What should be next development of transfer pricing law in Thailand?

by

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INTRODUCTION

The globalization era results in the change of business and trading practice. The integration of national economies and development of technology also have impact to this change. A business enterprise grows up by expanding its other business to other market or other country. It might invest in other country by means of establishment of new business entity, having joint venture or doing M&A with the existing business player. This is a key fact of creating multinational enterprises ("MNEs") in the global business.

Normally, each country may assert taxing rights based on residence or source of income or both. In fact, one country has different tax burden and benefit from the others. Some countries determine tax rate lower than the others. Some countries allow some deductible expenses whilst the others do not. In addition, some countries might have tax benefit from the bilateral or multilateral treaty with other countries. These differences result in difficulty for the MNEs to comply with tax legislations of the relevant countries. In the meantime, for the sophisticated MNEs, these differences become one of significant conditions for the enterprise to choose the target of investment.

Nowadays, the aforesaid differences on tax distort the purpose of foreign investment. Paying less tax means more profit for the business operator. Some MNEs set up business entity in other country for the purpose of tax benefit rather than business expansion. Someone might call this purpose as tax planning. As a result, it is easy to set price for goods and services sold between related legal entities within the MNEs group. The way of setting price is so called "transfer pricing" and the cost of those goods and services is called "transfer price". Generally, the transfer price should be in line with the price of goods and services in transaction between the independent parties, which is arm's length. However, if the transfer price is different from what it should be in the arm's length transaction, especially in the condition of lowering the profits in any country, it is unacceptable for that country which might lose its revenue from tax. Such country consequently finds the best mechanism to prevent the MNEs from doing so.

Thailand is considered one of the countries being a target of foreign investment. In the meantime, a number of enterprises in Thailand also do investment in other countries. Such investment may, in fact, have the actual purpose of tax-avoidance, rather than business expansion. The integration of economic community, i.e. ASEAN Economic Community ("AEC") also play significant role to rush this phenomenon. It is therefore worth studying the international recognized practice to deal with this issue in order to uplift the Thai laws to the international standard.

This article is dedicated to the topic of transfer pricing. Furthermore, as Thailand is now in process of development of transfer pricing legislations, the focus will be on general idea and principles of transfer pricing; but it still recognizes that there are other special considerations for specific transactions. This article will discuss about international practice to deal with the arm's length principle. The methodologies and dispute resolutions for conflict between the relevant countries will also be taken into account. And, finally, it will consider the laws of Thailand and the likelihood of development. For the benefit of comparison study, this article will also discuss about the practice in EU countries, especially Austria (as a country of the hosted Institute[1] for this research), Germany (as a biggest economic country in the EU representing a civil law country) and the UK (as a common law country).

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PART 1: GETTING TO KNOW TRANSFER PRICING AND ARM'S LENGTH PRINCIPLE

"Transfer pricing" refers to the allocation of profits for tax and other purposes between associated enterprises.[2] If the independent enterprises enter into transactions with each other, it is likely that the price of goods or services negotiated will be based on the market force. However, if that transaction is created between the parties associated, such price is possibly different from the market and may result in the decline or increase in profit of either party. This will therefore results in the authority to the tax administration of the country to adjust the price to be in line with the market for the purpose of tax payment and for guaranteeing fair taxation treatment of the independent enterprises.

However, the problem of transfer pricing is not due to the associated enterprises in one country. In fact, it involves the MNEs and several countries where there are differences on tax laws and regulations. One of the best taxation practices is that there should not be double taxation on the same income by two states. However, the readjustment of transaction price in one country can breach this theory if another country does not recognize the readjusted price. It therefore becomes an international topic for the countries around the globe to deal with and find the common-recognized practice.

The Organization for Economic Cooperation and Development ("OECD") has proposed the Model Convention with Respect to Taxes on Income and on Capital ("OECD Model Convention"). According to article 9 of the OECD Model Convention, it deals with adjustments to profits that may be made for tax purposes where transaction have been entered into between associated enterprises (parent and subsidiary) companies and companies under common control other than arm's length terms.[3] The key purpose is that a transaction between associated enterprises should be comparable to a similar transaction of independent enterprises. In paragraph 1, it states that:

Where

a) an enterprise of a Contracting State participates directly or indirectly in the management, control or capital of an enterprise of the other Contracting State, or

b) the same persons participate directly or indirectly in the management, control or capital of an enterprise of a Contracting State and an enterprise of the other Contracting State,

and in either case conditions are made or imposed between the two enterprises in their commercial or financial relations which differ from those which would be made between independent enterprises, then any profits which would, but for those conditions, have accrued to one of the enterprises, but, by reason of those conditions, have not so accrued, may be included in the profits of that enterprises and taxed accordingly.

This article treats the associated enterprises independently. Therefore, the tax administration has its power under the domestic law to adjust taxable base of a taxpayer if the transactions carried out by associated enterprises different from the transaction between the independent enterprises.

Nevertheless, the adjustment by the tax administration is normally acceptable only if the parties are in the same tax jurisdiction. If they are the MNEs, it is unlikely that other country shall agree with this primary adjustment and, as a result, it is likely creates double taxation on the same profit. Article 9 paragraph 2 of the OECD Model Convention therefore specifies the condition for the

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[2] Neighbour, J., "*Transfer pricing: Keeping it at arms' length*," Organisation for Economic Cooperation and Development. the OECD Observer, (230), Retrieved from http://search.proquest.com/docview/217470258?accountid=29104

[3] OECD, "*Commentary on Article 9: Concerning the taxation of associated enterprises*," in Model Tax Convention on Income and on Capital 2010 (Full Version), OECD Publishing. http://dx.doi.org/10.1787/9789264175181-43-en

tax administration of other country to make corresponding adjustment (to be discussed in 1.1.3 below).

On 27 June 1995, the Council of the OECD approved the report entitled Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations ("OECD Guidelines"), which has been periodically updated from time to time. The report represents the internationally agreed principles and provides guidelines for the application of the arm's length principle, of which article 9 of the OECD Model Convention is the authoritative statement.[4] The OECD Guidelines consist of two main purposes, i.e. (i) to make sure taxpayers reflect the real income related to the controlled transaction within the MNEs and to prevent avoidance of tax by shifting income while entering into that transaction within the MNEs, and (ii) to eliminate double taxation of the same income generated by the MNEs inter-transaction.[5]

The OECD Guidelines are mainly applied to the transaction within the MNEs. To say, there must be at least two countries involved in the transaction.[6] The OECD Guidelines also intend to help both the tax administration and the MNEs by indicating the way to find the mutually satisfactory solutions to transfer pricing cases.[7]

In this respect, the United Nations ("UN") has also proposed the UN Model Double Taxation Convention between Developed and Developing Countries ("UN Model Convention"), which generally favors retention of greater so called "source country" taxing rights under a tax treaty as compared to those of the "residence country" of the investor. This has long been regarded as an issue of special significance to developing countries, although it is a position that some developed countries seek in their bilateral treaties.[8] Article 9 paragraph 1 of the UN Model Convention contains the basis of arm's length principle exactly the same as provided in article 9 paragraph 1 of the OECD Model Convention as quoted above. In its Annual Session of 15-19 October 2012, the United Nations ("UN") Committee of Experts on International Tax Cooperation also approved the United Nations Practical Manual on Transfer Pricing for Developing Countries ("UN Manual") to deal with the commercial and financial relations between related enterprises, such as two parts of a multinational group, which differ from the relations between independent enterprises. The UN Manual also endorses the arm's length standard which is essentially an approximation of market-based pricing, for pricing of transactions within the MNEs. Both OECD Guidelines and the UN Manual are the basis for bilateral treaties for avoiding double taxation.[9] In this respect, similar to the OECD Guidelines it does not mention other possible standards that can be applied.[10]

1.1 Arm's Length Principle

The arm's length principle is international standard that is used for determining transfer prices for tax purposes.[11] It is used as a basis for adjustment of the transfer price within the MNEs. It is also recognized that this principle can find the mutually agreed price among the relevant parties, i.e. tax administration and MNEs. Such price is so called the arm's length price.

The arm's length price is in fact subjective and there is no perfect formula to seek for. One key concept for seeking such price is comparability analysis. To say, the controlled transaction in question must be compared with the condition in uncontrolled transaction. In order for such comparisons to be meaningful, the economically relevant characteristics of the situations being compared must be sufficiently comparable.[12] The following comparability factors are identified in the

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[4] *Ibid.*

[5] Berroho ,B., "*US, OECD, or U N. Transfer Pricing Methods*." Retrieved from http://www.academia.edu/7056558/US_OECD_or_U_N._Transfer_Pricing_Methods

[6] Preface Paragraph 13. OECD Transfer Pricing Guidelines 2010

[7] Preface Paragraph 15. OECD Transfer Pricing Guidelines 2010

[8] Introduction Paragraph 3. UN Model Convention

[9] Foreward. UN Practical Manual on Transfer Pricing for Developing Countries

[10] Lennard, M., "*The New United Nations Practical on Transfer Pricing for Developing Countries*," 19 Asia-Pac. Tax Bull. 1 (2013). Journal IBFD.

[11] Glossary. OECD Transfer Pricing Guidelines 2010

[12] Bakker, A., *Transfer pricing and business restructuring: streamlining all the way* (Amsterdam: IBFD, 2009) p.51

OECD Guidelines (Chapter 1 paragraph 1.19 - 1.35) and they should be considered in analyzing each case:

(1) *Characteristics of property or services* – examples of characteristics that are likely to affect the comparability include the quality, durability and reliability of the goods or services being transferred;

(2) *Functional analysis* – to assess the comparability of transactions it is necessary to consider exactly what functions, assets and risks of each party. Factors such as design, manufacturing, assembly, research, distribution, financing, management, associated business risks, and etc. should be considered;

(3) *Contractual terms* – differences in the contractual terms of the controlled transaction comparing with the uncontrolled transaction may significantly affect comparability. Examples of such differences could include payment, credit and delivery terms;

(4) *Economic circumstance* – factors such as competition in the markets, and overall levels of demand and supply need to be considered; and

(5) *Business strategies* – the adoption of a market penetration scheme, for example, could have a dramatic effect on the transfer price.[13]

In addition to the above factors, there are also other factors that should also be taken into account. Chapter I of OECD Guidelines also discuss about the transaction structure (to reflect the economic reality of the circumstances), multiple year data (to aid comparability), losses (actual reasons of that losses e.g. heavy start-up costs, unfavorable economic conditions or a policy of market penetration), intentional set-off (by getting goods or services in return), and government policies.[14] Basically, under the arm’s length principle, the more valuable the functions, assets, and risks contributed by a party to a transaction, the higher its anticipated return. However, it is also worth noting that in the open market, the assumption of increased risk must be compensated by an increase in the expected return, although the actual return may or may not increase depending on the degree to which the risks are actually realized.[15]

There is a project by the OECD to form a “substance-over-form” test to identify functions and risks. According to the project, the first analysis should be a risk examination of the contractual terms regarding contractual allocation of risks, if contractual arm’s length risks exist, if they are significant, and the consequences, in the sense of transfer pricing, of the risks allocation. Secondly, it should be analyzed whether the transactions are at arm’s length from a position of each party, e.g. manufacturer, distributor, or service provider.[16]

It is noteworthy that in Chapter 5 of the UN Manual also discusses about comparability analysis. It treats this term as designating two distinct through related analytical steps:

(a) an understanding of the economically significant characteristics of the controlled transaction and the respective roles of the parties to the controlled transaction. Five comparability factors for examination provided in the UN Manual are similar to those mentioned in the OECD Guidelines.

