



Newsletter No. 93 (EN)

**Synopsis on Transfer Pricing
in Hong Kong, Thailand and Vietnam**

September 2011

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I. Introduction

Transfer Pricing becomes highly important as soon as a business entity decides to expand its operations across international borders. *Transfer Pricing* deals with structuring the price of transactions between related parties within a group of companies.

Every Multi National Enterprise (“MNE”) wishes to minimise its tax obligations in order to maximise its overall profits. In principal, multi-corporate businesses have to pay tax in their host countries, based on the profit share which arises in (or is allotted to) the respective business in such host country (e.g. Thailand, Hong Kong or Vietnam). These host countries can differ in various respects e.g. tax systems, customs duties, currency exchange rates, legislation etc. As a result, *Transfer Pricing* also affects revenue and customs authorities, investors, creditors and the like.

The obligation to comply with national and international tax regulations regularly conflicts with the goal of a tax-efficient allocation of profits within MNE. This is primarily because while the enterprise will take a global perspective, the respective tax legislation is usually nationally focused.

Thus, anticipatory business and corporate tax planning which takes both concerns into consideration is vital.

II. Different Methods of Price Calculation

In most countries *Transfer Pricing* regulations are built around the core concept of the *Arm’s Length Principle*. According to this principle the transaction (or transfer) price charged between affiliated companies must be the same as the price which would have been charged to an independent company.

There are six generally accepted methods by which to compute the transfer price so that it accords with the Arm’s Length Principle. These six methods can be separated into two categories. Traditional methods (Transaction Methods) focus on the facts of the actual transaction in question in order to compute an appropriate transfer price (*bottom-up method*). Other methods (Profit-based Methods) utilise the profit generated by comparable companies when undertaking similar transactions in order to determine the price of the intercompany transaction in question (*top-down method*). The former methods are generally considered to be more accurate and appropriate.

1. Transaction Methods (TM)

- (Comparable Uncontrolled Price Method (CUP) and Comparable Uncontrolled Transaction Method (CUT)

Both transaction methods compare the price of the intercompany transaction with the price of an identical or sufficiently similar independent transaction (e.g. the price charged in transactions between independent parties).

- **Cost Plus Method**
This method summarises all the original costs of the unfinished product and then adds the customary net profit for such transactions for calculating the applicable transfer price.
- **Resale Minus Method**
Under this method the transfer price is computed by deducting the customary profit margin from the respective resale price. The customary profit margin is calculated on a partial cost basis.
- **Profit Split Method (PS)**
Profit Split is based on the total profit a MNE gains from an intercompany transaction. This profit is divided according to the functions and risks which each related party adopted, just as it would be in the case of a transaction between non-related parties.
- **Transactional Net Margin Method (TNMM)**
The net profit gained from the intercompany transaction is analysed in relation to an appropriate basis (cost, turnover, assets etc) and the resulting profit margin is checked against comparable independent transactions (This method is similar to Resale Minus or Cost Plus, thus strictly-speaking it is a bottom-up method as well).

2. Profit-based Methods (PBM)

- **Comparable Profit Method (CPM)**
This method is based on the operating profit gained from the intercompany transaction and the allocation of this profit to the respective business segment which is then defined and subdivided as precisely as possible. In order to compare these profits, the profit margin of comparable independent businesses are used for each business segment. A target operating result can be computed by applying this method to the total profit of the multi-national organisation. By comparing this result with the individual entities' actual financial statements, it can be assessed whether the correct transfer price was used.

*We hope that the information provided in this brochure was helpful for you.
If you have any further questions please do not hesitate to contact us.*

LORENZ & PARTNERS Co., Ltd.

22nd Floor Sathorn City Tower

175 South Sathorn Road, Bangkok 10120, Thailand

Tel.: +66 (0) 2-287 1882

E-Mail: info@lorenz-partners.com

Synopsis:

Jurisdiction	Hong Kong	Thailand	Vietnam
Competent Authority	Inland Revenue Department	Revenue Department (Krom Sumpakorn)	Ministry of Finance, General Department of Taxation
Organisations Affected	<ul style="list-style-type: none"> – Related parties – Parties controlled by the same third party 	<ul style="list-style-type: none"> – Voting rights, amount of shares held – Parties controlled by the same third party 	<ul style="list-style-type: none"> – One party controls at least 20% of the other's equity. – Both parties are indirectly or directly controlled by the same third party. – One party provides a guarantee or loan to the other that constitutes (i) 20% or more of the investment capital, or (ii) more than 50% of the total value of the long and medium term loans of the said other enterprise. – Family relationship
Legal Sources	<ul style="list-style-type: none"> – No special transfer pricing rules – Anti-Circumvention rules: includes transfer prices as well, Sec. 20 (2) IRO 	<ul style="list-style-type: none"> – In General: 65 to (4), (7), 65 to (13), (14), (15) Revenue Code – Specific: Departmental Instruction Paw 113/2545 (Appendix A1) 	<ul style="list-style-type: none"> – Law on Corporate Income Tax 2003 – Decree 164/2003/ND-CP – Circular 117/2005/TT-BTC – Circular 66/2010/TT-BTC
Methods	<ul style="list-style-type: none"> – TM: CUP, Resale Minus, Cost Plus – PBM: PS, TNMM, PM – Others 	<ul style="list-style-type: none"> – TM: CUP, Resale Minus, Cost Plus – PBM: PS, TNMM, CPM – Others 	<ul style="list-style-type: none"> – TM: CUP, Resale Minus, Cost Plus – PBM: PS, CPM – “Best Method” Rule
Documentation	No special regulations	<ul style="list-style-type: none"> – No legal obligation but necessary in practice – Dep. Instr. Clause 4 – To be performed at the date of the transaction – Submission on request – Effect: burden of proof reversed 	<ul style="list-style-type: none"> – Legal obligation – To be submitted with tax returns; – On request after 30 days; One-time extension of deadline is possible – Fine applicable for non-compliance
Reporting Obligation	No special reporting obligations	No special reporting obligations	Reporting with tax return
Sanctions	Up to 300% of the underpaid tax plus interest (However low tax audit activity)	See ordinary tax laws; surcharge of 1.5% monthly up to 100% additional tax and up to 100% penalty	See ordinary tax laws
Advance ruling	Possible: www.ird.gov.hk/eng/pdf/e_dipn31.pdf	Possible	De facto not possible

Appendix: Departmental Instruction (Thailand)

Departmental Instruction

No. Paw. 113/2545

Subject: Corporate Income Tax - The Determination of Transfer Price based on the Market Price

To provide assessment officials with a guideline in examining and advising taxpayers on the calculation of a juristic corporation's or partnership's net profits under Section 65 of the Revenue Code regarding the determination of transfer price based on the market price, the Revenue Department have given the following instructions :

Clause 1 A juristic corporation or partnership incorporated under Thai law, or incorporated under a foreign law (under Sections 66 and 76 bis of the Revenue Code) shall calculate the net profits of income for tax purposes under Section 65 of the Revenue Code by taking into account revenue derived from of businesses carried on in an accounting period and deducting expenses in accordance with conditions prescribed under Section 65 bis and 65 ter of the Revenue Code.

The calculation of revenue and expenses under the first paragraph shall apply on accrual basis, whereby all revenue, derived in any accounting period, even if not received in that period, shall be included as revenue of that period, and all expenses relevant to such revenue, even if not paid in that period, shall be included as expenses of that period.

Clause 2 If a juristic corporation or partnership under Clause 1 enters into a transaction with a contracting party receiving no consideration or receiving consideration at the amount less than the market price without justifiable reason, or enters into a transaction with a contracting party deriving expenditures higher than the market price without justifiable reason, and the juristic corporation or partnership does not adjust the revenue and expenses based on the market price for income tax purposes, then the assessment official shall have the power to assess the revenue and expenses based on the market price.

The term 'market price' under the first paragraph means the value of consideration, service fee or interest that an independent contracting party acting in good faith would charge in a commercial manner for the same characteristics, categories or types of property, service or loan that are transferred or provided on the date of the transfer of property, provision of service or lending of fund.

The term 'independent contracting parties' means contracting parties with no direct or indirect relationship in management, control, or capital between themselves.

Clause 3 In computing revenue or expenses for the purposes of determining the market price, one of the following methods may be selected :

(1) Comparable Uncontrolled Price Method - By comparing the price charged in a commercial manner, provision of service, or interest between independent contracting parties where the

same categories and types of property are transferred, or of service or loan are provided under the same or similar conditions.

(2) Resale Price Method - By taking into account the consideration (price) for the transfer of property or service fee where the purchaser of goods or service resells to other persons who are independent contracting parties and deducting it with an appropriate gross profit.

