Transfer Pricing
Ho Chi Minh City, Vietnam
14 May 2014
Agenda

1. Introduction
2. Key transfer pricing enforcement activities in Vietnam
3. Transfer pricing risk management through advance pricing agreements
## Cases in the news

### Net revenues by Operating segment

<table>
<thead>
<tr>
<th></th>
<th>Google</th>
<th>Apple</th>
<th>Starbucks</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>2012</td>
<td>2011</td>
<td>2010</td>
</tr>
<tr>
<td>Earnings before income taxes (US)</td>
<td>5,311</td>
<td>4,963</td>
<td>4,948</td>
</tr>
<tr>
<td>Earnings before income taxes (Rest of the world)</td>
<td>8,075</td>
<td>7,633</td>
<td>5,848</td>
</tr>
<tr>
<td>Total</td>
<td>13,386</td>
<td>12,596</td>
<td>10,796</td>
</tr>
</tbody>
</table>

### Taxes

<table>
<thead>
<tr>
<th></th>
<th>Google</th>
<th>Apple</th>
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</thead>
<tbody>
<tr>
<td></td>
<td>2012</td>
<td>2011</td>
<td>2010</td>
</tr>
<tr>
<td>US Taxes</td>
<td>2,513</td>
<td>1,998</td>
<td>2,115</td>
</tr>
<tr>
<td>Foreign Taxes</td>
<td>358</td>
<td>248</td>
<td>167</td>
</tr>
<tr>
<td>Total</td>
<td>2,871</td>
<td>2,246</td>
<td>2,282</td>
</tr>
</tbody>
</table>

### ETR

<table>
<thead>
<tr>
<th></th>
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</thead>
<tbody>
<tr>
<td></td>
<td>2012</td>
<td>2011</td>
<td>2010</td>
</tr>
<tr>
<td>US ETR (state + federal taxes)</td>
<td>47.3%</td>
<td>40.3%</td>
<td>42.7%</td>
</tr>
<tr>
<td>Foreign ETR</td>
<td>4.4%</td>
<td>3.2%</td>
<td>2.9%</td>
</tr>
<tr>
<td>Global ETR</td>
<td>25.8%</td>
<td>21.7%</td>
<td>22.8%</td>
</tr>
</tbody>
</table>
“Bad” news

- Transfer pricing has become synonymous to profit-shifting/tax avoidance.
Transfer pricing is actually a neutral concept
What is transfer pricing?

- Transfer pricing is the price charged for tangible/intangible goods/transactions, services or loans between associated entities.

- The “arm’s length principle”
  - Requires associated enterprises to price inter-company transactions (“controlled transactions”) as if they are unrelated or in a third-party scenario (“uncontrolled transaction”) and be able to demonstrate them.
  - Companies cannot set intercompany prices “in a vacuum.”
Why is transfer pricing important?

- TP determines, in large part, the income and expenses and therefore taxable profits of entities located in different tax jurisdictions.

- TP can be abused to take advantage of tax rate arbitrage between high tax and low tax entity / jurisdiction in a way that shifts pre-tax profits from high tax entity / jurisdiction to low tax entity / jurisdiction.
  - Google, Apple, Starbucks as examples

- TP is not just a tax issue, it can now impact brand, revenue and share price.
Active enforcement of Circular 66 since its issuance in 2010

- Formal requests for annual TP declaration form and TP documentation
- TP audits in 2012: 1,495 companies audited had VND 3.3 trillion (approx. USD 157 million) adjustment and VND 622.8 billion (approx. USD 30 million) additional tax and penalty


- Capacity-building of tax authorities
- Database enhancement
- TP-focused audits: 20% of annual tax audits to be devoted to TP audits
Key transfer pricing activities in Vietnam (2013-2014)

- Increasing TP audits
- GDT’s key task in 2014: fight against abusive TP practices
- Issuance of APA Circular (effective 5 Feb 2014)
- New TP disclosure form (effective 1 Jan 2014)
- Continuing “shame campaign” via publication in GDT’s website of taxpayers committing tax violations and those having “signs” of tax violations.
  - In latter, those with irregular transactions with related parties
TP audit results in 2013