(b) a comparison between the conditions of the controlled transaction and conditions in uncontrolled transactions taking place in comparable circumstances, which are often referred to as “comparable uncontrolled transactions” or “comparables”.[17]

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[13] Adam, C. and P. Graham, *Transfer pricing: a UK perspective* (London: Butterworth, 1999) pp.9,10
[14] *Ibid*. p.10
[15] *Supra*. n.12. p.52
[16] Simader, K. and E.Titz, *Limits to Tax Planning* (Vienna: Linde, 2013) p.139
[17] *Supra*. n.10

1.2 Transfer Pricing Methods

In order to find the arms' length character of the transaction in question, the transfer pricing methods shall be applied. Chapter II of the OECD Guidelines discuss about five methods that can be applied to consider whether the transactions between the MNEs in line with the arm's length principle. Three of them, i.e. the comparable uncontrolled price method ("CUP" method), the cost plus method, and the resale price method are so called "traditional transaction methods" and other two methods, i.e. the transactional net margin method ("TNMM") and the transactional profit split method, are so called "transactional profit methods".[18]

(1) *CUP Method* – According to the Glossary of the OECD Guidelines, the CUP Method is a transfer pricing method that compares the price for property or services transferred in a controlled transaction to the price charged for property or services transferred in a comparable uncontrolled transaction in comparable circumstances.

The CUP method evaluates the arm's length character of a controlled transaction by comparing its price and conditions to the price and conditions of similar transactions between the taxpayer and an unrelated party ("internal CUP"), or between two unrelated parties ("external CUP"). Where it is possible to locate comparable uncontrolled transactions, the CUP method is the most direct and reliable way to apply the arm's length principle and to determine the prices for the related party transactions. However, in considering whether controlled and uncontrolled transactions are comparable, the comparability requirement of applying the CUP method is very high. Thus, in practice, the CUP method is not usually applied unless the products or services can meet the strict requirements of high comparability.[19]

(2) *Cost Plus Method* - According to the Glossary of the OECD Guidelines, the cost plus method is a transfer pricing method using the costs incurred by the supplier of property (or services) in a controlled transaction. An appropriate cost plus mark up is added to this cost, to make an appropriate profit in light of the functions performed (taking into account assets used and risks assumed) and the market conditions. What is arrived at after adding the cost plus mark up to the above costs may be regarded as an arm's length price of the original controlled transaction.

The cost plus method is typically used to test the activities of manufacturing entities by comparing gross profits to cost of sales. This method requires detailed comparisons of products produced, functions performed, risks borne, manufacturing complexity, cost structures, and intangibles between controlled and uncontrolled transactions. Comparability is most likely found among controlled and uncontrolled sales of property by the same seller (i.e., internal cost-plus method). In the absence of such sales, an appropriate comparison may be derived from comparable uncontrolled sales of other producers (i.e. external cost-plus method).[20]

The cost plus method is less likely to be reliable if material differences exist between the controlled and uncontrolled transactions with respect to intangibles, cost structure, business experience, management efficiency, functions performed and products. A reasonable number of adjustments may be made to compensate for the lack of comparability between controlled and uncontrolled transactions in inventory turnover, contractual terms, transport costs and other measurable differences.[21]

(3) *Resale Price Method* – According to the Glossary of the OECD Guidelines, the resale price method is a transfer pricing method based on the price at which a product that has been purchased from a associated enterprise is resold to an independent enterprise. The resale price is reduced by the resale price margin. What is left after subtracting the resale price margin can be regarded, after adjustment for other costs associated with the purchase of product (e.g. custom

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[18] OECD, "*Transfer Pricing Methods*," OECD Publishing. p.1 Retrieved from http://www.oecd.org/ctp/transfer-pricing/45765701.pdf

[19] Transferpricing.wiki, "*OECD Transfer Pricing Methods*," Retrieved from http://www.transferpricing.wiki/general-transfer-pricing-information/transfer-pricing-methods/

[20] *Ibid.*

[21] *Ibid.*

duties), as an arm's length price of the original transfer of property between the associated enterprises.

The resale price method is normally used to test gross profits earned by sales and distribution entities. This method compares gross profit relative to turnover of the tested party to gross margins earned by comparable third parties. Comparability under the resale price method requires that there are no differences that would materially affect the resale price margin in the open market or that reasonably accurate adjustments can be made to account for such differences. The extent and reliability of adjustments will affect the reliability of the resale price method analysis itself.[22]

(4) *Profit Split Method* – According to the Glossary of the OECD Guidelines, the profit split method is a transactional profit method that identifies the combined profit to be split for the associated enterprises from a controlled transaction and then splits those profits between the associated enterprises based upon an economically valid basis that approximates the division of profits that would have been anticipated and reflected in an agreement made at arm's length.

Where transactions are very interrelated it might be that they cannot be evaluated on a separate basis. Under similar circumstances, independent enterprises might decide to set up a form of partnership and agree to a form of profit split. Accordingly, the profit split method seeks to eliminate the effect on profits of special conditions made or imposed in a controlled transaction by determining the division of profits that independent enterprises would have expected to realize from engaging in the transaction or transactions.

The profit split method first identifies the profit to be split between the associated enterprises from the controlled transactions in which the associated enterprises are engaged. It then splits those profits between the associated enterprises on an economically valid basis that approximates the division of profits that would have been anticipated and reflected in an agreement made at arm's length. The combined profit may be the total profit from the transactions or a residual profit intended to represent the profit that cannot readily be assigned to one of the parties, such as the profit arising from high-value, sometimes unique, intangibles. The contribution of each enterprise is based upon a functional analysis, and valued to the extent possible by any available reliable external market data.[23]

(5) *Transactional Net Margin Method* – According to the Glossary of the OECD Guidelines, the transactional net margin method is a transactional profit method that examines the net profit margin relative to an appropriate base (e.g. costs, sales, assets) that a taxpayer realizes from a controlled transaction.

The TNMM compares the tested party's net profitability on a controlled transaction to the net profit obtained by broadly similar uncontrolled companies on similar transactions. The OECD Guidelines state that the TNMM may be a practical solution to otherwise insolvable transfer pricing problems when used sensibly with appropriate adjustments to account for any material differences between transactions. Also, the degree of comparability required to apply the TNMM is less stringent than what is necessary under other methods. A primary benefit of the less stringent comparability standards is a significant increase in the number of arm's length observations available to establish the arm's length remuneration of the entities tested.[24]

Before 2010, the OECD Guideline suggested that the CUP method was the most preferred, next came the other "traditional transactional" methods (resale price and cost plus) followed. In "exceptional" cases where the first three methods cannot reliably be applied, the profit based methods (the transactional net margin method and profit split) shall be used. However, in 2010, The OECD Guidelines is amended to remove the existing strict hierarchy method to a more flexible standard. This is because in many cases the traditional transaction methods are difficult to apply due to the uniqueness of the goods or services and, more in particular, because of the lack of reliable comparable third party data information. The basis for choosing one method over the others is now expressed as

[22] *Ibid.*
[23] *Ibid.*
[24] *Ibid.*

"finding the most appropriate method for a particular case".[25] In order to select the most appropriate method, the factors that should be taken into account include the respective strengths and weakness of each of the OECD recognized methods; the appropriateness of the method considered in view of the comparability analysis (including functional analysis) of the controlled transaction under review; the availability of sufficiently reliable information (in particular on uncontrolled comparable) in order to apply the selected method and/or other methods; degree of comparability of controlled and uncontrolled transactions, and the reliability of comparability adjustments that may be needed to eliminated differences between them.[26]

The UN Manual also discusses the same methods in Chapter 6. In addition, it also acknowledges that a number of jurisdictions also apply other methods which are considered to provide arm's length results; however, the UN Manual notes that such methods should be consistent with the arm's length principle.[27] According to the UN Manual, there is no hierarchy of methods to be applied and, as a result, the most suitable method to be chosen must depend on the facts and circumstances, such as the type of transaction, the functional analysis, comparability factors, availability of comparable transactions and the possibility of making adjustments to the data to improve comparability.[28]

Those methods still have limitation for some types of assets or transaction, as their weakness is also discussed in the UN Manual. For example, the transaction which involve the intellectual property are unique and almost incomparable. In most cases only an estimate is possible.[29] The cost approach can only compare the costs used to create such intellectual property and are mainly calculated with the research and development. The market approach takes price that are on the market for a similar or most suitable product. The income approach calculates the advantages that arise from that intellectual property and add a certain mark up on the costs.[30]

1.3 Corresponding Adjustment

According to Article 9 paragraph 1 of the OECD Model Convention, the tax administration is entitled to adjust the business profit of transaction between the MNEs on the arm's length basis in order to protect the benefit of the country. In this respect, it is unlikely that other country shall agree with this primary adjustment and, as a result, it shall unavoidably create double taxation on the same profit. Article 9 paragraph 2 of the OECD Model Convention therefore determines the condition for the tax administration of second jurisdiction to make corresponding adjustment.

> *Where a Contracting State includes in the profits of an enterprise of that State – and taxes accordingly – profits on which an enterprise of the other Contracting State has been charged to tax in that other State and the profits so included are profits which would have accrued to the enterprise of the first mentioned State if the conditions made between the two enterprises had been those which would have been made between independent enterprises, then that other State shall make an appropriate adjustment to the amount of the tax charged therein on those profits. In determining such adjustment, due regard shall be had to the other provisions of this Convention and the competent authorities of the Contracting States shall if necessary consult each other.*

The corresponding adjustment to the tax liability of that associated enterprise in the second adjustment is normally a downward adjustment so that the allocation of profits between the two jurisdictions is consistent with the primary adjustment and no double taxation occurs.[31] It is also possible that the first tax administration will agree to decrease (or eliminate) the primary adjustment

[25] PWC, "*OECD publishes revised guidelines on transfer pricing*," A transfer pricing publication of July 22, 2010. Retrieved from http://www.pwcavocats.com/assets/files/pdf/2010/alerte_fiscal_OCDE_mise_a_jour_convention_prix_de_transfert_07_2010.pdf

[26] *Supra*. n.12 p.54

[27] *Supra*. n.10

[28] *Ibid*.

[29] *Supra*. n.10 p.140

[30] *Ibid*.

[31] Chapter IV Paragraph 4.32. OECD Transfer Pricing Guidelines 2010

as part of the consultative process with the second tax administration, in which case the corresponding adjustment would be small or unnecessary.[32] However, the corresponding adjustment shall not give any benefit to the MNEs greater than what they should get under the arm's length conditions.[33]

The problem is that if the tax administration of the second jurisdiction has agreed to make a corresponding adjustment, it is necessary to establish whether the adjustment is to be attributed to the year in which the controlled transactions giving rise to the adjustment took place or to an alternative year, such as the year in which the primary adjustment is determined.[34] The first approach is appropriate because it reflects the financial account but still has a problem in a case involving lengthy delays for consideration.[35] It therefore depends on the domestic law for implementation.

