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Transfer Pricing of Intangibles for Cross-Border Transactions of Associate Companies
The Comparative Study for Intercompany Transfer of Automobile’s Part

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Abstract

Nowadays, there is a lot of creativity in the intellectual property according to the rapid development of technology. Some group companies which have created their intellectual properties usually have the transferred of right between each associated company for the use of intangibles which reflect that the price in such transfer also need to be taken into consideration that it has to be charged in arm’s length, not for free of charge. In this regard, to see what the method and procedure in order to analyze the appropriate price for the intercompany transfer of intellectual property is the critical issue at present. As Thailand does not have the clear regulation in terms of transfer pricing yet, to use the guideline from the OECD TPG as well as the CFR of the United State might be able to help the taxpayer as well as the tax authority for the analysis of arm’s length in practice in terms of finding the most appropriate method for the cross-border transfer of design of automobile’s part from subsidiary to headquarter. Thus, to have the comparison on the analysis of finding the arm’s length of intangibles from OECD TPG and the law of the United States would be a great way to assist in making clearer vision on the method of finding intangibles’ transfer pricing within the group company.
# Table of contents

## I. Introduction
1. Objective ......................................................... 1
2. Delimitation ...................................................... 1
3. Problem .......................................................... 1
4. Method and material used ....................................... 2
5. Abbreviation ...................................................... 2

## II. Background
1. The Arm’s Length Principle .................................... 3
2. OECD Model Tax Convention .................................... 4

## III. Comparative Studies for Criteria and Practice regarding Transfer Pricing of Intangibles in Associated Companies from OECD Guideline and the United States’ Tax Regulation ......................................................... 6
1. Introduction ....................................................... 6
2. OECD Transfer Pricing Guideline ............................... 6
   2.1 Introduction .................................................. 6
   2.2 Identifying intangibles ...................................... 8
   2.3 Ownership of intangibles and transactions involving the development, enhancement, maintenance, protection and exploitation of intangibles ......................... 8
   2.4 Intangible ownership and contractual terms relating to intangible ......................... 9
   2.5 Function, assets, and risks related to intangibles ......................... 10
   2.6 Transactions involving transfers of intangibles or rights in intangibles ......................... 11
   2.7 Supplement guidance for determining arm’s length conditions in cases involving intangibles ......................................................... 12
   2.8 Example of the Annex to Chapter VI of OECD TP Guideline on the examples to illustrate the guidance on intangibles ......................................................... 19
   3.1 Definition of intangible ...................................... 21
   3.2 Methods to determine taxable income in connection with a transfer of intangible property ......................................................... 22

## IV. Thai Tax Regulation and the Analysis to Problems at Issues ......................................................... 30
1. Transfer pricing regulation of Thailand ........................ 30
   1.1 Introduction .................................................. 30
1.2 Intellectual property for the design of automobile’s part……………………………………30
1.3 Definition of associated enterprise for transfer pricing purposes……………………..30
1.4 Transfer pricing regulations and method……………………………………………………31
1.5 Transfer pricing documentation……………………………………………………………34
2. Problem at issues and the analysis from comparative study of OECD TPG and the Treasury Regulation of the United States for the guidance to solve problem for the loophole in the draft Transfer Pricing Act of Thailand………………………………………………………35
2.1 Whether the design of automobile’s part is a copyright which is an intangible asset to be transferred by using a commercial value that reflects the market price or it is just a piece of paper with no cost at all?.................................................................35
2.2 What transfer pricing method to use for cross-border transfer between the headquarter and its subsidiaries for arm length’s price of the design of automobile’s part?..............................36

V. Conclusion……………………………………………………………………………………………39

Bibliography……………………………………………………………………………………………41

Appendix………………………………………………………………………………………………43
I. Introduction

1. Objective
My thesis topic was inspired from my previous law firm works which is still unresolved until the present, May 2018, pertaining to the cross-border transfer of the mechanic design of automobile’s part from a subsidiary in Thailand to the headquarter in a foreign country. In this case, the subsidiary sees that the design of automobile’s part is not the product to transfer and would rather choose to transfer such work for free of charge, with no royalties. However, the revenue department of Thailand sees that the design of automobile’s part should be transferred in arm length’s price and should be recorded in the balance sheet of the company. In this regard, it comes to the question that what should be the price of the design of automobile’s part. Thus, this thesis discussed which transfer pricing method is appropriate for considering arm’s length consideration as well as discussed the guideline to be used for the transfer pricing in terms of intellectual property transfer in a cross-border situation of multinational companies.

2. Delimitations
This thesis has the scope within the discussion regarding only transfer pricing regarding intangibles, i.e., intellectual property in terms of the ownership of automobile’s design, which is concerned as copyrights, to see the appropriate method and factors to involve more in Thai revenue law and practice. Since this thesis only renders the brief explanation on the use of transfer pricing method, it delimited to the calculation in details of each method. Besides, this thesis is delimited to the transfer of goodwill and other intangibles apart from the transfer of copyrights, and the discussion would not go into details of the arrangement of business restructuring for both pre-business restructure and post business restructure for the arrangement of the establishment of IP company.

3. Problem
i) Whether the design of automobile’s part is a copyright which is an intangible asset to be transferred by using the commercial value that reflects the market price or it is just a piece of paper with no cost at all?
ii) What transfer pricing method and factors concerned to use for cross-border transfer between the headquarter and its subsidiaries for arm length’s price of the design of automobile’s part?
4. Method and material used

This thesis uses legal value of a specific source of law i.e. the comparative legal analysis in terms of transfer pricing method used for intellectual property transfer according to the OECD Transfer Pricing Guideline, Code of Federal Regulation (“CFR”) of the United State, and Transfer Pricing Law of the Kingdom of Thailand for the transfer of intellectual property in order to render legal comparison in the perspective of automobile’s design transfer between the associated companies. Besides, this comparison would be made for the analysis in the aspect of law, nature of business and economics of the suggestion for clearer and appropriate doctrine and method of intellectual property transfer in a cross-border situation within the associate companies to be adapted to use in Thailand in the future.

5. Abbreviation

<table>
<thead>
<tr>
<th>Abbreviation</th>
<th>Description</th>
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<tr>
<td>OECD TPG</td>
<td>OECD Transfer Pricing Guideline</td>
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<tr>
<td>BEPS</td>
<td>Base Erosion Profit Shifting</td>
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<tr>
<td>OECD MC</td>
<td>OECD Model Tax Convention</td>
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<tr>
<td>MNE</td>
<td>Multinational Enterprise</td>
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<tr>
<td>CFR</td>
<td>Code of Federal Regulations</td>
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<td>IRC</td>
<td>Internal Revenue Code</td>
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<td>IRS</td>
<td>Internal Revenue Service</td>
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<td>RD</td>
<td>Revenue Department</td>
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<td>TRC</td>
<td>Thai Revenue Code</td>
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<td>DTA</td>
<td>Double Taxation Agreement</td>
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II. Background

1. The Arm’s Length Principle

In general, when uncontrolled parties have commercial transactions with each other, they would be dealing the business and price of products as well as services in the market price since it has to be determined by market forces.¹ This situation should happen in the same way as the transactions conducted within the associated companies which are under control by other entities in a group. When transfer pricing of the products or services does not be consistent with the arm’s length doctrine, the tax revenue of the host country can be distorted² and it would be a result of tax avoidance in the host country as well as Base Erosion Profit Shifting (“BEPS”)³ to other low tax countries.

However, there might be the actual hardship to consider precise market price by using a specific business strategy which might contradict the use of market forces for associated companies, but it is also not fair to consider that legal entities within the same group would always have a plan to manipulate their profits by using the price not in accordance with the market price which would lead to the tax avoidance or BEPS.⁴

According to the international consensus to the principle of arm’s length as of the opinion of OECD member countries, the arm’s length principle should have the transfer price’s assessment of the associated companies since it renders the closest estimation, in theoretical aspect, of valuation where the property or service is transferred between them.⁵ Even if it is not so precise in practicality, it is still acceptable for the tax authority for the creation of a suitable level of income among the corporate entities in the group.

At present, there are many countries which have applied the arm’s length principle because it renders the similarity for tax treatment to be used both in associated companies in the same group and in independent enterprises as it provides associated and independent companies with

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¹ OECD TPG 2017, para. 1.1.
² Ibid., para. 1.2, 1.5.
³ Base erosion and profit shifting (BEPS) refers to tax avoidance strategies that exploit gaps and mismatches in tax rules to artificially shift profits to low or no-tax locations. Under the inclusive framework, over 100 countries and jurisdictions are collaborating to implement the BEPS measures and tackle BEPS, http://www.oecd.org/tax/beps, (Accessed 20 May 2018).
⁴ OECD TPG, loc. cit.
⁵ Ibid., para. 1.14.
equal footing for tax purposes. Besides, it also refrains from the establishment of tax in both beneficial and detrimental aspects that would lead to the distortion in market competition. To sum up, the arm's length principle would be one of the mechanisms to support the progress and growth of international trade and investment in this new era of digital age and globalization in a quality way.

