L&P

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Synopsis on Transfer Pricing in Hong Kong, Thailand and Vietnam

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I. Introduction

Transfer Pricing becomes highly important as soon as a business entity decides to expand its operations across international borders. *Transfer Pricing* deals with structuring the price of transactions between related parties within a group of companies.

Every Multi National Enterprise (**"MNE"**) wishes to minimise its tax obligations in order to maximise its overall profits. In principal, multi-corporate businesses have to pay tax in their host countries, based on the profit share which arises in (or is allotted to) the respective business in such host country (e.g. Thailand, Hong Kong or Vietnam). These host countries can differ in various respects, e.g. tax systems, customs duties, currency exchange rates, legislation etc. As a result, *Transfer Pricing* also affects revenue and customs authorities, investors, creditors and the like.

The obligation to comply with national and international tax regulations regularly conflicts with the goal of a tax-efficient allocation of profits within MNEs. This is primarily because while the enterprise will take a global perspective, the respective tax legislation is usually nationally focused.

Thus, anticipatory business and corporate tax planning which takes both concerns into consideration is vital.

II. Different Methods of Price Calculation

In most countries, *Transfer Pricing* regulations are built around the core concept of the *Arm's Length Principle*. According to this principle, the transaction (or transfer) price charged between affiliated companies must be the same as the price which would have been charged to an independent company.

There are six generally accepted methods by which to compute the transfer price so that it accords with the Arm's Length Principle. These six methods can be separated into two categories:

- Traditional methods (Transaction Methods) focus on the facts of the actual transaction in question in order to compute an appropriate transfer price (*bottom-up method*).
- Other methods (Profit-based Methods) utilise the profit generated by comparable companies when undertaking similar transactions in order to determine the price of the intercompany transaction in question (*top-down method*).

Transaction Methods are generally considered to be more accurate and appropriate.

1. Transaction Methods (TM)

a) Comparable Uncontrolled Price Method (CUP) and Comparable Uncontrolled Transaction Method (CUT)

Both CUP and CUT compare the price of the intercompany transaction with the price of an identical or sufficiently similar independent transaction (e.g. the price charged in transactions between independent parties).

b) Cost Plus Method

This method summarises all the original costs of the unfinished product and then adds the customary net profit for such transactions for calculating the applicable transfer price.

c) Resale Minus Method

Under this method, the transfer price is computed by deducting the customary profit margin from the respective resale price. The customary profit margin is calculated on a partial cost basis.

2. Profit-based Methods (PBM)

a) Comparable Profit Method (CPM)

This method is based on the operating profit gained from the intercompany transaction and the allocation of this profit to the respective business segment which is then defined and subdivided as precisely as possible. In order to compare these profits, the profit margins of comparable independent businesses are used for each business segment. A target operating result can be computed by applying this method to the total profit of the multinational organisation. By comparing this result with the individual entities' actual financial statements, it can be assessed whether the correct transfer price was used.

b) Profit Split Method (PSM)

PSM is based on the total profit an MNE gains from an intercompany transaction. This profit is divided according to the functions and risks which each related party adopted, just as it would be in the case of a transaction between non-related parties.

c) Transactional Net Margin Method (TNMM)

The net profit gained from the intercompany transaction is analysed in relation to an appropriate basis (cost, turnover, assets etc.) and the resulting profit margin is checked against comparable independent transactions. (This method is similar to Resale Minus or Cost Plus, thus strictly-speaking it is a bottom-up method as well.)

We hope that the information provided in this brochure was helpful for you.
If you have any further questions please do not hesitate to contact us.

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Synopsis:

Jurisdiction	Hong Kong	Thailand	Vietnam
Competent Authority	Inland Revenue Department	Revenue Department (Krom Sumpakorn)	Ministry of Finance, General Department of Taxation, Department of Taxation and Sub-department of Taxation
Organisations Affected	– Associated enterprises, i.e. parties that participate directly or indirectly in the management, control or capital of the other party – If the same person participates in the management, control or capital in both parties – Parties controlled by the same third party – Related parties	– One party directly or indirectly holds 50% or more of the other's equity. – The shareholders of one party directly or indirectly hold 50% of the other's equity. – The parties share the same management, capital or control in a way that makes it impossible to independently run the parties.	– One party controls at least 25% of the other's equity. – Both parties are indirectly or directly controlled by the same third party with at least 25% of each party's equity. – One party is the shareholder having the biggest ownership and controlling at least 10% of the other's equity. – One party provides a guarantee or loan to the other that constitutes (i) 25% or more of the investment capital, and (ii) more than 50% of the total value of the long- and medium-term loans of the said other enterprise. – One party appoints more than 50% members of the total members of the board of executive directors or the control board of the other enterprise or one member appointed by one party has power to decide on financial policies or business activities of the other enterprise. – More than 50% of members of the board of directors or a member of the board of directors who has power to decide on financial policies or business activities of each of the two enterprises are appointed by the same third party. – Family relationship – Both parties have transactions, either between their head offices and permanent establishments or between permanent establishments of overseas entities or individuals. – One or more enterprises is/are put under control of one individual through either his

			capital participation into that enterprise or his direct involvement in administration of that enterprise. – In other cases, where one party is in reality under management of, or control of decision on, business activities of the other.
Legal Sources	– Cap. 112 IRO (amended in 2018 by the Inland Revenue (Amendment) (No. 6) Bill 2017) – Anti-Circumvention Rules: include transfer prices as well, Sec. 20 (2) IRO.	– In General: Sec. 65 Bis (4), (7), 65 Ter (13), (14), (15) Revenue Code – Specific: Departmental Instruction Paw 113/2545 (Appendix A1) – Sec. 71 Bis para. 2, 3; Sec. 71 Ter Revenue Code	– Law on Corporate Income Tax 2008 – Law No. 32/2013/QH13 amending Law on Enterprise Income Tax – Circular 201/2013/ND-CP – Decree 20/2017/ND-CP – Circular 41/2017/TT-BTC
Methods	– TM: CUP, Resale Minus, Cost Plus – PBM: PSM, TNMM, CPM – Others	– TM: CUP, Resale Minus, Cost Plus – PBM: PSM, TNMM, CPM – Others	– TM: CUP, Resale Minus, Cost Plus – PBM: PSM, CPM – "Best Method" Rule
Documentation	– Legal obligation with exemptions based on business size of the entity, category of transaction or domestic character of transaction – Country-by-Country (CbC) Reporting if group turnover exceeds HKD 6.8 billion and ultimate parent company is HK resident – Master File and Local File are to be prepared within 9 months of the accounting year-end of the Group, respectively the entity	– Legal obligation to prepare and submit together with tax return if annual revenue exceeds THB 200 million (Sec. 71 Ter Revenue Code) – Dep. Instr. Clause 4	– Legal obligation – To be submitted with tax returns – On request after 30 days; one-time extension of deadline for 15 days is possible – Fine applicable for non-compliance
Reporting Obligation	Reporting with tax return (applied to years of assessment beginning on or after 1 April 2018)	Reporting with tax return if annual revenue exceeds THB 200 million	Reporting with tax return
Sanctions	Up to 100% of the underpaid tax plus interest (However, low tax audit activity)	– See ordinary tax laws: surcharge of 1.5% monthly up to 100% additional tax and up to 100% penalty – Penalty of non-compliance with reporting duty: up to THB 200,000	See ordinary tax laws
Advance ruling	Possible, see http://www.ird.gov.hk/eng/pdf/e_dipn31.pdf	Possible	De facto not possible