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GURU SPEAK

PANACHAI ANONTANUT

ALTHOUGH Thailand is not an OECD member, the country uses transfer pricing guidelines that follow the arm's length principle. While those multinationals in Thailand with significant related party transactions ought to ensure that, in setting and monitoring their transfer prices, their transfer pricing practices are consistent with the arm's length principle, it is the Revenue Department's job to test such compliance.

Thailand's transfer pricing guidelines do provide certain guidelines for inspectors. What they do not provide are the criteria in identifying transfer pricing audit targets.

Here is a closer look at transfer pricing audits selection in Thailand:

The most obvious criterion is to target multinational companies with losses. Under the arm's length principle, organisations exist to make profits. If multinationals incur prolonged losses (ie, for longer than two years), such losses may be questioned. Moreover, if multinationals suffer losses at the gross profit level – ie, even before taking into account other selling, general and administrative expenses – a red flag will be raised. Losses at gross level would indicate that for every dollar spent on the cost of goods, you would get less than a dollar back in return. Under normal circumstances this will occur only if you are a new start-up or are adopting price-penetration strategy, where profits will be expected after a certain period.

And for those who have fluctuating operating results, the Revenue Department may be interested to know the adopted business model – whether they are limited-risk ("routine") entities or risk takers of the supply chain. In many cases, Thai entities of multinationals are routine entities. Under the arm's length principle, risk is proportionate to the expected return. Routine entities should earn low but stable expected routine returns. For risk takers, who are entitled to residual profits or losses, the Revenue Department would expect to see proof of risk-taking status.

Profitable companies, however, are not exempted from transfer pricing audits. Multinationals having excessive inter-company payments, such as management fees and/or shared service costs, may also be unofficially summoned by the Revenue Department. It is imperative that Thai entities can prove the benefits of these inter-company payments and that amounts paid tally with such benefits. Unsupported expenses will be disallowed.

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Royalties are another form of inter-company payment that usually receive scrutiny. Companies with excessive royalty payments may be the target of a transfer pricing audit. Having said this, companies with no royalty payments can also be selected. This is especially the case for manufacturers employing manufacturing know-how who then sell goods back to the owner of that know-how. By not charging royalties for the know-how, the Revenue Department would stand to lose the VAT (7 per cent), withholding tax (15 per cent), and the 23-per-cent corporate income tax (20 per cent from 2013 onwards) on the same mark-up but bigger cost base.

Certain companies receive tax exemption privileges from the Board of Investment (BOI). For BOI promoted companies, if you think you are safe, think again. Companies with both BOI and non-BOI businesses are likely to be selected for transfer pricing audits. If the BOI business is highly profitable but the non-BOI business incurs losses or has significantly lower profits than the BOI business, be prepared to justify such difference with the Revenue Department. Also, businesses whose profitability drops materially after the tax holiday has expired, regardless of the size of the tax payments made, can expect the drop to trigger queries by the Revenue Department.

The same goes for those who undergo business restructuring and have a dramatic drop in profits as a result.

While you may have healthy profitability, no excessive inter-company payments, and even consistent profits between BOI and non-BOI businesses, if your business comprises more than one supply chain or several product types, the Revenue Department will still want you to ensure that the profit from each supply chain or each product type is arm's length, even if the overall profit is healthy. Losses by supply chain or by product could still result in transfer pricing adjustment. Thus, companies with overall healthy profits may also be selected for transfer pricing audits via reviews of profitability by supply chains or by product types.

The bottom line is, any multinational company with related party transactions may be selected for a transfer pricing audit. Some may be at more risk of being selection than others. Companies should therefore conduct regular reviews of their transfer pricing practices and the resulting yearly finances as a means to manage their transfer pricing risks in advance.

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