

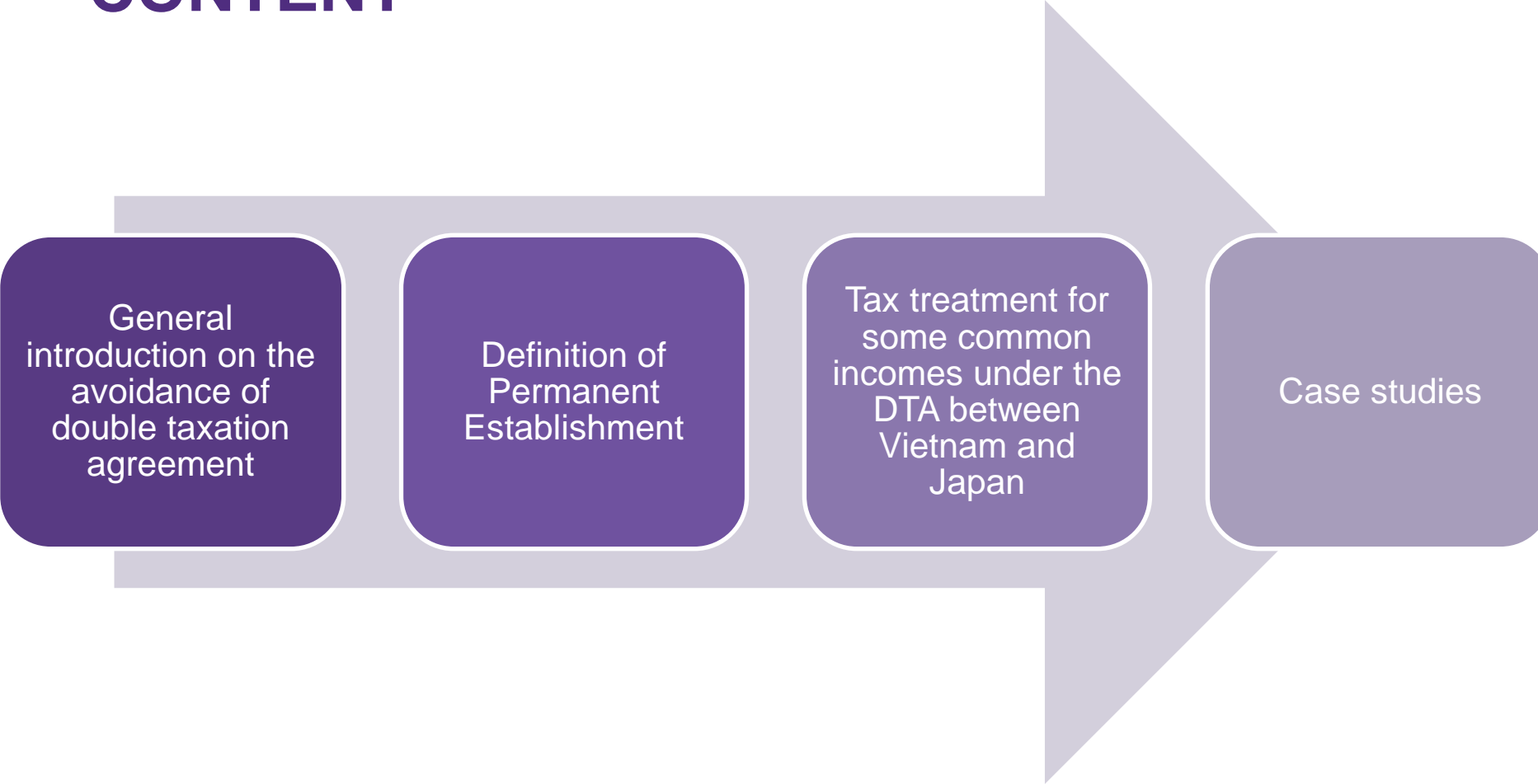
Avoidance of double taxation agreement between Vietnam and Japan