2. OECD Model Tax Convention

According to Article 9 of the OECD Model Tax Convention ("OECD MC")\(^7\), there is the arm’s length principle which indicates the basis of bilateral tax treaties engaging OECD member countries and an increasing number of non-member countries. This article states as follows:

"Where conditions are made or imposed between the two [associated] 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 enterprise and taxed accordingly."\(^8\)

In order to make a profit adjustment to be in accordance with the circumstance of comparable uncontrolled transaction, the arm’s length principle treats associated companies in the same group as separate companies, not the inseparable entity, since it is an approach to treat companies in the same group as the independent corporate entities. Besides, the comparability analysis is the key to apply arm’s length principle\(^9\) which this article has grounded the foundation and it also introduces the needs for the comparison made between associated companies and independent agents whether a re-writing of the accounts for the aims of calculating tax responsibility of associated companies is applied to be in accordance with this

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\(^6\) Ibid., para. 1.8.
\(^7\) OECD Model Tax Convention is an accord reached between member states of the Organization for Economic Cooperation and Development (OECD) that serves as a guideline for establishing tax agreements. The convention consists of articles, commentaries, position statements and special reports on evolving tax issues. Its primary application is in guiding the negotiation of bilateral treaties between two or more countries, see http://www.businessdictionary.com/definition/OECD-model-tax-convention.html(access 20 May 2018).
\(^8\) See OECD MC, Article 9, para.1.
\(^9\) OECD TPG, op. cit., para. 1.7.
article.\textsuperscript{10} Besides, this article also creates the need for the determination of the profits which would have accrued at arm’s length for considering the quantum of any re-writing of accounts.\textsuperscript{11}

\textsuperscript{10} Commentary to OECD MC, para. 2.  
\textsuperscript{11} OECD TPG, loc. cit.
III. Comparative Studies for Criteria and Practice regarding Transfer Pricing of Intangibles in Associated Companies from OECD Guideline and the United States’ Tax Regulations

1. Introduction
Nowadays, there is a lot of creativity in the intellectual property according to the rapid development of technology. Some group companies which has created their intellectual properties usually have the transferred of right between each associated company for the use of intangibles which reflect that the price in such transfer also need to be taken into consideration that it has to be charged in arm’s length, not for free of charge. In this regard, to see what the method and procedure in order to analyze the appropriate price for the intercompany transfer of intellectual property is the critical issue at present. Thus, to have the comparison on the analysis of finding the arm’s length of intangibles from OECD TPG and the law of the United States would be a great way to assist in making clearer vision on the method of finding intangibles’ transfer pricing within the group company.

2. OECD Transfer Pricing Guideline
2.1 Introduction
According to OECD TPG, there is a wide definition of intangibles that is especially for the field of transfer pricing. Intangibles, for transfer pricing purposes from OECD, has a definition as “something which is not a physical asset or a financial asset\textsuperscript{12}, which could be owned or controlled for utilizing in commercial activities and the use or transfer of such intangibles would be compensated if it occurs in a transaction between independent parties in a comparable situation”.\textsuperscript{13} It is crucial to focus on the criteria of ownership or control it had in this intangibles’ meaning since it differentiates intangibles from other situations that may have the impact on transfer prices in the absence of ownership or control by a company\textsuperscript{14}; for instance, the existence of the rivals in the market, or group synergies that do not draw from specific conduct of associated companies\textsuperscript{15}. The consideration of the condition would be determined by the thrust

\textsuperscript{12} According to OECD TPG, a financial asset is any asset that is cash, an equity instrument, a contractual right or obligation to receive case or anther financial asset or to exchange financial assets or liabilities, or a derivative. Examples include bonds, bank deposits, stocks, shares, forward contracts, futures contracts, and swap.
\textsuperscript{13} OECD, Guidance on Transfer Pricing Aspects of Intangibles 2014, p. 28-29, para. 6.6.
\textsuperscript{14} J. Monsenego, Introduction to Transfer Pricing, the Netherlands, Kluwer Law International BV, 2015, p. 66-67
\textsuperscript{15} Ibid.
of a transfer pricing analysis rather than emphasizing on accounting or legal definition.\textsuperscript{16} However, at present, this broad definition of intangibles is still criticized.\textsuperscript{17}

When intangibles are met with the definition of transfer pricing proposes, the next step is to find the party that has a right for the remuneration allocated to the intangibles on the used or transfer of such intangibles, in case that there is the remuneration so.\textsuperscript{18} According to the functional analysis\textsuperscript{19} that has to consider function performed, risk assumed and asset used\textsuperscript{20}, the transaction involving intangibles eventually have to consider which parties would be entitled to the remuneration allocated to such intangible, in which the consideration of whether or not there are legal registration\textsuperscript{21} or contractual arrangement which has to be also determined\textsuperscript{22}. Besides, referring the OECD TPG, the key determination is “whether a transaction transmits economic value from one associated company to another and whether such benefit comes from tangible property, intangible, services, other items or activities”.\textsuperscript{23}

In some case, the important intangibles to be determined for transfer pricing purpose is not always used as the intangible asset to be put for accounting purposes.\textsuperscript{24} However, such intangibles may be used to gain the essential amount of economic value and should be needed for considering in transfer pricing purposes.\textsuperscript{25} Besides, the amelioration in value that occurred from using intangibles is not reflected on the balance sheet as always. In this regard, to consider whether or not the intangibles would be concerned in the aspect of transfer pricing purposed

\textsuperscript{16} OECD TPG, op. cit., p. 249, para. 6.6.
\textsuperscript{17} C. Silberztein, M. Bennett and G. Lemein, the OECD Discussion Draft on the Transfer of Intangibles (Revision of Chapter VI of the OECD Transfer Pricing Guidelines) – Detailed Comments, vol. 41, issue 2, 2013, p. 66.
\textsuperscript{18} Monsenego, op. cit., p. 67.
\textsuperscript{19} OECD TPG, op. cit., p. 251, para. 6.12, the functional analysis should identify the relevant intangibles at issue, the manner in which they contribute to the creation of value in the transactions under review, the important functions performed and specific risks assumed in connection with the development, enhancement, maintenance, protection and exploitation of the intangibles and the manner in which they interact with other intangibles, with tangible assets and with business operations to create value.
\textsuperscript{20} Ibid., p. 26; functional analysis is the analysis aimed at identifying the economically significant activities and responsibilities undertaken, assets used or contributed, and risks assumed by the parties to the transactions.
\textsuperscript{21} This is the case for the situation that a copy right or intangibles are registered.
\textsuperscript{22} Monsenego, op. cit., P. 68.
\textsuperscript{23} OECD TPG, op. cit., p. 247, para. 6.2.
\textsuperscript{24} Ibid., para 6.7.
\textsuperscript{25} Ibid.
under Article 9 of the OECD Model Tax Convention cannot be determined by the characterization accounting purposed only.\textsuperscript{26}

\subsection*{2.2 Identifying intangibles}

The definition of royalties according to the Commentary on Article 12 of the OECD MC is not rendering the guidance on the amount of remuneration to be used for the use or transfer of intangibles between independent parties; thus, there is no relevance in terms of transfer pricing purposes.\textsuperscript{27} According to the OECD TPG, there are the categories of intangibles as follows:

1. \textit{Patents}: a legal instrument that would give an exclusive right to the owner to use the invention which is registered as a patent for a period in exact geography\textsuperscript{28}.

2. \textit{Know-how and trade secrets}: ownership for information or expertise that support or enhance a business activity, but it does not have a protection registration in a nature of patent or trademark\textsuperscript{29}.

3. \textit{Trademarks, trade names and brands}: a unique name, picture, logo or symbol which the proprietor might use in order to differentiate the product or service from other companies or corporate entities\textsuperscript{30}.

4. \textit{Rights under contracts and government licenses}: a license and concession that could cover a board extent of business affairs\textsuperscript{31}.

5. \textit{Licenses and similar limited rights in intangibles}: a limited right in intangibles usually transferred by contract or license\textsuperscript{32}.

6. \textit{Goodwill and ongoing concern value}

7. \textit{Group synergies}

8. \textit{Market-specific characteristics}

\subsection*{2.3 Ownership of intangibles, and transactions involving the development, enhancement, maintenance, protection and exploitation of intangibles}

There are the possible challenges for the fact and case involving intangibles, including:

\begin{itemize}
\item \textsuperscript{26} Ibid.
\item \textsuperscript{27} Ibid., para. 6.13
\item \textsuperscript{28} Ibid., para. 6.19
\item \textsuperscript{29} Ibid., para. 6.20
\item \textsuperscript{30} Ibid., para. 6.21
\item \textsuperscript{31} Ibid., para. 6.24
\item \textsuperscript{32} Ibid., para. 6.26
\end{itemize}
2.3.1 There is inadequate comparability between the intangible’s transactions between associated companies and independent companies;
2.3.2 There is no sufficiency in the comparability between the intangibles in question;
2.3.3 The ownership or use of different intangibles by different associated enterprises within the MNE group;
2.3.4 The difficulty of isolating the impact of any particular intangible on the MNE group's income;
2.3.5 The fact that various members of an MNE group may perform activities relating to the development, enhancement, maintenance, protection and exploitation of an intangible, often in a way and with a level of integration that is not observed between independent enterprises;
2.3.6 The fact that contributions of various members of the MNE group to intangible value may take place in years different than the years in which any associated returns are realized; and
2.3.7 The fact that taxpayer structures may be based on contractual terms between associated companies that separate ownership, the assumption of risk, and/or funding of investments in intangibles from performance of essential functions, control over risk, and decisions related to investment in ways that are not observed in transactions between independent enterprises and that may contribute to base erosion and profit shifting.

2.4 Intangible ownership and contractual terms relating to intangible
According to the OECD guideline, the term of the transaction can be in a written form of contracts as well as other communication. Such agreement may already indicate the reliability of the right to use intangibles of associated companies as well as the funding for research and development.\(^{33}\) Notwithstanding, if there are no written terms or the actual conduct is different from the writing contract, the actual transaction must be assumed to be according to the fact as it is actually conducted.\(^{34}\) Some of the right to use intangibles, e.g., patent, trademarks, and copyrights, might be protected under the intellectual property law in its registration system.\(^{35}\) Still, some intangible is not protected by the registration system of intellectual property law, but by other regulations, such as unfair competition law or commercial law for the use of

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\(^{33}\) Ibid., para. 6.35.
\(^{34}\) Ibid., para. 6.36.
\(^{35}\) Ibid., para. 6.37.
contract term. In terms of legal owner, if there is no legal owner named, the member of associated companies in a group which has the control or decision, depends on the fact and circumstance of the case, to use intangibles in practice will be regarded as the legal owner of such intangibles in question for transfer pricing perspective.

