Preface

International business transactions have increased dramatically over the years. Investment has increasingly expanded at an unprecedented rate in many countries. These international business activities have led to the formation of a group of companies with mutual interests which is known as "multinational enterprise" (MNE). Companies within the MNE may trade goods or services with one another by means of "Transfer Pricing".

The Revenue Department is aware of practical problems in calculating the market price. Therefore, the booklet "Determination of Market Price for Multinational Enterprises" is accordingly written to provide businesses with guidelines in determining acceptable market prices in accordance with international principles. The preparation of adequate documentation will save time and reduce the burden of proof on the market price to the Revenue Department.

This booklet comprises of four parts. Part I describes related tax laws in determining the market price. Part II explains methodologies in calculating the market price, whilst Part III provides process in establishing the market price. Lastly, the list of documentation that should be kept is suggested in Part IV.

The Revenue Department of Thailand
June 2002

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Multinational Enterprises and Transfer Pricing

International business transactions have increased dramatically over the years. Investment has increasingly expanded at an unprecedented rate in many countries. These international business activities have led to the formation of a group of companies with mutual interests which is known as "multinational enterprise" (MNE). Companies within the MNE may trade goods or services with one another by means of "Transfer Pricing".

- **Transfer Pricing** is the price set between related contracting parties for goods or services which may deviate from the market price.

- **What is a Market Price or Arm's Length Price?**

A market price or arm's length price is the price of consideration, service fee, or interest which independent contracting parties 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.

Part I

Tax Legislation on Transfer Pricing

In order to prevent the evasion of taxation caused by manipulated transfer pricing within the MNEs, tax authorities can price goods and services by applying the provisions of Section 65 bis (4) (7), Section 65 ter, and Section 70 ter under the Revenue Code, Double Tax Agreements between Thailand and other countries, as well as Standard Accounting No. 37 and 47. Moreover, the Revenue Department recently issued Departmental Instruction No. Paw 113/2545, - *Subject : Corporate Income Tax - The Determination of Transfer Price based on the Market Price,* in order to provide tax officials with a standardized guideline on how to determine the transfer price based on the market price. The Departmental Instruction is divided into the following sections.

1. Criteria for the Calculation of Net Profits of Juristic Partnerships or Corporations for Income Tax Purposes
2. Assessment of Revenue and Expenses Based on the Market Price
3. Methodologies in Determining the Market Price
4. Documentation that should be prepared
5. Advance Pricing Arrangements (APAs)

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 the Thai law, or incorporated under a foreign law, under Sections 66 and 76 bis of the Revenue Code shall calculate net profits for income tax purposes under Section 65 of the Revenue Code by taking into account revenue derived from or in consequence 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 the 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 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 is independent to the contracting parties 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 to the price charged in a commercial manner for consideration, 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 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 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 of consideration, 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 juristic 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 together with relevant documentation 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

Part II

Methodologies in Calculating the Market Price

The transfer pricing methodologies which are accepted internationally are as follows :

1. Traditional Transaction Methods
   - Comparable Uncontrolled Price Method
   - Resale Price Method
   - Cost Plus Method

2. Transactional Profit Methods
   - Profit Split Method
   - Transactional Net Margin Method

Part III

Process in Establishing the Market Price

Taxpayers are advised to apply four steps to implement a process for setting the market price. The four steps link the arm's length principle, questions of comparability and the transfer pricing methodologies into a process that takes into account of the facts and circumstances of the taxpayers and assists in the collection and analysis of information as well as the documentation of the results and process of each step.

<u>Step 1</u> Characterise the international dealings between related parties.

1. The identification of the scope, type, value and timing of international dealings with related parties. In this regard, the following details need to be made.
   - 1.1 Organisational structure and relationship between business entities within the same group, operation plans, minutes of the meetings of board of directors or executives;
   - 1.2 External factors affecting the business such as nature of industry and market conditions, structure and nature of the competition, distributors, customers, new competitors, and other economic factors affecting the business.
   - 1.3 Intangible assets used and their ownership; and
   - 1.4 Details of the transactions with related parties, describing characteristics of property and service, value, and other contractual terms.
2. The identification of the economically important activities and description of operations of each business entity.
   - 2.1 Functions performed, indicating the economically significant functions or activities;
   - 2.2 Assets used, both tangible and intangible assets including human resources and nature and extent of its use; and
   - 2.3 Risks assumed by each of the parties.

<u>Step 2</u> Select the most appropriate method in calculating the market price

1. Identify the data that may establish the market price for the transaction between related parties.
2. Determine the most appropriate methodology in calculating the market price based on the facts and circumstances of the particular case.

<u>Step 3</u> Apply the method selected in Step 2 and calculate the market price.

The objective of Step 3 is to apply the methodology selected in Step 2 to calculate the market price that is reasonable and credible. It is necessary to consider the data obtained from Step 1 to enable comparability to be properly assessed.

Taxpayers should:

1. Adjust data to eliminate material differences, for example accounting policies of each country may be different.
2. Group data in the same format.
3. Extend the analysis over 3 - 5 years in order to observe irregularities which may affect the business.