Concept of Permanent Establishment

Lac Boi Tho
Senior Manager
Tax and Corporate services



CONTENT



General
introduction on the
avoidance of
double taxation
agreement

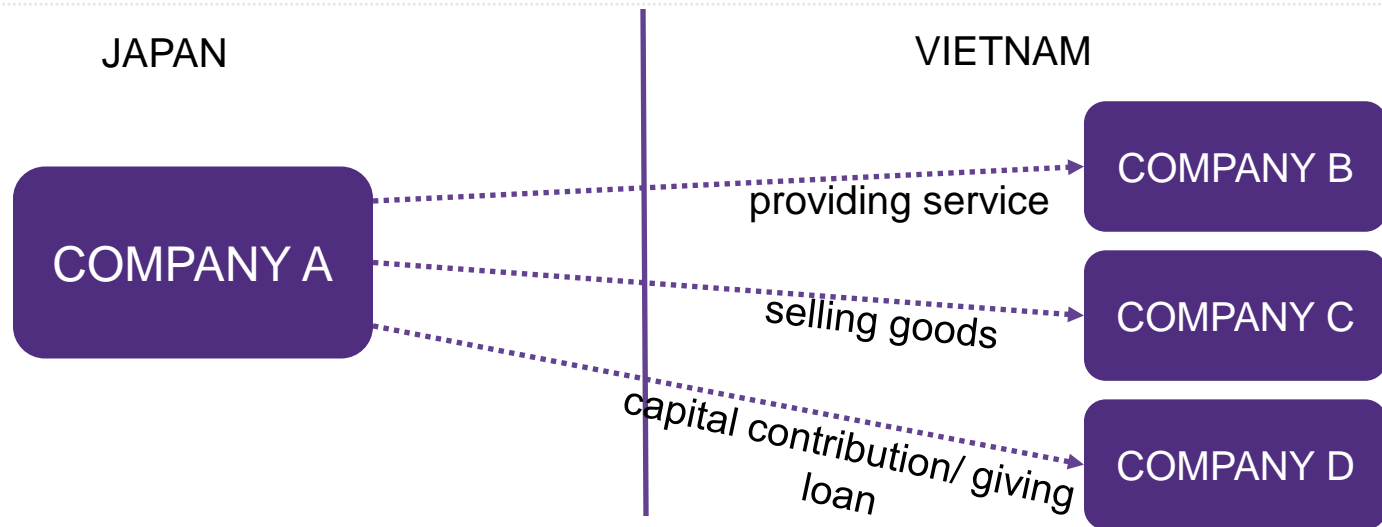
Definition of
Permanent
Establishment

Tax treatment for
some common
incomes under the
DTA between
Vietnam and
Japan

Case studies

I. General introduction on the avoidance of double taxation agreement

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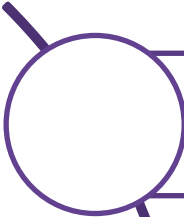


Benefits for entering into the Avoidance of double taxation agreement (herein after referred to as “the DTA”):

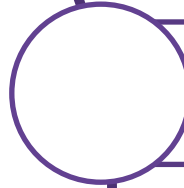
- prevent double taxation of income earned in one jurisdiction by a resident of the other jurisdiction
- makes clear the taxing rights between the two jurisdictions on the income arising from cross-border transactions
- reduction or exemption of tax on certain types of income.

I. General introduction on the avoidance of double taxation agreement (Cont.)

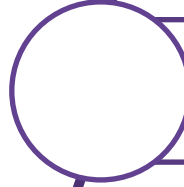
Applicable tax legislations



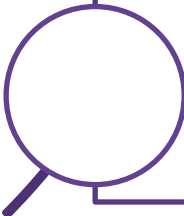
Law on the conclusion, accession to and implementation of treaties no. 41/2005/QH11



Circular 205/2013/TT-BTC issued by Ministry of Finance dated 24 December 2013 providing guidance on implementation of the DTA



Consolidated Circular 14/VBHN-BTC issued by Ministry of Finance dated 15 May 2017 providing guidance implementation of Law on administration



The avoidance of double taxation agreement between Vietnam and Contracting Countries.

