

TRANSFER PRICING INSIGHT

Managing Connected Person Risks in the United Arab Emirates

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Introduction

For decades, the UAE commercial landscape has been defined by family-owned conglomerates and closely held groups. In this environment, the boundary between corporate treasury and personal wealth has often been fluid, governed more by legacy and trust than by formal tax documentation. However, the introduction of Federal Decree Law has reshaped the tax landscape in the UAE. With the formalisation of the Connected Persons regime, arrangements that were historically left to the discretion of promoters and management are now subject to regulatory and tax scrutiny.

This article explores the shifting regulatory landscape of the UAE's Connected Persons regime. It provides corporate finance teams with technical benchmarking methodologies, practical case study and action points for finance teams to adopt a proactive audit ready strategy.



Why Connected Persons Matter

The UAE business ecosystem is uniquely distinct, characterized by a foundational framework of family conglomerates and entrepreneurial ventures. Within this landscape, Connected Persons including owners, directors, and their relatives frequently hold multifaceted roles, concurrently serving as shareholders, strategic advisors, operational managers, and landlords.

In many jurisdictions, Transfer Pricing (TP) primarily targets cross border transactions between multinational subsidiaries. However, the UAE corporate tax framework introduces a specific domestic consideration. Because the UAE does not have a personal income tax, there is a natural incentive for businesses to extract profits through deductible expenses such as high salaries, management fees, or benefits to owners rather than declaring taxable dividends.

Article 36 of Federal Decree-Law No. 47 of 2022 (the UAE CT Law) is the Federal Tax Authority's (FTA) primary tool to prevent this leakage. It ensures that any payment to a Connected Person is deductible only if it corresponds to the market value of the service provided and is incurred wholly and exclusively for the purposes of the Taxable Person's business.



Connected Persons vs. Related Parties

A common point of confusion for finance teams is the overlap between Related Parties and Connected Persons. They are often used interchangeably but their functions differ:

Related Parties

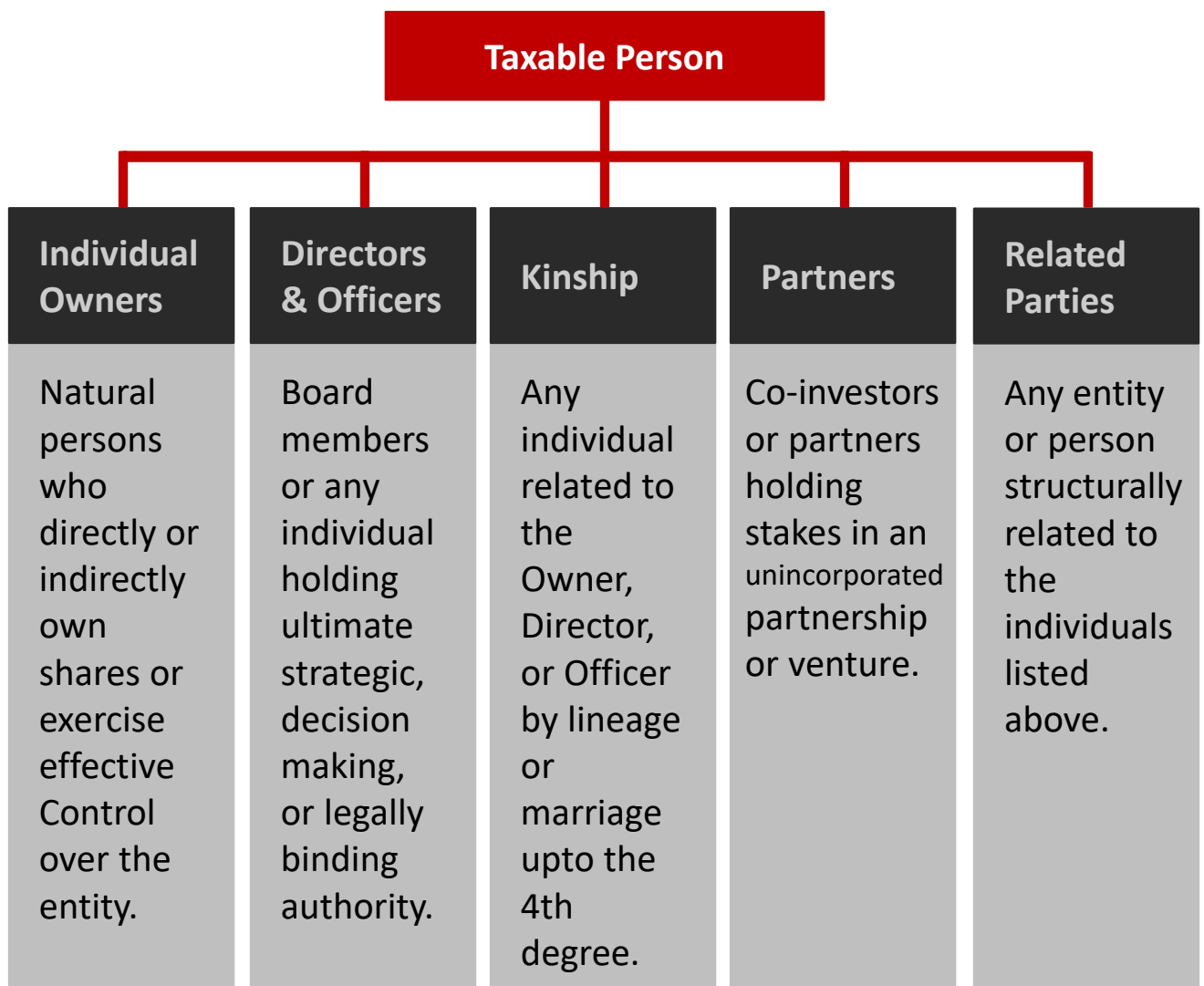
Focuses on the relationship between two or more entities or individuals based on control, ownership, or kinship. Transactions between related parties must be at arm's length.

