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JUNE 2018 ISSUE 27
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TRANSFER PRICING NEWS

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INTRODUCTION

Transfer pricing is increasingly influencing significant changes in tax legislation around the world. This 27th issue of BDO's Transfer Pricing Newsletter focuses on recent developments in the field of transfer pricing in Brazil, Luxembourg, Panama, Poland, Singapore, and Vietnam. As you can read, there are interesting developments in various countries around the world, including changes in legislation and important court rulings.

We are very pleased to bring you this issue of BDO's Transfer Pricing News, which we were able to produce in close co-operation with our colleagues from the above-mentioned countries. We trust that you will find it useful and informative. If you would like more information on any of the items featured, or would like to discuss their implications for your business, please contact the person named under the item(s). The material discussed in this newsletter is intended to provide general information only, and should not be acted upon without first obtaining professional advice tailored to your particular needs.

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BRAZIL

DISCUSSIONS ON UPDATING BRAZILIAN TRANSFER PRICING RULES TO THE INTERNATIONAL STANDARD

The transfer pricing rules of the world's major economies follow the model created by the Organisation for Economic Cooperation and Development (OECD). Even non-OECD countries are using these rules as a basis when introducing transfer pricing into their respective countries.

As every rule has at least one exception, Brazil is the exception. Our standards are very different from the OECD, and for this reason, it is not uncommon for multinational groups to be penalised by double taxation in transactions with Brazil.

The event 'The OECD Transfer Pricing standard and the Brazilian approach: Challenges and Opportunities', held on 28 February and 1 March, at the headquarters of the National Confederation of Industries (CNI), marked a major step towards important changes and/or to a possible convergence of the current Brazilian transfer pricing rule to the international standard.

The event, organised by CNI, had the participation of the OECD and the Brazilian Tax Authorities (RFB); the Minister of Finance, Henrique Meirelles; the Secretary of the Revenue, Jorge Rachid; the Secretary General of the OECD, Angel Gurría; and the president of CNI, Robson de Andrade, among other authorities and professionals of the industries.

Brazil had already acted as a guest in several OECD working groups, with the concrete result in tax matters being the adoption of the minimum standards of the BEPS (Base Erosion and Profit Shifting) action plans internalised in the legislation in 2016. Brazil's application for OECD membership in 2017 is bringing a greater pressure for changes in transfer pricing rules.

Secretary Gurría said that the OECD and the RFB had set up a joint tax project with an estimated duration of 15 months to study possible changes and alignment of the rules. Vijay Rangarajan, the United Kingdom's ambassador in Brazil, said that the UK will spend GBP 80 million to help Brazil with the various tasks necessary for the accession process and that part of this resource will be applied in this joint tax project.

The RFB contextualised that Brazil's transfer pricing rules, in force since 1996, were created in an economic scenario with importation that started many years ago (1990) and designed for an economy that essentially transacted goods and merchandise. Considering the delicate fiscal situation of the country with external debt, and fresh out of a period of inflation, a low administrative and high predictability solution was sought.

During the event, several difficulties and needs of Brazilian and foreign multinational companies were exposed, as well as the opinion of experts and academics about the current rules and how they can be improved. RFB representatives recognised that the rules need to be updated and signalled that there could be changes to accommodate the transactions that are not best covered.

The main points discussed during the event were:

- Profit Margin of the Resale minus Profit Method (PRL) – It is still unclear to taxpayers how RFB has reached the profit margins applied in the PRL method of 40%, 30% and 20% depending on the industry. On the other hand, it is clear to taxpayers that these margins are far from the reality of many companies. It is necessary to have a revision and a much wider range of margins, using as reference the margins used in the calculation of tax substitution ICMS;
- Request to change the profit margin – It is known that only two taxpayers have complied with this request, with no success. RFB could re-analyse the criteria established in Administrative Rule 222/2008 to modify the margins only with the analysis of the operation of the company itself in the country;
- Exchange rate – Brazil has always been and will be exposed to exchange rate fluctuations. The quotation of a currency can vary greatly from one fiscal year to another and there is currently no foreign exchange adjustment mechanism in the transfer pricing calculation;
- Portfolio of products – Companies offer a 'menu' of products from A to Z and within this menu, not all products are profitable, but it is important to keep them in stock to meet the customers' needs. The current legislation does not allow to compensate the products with adjustments that did not reach the required minimum profit margin, with those without adjustment that have a higher margin than required. A possible solution would be the NCM (Harmonised Code) grouping, in which the taxpayer could also have the option of grouping and calculating the transfer pricing by family of products;
- Commodity transactions – Taxpayers are obliged to use only the Import Price Index (PCI) or Export Price Quote (PECEX) methods. These are well accepted by taxpayers, but the request is to be more flexible and have the option of also using the Comparable Uncontrolled Price (CUP) or Export Sale Price (PVEx) methods;
- Specific rules for services and intangibles – Considering the economic scenario of the 1990s, when the rules were created, it is necessary to update the standards including methods that are better applicable to services and intangibles, a representative and growing part of the current economy;
- Adoption of OECD methods – A more controversial discussion, mainly defended by foreign speakers. The OECD rule provides for a non-transactional method that does not analyse products and/or services like our rules, but that takes into account the economic result as a whole, considering the functions and risks assumed by the company within the value chain of the multinational group. It seems to be a fair method in which each group company is remunerated according to its participation and relevance in the chain. On the other hand, it can be complex, costly and with subjective premises.

