

Intra-group services in the post-BEPS era: A look at Japan and Vietnam

Speakers: Ken Kurokawa, Chihiro Takeuchi, James Radford, Shimpei Imai

DANA:

Hello everyone, welcome to TP Talks, PwC's global transfer pricing podcast series. Today's episode takes a closer look at Intra-Group Services ("IGS") in the post-BEPS era. It features Japan, home to many head office service providers; and Vietnam, home to many subsidiary service recipients. Our TP specialists from Japan and Vietnam will provide insights into the tax and TP risks of IGS in both jurisdictions, including practical strategies to effectively manage these challenges.

My name is Dana Hart and joining me today I have Ken Kurokawa, a transfer pricing partner from PwC Japan, Chihiro Takeuchi, a transfer pricing director from PwC Japan; I also James Radford a transfer pricing director from PwC Vietnam, and Shimpei Imai, a transfer pricing senior manager from PwC Vietnam. Thank you all for joining me today.

So we are living in a "post BEPS" era, in which IGS continues to be a hot topic. The tax authorities in both Japan and Vietnam regularly challenge and adjust Intra-Group Services transactions as part of tax and transfer pricing audits.

Ken, why don't we start with you. I've heard that the Japanese tax examiners have recently become very aggressive when it comes to IGS. Can you give our listeners some insights on this development?

KEN:

Sure. And you are correct. In line with OECD BEPS recommendations, in February 2018, the National Tax Agency released a revised version of the Commissioner's Directive on Operation of Transfer Pricing, known as the Administrative Guidelines. Part of this provides revisions concerning IGS provision.

Since then, IGS has become a keen focus for the Japanese tax examiners during audits, who have a tendency to scrutinize IGS and subsequently argue that Japanese HQs are not charging out IGS costs "sufficiently".

DANA:

So building on this development, Chihiro, perhaps you can share with us what you see happening on the ground?

CHIHIRO:

Historically, a lot of Japanese HQs were in the “habit” of undercharging IGS costs (in some cases, with no charge at all), which caught the attention of the Japanese examiners. Such transactions are now a particular focus for challenge and re-assessment.

For example, a Japanese manufacturer of automotive parts has a subsidiary in Vietnam. These produce and sell the Group’s products to the Vietnamese manufacturing entities of the Group’s customers, Japanese car makers, with HQ’s support.

During a tax audit in Japan, the HQ was challenged by tax examiners for not charging a sales commission or marketing support services fee to its manufacturing subsidiaries in Vietnam. The tax examiners insisted that the HQ’s efforts in conducting marketing activities in Japan contributed significantly to secure sales orders for the Vietnam factories. A charge was therefore deemed by the tax examiners to be reasonable and warranted.

To mitigate TP risk and the corporate tax risk (i.e. donation challenge) in Japan, the HQ had to start charging its Vietnamese subsidiaries for such services. However, at the same time, I understand that such an arrangement increases TP risk in Vietnam, as newly introduced expenses may not be tax deductible for the local entities, and this may lead to double taxation.

So James, have you ever encountered this type of situation in Vietnam? In practice, are such arrangements often challenged by the Vietnamese tax examiners?

JAMES:

Thank you Chihiro. To answer your question, I’d like to first explain a bit about the history of TP enforcement in Vietnam regarding this matter. In the past, the approach of the Vietnamese tax examiners heavily focused on the form rather than the substance of intercompany transactions. Simply put, if supporting documents (such as contract, invoices) could be provided, IGS would likely be treated as deductible.

However, over the last few years, and especially after the release of the new TP Decree 20 in 2017, which introduced the “substance over form” principle, the focus of Vietnamese tax examiners has broadened to also cover “substance”. Back to your case, the taxpayer should now maintain evidence that can substantiate the economic substance of the newly introduced intercompany service charges. An example of this evidence could be internal memos or emails documenting the meetings between the HQ with the customer’s HQ, which could help to demonstrate the HQ’s efforts to support the Vietnamese subsidiary to secure customer sales orders in Vietnam. This is just one of the many forms of evidence which the Vietnamese tax examiners may ask for.

Besides TP, there could be other potential withholding tax, value added tax, and treasury implications. So I would recommend that taxpayers consult their advisors in Japan and Vietnam before implementing IGS.

CHIHIRO:

I see, so with this recent development, it is crucial that the HQ and local teams collaborate closely and share information in order to effectively manage the risks arising from IGS. Shimpei, perhaps you can tell us more about this.

SHIMPEI:

Sure. I've seen cases where, due to lack of communication, the Vietnamese subsidiary don't understand the "big picture" in terms of the role of the Japanese HQ, and don't get the economic substance of the IGS as a whole. In such cases, Vietnamese entities cannot explain the commercial rationale of the IGS to tax authority. The HQ was often not aware of this situation until too late. When the HQ finally identified the situation, and tried to intervene, the tax authority had already decided to deny the tax deduction for the IGS charge.

Even where a reasonable explanation is provided, the Vietnamese tax authority may also perform field work to form their own conclusions. Taking your case again as an example, Vietnamese tax authority may request an interview to the local entity's sales & marketing team. In case without careful preparation, local entity staffs may understate the importance of the HQ's role. In that case, the tax authority may deem that all sales & marketing activities are performed locally as the basis to disallow a sales commission or marketing support service fee.

If the transaction value is significant (say, millions of USD), we would advise the HQ to consider sending HQ personnel to attend the interviews with the tax authority, in order to inform the tax authority precise explanation and have them convinced of tax payer's explanation.

So again, taxpayers and their advisors in Japan and Vietnam need to proactively communicate and collaborate with each other so that both of them can effectively manage the tax and TP risks arising from IGS in both country jurisdictions.

Dana, we are sending it back to you.

DANA:

So that's it for this podcast. Thank you, Ken, Chihiro, James and Shimpei; and thank you to all of our listeners. If you would like further information about this topic, please contact the speakers. You can find their contact information in the description of this episode on www.pwc.com/tptalks.

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