DFDL LEGAL & TAX

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

	Google			Apple			Starbucks		
	2012	2011	2010	2012	2011	2010	2012	2011	2010
Net revenues by Operating segment									
Earnings before income taxes (US)	5,311	4,963	4,948	23,733	13,538	7,590	1,679	1,523	1,308
Earnings before income taxes (Rest of the world)	8,075	7,633	5,848	39,883	26,838	15,306	379	287	128
Total	13,386	12,596	10,796	63,616	40,376	22,896	2,058	1,810	1,436
Taxes									
US Taxes	2,513	1,998	2,115	13,317	7,681	4,366	546	406	538
Foreign Taxes	358	248	167	713	602	161	77	37	38
Total	2,871	2,246	2,282	14,030	8,283	4,527	623	443	576
ETR									
US ETR (state + federal taxes)	47.3%	40.3%	42.7%	56%	57%	58%	33%	27%	41%
Foreign ETR	4.4%	3.2%	2.9%	2%	2.2%	1.1%	20%	13%	30%
Global ETR	25,8%	21,7%	22,8%	24%	29,6%	29,5	26,5	20%	35,5%

“Bad” news

- Transfer pricing has become synonymous to profit-shifting/tax avoidance.

Good news

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") <u>and</u> 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.

Key transfer pricing activities in Vietnam (2010-2012)

- 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
- National Action Plan for TP management for 2012-2015
  - 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

Recent transfer pricing enforcement activities in Vietnam

DFDL LEGAL & TAX

- 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

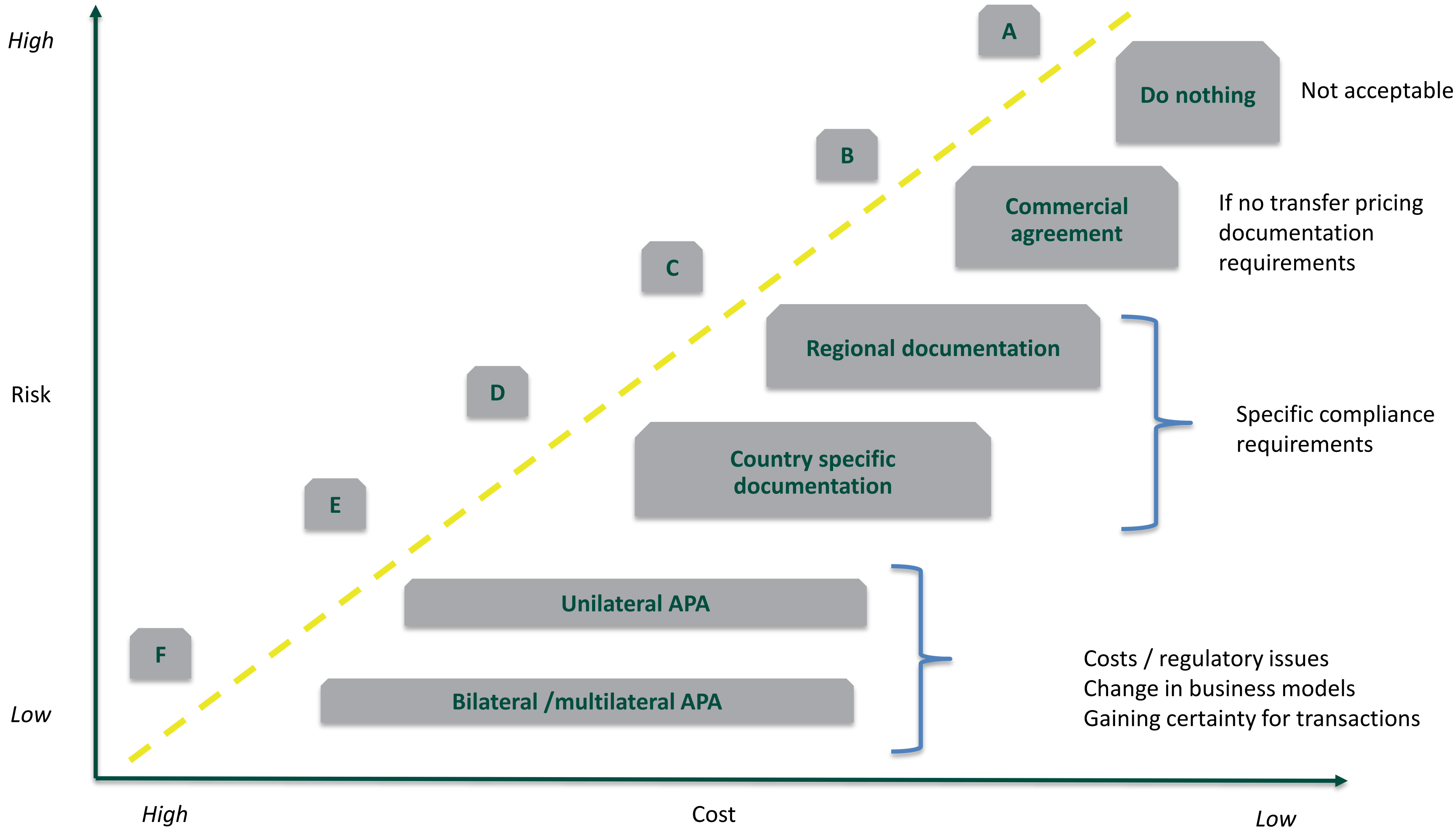
Recent transfer pricing enforcement activities in Vietnam *cont'd*