The RFB does not have sufficient tax auditors to examine the calculations of all taxpayers subject to the transfer pricing rules. To meet this need, RFB could create the obligation to audit the calculation for companies with a certain volume of transactions, as is done in other countries and also in Brazil for the tax incentives arising from R&D.

It is not possible to say that the OECD rules are better or worse than the Brazilian ones, nor is it possible to know if Brazil will adopt the OECD standard. There is a consensus that our rules can and do need to be improved and that many of these adjustments do not depend on this joint work with the OECD and can be introduced immediately into legislation by a simple Normative Ruling.

RFB's desire is for transfer pricing rules to be simple and practical for the taxpayer and public administration, to ensure legal certainty, avoid double taxation and non-taxation. This is a complex equation to be solved and will be worked on for at least the next 15 months, so that the Brazilian rules are in line with the global economy and stop being an obstacle to attracting foreign investments to the country.

Let's wait and see the next chapter of the transfer pricing legislation.

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LUXEMBOURG

RECENT DEVELOPMENTS IN RELATION TO THE USE OF INTANGIBLES

The Amazon State Aid case

Intangibles are often the key value drivers for a firm's business and their importance in the digital age is increasing. Not surprisingly, the world's most valuable enterprises are technology firms. Amazon – currently one of those firms with the strongest growth in market capitalisation and brand value – has been challenged by tax authorities because of the way it prices the use of intangibles in intra-group situations.

Amazon was successful last year in defending its position in front of the US tax court against the Commissioner who believed that the buy-in for a cost sharing arrangement (CSA) with a Luxembourg limited partnership (LP) was not priced adequately. However, the result of the European Commission's state aid investigation of an advance pricing agreement (APA) granted by the Luxembourg direct tax administration in relation to the same CSA was less favourable for the group.

In its decision on 4 October 2017, the EU Commission said that the APA granted in 2003 and renewed in 2011 approved a method for determining the royalty payable to the LP by its affiliated Luxembourg operating company (OPCO) that '… was inflated and did not reflect economic reality.' Based thereon, the EU Commission concluded that still granting the APA provided a selective economic advantage to Amazon, which is illegal under the EU state aid rules, and Luxembourg should therefore claim from Amazon an estimated additional amount of EUR 250 million (approx. USD 300 million, as at 31 December 2017) of income taxes.

The non-confidential version of the decision was released on 26 February 2018. The Luxembourg Ministry of Finance had already announced on 15 December 2017 that it would appeal the EU Commission's decision.

What makes the EU Commission believe that Amazon underpaid income taxes in Luxembourg?

In its investigation launched in 2014, the EU Commission applied the principles that are known from the OECD/G20 BEPS-project and reflected in the 2017 version of the OECD transfer pricing guidelines. In summary, the EU Commission believes that the transfer pricing outcomes of Amazon's Luxembourg activities were not in line with the value created by the Luxembourg LP and OPCO.

In 2014, OPCO employed about 500 people in Luxembourg. Besides organising, administering and managing the European retail activities of Amazon, OPCO also adapted the technology and software behind Amazon's e-commerce platform in Europe, invested in marketing and gathered customer data. Furthermore, OPCO had an exclusive license for the use of the intangibles owned by LP.

The transfer pricing applied to OPCO's operations left the company with a profit of 4% to 6% of its operating costs, subject to a floor of 0.45% and a ceiling of 0.55% of total EU sales. The remainder of the profits was qualified and paid as royalties to LP for the exclusive use of the intangibles.

LP did not employ any personnel. Nevertheless, it was the undisputed legal owner of the intangibles due to its contributions to the CSA. Amazon furthermore argues that LP has borne risk and therefore was entitled to earn a return for bearing that risk, in addition to the return for the licensed intangibles.

