

UAE Freezone Regime – Important Transfer Pricing Concepts and Considerations



CONTEXT

The UAE Federal Tax Authority (FTA) conducted on June 27th, a comprehensive webinar on the General Principles of Corporate Tax and Business Taxation for Freezones. The session provided valuable insights and clarifications, particularly on some illustrative examples included in the newly released Corporate Tax Guide (CTGFZP1, May 2024).

In line with our recent publication on the link between the UAE Economic Substance Requirements (ESR) and Transfer Pricing (TP), this article brings the light on the importance to explore the connection between the UAE Freezone (FZ) prerequisites and TP.

Asked differently: How can the core TP concepts aid in the interpretation and application of the UAE Freezone regime?

There are numerous ways to address this question, as tax base concepts are generally interlinked. When assessing economic substance and taxpayer conduct from an economic standpoint beyond legal ties, TP plays a crucial role.

Here are a few key TP concepts to consider while assessing the application and/or qualification for the UAE freezone regime:

Functional Intensity

•**Definition:** functional intensity refers to the degree and extent to which a business entity performs and is involved in key operational functions, assumes risks, and utilizes assets in the value creation process. It is a crucial concept in transfer pricing, used to assess the economic substance of an entity's activities and to ensure that profits are allocated in line with the actual economic contributions of each entity within a multinational enterprise (MNE).

•**Application:** Documented through a Functional Analysis Report, it helps in accurately assessing and documenting the economic substance of an entity's activities, ensuring that profits are allocated appropriately based on the actual economic contributions of each entity within an MNE (substance over form approach).

Comparability Analysis

•**Definition:** comparability refers to the process of determining the degree of similarity between controlled transactions (i.e., transactions between related parties within a multinational enterprise) and uncontrolled transactions (i.e., transactions between independent entities) to ensure that the prices charged in respect of the controlled transactions are consistent with the arm's length principle.

•**Application:** A comparability analysis, conducted via benchmarking, measures profitability, level of expenses, etc., against functionally comparable and independent companies. This provides a market reference to quantitatively assess the substance level of a group entity.

Significant People Functions (SPFs)

•**Definition:** SPFs encompass activities and decisions made by individuals that significantly impact business operations, strategic directions, and financial outcomes. The identification and analysis of SPFs are essential for accurately determining where and how value is generated within a multinational enterprise (MNE).

•**Application:** Key components of SPFs include, strategic decision making, operational control, financial management, intellectual property management and human resources management processes. Analysing SPFs helps determine where key managerial decisions are made, influencing profit allocation and compliance with TP rules. SPFs are central to demonstrating economic substance, as they highlight the actual economic activities and decision-making processes that contribute to value creation within the entity.

Additional Considerations

•**Outsourcing with supervision and control:** The UAE FZ regime permits outsourcing of certain activities on the condition of maintaining control and supervision over the outsourced activities. For this purpose, conducting a FAR / SPF analysis helps in assessing the level of control and supervision over the outsourced activity by focusing on the actual business conduct of the entities involved.

•**Arm's Length Principle:** Complying with arm's length requirements and maintaining thorough TP documentation is one of the inherent conditions for qualifying as a Freezone person.

Conclusion

With the rapid evolution of the tax landscape in the UAE, it becomes important and crucial at once to connect the dots between the various tax reporting and assessment requirements and ensure consistency between the different tax concepts and interpretations.

The TP concepts outlined above, not limitative, provide valuable tools for assessing important aspects for the application of the UAE Freezone regime, particularly in determining economic substance and outlining the actual functions of business entities by adopting a substance over form approach.



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