- GDT conducted inspection tours aimed mostly at loss-making entities across 23 cities and provinces
- Industry focus: textile, garments, real estate, construction, steel, those in export-processing zones
- Transactions under focus: purchase/sale of goods, services, financial expense, fixed assets
- HCM, Hanoi, Dong Nai, Binh Duong, Quang Ngai province
TP audit results in 2013 cont’d

– 2,110 inspected enterprises:
  • Had adjustment of VND 4 trillion (approx. USD 190M) and
  • Paid additional tax and penalty of VND 988 billion (approx. USD 47M)

– Compared to 2012, this is an increase of around
  • 40% in number of companies forced to make adjustments and pay
    additional tax and penalty; and
  • 21% in adjustments
  • 56% in additional tax and penalty
Vietnam Chamber of Commerce and Industry (VCCI) recent survey:

- 1,609 FIEs from 49 countries, which are operating in 13 cities and provinces of Vietnam
- 20% admitted that they commit transfer pricing abuse in order to ease their tax burdens.
Strategies to manage transfer pricing risks

- Bilateral/multilateral APA
- Unilateral APA
- Country specific documentation
- Regional documentation
- Commercial agreement
- Do nothing

Not acceptable

If no transfer pricing documentation requirements

Specific compliance requirements

Costs / regulatory issues
Change in business models
Gaining certainty for transactions
APA is an advance arrangement to ascertain the transfer prices of specified related party transactions over a specified period of time.

APA is considered binding on tax authorities and on the taxpayer, subject to any qualifications stated in APA.

APA is a facility available to taxpayers to avoid potential double taxation.
Advance Pricing Agreements (APAs)

Key contents of an APA

- Taxpayer/s involved
- Related party transactions covered
- Agreed transfer pricing methodology and profit level indicator
- Agreed pricing or arm’s length range
- Duration of APA (5 years, extendible for another 5 years)
- Nature of critical assumptions
- Annual compliance reporting
- Signature
Key contents of an APA cont’d

- Appendices:
  - Functional and industry analysis
  - Selection of methodology and profit level indicator
  - Economic analysis to determine the pricing/profitability for the APA
  - etc.
Advance Pricing Agreements (APAs)

- Requires agreement between taxpayer and tax authority within the resident’s country
- Does not achieve same level of certainty for taxpayers as bilateral/multilateral APA
- Provides assurance on pricing arrangement only in one particular country

Unilateral APA

Country A

Taxpayer
Country A

International related party transactions

Country B

Taxpayer in
Country B

Tax Authority
Country B

Possible exchange of information in accordance with double tax treaty

Agreement

Tax Authority
Country A

Tax Authority
Country A
Advance Pricing Agreements (APAs)

- Requires agreement between tax authority and another tax treaty partner
- It involves agreement/negotiation with foreign Competent Authority
- Provides a higher level of certainty and minimizes risks compared to unilateral APA
Advance Pricing Agreements (APAs)

- Requires agreement between one tax authority and two or more tax treaty partners
- It involves agreement/negotiation with foreign Competent Authority
- Provides a higher level of certainty and minimizes risks compared to unilateral APA
APAs under Vietnam APA Circular

**Taxpayer**
- Request for pre-lodgement meeting, and preparation of supporting documents (Form 1/APA-TV)
- Submit formal APA application (Form 2/APA-CT) within 120 days from receipt of GDT written approval (subject to 30-day extension)
- Consider the need for MAP (Form 4/APA-MAP) to resolve double taxation
- Prepare annual report for each year (Form 3/APA-BC) during APA period to demonstrate compliance with terms of APA;
- Prepare ad-hoc reports and submit to tax authorities within 30 days from happening of events affecting APA or request
- Consider possibility of roll forward of APA for next 5 years (max)

**GDT**
- GDT reviews documents and conducts one or more pre-lodgement meetings
- Meeting with taxpayer within 15 days from receipt of application; APA application is evaluated and further information/meetings may be required within 90 days (subject to 60-day extension)
- APA negotiation and discussion between taxpayer and GDT (for unilateral APA) or between/among tax administrations (for bilateral/multilateral APAs)