In which, the DTA between Vietnam and Japan has been entered on 24 October 1995.

II. Definition of Permanent Establishment

II. Definition of Permanent Establishment

Under the Vietnam domestic regulations:

A Permanent Establishment of a foreign enterprise is business establishment through which the foreign enterprise conducts all or part of its business operation in Vietnam, including:

Branches, offices, factories, means of transportation, mine, oil fields, or other natural resource extraction sites in Vietnam

Construction sites, installation and assembly works

Establishment providing services, including consultancy services via its employees or other entities

Agent for a foreign enterprise

Representative in Vietnam with authority to enter into contracts in the name of the foreign enterprise; or a representative not so authorized to enter into contracts in the name of a foreign enterprise but which regularly delivers goods or provides services in Vietnam.

II. Definition of Permanent Establishment (Cont.)

Whereas, the DTA between Vietnam and Japan stipulates the term “Permanent establishment” including:

- ❖ A place of management, a branch, an office, a factory, a workshop, a mine, an oil or gas well, a quarry or any other place of extraction of natural resources; and, a warehouse
- ❖ A building site, a construction, installation or assembly project or supervisory activities in connection therewith, constitute a permanent establishment if such site, project or activities last more than six months;
- ❖ Furnishing consultancy services through employees or other personnel provided that such activities last (for the same project or two or more connected projects) for a period or periods aggregating more than six months within any twelve-month period;
- ❖ A person (except for an agent of an independent status) shall be deemed as PE construction if such person/ entity has and habitually exercises an authority to conclude contracts in the name of the enterprise; OR, has no such authority, but habitually maintains a stock of goods merchandise for regularly deliver of goods or merchandise on behalf of the enterprise

II. Definition of Permanent Establishment (Cont.)

Notwithstanding the above, the term “Permanent establishment” under the DTA between Vietnam and Japan shall be deemed not to include:

- ❖ the use of facilities solely for the purpose of storage or display of goods or merchandise belonging to the enterprise;
- ❖ the maintenance of a stock of goods or merchandise belonging to the enterprise solely for the purpose of storage or display; OR, processing by another enterprise;
- ❖ the maintenance of a fixed place of business solely for the purpose of purchasing goods or merchandise or of collecting information; or, carrying any other activity of a preparatory or auxiliary character, for the enterprise;
- ❖ the maintenance of a fixed place of business solely for any combination of above activities, provided that the overall activity of the fixed place of business resulting from this combination is of a preparatory or auxiliary character.

III. Tax treatment for some common incomes under the DTA between Vietnam and Japan

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Business profits

- The profits of an enterprise of a Contracting State shall be taxable only in that Contracting State, unless the enterprise carries on business in the other Contracting State through a permanent establishment (herein after referred to as “PE”) → the profits attributable to that permanent establishment may be taxed in the other Contracting State
- In determination of the profits of a PE, there shall be allowed as deductions expenses which are incurred for the purpose of the business of such PE

Interest payments, Dividends, royalties

- Interest payments/ dividends/ royalties arising in a Contracting State and paid to a resident of the other Contracting State may be taxed in that Contracting State under its domestic law (if any)
- However, the tax shall not exceed 10% of the gross amount of the interest payments/ dividends/ royalties

III. Tax treatment for some common incomes under the DTA between Vietnam and Japan (Cont.)

Capital Gains

- Gains derived by a resident of a Contracting State from the alienation of shares issued by a company being a resident of the other Contracting State may be taxed in that other Contracting State if:
 - Shares held by the alienator at least 25% of the total shares issued by such company at any time during the taxable year; and
 - The total of shares alienated by the alienator during that taxable year amounts to at least 5% of the total shares issued by such company.