In some countries, the tax administration allows the procedure of "compensating adjustment" by letting the taxpayer report the transfer price for tax purpose that is arm's length although it might be different from the actual price.[36] However, it still give rise a problem because if the second country does not recognized the compensating adjustment, the double taxation cannot be eliminated.[37]

The corresponding adjustment in the second country by reduction of income or profit results in the excess amount different from the actual income or profit. In order to make the actual allocation of profits consistent with the primary transfer pricing adjustments, the domestic laws in some countries require the enterprise to create the constructive transaction (a secondary transaction) in order to allocate the excess profit. However, this constructive transaction cannot solve the double taxation problem due to the fact that the secondary transaction itself may have tax consequences and results in an adjustment. For example, the amount of the income adjustment to a subsidiary on a transaction with a non-resident parent may be treated by the subsidiary's jurisdiction as a deemed dividend paid to the parent and a withholding tax may be applicable.[38] Another example may be a case where the tax administration making a primary adjustment treats the excess profits as being a constructive loan from one associated enterprise to the other associated enterprise. In this respect, an obligation to repay the loan would be deemed to arise and the application of the arm's length principle must be made to impute the arm's length rate of interest.[39]

As a result, it is possible that a transfer pricing adjustment is accompanied by a "secondary adjustment". The OECD defines secondary adjustments in the Glossary of the OECD Guidelines as an adjustment that arises from imposing tax on a secondary transaction in transfer pricing cases, and defines a "secondary transaction" as "a constructive transaction that some States assert under their domestic transfer pricing legislation after having proposed a primary adjustment in order to make the actual allocation of profits consistent with the primary adjustment. Secondary transactions may take the form of constructive dividends (that is items treated as though they are dividends, even though they would not normally be regarded as such), constructive equity contributions, or constructive loans".[40] In respect of the deemed dividend, Article 10 of the OECD Model Convention is also applicable for deemed distributions and the secondary adjustment according to Article 9 of the OECD Model Convention should be made.[41]

In fact, a secondary adjustment is not regulated in Article 9 of the OECD Model Convention and is certainly not required; however, if a secondary adjustment is made, according to Article 9 paragraph 2, the tax authorities are bound to manner in which it is implemented to the substantive

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[32] *Ibid*.
[33] *Ibid*.
[34] Chapter IV Paragraph 4.36. OECD Transfer Pricing Guidelines 2010
[35] *Ibid*.
[36] Chapter IV Paragraph 4.38. OECD Transfer Pricing Guidelines 2010
[37] Chapter IV Paragraph 4.39. OECD Transfer Pricing Guidelines 2010
[38] European Commission, "*Final Report on Secondary Adjustments*," EU Joint Transfer Pricing Forum, p.2. Retrieved from http://ec.europa.eu/taxation_customs/resources/documents/taxation/company_tax/ transfer_pricing/forum/ final_report_secondary_adjustments_en.pdf
[39] Chapter IV Paragraph 4.67. OECD Transfer Pricing Guidelines 2010
[40] *Ibid*.
[41] *Supra*. n.16 p.141.

rules of the treaty.[42] It is also worth noting that the secondary adjustments are rejected by some countries because of the practical difficulties. The OECD Guidelines also illustrate some difficulties by giving examples. If a primary adjustment is made between brother-sister companies, the secondary adjustment may involve a hypothetical dividend from one of those companies up a chain to a common parent, followed by constructive equity contributions down another chain of ownership to reach the other company involved in the transaction. Many hypothetical transactions might be created, raising questions whether tax consequences should be triggered in other jurisdictions besides those involved in the transaction for which the primary adjustment was made.[43] Some countries that have adopted secondary adjustments also provide another option to avoid secondary adjustment by having the taxpayer arrange for the MNE group repatriate the excess profits to enable the taxpayer to conform its account to the primary adjustment. The repatriation may be in a form of dividend payments, account receivable, payment of additional transfer price (where the original price was too low) or as a refund of transfer price (where the original price was too high).[44]

Article 9 paragraph 2 the UN Model Convention specifies the provision exactly similar to article 9 paragraph 2 of the OECD Model Convention, as quoted above. However, article 9 paragraph 3 of the UN Model Convention further provides that *the provisions of paragraph 2 shall not apply where judicial, administrative or other legal proceedings have resulted in a final ruling that by actions giving rise to an adjustment of profits under paragraph 1, one of the enterprises concerned is liable to penalty with respect to fraud, gross negligence or willful default.*

1.4 Dispute Preventions and Resolutions

The application of transfer pricing law can result in disputes due to disagreement of the arm's length price. The dispute may be between the tax administration and the taxpayer. And another dispute may arise between the tax administrations in different countries in relation to the corresponding adjustment. Therefore, in addition to appeal of the tax administration order and litigation, it is worth considering the possible preventions and resolutions of such disputes.

(1) Possible Preventions of the Disputes

- *Tax Examination / Tax Audit* – The tax audits might be done on a regular basis or due to the information received by the tax administrations through an exchange of information between tax administrations of different countries. From the transfer pricing perspective, the tax audits are very fact-intensive and may include difficult assessments of comparability, judgment of industry, market and financial information, analysis of intangible ownership and interpretation of intercompany agreement. Transfer pricing audits and dispute may therefore become very complex and somewhat subjective.[45] Once there are some findings in the audit process, the settlement may be done by negotiation, depend on the existing administrative procedures, litigation or arbitration.[46]

However, as a nature of transfer pricing involves the multinational transaction, the international cooperation between the countries involved can effectively help the examination. The OECD Guidelines also discuss about the simultaneous tax examinations which is a form of mutual assistance that allows two or more countries to cooperate in tax investigations. Its legal basis is Article 26 of the OECD Model Convention that provides for cooperation between the competent authorities of the Contracting States in the form of exchanges of information necessary for carrying out the provisions of the Convention or of their domestic laws concerning taxes covered by the Convention.[47] This process is particularly useful where information based in a third country is a key to a tax investigation because they generally lead to more timely and more effective exchanges of

[42] Vogel, K., *Klaus Vogel on double taxation convention: a commentary to the OECD-, UN- and US model conventions for the avoidance of double taxation on income and capital with particular reference to German treaty practice*. (Munich: Kluwer Law International, 1996) p.557

[43] Chapter IV Paragraph 4.70. OECD Transfer Pricing Guidelines 2010

[44] Chapter IV Paragraph 4.72. OECD Transfer Pricing Guidelines 2010

[45] Bakker, A.and M.M.Levey, *Transfer pricing and dispute resolution: aligning strategy and execution* (Amsterdam: IBFD, 2011) pp.16,17

[46] *Ibid*. p.17

[47] Chapter IV Paragraph 4.80. OECD Transfer Pricing Guidelines 2010

information.[48] It has also been suggested that the simultaneous tax examinations can reduce the possibilities for economic double taxation, reduce the compliance cost to taxpayers and speed up the resolution of issues. Normally, if the reassessment is made, both countries involved should endeavor to reach a result that avoids double taxation for the MNEs.[49]

- *Tax Administrative Ruling* - The advance determining ruling of the tax administrations can crystallizes the practical problem in order to allow the taxpayer to easily comply with tax legislations. It is a written statement which the taxpayer seeks from the tax administration about the tax implications of a transaction.

- *Safe Harbour* – It is a provision that applies to a defined category of taxpayers or transactions and that relieves eligible taxpayers from certain obligations otherwise imposed by a country's general transfer pricing rules.[50] A safe harbour substitutes simpler obligations for those under the general transfer pricing regime. Such a provision could, for example, allow taxpayers to establish transfer prices in a specific way, e.g. by applying a simplified transfer pricing approach provided by the tax administration.[51] Alternatively, a safe harbour could exempt a defined category of taxpayers or transactions from the application of all or part of the general transfer pricing rules. Often, eligible taxpayers complying with the safe harbour provision will be relieved from burdensome compliance obligations, including some or all associated transfer pricing documentation requirements.[52]

Basically, the safe harbour provision can help simplify the compliance and reduce the cost for eligible taxpayers. Also, it can provide certainty to eligible taxpayers. And the tax administration can allocate its resource to examinations of more complex and higher risk transactions.[53] On the other hand, the safe harbour provision may become a gap of law for inappropriate tax planning and raise the issues of equity and uniformity. Furthermore, if the safe harbor is unilaterally adopted, it may increase the risk of double taxation.[54]

- *Advance Pricing Arrangement ("APA")* – The APA is an arrangement that determines, in advance of controlled and appropriate set of criteria (e.g. method comparables and appropriate adjustments thereto, critical assumptions as to future events) for the determination of the transfer pricing for those transactions over a fixed period of time. It is normally negotiated by a taxpayer and requires negotiations between the taxpayer, one or more associated enterprises, and one or more tax administrations. It is normally initiated by the taxpayers.[55] There are two types of APA, namely – a unilateral APA, which is an agreement between a taxpayer and the tax administration of its country of residence; and a bilateral or multilateral APA (so-called "MAP APA") which is a single mutual agreement between the competent authorities of two tax administrations. A multilateral APA consists of more than one bilateral APA. The bilateral and multilateral APA are governed by Article 25 of the OECD Model Convention.[56]

Its advantages are to help taxpayers to eliminate uncertainty through enhancing the predictability of tax treatment in international transactions, to help both tax administrations and taxpayers to consult and cooperate in a non-adversarial environment, and to prevent costly and time-consuming examinations and litigation of major transfer pricing issues.[57] However, if the APA is unilateral, it is still uncertain and the problem may arise if the tax administration of the other jurisdiction disagrees with the APA's conclusions.[58] Furthermore, if the APA involved an unreliable prediction on changing market conditions without adequate critical assumption, in no way shall the

[48] Chapter IV Paragraph 4.77. OECD Transfer Pricing Guidelines 2010
[49] *Ibid.*
[50] Chapter IV Paragraph 4.100. OECD Transfer Pricing Guidelines 2010
[51] *Ibid.*
[52] *Ibid.*
[53] Chapter IV Paragraph 4.103. OECD Transfer Pricing Guidelines 2010
[54] Chapter IV Paragraph 4.108. OECD Transfer Pricing Guidelines 2010
[55] Chapter IV Paragraph 4.123. OECD Transfer Pricing Guidelines 2010
[56] *Supra*. n.45 p.30
[57] Chapter IV Paragraph 4.142-4.144. OECD Transfer Pricing Guidelines 2010
[58] Chapter IV Paragraph 4.147. OECD Transfer Pricing Guidelines 2010

problem of transfer pricing can be avoided. As a result, it is suggested that the APA should remain flexible.[59]

(2) Alternative Dispute Resolutions

- *Mutual Agreement Procedures ("MAP")* – According to Article 25 of the OECD Model Convention, if the actions of one or both of the Contracting States result or will result in taxation not in accordance with the provision of the OECD Model Convention, the person may, irrespective of the remedies provided by the domestic law of those States, present his case to the competent authority of the Contracting State of which he is a resident, within three years from the first notification of the action resulting in taxation not in accordance with the provision of the Convention. In this respect, such motion presented to the authority may be submitted even before the tax has been charged or even notified to the taxpayer.[60] In such case the competent authority shall endeavor, if the objection appears to it to be justified and if it is not itself able to arrive at a satisfactory solution, to resolve the case by mutual agreement with the competent authority of the other Contracting State, with a view to the avoidance of taxation which is not in accordance with the Convention. In such case, the competent authorities of the Contracting States shall endeavor to resolve by mutual agreement any difficulties or doubts arising as to the interpretation or application of the Convention.[61]

After receipt of the MAP request, the competent authority will consider the request's acceptability based on the aspects (i) whether the issue of transaction is covered by the applicable treaty, (ii) whether the request is submitted within the time limits, and (iii) whether the issue or objections seem to be justified.[62] If the competent authority cannot resolve the issue unilaterally, it will engage the other competent authority and the second phase of the MAP commences. In this respect, it is not necessary to use the diplomatic channel.[63]

OECD has published guidance, so called the "Manual on Effective Mutual Agreement Procedures", on how the MAP should identically work. According to the guidance, it also prescribes the ideal timeline and procedure for a typical MAP process.[64]

- *Arbitration* –Paragraph 5 of article 25 of the OECD Model Convention is added in order to allow the requesting person to submit the issue which is unable to resolve by the competent authorities under the MAP process within 2 years, to the arbitration. However, the arbitration is not allowed if the decision on that issue has already been rendered by a court or administrative tribunal of either State. The OECD commentary on article 25 also provides the detailed information about the arbitration process.

