



DEZAN SHIRA & ASSOCIATES

Your Partner for Growth in Asia

Transfer Pricing in Vietnam: Legal Framework and Recent Developments

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Section 1

Current Legal Framework

Current Legal Framework

Decree no. 20/2017/ND-CP (“Decree 20”) objective is to prevent the loss of tax revenue

- ❖ Compliance requirements
- ❖ Deductibility of expenses and interests

Circular no. 41/2017/TT-BTC (“Circular 41”) providing guidance on

- ❖ Comparability analysis, selection of comparable companies
- ❖ Preparation of disclosure forms

Key Prescriptions (1/3)

Definition of Related Parties

- ❖ An enterprise participate directly or indirectly in at least 25% of equity of the other enterprise
- ❖ An enterprise guarantees or offer another enterprise a loan under any form that accounts for at least 25% of equity of the borrowing enterprise and makes up for more than 50% of total medium and long term debts of the borrowing enterprise
- ❖ Other cases of actual influence/control

Disclosure Forms

- ❖ A taxpayer shall disclose information about its related parties and related party transactions at the time of submitting the annual tax return
- ❖ Any gaps/differences between related party and third party transactions is likely to trigger inquiries from the tax authorities

Key Prescriptions (2/3)

Transfer Pricing Documentation

- ❖ A taxpayer is required to prepare a Master file, a Local file
- ❖ A taxpayer is required to prepare Country by country reporting if the ultimate parent company is obliged to prepare and submit such report

Exemption Criteria

- ❖ Revenue below VND 50 billion and total value of related party transactions below VND 30 billion in a tax period
- ❖ Concluded an Advance Pricing Arrangement (APA)
- ❖ Revenue below VND 200 billion while performing simple functions and achieving at least:
 - EBIT/Revenue of 5% (distribution)
 - EBIT/Revenue of 10% (manufacturing)
 - EBIT/Revenue of 15% (processing)

Key Prescriptions (3/3)

Deduction of Expenses

- ❖ Interests on loans are capped at 20% of EBITDA
- ❖ A taxpayer needs to demonstrate that intercompany services provide economic benefit, with evidence (supporting documents) of the reasonableness of the service charge calculation method
- ❖ No deductions for expenses where the direct benefit or additional value to the taxpayer cannot be determined
- ❖ No deductions for the marked-up portion of third party expenses recharged to a Vietnamese taxpayer

Transfer Pricing Audits in 2018

Tax audits and inspections

- ❖ Total tax audits and inspections in Vietnam: 90,394 (-12%)
- ❖ Total enterprises under TP audits and inspections: 593 (-19%)

Tax and penalties collection from TP audits

- ❖ Total collected tax and penalties: VND 12,287 billion (-20%)
- ❖ Total tax collected from TP adjustments: VND 1,638 billion (-28%)

Reduction of declared loss and increased taxable income

- ❖ Total reduction of declared loss: VND 34,411 (-8%)
- ❖ Total increased taxable income: VND 17,302 (-9%)
- ❖ Total reduction of declared loss from TP audits and inspections: VND 4,808 (-35%)
- ❖ Total increased taxable income from TP audits and inspections: VND 7,292 (+76%)

Source: "The online conference reporting working achievements in 2018 and marking out expected activities for the year 2019" held by General Department of Customs

The background features a low-angle shot of two modern skyscrapers. The building on the right is a dense grid of windows, while the one on the left is more slender with a curved facade. A large, dark blue gradient shape covers the left side of the image, creating a sense of depth and focus on the text.

Section 2

Recent Changes

New Law on Tax Administration: Impact on Transfer Pricing

Law no. 38/2019/QH14 takes effect from July 2020

Art. 17 on *Tax-related International Cooperation by Tax Authorities*

[...] 3. *Organizing the development and exchange of information and professional cooperation with foreign tax authorities, relevant international organizations. Exchanging information on taxpayers and on parties related to foreign tax authorities so as to support tax administration regarding related-party transactions;*

[...].