2.5 Function, assets, and risks related to intangibles

As aforementioned, the name of legal owners does not imply that they have the right to the income earned. To find the arm’s length price for associated companies’ transaction, the allocation of income incurred from the value of intangibles should be considered in the form of functions performed, asset used and risks assumed. However, the analysis might be harder and more complicated when it comes to the situation; including, intangibles that are developed by associated companies and there is a transaction of intangibles between associated companies when it is under the arrangement of development of intangibles.

There is the guideline in which it is applied to the case that is more complicated and arduous, as follows:

2.5.1 Performance and control of functions

Owing to the OECD TPG, there should be the remuneration at arm’s length for the function performed between the companies in a group. The important determination for considering arm’s length for controlled transactions is the function of the companies in a group which relating to the development, maintenance, enhancement, protection, and exploitation of intangibles.

2.5.2 Use of assets

Companies that utilized assets in the way of development, maintenance amelioration as well as manipulation of intangibles should receive the proper return. The assets are such as physical assets, funding as well as intangibles utilized in research and development.

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36 Ibid., para. 6.38.
37 Ibid., para. 6.40.
38 Ibid., para. 6.47.
39 Ibid., para. 6.48.
40 Ibid., para. 6.50.
41 Ibid.
42 Ibid., para. 6.59.
2.5.3 Assumption of risks
The risk that is necessary to determine in the functional analysis is; for instance, risks that occur from intangibles’ research and development would prove not to be achieved, the chance that the progress of technology of business rivals would have the adverse outcome for intangibles, infringement risk in the aspect of time-consuming, product liability cases and the foreseeability and uncertainties for the profit and income generated by intangibles.43

2.5.4 Actual, ex post returns
As the actual result of profit might be different from the estimated profit because of the risks from an unexpected effect of development.44

In this regard, generally, associated company’s transaction would be identified by the legal registration or the contract. However, the actual conduct is prioritized.45 Besides, an essential factor for considering the arm’s length remuneration is that company member of the group must get to see the development and enhancement of marketing intangibles46, research, development and process improvement arrangements47 and payment for the use of company name48. In addition, it is also crucial to determine the nature of activities it had, the quantity and kind of remuneration it has been paid.49

2.6 Transactions involving transfers of intangibles or rights in intangibles
2.6.1 transfers of intangibles or rights in intangibles
The ownership of rights and rights to use might be transferred in controlled transaction which might involve all rights or limited rights. In this transaction between associated companies, it is important that the functional analysis would take into account the specificity of the intangibles and rights in intangibles as well as the extent of such transfer of rights, i.e., whether or not there is a limitation, such as the restriction had in license or agreement50, or full extent of rights, which is an essential factor of functional analysis.51 The nature of any restriction to

43 Ibid., para. 6.65.
44 Ibid., para. 6.69.
45 Ibid., para. 6.73.
46 Ibid., para. 6.76.
47 Ibid., para. 6.79.
48 Ibid., para. 6.81.
49 Ibid., para. 6.73.
50 Ibid., para. 6.90.
51 Ibid., para. 6.89.
the transfer of intangibles could have an impact on the value of rights that would be transferred as well as the comparability of two transactions which have a close comparable situation of the nature of intangibles.\textsuperscript{52}

2.6.2 Transfer of combinations of intangibles
Some kind of intangibles might need to be transferred together with other intangibles\textsuperscript{53} because of the economic nature of several different intangibles interacted; for instance, to transfer a group of intangibles together renders more value than to transfer it separately.\textsuperscript{54} Besides, to transfer intangibles together is also because of the intangibles are intertwined that it is unable to transfer separately.\textsuperscript{55} In addition, it is crucial to focus on the consideration that whether or not the transaction should be aggregated or segregated for the analysis regarding the delineation of the transaction in reality with regard to the agreement and actual conduct.\textsuperscript{56}

2.6.3 Transfer of intangibles or rights in intangibles in combination with other business transactions
Some intangibles or right in intangibles might be transferred together with the assets of the business as well as the services which need to be recognized for the transfer pricing analysis.\textsuperscript{57} It also should be considered whether or not intangibles transfer is in the situation that it is intertwined with other business asset or services that they could not be transferred individually for transfer pricing analysis\textsuperscript{58}.

2.7 Supplement guidance for determining arm’s length conditions in cases involving intangibles
The transfer of intangibles between associated companies is sometimes hard to find a comparable situation since there is a particular characteristic that is complex and it is hard to

\textsuperscript{52} Ibid., para. 6.90.
\textsuperscript{53} Ibid., para. 6.92.
\textsuperscript{54} Ibid., para. 6.93.
\textsuperscript{55} Ibid., para. 6.95.
\textsuperscript{56} Ibid., para. 6.103.
\textsuperscript{57} Ibid., para. 6.98.
\textsuperscript{58} For example, some transfers of rights in software may be combined with an undertaking by the transferor to provide ongoing software maintenance services, which may include periodic updates to the software. In situations where services and transfers of intangibles are intertwined, determining arm’s length prices on an aggregate basis may be necessary.
make pricing’s consideration during the time of its transaction for some cases.59 Besides, the
group companies may have a transaction which independent companies would not contemplate
in some cases.60 In this regard, the transfer of intangibles might increase the challenge
concerning the comparability, the consideration of arm’s length restriction for a transaction as
well as the selection of transfer pricing method.61

2.7.1 General principles applicable in transactions involving intangibles
According to the comparability analysis for the transaction of intangibles, the consideration of
the options realistically available to the parties of the transaction has to be made for a transfer
pricing analysis.62 However, a comparability analysis does not render an adequate basis for
estimating transaction involving intangibles since it only focuses on one side of a transaction.63

2.7.2 Supplemental guidance regarding the transfer of intangibles or right in intangibles
2.7.2.1) Comparability of intangibles or rights in intangibles
For the comparability analysis for the transfer of intangibles, it is necessary to determine the
unique feature of intangibles.64 Besides, it is also important the see whether the potential
comparables show the resemblance of profit potential.65 In this regard, there are some specific
features of intangibles in which it shows the crucial part for comparability analysis of
intangibles’ transfer or rights in intangibles as follows.66

1) **Exclusivity**
The right of intangibles whether it is exclusive or non-exclusive could be an important
factor of consideration for comparability analysis since the party that has the exclusive
power for some intellectual properties, e.g., patent, would have a high market power
and influence that it would be able to exclude other parties or competitors from the

59 Ibid., para. 6.108.
60 Ibid., para. 1.11.
61 Ibid., para. 6.108.
62 Ibid., para. 6.111.
63 Ibid., para. 6.112.
64 Ibid., para. 6.116.
65 Ibid.
66 Ibid., para. 6.117.
market.\textsuperscript{67} On the other hand, a party which has non-exclusive right could not do such thing, i.e., exclude other competitors in the market.\textsuperscript{68}

2) \textbf{Extent and duration of legal protection} 
Legal protection, regarding the legal registration, of intangibles is able to prevent competitors in the market. However, other intangibles which do not require to have the legal registration is also received the legal protection in the way that is not as strong and as long as the intangible which are intellectual properties that have legal registration.\textsuperscript{69} In this regard, the duration of intangibles referred from the legal protection is an important consideration since it is the reason that the parties would bring up the expectation from the use intangibles in order to receive future exploitation and remuneration thereafter.\textsuperscript{70}

3) \textbf{Geographic scope} 
The geographic scope is also the significant factor for the consideration for comparability analysis since the global permission of intangible rights has a higher value than the grant from few countries.\textsuperscript{71} Notwithstanding, it also depends on the category of the product, market, and intangibles altogether.

4) \textbf{Useful life} 
Useful life is the time length of legal protection for intangibles which many intangibles have a limitation\textsuperscript{72}, which might be able to be affected by the change in technology as well as the development of new products in the industry.

5) \textbf{State of development} 
In general, intangibles which are entirely ready to be used of the implement in practice would tend to have a higher value in the market than the one which commercial viability is still under the process of having the establishment and completeness.\textsuperscript{73}

\textsuperscript{67} Ibid., para. 6.118. 
\textsuperscript{68} Ibid. 
\textsuperscript{69} Ibid., para. 6.119. 
\textsuperscript{70} Ibid. 
\textsuperscript{71} Ibid., para. 6.120. 
\textsuperscript{72} Ibid., para. 6.121. 
\textsuperscript{73} Ibid., para. 6.124.
6) Rights to enhance, revisions, and updates
Future enhancement, revision as well as updates is the factor for comparability purpose also because the products safeguarded by intangibles us somehow could be obsolete if there is no continuing progress and amelioration of such intangibles.  

7) The expectation of future benefit
If there is an important difference between the estimated benefit of using intangibles in the future, the consideration of intangibles will be hard to see that it is in enough comparable situation for transfer pricing analysis without the adjustment of reliable comparability. Moreover, it is necessary to determine the actual ability to make a profit from the intangibles-related product since high-profit product would be are not usually comparable to average profit one.

2.7.2.2 Comparison of risk and adjustment from transfers of intangibles or rights in intangibles
Referring to the risk, the risk of receiving an economic benefit in the future from the transfer of intangibles need to be considered. For instance, risks related to the development of intangibles in the future, product obsoleteness and depreciation, infringement of intangible rights and product liability.