It is noteworthy that in addition to the arbitration under article 25 paragraph 5 of the OECD Model Convention, the EU Convention on the Elimination of Double Taxation in Connection with the Adjustment of Profits of Associated Enterprises ("Arbitration Convention") also applies to the transfer pricing adjustments between related parties in different EU Member States. Article 1 of the Code of Conduct for the effective implementation of the Arbitration Convention also includes EU triangular transfer pricing cases and profit adjustments arising from financial relations, including a loan and its terms, within the scope of the Arbitration Convention.[65]

Based on the above discussion of possible dispute preventions and resolutions, it is possible to conclude that the preventions can give benefit to the taxpayers in term of certainty and times. But in no way shall the taxpayer can think ahead all the problem and once the dispute occurs, alternative dispute resolutions are still available for them in addition to the appeal to the tribunal or litigation .

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[59] Chapter IV Paragraph 4.149. OECD Transfer Pricing Guidelines 2010

[60] OECD, "*Commentary on Article 25: Concerning the mutual agreement procedure*," in Model Tax Convention on Income and on Capital 2010 (Full Version), OECD Publishing. http://dx.doi.org/10.1787/9789264175181-59-en

[61] Article 25 paragraphs 1-3. OECD Model Convention with Respect to Taxes on Income and on Capital

[62] *Supra*. n.45 pp.23,24

[63] *Ibid*. p.24

[64] *Ibid*.

[65] *Ibid*. p.26

PART 2: PRACTICES IN AUSTRIA AND THE EU COUNTRIES

Although the OECD Model Convention and the OECD Guidelines allow the country to make primary adjustment, it is only possible if there is a domestic provision authorizing the tax administration to do so.[66] In order to understand the actual application of the OECD Model Convention and the OECD Guidelines, it is advisable to consider how the countries adopt them to be the domestic legislations. Austria, Germany and the UK, which are members of OECD, are models herein considered for illustration of such application.

2.1 Statutory Rules, Arm's Length Principle and Primary Adjustment

(1) Austria

Austria has general statutory rules which are aimed at dealing with transfer pricing. The requirements to apply arm's length principle on inter-company dealings and for adequate documentation of transfer pricing are constituted in Article 6 paragraph 6 of the Income Tax Act (Austria EStg § 6 Z 6) and Article 124, 131 and 138 of the Federal Fiscal Code.[67] According to Article 6 paragraph 6 of the Austrian Income Tax Act, assets transferred to a foreign permanent establishment or business of the same taxpayer and to a group of companies must be valued at the price that would be realized if the assets were sold to unrelated parties.[68]

In October 2010, the Austrian Ministry of Finance issued specific transfer pricing guidelines as a decree, which is binding on the Austrian tax authorities but not binding on taxpayers and the courts. These are the first domestic transfer pricing guidelines (*Verrechnungspreisrichtlinien 2010, VPR 2010)* ever published by the Austrian Ministry of Finance, and they refer to the OECD transfer pricing guidelines, as amended in 2010, as well as to the OECD Report on the Attribution of Profits to Permanent Establishments.[69] However, the guidelines are aimed to provide guidance for the tax inspectors on how to handle transfer pricing cases by interpretation of the OECD Guidelines. It therefore do not represent comprehensive guidelines on the determination and documentation of transfer prices, but in fact refer back in many aspects to formerly published opinions of the Ministry of Finance in connection with specific questions of international tax issues, the so-called Express Answer Services ("EAS").[70]

(2) Germany

Section 1 of the German Foreign Tax Act (AStg) is the main source for transfer pricing guidance. It rules on the followings:

- Definition of the arm's length principle, including the notion that unrelated parties would have knowledge on all relevant facts and circumstances of the transaction and would act as prudent and diligent business managers. This definition is supplemented by the hypothetical arm's length principle that shall be applied if the set of comparables does not meet limited comparability requirements.

- Definition of related parties, which means an ownership of 25% or more.

- Establishment of the preference of traditional transaction based methods; and the limitation of profit based methods to cases where the three traditional methods are not appropriate.

- Emphasis on the adjustment of transfer pricing ranges; if no fully comparable data exists; transfer pricing ranges need to be narrowed. When a taxpayer selects a transfer price outside of the range, the adjustment will be made to the median of the range.

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[66] *Supra*. n.16 p.138.

[67] PWC, "*International Transfer Pricing – Austria*," p.251, Retrieved from http://www.pwc.com/gx/en/international-transfer-pricing/assets/austria.pdf

[68] OECD , "*Transfer Pricing Country Profiles – Austria*," p.1 Retrieved from http://www.oecd.org/ctp/transfer-pricing/Austria_TPcountryprofile_Sept2012.pdf

[69] Deloitte, "*2015 Global Transfer Pricing Guide*," p.17, Retrieved from https://www2.deloitte.com/content/dam/Deloitte/global/Documents/Tax/dttl-tax-transfer-pricing-country-guide-2015.pdf

[70] *Supra*. n.67 p.251

- Introduction of the Transfer of Function rules, which leads to the establishment of an exit taxation, if certain functions, risks, assets, and opportunities are relocated.

- General authority to adjust transfer prices that do not meet the arm's length requirement, including a price adjustment mechanism that allows for adjustments within a ten-year period.[71]

The interpretation of the term arm's length principle as regards the double taxation agreement and section 1 of German Foreign Tax Act follows the OECD Commentary on article 9 of OECD Model Convention and the publications of the OECD on the arm's length principle.[72]

In 2008, a special approach regarding the taxation of migrated functions, which is so called "Transfer Package" approach, is added to the transfer pricing law of Germany. According to the approach, the German tax authorities are authorized to tax cross-border transfers of business functions between related parties as a whole (i.e., as a "transfer package"). The new provisions provide guidance on how the value of the transfer package will need to be determined for German tax purposes instead of separately valuing each individual identifiable asset subject to transfer, as it was the case under the old regulations. The "transfer package" is regarded as a partial business and comprises all assets and advantages transferred in connection with the business function. The "transfer package" includes: (i) transferred assets; (ii) opportunities and risks; and (iii) any advantages and benefits in connection with the relocation of the function.[73]

In this respect, the OECD Guidelines support the application of the arm's length principle on a transaction-by-transaction basis (paragraph 1.42). A "package approach" should be used only in cases where the transactions are so linked together that it is not possible to evaluate them separately. The new German transfer pricing regulations amended in 2008, however, provide for a mandatory "transfer package" approach; valuation on asset basis is acceptable only in exceptional cases. The taxation of profit potential of transferred functions, synergies and advantages of location as a "transfer package" is a rather unique approach, not covered in the OECD Guidelines and not known to be applied by other OECD countries.[74]

(3) The United Kingdom

The transfer pricing legislation of the United Kingdom is specified in Part 4 of Taxation (International and Other Provisions) Act 2010 (also known as "TIOPA 2010"). In section 147 of the TIOPA 2010 describes the general rules and conditions to apply the arm's length principle and section 167 also insists that the transfer pricing legislations shall be interpreted in accordance with the OECD Model Convention. In addition, the HM Revenue and Customs (HMRC) publishes guidance on its interpretation of transfer pricing legislation, OECD principles and UK case law.[75]

2.2 Associated Enterprises / Related Parties

(1) Austria

There is no specific definition of related parties in the Austrian Income Tax Act. General reference is made to article 9 of the OECD Model Convention.

(2) Germany

Section 1 paragraph 2 of the Foreign Tax Act contains the definition of related parties.[76] A person is related to the taxpayer: (i) if that person holds, directly or indirectly, a participation of at least ¼ in the taxpayer's capital, or if that person is able to exercise, directly or indirectly, a controlling influence or vice versa, if the taxpayer holds a substantial participation in that person's

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[71] PWC, "*International Transfer Pricing – Germany*," p.433, Retrieved from http://www.pwc.com/gx/en/international-transfer-pricing/assets/germany.pdf

[72] Haase, F. and D. Steierberg, *Tax Law in Germany* (Munich: C.H.Beck, 2012) p.276

[73] Stephoudt, T.V., "*New German Legislation on Transfer Pricing and Relocation of Functions*", Duff&Phelps Transfer Pricing Insight, p.2 Retrieved from http://www.duffandphelps.com/SiteCollectionDocuments/tp_nwsltr_4q07.pdf

[74] *Ibid*. p.3

[75] *Supra*. n.69 p.226

[76] OECD, "*Transfer Pricing Country Profiles – Germany*," p.1 Retrieved from http://www.oecd.org/tax/transfer-pricing/Germany_TPCountryProfile_Nov2012.pdf

capital or is able to exercise, directly or indirectly, a controlling influence on that person; (ii) if a third person holds a substantial participation both in that person's and the taxpayer's capital, or is able to exercise, directly or indirectly, a controlling influence on both of them; or (iii) if that person or the taxpayer is able, in agreeing on the terms and conditions of a business relationship, to exercise influence on the taxpayer or on the person based on facts beyond the business relationship, or if one of them is personally interested in the other party's earning of such income.[77]

(3) The United Kingdom

The participation condition is one of the basic pre-conditions specified in section 147(1) to apply the transfer pricing legislation. According to sections 148, and 157-163 of TIOPA 2010, the parties are related when one party, directly or indirectly, participates in management, control or capital of the other, or when the same person or persons, directly or indirectly, participates in management, control or capital of both parties. Generally, there is a 51 percent test of control, but this can be reduced to 40 percent in joint venture situations. Persons acting together to exert control in relation to financing arrangements are also treated as being related.[78] In this respect, it is worth noting that in order to consider the indirect participation, TIOPA 2010 considers not only the shareholding, but also the actual rights and powers to control the other persons.