- 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

Recent transfer pricing enforcement activities in Vietnam *cont'd*

- 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



Managing TP risks through Advance Pricing Agreements (APAs)

DFDL LEGAL & TAX

- 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.

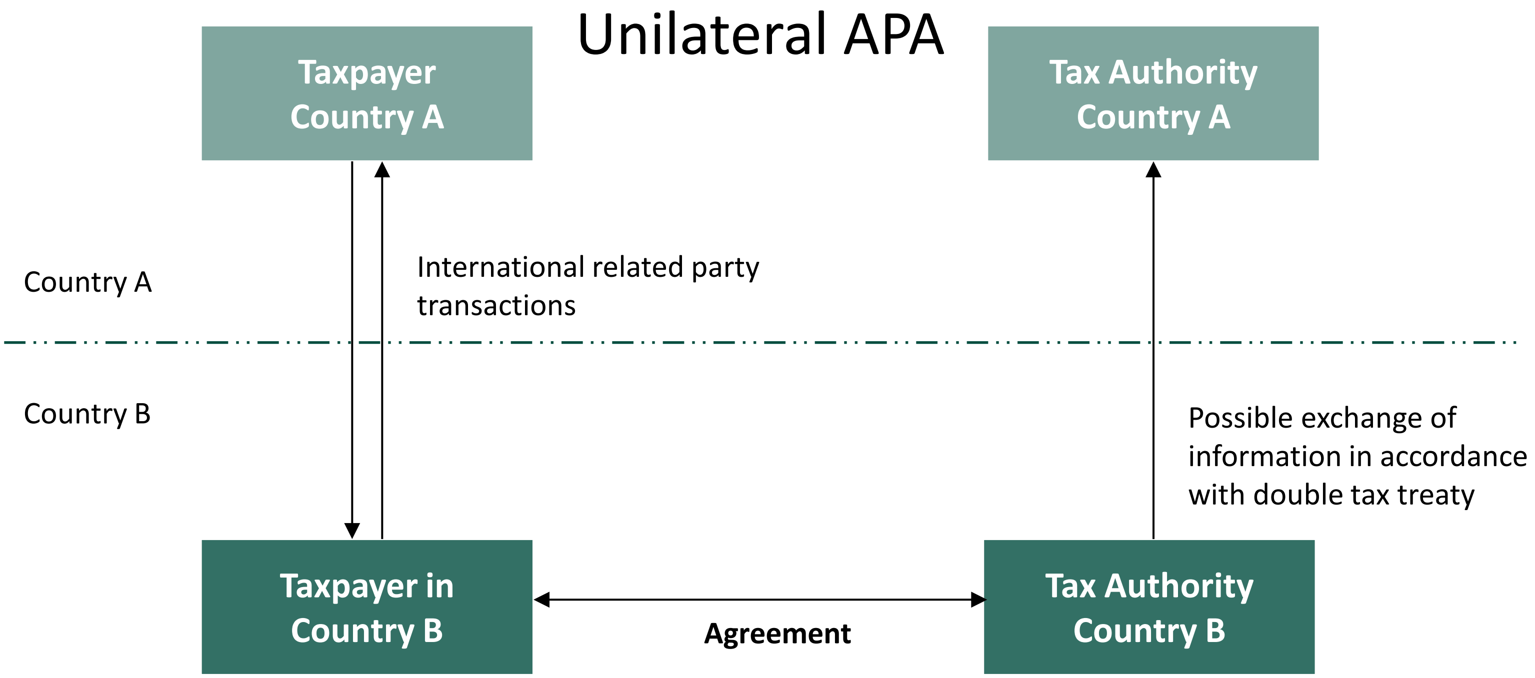
Key contents of an APA

- 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.

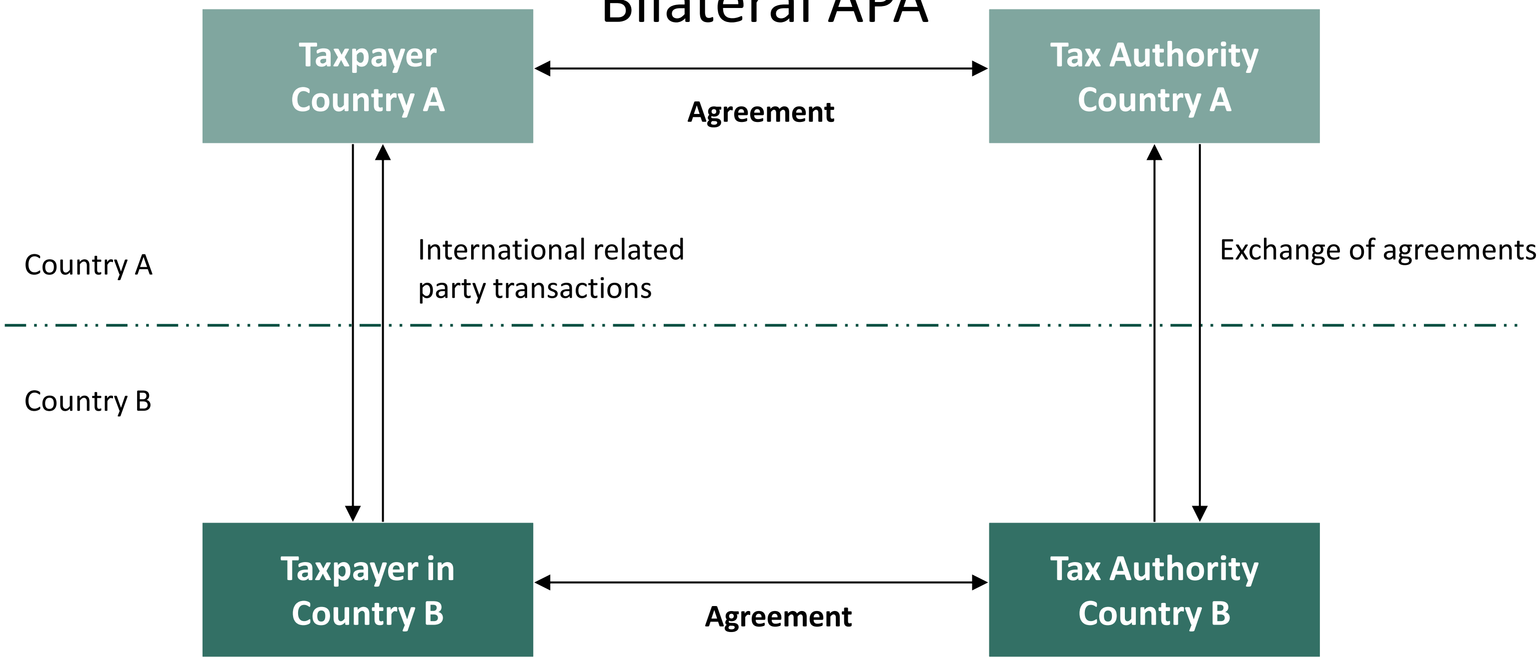
Advance Pricing Agreements (APAs)



