TMI EYES No. 4: Year-End Profit Adjustment and Tax Implications

It is relatively commonplace for group companies to conduct transfer pricing studies, and in many cases, apply resale minus, cost-plus, or transactional net margin method ("TNMM") to their financials, which frequently leads to year-end profit adjustments. At a glance, year-end profit adjustments seem to be in line with transfer pricing norms; however, it should be noted that such adjustments often result in non-compliance with customs valuations and lead to corporate income tax and VAT implications. In this article, TMI will discuss the tax implications of these year-end profit adjustments and how companies can prepare in the event of an audit from the Thai Revenue Department and Customs Department.

Year-End Adjustment

As of the end of the December 2022 accounting period, TMI came across a number of cases in which corporate taxpayers had performed year-end profit adjustments to match the results of their transfer pricing studies. For example, in the trading business, foreign parent companies reviewed their subsidiaries' performance and provided compensation thereto if the subsidiaries' profits failed to reach a certain percentage; conversely, in the event of excess profits, the parent companies retroactively charged higher prices for goods imported by the subsidiaries in order to recoup such excess profits.

Tax Implications

To the extent that foreign parent companies pay compensation to the Thai subsidiaries, such adjustments may not incur significant tax implications. From a corporate income tax perspective, the subsidiaries must include such compensation when calculating net profits and then pay corporate income tax accordingly. From a customs valuation perspective, the compensation is viewed as a credit note that reduces the import price, and, in such case, there is no danger of under-declaration of the import price of the goods. As such, the subsidiaries are not at risk of having to pay customs duty shortfalls.

Nevertheless, when parent companies issue invoice/debit notes for subsidiaries to pay, there are a number of issues which need to be discussed.

First, there is the issue of corporate income tax risk. Under Section 65 Ter (19) of the Revenue Code, the Revenue Department considers price adjustments to be expenses calculated and payable from profits at the end of the accounting period and does not allow taxpayers to use the adjusted price as an expense in calculating net profits. However, it should be noted that the possibility remains that the Revenue Department will not allow taxpayers to do so, despite the existence of Section 71 Bis of the Revenue Code (legislated 2018), which specifically governs transfer pricing issues. The reason for this is that a number of Revenue Department Officers are still more familiar with the traditional disallowance of expenses outlined under Section 65 Ter (19) of the Code. More specifically, they may consider that the price adjustment under the TNMM method should be determined by profits.

Otherwise, based on our experience, the Revenue Officers in some cases tend to argue that applying TNMM with benchmarking studies results in profits that are too low to be kept by the Thai entities. On the other hand, however, we have also seen cases in which Thai entities purchased products from their parent companies at an excessively high price and were prevented from being able to claim the excessive costs as cost of goods sold under Section 65 Ter (15) of the Code.

Second, in terms of the customs valuation, a price adjustment in which a Thai subsidiary makes additional payments to its parent company will trigger additional customs duties and duty surcharges, as such additional prices or payments theoretically constitute an increase in the customs value of the imported goods. In addition to the obligation to pay duty shortfalls and surcharges, the Customs Department will also consider the subsidiaries to have violated Section 243 of the Customs Act B.E. 2560, which is a sanctionable criminal offense.

Initial Measures

While there is no quick fix for or universal antidote to the above risks and liabilities, group companies (and particularly Thai companies), should be aware of these issues. In this regard, the companies should consider the following:

- Review and regularly update transfer pricing policies, studies and benchmarking reports;
- Collect information about the price adjustments and assess the initial impact they will have on the corporate income tax and customs duty;
- Avoid adjustments which necessitate additional payments;
- Revise the distributorship agreement in a way to minimize the risks involved; and
- Where necessary, approach the Customs Department on this issue carefully before making any payments to confirm the customs valuation implications involved, and proactively find a method to resolve the issues faced.

As mentioned above, transfer pricing compliance with year-end price/profit adjustments can expose taxpayers to corporate income tax and customs duty liabilities. As such, it is important for foreign parent companies and their Thai subsidiaries to have a clear understanding of all relevant laws involved and ensure proper planning in order to minimize the risk of any undesired tax implications.

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