



Global Tax Update

Vietnam

Deloitte Tohmatsu Tax Co.

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Trend in Transfer Pricing Audit/ Inspection in 2015 – Advancing development

The Transfer Pricing (“TP”) audit/inspection landscape in Vietnam has become significantly more challenging in the past few years. During 2014, based on the public media, the tax authorities have conducted TP audit/inspection in 2,866 enterprises with indication of potentially high TP risks, increased by 80% compared to 2013. During the TP audits/inspections, tax authorities have made decision on the loss deduction of VND5.8 trillion and tax arrears of more than VND1.7 trillion.

Year 2015 is not exception, and transfer pricing would be more challenging. During this year, TP is obviously one of the key areas in the Tax Audit/Inspection plan, which accounts for a majority of total audit/inspection cases of the Tax Authorities in large cities and provinces. The first five months of 2015 witness activeness of the Tax Authorities toward transfer pricing. The significant adjustments made recently by the Tax Authorities in several transfer pricing audits are also a testimony to this trend.

In this tax alert, we will provide an overview of the recent development of TP audit/inspection, share recent scrutiny experience, discuss some related issues and also provide recommendations to the taxpayers.

(1) Specific list of target for TP audit/inspection in 2015

Transfer pricing and TP audit/inspection have been focused in recent years during tax audit/inspection. 2015 noted a big difference from the previous years, as there is a specific list of TP target companies proposed for tax audit. The audit/inspection on TP could be either included in the scope of general tax audit/inspection which is similar to previous years or in separated TP audit/inspection.

Identifying specific targets for TP audit/inspection is one of the key functions of the internal TP risk statistics & analysis software system of the tax authorities. Using the internal database, the tax authority now has the ability to point out the enterprises with clear indications and high TP risk and thus will be audited.

(2) Capabilities of TP auditors and resources

Along with the development of TP audit/inspection, during the last few years, the Ministry of Finance (MOF) and the General Department of Taxation (GDT) have invested significantly to develop good resources for TP auditor team. They actively organize training courses, and invited specialist/experts on TP

inside and outside of the country, to share knowledge base, technical analysis and approaches, as well as audit methodology to many Tax Authorities in different levels; with focus on cities and provinces where there are many FDI companies operating which may have high TP indicators and risks. The core TP technical team of the GDT, which has many years of TP audit experiences, also regularly shares and update technical issues and audit methods with the tax authorities at city/provincial levels to ensure the effectiveness of local TP audits.

(3) Standard forms and information list used for TP audit/inspection purpose

During the TP audit/ inspection in this year, standard forms and information list have been used by the tax authority to collect the enterprises' information prior visiting the taxpayers' site. In fact, forms and information request list have been previously used in TP audit cases conducted by the GDT core team, and are now improved and utilized by provincial tax offices.

The forms require the enterprises to provide key information and/or documents on functions, assets and risks analysis, business environment, supply chain, accounting and financial data, etc. These will provide the tax authority with the basis to conduct initial analysis on the audited enterprise's financial performance. The information will also be used to make TP adjustment (if any) in the later stage of audit/inspection process.

Some of the key notable points in these standard forms are presented below.

1) Information on the related parties

The enterprises are requested to provide detail information on parent company as well as other related parties. Such required information is not limited to the general information of the enterprise but extended to key management executive members, functions and industrial

information, etc. of the related parties.

2) Enterprise's position in the supply chain

The tax authority also focuses on the information regarding the enterprise and its related parties' position in the supply chain. Based on this information, together with internal statistic data of similar businesses in the same industry, the tax authority not only can see the "bigger picture" of the group's business but also form the initial assessment of appropriate remuneration and potential profit sharing of the involved parties.

Justifying an enterprise's role in a supply chain and the appropriate profit corresponding to such role will require a comprehensive analysis of the supply chain which is time and effort consuming for the enterprises. However, without the availabilities of such detail analysis, enterprises may exposure themselves to the risk of inadequate assessment of the supply chain, as well as raising negative impression to the tax authority.

3) Detail explanation on the selection of TP method

Under the prevailing Vietnam's TP regulation, there is no hierarchy among the five regulated TP methods to assess the arm's length nature of an enterprise's related party transactions. However, in practice, the tax authority tends to assess the applicability of Comparable Uncontrolled Price ("PP1 - CUP") method prior any other methods. The tax authority, therefore, request in detail the information regarding the applicability of internal CUP in their forms and tables sent to the enterprise.

If the enterprise has employed another method to evaluate their related party transactions, detailed reason for rejection of other methods is required. In the absence of reasonable argument from the enterprise, the tax authority may reject the whole submitted TP documentation and economics analysis.

4) Detailed information regarding related party and third party transactions

Other than the general information on the enterprise's financial performance and corporate income tax liability, the tax authority shall require the enterprise to present in detail of the accounting records and financial data with break-out of its related party and third party transactions such as sales of finished goods, purchases of materials, intangible transactions, etc.

(4) What taxpayers can do better?

Given the above highlighted points, we would like to provide some recommendations for the enterprises as following:

- The TP annual declaration forms (i.e. Form 01/GCN-QLT for years before 2014, and now replaced by Form 03-7/TNDN from year 2014) are repeatedly stressed in the information requested by the tax authority. The TP form is considered as not only a compulsory compliance under the regulation, but also the first self-assessment on the compliance level, as well as the readiness of TP documentation of the enterprise which is clearly reflected in the new TP Form. This will also be used by the tax authority as the basis to make adjustment on the enterprise's business' result. It is important to note that, the TP form must be submitted within regulated deadline, i.e. together with the annual CIT return.
- Enterprises should invest time and efforts to timely prepare the TP documentation report as well as other supporting document to justify the arm's length principle of the related party transactions. It is strongly recommended that the enterprises should maintain transfer pricing documentation on a contemporaneous basis with annual update, and not wait for the audit/inspection to commence to avoid

adverse result. Failure to meet the compliance requirement in a tax audit/inspection process can invite severe consequences. In the worst case, the tax auditor has the rights to object its review of the TP documentation report prepared retroactively for previous years, which was only prepared right before the tax auditors come and request for. This negative treatment is similar to a view that, an economic transaction occurred long time ago, but its supporting document is only prepared and recorded in the accounting system now.

- Enterprises should perform self-assessment on its-own TP risk profile as they could be in the list of next audit/inspection target. Enterprises then should proactively prepare and make necessary improvement of the existing argument and documentation. Given that tax audit/inspection will be conducted after short notice from tax authority and the information request will be sent out in a tight schedule, these actions will enable the enterprises to provide a more comprehensive documentation package and would be at a better position in the later negotiation with the tax authorities.
- The forms/questionnaire requested by the tax authority should not be prepared without sufficient due diligence and review from TP perspective to avoid misleading information and undesirable consequences. Failure to present justifiable information will provide the tax authority enough basis to characterize the enterprise as it deemed fit and used its own set of comparable companies which will resulted in a high margin benchmarking.
- Neglect in the preparation makes it extremely difficult for the taxpayers to present a convincing case during the later stages of objection and appeal.

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