2.3 Acceptable Transfer Pricing Methods

(1) Austria

As Austria implementing the 2010 OECD Guidelines, the selection of a transfer pricing method always aims to find the most appropriate method for a particular case. In cases when more than one method can be applied in an equally manner, the traditional transaction methods are preferable to the transactional profit methods.[79]

(2) Germany

Germany accepts the traditional methods as priority standards for transfer pricing examination, i.e. CUP method, resale price method, and cost plus method. However, there exists no priority among them.[80] The profit based methods are also recognized, but limited to the case where the three traditional methods are not appropriate.[81] In verifying the appropriateness of determination as regards and its application, it is assumed that a sound business manager

- would refer to the method closest to the circumstances under which arm's length prices are formed in commercially comparable markets, and

- will, in case of doubt refer to the method for which most reliable price, use relevant data available from actual transactions of the participating affiliated companies with third parties. In this context the circumstances of the individual case shall be determined.[82]

The circumstances will often make it necessary to rely on several methods to determine the transfer prices. It is thus not objected if standard methods are specified, mixed or supplemented by other elements to meet the market conditions.[83]

(3) The United Kingdom

The UK transfer pricing legislation follows the 2010 OECD Guideline. Therefore, the traditional transaction methods and the traditional profit methods are recognized and there is no distinct hierarchy of methods, but rather the most appropriate method to the circumstance of the case is applied.[84]

[77] *Supra*. n.69 p.84
[78] *Supra*. n.69 p.226
[79] *Supra*. n.69 p.17
[80] *Supra*. n.72 p.267
[81] *Supra*. n.68 p.1
[82] *Supra*. n.72 p.267
[83] *Ibid*.
[84] *Supra*. n.69 p.227

2.4 Secondary Adjustment

(1) Austria

There are nine EU Member States (including Austria and Germany) that apply secondary adjustments. However, in a case where secondary adjustments are treated as hidden profit distribution/contribution and considered as constructive dividends, the EU has Parent Subsidiary Directive to solve the problem of double taxation of the secondary adjustments. To say, in a situation whereby a subsidiary in an EU Member States is subject to a secondary adjustment based on a primary transfer pricing adjustment relating to a transaction with its parent company situated in another member state, both Austria and Germany would not impose any withholding tax on the basis of the provisions of the EU Parent Subsidiary Directive (Articles 4 and 5).[85] It is also noteworthy that this relief is not applied to a transaction which either parent or subsidiary is in the state being not a member of EU but it is still possible to solve problem by means of the MAP.

(2) Germany

Please see above in 2.4(1).

(3) The United Kingdom

HMRC does not make secondary adjustments when it makes a transfer pricing adjustment, as there is no basis in the UK law. When a treaty partner applies a secondary adjustment by deeming a distribution to have been made, this is normally exempt from tax in the UK under the dividend exemption rules. Any withholding tax on the deemed dividend would likewise not be eligible for relief in the UK.

2.5 Dispute Preventions and Resolutions

Since all sample countries are members of the EU and their domestic laws recognize the OECD Guidelines, the possible dispute resolutions according to article 25 of the OECD Model Convention and the EU CONVENTION on the elimination of double taxation in connection with the adjustment of profits of associated enterprises (90/436/EEC), i.e. MAP and arbitration, are options for solving tax dispute in those countries. Although the UK has traditionally taken its robust line in relation to engaging in MAP discussions before a transfer pricing adjustment has been made in the UK, it has recently issued a Statement of Practice on MAPs which has marked a softening its traditional approach by suggesting that HMRC may now be willing to take part in MAP discussions before a transfer pricing enquiry is concluded in particular circumstance.[86] This part will therefore discuss only the possible preventions under domestic laws of each country.

(1) Austria

In Austria, there is no specific procedure for transfer pricing investigations. Normally, the tax auditors visit the company and review books and records. Then the auditors shall issues a list of findings. If the company cannot agree with any issue that is come up from the inspection, it has been entitled to appeal against assessment.[87]

The company may obtain unilateral advance pricing agreement. The Ministry of Finance published the decree that enable taxpayers to ask for binding APA regarding certain issues in taxation such as transfer pricing. Bilateral advance pricing agreement is also possible under the MAP clause of applicable double tax agreement.[88] In addition, according to Section 118 of the Federal Fiscal Code, it is also possible to apply for a unilateral, binding and appealable advance ruling regarding transfer pricing by submitting a written application.[89]

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[85] *Supra*. n.38 p.4

[86] PWC, "*International Transfer Pricing – United Kingdom*," pp.807,808, Retrieved from http://www.pwc.com/gx/en/international-transfer-pricing/assets/united-kingdom.pdf

[87] *Supra*. n.67 p.258

[88] *Ibid*. p.260

[89] European Commission, "*Austria Transfer Pricing Profile*," p.2, Retrieved from http://ec.europa.eu/taxation_customs/resources/documents/taxation/company_tax/transfer_pricing/forum/profiles/tpprofile-at.pdf

(2) Germany

The German tax authority examines transfer pricing during the normal tax field audits which are performed at regular intervals. Almost all tax audits are focusing on transfer pricing and tighter investigations by tax auditors into transfer pricing issues are occurring.[90] After investigation, the tax auditor shall prepare and present a report, including suggestions for any tax adjustment, to the tax authority. Then, the tax authority shall prepare revised tax assessments. The taxpayers may appeal against the revised assessment.[91]

With regard to the APA, it is unlikely that the Federal Ministry of Finance shall grant unilateral APA in transfer pricing issues because of non-binding effect on the other country.[92] Furthermore, the tax authorities closely examine any unilateral APA granted by a foreign tax authority that has detrimental effects in Germany, unless the German tax authorities themselves actively participated in the APA process.[93]

For the bilateral or multilateral APA, the Federal Ministry of Finance released a circular on this respect which was designed to facilitate the processing of APA and to establish more certainty for taxpayers.[94] An agreement reached between two competent tax authorities will be made based on two conditions; i.e. (i) the taxpayer must consent to the intergovernmental agreement, and (ii) must waive its right to appeal against tax assessments, to the extent that they are in line with the content of the APA.[95]

(3) The United Kingdom

The UK enterprises are required to self-assess their compliance with the arm's length principle in filing tax returns, in which they must identify and make transfer pricing adjustment.[96] Such adjustment shall be made according to a "one-way street" approach. To say, the adjustment must result in increased taxable profits or reduced allowable losses in the UK. Failure to comply with this approach is the potential for interest and penalties for carelessness.[97] HMRC may commence an enquiry into the return by issuing a formal notice. The scope of enquiry may extend to anything including transfer pricing.[98] In this respect, the Transfer Pricing Group has been introduced to work on enquiries. The size and make-up of a transfer pricing team depends on the scale and complexity of the enquiry.[99] Once there is an open enquiry or HMRC has issued a closure notice, amended the taxpayer's return or made a discovery assessment, the taxpayer may ask for the case to be heard by the tax tribunal. Alternatively, the taxpayer may require HMRC to review the point at issue or HMRC may offer the taxpayer a review. If HMRC's review is unfavorable and the taxpayer does not wish to accept it, the taxpayer must file an appeal to the tax tribunal within 30 days.[100]

It is worth noting that HMRC is seeking to make more use of collaborative dispute resolution tools to resolve long-running and difficult transfer pricing enquiries as an alternative to litigation. Facilitative mediation is being explored, but it is likely to be used only in a small number of cases.[101] Furthermore, HMRC is able to participate in simultaneous tax examinations with another tax authority using the exchange of information provisions in their respective double tax treaty or under the

[90] *Supra*. n.71 p.439
[91] *Ibid*. p.440
[92] *Ibid*. p.444
[93] *Ibid*.
[94] *Ibid*.
[95] EY, "*Worldwide transfer pricing reference guide 2014*," p.120 Retrieved from http://www.ey.com/Publication/vwLUAssets/EY-Worldwide-transfer-pricing-reference-guide-2014/$FILE/Worldwide%20transfer%20pricing%20reference%20guide%202014.pdf
[96] *Supra*. n.86 p.793
[97] *Ibid*.
[98] *Ibid*. p.800
[99] *Ibid*.
[100] *Ibid*. p.802
[101] *Ibid*. p.811

provisions of the OECD / Council of Europe Convention on Mutual Administrative Assistance in Tax Matters.[102]

The APA option is also available according to Part 5 of TIOPA 2010. A statement of practice governing the application of the statutory provisions for APA was first introduced in 1999, and a revised statement was published at the end of 2010 (SP 2/10).[103] Section 218(1) of TIOPA 2010 provides that APA process is initiated by a business making an application for clarification by agreement regarding the application of the statutory provision. An executed agreement between the business and HMRC determines the treatment of the transfer pricing issues for a specified period of time.[104] However, a business may request the renewal of the APA no later than six months before the expiration of the APA's current term.[105]

2.6 Burden of Proof in Tax Case Procedures

(1) Austria

As a matter of principle, the tax authorities carry the burden of proof. If the tax authorities challenge a tax return, the taxpayer does not have to prove the accuracy of the return rather, the tax authorities would have to prove the contrary. However, if the documentation is not provided to the tax authorities as requested, the burden of proof shifted to the taxpayer. In addition, in international tax cases, the taxpayer bears a special liability of cooperation.[106] In this respect, the taxpayer has a duty to obtain evidence and submit this to the tax authorities regardless of the possibilities of assistance from foreign tax authorities.[107] It is also worth noting that the Administrative Court indicate that there is a limit to this duty insofar as the tax authorities cannot demand impossible, unreasonable or unnecessary information from the taxpayer.[108]

(2) Germany

In principle, the taxpayer has to prove compliance with German tax law for all business transactions, including transfer pricing matters. In this respect, the decision of the Federal Tax Court of 17 October 2001 provides guidance that the taxpayer has to prove the underlying facts of a transaction, which includes presentation of the functions and risks and a description of how the transfer price for the transaction was determined, including the appropriateness of the transfer prices applied. Then, the burden is shifted to the tax authorities to prove that the transfer price is or is not arm's length. If the taxpayer cannot fully comply with his/her obligation to present all facts, the tax authorities may conclude that the pricing has been determined by the affiliation of the parties; but tax authorities must still determine the proper pricing by means of a comparability study or an appropriate estimation.[109]

In 2003, the legislation has introduced a rebuttable assumption providing that, in a case of absence of appropriate documentation, the actual income from intercompany transaction is higher than the income declared. If the taxpayer is not able to rebut this assumption, the tax authorities may have to estimate the arms length result. And if the income can be determined only within a certain price range, the authorities may use the least favorable end of the price range. Otherwise, according to the aforesaid decision of the Federal Tax Court, one would benefit to the use of most favorable end of the price range.[110]

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[102] *Ibid*. p.812
[103] *Supra*. n.95 p.309
[104] *Supra*. n.86, p.809
[105] *Ibid*. p.810
[106] *Supra*. n.67 p.257
[107] *Ibid*. p.258
[108] *Ibid*.
[109] *Supra*. n.71 p.438
[110] *Ibid*.