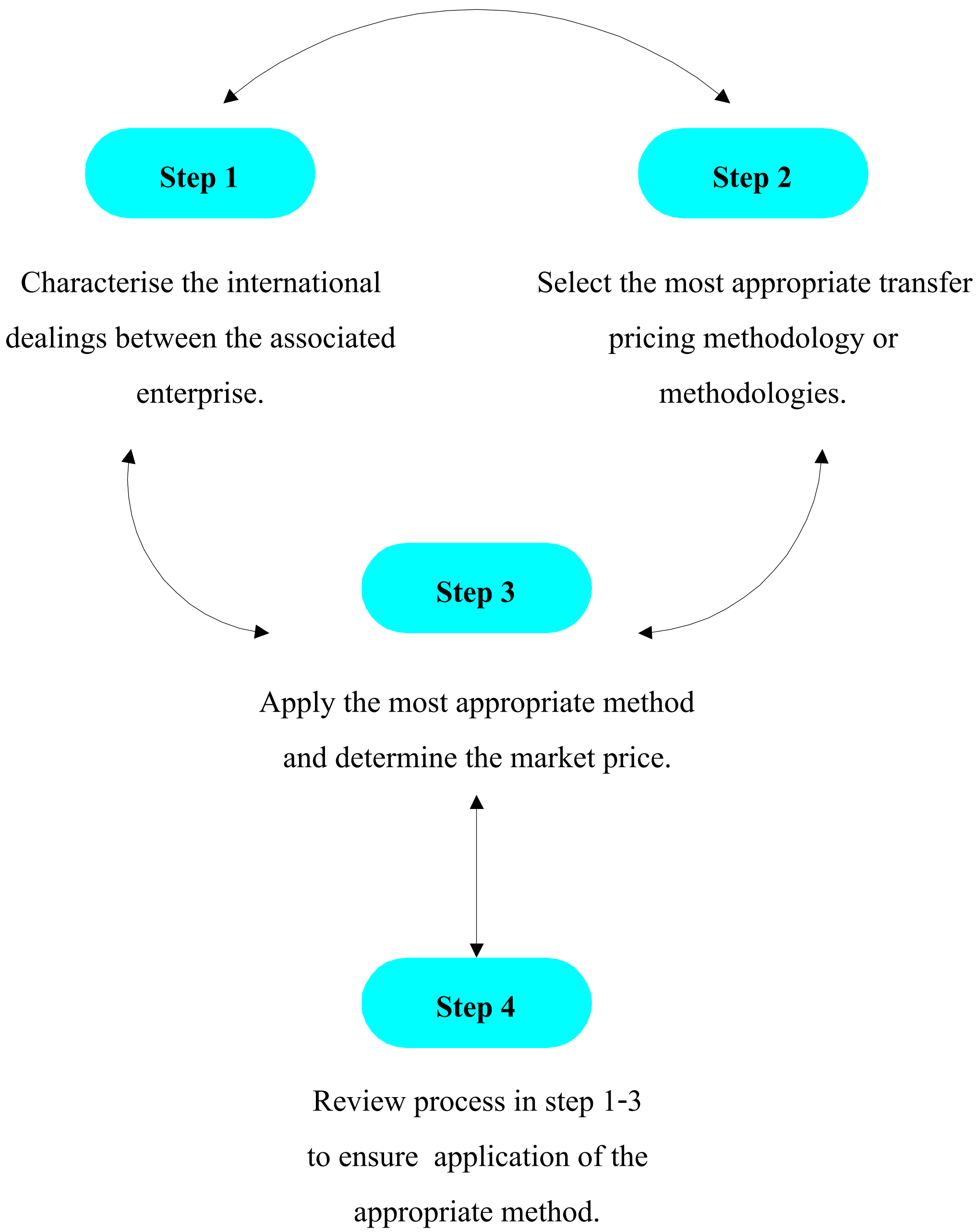
The market price calculated under this step may be a single price or a range of results.

Step 4 Review the process from Steps 1 - 3 to ensure the use of the appropriate methodology.

After the market price was decided under Step 3, whether in the form of a single price or a range of results, the taxpayer shall review the process in Steps 1 - 3 to ensure that the selected methodology is appropriate. If the methodology is appropriate he shall apply the calculated market price to the present and future transactions with related parties.

Nevertheless, if material changes occur that affect the calculated market price, i.e. the information or selected methodology is outdated, an event occurs that directly effects the assumptions used, or better information or information sources for comparability analysis is found, taxpayers must once again apply Steps 1 - 4.

Process in Establishing the Market Price



Note

1. The four steps are not prescriptive and are not mandatory to taxpayers. The most important thing is that the taxpayer should conduct transaction leading to a market price that is appropriate and reasonable and takes into account the facts and circumstances of the case.
2. In collecting and analysing information, there should be sufficient, detailed information in determining the market price. The information depends on the size of the business and the complexities of the transaction.
3. The proper application by the taxpayer of the four steps to the facts and circumstances of the case should normally be sufficient to establish the market price.
4. A person with knowledge on information used to determine the market price may not necessarily be from the finance or accounting department/section of the company.
5. Most of the information may already be contained in existing business documents such as market reports and information, business plans and budgets. Thus, the juristic corporation or partnership is well advised to systematically gather the existing documentation. It is not necessary for the taxpayer to produce new documentation.

Part IV

Documentation

Taxpayers are well advised to prepare contemporaneous documentation indicating steps and rationale in determining the market price during each stage of a transaction, and retain them at their office.

The list of documentation which should be prepared and kept is as follows:

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 pricing 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).

Note : This translation is for those who are not familiar with the Thai language. The Thai text is an official text.