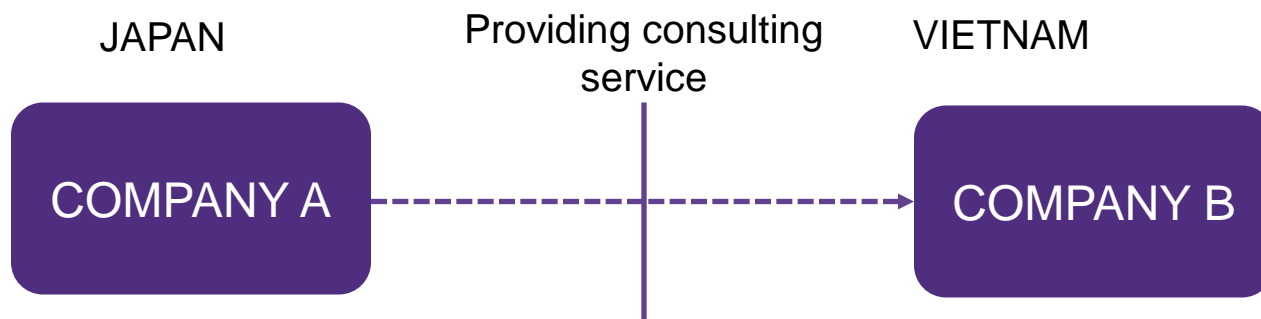
III. Tax treatment for some common incomes under the DTA between Vietnam and Japan (Cont.)

Employment income for a resident

- If the employment of a resident of a Contracting State is exercised in the other Contracting State → employment income as is derived therefrom may be taxed in that other Contracting State
- Notwithstanding the above, such employment income shall be taxable only in the first-mentioned Contracting State if:
 - The recipient is present in that other Contracting State not exceeding 183 days in the calendar year; and
 - The remuneration is paid by an employer who is not a resident of that other Contracting State; and
 - The remuneration is not borne by a permanent establishment or a fixed base which the employer has in that other Contracting State.

IV. Case study

IV. Case study 1



Background:

- Company A enters into the service agreement with Company B to provide consulting service in Vietnam; in which, Company A will assign its employees to Vietnam to perform the service. The expected duration is 2 months.
- Company A will receive the service payment from Company B, upon completion of service
- Company A will pay the employment income of its employees as normally.

Questions:

1. Will Company A be subject to tax in Vietnam for the income earned under the Vietnam domestic regulations? Is there any possibility for Company A to apply DTA under this circumstance?
2. Tax implications imposed on the employment income that Company A paid to the employee for coming to Vietnam to perform the service?

IV. Case study 1

Questions:

1. Will Company A be subject to tax in Vietnam for the income earned under the Vietnam domestic regulations? Is there any possibility for Company A to apply DTA under this circumstance?

Vietnam domestic laws

Company A shall be deemed as creating PE in Vietnam through its employees

Subject to Foreign Contractor Tax on the service payment (5% Corporate Income Tax and 5% Value Added Tax)

The DTA between Vietnam and Japan

No PE in Vietnam due to the duration of service provision is less than 183 days

Submit the DTA application to be entitled to tax exemption for CIT portion in Vietnam; OR