(3) The United Kingdom

Under the UK legislation, the burden of proving that transfer prices are at arm's length falls on the taxpayer because of the self-assessment approach (as mentioned in 2.5(3) above). The submission of the return under the self-assessment implicitly assumes that the taxpayer has made all necessary adjustments to taxable profits to take account of non-arm's length pricing. However, if the HMRC considers there has been tax revenue lost as a result of negligence or carelessness, rather than for the reasons given by the taxpayers, the burden of proof falls on HMRC.[111]

2.7 Other Interesting Issues in the EU Regulations

Within the EU, there is no harmonization in taxation and the Treaty of Functioning of the European Union ("EU Treaty"), which constitutes primary law of the EU does not directly deal with taxation and transfer pricing.[112] Most of them are part of case law of the European Court of Justice ("ECJ") or the domestic law of the Member States. In principle, the domestic law should not violate the freedom of EU Treaty. To say, the European community internal market is typified by the abolition between the Member States, of all obstacles to the free movement of goods, persons, services and capital.[113] The ECJ follows this scheme by examining following grounds, respectively:

- if the matter of fact is governed by the Treaty freedoms;
- if it is discriminatory or restricts the Treaty freedoms;
- if there is a justification for the discrimination or restriction on grounds of domestic law (general or public interest); and
- if the first three points are accepted, the ECJ analyzes the proportionality.[114]

The EU Treaty mentions only the custom and indirect tax (VAT). For the direct tax, there is only Article 65 of Consolidated version of the Treaty on the Functioning of the European (ex 308 of Treat Establishing the European Community) legitimizing different tax treatment of resident and non-resident taxpayers, and of domestic and foreign-source investment income, at least as far as the freedom of capital and payments is concerned.[115] The only legal bases in the EU Treaty for harmonization taxes are the general harmonization provisions permitting appropriate measures to be adopted.[116] Article 352 paragraph 1 of Consolidated version of the Treaty on the Functioning of the European (ex 308 of Treaty Establishing the European Community) provides that:

> *If action by the Union should prove necessary, within the framework of the policies defined in the Treaties, to attain one of the objectives set out in the Treaties, and the Treaties have not provided the necessary powers, the Council, acting unanimously on a proposal from the Commission and after obtaining the consent of the European Parliament, shall adopt the appropriate measures. Where the measures in question are adopted by the Council in accordance with a special legislative procedure, it shall also act unanimously on a proposal from the Commission and after obtaining the consent of the European Parliament.*

In respect of the transfer pricing and anti-avoidance measures, there are the Parent Subsidiary Directive and the Interest and Royalty Directive, which are considered as secondary law of the EU. In addition, there are bilateral agreements between Member States that provide for certain procedures or guidelines on a specific topic. And in the case of double taxation and the arm's length principle, the Arbitration Convention is relevant.[117]

In addition, there are endeavors to harmonize the taxation practice of the Member States. In June 2002, the EU Joint Transfer Pricing Forum was informally set up as a follow-up to Staff working

[111] *Supra*. n.86 p.800
[112] *Supra*. n.16 p.145
[113] Terra, B. and P.Wattel, *European Tax Law*. (The Hague: Kluwer Law International: 2001) p.30
[114] *Supra*. n.16 p.146
[115] *Supra*. n.113 p.18
[116] *Ibid*. p.14
[117] *Supra*. n.16 p.145.

paper SEC(2001) 1681 on company taxation in the internal market and Communication 2001/58 Towards an Internal Market without tax obstacles – A strategy for providing companies with a consolidated corporate tax base for their EU-wide activities; then it was formally established by Decision 2007/75/EC setting up an expert group on transfer pricing. It assists and advises the European Commission on transfer pricing tax matters.[118] Until now, it has proposed a number of reports and guidance in order to harmonize the transfer pricing practice of the EU Member States.

(1) Parent Subsidiary Directive

The parent-subsidiary directive (2011/96/EU), adopted in November 2011, is intended to ensure that profits made by cross-border groups are not taxed twice, and that such groups are thereby not put at a disadvantage compared to domestic groups. It requires member states to exempt from taxation profits received by parent companies from their subsidiaries in other member states.[119] The Directive applies to a cross-border situation a holding of 20% of capital. If a double taxation treaty exists and article 10 of the OECD Model Convention is applicable, a source tax will be levied for outbound dividends, but if the requirements of the Directive are fulfilled the source state will not levied a withholding tax.[120]

In July 2014, the Council formally adopted an amendment to this Directive that prevents the double non-taxation of dividends distributed within corporate groups deriving from hybrid loan arrangements.[121] Before the amendment, cross-border groups avoid paying taxes altogether by exploiting mismatches between national tax rules. In such cases, the received distributed profits were not taxable in the member state of the parent company, whilst they were treated as a tax-deductible expense in the member state of the subsidiary. The result of this amendment is that the member state of the parent company will refrain from taxing profits from the subsidiary only to the extent that such profits are not tax deductible for the subsidiary. In this respect, Member states will have until 31 December 2015 to transpose the amendment into national law.[122]

(2) Directive on a common system of taxation applicable to interest and royalty payments made between associated companies of different Member States ("Interest and Royalty Directive")

The Interest and Royalty Directive (2003/49/EC) is designed to eliminate withholding tax obstacles in the area of cross-border interest and royalty payments within a group of companies by abolishing withholding taxes on royalty payments arising in a Member State, and withholding taxes on interest payments arising in a Member State. These interest and royalty payments shall be exempt from any taxes in that State provided that the beneficial owner of the payment is a company or permanent establishment in another Member State.[123] According to Article 5 paragraphs 1 and 2, if there are abusive practices whereas a transaction is only made for tax evasion, tax avoidance, or fraud, then the advantages of the Directive are not applicable for the non-arm's length part of the transaction. This Directive requires a direct holding of 25% in the capital or voting rights for cross-border transactions of associated companies.[124] However, there is a proposal to reduce the shareholding requirements to establish that companies are associated, from a 25% direct holding to a 10% direct or indirect holding.[125]

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[118] European Commission, "*Joint Transfer Pricing Forum*," Retrieved from http://ec.europa.eu/taxation_customs/taxation/company_tax/transfer_pricing/forum/

[119] Council of the European Union, "*Parent-subsidiary directive: Council agrees to add anti-abuse clause against corporate tax avoidance*," Press Release ST 15103/14, Retrieved from http://www.consilium.europa.eu/uedocs/cms_data/docs/pressdata/en/ecofin/146127.pdf

[120] *Supra*. n.16 p.146.

[121] Hybrid loan arrangements are financial instruments that have characteristics of both debt and equity.

[122] Council of the European Union, "*Council adopts amendment closing tax loophole for corporate groups*," Press Release 11647/14, Retrieved from http://register.consilium.europa.eu/doc/srv?l=EN&f=ST%2011647%202014%20INIT

[123] European Commission, "*Taxation of cross-border interest and royalty payments in the European Union*," Retrieved from http://ec.europa.eu/taxation_customs/taxation/company_tax/interests_royalties/index_en.htm

[124] *Supra*. n.16 p.146.

[125] *Supra*. n.123

(3) EU Convention on the Elimination of Double Taxation in Connection with the Adjustment of Profits of Associated Enterprises ("Arbitration Convention")

Whilst most bilateral double taxation treaties include a provision for a corresponding downward adjustment of profits of the associated enterprise concerned, they do not generally impose a binding obligation on the Contracting States to eliminate the double taxation. The Arbitration Convention establishes a procedure to resolve disputes where double taxation occurs between enterprises of different Member States as a result of an upward adjustment of profits of an enterprise of one Member State.[126]

(4) Other Proposed Guidance

In addition to the EU laws mentioned above, the Council of European Union has adopted guidance on various aspects relating to transfer pricing, as proposed by Joint Transfer Pricing Forum, in order to harmonize the transfer pricing practice within the EU. However, the guidance is treated as a suggestion and do not bind the Member States. For example, on 27 June 2006, the Council adopted a Code of Conduct on transfer pricing documentation for associated enterprises in the European Union. The Code of Conduct aims to standardize the documentation that multinationals must provide to tax authorities on their pricing of cross-border intra-group transactions.[127]

Another sample is Guidelines for Advance Pricing Agreements in the EU. The guidelines aim to prevent transfer pricing disputes and associated double taxation from arising in the first place by laying down how an efficient APA process should work. The Guidelines set out the framework for the overall procedure and provide details of how some specific problems could be resolved. They also provide examples of the necessary time frame and the types of areas which would need to be covered by the APA. On 5 June 2007 the Council welcomed the Commission Communication on the work of the Joint Transfer Pricing Forum in the field of dispute avoidance and resolution procedures including guidelines for Advance Pricing Agreements within the EU. The Council noted the commitment of Member States to follow the Guidelines and to implement them in their national administrative practices as far as legally possible.[128]

PART 3: TRANSFER PRICING IN THAILAND

3.1 Statutory Rules, Arm's Length Principle and Primary Adjustment

The Thai Revenue Code (the "Code") is a primary law regarding taxation. According to Section 65 of the Code, net corporate profit, which is the outstanding amount from its income, deducted by the deductible expenses, is subject to corporate income tax. In Section 65*bis*(4) of the Code, the revenue officers are empowered to make pricing adjustments on the transfer of properties, rendering of services and lending of money without compensation or with compensation below the market price without justifiable reason. Furthermore, in Section 65*bis*(7), the revenue officers are empowered to make adjustment on the price of imported goods by comparing with the price of the same type of goods imported into another country. Section 65*ter* also provides a list of expenses which are not deductible. Such non-deductible expenses also include (i) a price of purchased goods which is higher than market price without justifiable reason, (ii) an expense that is not for the purpose of acquiring profits nor for the benefit of business in Thailand, and (iii) an expense determined on and payable out of profits after the end of an accounting period.

As the law is very ambiguous, in 2002, the Revenue Department issues its Instruction No. Paw.113/2545 ("Instruction") in order to give guidance to the tax officer in order to effectively implement power under those legislative provisions in a case of the transfer pricing. According to the Instruction, there are only five clauses, mostly implemented from the OECD Guidelines.

[126] European Commission, "*Transfer Pricing and the Arbitration Convention*," Retrieved from http://ec.europa.eu/taxation_customs/taxation/company_tax/transfer_pricing/arbitration_convention/index_en.htm

[127] *Supra*. n.118

[128] *Ibid.*

Clause 1: The companies or incorporated partnerships established under Thai law or foreign law shall be governed by the Instruction and they shall comply with the profit calculation specified in the Code.

Clause 2: If the companies or incorporated partnerships enter into a transaction without compensation or with compensation but lower than the market price, or such transaction result in payment of expense higher than the market price without justifiable reason, they must adjust incomes or expenses to be in line with the market price. Otherwise, the revenue officers are empowered to make price adjustment to the market price. In this respect, paragraph 2 of this clause provides definition of the "market price" as a price of goods, service, or loan interest that the independent contracting parties determined in good faith in the case of transfer of goods, rendering of service or lending of money, respectively, which is of the same type as the related parties' transaction on the same date. In paragraph 3, the term "independent contracting parties" is defined as parties without direct or indirect relationships between each others in terms of management, control or shareholding.

