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UAE FTA Clarifies Transfer Pricing Downward Adjustments – Relief for Taxpayers, but with Strings Attached

The UAE Federal Tax Authority (FTA) has recently issued Public Clarification CTP011, providing guidance on one of the more complex areas of transfer pricing compliance under the UAE Corporate Tax regime: downward transfer pricing adjustments in the Corporate Tax Return.

While the clarification confirms that taxpayers can adjust taxable income downwards where related party transactions have not been recorded at arm's length, the message from the FTA is equally clear: if you reduce your taxable income, be prepared to explain it.

> The real question is not only whether a downward adjustment reduces tax, but whether it could have been identified and recorded before year-end.

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Having reviewed the clarification, there are four key themes that stand out.

1. Taxpayers can make downward adjustments without prior approval

One of the more welcome aspects of the clarification is the confirmation that taxpayers do not need to seek prior approval from the FTA before making a transfer pricing adjustment in their tax return. The UAE Corporate Tax system operates on a self-assessment basis and taxpayers are expected to determine whether an adjustment is required to align the outcome of related party transactions with the arm's length principle.

This provides flexibility and is broadly consistent with international transfer pricing practices.

However, taxpayers should not confuse the absence of a pre-approval requirement with the absence of scrutiny.

The clarification expressly notes that any adjustment made in the tax return may be subject to a tax audit.

In practice, a downward adjustment is reducing the tax base. That fact alone is likely to make it an area of interest during an FTA review.

2. Disclosure requirements are broader than many taxpayers may expect

This is arguably the most significant practical takeaway from the clarification.

Generally, related party transactions are disclosed in the Corporate Tax Return only if they exceed the prescribed thresholds. However, the FTA has clarified that where a taxpayer makes a downward transfer pricing adjustment, the relevant transaction must be disclosed regardless of its value, nature or materiality.

Many taxpayers may have assumed that smaller transactions falling below the disclosure thresholds would remain outside the reporting requirements.

The clarification effectively removes that assumption.

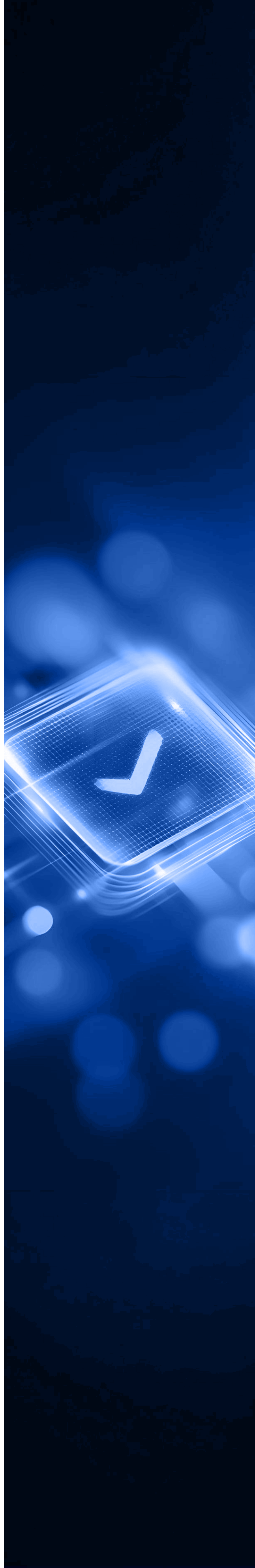
A transaction that would otherwise not require disclosure becomes reportable once a downward adjustment is made.

This is an important point for tax and finance teams. Transfer pricing adjustments can no longer be viewed in isolation from compliance obligations, as a downward adjustment may trigger disclosure requirements even where the transaction itself is relatively small.

3. Documentation will be the deciding factor

If there is one message taxpayers should take away from CTP011, it is that documentation matters.

The FTA has specifically highlighted the need for taxpayers to maintain adequate support where a downward adjustment is made, including:



- A clear rationale explaining why the original pricing did not reflect an arm's length outcome.
- An arm's length analysis, including benchmarking support.
- A reconciliation between the amounts reflected in the financial statements and those reported in the Corporate Tax Return.
- Evidence of corresponding or symmetrical adjustments made by the relevant related parties.

While none of these requirements are surprising from a transfer pricing perspective, their inclusion in the clarification is noteworthy.

The FTA appears to be signalling that a simple journal entry, management estimate or spreadsheet calculation will generally not be sufficient to justify a reduction in taxable income.

A downward adjustment should be capable of standing on its own merits and being defended during an audit several years later.

Questions taxpayers should be able to answer

- Why was the original pricing not arm's length?
- How was the revised arm's length outcome determined?
- What benchmarking analysis supports the position?
- Can the adjustment be reconciled to the accounting records?
- Has the related party reflected a corresponding adjustment where appropriate?

If these questions cannot be answered convincingly, taxpayers may find themselves exposed during an FTA audit.