Art. 96 on *Development, Processing and Management of the Taxpayer Information System*

[...] 2. *Tax authority shall implement necessary measures for collecting, exchanging and processing domestic and overseas information, official information provided by foreign competent authorities and tax authorities under international treaties to which Vietnam is a signatory [...].*



- ❖ proactive approach to optimize taxation
- ❖ worldwide transfer pricing strategy
- ❖ consistency of transfer pricing documents across various jurisdictions

New Law on Tax Administration: Other Changes

Law no. 38/2019/QH14 takes effect from July 2020



- ❖ taxpayers are not subject to admin penalties and late payment interests if they pay taxes in accordance with rulings issued by tax authorities
- ❖ taxpayers are entitled to interests on any tax refunded as a result of appeal or litigation
- ❖ taxpayers are allowed to submit revised returns up to 10 years after the filing deadline (but before the decision to commence a tax audit of the years in question)



- ❖ taxes assessed after a tax audit must be paid pending any appeal or litigation (includes tax amount, penalties and late payment interests imposed by the tax authorities)
- ❖ legal representative of a company can be prohibited from leaving Vietnam if the employer has not paid its taxes due
- ❖ duration of tax audit increased from 5 to 10 working days

Section 3

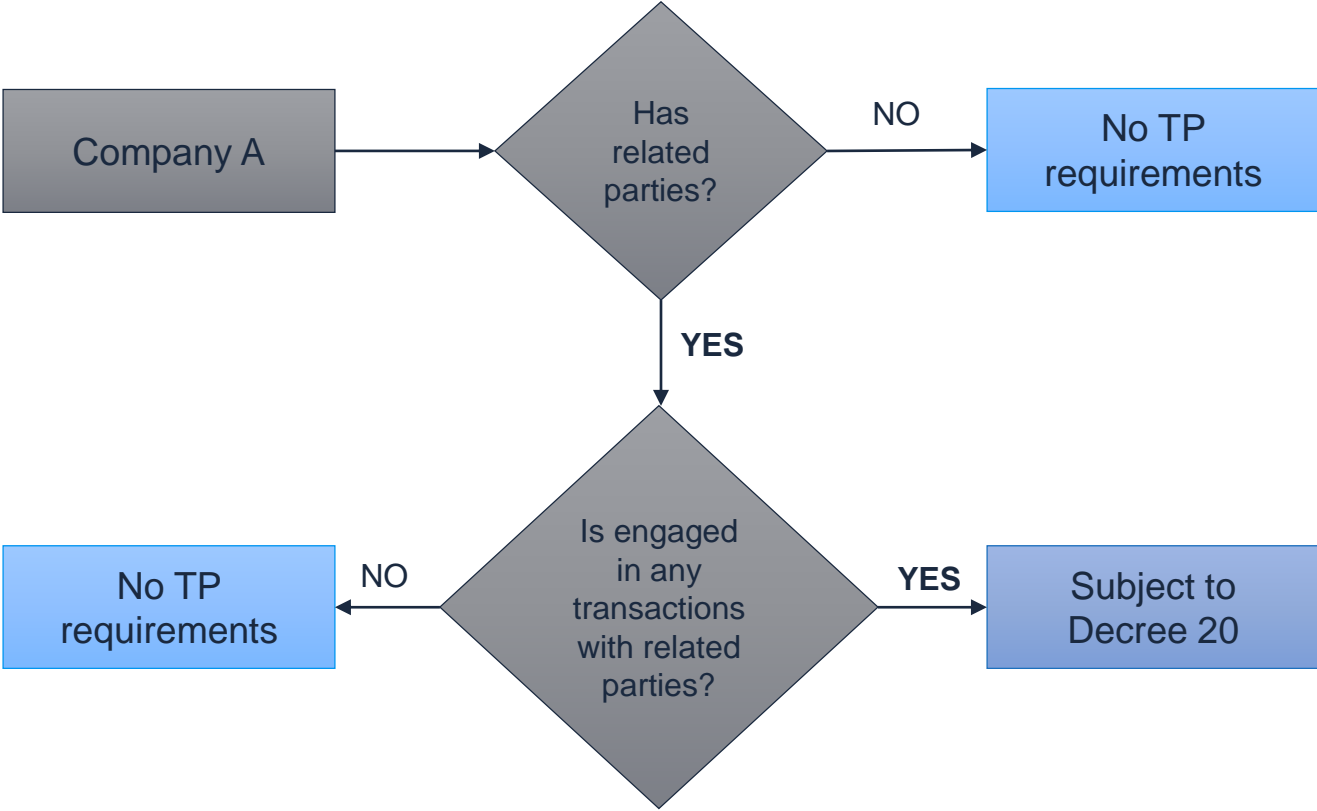
Case Study



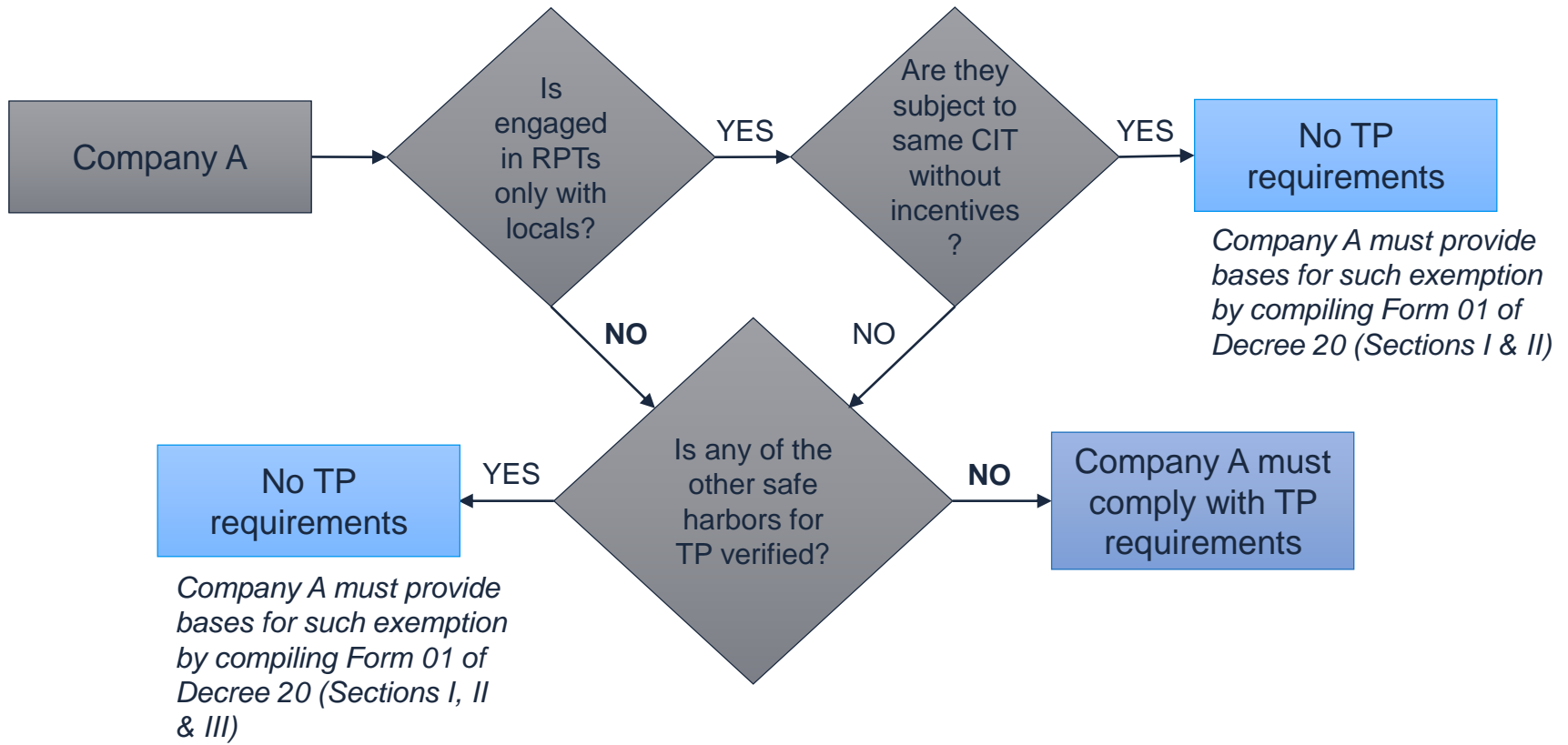
Introduction

- ❖ Company A is legally established in Vietnam, the investor being Company B, which is located overseas and holds 100% of equity in Company A
- ❖ Company A signed a subcontractor agreement with Company B, in force of which Company B outsources to Company A manufacturing services for a fixed price