Appropriate gross profit shall be calculated by multiplying the above resale price of the property or service by the gross profit margin derived from the transfer of the same characteristics, categories or types of property or service to independent contracting parties.

Example

Company G sells goods to Company A, an associated company, at the price of 50 Baht. Company A then resells such goods to Company B, an independent contracting party, at the price of 90 Baht. Assume that the gross profit margin arising from the sale to independent contracting parties within the market selling the same goods is 20 per cent of resale price.

The market price at which Company G sells goods to Company A is calculated as follows:

Resale price to an independent contracting party	=	90 Baht
Less Gross profit (90 x 20%)	=	18 Baht
Market price	=	72 Baht

(3) Cost Plus Method - By taking into account the cost of property or service, which is sold to the purchaser of goods or service and marking it up with an appropriate gross profit. Appropriate gross profit shall be calculated by multiplying the above cost of property or service with the gross profit margin derived from the transfer of the same characteristics, categories or types of property or service to independent contracting parties.

Example

Company G sells goods to Company A, an associated company, at the price of 75 Baht. The cost of goods sold is 50 Baht. Company K sells the same goods to Company B, an independent contracting party, at the price of 100 Baht. The cost of goods sold is 60 Baht. Therefore, gross profit margin arising from the sale to independent contracting parties is 40 per cent of the selling price, or 66.67 per cent of cost of goods sold (40/60).

The market price at which Company G sells goods to Company A is calculated as follows :

Cost of goods sold to associated company	=	50.00 Baht
Plus Gross Profit (50 x 66.67%)	=	33.34 Baht
Market price	=	83.34 Baht

(4) Other Methods - If methods (1), (2) and (3) cannot be applied in calculating revenue or expenses in order to derive the market price, service fee or interest, other methods that are internationally accepted and are commercially appropriate to the facts and circumstances in respect of the transfer of property, provision of service, or lending of fund may also be applied.

Clause 4 In a tax investigation by an assessment official regarding the methods in calculating revenue and expenses for the purposes of determining the market price under Clause 3 for a ju-

ristic corporation or partnership under Clause 1, the assessment official shall consider the following documentation, which is actually prepared by the juristic corporation or partnership during each stage of a transaction and is retained at its office.

- (1) Documentation indicating the structure and relationship between business entities within the same group, including the structure and nature of business carried on by each entity;
- (2) Budgets, business plans and financial projections;
- (3) Documentation indicating taxpayers' business strategies as well as the reasons for adopting such strategies;
- (4) Documentation indicating sales and operating results and the nature of its transactions with business entities within the same group;
- (5) Documentation indicating the reasons for entering into international transactions with business entities within the same group;
- (6) Pricing policies, product profitability, relevant market information and profit sharing of each business entity. Consideration should be given to functions performed, asset utilized and risks assumed of the related business entities;
- (7) Documentation supporting selection of a particular method;
- (8) Where several methods are considered, documentation indicating details of the methods apart from the method stated in (7) and the reasons for rejection of these methods. These documents should be created at the same time the decision is made to select the method in (7);
- (9) Documentation used as evidence indicating the negotiation positions taken by the taxpayer in relation to the transaction with business entities within the same group and the basis for those negotiating positions;
- (10) Other related documentation in determining the transfer price (if any).

The term 'business entities within the same group' under the first paragraph refers to business entities in a group of juristic corporations or partnerships with direct or indirect relationship in management, control, or capital between themselves.

If a juristic corporation or partnership under Clause 1 prepares documents and evidence according to the first paragraph with sufficient details to show that the method of calculating revenue and expenses in deriving the market price of a juristic corporation or partnership under Clause 3 is justified and appropriate, then the assessment official shall adopt that method of calculating revenue and expenses for the purposes of determining the market price of that juristic corporation or partnership.

Clause 5 If a juristic corporation or partnership under Clause 1 wishes to enter into an advance pricing arrangement with the Revenue Department for any transaction with its dependent contracting party, then the juristic corporation or partnership shall submit a request for an advance pricing arrangement in writing with relevant documentation attached to the Director-General of the Revenue Department in order to set out the rules, methodologies, and conditions which the corporation or partnership has to follow under the advance pricing arrangement.

Given on the 16th Day of May B.E. 2545
Suparut Kawatkul (Director-General of the Revenue Department)