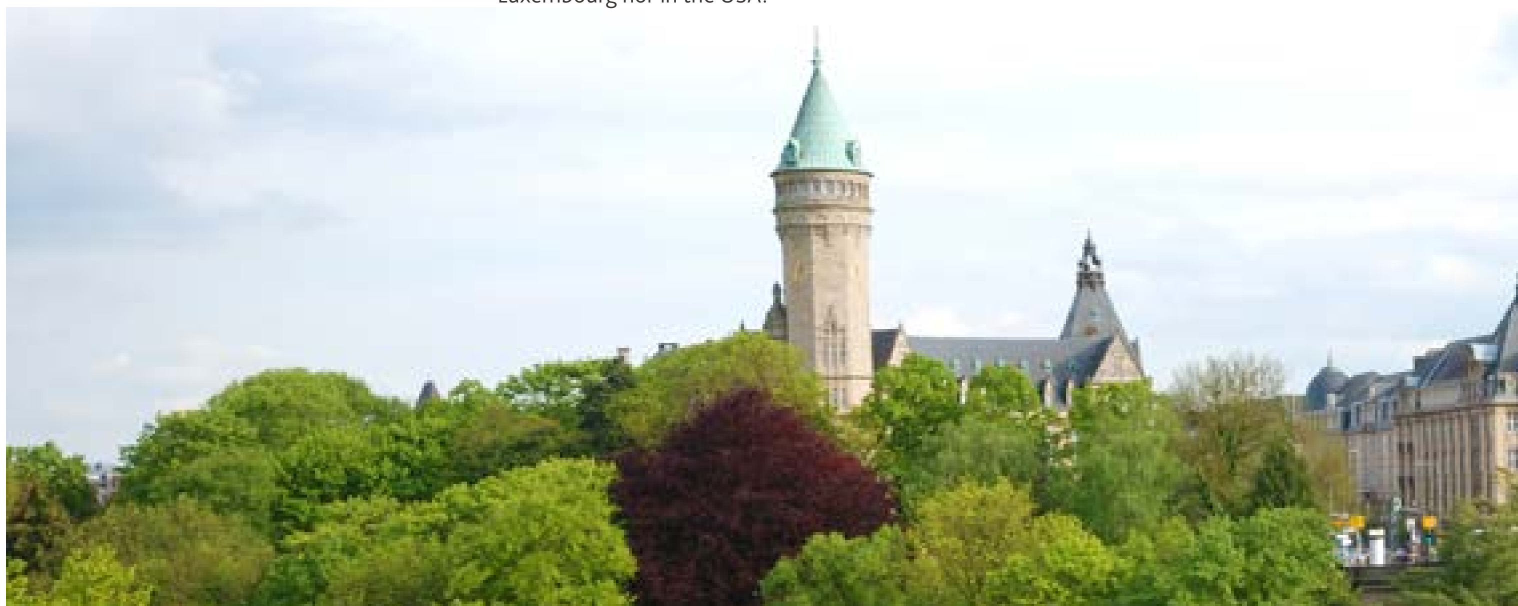
The EU Commission says that as a consequence of the transfer pricing mechanism applied by Amazon, OPCO paid on average more than 90% of its profits as royalty to LP, and that the royalties received by LP represent approx. 1.5 times the contributions it has made to the CSA.

Whereas OPCO was fully subject to Luxembourg income taxes, the royalty income received by LP was not subject to income tax in Luxembourg nor in the USA.

What does the decision of the EU Commission in the Amazon State Aid case mean for practitioners?

The EU Commission has applied principles that were developed under the OECD/G20 BEPS-project to intra-group transactions that were realised prior to the issue of the OECD's revised guidance in October 2015. Therefore, multinational enterprises that have included intangibles in their intra-group transactions are well advised to pay attention to these principles also for their pre-BEPS transfer pricing policies, especially with regard to the following aspects:

- **Functional and Risk Analysis** – Which entities are performing the DEMPE-functions (Development, Enhancement, Maintenance, Protection, Exploitation)? In the Amazon state aid case, the EU Commission concluded that LP as the owner of the intangibles performed especially legal protection and administration functions, whereas OPCO was regarded as performing the functions that are relevant for the value creation and exploitation of the intangibles.
- **Economic Analysis** – In light of the functional and risk analysis, which is the most appropriate transfer pricing method to be applied? As a result of its findings in terms of functions and risks, the EU Commission disregarded the methods suggested by Amazon.
- **Comparable uncontrolled prices (CUPs)** – How to assess comparability? Whereas the US tax court has accepted the external comparables identified by Amazon to support its transfer pricing, the EU Commission has rejected them due to a perceived lack of comparability. This different judgement points to one of the most difficult aspects in transfer pricing practice, which is the often inhomogeneous understanding of 'comparability' in practical cases by different tax authorities, institutions and taxpayers.



