Fundamentals of Transfer Pricing

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What is Transfer Pricing

Transfer Price	• Price of goods, services, intangible asset or any other transactions between related parties
Related parties	• Directly or indirectly under common control
Why TP is important	• When related parties transact with each other, their commercial and financial relations may not be aligned with market forces
Impact	• Shifting of income between different jurisdictions having different tax rates, which impacts the effective tax rate of MNEs

What is the need for transfer Pricing

Parent Company

Sale to Subsidiary @ 500

Expenses		Income	
COGS	300	Sales	500
Profit	200		
Tax @ 30% - 60			

Subsidiary Company

Sale to Customers @ 800

Expenses		Income	
COGS	500	Sales	800
Profit	300		
Tax @ Nil - Nil			

Overall tax burden of group is USD 60

Parent Company

Sale to Subsidiary @ 700

Expenses		Income	
COGS	300	Sales	700
Profit	400		
Tax @ 30% - 120			

Subsidiary Company

Sale to Customers @ 800

Expenses		Income	
COGS	700	Sales	800
Profit	100		
Tax @ Nil - Nil			

Overall Tax burden of group is USD 120

Concept of transfer Pricing

It provides conceptual framework for pricing the intercompany transactions

The concept of transfer price primarily revolves around the following three pillars

1. Associated Enterprises
2. Controlled Transactions
3. Arm’s Length determination

- Concept of Associated Enterprises

Associated Enterprises for the purpose of Transfer pricing has been Provided under Article 9 of the Model Tax Conventions, Which reads as follows

"Where,

a) An enterprise of a contracting state participates directly or indirectly in the management, control or capital of an enterprise of the other contracting state,

b) The same persons participate directly or indirectly in the management, control or capital of an enterprise of a contracting state and an enterprise of the other contracting state,

And in either case, conditions are made or imposed between the two enterprises in their Commercial or financial transactions.

- **Related parties for transfer pricing as per Public Consultation Document**
  - A relate party is an individual or entity who has a pre-existing relationship with a business that is within the scope of the UAE corporate tax regime through ownership, control or kinship (in case of natural person)

❑ Delineation of controlled transactions

The economically relevant characteristics or comparability factors to accurately delineate the actual transaction can be broadly classified into the following five categories

1. The Contractual terms of the transaction
2. Functional Analysis
3. The Characteristics of property transferred, or services provided
4. The Economic Circumstances of the parties and of the market in which the parties operate
5. Business Strategies pursued by the parties

❑ Arm’s Length Determination

The five methods outlined in the OECD guidelines are as follows

1. Comparable Uncontrolled Price method
2. Cost plus method
3. Resale price method
4. Profit Split method
5. Transactional net margin method

- **Documentation**

A Transfer Pricing Documentation is

- A document prepared by a taxpayer (company) who has conducted transactions with its related parties in a year to reflect that the arms length principle has been satisfied in the conduct of such transactions

- The three- Tier Documentation requirement
  - Master File
  - Local file
  - Country by Country (cbc)report

Thank You