Connected Persons

A narrower definition focusing on the relationship between a Taxable Person (the company) and the Natural Persons who exert direct influence over it.

Public Clarification CTP010: Where a natural person qualifies as both a Related Party and a Connected Person, they must be treated as a **Related Party** for UAE Corporate Tax reporting purposes.

Who is a Connected Person?



Public Clarification CTP010 - The FTA has clarified that, for Connected Person purposes, the status of a Director or Officer is determined based on substance rather than a formal job title. This definition applies to any natural person on the Board (or its equivalent) or any individual holding ultimate strategic, decision-making, or legally binding authority. From a compliance perspective, businesses must look past organizational charts to evaluate actual decision making behaviour, ensuring any payment or benefit is benchmarked to Market Value and aggregate payments exceeding AED 500,000 per connected person is accurately disclosed in the tax return.

Transactions under Scrutiny

From a TP perspective, risk is driven not only by the quantum of a payment but by the underlying nature of the transaction and the substance behind it. The following areas represent high risk zones for UAE taxpayers:

01

Executive Salaries and Bonuses

In many UAE SMEs, the owner's salary is determined by cash flow requirements or historical drawings rather than a formal HR grading system. Under CT, an excessive monthly salary for an owner/manager who rarely handles daily operations will be immediately flagged. The FTA will look for evidence of actual services rendered and compare the compensation to what a non-connected professional manager would earn.

02

Directors' Remuneration and Sitting Fees

Director fees must reflect the time commitment and the complexity of the business. Excessive fees paid to family members who sit on the board but lack relevant industry expertise are highly susceptible to disallowance.

03

Shareholder Compensation and Benefits

This includes soft benefits funded by the business like company-paid personal travel, luxury vehicles, housing allowances, or private insurance policies for family members. If these are not part of a standardized employee benefit policy, they may be deemed non-deductible.

Benchmarking

The CT Law mandates that payments to Connected Persons must meet the Market Value standard. While this is synonymous with the ALP, applying it in the UAE presents unique hurdles due to data limitations.

The UAE lacks a deep pool of public salary data or detailed financial filings for private companies. Unlike the US or Europe, where public databases are readily accessible, UAE TP professionals might have to look for alternate sources.

01

Internal Comparable Uncontrolled Price (CUP)

The strongest defence is often an Internal CUP. If the company employs a C-suite executive who is not a Connected Person, their salary and bonus structure serves as a perfect benchmark for the Connected Person, provided their roles and responsibilities are comparable.