Intangibles in the context of the new Luxembourg IP-regime

With effect from the tax year 2018, the Luxembourg Government has introduced a new fully BEPS compliant tax regime available for intangible property rights (IPR) that have been constituted, developed or improved after 31 December 2007 (Article 50ter Luxembourg Income Tax Law). IPR that are related to marketing (like brands, trademarks, etc.) do not qualify for the new regime. Furthermore, the scope of 'IPR' is much narrower than the scope of 'intangible' that is defined in the OECD transfer pricing guidelines.

The new regime transposes the recommendations under Action 5 of the BEPS-project, including the modified Nexus approach. The modified Nexus approach aims to grant benefits only to income that arises from IPR where the actual research and development activity was undertaken or has been paid by the taxpayer (with further restrictions if paid to a related party).

The previous Luxembourg IP-regime expired earlier on 1 July 2016, with a grandfathering period until 30 June 2021 for qualifying intangibles acquired prior to 1 July 2016 (for Net Worth Tax purposes, the IP-regime expired on 1 January 2017, with grandfathering until 1 January 2022). During the transition period between the old and the new IP-regime, taxpayers benefitting from the old IP-regime may opt for the new IP-regime.

For IPR qualifying for the new IP-regime:

- 80% of the net qualifying revenues derived from the exploitation of the IPR are exempt from Luxembourg income tax; and
- 100% of the IPR value is exempt from Luxembourg Net Worth Tax.

Apart from the general transfer pricing considerations that are always relevant where intangibles or IPR are involved in intra-group transactions, the following aspects should particularly be taken into consideration with regard to the new Luxembourg IP-regime:

- Qualifying income and total expenses related to IPR must be determined in line with the arm's length principle; this is especially relevant where royalty income is derived from licenses granted to related parties or development activities are outsourced to related parties;
- Determination of the income directly related to the IPR and embedded in the sales price of products and services;
- The tracking and documentation of the qualifying expenses, the total expenses and the qualifying income for each IPR, or under certain circumstances for each type or group of products or services.

Unlike the provisions of many BEPS-compliant IP-regimes recently introduced by other countries, qualifying expenses may also be incurred by a foreign permanent establishment of the taxpayer located in a member state of the European Economic Area. However, this requires that the income generated by the IPR is allocated to the Luxembourg taxpayer under the applicable double tax treaty and in conformity with the applicable transfer pricing regulations. Furthermore, the foreign permanent establishment must not benefit from a similar IP-regime in its own country.

Closing remarks

The importance of intangibles and IPR for the business operations of multinationals should be mirrored by the attention dedicated to these types of assets for international tax and transfer pricing purposes. Tax authorities globally are certainly dedicating this attention, given the large numbers usually at stake and the broad room of possible interpretation when applying transfer pricing principles to intangibles and IPR.

To be prepared, the review of existing transfer pricing policies with regard to open tax years as well as the potential need for modification going forward seems unavoidable to reduce the risk of successful challenges by tax authorities. It is understood that respective transfer pricing documentation should not only exist, but also needs to be consistent with the facts and circumstances of the business operations and with the transfer pricing policies applied by the multinational enterprise.

As the new Luxembourg IP-regime demonstrates, for example, the new environment can also provide opportunities in relation to tax and transfer pricing planning related to intangibles and IPR.

Not only in relation to IPR and the modified Nexus-approach, but in general, multinationals should especially be conscious of the fact that demonstrating substance and presence in Luxembourg (in quantitative and in qualitative terms) is crucial to be prepared for reviews that the Luxembourg direct tax administration is increasingly conducting in that respect.

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PANAMA

ADMINISTRATIVE TAX COURT RULING ON TRANSFER PRICING AND COMPARABILITY ANALYSIS

The General Directorate of Revenue of the Ministry of Economy and Finance (DGI) carried out a transfer pricing audit for the fiscal years 2012 and 2013 of a company engaged in the manufacture and distribution of bread and related products ('the Taxpayer').

The DGI considered that the audit resulted in some deficiencies and inconsistencies.

In accordance with the resolution issued by the DGI, the following inconsistencies were identified in the information and paperwork filed by the taxpayer:

- The Taxpayer failed to report in its Income Statement the total transactions with foreign related parties, in accordance with Article 762-I of the Fiscal Code of the Republic of Panama;
- The sums and concepts reported in the Income Statement and Transfer Pricing Report showed differences amongst each other;
- The value of the performance indicator obtained and notified in the Transfer Pricing Form and in the Transfer Pricing Report, for the same transaction, was different;
- Disbursement transactions for interest paid to related parties overseas were not stated in the Transfer Pricing Form, while they were included in the Transfer Pricing Report;
- There were differences between the sum of purchases of finished products as reported in the Transfer Pricing Report and in the audited financial statements in relation to the cost of sales amount of the segmentation made by the Taxpayer;
- Due to the inconsistencies in the aforementioned segmentation amounts, the profit indicator calculated by the Taxpayer in the Report was rejected by the DGI.