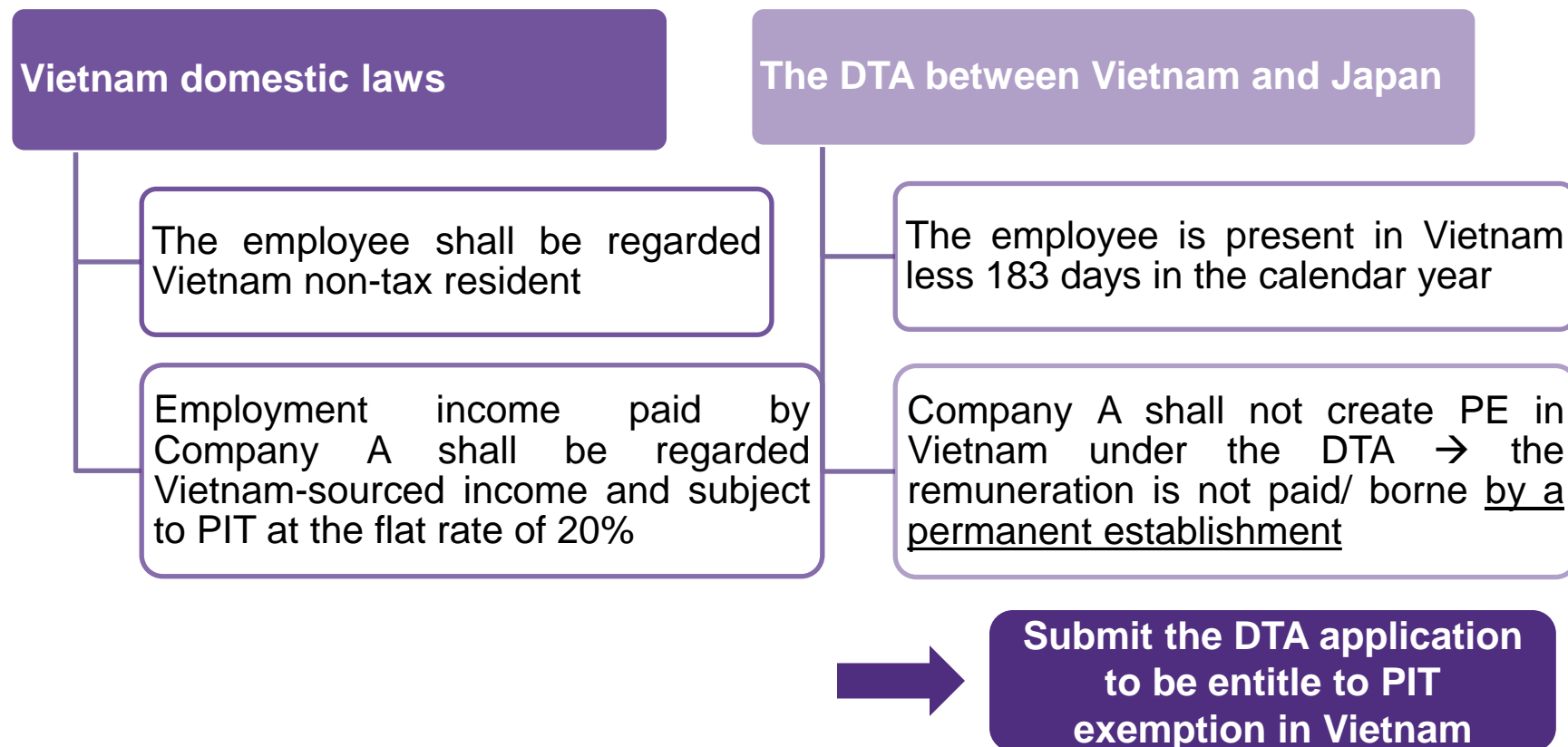
Tax paid in Vietnam shall be offset against the tax liabilities in Japan (*)