Clause 3: The traditional transaction methods, i.e. CUP Method, Resale Method, and Cost Plus Method, are introduced in order to find the arms' length character of the transaction in question. The Instruction allows other recognized method only in a case that the traditional methods cannot be applied.

Clause 4: List of documentations that the companies or incorporated partnerships must keep in their offices for tax examination and adjustment by the revenue officers.

Clause 5: Taxpayer is allowed to enter into APA with the Revenue Department.

3.2 Associated Enterprises / Related Parties

Instead of describing related parties, Clause 2 paragraph 3 of the Instruction gives definition of the term "independent contracting parties" as parties without direct or indirect relationships between each others in terms of management, control or shareholding.

3.3 Acceptable Transfer Pricing Methods

According to Clause 3 of the Instruction, transaction-based methods are preferred. The profit-based methods may be used only if the transaction-based methods cannot be applied.

3.4 Secondary Adjustment

There is no legislation regarding this issue.

3.5 Dispute Preventions and Resolutions

Taxpayers are not required to submit their transfer pricing documentation with their annual corporate income tax returns unless they are requested by the revenue officers. There is no specific transfer pricing audit. However, the normal tax audit process may raise the transfer pricing issue. The Revenue Department shall issue a letter requesting the taxpayers to provide information and documents on the adopted transfer pricing practices. The targets of request for investigation are considered based on their analysis of the tax returns submitted and information obtained from the business operation visit. The transfer pricing team of the Revenue Department shall review and analyze received documents and information. Then the Revenue Department shall inform the taxpayers of its opinion and require the taxpayers to file amended tax return. If the taxpayers do not accept its opinion, the Revenue Department shall issue a summons to audit all taxes. In this respect, the taxpayers may appeal to the Appeals Division of the Revenue Department. If the taxpayers disagree with the Board of Appeals' ruling, they may bring the case to the Tax Court within 30 days from the date of receipt of the notice of the ruling.[129]

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[129] PWC, "*International Transfer Pricing – Thailand*," pp.776,777. Retrieved from http://www.pwc.com/gx/en/international-transfer-pricing/assets/thailand.pdf

In respect of the APA, Clause 5 of the Instruction allows taxpayers to enter into the APA with the Revenue Department. The Revenue Department has issued guidance on bilateral APA process[130] to allow certainty for the taxpayers and eliminate double taxation under the double tax treaties between Thailand and other jurisdictions. Normally, the term of APA will be 3-5 years. It is worth noting that, based on current practice, the Revenue Department is not willing to accept applications for unilateral APA.[131]

3.6 Burden of Proof in Tax Case Procedures

The burden of proof in the tax case relies on the civil procedure code, in which each party must prove those facts which gave rise to right or defenses on which it relies. Normally, the burden of proof lies with the taxpayer to clear alleged transfer pricing abuses. In the event of a dispute, the taxpayer must be able to substantiate, with supporting documents, to the satisfaction of the revenue officers, the Board of Appeals, or the courts, as the case may be, that its transfer prices have been determined in accordance with the arm's length principle.

PART 4: SUGGESTIONS FOR THAILAND FROM PERSPECTIVES OF COMPARISON STUDY, AEC INTEGRATION, AND GLOBAL TRENDS

The ASEAN Economic Community (AEC) shall be the goal of regional economic integration in Southeast Asian region. AEC envisages the following key characteristics: (a) a single market and production base, (b) a highly competitive economic region, (c) a region of equitable economic development, and (d) a region fully integrated into the global economy.[132] An ASEAN single market and production base shall comprise five core elements: (i) free flow of goods; (ii) free flow of services; (iii) free flow of investment; (iv) free flow of capital; and (v) free flow of skilled labor.[133] The economic integration of ASEAN region induces increase of investment by investors both from outside and inside of the region.

Among other ASEAN members, Thailand has potentials of being target of investment from outside the region. In order to increase its competitiveness, the domestic laws should support the foreign investment. One of domestic laws that are key success of competitiveness is the transfer pricing law. This part will consider the transfer pricing law on three aspects; i.e. (i) current legislation and suggestion, (ii) multilateral cooperation within the AEC, and (iii) global trends on transfer pricing that might result in the next development. In first aspect, current transfer pricing legislation described in Part 3 will be addressed by comparing international standard already discussed in Part 2 in order to illustrate its problems. For reader's convenience, comparison chart is illustrated in ANNEX. Then, it will consider the potential change in laws to harmonize the transfer pricing law of ASEAN members by comparing current EU practices. And for the last aspect, it will address global trends that are now under consideration.

4.1 Problems of Thai Transfer Pricing Legislation

According to comparison study, the following issues should be considered for improving Thai transfer pricing legislation.

(1) Statutory Law

Arm's length principle is actually for adjustment of price in the transaction between the MNEs. However, the primary law of Thailand which is basis for the Revenue Department Instruction is relating to the adjustment of the price based on the market price, of which the concept disregards the relationship between the parties. It is not necessary that the arm's length price should be the same

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[130] The Thai version of the guidance can be retrieved from http://www.rd.go.th/publish/fileadmin/download/GUIDANCE-ON-APA-PROCESS-TH.pdf

[131] *Supra*. n.69 p.219

[132] ASEAN, "*ASEAN Economic Community*," Retrieved from http://www.asean.org/communities/asean-economic-community

[133] Section 9. ASEAN Economics Community Blueprint

as the market price. Furthermore, it is still questionable whether the Instruction is issued beyond the scope of the primary law. As shown in Part 2, Austria, Germany and the United Kingdom prescribe this legislation in the Act of Parliament. Therefore, there should be a primary law specifically dealing with the arm's length principle.

(2) Focus on Multinational Transactions

The Instruction of the Revenue Department applies to both domestic transaction and multinational transaction. But, in fact, the basis of arm's length principle is for dealing with the transfer pricing in the multinational transaction between the MNEs, as a tool for anti tax-avoidance. Current legislation of Thailand is therefore not in accordance with the objective of the arm's length principle. This reason also supports need of specific legislation dealing with the transfer pricing.

(3) Adjustment

Current practice allows the revenue officers to adjust the price either by increase or decrease in transaction price. This practice allows the revenue officers to make corresponding adjustment in a case where Thailand has a treaty with other country and there is primary adjustment in that jurisdiction. In such case, non-double taxation will effectively be recognized. Furthermore, this practice also allows secondary adjustment if Thailand prefer to apply this mechanism. However, as noted above that many countries reject the secondary adjustment because of the practical difficulties and there are only nine countries in the EU apply this practice, Thailand should reconsider if it plans to apply the secondary adjustment in this first stage of development of transfer pricing legislation.

(4) Arm's Length Price and Related Party

According to the Instruction, the terms "market price" and "independent contracting parties" are defined in line with the concept of arm's length price. However, those definitions are still ambiguous. The Instruction considers the fact of management, control, and capital to determine independence between parties. But there is no clear cut on this aspect and no reference to any source if there is a dispute in interpretation. Furthermore, the word "indirect relationship" in the definition of "independent contracting parties" is not clear. Comparing to the EU countries mentioned in Part 2, they refer to OECD Model Convention or OECD Guidelines. Furthermore, in Germany, the law specifies the shareholding proportion. Even in the UK, it has a recognized practice of shareholding proportion test and reduces the proportion in case of joint venture. Moreover, the laws of those countries clearly apply to the brother-sister companies. The definition used in the Instruction likely creates dispute due to different goals between the companies, which want to pay less tax, and the Revenue Department, which want to collect more tax.

(5) Hierarchy of Methods

The Instruction was issued in 2002 and it is now outdated. According to the Instruction, only transaction-based methods are described although it allows other recognized methods but only in a case that the traditional transaction methods cannot be applied. In 2010, OECD Guidelines have been amended to remove this hierarchy to a more flexible standard. The basis for choosing one method over the others is now expressed as "finding the most appropriate method for a particular case". According to the revision of the OECD Guidelines, the most appropriate method must be determined after considering the strengths and weaknesses of each method, together with the availability of reasonably reliable information. This is because in many cases the traditional transaction methods are difficult to apply due to the uniqueness of the goods or services and, more in particular, because of the lack of reliable comparable third party data information. Therefore, in order to uplift the standard of the transfer pricing legislations, this issue must be taken into account.

(6) Unilateral APA

Unilateral APA can create certainty for taxpayers to comply with the law and help tax authority to save its resources and use them only for examination of other major cases. Although other relevant jurisdiction may not accept that agreement, it is still possible to make reservation clause in the unilateral APA. This mean can somehow prevent the dispute between the taxpayers and the Revenue Department. In the meantime, the Revenue Department can still exercise its right under the reservation clause in a case of disagreement made by tax authorities in other jurisdictions. The Revenue Department should therefore consider issuing guidance which supports the unilateral APA.

(7) Burden of Proof

Considering the fact that the Revenue Department is a regulator of transfer pricing, it should have a burden to prove whether the transaction price is in line with the arm's length price. Given the fact that they have a power to request and review documents and information relating to the transaction, in no way shall the taxpayers realize actual reason of making adjustment nor shall they notice any flaw in the information they provide. In addition, as it is a sole authority to initially review transfer pricing matter, carrying burden of proof can guarantee that there will not be double standard on its practice as it knows how it should implements the law on similar situation. Otherwise, the standard used might be different subject to allegation of taxpayers in each individual case. However, reliable information is needed for the Revenue Department to perform its function. The German concept might be the best for Thailand, whereby the taxpayers prove the underlying facts of a transaction and the burden is shifted to the Revenue Department with an exception of rebuttable assumption in a case of absence of appropriate documentation.

4.2 Looking toward AEC Integration

In addition to improve domestic law, as a member of AEC, Thailand should forecast upcoming problems of the transfer pricing due to integration of economic community. This is because AEC integration increases a chance of not only investment from outside, but also investment within the region due to the free flow of five core elements. Single market and production base will create and support more cross-border transaction between inter-related companies within the region. It is also likely that there will be restructure of existing businesses in the region in order to maximize benefit from the AEC integration. Transfer pricing law therefore needs to be ready for unavoidable change in business practice. This respect is not only the domestic issue, but in fact the regional topic that all members should think ahead to make harmonization of law. The EU problems and practices are the best example for the AEC and Thailand should also take into account of this factor to forecast what the domestic law should be and, as a member of AEC, what the role it should play.

It is possible to say that tax integration is important in realizing the internal market of the economic community. However, even in the EU, the integration is still far from reality. The reasons are that (i) there are a number of different tax jurisdiction and direct tax law falls within the internal market; (ii) there is a need of unanimous consents of members in respect of taxation, (iii) European institutions are granted a competence that is limited and which is only possible when such tax measures are necessary to ensure the establishment or functioning of the internal market and to avoid distortion of competition, and (iv) secondary law must comply with the principle of "subsidiarity"[134] in all areas which do not fall within the exclusive competence of the Member States.[135] However, such causes are, in fact, not obstacles of the EU Member States' endeavor to harmonize the transfer pricing law and practice. Based on the EU study on the transfer pricing aspect, the following practices should be initiated and implemented in the AEC.