In terms of adjustment, it is necessary to focus on the difference between intangibles which it is hard to alter in a reliable manner when it comes to comparability analysis. In this regard, if the reliability of comparability adjustment does not seem to be in a possible manner, it is important to choose a transfer pricing method which uses less weight on comparable intangibles or comparable transaction.

2.7.2.3 Selecting the most suitable transfer pricing method in a matter involving the transfer of intangibles or rights in intangibles

74 Ibid., para. 6.125.
75 Ibid., para. 6.127.
76 Ibid.
77 Ibid., para. 6.129.
To choose the transfer pricing method that is suitable the most for transfer of intangibles or rights in intangibles, there should be the emphasis on the nature of intangibles, troublesome of determining comparable uncontrolled transaction as well as the difficulty of using reliable transfer pricing methods. The most suitable transfer pricing method has to be on a functional analysis that shows the distinct perspective of the worldwide business of group companies for the interaction of functions, asset and risks that build up its global business. In this regard, the method selected and the adjustment had, it ought to focus no only on intangibles and its function, but also the factors which would constitute the value establishment.

In order to make a consideration when the comparable uncontrolled transaction could not be found, the price that independent company would have agreed in comparable situations should be considered by using the important grounds as follows:

- the function, asset, and risks of parties in the transaction.
- the business reasons for involving in the transaction.
- choices realistically available to each of the parties in the transaction.
- the competitive advantages of intangibles.
- the anticipated economic benefits from the transaction in the future.
- other comparability factors; including, assemble workforce, local markets, MNE group synergies, and location savings.

a) Application of CUP Method
This method would make the comparison between the price charge of service or property which is transferred within a controlled transaction in a comparable situation. Then, if there is the difference, the financial relationships of the controlled company might not be within the arm’s length basis. It might be hard to discover a transaction between an independent party and an controlled party which has no difference in significance to the price. Besides, to see if it is under the comparable situation between such two parties, it had to determine that it has the impact on

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78 Ibid., para. 6.131.
79 Ibid., para. 6.133.
80 Ibid.
the price of the business function in large extent rather than to consider the product comparability.\footnote{Ibid., para. 2.17.}

**b) Application of transactional profit method**

Transactional profit methods investigate the profit gained from specific transaction among associated enterprises, and the only profit methods that serves the arm’s length principle has to be consistent with Article 9 of the OECD Model Tax Convention and also follow the criteria of the comparability analysis.\footnote{Ibid., p. 117, para. 2.62-2.63.} Since it is the intangible asset and no adequate information which will be reliable to set arm’s length price by using the traditional transaction methods, i.e., the CUP method, the resale price method, and the cost plus method, two transactional profit methods would be used\footnote{Monsenego, op. cit., p. 47-48.}, i.e., transactional profit split method and the transactional net margin method. However, it is still determined that a traditional transaction method and a transactional profit method can be applied in an equally reliable manner, the traditional transaction method is preferable to the transactional profit method.\footnote{OECD Guideline 2010, para. 2.3; Monsenego, op. cit., p. 47-48.}

**i) transactional profit split method**

The transactional profit split method is to reduce the effect on profits in a special circumstance in the controlled transaction by considering the profits that the uncontrolled company would have anticipated to realize from participating in transactions.\footnote{OECD TPG, op. cit., para. 2.114.} This method is a two-sided method which determines splitting losses or profits between two or more parties.\footnote{Monsenego, op. cit., p. 56.} Multi-national companies rely more on this method since it helps to fragment the value chain and broaden it across borders.\footnote{It is also described as global value chain, see OECD, Interconnected Economies: Benefitting from Global Value Chains 2013, p. 14; Monsenego, op. cit. p. 56.} Furthermore, this method is also a part of BEPS project which might bring about the increase of the application of this method which rendered the aim of hardening the linkage between the taxation an establishment of value. The strength of this method is that it offers the way for a highly integrated business operation which one-
sided method would not be suitable, for instance, the application of this method to the global trading of the financial instrument between associated company.\textsuperscript{89}

This method utilizes to consider the arm’s length price of intangibles’ transfer or right-in-intangible transfer when it could not find the reliability in the comparable uncontrolled transaction.\textsuperscript{90} Transactional profit split methods might apply with the sale of full right in intangibles. In this method, as a full functional analysis the function performed, risks assumed and assets used is the analysis’ crucial part where it has the basis of estimated revenues and expenditure.\textsuperscript{91}

\textbf{ii) the transactional net margin method}

This method is a one-sided transfer pricing method which focuses on the gross margin.\textsuperscript{92} It examines the net profit relating to the suitable basis; including assets, sales, cost and, etc., which it is recognized from controlled transactions. The net profit indicator of uncontrolled entities ought to be created in the same nature of net profit indicator that they have in the comparable independent transaction.\textsuperscript{93} Besides, the suitability of the indicator needs to be determined in the nature of controlled transactions, the reliability of available information, the level of comparability between the controlled and independent transactions as well as the reliability of the adjustment to reduce any difference need to be taken into consideration for this method as well as to consider its net profit and weighting.\textsuperscript{94} A comparability analysis, as well as functional analysis for both controlled and independent transaction, is needed in order to consider whether or not it is in the comparable situation as well as the need for the adjustment for a more reliable outcome.\textsuperscript{95} However, this method is not trustworthy in the case that each party produces valuable and unique contribution, but to use a transactional profit split method would be more appropriate.\textsuperscript{96}

\textsuperscript{89} Report on the Attribution of Profits to Permanent Establishments, approved by the Committee on Fiscal Affairs on 24 June 2008 and by the Council for publication on 17 July 2008 and the Report on the Attribution of Profits to Permanent Establishments, approved by the Committee on Fiscal Affairs on 22 June 2010 and by the Council for publication on 22 July 2010.
\textsuperscript{90} OECD TPG, op. cit., para. 6.148; Monsenego, op. cit., p. 47.
\textsuperscript{91} Ibid, para. 6.149.
\textsuperscript{92} Monsenego, op. cit., p. 48.
\textsuperscript{93} It is also known as internal comparables, see OECD TPG, op. cit., para. 3.27-3.28.
\textsuperscript{94} OECD TPG, op. cit., para. 2.82.
\textsuperscript{95} Ibid., para. 2.64.
\textsuperscript{96} Ibid, para. 2.65.
Notwithstanding, this method ought to be used only in the case that the party does not improve and develop or own intangibles as a part of the transaction to be priced.\(^97\) The ability to make the profit of the party would be hard to evaluate and it may also hard to find the comparable circumstance; this method might be appropriate.

c) Use of valuation techniques
In the circumstance when it is not possible to find a comparable uncontrolled transaction for intangibles’ transfer, the valuation techniques might be a tactic to approximate the arm’s length price for the transfer of intangibles between companies in a group.\(^98\) This valuation technique presupposes the discounted value of estimated future income stream’s calculation or cash flow from the utilization of intangibles, which might be useful if it is applied appropriately.\(^99\)

2.8 Example of the Annex to Chapter VI of OECD TP Guideline on the examples to illustrate the guidance on intangibles
Example 1

“Premiere is a parent company of a business group, and Company S is an entirely owned subsidiary of Premiere and also be a member of the premiere group. Premier of a company which fund, develop, and perform the functions in order to support the business. Besides, the control, as well as the key decision, is under Premier. For Company S, it is the company to have the ownership of the patent in order to centralize and do patent administration of the group worldwide, but it has no control over the patent. In this regard, there is the nominal assignment of rights to Company S and the full permission of exploitation of patent to Premiere. Thus, for the arm’s length price for the income incurred from the patent, Company S would be considered to get the remuneration from the administration service of patent and Premiere would get the balance of the returns acquired by the group company from the utilization of the patent.”\(^100\)

\(^97\) Monsenego, loc. cit.
\(^98\) OECD TPG, op. cit., para. 6.153.
\(^99\) Ibid.
\(^100\) Ibid, p. 565-566.
Example 14

“Shuyona is the parent company of the group which operated in Country X. Shuyona does the business of production and sale of consumer goods. Shuyona group has two R&D centers, one is Shuyona R&D center conducted under Shuyona in Country X, and another is Company S R&D center, which is a subsidiary of Shuyona, performed in Country Y. Shuyona R&D center is the one to design and develop the research program, do budget management, do decision making of all projects as well as control the function of R&D in a group. Regarding Company S R&D center, it operates different projects appointed by the Shuyona R&D center. Any research program modification has to be approved by Shuyona R&D center and any progress of Company S has to be reported to Shuyona R&D center. Besides, Shuyona R&D need to bear the expenditure as well as bear the risk of the research of Company S, according to the contract between 2 parties. In this regard, the return from the use of intangibles of Company S R&D center would be granted to Shuyona R&D center.

In this regard, the transfer pricing analysis would begin by seeing that Shuyona is intangibles’ legal owner and Shuyona is entitled to returns derived from the exploitation of the intangibles developed through the R&D efforts and Company S has a right for remuneration of its function performed, assets used, and risks assumed. For the amount of return for company S, the officer’s performance of Company S R&D center as well as the research’s nature and other factors relating to the value of intangibles have to be determined as comparability factors. In terms of transfer pricing adjustment, the adjustment must reflect the comparable R&D service to be paid for such service which has to relate to the year that the service renders. However, it would not have the impact on the right of Shuyona for the returns from using intangibles form Company S R&D center.”

