, Facebook, and Starbucks have been alleged to adopt harmful tax practices to avoid paying the right amount of taxes.

Developing countries tend to lose out on rightful taxes that would have been earned if MNEs adopted appropriate TP mechanisms.

TYPES OF TP

International TP
Pertains to transactions between related parties which are in different jurisdictions

Domestic TP
Pertains to transactions between related parties which are in the same jurisdiction, particularly where one of the companies enjoys tax incentives or tax breaks (relevant for groups having free zone companies)

Connected persons
Pertains to individuals who own or control a company, are directors or officers in a company, or are relatives to such individuals

WHY IS THIS RELEVANT?

In a fast-paced global economic environment, TP becomes highly relevant to MNEs.

Being viewed as an organisation engaged in harmful tax practices carries a reputational risk.

Adopting a compliant TP policy minimises penalty risks and costs of litigation.

As the world is moving towards a Global Minimum Tax regime, aligning inter-company transfer prices is the first step towards tax transparency.

ARE WE DONE?

NO!

THIS IS JUST THE START...

You would not believe that the OECD and the United Nations have both issued guidelines ranging from 600 pages each just on TP!!

KEEP WATCHING THIS SPACE AS WE SIMPLIFY THOSE FOR YOU..

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