4. Why TP provisioning matters more than ever

Beyond the immediate guidance on disclosures and documentation, I believe CTP011 sends a broader message about the importance of undertaking a robust transfer pricing provisioning exercise before finalising financial statements.

In many cases, downward transfer pricing adjustments arise because the arm's length outcome was not assessed or reflected when the books were being closed. The result is an out-of-book adjustment in the Corporate Tax Return to arrive at the appropriate taxable income.

While the clarification confirms that such adjustments are permissible, the associated compliance burden can be significant:

- Mandatory disclosure regardless of thresholds.
- Extensive supporting documentation requirements.
- Reconciliations between accounting and tax figures.
- Increased visibility to the FTA.
- Greater likelihood of audit scrutiny.

A robust TP provisioning exercise performed before the accounts are finalised can help identify potential transfer pricing adjustments at an earlier stage. Where necessary, adjustments can be reflected directly in the books, ensuring that both the accounting outcome and tax position align with the arm's length principle from the outset.

From a risk management perspective, this is a far cleaner outcome.

A taxpayer whose financial statements already reflect an arm's length position is generally better placed than one that must explain why a material transfer pricing adjustment was required only at the tax return stage.

Such taxpayers are also likely to benefit from:

- Reduced disclosure complexities.
- Fewer reconciliation challenges.
- Stronger audit defensibility.
- Better transfer pricing governance.
- More efficient year-end tax compliance processes.

The broader lesson

In my view, the real lesson from CTP011 is not simply that downward adjustments are allowed.

Rather, it is that taxpayers should place greater emphasis on proactive transfer pricing governance and year-end TP provisioning.

The most effective transfer pricing adjustment is often the one that is identified and incorporated during the financial statement close process itself.

As the UAE Corporate Tax regime continues to mature and transfer pricing reviews become more sophisticated, taxpayers should consider embedding transfer pricing provisioning into their year-end close procedures. Doing so can significantly reduce the need for post-closing tax adjustments and minimise the audit risks associated with out-of-book transfer pricing corrections.

Why taxpayers should pay particular attention to audit risk

From a risk perspective, downward adjustments and upward adjustments are unlikely to attract the same level of attention.

An upward adjustment increases taxable income and generally results in additional tax being paid.

A downward adjustment has the opposite effect, lowering taxable income and reducing the tax liability.

Combined with the mandatory disclosure requirement, taxpayers should assume that downward adjustments will be visible to the FTA from the outset.

In my experience, whenever a tax authority is given visibility over a position that directly reduces the tax base, the quality of the supporting documentation becomes increasingly important.

Accordingly, taxpayers should ask themselves:

- Can we clearly explain why the original pricing was not arm's length?
- Have we undertaken a robust benchmarking exercise?
- Can we reconcile the financial statements to the tax return?
- Is there evidence of corresponding treatment by the related counterparty?
- Would we be comfortable defending this position during an audit three or four years from now?

If the answer to any of these questions is "no", additional work may be required before filing.

Illustrative examples

Example 1 – Upward Adjustment

A UAE company sells goods to a related party for AED 80, while an arm's length analysis indicates that the appropriate price should have been AED 100.

The company therefore makes an upward adjustment in its Corporate Tax Return to align taxable income with the arm's length outcome. Under the clarification, disclosure would generally only be required if the applicable related party disclosure thresholds are exceeded.

Example 2 – Downward Adjustment

A UAE company sells goods to a related party for AED 120, while an arm's length analysis supports a price of AED 100.

The company may make a downward adjustment in its Corporate Tax Return to reduce taxable income to the arm's length level.

The critical point is that this transaction becomes reportable regardless of value or materiality thresholds.

The taxpayer should also be able to demonstrate:

- Why AED 120 was not arm's length.
- How AED 100 was determined.
- The benchmarking analysis supporting that conclusion.
- The reconciliation between accounting profits and taxable income.
- The treatment adopted by the related counterparty.

Final thoughts

CTP011 is less about creating a new opportunity and more about setting expectations.

The FTA has confirmed that taxpayers may self-assess and make downward transfer pricing adjustments where appropriate. At the same time, it has made it clear that such adjustments come with enhanced disclosure obligations, significant documentation expectations and an increased likelihood of scrutiny

Perhaps the most important practical takeaway is that taxpayers should not wait until the Corporate Tax Return is being prepared to assess transfer pricing outcomes. A robust TP provisioning exercise undertaken during the financial statement close process can help identify and quantify potential adjustments early, allowing arm's length outcomes to be reflected directly in the books and significantly reducing the need for out-of-book tax adjustments later.

Andersen Perspective

> "A downward transfer pricing adjustment may reduce tax, but it almost certainly increases visibility."

Taxpayers should therefore ensure that any such adjustment is supported by a well-documented arm's length analysis, robust evidence, and an audit-ready defence file. More importantly, they should consider whether the adjustment could have been identified and recorded during the year-end close process itself.

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