Connecting you to the topical Transfer Pricing issues

Transfer Pricing sharing series

29 May 2020

Situation

While multiple impacts of the Covid-19 pandemic are spreading over the global economy, transfer pricing matters arising from unexpected business closures, reduced operations, low operating results or being unable to implement pricing policy are yet other things to consider. These transfer pricing issues are wide ranging, and vary between industries and even between enterprises in the same industry.

Accordingly, taking into account new global economic reality which is badly affected by Covid-19, Deloitte is publishing a sharing series highlighting transfer pricing implications in the context of the Covid-19 pandemic. We hope that this would provide helpful insights for finance and tax executives at both the headquarter and the local company in Vietnam for finance and tax planning process – which must now be most accurate and adaptable to changes in the least time possible.

Deloitte's sharing series is intended to bring to your attention to intra-group pricing matters that should be actively managed and monitored to change the negative impact of Covid-19 into opportunities and rise in this chaos.

Our sharing series will cover the following key areas (and beyond):

1. Supply chain disruption due to Covid-19 – How the existing group supply chain model may be changed forever and what potential subordinate risks may be involved
2. Pre-Covid-19 intra-group pricing arrangements may potentially become irrelevant and the need to revisit them
3. Planning ahead for loss-making or fluctuating profitability in periods impacted by Covid-19
4. Business re-structuring from the perspective of transfer pricing specialists
5. More tolerance for low-risk entities due to Covid-19 – is it true?
6. Covid-19's impact on APA negotiation and/or implementation process
7. Transfer pricing audit trends: relaxation in approach for taxpayers or aggressive plan for State budget?

Supply chain disruption due to Covid-19

How the existing group supply chain model may be changed forever and what potential subordinate risks may be involved

In this first episode, we will discuss the current disruption in supply chains caused by Covid-19 – how the future changes may give rise to potential subordinate transfer pricing risks that need to be considered and addressed right from the very initial planning stage by both group and local finance executives.

Could Covid-19 be the wake-up call that forces multinational enterprises over the globe to see how fragile the economy is and rethink the supply chain model?

Covid-19 took the world by surprise starting at the world's factory – China from where global supply chains were impacted. We believe that many financial and tax managers of multinational enterprises are considering where to start in their recovery and rebuild strategy. Some of our observations and suggestions below may be of assistance.

What we observe

- Covid-19 created an unexpected shut down in Wuhan where over 200 of the Fortune Global 500 firms have a presence. Dun & Bradstreet researchers found that at least 51,000 companies worldwide, 163 of which are in the Fortune 1000, have one or more direct or "tier 1" suppliers in the impacted region [1] .

- Supply chains have been severely cut off, forcing companies over the world to identify temporary supply options and/or deal with the unexpected situation of not being able to supply.

In light of the above, it is important group transfer pricing arrangements are revisited and carefully reviewed to reflect the extraordinary situations due to supply chain disruption.

Our suggestions

- Considerations for alternative production bases outside China are rising, and companies may consider re-allocating capacity throughout the value chain, which will lead to the restructuring of related party arrangements within the group.

- The re-evaluation of premises relocation should be considered holistically before the actual relocation to assess the functional and risk profile of all elements of the supply chain and analyze which part or component should bear the ultimate risks or entrepreneurial risks. This re-evaluation is critical for both business and risk (including tax) optimization for the post-Covid-19 operations.

- In most typical supply chains, companies tend to have low risk entities such as limited risk distributors and contract manufacturers. These entities generally earn a routine profit - with a drop in their results would there be a need to adjust their transfer prices to earn back their routine profits to avoid potential questions/challenges from a transfer pricing perspective from stakeholders (including suppliers, customers, shareholders and especially tax authorities).

