Arm's Length Price

1. Overview

When a business entity has a transaction with an overseas related party, a transfer pricing issue is always encountered. The purpose of the transfer pricing taxation is to find the taxable income that has to be attributable to the transaction parties as a result of a transaction between related parties and the transactions subject to the transfer pricing taxation include all transactions that affect the profit and loss of a business entity. The clause 1 of Article 9 of the OECD Model specifies this. The price as a standard of judgment in this transfer pricing taxation is referred to as the arm's length price. The arm's length price is a price that is applied or is believed to be applied in a common transaction between independent parties.

2. Arm's length principle

The arm's length principle follows an approach in which the business entities of a multi-national business group are treated as independent business entities rather than one integrated business entity which cannot be separated by seeking a profit adjustment based on the transaction conditions which are likely to be determined by an independent business entity for a comparable transaction with a third party in a comparable situation. Such an analysis of related transactions and independent transactions referred to as comparability analysis.

However, both the tax authority and taxpayers encounter a difficulty in obtaining appropriate information for the application of arm's length price. In spite of this problem, the transfer pricing between related parties must be evaluated in accordance with the arm's length principle.

3. Transfer pricing methods

There are six transfer pricing methods.

- Comparable uncontrolled price method ("CUP")
- Resale price method ("RPM")
- Cost-plus method ("CPLM")
- Transactional net margin method ("TNMM")
- Profit split method ("PSM") and
- Other reasonable method

There is no hierarchy in its application for the first five transfer pricing methods. Taxpayers can select the most reasonable method among the first five methods. Other reasonable method can be used only when the transfer price cannot be calculated using the first five method.