(*) The amount to be credit in Japan will depend on Japan tax regulations

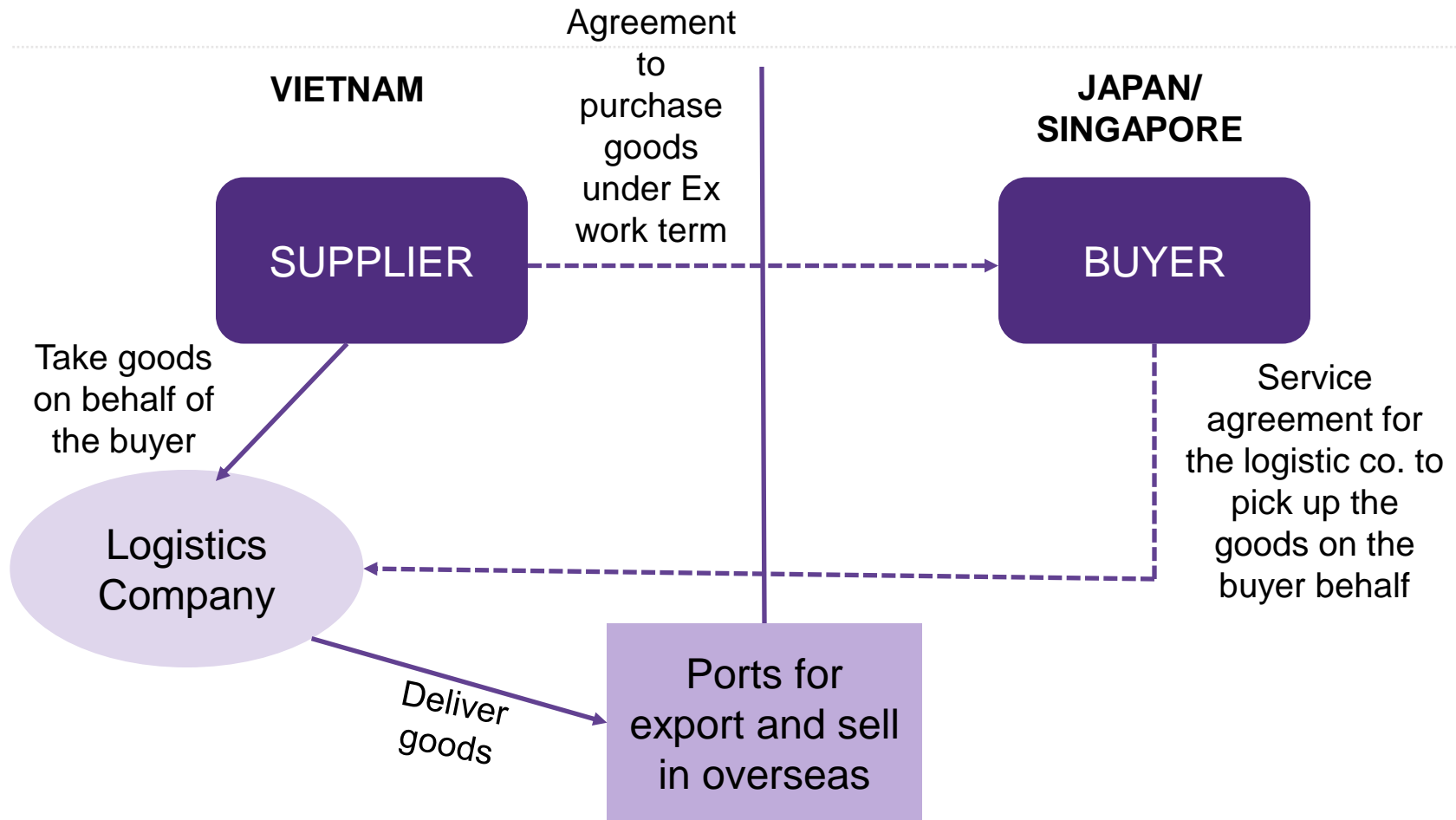
IV. Case study 1

Questions:

2. Tax implications imposed on the employment income that Company A paid to the employee for coming to Vietnam to perform the service?



