

# Call in for a Coffee

RSM Nelson Wheeler, Thailand

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## Introduction

Welcome to RSM's seventh edition of "Call in for a Coffee". One of the most contentious and often least understood issues facing foreign companies establishing an overseas office in Thailand and elsewhere is that of transfer pricing ("TP"). This edition summarises the TP mechanism, the potential dangers to companies of using TP to maximise profits by tax avoidance and obtaining tax rebates, the Thai TP legislation and the need for companies to develop a TP strategy.

## What is Transfer Pricing?

### Definition

TP is the mechanism by which a company in one country transfers (sells) products, services or intellectual property to a related company in another country with the price paid being the transfer price.

### Transfer Pricing Calculation

The Transfer Price determined may be a totally arbitrary figure bearing no relation to the cost incurred, the business operations or added value. Often the Transfer Price is set at a level to reduce or cancel tax paid by the parent company or even to receive rebates.

### Tax Avoidance

It is often possible to avoid tax by adjusting profits until the government of a particular country legislates to prevent such practices. There are two (2) sides to this issue insofar as it is possible for a holding/parent company to benefit as the tax paid to a host-country may increase, whilst the tax paid to the home country may decrease. Accordingly, one government's loss may become the other government's gain.

## Does Thailand have Transfer Pricing Legislation?

In May 2002, the Thai Revenue Department (RD) issued Department Instruction No. Por 113/2545 (Por 113) principally for the purpose of providing guidance to revenue officers when examining the TP arrangements of Thai companies.

## Transfer Pricing Review (TPR)

We are informed that the Thai Revenue Department ("RD") has recently focussed its attention on TP as part of its policy to increase revenues from foreign companies that **blatantly** attempt to avoid or reduce their tax liabilities in the Kingdom by implementing "sham" arrangements.

A Transfer Pricing Review (TPR) of many foreign companies operating in Thailand may be contemplated by the RD in the near future. **RSM strongly advises** that foreign companies with TP issues should not only comply with the expectations of the RD (as set out in Por 113) but that the outcomes from related party transactions should have a proper business purpose.

### Purpose of Business Factor

It is apparent that most companies review their compliance in the light of the "list of 10" documents contained in Por 113, but do not consider the commercial realism or "purpose of business" factor. This is because there is no specific reference to this in Por 113. Reference to the commercial realism factor is found in Section 65 ter (13) of the Revenue Code which prescribes that any expenses not expended for the "purpose of business" are not allowed as expenses.

### Transfer Pricing Strategic Thinking

**RSM strongly recommends** that in order to reduce the risks of a TPR and tax adjustment by the Revenue officers, it is important to have a TP strategy.

### Potential Strategic Courses of Action

#### 1. Enhance the Documentation

Review any existing documentation in the light of Por 113, which includes the "list of 10" documents. This would include an assessment of the following:

1. Does your overseas parent produce the documentation? If so, does it need to be tailored to the Thai requirements?
2. Due to "market price" being referenced to transactions between "independent contracting parties", has the company used the Comparable Uncontrolled Price method as a primary method or at least a backup method?

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3. Does the application of the methodology section adequately explain your company's position either within or outside the comparability range?

4. Is the comparability analysis based on the latest financial data available?

Where the financial performance of a company is poor, by not considering other strategies discussed below, the company is relying on other companies being ranked higher in terms of audit risk. By adopting this strategy, a company may lose control of the TPR exercise and the possible outcomes to the RD.

## 2. Make a presentation to the RD on the company's financial performance

If the company's lack of performance is the key reason for the TPR, this should be demonstrated to the RD explaining the mitigating factors such as, for example, local management decisions, extraordinary items or external economic factors.

## 3. Prepare specific issue documentation

Alternative 3 envisages that documentation is prepared that defends the financial position of the company. The RD is presented with comprehensive documents that, prima facie, set out a likely defence of the company. This may deter the RD from carrying out further follow up action.

## 4. Prepare specific issue documentation

This may circumvent the review process and focus in on the concerns that the RD may have.

## 5. Consider an Advance Pricing Agreement (APA)

The advantage of an APA is that where a company assesses its risk of investigation as high, an APA may be used to minimise the risk and achieve certainty going forward. The RD may be keen to achieve certainty for a company going forward ignoring possible past transfer pricing transgressions.

## 6. Adjust Transfer Prices

The company concludes that transfer prices are not at "market price" or that settlement with the RD is preferable to a full investigation. Given the lack of certainty in relation to the determination of what is "market price", this alternative must be considered as a last resort. Adjusting prices going forward is not as extreme as adjusting prior income tax returns.

## Conclusion

Alternatives 2 to 5 acknowledge a transfer pricing risk and the desire to manage that risk by adopting a strategy that embodies a willingness to work with the RD in order to circumvent any protracted RD investigation. Any of these alternatives are preferable to alternative 1 (a passive action) and strategy 6 (an extreme action).

Accordingly, it is advisable for companies to carry out the following steps:

1. Assess the potential risk issues;
2. Evaluate those risks in terms of likely RD follow up action; and
3. Choose the most appropriate strategy to minimise the risk.

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## Free Consultation

If your company has any transfer pricing issues requiring clarification or alternatively, whether you need assistance with legal, financial, taxation, accounting, auditing or other problems that require innovative solutions, please contact the RSM team and "**Call In For A Coffee**" for a free consultation.

Translation of business ideas into realistic projects requires expert advice. RSM can assist you in formulating practical solutions to obstacles which may be encountered while undertaking business in Thailand

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