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TRANSFER PRICING IN THAILAND

Transfer pricing is one of the most publicized international tax issues in the developed world today. The reason for this is due to the political and media attention on the tax affairs of multinational companies such as Google, Apple, Amazon and Starbucks and particularly how the majority of the profits of these companies are recognized, for tax purposes, in low or no tax countries.

This political and media scrutiny, coupled with the OECD's Base Erosion and Profit Shifting ("BEPS") initiatives are making transfer pricing a hot topic and one that every multinational needs to be well aware of.

So what is transfer pricing? In its simplest form, transfer pricing involves the attribution of profits derived by a multinational from its value-chain between the segments of the multinational that contribute to that profit. Where those contributions occur in more than one country, the issue becomes one of what portion of the profit should be attributed to which country. Transfer pricing relates not only to the transfer of products between countries but also the provision of value, by way of value-adding services, the provision and use of funding as well as valuable intangibles such as patents, know-how and brands. The international transfer pricing rules are governed by the OECD (and generally apply to both OECD and non-OECD members: there is also a United Nations version of the rules) and seek to apply the "arm's length principle". The arm's length principle requires the various members of a multinational group to interact with each other (for tax purposes) as if they were separate unrelated entities. There is an expectation that taxpayers prepare and maintain documentation that evidences the analysis involved in determining the arm's length pricing.

Why is it relevant for tax authorities (and therefore taxpayers)? Tax authorities are concerned about multinationals and their transfer pricing practices because they can reduce a country's corporate tax collections. The Google, Apple, Amazon and Starbucks cases are all about whether those companies are paying an arms' length level of tax in the various countries in which they operate or are using transfer pricing methodologies to shift profits to tax advantageous locations. The attribution of profits is determined by the level of economic activity – based on functions, assets and risks – in each tax jurisdiction. This is why the multinational's transfer pricing documentation is so important because it sets out the appropriateness of the pricing and the arm's length nature of the profit attribution by reference to the company's functions, assets and risks. When tax authorities disagree with the position a taxpayer has taken, they can adjust the taxable profits and/or conduct an audit, which a taxpayer would obviously prefer to avoid. On top of any adjustment, penalties and interest can be imposed for getting it wrong.

In the case of Thailand, when it comes to transfer pricing and tax law in general the Thai Revenue Department ("TRD") has focused on gaining the co-operation of taxpayers in enforcing the arm's length principle. However, since 2006, there has been a significant increase in transfer pricing audit activity as the TRD seeks to increase its revenue collections to fund infrastructure spending, amongst other objectives.

The TRD use certain criteria to identify taxpayers that they would like to select for a transfer pricing investigation. These

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include companies with high levels of transactions with related parties, those that have been in sustained losses and those transacting with companies located in tax havens. These factors do not mean a taxpayer is in breach of transfer pricing rules, just that there is a valid reason to investigate their activities further.

We have observed a sharp increase in investigations and audits involving management service fee payments made to non-resident service providers. Under the TRD's scrutiny, the burden of proof lies with the taxpayer who is expected to show that the expenses charged by the foreign service providers are reasonable based on what has in fact been provided; and that the expenses are related to the business and generation of profits for the Thai service recipient. This is quite a standard test in most jurisdictions but is applied quite aggressively in the case of the TRD.

What should taxpayers be doing? Taxpayers need to make sure that they are proactively managing their transfer pricing position and that they are not simply relying on instructions from head office in this regard. Taxpayers need to ensure that they have the relevant legal agreements and invoices to support their inter-company transactions; that their pricing practices are consistent with the company's pricing policies; and that they can demonstrate that their inter-company transactions result in arm's length outcomes. They also need to ensure that they have the documentation expected of them by the local tax authority.

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