02

Specialized salary surveys

Generic recruitment marketing reports are rarely sufficient to survive an FTA audit. Taxpayers should utilize specialized, industry specific salary surveys that provide verified quartiles and deciles of compensation tailored to specific UAE sectors.

03

Shareholder Compensation and Benefits

Where no direct comparable exists, practitioners may rely on a detailed functional analysis by documenting the Connected Person's actual role, time allocation, decision-making authority and risk assumption to justify the compensation level on a cost-plus or value-based basis.

Commercial Rationale Test

Benchmarking isn't just about proving the price; it is about proving the commercial rationality. Taxpayers must satisfy two core tests:

01

Benefit Test: Did the business actually need this service?

02

Quantum Test: Is the amount paid commensurate with the economic value received?

If a business pays a Connected Person for strategic consulting, the FTA will expect to see supporting documentation such as meeting minutes, deliverables, reports, or emails proving that the consulting actually took place and benefited the business.

TP Documentation: Beyond the Thresholds

The UAE has established specific thresholds for TP documentation (Master File and Local File):

- **Standalone Revenue:** **AED 200 million** or more in the relevant Tax Period, or
- **Group Revenue:** Part of a Multinational Enterprise (MNE) Group with consolidated revenue of **AED 3.15 billion** or more.

Even if a taxpayer falls below these thresholds, the obligation to comply with the ALP still remains. SMEs are not exempt from the Market Value requirement. In the event of a query, the FTA can request sufficient information to support the arm's length nature of transactions. For these businesses, a robust TP Memo or a simplified benchmarking study is a vital requirement.

PRACTICAL CASE STUDY

UAE Retail Group — Founder Compensation

Scenario: A UAE based retail group is 100% owned by a founder who acts as the Chairman. The company pays the founder a strategic guidance fee of AED 5 million annually. The founder spends roughly 10 hours a month on business matters. The company's net profit is AED 20 million.

TP ANALYSIS

25% of net profit

The fee represents 25% of total net profit for minimal time commitment. Local benchmarking for independent, non-executive chairmen in the UAE retail sector suggests a market range of AED 300,000 to AED 600,000 per annum.

RISK

AED 4.4M disallowed

The FTA is likely to disallow AED 4.4 million of the deduction, recharacterizing it as a dividend. This results in an additional tax liability of 9% on the disallowed amount, plus potential late payment penalties.

SOLUTION

Restructure compensation

The group should proactively restructure the compensation into a mix of a benchmarked salary for actual board duties and standard dividends (which, while non-deductible, are tax neutral for the corporate entity).

Action Points for consideration

Map All Connected Person Relationships

Conduct a comprehensive, full inventory of all payments made directly or indirectly to owners, directors, officers, family members (up to the fourth degree), and entities they control. This registry must account for all benefits alongside monetary payments.

Formalize Agreements

Every transaction with a Connected Person must be backed by a written contract. This contract should mirror third-party standards stating clear deliverables, payment terms, and termination clauses.

Establish Formal Compensation Policies

Implement documented HR grading systems and benchmarking structures that apply objectively and equally to both connected and non-connected employees.

Conduct a Benchmarking Study

Before the first CT return is filed, perform a benchmarking study on all executive compensation and management fees. If your figures sit outside the standard interquartile range, adjust your pricing policies. Do not wait for a formal query from the tax authority before initiating benchmarking.

Maintain Contemporaneous Documentation

Maintain records of board resolutions and HR committee minutes that justify salary increases or bonus payouts to Connected Persons. Retain signed service agreements, timesheets, and professional correspondence that substantiate every payment.

Distinguish Salary from Dividends

Work closely with qualified tax advisors to restructure historically excessive remuneration packages into a legally compliant, defensible mix of market-benchmarked salaries and formal dividends.

Separate Personal and Business Expenses

Ensure that personal lifestyles are completely separated from the company's profit and loss statement. Personal travel, family insurance, and non-business assets must be flagged, isolated, and excluded from tax deductible corporate expenses.

CONCLUSION



In the UAE, TP is no longer a check-the-box exercise for large companies. It is a fundamental pillar of corporate governance for every family office and local companies operating in the region.

The rules on Connected Persons are designed to ensure that the UAE's tax base is protected from artificial erosion. However, for the well-prepared taxpayer, these rules present an opportunity to professionalise internal operations, align compensation with global standards, and reduce exposure to costly disputes with the FTA.



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