- ❖ Company B is the sole customer of Company A
- ❖ At the beginning of financial year 2019, Company B decides to offer Company A long-term, interest-bearing loan to increase its total capacity. The loan has been already disclosed in Company A's Investment Registration Certificate
- ❖ Company B also charges Company A for commercial services to develop the business in Vietnam
- ❖ Company A has not entered an advanced pricing arrangement in Vietnam
- ❖ Revenue of Company A are more than VND 30 billion during financial year 2019
- ❖ The ultimate parent company of Company A is not obliged to prepare a Country-by-country report

Preliminary Assessment (1/2)



Preliminary Assessment (2/2)



Compliance with Local Transfer Pricing Requirements

Form 01: Information about related-party relationship and transactions	Section I: Information about related parties	Submitted together with the annual tax return
	Section II: Safe harbor for transfer pricing declaration and documentation	
	Section III: Information about transfer pricing	
	Section IV: Operating results defined after the transfer pricing	
Transfer Pricing Documentation Package	Local File	Prepared before the annual tax return
	Master File	
	Country-by-Country Report	Not necessary

Assessment of Related-Party Transactions (1/4)

Company A has been involved in the following related-party transactions:

- ❖ Provision of manufacturing services to Company B
- ❖ Purchase of commercial services from Company B
- ❖ Borrow an interest-bearing loan from Company B

Assessment of Related-Party Transactions (2/4)

Provision of processing services to Company B

The fixed price for the manufacturing services provided by Company A to Company B shall comply with the arm's length principle.

Assessment of Related-Party Transactions (3/4)

Purchase of commercial services from Company B