Transfer pricing and comparability analysis

In relation to the comparability analysis, the DGI approved the methodology and quantitative and qualitative criteria employed by the Taxpayer in the search for external comparables.

However, when analysing public information (10-K reports), and descriptions of the business and income statements of comparable companies chosen by the Taxpayer, the DGI objected to three of a total of five companies considered as comparable.

The questioning and rejection of these companies arose from the fact that they did not substantially comply with the comparability criteria established by the Fiscal Code in its Article 762-E, namely:

- Characteristics of marketed products;
- Functions or economic activity assumed;
- Characteristics of the geographic market in which it operated;
- Relevant extraordinary economic circumstances;
- Contractual terms and risks arising from operations.

The DGI underpins the objections made in Article 762-E of the Fiscal Code, also relying on Paragraphs 1.42, 1.45, 1.47, 1.52, 1.55 and 1.57 of the OECD Transfer Pricing Guidelines.

Decision of the Administrative Tax Court

On 8 November 2017 the Administrative Tax Court upheld each of the DGI's arguments for rejecting the three companies chosen by the Taxpayer as comparable.

According to the Tax Court, the Taxpayer did not file sufficient information or supporting documentation to challenge the conclusions of the DGI; so in conclusion, there was sufficient evidence to confirm the rejection of comparable companies as proposed by the Tax Administration.

Regarding the irregularities found in the information and paperwork originally submitted by the Taxpayer, the Tax Court emphasised the importance of an adequate analysis of transfer pricing aligned to the information included in the Income Statement, Audited Financial Statements, Transfer Pricing Report and Transfer Pricing Form (meaning symmetry in the information represented at all information levels).

Our recommendations

From the Tax Court's decision, we can share the following recommendations and lessons from this first precedent in transfer pricing matters. Taxpayers must:

- Perform a proper analysis of the quantitative and qualitative aspects of the Income Statement, transfer pricing report, transfer pricing form and paperwork related to the business group;
- Avoid inconsistencies amongst each of these documents, which might result in a transfer pricing audit, plus a possible case of tax evasion, as established in Article 752, Chapter VIII of Title I, Book IV of the Fiscal Code of the Republic of Panama;
- Meet the standards of comparability criteria established in Article 762-E of the Fiscal Code when choosing the comparable operations of transfer pricing Studies, since they define if the price or margin obtained by the Taxpayer is at market value, as established in Article 762-F of the Fiscal Code;
- Consider that companies rejected as comparable by the Tax Court will have an effect on fiscal years subsequent to the audit;
- Evaluate the implications of transfer pricing adjustments, particularly in any potential impact on any loss carry forwards or other income tax items affecting multiple fiscal years, as in the case under analysis; and
- Evaluate if there is a need to estimate an accounting provision for subsequent fiscal years, since it will not be possible to carry forward losses that were decreased as a result of transfer pricing adjustments, increasing the tax liability in future fiscal periods.

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POLAND

TRANSFER PRICING CHANGES IN 2018

The amendment to the Corporate Income Tax (CIT) Act introduced significant modifications concerning transfer pricing regulations, which came into force at the beginning of 2018.

The most important change pertains to related entities, and results in the establishment of a restriction on the recognition of expenses related to intangible services provided between related parties as tax deductible costs. The Act indicates that some of them, directly or indirectly borne solely by related entities or having their registered office in a tax haven, may be included in tax deductible costs only in a specified amount. The amount that is not subject to restrictions is PLN 3 million. Any expenditure exceeding this limit may be included in tax deductible costs only in a specified amount. This amount has been set at a level which does not exceed 5% EBITDA.

Another change in the field of transfer pricing regulation in Poland starting from 2018 is the fact that provisions, as a result of the legislative amendment, do not apply to entities that could be classified as related solely on the basis of a connection between them through the state treasury or local government unit.

Furthermore, according to the subsequent amendment of the CIT Act, Advance Pricing Agreement (APA) transactions are exempted from the transfer pricing documentation requirement. This fact should be perceived as another advantage created by the tax provisions that came into force at the beginning of 2018 for taxpayers who had obtained APAs. APAs should take the form of the decision issued by the Chief of the National Revenue Administration.