**Decision**
- GDT written notice within 30 days
- Approve
- Reject

**Formal APA**
- Formal APA is drafted based on terms of agreement reached
- APA can be extended within 6 months before expiry of previous APA
Factors to consider when applying for APA

- **Availability of APA**
  - Location of counter-parties
  - Existence of double tax treaty
  - Strength of overseas competent authority

- **Likelihood of success**
  - Nature of related party transactions
  - Clarity and stability of business model
  - Alignment of tax model with business model
  - Availability and quality of data to support case
  - Tax authorities will expect a great deal of information/data
Factors to consider when applying for APA cont’d

- Cost/benefit analysis
  - Requirement for provision of additional data and economic analyses
  - What are the risks of transfer pricing dispute in the future?
    - High audit risk: preemptive action
    - Following audit: prevent another bad experience
  - What is the amount of double taxation at stake?
  - Up-front investment required in time and resources
  - Long-term benefits – simplified compliance / avoidance of double taxation
Advantages of an APA

- **Certainty**
  - Transfer pricing methodology
  - Substantial reduction or elimination of possibility of double taxation in future
  - Less prospect of protracted and expensive litigation

- Negotiated in a cooperative environment between the taxpayer and the tax authority.

- Avoids lengthy and adversarial transfer pricing examination and possible imposition of penalties.
Advantages of an APA cont’d

- Certainty over a longer period: in Vietnam, APA duration for 5 prospective years with potential roll-forward for another 5 years.

- Requires up-front investment but overall costs normally lower.

- Can cover all domestic and international related party transactions – other jurisdictions would normally use TNMM on whole of entity basis.
Disadvantages of an APA

- **Client confidentiality and disclosure**
  - Taxpayers need to present the salient information such as company’s business model, industry information, transactions and period involved for the APA
  - Taxpayers need to analyze risk of disclosure in treaty country.

- **Requires up-front investment and time**
  - Viable option if significant related party transactions involved
  - Procedural formalities involved can make it a time consuming exercise
  - Multilateral APA involves consensus between foreign & local tax authorities which can prolong the APA process further
Disadvantages of an APA cont’d

- Uncertainty regarding efficiency of GDT
  - Predictability of outcome and process?

- Uncertainty over unilateral APAs
  - Unilateral APA does not assure taxpayer of reduction in double taxation.
  - Foreign tax authorities may disagree with conclusions under unilateral APA although a signed APA from another tax authority can be a useful tool in a negotiation.
Disadvantages of an APA cont’d

- No retroactive application/roll-back
  - Circular 201 does not allow retroactive application of an APA before the date of lodging an APA application
  - It is unclear if taxpayer can self-adjust the taxable income for years prior to an effective APA or for prior open years
Availability

- APAs increasingly popular with taxpayers and tax authorities around the world
- Bilateral APA can be negotiated via MAP articles in double tax agreement
- Bilateral typically preferred by tax authority when double tax treaty in place
- Unilateral APAs are akin to domestic tax ruling, so widely available
Practical use of APAs in other jurisdictions cont’d

Likelihood of success

- High chance of success once process commences
- Voluntary APA applications viewed favourably
- APAs arising from audit – less certain as coming from existing conflict
- Depends on countries involved – greater chance if counter-party viewed as sophisticated
- Depends on flexibility and aggressiveness of taxpayer
Duration of application process

- Unilateral typically less than 1 year (but still untested in Vietnam)
- Bilateral typically 1-2 years, depending on the issues and the countries involved

Complexity of the application process

- Varies depending on the issues in dispute and the experience of Competent Authorities
- Complex issues may require further detailed analysis to be prepared
Key take-aways

In this time of uncertainty and growing perception by the public to perceived “tax avoidance” practices, multinationals need to:

- Assume that whatever they do will be fully transparent to tax officials;
- Ensure that tax and transfer pricing structures mirror their substance;
- Expect increased enforcement of transfer pricing rules and more audits;
Key take-aways

- Consider a risk-based approach to transfer pricing management
  - Consider the use of APAs as a risk-management tool
  - Consider a risk-based approach to transfer pricing documentation

- Think about international tax and transfer pricing from a governance and corporate reputational perspective.
Thank you

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