



Transfer Pricing Sharing Series

Episode 04: Planning ahead for loss-making or fluctuating profitability in periods impacted by Covid-19

04 August 2020

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

1. Supply chain disruption due to Covid-19 – How existing group supply chain model may require long-term changes and what potential risks may be involved. Please refer the [link](#) for details.
2. Pre-Covid-19 intra-group pricing arrangements may potentially become irrelevant and the need to reevaluate them. Please refer the [link](#) for details.
3. Amending regulations on interest deductibility cap: What enterprises should consider and proposed action.
4. Planning ahead for loss-making or fluctuating profitability in periods impacted by Covid-19.
5. Business re-structuring from the perspective of specialists.
6. Are low-risk classified entities actually less impacted by Covid-19?
7. Covid-19's impact on APA negotiation and/or implementation process.
8. Transfer pricing audit trends: relaxation in approach for taxpayers or aggressive plan for State budget?

Introduction

The second quarter of 2020 ended with the expectation that the peak period of Covid-19 is not yet over. It can be seen that almost all financial reports showed a decrease in profits compared to the prior period of the Covid-19 pandemic.

Adversely affected companies with decreased profit or even loss-making might face challenges from the Tax authorities on the correlation between Fiscal Year ("FY") 2020's business and mis-transfer pricing activities moving profit out of Vietnam.

It may be prudent to model and quantify the impact of Covid-19 on business results at present and over the next few months, to help demonstrate the economic, financial and commercial rationale in changing pricing policy and other strategic decisions, and ultimately show that low profits or losses were not the result of non-arm's length transfer pricing policies.

What We Observe

- Vietnam's economy was reported to achieve 1.81% growth in the first half of 2020, the lowest rate in 10 years. At the same time, Covid-19 significantly hurt services, the commercial sector and international trading¹.
- Quarter II/2020 was impacted adversely by the Covid-19 pandemic while the Government required social distancing aggressively, saw GDP growing 0.36% in comparison with prior Quarter II, which is the lowest quarterly increase in the last 10 years.
- According to the General Statistics Office of Vietnam, major economies such as the United States, Japan and the European Community are also facing the worst economic recession in decades with continuously declining global trade and disrupted supply chain.
- Along with the trend of decreasing foreign invested capital, multinational enterprises ("MNEs") also started to restructure their supply chains to reduce cost and optimize business opportunities, reduce business scale, and even close some factories to ensure production and business after considering pros and cons of continuing a business at a loss or closing a company. In 06 months of 2020, the number of firms ceasing operation increased sharply to 29,200, increasing of 38.2% in comparison with the same period of 2019, in which mainly enterprises are in the accommodation, catering and distribution industry².



For those MNEs continuing business, they should be prepared to further review their transfer pricing approach during this economic downturn in order to:

- Cautiously keep track expense/cost record to quantify Covid-19 impact;
- Conduct appropriate adjustment in transfer pricing analysis for 2020.

Note:

¹ <http://tapchitaichinh.vn/su-kien-noi-bat/gdp-6-thang-dau-nam-2020-dat-muc-tang-truong-181-324929.html>

² <https://www.gso.gov.vn/default.aspx?tabid=621&ItemID=19651>

Our Suggestions

I. Utilization of safe harbors:

According to Organization for Economic Cooperation and Development (OECD) guidelines, a safe harbor is “a statutory provision that applies to a given category of taxpayers and that relieves eligible taxpayers from certain obligations otherwise imposed by the tax code by substituting exceptional, usually simpler obligations”. Businesses should monitor and regularly update changes in the Safe Harbor regulations, a measure that can be considered by the Government to deal with the influence of Covid-19. The ability to apply current safe harbor regulations may also change due to the alternation in actual situation of the business by the decline in revenue, transaction volume, restructuring of intragroup transactions, etc.



II. Profit fluctuation analysis for transfer price purposes:

Low profits or loss-making in business can be the result of many factors. In particular, the key to prove the fluctuation of profits (or even losses) was entirely attributed to the special circumstances of Covid-19 and not transfer pricing, is to analyze the commercial and financial causes of (negative) profit fluctuation in the context of the pandemic. Possible reasons include decline in demand, abrupt discontinuance of revenue, supply chain disruption, idle capacity, bad debts recovery costs, severance payments for temporary or permanent layoffs, maintenance costs of unused facility, or other extraordinary costs. The recording and quantification of losses related to the above causes should be done in a reasonable and consistent manner, ensuring comparability with similar companies in the market.

III. Practical approaches for benchmarking study (“BMS”):

The BMS should be considered for adjustment to seek companies comparable in functions, assets and risks with the tested party, especially in the context of the Covid-19 pandemic. Adjustments may include:

Eliminating companies in the previous BMS that were not affected by Covid-19, or those obtaining unusual positive benefits from Covid-19 (which would unlikely happen in normal business circumstances) or did not have comparable data in the similar adverse condition period with the tested party;



Adding or removing screening criteria to ensure the selection of comparable companies;



Selection of years for comparison: Taxpayer should consider which year of comparable data should be collected. At the time of a tax audit for FY20, FY20 financial data of comparable might not available; however, the usage of FY19 comparable data is impossible due to different economic conditions;



Application of loss-split model: The loss-split model among group members can be considered after assessment of the suitability to apply in current economic conditions.

Our Suggestions (Cont'd)

IV. Negotiate/planning pricing policies of intra group services to share the impact of Covid-19:

The pricing policy agreement for related party transactions should be carefully considered to reflect appropriately losses of the parties in the supply chain and must be applied consistently across the group. In particular, financial transactions should be noted, due to a heightened need for intragroup funding as well as guarantees for loans in difficult times.

V. Engage with the Tax authority if possible:

Enterprises should proactively discuss and seek guidance from the Tax authorities, if possible, on the approaches to transfer pricing policy during the sensitive period of the Covid-19 pandemic (and seek comments from Tax authorities on acceptable approaches, where relevant) to ensure that decisions will be made in a reasonable way. At the same time, this communication will help the Tax authorities to update the actual business situation of enterprises, thereby making appropriate policies.



How we can help

- In-depth transfer pricing analysis from a local perspective
- BEPS-contracts/Intra-group agreements review
- Transfer pricing documentation review
- Transfer pricing health-check
- APA strategic planning, dossier preparation and process assistance

WHAT'S NEXT:

Our next episode will discuss on business re-structuring from the perspective of specialists.

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