Another issue covered by the amendment concerns the arm's length nature of transactions in tax capital groups. For this reason , starting from the 2018, amended provisions provide that the obligation to prepare transfer pricing documentation does not apply to transactions between tax capital groups, and is applicable to transactions between tax capital groups and related parties situated outside those groups.

On 15 March 2018 the Ministry of Finance released a decree that extends the deadline for taxpayers to comply with the new transfer pricing documentation requirements. The new deadline is extended to the end of the ninth month after the end of the tax year. The extension applies to deadlines in 2018 and 2019.

The focus on transfer pricing matters is exemplified by the organisation of a Transfer Pricing Forum by the Ministry of Finance on 12 April 2018. The main subject of the Forum was tasks stemming from benchmarking analyses. The next issue that was discussed during the Forum was the simplified procedure for concluding APAs. This procedure will apply to low value adding services and simple intangible assets' transactions.

The Transfer Pricing Forum was a new project of the Ministry of Finance aimed at strengthening the cooperation between the Ministry of Finance, representatives of business and tax specialists in the field of transfer pricing issues.

It is planned to publish explanations to CIT/TP and PIT/TP forms because of the need to clarify doubts concerning the filling of the above-mentioned documents. The date for the publication that was set during the Forum is the end of May 2018.

It should also be noted that further meetings of the Transfer Pricing Forum will be arranged, with dates to be announced.

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SINGAPORE

NEW GUIDANCE ON PREPARATION OF TRANSFER PRICING DOCUMENTATION

On 23 February 2018, the Inland Revenue Authority of Singapore (IRAS) released a fifth edition of the Singapore transfer pricing guidelines ('2018 TPG') along with a set of the Income Tax (Transfer Pricing Documentation) Rules 2018 ('2018 TPD Rules'). The revised edition follows the amendments to mandatory transfer pricing documentation requirements, introduction of penalties for non-compliance and a surcharge on transfer pricing (TP) adjustments as announced in the Income Tax (Amendment) Bill 2017. The 2018 TPG and the 2018 TPD Rules are effective from Year of Assessment (YA) 2019.

Within the 2018 TPG, the entire Section 6 which deals with TP documentation has been re-written and a new section which deals with penalty and surcharges has been introduced. In line with the Base Erosion and Profit Shifting project, the 2018 TPG draws on some references from the recently updated 2017 OECD Transfer Pricing Guidelines when stating 'that the contractual terms alone may not provide all the information necessary to perform a transfer pricing analysis … and that the actual transaction should be determined from the actual conduct' – emphasising the importance of substance over form and that the burden of proof is on the taxpayer.

The key changes have been summarised hereunder.

1. **Transfer pricing documentation**

With effect from YA 2019, taxpayers who meet either of the following conditions must prepare TP documentation under Section 34F(3) of the Singapore Income tax Act (SITA) for their related party transactions undertaken in a basis period:

a) If the gross revenue derived from their trade or business is more than SGD 10 million for that basis period; or

b) TP documentation is required to be prepared for a transaction undertaken by the taxpayer in the basis period immediately before the basis period concerned.

Following from the above, the conditions for preparing TP documentation have been revised substantially from YA 2019 and onwards. Taxpayers will not be required to consider the existing quantum thresholds (SGD 15 million for purchase, sales and loans and SGD 1 million for services and other categories) to determine the need for preparing TP documentation. From YA 2019, the conditions would be whether the gross revenue exceeds SGD 10 million or whether the taxpayer was required to prepare a TP documentation for the previous basis period. If the taxpayer satisfies any one of these two conditions, then the requirement to prepare TP documentation would be triggered.

It has been clarified that condition (b) will only apply when the taxpayer was required to prepare TP documentation under Section 34F(3) in the previous basis period. Therefore, YA 2020 will be the first year of its applicability. In other words, if for YA 2020, the gross revenue is below SGD 10 million, TP documentation will still need to be prepared if for YA 2019 TP documentation was prepared under Section 34F(3).

However, one would then need to refer to the 2018 TPD Rules which provide for the exemptions from preparing a TP documentation (even when the above condition (a) or (b) is satisfied). If any of the following conditions is satisfied, the taxpayer will be exempt from preparing a TP documentation:

(a) Taxpayer's gross revenue is not more than SGD 10 million for the basis period and two immediately preceding basis periods; and the TP documentation was required to be prepared under Section 34F for the two immediately preceding basis periods;

(b) Related party domestic transactions (excluding loans) are subject to the same tax rate;

(c) Related party domestic loan;

(d) Related party loan on which an indicative margin is applied;

(e) Routine support services on which a 5% cost mark-up is applied;

(f) Related party transaction covered by an advance pricing agreement;

(g) Related party transaction not exceeding SGD 15 million for related party purchases, sales and loans respectively and SGD 1 million for services, guarantees, lease or any other transaction respectively. In calculating the quantum thresholds, the amount should exclude the value of any transaction to which Sub-Paragraph (b), (c), (d), (e), or (f) applies as above.