- 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

Advance Pricing Agreements (APAs)

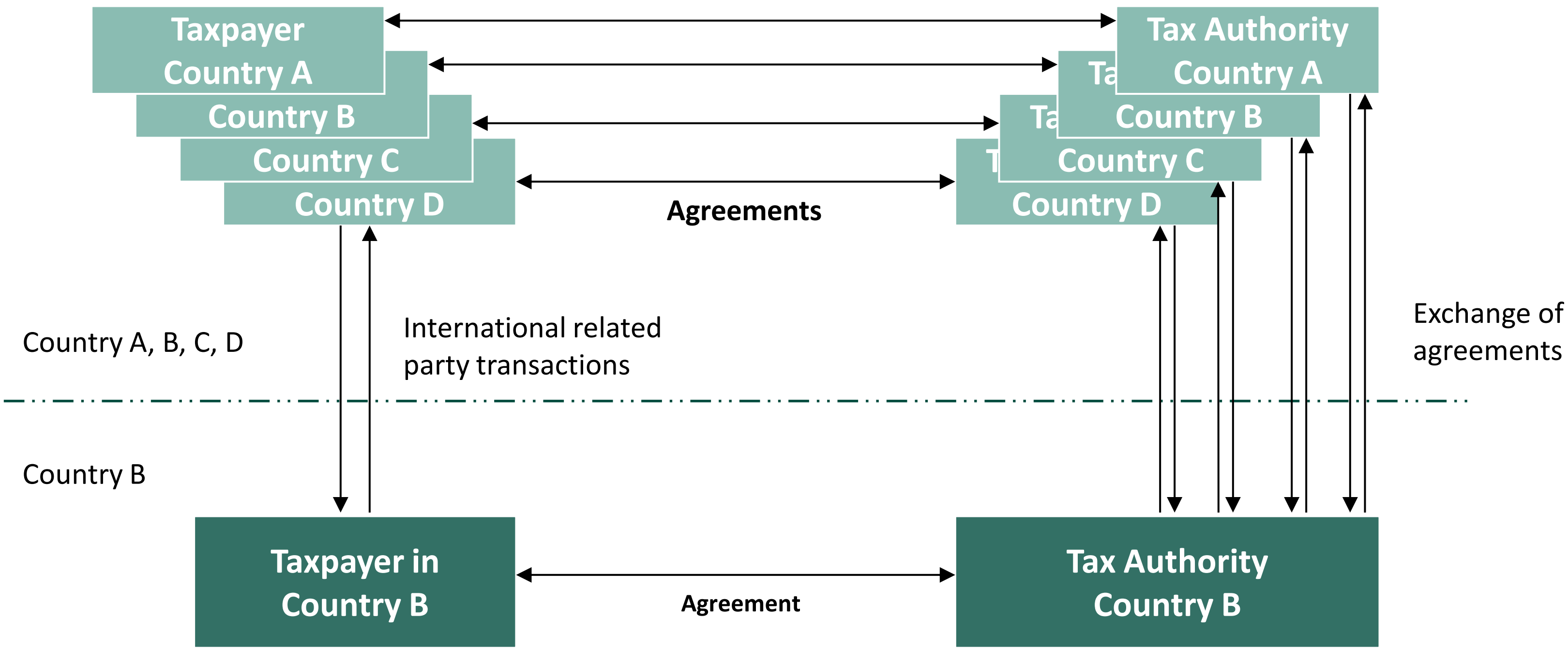
Bilateral APA



- 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)

Multilateral APA



- 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

APA process and timing under Vietnam APA Circular

DFDL

Reject

Taxpayer

Request for pre-lodgement meeting, and preparation of supporting documents (Form 1/APA-TV)

GDT

GDT reviews documents and conducts one or more pre-lodgement meetings

GDT written notice within 30 days

Approve

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

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)

Formal APA is drafted based on terms of agreement reached

APA can be extended within 6 months before expiry of previous APA

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)

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*

DFDL

- 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

Practical use of APAs in other jurisdictions

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

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

Practical use of APAs in other jurisdictions *cont'd*

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

Grace Molina
Transfer Pricing Director

grace.molina@dfdl.com

Excellence · Creativity · Trust

Since 1994