According to substance-over-form, the commercial services shall contribute to creating operating sales revenues or income for Company A.

In this case, Company A is not involved in sales (in Vietnam or in other markets) but just provide manufacturing services to Company B.

Therefore related expenses are not deductible from Company A's taxable income.

If Company A would also be engaged in the provision of services or sales in Vietnam, then those commercial services would comply with the substance-over-form and related expenses could be deducted within the arm's length range (market level).

Assessment of Related-Party Transactions (4/4)

Borrow an interest-bearing loan from Company B

The loan has been provided in order to increase the capacity of Company A. The duration of the loan is more than one year The interest rate shall comply with the arm's length principle.

Furthermore, even if the interest rate is within the arm's length range, the overall amount of deductible interests for Company A is equal to 20% of its EBITDA.

Transfer Pricing Methods (1/2)

Traditional transaction methods	Comparable uncontrolled price method (CUP)
	Resale price method (RPM)
	Cost plus method (CPM)
Transactional profit methods	Transactional net margin method (TNMM)
	Transactional profit split method (PSM)
Other methods	Global formulary apportionment
	Valuation techniques

Transfer Pricing Methods (2/2)

Type of transaction	Methods that may be suitable	Commonly used method
Provision of manufacturing services Provision of R&D services Provision of strategic management and administrative services	CUP, RPM, TNMM, PSM	TNMM
Distribution of products	CUP, RPM, TNMM, PSM	TNMM
License of royalties, patents, know-how	CUP, PSM	CUP
Integrated business operations involving intangibles on both parties	PSM	PSM
Intercompany financing	CUP	CUP