Nonetheless, in cases where transfer pricing risks are high or taxpayers are unable to demonstrate compliance with arm's length principle, IRAS encourages preparation of TP documentation (even when not required) in order to avoid adverse consequences.

2. **Qualifying past TP documentation**

IRAS requires taxpayers to review and refresh their TP documentation annually. In recognition that the transaction and the related parties to the transaction may not change significantly from year to year, IRAS allows taxpayers to use past TP documentation to support the transfer prices in the basis period concerned. The use of past TP documentation is conditional on it being a 'qualifying past TP documentation'.

A 'qualifying past TP documentation' is a document that was prepared in either of the two immediately preceding years. For example, a TP documentation prepared in either YA 2019 or YA 2018 will qualify as a 'qualifying past TP documentation' for the basis period for YA 2020, provided that:

- The transaction in past TP documentation is of the same type of transaction undertaken in the basis period concerned;
- The transaction in the basis period concerned is undertaken with the same related parties as documented in past TP documentation; and
- Past TP documentation includes documentation at Group level and Entity level as prescribed in the 2018 TPD Rules.

It has been clarified that a qualifying past TP documentation cannot be used on a perpetual basis. To that extent, taxpayers will be required to prepare a fresh TP documentation in Year 4, i.e. YA 2021 if the TP documentation was previously prepared for YA 2018.

Once the TP documentation qualifies as a 'qualifying past TP documentation', taxpayers have a choice of using it or preparing a new TP documentation. On the consideration that taxpayers opt to use the qualifying past TP documentation, a declaration (in any format) has to be made and the copy of this qualifying past TP documentation should be attached to the declaration (the declaration and the qualifying past TP documentation are referred to as 'simplified TP documentation'). Such simplified TP documentation should be submitted to IRAS within 30 days upon request.

3. **Transfer pricing surcharge**

Effective from YA 2019, a 5% surcharge under Section 34E will be levied on TP adjustments which result in an increase of taxpayer's income or reduction of its losses. The 5% surcharge will be applicable independent of whether there is any tax payable arising from the adjustments or not. It is payable within one month from the date of notice specifying the levy of surcharge irrespective of any objection to or an appeal lodged against such assessment.

The immediate impact will be on taxpayers' cash flow and therefore a robust TP documentation would be necessary to defend or argue against any TP adjustments proposed by IRAS.

4. **TP penalties**

Section 34F introduces transfer pricing-specific penalties compared to a generic penalty of SGD 1,000 in the past. From YA 2019, culpable taxpayers will be levied a fine not exceeding SGD 10,000 for:

- Failure to prepare TP documentation by the due date for filing the tax return;
- Failure to prepare TP documentation in accordance with the requirements prescribed by the 2018 TPD Rules;
- Failure to retain TP documentation for a period of **at least five years from the end of the basis period in which the transaction took place**;
- Failure to submit the TP documentation within 30 days of written notice served by the Comptroller; or
- Submission of false or misleading documentation.

Key points

The Guidelines set out detailed rules for the preparation of transfer pricing documentation.

Whilst the introduction of the gross revenue threshold may relieve small businesses from transfer pricing requirements, the onus is on taxpayers to determine whether they qualify for the TP documentation exemption. Failure to properly ascertain such exemption may result in a penalty. The operation of the exemption rules is somewhat complex and will require careful analysis of the facts to avoid the imposition of penalties.

With the ability to use past TP documentation, taxpayers would not be required to prepare new TP documentation on the presumption that the past TP documentation contains necessary information as prescribed under the 2018 TPD Rules and is a qualifying past TP documentation. It is therefore important to review the past TP documentation to ensure all the relevant conditions have been met. Again, if past TP documentation has been inappropriately relied upon as current TP documentation, a penalty may ensue.

To demonstrate Singapore's commitment to the OECD's BEPS project, information requirements in the Group level documentation on intangibles and financing have been aligned with the OECD's Action 13 requirements. Taxpayers will therefore need to undertake a detailed analysis of the Group's R&D and financing activities to ensure that profits are allocated to jurisdictions where value is created.

All in all, it is recommended that taxpayers perform a detailed assessment of their related party transactions to determine their compliance obligations, as any error will result in penalties and surcharges impacting cash flow. The introduction of TP-specific penalties and a surcharge demonstrates that IRAS is adopting a hard-line approach to those defaulting on TP compliance requirements in Singapore.