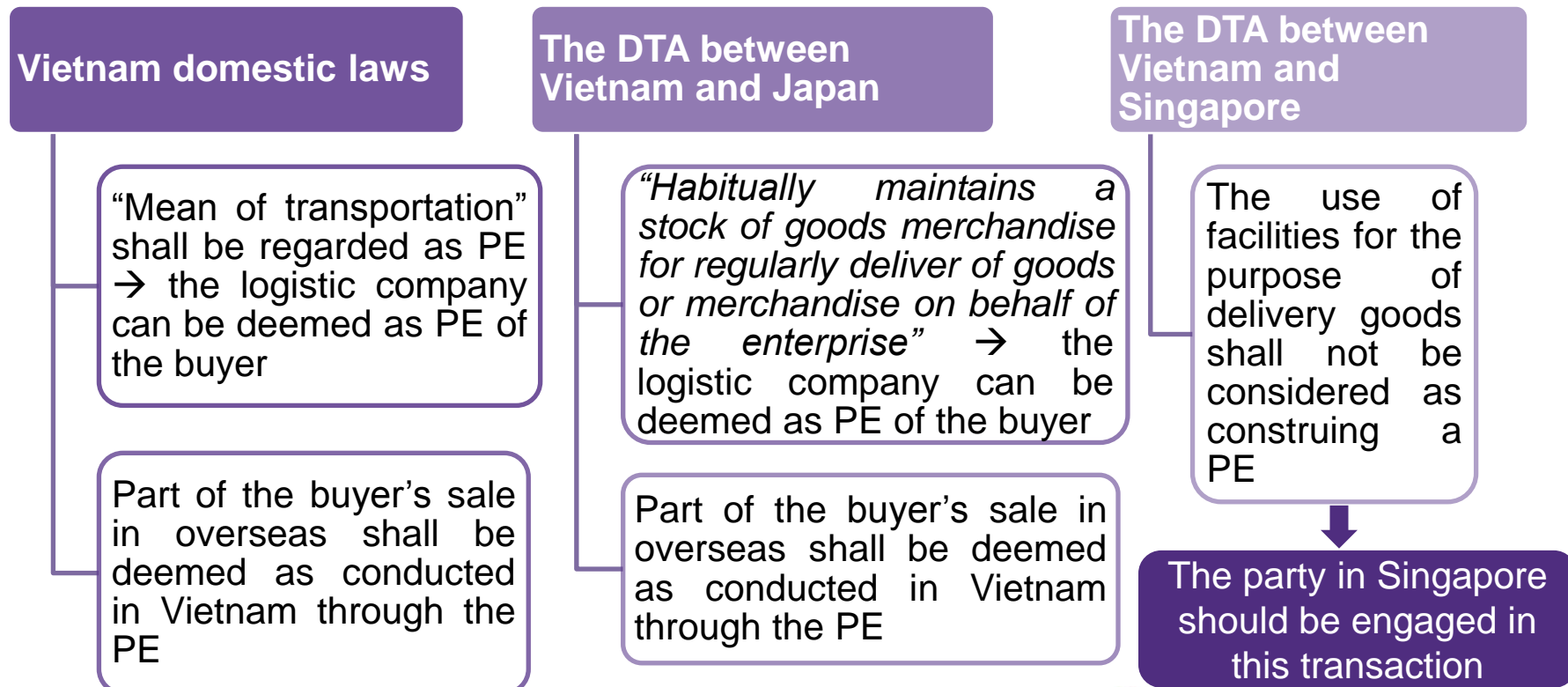
IV. Case study 2



IV. Case study 2

Questions:

1. Will the Buyer be deemed as creating PE in Vietnam under the domestic law?
2. The Buyer is the multinational company, whether the Company in Japan or Singapore should be the party to be engaged in this transaction to avoid the PE risk?



Updates on Tax and Transfer pricing audit in 2018

Notable points on Transfer Pricing compliant documents

Do Vu Bao Khanh

Transfer Pricing Division



1. Update on tax audit/inspection

Official Letter No. 5339/TCT-TTr dated 20 November 2017 has mentioned the focal points on conducting tax audit and inspection in 2018:

- ***Article 2:*** Enterprise that conducted significant related party transactions, resulted in loss for many years or had lower profitability comparing to other enterprises in similar field/industry.
- ***Article 6:*** Enterprises not subject to tax audits/inspections for many years, especially large enterprises and enterprises subject to tax incentives.

1. Update on tax audit/inspection

Transfer pricing inspection/audit in 2017:

- *Transfer pricing audits/inspections at 120 premises and 899,794 returns*

Target for Tax inspection in 2018:

Tax authority	Target
Dong Nai	2,546
Quang Ninh	1,167
Ba Ria – Vung Tau	1,383
Hai Phong	2,087
Binh Duong	2,467
Da Nang	2,493

Tax inspection/audit status in the first 2 months of 2018:

- *1,746 audits/inspections, equivalent to 2% annual target*
- *Supplement VND 128.03 billion to State budget, i.e. 568% year-to-date 2017*