101 Ibid., p. 566-567.
3. Code of Federal Regulation ("CFR") of the United States

The United States ("the US") is also a member of OECD; however, the US has their transfer pricing regulation which somehow does not use the OECD TPG. According to Section 482 of Internal Revenue Code ("IRC") of the US, it allows the Internal Revenue Service ("IRS") to make the distribution to make sure that the taxpayers show the clear income which is allocated to controlled transactions as well as to restrain the tax evasion. There are three requirements\(^{102}\) of Section 482\(^{103}\) of IRC in order to apply this section; including, it has to be "two or more organizations"\(^{104}\), "trade or business"\(^{105}\) involved, it has to be the "common ownership or control"\(^{106}\) directly or indirectly for such juristic persons and lastly the IRS has to consider that the apportionment is either to prevent the tax evasion or to "clearly reflect the income"\(^{107}\) of such corporate institutions.

3.1 Definition of intangible

For the objective of Section 482, "an intangible is an asset that composes of items that has considerable value independent of the services as follows:

1) Patents, inventions, formulae, processes, designs, patterns, or know-how;

2) Copyrights and literary, musical, or artistic compositions;

3) Trademarks, trade names, or brand names;

4) Franchises, licenses, or contracts;


\(^{103}\) It applies to domestic transactions as well as international transactions, see IRC, s. 482.

\(^{104}\) An “organization” is defined as one of any kind including: sole proprietorship; partnership; trust; estate; association; corporation, see Treasury Regulation, s. 1.482-1(i)(1).

\(^{105}\) A “trade or business” means: A trade or business activity of any kind regardless of: Place of organization; formal organization; type of ownership (individual or otherwise); place of operation. Thus, the definition of “organization, trade, or business” under IRC 482 is very broad, see Treasury Regulation, op. cit., s. 1.482-1(i)(2).

\(^{106}\) Ownership or control specifically includes a broad definition of what constitutes control: any kind of control direct, indirect, legally enforceable or not, two or more taxpayers: acting in concert, or with a common goal or purpose, reality of the control is decisive, form of the control is not decisive. This regulation further states that presumption of control arises if income or deductions have been arbitrarily shifted, see Treasury Regulation, op. cit., s. 1.482-1(i)(4).

\(^{107}\) Reallocation to clearly reflect the income is that the allocation must be necessary to prevent evasion of taxes, or clearly reflect income. The allocations affecting taxable income can be made to income, deductions, credits, and allowances.
(5) Methods, programs, systems, procedures, campaigns, surveys, studies, forecasts, estimates, customer lists, or technical data; and

(6) Other similar items. For the aim of section 482, an item is determined to be similar to items listed in paragraph (b)(1) through (5) of this section if it acquired its value not from its physical attributes but from its intellectual content or other intangible properties.”

3.2 Methods to determine taxable income in connection with a transfer of intangible property

3.2.1 The comparability analysis

According to CFR, each method needs the analysis of factors which leads to comparability under such method; including, function, contractual terms, risk, economic conditions; and property and services. In order to determine the comparability, the factors which need to concern is the functional analysis which compares the economic significance of activities of controlled and independent transactions; including, research and development, product design and engineering, manufacturing, production and process engineering and etc.

Besides, the contractual terms would also be used in order to see the level of comparability between such controlled and independent transaction. For instance, the terms of a form of consideration, the volume of sale and purchase, warranties, rights, duration of the license, credit extension, collateral and etc.

In additional, the risk is also part to see the degree of the two transaction which also should consider in terms of its market risk, risk related to research and development, financial risk, credit and allocation risk, product liability risk as well as general business risk.

Moreover, the economic condition also ought to take into consideration for finding the level of two transactions’ comparability such as the resemblance of geographic market, market size, and level, market share, the extent of market competition, specific industry’s economic condition as well as factors of the product and its distribution.

\[108\] CFR, s. 1.482-1 (d).
3.2.2 Best method rules for intangible property

Generally, the arm’s length of the controlled transaction has to be considered under the suitable method that has the most reliable measure, which depends on the fact and situation of the case. However, there is no method which has a strict priority. To determine the best method to be used in each circumstance, the information of transaction between independent party should give the most match ground for considering whether or not the controlled transaction has used the arm’s length basis. In this regard, the level of comparability between controlled and independent party as well as the adequate data and assumption need to be taken into account for the analysis.

3.2.3 Special rules for transfers of intangible property

According to special rules for intangible property, the form of consideration has to be royalty unless other forms is more appropriate. In terms of periodic adjustments, supposing that intangibles are transferred for more than one year, the return charged in each tax year should be equivalent to the income from the use of intangibles. However, there is the exemption for the situations; including, transactions involving the same intangible, transactions involving comparable intangible, methods other than comparable uncontrolled transaction, extraordinary events and five-year period.

Owing to the ownership of intangibles according to Section 1.482-4, the legal proprietor of intangibles as of the intellectual property law of relating jurisdiction or the rights’ holder of intangibles as of the contract or other relevant laws would be concerned as the sole proprietor of intangibles, except the case in which it would be contrary to the economic circumstance of

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109 Ibid., s. 1.482-1 (c).
110 Ibid., s. 1.482-1 (c)(1).
111 Ibid., s. 1.482-1 (c)(2)(i).
112 Ibid., s. 1.482-1 (c)(2)(ii); factors that are used to evaluate the degree of comparability between the controlled and uncontrolled transactions are; including, completeness and accuracy of data, Reliability of assumptions, and sensitivity of results to deficiencies in data and assumptions.
113 Ibid., s. 1.482-4 (f)(1).
114 Ibid., s. 1.482-4 (f)(2).
115 Ibid., s. 1.482-4 (f)(2)(ii)(A).
117 Ibid., s. 1.482-4 (f)(2)(ii)(C).
118 Ibid., s. 1.482-4 (f)(2)(ii)(D).
such intangibles. If there is no proprietor pursuant to the situations above, the sole proprietor of intangibles would be the person who has the control over such intangibles.\textsuperscript{120}

### 3.2.4 Four methods of CFR for the transfer of intangibles

According to Section 1.482\textsuperscript{121} of CFR, to find the arm's length price in a controlled transfer of intangibles, there is four methods as follows:

1) the comparable uncontrolled transaction method\textsuperscript{122};
2) the comparable profits method\textsuperscript{123};
3) the profit split method\textsuperscript{124}; and
4) unspecified methods\textsuperscript{125}.

Each of the methods must be consistent with Section 1.482-1; including, the best method rule\textsuperscript{126}, the comparability analysis\textsuperscript{127}, and the arm's length range\textsuperscript{128}. The arm's length consideration for intangible transferred to be considered under this section must be equivalent to the income paid to the use of intangibles\textsuperscript{129}. However, in this thesis would delimit to the discussion of the arm’s length range.

#### 1) Comparable uncontrolled transaction method

Generally, this method would assess the amount charged for the use in intangibles under the controlled transaction to see whether or not it is abided by the arm’s length price. The amount to be charged would be altered according to the periodic adjustment.\textsuperscript{130}

In order to apply this method, the comparability and reliability considerations must be taken into account, i.e., the reliability, comparability and data assumption. In terms of the reliability, supposing that the independent transaction of intangible transfer is under the same situation or has only the minor difference as the controlled transaction, this method would be the most

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\textsuperscript{120} Ibid., s. 1.482-4 (f)(3)(i)(A).
\textsuperscript{121} Ibid., s. 1.482-4.
\textsuperscript{122} Ibid., s. 1.482, para. (c).
\textsuperscript{123} Ibid., s. 1.482-5.
\textsuperscript{124} Ibid., s. 1.482-6.
\textsuperscript{125} Ibid., s. 1.482, para. (d).
\textsuperscript{126} Ibid., s. 1.482-1(c).
\textsuperscript{127} Ibid., s. 1.482-1(d).
\textsuperscript{128} Ibid., s. 1.482-1(e).
\textsuperscript{129} Ibid., s. 1.4821.482-4(f)(2); periodic adjustments.
\textsuperscript{130} Ibid., 482, Para. (f)(2).
trustworthy one. Owing to the comparability analysis\textsuperscript{131}, the factor that CFR stated to use in the consideration is the comparable intangible property, that is to say, intangibles in concerned should have a comparable profit potential\textsuperscript{132} and has to be utilized with reference to the identical products or procedure in the same nature of market or industry. Besides, in accessing the comparable circumstance\textsuperscript{133} of controlled and independent transaction apart from the factors as aforementioned, specific factors need to be considered as follows:

- the terms of transfer\textsuperscript{134};
- the stage of intangibles’ development\textsuperscript{135} in the market\textsuperscript{136};
- the rights to get revisions, updates or modification of intangibles\textsuperscript{137};
- the uniqueness of intangibles\textsuperscript{138};
- the duration of the license, contract or negotiation\textsuperscript{139};
- product liability\textsuperscript{140};
- the existence and extent of collateral or any business conduct between the two parties i.e. transferee and transferor\textsuperscript{141}; and
- the function performed by transferee and transferor\textsuperscript{142}.

In addition, regarding the data assumption, the trustworthiness of the outcome received from this transfer pricing method would be impacted by the precision and completeness of the data

\textsuperscript{131} Ibid., s. 1.482-1 (d).
\textsuperscript{132} Ibid., s. 1.482-4 (c)(2)(iii)(B)(1)(ii); the profit potential of an intangible is most reliably measured by directly calculating the net present value of the benefits to be realized (based on prospective profits to be realized or costs to be saved) through the use or subsequent transfer of the intangible, considering the capital investment and start-up expenses required, the risks to be assumed, and other relevant considerations. The need to reliably measure profit potential increases in relation to both the total amount of potential profits and the potential rate of return on investment necessary to exploit the intangible. Besides, the reliability of a measure of profit potential is affected by the extent to which the profit attributable to the intangible can be isolated from the profit attributable to other factors, such as functions performed and other resources employed.
\textsuperscript{133} Ibid., s. 1.482-4 (c)(2)(iii)(B)(2).
\textsuperscript{134} Ibid., s. 1.482-4 (c)(2)(ii)(B)(2)(i).
\textsuperscript{135} For instance, governmental approvals, authorizations, or licenses.
\textsuperscript{136} Ibid., s. 1.482-4 (c)(2)(iii)(B)(2)(ii).
\textsuperscript{137} Ibid., s. 1.482-4 (c)(2)(iii)(B)(2)(iii).
\textsuperscript{138} Ibid., s. 1.482-4 (c)(2)(iii)(B)(2)(iv).
\textsuperscript{139} Ibid., s. 1.482-4 (c)(2)(iii)(B)(2)(v).
\textsuperscript{140} Ibid., s. 1.482-4 (c)(2)(iii)(B)(2)(vi).
\textsuperscript{141} Ibid., s. 1.482-4 (c)(2)(iii)(B)(2)(vii).
\textsuperscript{142} Ibid., s. 1.482-4 (c)(2)(iii)(B)(2)(viii).
utilized as well as the reliable presupposition in using this method. Furthermore, the arm’s length range would be taking into account thereafter.