(1) Setting up Joint Transfer Pricing Forum

In order to harmonize the taxation practice, it is advisable to have joint committee or joint forum within the region. This is to allow members to work together on proposing guidance in order to harmonize the transfer pricing practices and other anti tax-avoidance measures. Furthermore, it might create cooperation between tax administrations within the members and lead to multilateral treaty on taxation. Function of this forum is a key to drive implementation of other harmonization of transfer pricing within the region.

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[134] Term "Subsidiarity" is specified in Article 5 of the Treaty on European Union. It is an organizing principle that matters ought to be handled by the smallest, lowest or least centralized competent authority. Political decisions should be taken at a local level if possible, rather than by a central authority.

[135] Weber, D., "*Traditional and Alternative Routes to European Tax Integration* (Amsterdam: IBFD, 2010) p.33

(2) Standardized Documentations

The EU Code of Conduct on transfer pricing documentation for associated enterprises in the European Union is one of simple and possible harmonization that can apply to the AEC. It can help all members to set standard of documents to be reviewed for transfer pricing aspect. It likewise supports the exchange of information that are required for examination of transfer pricing between the MNEs.

(3) Arbitration

The different domestic laws and practices of each member unavoidably create dispute between the relevant countries. Article 25 of the OECD Model Convention suggests the arbitration clause to solve the dispute. Rather than making each bilateral treaty to deal with the arbitration, the multilateral agreement can harmonize the practice of members to the same standard. It is therefore possible to have an agreement similar to the EU Arbitration Convention, between the members.

4.3 Global Trends on Transfer Pricing

In order to uplift the Thai transfer pricing legislation, global trends that lead to change transfer pricing practice should also be recognized. Otherwise, the law might be outdated once it is enacted. This article therefore addresses following issues to let us think ahead the trends and likelihood of development of law in the near future.

(1) Special Considerations for Specific Transactions

Some specific transactions have their natures different from sale of goods. The circumstances and methods to find the arm's length price are in no way similar to those applied in the sale of goods. The OECD Guidelines therefore discuss some special considerations for the specific transactions; i.e. intangible property in Chapter VI, intra-group services in Chapter VII, cost contribution arrangements in Chapter VIII, and business restructuring in Chapter IX. Therefore, the development suggested in this part may not be sufficient to govern all aspects of transfer pricing. However, it is possible to say that Thai transfer pricing legislation is now at first step of development. The focus should be based on basic idea of general consideration before jumping into the detailed complexity of specific transaction.

(2) Base Erosion and Profit Shifting Action Plan

It is recognized that the current global business practice is in the era of base erosion and profit shifting ("BEPS"), which refers to tax planning strategies that exploit gaps and mismatches in tax rules to make profits 'disappear' for tax purposes or to shift profits to locations where there is little or no real activity but the taxes are low, resulting in little or no overall corporate tax being paid.[136] Corporate tax is levied at a domestic level. When activities cross border, the interaction of domestic tax systems means that an item of income can be taxed by more than one jurisdiction, thus resulting in double taxation. The interaction can also leave gaps, which result in income not being taxed anywhere. BEPS strategies take advantage of these gaps between tax systems in order to achieve double non-taxation. BEPS distorts competition and may lead to inefficient allocation of resources by distorting investment decisions towards activities that have lower pre-tax rates of return, but higher after-tax returns. Furthermore, it is an issue of fairness. When taxpayers (including ordinary individuals) see multinational corporations legally avoiding income tax, it undermines voluntary compliance by all taxpayers.[137]

Many BEPS strategies take advantage of the interaction between the tax rules of different countries, which means that unilateral action by individual countries will not fully address the problem. There is therefore a need to provide an internationally coordinated approach which will facilitate and reinforce domestic actions to protect tax bases and provide comprehensive international solutions to respond to the issue. The BEPS Action Plan provides a consensus-based plan to address

[136] OECD. "*OECD/G20 Base Erosion and Profit Shifting Project – Frequently Asked Questions*," p.15 Retrieved from http://www.oecd.org/ctp/beps-frequently-asked-questions.pdf

[137] *Ibid.*

these issues and is part of the OECD's ongoing efforts to ensure that the global tax architecture is equitable and fair. The action plan consists of 15 actions to address BEPS in a comprehensive and coordinated way. These actions will result in fundamental changes to the international tax standards and are based on three core principles: coherence, substance, and transparency.[138]

The current transfer pricing rules do not always properly address the way modern businesses operate in a globalised environment, and taxpayers have thus been able to use/misuse the rules to artificially shift profits. In particular, the arm's length principle faces challenges in addressing transfers of intangibles, risks, and capital, and other high-risk transactions.[139] Action 13 of BEPS enhance transparency for tax administrations by providing them with adequate information to assess high-level transfer pricing and other BEPS-related risks is a crucial aspect for tackling the BEPS problem.[140] In September 2014 the countries participating in the OECD/G20 Base Erosion and Profit Shifting (BEPS) Project published the report "Guidance on Transfer Pricing Documentation and Country-by-Country Reporting" (the September Report). It described a three-tiered standardized approach to transfer pricing documentation. This standard consists of (i) a master file containing standardized information relevant for all MNE group members; (ii) a local file referring specifically to material transactions of the local taxpayer; and (iii) a Country-by-Country Report containing certain information relating to the global allocation of the MNE group's income and taxes paid together with certain indicators of the location of economic activity within the MNE group.[141]

Furthermore, the Action Plan directs the OECD to address a number of transfer pricing issues, as follows:

> **Action 8 – Intangibles**
>
> Develop rules to prevent BEPS by moving intangibles among group members. This will involve (i) adopting a broad and clearly delineated definition of intangibles; (ii) ensuring that profits associated with the transfer and use of intangibles are appropriately allocated in accordance with (rather than divorced from) value creation; (iii) developing transfer pricing rules or special measures for transfers of hard-to-value intangibles; and (iv) updating the guidance on cost contribution arrangements.
>
> **Action 9 – Risks and capital**
>
> Develop rules to prevent BEPS by transferring risks among, or allocating excessive capital to, group members. This will involve adopting transfer pricing rules or special measures to ensure that inappropriate returns will not accrue to an entity solely because it has contractually assumed risks or has provided capital. The rules to be developed will also require alignment of returns with value creation. This work will be co-ordinated with the work on interest expense deductions and other financial payments.
>
> **Action 10 – Other high-risk transactions**
>
> Develop rules to prevent BEPS by engaging in transactions which would not, or would only very rarely, occur between third parties. This will involve adopting transfer pricing rules or special measures to: (i) clarify the circumstances in which transactions can be recharacterised; (ii) clarify the application of transfer pricing methods, in particular profit splits, in the context of global value chains; and (iii)

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[138] *Ibid.* pp.15,16
[139] *Ibid.* p.16
[140] PWC. "*BEPS Action Plan: Action 13 Transfer Pricing Documentation*," Retrieved from http://www.pwc.com/gx/en/tax/tax-policy-administration/beps/transfer-pricing-documentation.jhtml
[141] OECD. "*OECD/G20 Base Erosion and Profit Shifting Project - Action 13: Guidance on the Implementation of Transfer Pricing Documentation and Country-by-Country Reporting*," Paragraphs 1,2. Retrieved from http://www.oecd.org/ctp/beps-action-13-guidance-implementation-tp-documentation-cbc-reporting.pdf

provide protection against common types of base eroding payments, such as management fees and head office expenses.[142]

These trends likely result in the change made to the global standard on transfer pricing and Thailand should take into account at the time of legislation enactment so that the Thai transfer pricing law can be effectively implemented.

PART 5: CONCLUSION

In order to strike the balance between the interest of taxpayers and tax administration in a way that is fair to all parties, all aspects of the system that are relevant in a transfer pricing case must be taken into account.[143] However, the relevant legislation should be clear and support this achievement.

This article analyzes practice of transfer pricing that is recognized by international standard with a focus on OECD and some EU countries and then consider current Thai legislation. The comparison study shows that transfer pricing legislation in Thailand is quite far from that standard. Furthermore, ASEAN economic integration not only increases strength of the ASEAN region to compete with other regions or other countries, but also increases the chance of foreign investment in the region members. The ASEAN members among themselves also need to compete with each others to attract such foreign investment. Transfer pricing law is one of factors to create the environment of such investment. The analysis shows that Thailand need to uplift standard of transfer pricing law to ensure its competitiveness.

As a result, the problems of current transfer pricing law of Thailand and suggestions are herein addressed. Furthermore, this article proposes to implement practice of the EU to the AEC. It also mentions the global trend that might change international recognized standard so that Thailand may think ahead and plan for further development in order to ensure that transfer pricing law will no longer be obstacle of foreign-investment environment.

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[142] OECD. "*OECD/G20 Base Erosion and Profit Shifting Project Guidance on Transfer Pricing Aspects of Intangibles*," pp.9,10. Retrieved from http://www.oecd-ilibrary.org/docserver/download/2314291e.pdf?expires=1441094390&id=id&accname=guest&checksum=32EE411A8546AC2A74E48032222C3F55

[143] Preface Paragraph 18. OECD Transfer Pricing Guidelines

ANNEX

COMPARISON OF TRANSFER PRICING LAWS

	Austria	Germany	United Kingdom	Thailand
Statutory Rules, Arm's Length Principle and Primary Adjustment	Primary law (Article 6 paragraph 6 of the Income Tax Act)	Primary law (Section 1 of the German Foreign Tax Act **)**	Primary law (Part 4 of Taxation (International and Other Provisions) Act 2010**)**	• Instruction for the Revenue Officer • Applicable to transactions regardless of multinational factor • Definition of "market price" is in line with the arm's length price concept, but it is still ambiguous and there is no reference to any source in case of interpretation problem.
Associated Enterprises / Related Parties	No specific definition but generally reference is made to OECD Model Convention.	Definition is specified in line with OECD Model Convention, but determines shareholding ratio in respect of capital relationship.	Definition is specified in line with OECD Model Convention, but has a practical test shareholding ratio in respect of capital relationship in general circumstance and in case of joint venture.	The term "independent contracting parties" is defined to supplement the definition of market price. However, it is broadly defined without reference to any source in case of interpretation problem.
Acceptable Transfer Pricing Methods	All transaction-based methods and profit-based methods are recognized and implement "most appropriate method for a particular case".	All transaction-based methods and profit-based methods are recognized but hierarchy preference is the transaction-based methods**.**	All transaction-based methods and profit-based methods are recognized and implement "most appropriate method for a particular case"	All transaction-based methods and profit-based methods are recognized but hierarchy preference is the transaction-based methods**.**
Secondary Adjustment	Applicable	Applicable	Not Applicable	Not Applicable
Dispute Preventions and Resolutions	• Tax Examination • APA (either unilateral or bilateral) • Arbitration	• Tax Examination • APA (pro bilateral) • Arbitration	• Tax Examination • APA (either unilateral or bilateral) • Arbitration • Facilitative Mediation	• Tax Examination • APA (pro bilateral)
Burden of Proof in Tax Case Procedures	Tax authorities	Taxpayers prove the underlying facts of a transaction and the burden is shifted to tax authorities with an exception of rebuttable assumption in a case of absence of appropriate documentation	Taxpayers *(because of self-assessment approach)*	Taxpayers *(as parties alleging the fact not agree with tax authorities)*

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