Benchmarking Study

Evaluating transactions on a separate or aggregate basis

Using multiple year data

Considering losses

Internal comparable

External comparable

- ❖ Commercial database
- ❖ Listed companies on stock exchanges
- ❖ Commodity trading database

Industrial expansion

Geographic expansion

- ❖ Vietnam > ASEAN > Asia

Time expansion (using multiple year data)

Selection of comparables

*Taxpayers shall illustrate their compliance respecting this **priority hierarchy** when conducting the benchmarking study*

Compilation of Form 01

Form 01, Section III

No.	Description	Transaction value of sales to the related party				Transaction value of purchases from the related party				Increased profit
		Recognized value of related-party transaction	Predetermined value based on the arm's length price	Difference	Pricing method	Recognized value of related-party transaction	Predetermined value based on the arm's length price	Difference	Pricing method	
(1)	(2)	(3)	(4)	(5)=(4)-(3)	(6)	(7)	(8)	(9)=(8)-(7)	(10)	(11)=(5)+(9)

Form 01, Section IV

No.	Indicator	Value of related-party transaction		Value of transactions with unrelated parties	Total value of transactions arising from business activities within a specified tax period
		Value on transfer pricing documentation	Value defined based on the APA price		
(1)	(2)	(3)	(4)	(5)	(6)=(3)+(4)+(5)
15	Profit margin used for transfer pricing				
a	Margin of.....				
b	Margin of.....				

Master File

1. Organizational structure
2. Description of businesses
3. Intangibles assets
4. Financial activities
5. Financial statements & APA

Information from parent company

- ❖ Functional analysis of group members
- ❖ Agreement and strategy related to DEMPE
- ❖ Financing activities

Additional requirements

- ❖ Analysis of headquarter contribution to group's value creation
- ❖ Explanation of the reasons for using purchasing hubs or centralized marketing entities
- ❖ Tax rates and taxable incomes of related parties having transactions with Vietnamese taxpayer

Local File

1. Management structure showing the reporting lines between the company and its related parties
2. Organizational structure of the company and a description of its business
3. List of related-party transactions in which the Company was involved in the period
4. Determination of related parties involved in those transactions and their relationship
5. Function and comparability analysis of the Company and related parties involved in each related-party transactions
6. Selection of the most appropriate transfer pricing method
7. Selection of comparables
8. Analysis of taxpayer's and comparable companies' financial data
9. Benchmarking study

Risk Mitigation

- ❖ **Providing disclosures:** All companies should disclose information about their related-party relationships and transactions in the prescribed forms and in accordance with the requisite timeframes.
- ❖ **Risk assessments:** Conducting risk assessments to monitor and revise intercompany transactions and planning ahead to create a robust transfer pricing strategy is also an important risk mitigation tool.
- ❖ **Transfer pricing documentation preparation:** Taxpayers meeting the abovementioned thresholds are required to prepare transfer pricing documentation. Companies not meeting the thresholds should however still accurately document their associated party transactions and be able to substantiate the rationale adopted in case they receive any queries or audit notices from the tax bureau.
- ❖ **Advanced Pricing Arrangements:** Taxpayers have the option to proactively manage their transfer pricing risk profiles by entering into an Advanced Pricing Agreement (APA) with the local tax authority. An APA is a binding agreement as to how taxpayers' transfer pricing arrangement will be taxed.



Section 4

Key Takeaways

Key Takeaways

- ❖ Check exemption conditions and prepare to prove the eligibility for exemption
- ❖ If the Group does not provide or prepare the Master File, request minimum necessary information and prepare the Master File dossier based on local requirements
- ❖ Loss explanation and how to adjust the impact of negative factors on financial results before making TP and tax declaration
- ❖ Discuss with the group about responsibilities, activities and transactions in Vietnam according to local transfer pricing regulations
- ❖ Consult expert advice whenever in doubt to ensure appropriate compliance, risk mitigation as well as effective planning is maximized



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