2) The comparable profits method
This method would assess the price charged in a controlled transaction to see if the price is under the arm’s length basis for the measurement of profit level received from the independent transaction of the same or similar business nature and situation.

In order to consider the arm’s length of this method, the consideration is basically on the quantity of the operating profit that the tested party would have received in case that the profit level indicator is equivalent to the independent comparable transaction. The operating profit would be calculated by considering the profit level factor of the independent agent and use this factor to its financial information of such tested party in the most identical business circumstance and such transaction needs to be related to the financial data of the control transaction.

Owing to the comparability and reliability consideration, it has to see factors as described in the best method rule in the first place. Then, by using this method, it compares the ability to make profits between the tested party, which would be assessed by the profit level indication that is based on the operating profit, and the capability of producing the profit from the independent party. Besides, it depends on the nature of business, product, market, the quantity of intangible and tangible asset as well as the working capital and, etc. This method relies on the external market benchmark; thus, the ore level of comparability, the more reliable of this

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143 Ibid., s. 1.482-4 (c)(2)(iii); s. 1.482-1(c).
144 Ibid., s. 1.482-1(e)(2); the determination of an arm's length range.
145 Ibid., s. 1.482-5 (a).
146 Ibid., s. 1.482-5 (b) (2); the tested party will be the participant in the controlled transaction whose operating profit attributable to the controlled transactions can be verified using the most reliable data and requiring the fewest and most reliable adjustments, and for which reliable data regarding uncontrolled comparables can be located. Consequently, in most cases the tested party will be the least complex of the controlled taxpayers and will not own valuable intangible property or unique assets that distinguish it from potential uncontrolled comparables.
147 Ibid., s. 1.482-5 (b) (4); profit level indicators are ratios that measure relationships between profits and costs incurred or resources employed. Profit level indicators that may provide a reliable basis is; including, (i) rate of return on capital employed which is the ratio of operating profit to operating assets (ii) financial ratios such as ratio of operating profit to sales and Ratio of gross profit to operating expenses (iii) other profit level indicators.
148 Ibid., s. Section 1.482-1(c).
Moreover, as the operating profit displays a remuneration to the investment as well as the risk assumption, the comparability would depend on the resources which are employed, risks assumed, and function performed that are linked directly to such risks. In addition, if there are the difference between the controlled party and independent party that would have a significant impact on the profit, the adjustment should be taken account. Moreover, the level of reliability is related to the amount of data assumption i.e. the consistency in accounting as well as allocations between the relevant business activity and other activities.

3) The profit split method

This method is to measure to see if the combined operating profit or loss, which is received from the identical business activity of controlled party, is distributed to the controlled transactions according to the arm’s length basis. Besides, the contributed value has to reflect the function performed, resources employed and risk assumed by each of the parties in relating business activity in order to have the suitable share of profit and losses. To apply this method, the profit and loss distribution has to be utilized by either the method of the comparable profit split or the residual profit split.

Referring to the comparable profit split, it is the combination of operating profit of independent party that has the identical or similar business activity as to the controlled party and the percentage of its profit and loss would be used to distribute the combined profit and loss of the relating business activity. Regarding the comparability and reliability consideration of this method, it is the comparison of the operating profit between controlled parties and independent parties in the same business activities as well as situations it had. In addition, the comparability weights on the contractual terms between both parties since the agreement are the mandatory factor for the distribution of function and risk. For the data

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149 Ibid., s. 1.482-1(c)(2)(i).
150 Ibid., s. 1.482-1(c)(2)(ii).
151 Ibid., s. 1.482-1(d)(2).
152 Ibid., s. 1.482-1(d)(3).
153 For example, if differences in inventory and other cost accounting practices would materially affect operating profit, the ability to make reliable adjustments for such differences would affect the reliability of the results.
154 Ibid., s. 1.482-6 (a).
155 Ibid., s. 1.482-6 (b).
156 Ibid., s. 1.482-6 (c)(1).
157 Ibid., s. 1.482-6 (c)(2).
158 Ibid., s. 1.482-6 (c)(2)(i).
159 Ibid., s. 1.482-6 (c)(2)(ii)(b)(1).
assumption, the reliability of costs, income, and assets allocation between relating business activity as well as other activities has to be considered since it would have an impact on the precise of the consideration of combined operating profit and its distribution among the parties.\textsuperscript{160} Besides, the level of consistency between the controlled and independent party in terms of accounting which would be the factor to consider the amount and distribution of operating profit is also the factor to concern and strengthen the reliability more.\textsuperscript{161}

In terms of the residual profit split, to distribute the profit and loss from this method, it has to follow two steps, which is allocating the income to routine contributions\textsuperscript{162} and allocating residual profit\textsuperscript{163}. Regarding to comparability consideration, it has to determine the profit slip which are utilized in the market transfer for routine contribution since this method is based on the market benchmark of the ability to make the profit. Then, the reliability, in this case, would be reduced due to the extent of distribution of profit which is not rely on benchmarks of the market.\textsuperscript{164}

The first step of the residual profit split method depends on market benchmarks of the ability to make profits. Accordingly, the determination of comparability that are relating to the first step of the residual profit split are utilized to consider the market returns for the routine contributions. Then, the subsequent step of the residual profit split might not also depend on the market benchmarks in a direct way and the reliability of this method would be increased due to the allocation of profits in such subsequent step that does not rely on market benchmarks. Finally, the distribution of costs, income and assets, accounting consistency as well as the trustworthiness of data utilized and the assumption in valuing the intangibles allocated by each party would reflect the reliability in terms of data and assumption.\textsuperscript{165}

\textsuperscript{160} Ibid., s. 1.482-6 (c)(2)(ii)(c)(1).
\textsuperscript{161} Ibid., s. 1.482-6 (c)(2)(ii)(c)(2).
\textsuperscript{162} Ibid., s. 1.482-6 (c)(3)(i)(a), routine contributions ordinarily include contributions of tangible property, services and intangible property that are generally owned by uncontrolled taxpayers engaged in similar activities. A functional analysis is required to identify these contributions according to the functions performed, risks assumed, and resources employed by each of the controlled taxpayers.
\textsuperscript{163} Ibid., s. 1.482-6 (c)(3)(i)(b), the allocation of residual profit has to consider the non-routine contributions generally and non-routine contributions of intangible property altogether.
\textsuperscript{164} Ibid., s. 1.482-6 (c)(3)(ii)(b).
\textsuperscript{165} Ibid., s. 1.482-6 (c)(3)(ii)(c)(1), (2), (3).
4) Unspecified methods

An unspecified method should also consider the general principle that the independent person assesses the condition of a transaction by concerning the actual option to such transaction and only go with a specific transaction if there are no options that should be preferred. For instance, the comparable uncontrolled transaction method compares with a controlled transaction to an identical independent transaction in order to grant an approximate price that the parties would agree if they choose the option to go with the controlled transaction. Besides, for the reliability of this method, the data and assumption also have to be taken into consideration.
IV. Thai Tax Regulation and the Analysis of Problems at Issues

1. Transfer pricing regulation of Thailand
1.1 Introduction
In terms of Thai tax legislation on transfer pricing, to protect the Thai tax system with the tax avoidance incurred by cross-border transaction of associated companies, tax authority of Thailand is able to apply the regulation as stated in Section 65 bis (4) (7), and Section 70 ter of the Thai Revenue Code (“Thai RC”), Double Taxation Agreement (“DTA”) between Thailand and other countries as well as Standard Accounting No. 37 and 47166, for pricing goods and services to be in accordance with arm length’s principle. Moreover, there is the tax regulation issued by the Revenue Department, i.e., the Departmental Instruction No. Paw 113/2545 – Subject: Corporate Income Tax – Tax Determination of Transfer Price based on the Market Price, for rendering the standard guideline of transfer price determination by using market price as its basis for the tax authority.

1.2 Copyright Law of Thailand
Article 6 of the Copyright Act B.E. 2537 (1994) of Thailand (“Thai Copyright Act”):
“The Copyright work by virtue of this Act means a work of authorship in the form of literary, dramatic, artistic, musical, audiovisual, cinematographic, sound recording, sound and video broadcasting work or any other work in the literary, scientific or artistic domain whatever may be the mode or form of its expression. Copyright protection shall not extend to ideas or procedures, processes or systems or methods of use or operation or concept, principles, discoveries or scientific or mathematical theories.”

1.3 Definition of an Associated Enterprise for Transfer Pricing Purposes
Under the Departmental Instruction No. Paw 113/2545 (2002), the independent contracting parties means the contracting parties which do not have any direct or indirect relationship with the management, control or joint investment between each other. Thus, the definition for independent contracting parties in this Departmental Instruction is ambiguous since the

regulation does not impose the exact percentage of shareholding to be regarded as the contracting party to be under or not under a controllable situation.

