Transfer Pricing Audit Newsletter

March 2021

In 2020, with the impact of the Covid-19 pandemic, tax authorities' tax and transfer pricing audits were conducted under a "new normal" with changes in their approach, i.e. lengthened desk audit at tax authorities' premises and shortened field audit at taxpayer's premises. This practice is expected to continue in 2021 due to the continuing developments of the Covid-19 pandemic.

To assist taxpayers to approach and handle tax and transfer pricing audits more effectively, KPMG would like to provide some insights and recommendations from a professional perspective.

Overview of tax and transfer pricing audits in 2020

In response to the impact of the Covid-19 pandemic from early 2020, the Prime Minister of Vietnamese Government issued Directive No. 11/CT-TTg dated 4 March 2020 on urgent objectives and solutions for assisting businesses facing difficulties amid the Covid-19 pandemic, which requested tax authorities to consider exemption of periodic inspection in 2020 at enterprises that are not suspected of violations.

The actual amount of tax revenue collected in 2020 was still 1.9% higher than the forecast. It is reported by the Ministry of Finance that in 2020, 83,979 tax audits were conducted, contributing to an increase of tax revenue to the State Budget of VND19,867 billion, a decrease in tax deductions of VND2,248 billion, and a decrease of tax losses of VND49,760 billion[1]. 263 enterprises having related-party transactions were tax audited, contributing to an increase of tax arrears of VND278.82 billion, a decrease of tax losses of VND3,366.16 billion and an upward transfer-pricing adjustment of taxable profit of VND3,125.84 billion in just the first 10 months of the year[2]. Tax revenue estimate in 2021 is expected to be much more rigorous than that in 2020, and tax authorities will continue rigid tax audit practices to achieve such target.

Due to the impact of the Covid-19 pandemic, tax authorities strengthened desk audits at the tax authorities' premises. This, means shortened time for taxpayers to prepare their responses to the tax authorities.

KPMG's insights on tax and transfer pricing audits in 2021

In accordance with Resolution No. 01/NQ-CP of the Vietnamese Government issued on 1 January 2021 on major tasks and solutions guiding the realization of the socio-economic development plan and State budget estimates for 2021 and Conclusion of the Standing Deputy Prime Minister in the national conference on taxation practice in 2020

[1]Source: Information collection from the Ministry of Finance's Inspectorate
[2]Source: Information collected from the General Department of Taxation

on 5 January 2021, apart from tasks of improvement and development of tax policies, etc., other focuses of tax authorities in 2021 will be transfer pricing audit, transfer pricing administration, identification and prevention of transfer pricing violations and tax evasion.

It is assessed by KPMG that like previous years, tax authorities will continue scrutinizing taxpayers having high transfer pricing risks, especially foreign direct investment (FDI) companies which have significant related-party transactions in the course of business operations and negative/unstable operating results. Tax and transfer pricing audits are likely to have an industry focus including industrial manufacturing, electronic components, motor vehicles, distribution, consumer goods, banking, construction, petroleum, etc.

Overview of tax authorities' approach in transfer pricing audits and KPMG's recommendations

KPMG has observed through several transfer pricing audits, the tax authorities' common approach is as follows:

- Tax authorities focus on reviewing taxpayer's compliance in submission of transfer pricing forms and preparation of transfer pricing documentation. In accordance with the Vietnamese transfer pricing regulations (the most recent of which is Decree No. 132/2020/ND-CP), tax authorities have the power to assess taxpayer's transfer price/profit margin if the taxpayer does not fulfill such compliance requirements. In this regard, KPMG recommends where taxpayers are required to prepare transfer pricing, to prepare quality documentation and strictly follow the Vietnamese transfer pricing regulations.
- Tax authorities usually pay significant attention to operating results of taxpayers which have related-party transactions. The profit margin of taxpayers whose operating results are negative or lower than the perceived arm's length range is at a high risk of being adjusted to the median of the perceived arm's length range. Consequently, taxpayers shall pay taxes at the assessed/adjusted profit margin, plus relevant penalties and late payment interests. Therefore, taxpayers should prepare robust analyses explaining non-transfer pricing causes/factors affecting their operating results and their business plans in the coming years. Taxpayers should review the appropriateness of their transfer pricing policy such that the operating results are appropriately reflected .
- Also, tax authorities are specifically concerned with certain types of related-party transactions, including: (1) payment of royalties and (2) payment of intra-group service charges. To enjoy CIT deductibility, taxpayers must provide evidence on key factors, including actual transfer/provision of intangibles/services, economic and commercial benefits gained from use of such intangibles/services as well as the arm's length nature of the royalties/service charges. Accordingly, KPMG highly recommend taxpayers to prepare all documentation to prove the arm's length nature of such transaction categories.
- In practice, several transfer pricing issues may arise depending on the taxpayer's specific circumstances. For example, tax authorities may challenge taxpayer's selection of independent comparable companies, use of internal comparable data and segmented data (by business/product) for transfer pricing adjustment. Therefore, taxpayers should be well-prepared to have a full explanation to tax authorities.

To effectively approach and handle transfer pricing audits, some recommendations for taxpayers' consideration are as follows:

- *Pre-audit:* Taxpayers should proactively prepare and maintain all transfer pricing documentation in accordance with relevant regulations in terms of submission timeline and content requirements, as well as supporting documents/information for certain types of related-party transactions as mentioned above. For taxpayers with operating results impacted by external and internal non-transfer pricing factors, it is necessary for them to provide good presentation of relevant causes, contributing factors, business plans, etc. in their transfer pricing documentation.

— *During audit:* Several transfer pricing issues may arise, including the tax authority's suggestion on the adjustment of taxpayer's transfer price/profit margin. Therefore, taxpayers should thoroughly review issues raised by tax authorities and provide adequate responses in a timely manner.

  Due to the Covid-19 pandemic, tax authorities' field audit at taxpayer's premises is shortened. Therefore, KPMG suggests that taxpayer's preparation is critical for both desk audit and field audit, which has direct impact on audit results and avoid undesirable tax expenses.

— *Post-audit:* If the audit conclusion is deemed not appropriate, taxpayers may consider filling appeals to require for local tax authority's and/or the General Department of Taxation's review of the audit conclusion. Furthermore, if its transactions involve overseas related parties, taxpayers may consider application of Mutual Agreement Procedure (MAP), which requires Vietnamese tax authorities and respective overseas tax authorities to mutually resolve disputes and mitigate double taxation implications in the case of transfer pricing adjustments.

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