2. Legal basis and effectiveness



3. Requirements for compliant documents

Compliant requirement	Circular 66/2010/TT-BTC	Decree 20/2017/ND-CP Circular 41/2017/TT-BTC
Disclosure Forms	Form 03-7/TNDN	<ul style="list-style-type: none"> ▪ Form 01: Information on related party and related party transactions ▪ Form 02: Checklist of information on <u>Local File</u> ▪ Form 03: Checklist of information on <u>Master File</u> ▪ Form 04: Country-by-country profitability report.
Transfer Pricing Documentation report	Transfer pricing documentation report	<ul style="list-style-type: none"> ▪ Local File ▪ Localized Master File ▪ A copy of Country-by-country report

The above documents are required to be prepared on an **ANNUAL BASIS** and **BEFORE** the Corporate Income Tax finalization date.

4. Form 01

Notable points on Form 01 - Information on related party and related party transactions

- Disclose all relationship category of related party that may arise per each party.
- “Other method” does not exist.
- Disclose **Section III** in term of transactional value instead of Profit and Loss values as regulated in Circular 66/2010/TT-BTC.
- Disclose **Section IV** by segregation of accounting records or allocation by appropriate basis, based on Transfer pricing documentation.

5. Transfer pricing documentation reports

Notable points for Transfer pricing documentation reports:

- Create declaration basis for Form 01 (Section III and Section IV of Form 01).
- Database for comparable analysis.
- *The benchmarking procedure and result would serve as a basis for profitability adjustment made by taxpayer or a basis in negotiation with the tax authority to avoid the adjustment using secret database.*



6. Benchmarking

Notable points for benchmarking:

- Hierarchy of application for comparison method:



There are several cases that Comparable Uncontrolled Price method is required:

- ✓ Transactions relating to fixed assets;
 - ✓ Loan interest;
 - ✓ Royalty fees; etc.
- Request accounting records prior for CUP examination prior to audit
 - Difference in **Internal pricing method (setting method)** vs. **Testing method** in disclosure and analysis.

7. Other notable points

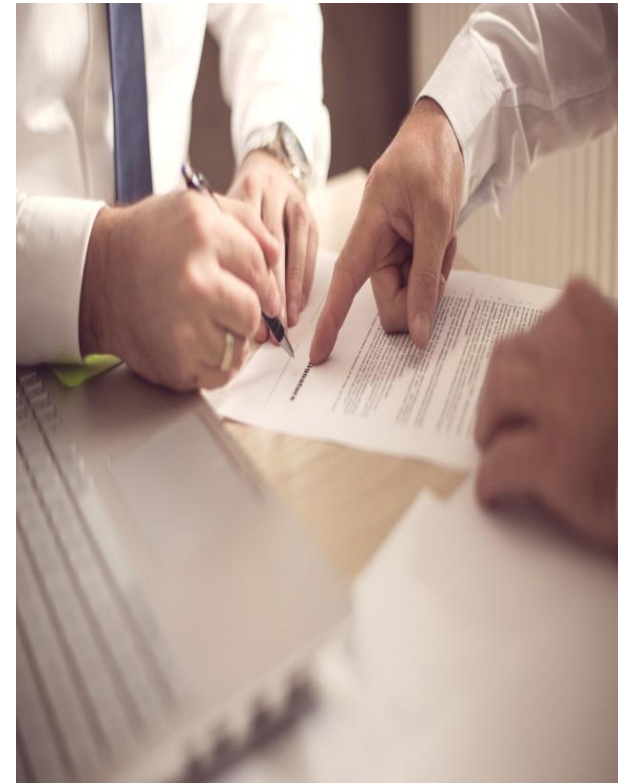
Support service fees, royalty fees:

- Scope & nature of transaction(s) should be clearly documented, together with benefit tests.
- Supporting documents shall be kept in full for tax audits, if any, in the future.
- Separate Benchmarking analysis strongly recommended to defense royalty fees.



8. Exemption from disclosures and/or documentation requirements under the cases of "simple functions"

- Till now, no clear definition of “simple function(s)” - Only qualitatively defined.
- Application should be based on guidance from local tax authorities.
- Documentation evidencing “simple functions”, such as Functional Analysis, is strongly recommended.



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Thank you

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