1.4 Transfer pricing regulations and method

According to Thai law, tax regulations imposed for transfer price of intangibles are as follows:

1) Section 65 bis (4) of Thai Revenue Code

According to Section 65 bis of Thai Revenue Code, the calculation of net profit and net loss for items as specified in Section 65 Ter shall not be deductible as an expense. Besides, depreciation and depletion of assets shall be deductible under the rules, procedures, conditions and rates as stated in a Royal Decree.

In Section 65 bis (4), it states that

“in the case of transfer of assets, provision of service or lending of money without remuneration, fee or interest; or with remuneration, fee or interest that is lower than the market price without reasonable cause, an assessment official shall have the power to assess such remuneration, fee or interest in accordance with the market price on the date of transfer, provision or lending”

This Section grants the authority to the Revenue Department officials to assess the remuneration from the transfer of asset, fee from service and interest from loan supposing that such transaction offers the price in which it is lower than the market price or the case that there is no calculation of asset, fee from service and interest from loan for no reasonable cause. In this regard, in order to prevent the tax avoidance from conniving at using the price of the transfer or the purchase of asset, service or loan in which it is lower than the market price, the arm length’s principle needs to be utilized in the way that the business between parties would use

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167 The calculation of net profit and net loss under this Part shall follow the following conditions: (1) Items specified in Section 65 Ter shall not be deductible as expense. (2) Depreciation and depletion of assets shall be deductible under the rules, procedures, conditions and rates specified by a Royal Decree.

168 R.D.No.145 N. DG. IT. No.51; the depreciation and depletion of assets shall be deductible in proportion to the period from the acquisition of such assets.

169 Thai RC, s. 65 bis (4).

170 The Judgement of Supreme Court of Thailand No. 1259/2520 (1977) explained that the reasonable cause could not be precisely imposed but it is up to case-by-case basis which has to determine the fact, demeanor and the category of business sector. Thus, it is the decision that render the guideline for revenue department official to do tax assessment broadly.
the market price for remuneration, service, and interest, except there is reasonable cause. Furthermore, the tax department officials could assess the price of such transaction according to the market price as per the date of transferring, rendering services or rendering a loan. In this circumstance, it could be seen that the tax department officials have a broad extent to assess since they could do the transfer pricing adjustment of the transaction which is lower than the market price regardless of the existence of the relationship between contracting parties of such transaction. There are several precedent cases for the utilization of this sections, i.e., Judgement of Supreme Court of Thailand No. 1680/2547 (2004)\(^\text{171}\), No. 2661/2545(2002)\(^\text{172}\) and No. 1065/2541(1998)\(^\text{173}\).

However, this section would be utilized for calculating the net profit for income tax of juristic persons only. Supposing that such juristic persons are not in the scope to be taxed from net profit, the Revenue Department would not be able to use this section to adjust the income.

2) Section 65 bis (7)\(^\text{174}\) of Thai Revenue Code

This section refrains the enterprise from arbitrarily imposing the cost price of the product imported from foreign countries, especially to impose the cost price higher than the fact which leads to a decrease of taxable net profit or even makes the enterprise shows the loss instead\(^\text{175}\). To handle with this situation, the Revenue Department Officials has the authorization to assess the cost of the products which are imported from offshore to Thailand and make the comparison of the products with the same price and categories which would be sent to other countries. In this regard, if the imported product has too high or low price, there would be a new arrangement for price assessment to make a more appropriate price.

3) Section 70 ter\(^\text{176}\) of Thai Revenue Code

\(^\text{171}\) Judgement of Supreme Court of Thailand No. 1680/2547 (2004).
\(^\text{172}\) Judgement of Supreme Court of Thailand No. 2661/2545(2002).
\(^\text{173}\) Judgement of Supreme Court of Thailand No. 1065/2541(1998).
\(^\text{174}\) Thai RC, op. cit., s. 65 bis (7); in calculating the cost of goods imported from abroad, the assessment official shall have the power to assess by comparing with the cost of the same type and kind of goods imported into other countries.
\(^\text{176}\) Thai RC, op. cit., s. 70 Ter; for any company or juristic partnership sending goods abroad to or under an order of a head office, branch, associated company or juristic partnership, principal, agent, employer or employee, such sending of goods shall be deemed to be also a sale in Thailand and the market price of goods on the sending date shall be deemed to be the income for the accounting period in which the goods are sent. The provisions in
Section 70 ter states that “any company or juristic partnership sending goods abroad to or under an order of a head office, branch, associated company or juristic partnership, principal, agent, employer or employee, such sending of goods shall be deemed to be also a sale in Thailand and the market price of goods on the sending date shall be deemed to be the income for the accounting period in which the goods are sent.”

This section has the objective to prevent the juristic persons, i.e., company, registered partnership and etc., to transfer the goods to another juristic person of which it has a close relationship or under control by not charging any remuneration. This section regards such free-of-charge transaction of cross-border transfer of goods to an associated company or other categories, as mentioned in Section 70 ter, as a sale of goods in Thailand’s jurisdiction. In this regard, it brings about the obligation to the corporate entities to show the list of such goods as an income from purchasing transaction and has to calculate the net profit of such items in order to arrange the income tax payment in Thailand, unless the case meets the criteria for the exemption under Section 70 ter (1)-(4) of Thai Revenue Code.

4) Departmental Instruction No. Paw 113/2545 (2002) dated 16 May 2002 Re: Income tax payment of Companies or Partnership Regarding the Appointment of Transfer Pricing to be following the Market Price

This departmental instruction is the guideline of the Revenue Department Officials in order to inspect and suggest the tax payer for setting the market price according to the authorization of the officials under Section 65 bis (4) to have them adjust the proposed price to be in line with the market price which is used only in the income for calculating net profit for income tax payment of the juristic person, excluding the adjustment of expenses\(^\text{177}\). The price of every kind of business transaction has to be adjusted as per the Departmental Instruction No. Paw 113/2545 (2002); including, a sale of goods, service, hire of work\(^\text{178}\) as well as a loan which would incur several categories of income in return, such as remuneration from purchase, royalties, Paragraph 1 shall not apply if such goods (1) are samples or for research purpose (2) are transit goods (3) are goods imported into Thailand and re-exported to the sender within one year from the date that such goods is imported into Thailand (4) are goods exported out of Thailand and returned to the sender in Thailand within one year from the date in which such goods is exported out Thailand.”

\(^{177}\)S. Wattanakorn, loc. cit.

\(^{178}\) According to Section 587 of Thai Civil and Commercial Code (“CCC”), hire of work is a contract whereby a person, called contractor, agrees to accomplish a definite work for another person, called employer, who agrees to pay him a remuneration of the result of the work.
consulting fees, interest and etc. The scope of income is from both inshore and offshore transaction.

Furthermore, this instruction also gives the definition of “market price” as the price of remuneration, service or interest in which the independent contracting parties, by good faith, has used in commercial relation in terms of the transfer of asset, service providing or loan which has the same category as at the date of asset transfer, service providing or loan.

**Method for transfer pricing as of the Departmental Instruction No. Paw 113/2545 (2002)**

According to the Departmental Instruction, it refers to the OECD guideline which would use the methods as follows:

1) Comparable Uncontrolled Price Method (“CUP”);
2) Resale Price Method (“RP”);
3) Cost Plus Method (“CP”); and
4) Other appropriate methods in which 1) – 3) above are unable to use to calculate the income or expense to get the arm length price of remuneration, service fee or interest.

**1.5 Transfer pricing documentation**

The transfer pricing documentation (TP documentation) need to be submitted to the Revenue Department of Thailand only upon request according to the list of documents hereunder. In this regard, if there is no request, the taxpayer does not have an obligation to file the document to the official. Besides, in practice, there is no fixed form or official form for the TP documentation.

1) Documents displayed the structure and relationship of companies in a group, including the structure and the business sector of each company
2) Budget, business plan, and financial estimation
3) Documents showing business strategies of the tax payer and reasons behind such strategies
4) Document to show the sale volume, turnover of taxpayer and characteristic of transaction with the associated company
5) Document showing the reason to conduct a cross-border transaction within the group company
6) The policy of setting the price the capability to make a profit of each product and market information as well as market share of each company which has to consider the function performed, assets used and risk assumed of each relating company
7) Documents showing the reason for choosing transfer pricing method
8) In case that there are many transfer pricing methods to be used, the additional document for
details of the method need to be shown further than the one displayed in 7) as well as indicate
the reason behind the choice of such method
9) Documents showing the fundamental reason for negotiation of the taxpayer for a transaction
within the group such as e-mail, minutes of meeting and resolution and etc.
10) other documents which are relevant

2. Problems at issues and the analysis from comparative study of OECD TPG and the
Treasury Regulation of the United States for the guidance to solve problems for Transfer
Pricing Law of Thailand

2.1 Whether the design of automobile’s part is a copyright which is an intangible asset to
be transferred by using a commercial value that reflects the market price or it is just a
piece of paper with no cost at all?

According to Article 6 of the Copyright Act B.E. 2537 (1994) of Thailand (“Thai Copyright
Act”) which states that “The Copyright work by virtue of this Act means a work of authorship
in the form of literary, dramatic, artistic, musical, audiovisual, cinematographic, sound
recording, sound and video broadcasting work or any other work in the literary, scientific or
artistic domain whatever may be the mode or form of its expression. Copyright protection shall
not extend to ideas or procedures, processes or systems or methods of use or operation or
concept, principles, discoveries or scientific or mathematical theories”, I see that the design of
automobile part is regarded as the copyright which is assignable according to Article 17 of the
same act179.

In this regard, I opine that the design of automobile part is regarded as an intangible asset to be
transferred to another party. However, according to transfer pricing regulation and guideline,
such transfer has to be done through arm’s length price.

