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Decoding Transfer Pricing with GT UAE

TP considerations for Intra-group financing

December 2024

Intra-group financing

The UAE's Transfer Pricing (TP) rules apply to intra-group financing, including those from central treasury entities, parent companies to subsidiaries, between subsidiaries, or from investors to portfolio companies. When financing are provided by a centralized treasury entity, their pricing should generally be separate from any other routine services the entity may also offer.

Economically relevant characteristics for accurate delineation of financing transaction

To accurately determine whether transfer of funds constitutes a loan or debt, the following economic factors shall be considered, depending on the specific circumstances:

01. Borrower's Access to Credit
The borrower's ability to obtain loans from external financial institutions.

02. Repayment Terms
Whether a fixed repayment date exists and if interest is charged.

03. Creditor Rights
The lender's ability to enforce payment of principal and interest.

04. Creditor Status
The lender's position relative to other creditors of the borrower.

05. Loan Security
The presence of financial covenants or collateral

06. Interest Source
The origin of interest payments

07. Fund Usage
The purpose for which the funds are used.

08. Repayment Behavior
The borrower's adherence to repayment deadlines and any requests for extensions.

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Presence of Shareholder activity

As stated in the OECD guidelines, a more complex analysis is necessary when an associated enterprise undertakes activities that benefit multiple group members or the group as a whole. In certain instances, the parent company or a regional holding company solely due to its role as shareholder, rather than as a service provider to other group entities provides funds to its group entities.

Such shareholder activities performed by the shareholder are not considered as intra-group services and do not warrant separate charges to other group members. Instead, the associated costs should be borne and allocated at the level of the shareholder entity itself since these are conducted for its own interest as shareholder(s).

Options realistically available

When considering intra-group financing, independent enterprises would assess all viable alternatives, selecting the option that best aligns with their commercial objectives. This perspective applies to both, the lender and the borrower.

Lenders (shareholder) would consider and evaluate their own financial goals and the overall business circumstances when analysing whether to lend money to any group company. A shareholder would weigh the potential risk and returns involved.

Similarly, borrowers (subsidiary) will assess their ability to repay the loan, taking into account their operational needs, creditworthiness, cashflows, and potential effects on their financial standing and market reputation.

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Determination of arm's length pricing for intra-group financing

The UAE's TP regulations mandate that the financing transactions must be priced in line with the Arm's Length Principle (ALP). Given the abundance of data on third-party loans, the Comparable Uncontrolled Price (CUP) method is often suitable for pricing intra-group loans. Herein, it is important to note that a detailed benchmarking analysis (via public databases) vis-à-vis quotations received from bank/ financial institutions. Hence, it is recommended to maintain a detailed benchmarking analysis (*for additional guidelines please refer to the OECD TP Guide on Financial Transactions and UAE TP Guide issued by FTA in October 2023*). The CUP method typically involves these steps:

Step 01

Analysis of loan terms, including issue date, tenor, borrower's country, currency, options, and interest rate type, to determine appropriate pricing.

Step 02

Analysis of the borrower's credit rating and the implicit group support to assess the lender's credit risk.

Step 03

Identify comparable third-party loans with similar credit ratings and terms.

Step 04

Perform necessary comparability adjustments and calculation of the arm's length range.

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Next steps

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- Identify the inter-company financing transactions prevailing between Related parties
- Conduct a thorough analysis of the economically relevant characteristics for accurate delineating of transactions
- Delineate the Intercompany financing transaction as Debt or Equity in accordance with the said analysis
- If the inter-company financing is characterized as loan or debt, maintain TP documentation, credit rating and benchmarking analysis to justify the interest rate charged as per arm's length principle.

Stay tuned for our next publication on Cash Pooling

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Contact our Transfer Pricing team

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For more details regarding this topic or other Tax issues, reach out to our team of experts on the latest Tax developments within the UAE and the Middle East region.

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