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VIETNAM

TRANSFER PRICING POLICY UPDATE

Vietnam's transfer pricing (TP) regulations are currently governed by Decree No. 20/2017/ND-CP (Decree 20) dated 24 February 2017 effective from 1 May 2017, replacing Circular No. 66/2010/TT-BTC dated 22 April 2010 (Circular 66). Some key changes are listed below.

Expanding the definition of controlled transactions

Apart from some cases that are considered as controlled transactions in Circular 66, Decree 20 has added other cases qualifying as controlled transactions, such as: buying, selling, exchanging, renting, leasing, borrowing, lending and transferring machines and equipment; borrowing and lending financial services, financial security and other financial instruments; buying, selling, exchanging, leasing, borrowing and transferring tangible and intangible assets and making a deal of sharing resources such as synergy and human resource usage co-operation; sharing costs between affiliates.

Related party definition

With an aim of narrowing the definition of related party relationships, Decree 20 has increased the ownership threshold from 20% to 25% compared to Circular 66. In addition, the provision whereby two entities would be considered having controlled transactions if more than 50% of one party's sales or purchases is controlled directly or indirectly by another party, as per Circular 66, is now removed in Decree 20. The new decree also provides additional types of relationship in relation to other cases where a party participates directly or indirectly in the management, control or equity of the other, or invests in the other.

Compliance in terms of declaration and timelines

Another significant change in Decree 20 is that a new set of transfer pricing declaration forms is introduced, which requires the taxpayer to provide more in-depth information, such as a breakdown of profit and loss by related party and third party transactions. The purpose of the three-tiered TP documentation (TPD) is to help tax officers to obtain more relevant information on multinational corporations' business operations whereby the taxpayers are required to submit their Master file, Local file and Country-by-Country report.

The submission deadline of the transfer pricing documentation package is within 15 working days from the date of receipt of the tax authority's request, instead of 30 working days as prescribed in Circular 66.

It should be noted that certain taxpayers would be exempted from the TPD requirement, yet would still be required to complete the annual related party disclosure form, including:

- Companies with annual revenue of less than VND 50 billion and total value of controlled transactions arising within a specified tax period of less than VND 30 billion;
- Companies that have concluded an Advanced Pricing Agreement (APA) and complied with the annual APA reporting requirements; or
- Companies that perform basic functional activities with no revenue nor expenses relating to usage of intangible assets; have revenue of less than VND 200 billion and also apply the ratio of net operating profit (before loan interest and corporate income tax) over sales revenue exceeding 5%, 10% and 15% for distribution, manufacturing and processing industry, respectively.

Transfer pricing methodologies

Decree 20 introduces a few changes regarding transfer pricing methodologies for the purpose of reassessing the value of controlled transactions. In general, the acceptable methodologies for determining arm's length pricing align with those instructed by OECD in the Transfer Pricing Guidelines. Particularly, Decree 20 sorts the methodologies into three different categories depending on the financial and operational background of the company:

- **Arm's length price comparison method** – To determine the value of controlled transactions comparing the price of a related-party transaction with that of an independent transaction;
- **Profitability ratio method** – Combination of the 'resale price method', 'cost plus method' and 'comparable profit method' as regulated by Circular 66; and
- **Profit-split method** – Used to establish arm's length outcomes or test reported outcomes for controlled transactions by determining the division of profits that independent enterprises would have expected to realise from engaging in a comparable transaction or transactions.

Additional provision on deductible expenses regarding service charges from a related party

Circular 66 did not provide a deductible condition for service expenses and other payments from related parties, whereas Decree 20 specifies that enterprises are subject to complying with certain conditions for deductible and non-deductible expenses. Decree 20 also provides a cap of 20% of EBITDA for deductible interest expenses from related parties.

Database used in Transfer Pricing Documentation

Decree 20 clearly defines the database to be used in Transfer Pricing Documentation, whereby databases provided by information-trading organisations are officially allowed. Simultaneously, the order of selecting the independent comparables in the analysis and determination of standard arm's length range is also stipulated in Decree 20.

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CURRENCY COMPARISON TABLE

The table below shows comparative exchange rates against the euro and the US dollar for the currencies mentioned in this issue, as at 25 May 2018.

Currency unit	Value in euros (EUR)	Value in US dollars (USD)
British Pound (GBP)	1.14149	1.33795
Euro (EUR)	1.00000	1.17199
US Dollar (USD)	0.85315	1.00000
Polish Zloty (PLN)	0.23218	0.27213
Singapore Dollar (SGD)	0.63612	0.74562
Vietnamese Dong (VND)	0.00004	0.00004

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