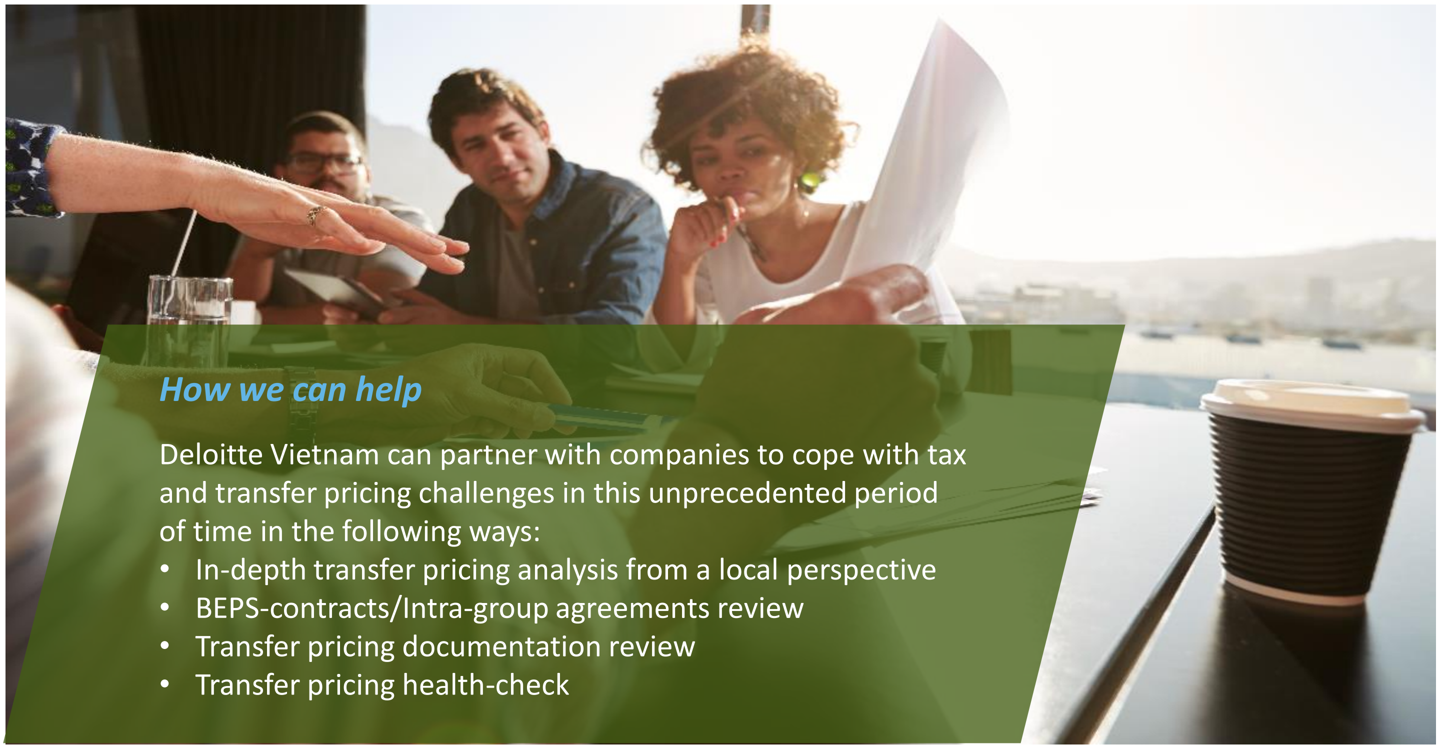
- It is important to note that these are not zero risk entities and they actually bear some level of risk - as such a detailed analysis of the supply chain and how the losses or reduced margins arose would help the companies to substantiate the need to make the right transfer pricing adjustment(s).

Our suggestions (Cont.)

- The companies' systems, including internal management information systems, should also be carefully examined (and calibrated if needed) to reflect the new transfer price so that financial forecasts and accounting results can be fairly and accurately achieved going forward. These "calibrations" will result in changes to not only systems but also other related issues, such as which cost(s) should be recovered and what should the new margin or transfer price be.
- Companies should examine and document the impacts (especially damages) the pandemic is having on the supply chain to be able to effectively defend challenges by tax authorities in subsequent tax audits/inspections. From a compliance perspective, it is important that Transfer Pricing documentation should be sufficiently robust to document the losses or drop in margins. This goes far beyond just stating that the low margins were due to Covid-19, in fact detailed analysis of the impact in volume, production capacity, cost etc. are strongly recommended. This should also be reflected in the industry analysis to substantiate that the impact is wide reaching across the entire industry.

In summary, the existing supply chains of many multinational enterprises may be subject to permanent changes, and operate under rapid and frequent changing environment post-Covid-19. Financial and tax leaders at regional level of multinational enterprises will need to learn to adapt to the rapidly changing environment due to Covid-19 and manage the supply chain to ensure a sustainable future.

In this context, it is important those leaders have a full understanding and take into account in their financial planning the potential impacts from possible changes in related party transactions and arrangements in each country where subsidiaries are located. Certainly in Vietnam, the local finance executive (Chief Accountant, Chief Finance Officer) would also be involved to assist leaders at regional level to understand the "entire landscape" in Vietnam, including local corporate tax and transfer pricing implications.



How we can help

Deloitte Vietnam can partner with companies to cope with tax and transfer pricing challenges in this unprecedented period of time in the following ways:

- In-depth transfer pricing analysis from a local perspective
- BEPS-contracts/Intra-group agreements review
- Transfer pricing documentation review
- Transfer pricing health-check

Note:
[1] https://www.cnbc.com/2020/02/17/coronavirus-could-impact-5-million-companies-worldwide-research-shows.html

WHAT'S NEXT :

Our next episode will analyze in detail how the intra-group pricing arrangements before Covid-19 are likely to have been severely disrupted, as well as why and how they need to be revisited for tax risk management.

Deloitte.

Contact us

Thomas McClelland
National Tax Leader
+84 28 7101 4333
tmcclelland@deloitte.com

Dinh Mai Hanh
National TP Leader
+84 24 7105 0050
handinh@deloitte.com

Bui Ngoc Tuan
Tax Partner
+84 24 7105 0021
tbui@deloitte.com

Bui Tuan Minh
Tax Partner
+84 24 7105 0022
mbui@deloitte.com

Phan Vu Hoang
Tax Partner
+84 28 7101 4345
hoangphan@deloitte.com

Suresh G Kumar
Tax Partner
+84 28 7101 4400
ksuresh@deloitte.com

Vo Hiep Van An
Tax Partner
+84 28 7101 4444
avo@deloitte.com

Vu Thu Nga
Tax Partner
+84 24 7105 0023
ngavu@deloitte.com

Hanoi Office
15th Floor, Vinaconex Building,
34 Lang Ha Street, Dong Da District, Hanoi
Tel: +84 24 7105 0000
Fax: +84 24 6288 5678

Ho Chi Minh City Office
18th Floor, Times Square Building,
57-69F Dong Khoi Street, District 1, Ho Chi Minh City
Tel: +84 28 7101 4555
Fax: +84 28 3910 0750

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