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LEADING THE WAY

Transfer pricing at the advent of the Asean Economic Community

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With the Asean Economic Community (AEC) due to take effect late next year, many Thai companies are enthusiastic about increasing their investments in other Asean members. With Asean becoming a single market and production base, it is not surprising that Thai companies would want to expand across borders to take advantage of cheaper resources or other favourable economic conditions.

The AEC blueprint covers a lot of ground and sets a lot of rules and guidelines, but harmonisation of corporate income tax rates among Asean members is not one of them, and tax rates remain inconsistent. And already we've seen some countries reducing their tax rates to attract foreign investment. At the moment, corporate income tax rates for Asean members range from 17% in Singapore to 30% in the Philippines. Thailand's rate is 20%.

With a freer market where it's easier for resources, funds and capital to move across borders, it's inevitable that multinational companies will be tempted to move their profits to locations where corporate income tax is lower. Without specific transfer pricing rules and legislation, profits could be disproportionately allocated, resulting in some governments losing their fair share of tax revenue.

Thailand issued its transfer pricing guidelines in 2002. They use the arm's-length principle, meaning related parties are required to be transacting as if they were unrelated parties and also outline acceptable transfer pricing methods and documentation requirements.

Enforcement in Thailand, which has become more intensive over time, has relied on general tax provisions. Nevertheless, the Revenue Department is in the process of introducing specific transfer pricing provisions into the tax law with a view to protecting its fair share of tax revenue.

Singapore released its transfer pricing guidelines in 2006, also endorsing the arm's-length principle. In 2010, it enacted the arm's-length principle into its Income Tax Act, specifying mandatory compliance.

Just this month, Singapore released a proposed update to the transfer pricing guidelines, requiring taxpayers to prepare and maintain contemporaneous transfer pricing documentation — that is, documents declaring the intercompany transactions, the pricing methods used and other required information must be prepared at the time the transactions take place. The proposed update is now under public consultation.

Malaysia's transfer pricing guidelines were introduced in 2003. The arm's-length principle was enacted into that country's Income Tax Act effective Jan 1, 2009. Subsequent developments include the revised Malaysian Transfer Pricing Guidelines in May 2012, providing further guidance on the application of the arm's-length principle and requiring taxpayers to prepare contemporaneous transfer pricing documentation.

For Indonesia, Article 18 of the Income Tax Act allows tax authorities to make income adjustments in a case where related-party transactions were not conducted at arm's length. In 2010, transfer pricing regulations outlining the application of the arm's-length principle and the documentation requirements were issued. The regulations were later amended in 2011.

The Philippines' transfer pricing guidelines were issued last year as Revenue Regulation No.2-2013. They provide guidance on the application of the arm's-length principle and require taxpayers to prepare and maintain contemporaneous transfer pricing documentation.

Among the newer members of Asean — Brunei, Cambodia, Laos, Myanmar and Vietnam — only Vietnam has transfer pricing regulations.

Vietnam's first transfer pricing regulation was issued under Circular No.117/2005, which mandates taxpayers to comply with the arm's-length principle and prepare contemporaneous documentation from the 2006 tax year onwards. In 2010, Circular No.66/2010 was released, providing some additional guidance on the application of the arm's-length principle. In 2012, Hanoi released its Action Plan on Transfer Pricing Management, which has generated movement on the enforcement front.

The remaining Asean members have no transfer pricing rules or regulations but rely on general provisions allowing tax authorities to make adjustments in cases where transactions are not conducted at the "appropriate" price.

The above illustrates that transfer pricing legislation among Asean members remains in different stages of development. We expect a tightening of transfer pricing guidelines and regulations as well as a faster pace of increase in the sophistication of enforcement in the region over time.

This article was prepared by Peerapat Poshyanonda, a partner, and Voraprapa Nakavachara, PhD, a senior manager at PwC Thailand. We welcome your comments at leadingtheway@th.pwc.com