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179 Copyright Act, Thailand, s. 17; the copyright is assignable. The owner of copyright may assign the copyright
of the whole or in part and may assign it for a limited duration or for the entire term of copyright protection. The
assignment of copyright by other means except by inheritance must be made in writing with the signatures of the
assignor and the assignee. If the duration is not specified in the assignment contract, the assignment shall be
deemed to last for ten years.
2.2 What transfer pricing method to use for cross-border transfer between the headquarter and its subsidiaries for arm length’s price of the design of automobile’s part?

Thai tax law still has the ambiguousness regarding transfer pricing regulation to find the arm length price. According to the Thai Revenue Code with regard to transfer pricing, there is still no specific countermeasure for determining the transfer price, i.e., there is only general provision regarding arm length’s price in order to use in terms of income and expense assessment in general cases for assessing corporate income tax as per Thai tax law only. In this regard, the regulation is still not clear enough to determine the transfer price to be following Arm Length Principle under Section 65 bis (4) (7) and Section 70 as aforementioned. For instance, according to Section 65 bis 4\(^{180}\) of Thai Revenue Code, the meaning of unreasonable cause according to this Section is vague. There is the Judgement of Supreme Court of Thailand No. 1259/2520 (1977) which explained that the reasonable cause could not be imposed precisely and it depends on the fact, nature as well as the business sector for case-by-case basis, which is the gaps for the authority to assess the price broadly.

Even if the Revenue Department of Thailand has launched the Departmental Instruction No. Paw 113/2545 (2002) which use as the guideline to inspect and recommend the taxpayer to calculate the net profit for income tax payment of the juristic persons under Section 65\(^{181}\), it is the instruction that does not have the status to be the law to enforce with the tax payment directly. Besides, even if such Departmental Instruction focuses on the inspection of arm

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\(^{180}\) Thai RC, op. cit., s. 65 bis (4); in the case of transfer of assets, provision of service or lending of money without remuneration, fee or interest; or with remuneration, fee or interest that is lower than the market price without reasonable cause, an assessment official shall have the power to assess such remuneration, fee or interest in accordance with the market price on the date of transfer, provision or lending.

\(^{181}\) Thai RC, op. cit., s. 65; taxable income under this Part is net profit which is calculated by deducting income from business or income arising from business carried on in an accounting period with expenses in accordance with conditions prescribed in Sections 65 Bis and 65 Ter. An accounting period shall be twelve months except in the following cases where it may be less than twelve months: 1. a newly incorporated company or juristic partnership may elect to use the period from its incorporation date to any one date as the first accounting period. 2. a company or juristic partnership may file a request to the Director-General to change the last day of an accounting period. In such a case, the Director-General shall have the power to grant approval as he deems appropriate. Such an order shall be notified to the company or juristic partnership who files the request within a reasonable period of time and in the case where the Director-General grants the permission, the company or juristic partnership shall comply to the accounting period as prescribed by the Director-General. The calculation of income and expenses in paragraph 1 shall use an accrual basis. Income arising in an accounting period, even though it is not yet received in such accounting period, shall be included as income for that accounting period. All expenses relating to such income, even though they are not yet paid, shall be included as expenses for such accounting period.
length’s price for the transaction of an asset, there is no specific method and example to use concerning intangibles in the guideline. To illustrate, in terms of the arm’s length price of intangibles, the Departmental Instruction gives the definition of “arm’s length price” as the price of remuneration, service or interest in which the independent contracting parties, by good faith, has used in commercial relation in terms of the transfer of asset, service providing or loan which has the same category as at the date of asset transfer, service providing or loan. However, there is no specific guideline and law to intangibles at all. Moreover, Thailand never has the precedent cases for the transfer pricing of intangible to be used as the guideline also.

In addition, owing to the meaning of the independent contracting parties, under the Departmental Instruction, it is still unclear since it renders the definition that the independent contracting parties mean the contracting parties which do not have any direct or indirect relationship with the management, control or joint investment between each other. Thus, the definition for independent contracting parties in this Departmental Instruction is ambiguous since the regulation does not impose the exact percentage of shareholding to be regarded as the contracting party to be under or not under a controllable situation.

I opined that the creation of intangibles, i.e., intellectual property, especially copyright, is significant since there are more innovation and the technology development nowadays and it has continued to grow. Concerning the design of automobile’s part which is regarded as the copyrights would also affect this ambiguousness of Thai Transfer Pricing Regulations. Thus, the multi-national company may be able to take advantage of this ambiguous transfer pricing law of Thailand to do tax avoidance by using their techniques. However, other countries such as the United States as well as OECD countries have emphasized on this issue and have created the method and criteria for the transfer of intangibles specifically with a more explicit guideline, examples, and specific law. Thus, I opine that it is an effective way to learn from the comparative analysis of these two guidelines of the United States’ transfer pricing regulation and OECD guideline to adapt to use with Thai transfer pricing law in the future.

Thus, according to CFR of the United States, before applying any methods for the transfer of intangibles, the best method rule\textsuperscript{182}, the comparability analysis\textsuperscript{183}, and the arm's length range\textsuperscript{184},

\textsuperscript{182} CFR, op. cit., s 1.482-1(c).
\textsuperscript{183} Ibid., s. 1.482-1(d).
\textsuperscript{184} Ibid., s. 1.482-1(e).
should be taken into consideration first. Besides, the arm’s length consideration for intangible transferred to be considered must be equivalent to the income paid to the use of intangibles. In addition, pursuant to special rules for the intangible property of CFR, the form of consideration has to be royalty, unless other forms are more appropriate.185

In terms of comparability analysis for intangibles, according to the OECD TPG, the comparability of intangibles or rights in intangibles is necessary to determine the unique feature of intangibles.186 The essential factors for considering the arm’s length remuneration also should take into consideration such as development and enhancement of marketing intangibles187, research, development and process improvement arrangements188 and payment for the use of company name189. In addition, it is also crucial to determine the nature of activities it had, the quantity and kind of remuneration it has been paid190 as well as to see whether the potential comparables show the resemblance of profit potential. Some specific features of intangibles in which it shows the crucial part for comparability analysis of intangibles’ transfer or rights in intangibles191 should also be taken into account; including, exclusivity of intangibles192, extent and duration of legal protection193, geographic scope194, useful life195, state of development196, rights to enhance, revisions, and updates197 as well as the expectation of future benefit198.

Since the transfer of design of automobiles i.e. copyrights, is the full sale of rights and it is hard to find the comparable situation and the type of business is unique, according to OECD TPG and the CFR of the United States, I see that the transactional profit split method is appropriate as this method utilizes to consider the arm’s length price of intangibles’ transfer or right-in-intangible transfer when it could not find the reliability in the comparable uncontrolled

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185 Ibid., s. 1.482-4 (f)(1).
187 Ibid, para. 6.76.
188 Ibid, para. 6.79.
189 Ibid, para. 6.81.
190 Ibid, para. 6.73.
191 Ibid, para. 6.118.
192 Ibid, para. 6.118.
193 Ibid, para. 6.119.
194 Ibid, para. 6.120.
195 Ibid, para. 6.121.
196 Ibid, para. 6.124.
197 Ibid, para. 6.125.
198 Ibid, para. 6.127.
transaction\textsuperscript{199} and it applies with the sale of full right in intangibles. This method is to reduce the effect on profits in a special circumstance in the controlled transaction by considering the profits that the uncontrolled company would have anticipated to realize from participating in transactions.\textsuperscript{200} Multi-national companies rely on more on this method since it helps to fragment the value chain and broaden it across borders.\textsuperscript{201} Furthermore, this method is also a part of BEPS project. Accordingly, it is suitable for the transfer of design of automobile’s part between companies in a group to use the transactional profit split method for the arm’s length determination.

Consequently, in my point of view, to consider the factors above for the determination of arm’s length price for the cross-border transfer of design of automobile’s part from subsidiary to headquarter, crucial elements as aforementioned should be considered in order to have more accuracy in terms of the comparability analysis. Besides, according to the nature of the transaction, I see that the transactional profit split method is appropriate method to find the arm’s length price in this case.

\textsuperscript{199} Ibid, para. 6.148; Monsenego, op. cit., p. 47. 
\textsuperscript{200} OECD TPG, op. cit., para. 2.114. 
\textsuperscript{201} It is also described as global value chain, see OECD, Interconnected Economies: Benefitting from Global Value Chains, 2013; Ibid.
V. Conclusion

As Thailand does not have the clear regulation in terms of transfer pricing yet, to use the guideline from the OECD TPG as well as the CFR of the United State might be able to help the taxpayer as well as the tax authority for the analysis of arm’s length in practice. In terms of finding the most appropriate method for the cross-border transfer of design of automobile’s part from subsidiary to headquarter, the proper transfer pricing method must be used. In order to use guidelines from CFR and OECD TPG, before applying any methods for the transfer of intangibles, the best method rule, the comparability analysis, and the arm's length range, should be taken into consideration first according to CFR of the United States. Besides, according to OECD, essential factors for considering the arm’s length remuneration such as development and enhancement of marketing intangibles, research, development and process improvement arrangements and payment for the use of company name must be considered altogether with the exclusivity of intangibles, extent and duration of legal protection, geographic scope, useful life, state of development, rights to enhance, revisions, and updates as well as the expectation of future benefit. Moreover, according to the nature of the transaction, I see that the transactional profit split method is appropriate method to use in order to find the arm’s length price in this case. In this regard, I see that Thailand could use these factors for future consideration for proper analysis of transfer pricing as the guideline to implement the transfer pricing law of Thailand to be more apparent and clearer than at present.
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Appendix

Figure: the example of the design of automobile’s part