

Transfer Pricing Newsletter

Circular No. 41/2017/TT-BTC providing detailed guidelines for implementation of Decree No. 20/2017/ND-CP promulgated the management of taxation on businesses having related party transaction(s)

August 2017





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In an effort to provide detailed guidelines for implementation of some articles of the Decree No. 20/2017/ND-CP (“Decree 20”) issued by the Government on 24th February 2017 and promulgated the management of taxation on businesses having related party transaction(s), on 28th April 2017, the Ministry of Finance has issued Circular No. 41/2017/TT-BTC (“Circular 41” or “the Circular”) with effect from 1st May 2017 onwards.

The Circular has provided detailed guidelines for implementing comparability analysis, selection and application of transfer pricing method(s), disclosures and documentation of transfer pricing files, and exemptions from transfer pricing disclosures and documentation. In this Newsletter, we highlight the key guidance of the Circular that Grant Thornton Vietnam would like to bring to your attention.

1. Comparability analysis

The Circular reinforces the principle of substance over form, i.e. factual business dealings shall be prioritised in analysing related party transactions, characterization of taxpayers and selecting the most suitable transfer pricing method(s), especially for those cases having discrepancies from legal contracts or agreements on related party transaction. In cases, where the substance and facts of the related party dealings are not conducted as if dealing between independent parties, the tax authority shall reassess the business nature of the related party dealings and re-allocate the risks assumed between the related parties involved, based on practical dealings between independent parties.

In addition, the Circular provides clear guidelines for transfer pricing adjustments, which shall adopt (i) the 1st quartile of the arm's length range, if all material differences are adjustable, or (ii) the median value of the arm's length range, if there are at least 05 selected comparables but only if most of material differences are adjustable.



Analysis of properties



Analysis of FAR



Analysis of contractual conditions



Analysis of economic conditions



Analysis of material differences

The Circular provided detailed guidelines on analyses that should have taken place in preparation of transfer pricing documentation, and particularly should include:

- Analysis of properties of goods, services and assets transacted, including intangible assets, if any;
- Analysis of **F**unctions performed, **A**ssets employed including intangibles, **R**isks assumed, normally referred to as “**FAR**”, by the related parties involved. From that, the characterization of the tested party shall be determined, which, in reverse, will help tax authorities reassess the substance of business dealings or transaction(s) and reallocate the risks assumed by the involved parties, as if such dealings were conducted between independent parties;
- Analysis of contractual conditions, which are set forth in written form and actually conducted even if neither written agreement nor contract exists;
- Analysis of economic conditions impacting the price(s) used in the related party transaction, profitability of and profit allocation for the taxpayer selected as the tested party. Notably, analyses on comparability of markets and industries, in which the tested party and selected comparables are operating in, especially if they are physically located outside Vietnam, shall be performed; and
- Analysis of material differences, based on the quantitative and qualitative criteria determined by the taxpayer, i.e. differences with significant impacts on price, profitability and/or profit allocation shall be available for benchmarking the taxpayer against selected comparable companies.

2. Transfer pricing methods

The Circular provided in detail the criteria for application of the Resale Price method, the Cost Plus method and the Comparable Profit method. At the same time, Circular 41 clarifies material differences that could make each of provided methods fail to be applicable, e.g. specific accounting policies and treatment, cost structures for selling or marketing functions, manufacturing on consignment or contractual basis, intercompany services including group synergy and centralized services, and so on.

Specifically, regarding the frequently-adopted Comparable Profit method, Circular 41 requires that the applicable profit level indicator shall be Earnings before Interest and Tax, normally referred to as “EBIT”, exclusive of net financial income/expenses, over Net Revenues, or Costs/Total Costs, or Total Assets/Total Fixed Assets.

3. Disclosure and documentation of transfer pricing files

The Circular provides detailed guidelines for preparation of four (04) new forms for disclosure of related party transactions, which shall replace Form 03-7/TNDN issued as an attachment to Circular No. 156/2013/TT-BTC, and transfer pricing files. In particular, the disclosure forms now shall include:

Form 01 – Disclosures of information on related party(ies) and related-party transaction(s);

Form 02 – Checklist of information on local files prepared;

Form 03 – Checklist of information on group master files prepared, which shall include the group structure and business activities, group policies on allocation of FAR within its supply chain and corresponding profit sharing, transfer pricing methods adopted within the group or at a transactional level, etc.

Form 04 – Disclosure of information reported in country-by-country profit report of the ultimate parent for the corresponding assessment year or the preceding one. Copy of the country-by-country profit report of the ultimate parent for the corresponding assessment year or the preceding one shall be maintained by the taxpayer. In cases, where a taxpayer has more than one ultimate parent, copies of all country-by-country profit reports shall be maintained.

4. Exemptions from transfer pricing documentation

The Circular provided exemptions from transfer pricing documentation requirement for 03 cases, including:

- a) Taxpayer with total revenues of less than VND50 billion and total value of related party transaction(s) of less than VND30 billion in the tax assessment year;
- b) Taxpayer entered into an Advance Pricing Agreement (“APA”) signed with the tax authority and annual reports as might be required for APA purposes under the prevailing regulations; and
- c) Taxpayer fully met the following requirements:
 - Performing simple functions;
 - Not engaging in creation and development of any intangible assets;
 - Having annual total revenue of less than VND200 billion; and
 - Achieving a profit margin of EBIT to Net Revenues, exclusive of net financial income/expenses, of 5% or more for distribution activities, 10% or more for manufacturing activities, or 15% or more for processing activities.



5. Grant Thornton Vietnam’s recommendations

While the tax authorities are reinforcing their tax and transfer pricing audits and inspections, the issuance of Decree No. 20/2017/ND-CP and Circular 41/2017/TT-BTC are obviously an effort by the authorities to provide the legal frameworks for transfer pricing administration and management, which may set the foundation for consistent implementation of tax and transfer pricing audits and inspections, in a professional and transparent manner. More than that, consistent treatment over the cases of transfer pricing issues is something we can look forward to.

At the same time, tax authorities are also spending efforts to accomplish an **internal** database applied for imposing transfer pricing adjustments, if any. Recently, tax and transfer pricing audits have been conducting in a more professional and sophisticated manner, requiring deeper analyses of business models and factors impacting the pricing, not limited to those of local taxpayers but extended to the whole value chain of a Group.





Accordingly, Grant Thornton Vietnam would like to recommend that businesses engaged in related party transactions should:

- Actively prepare sufficient documents evidencing the arm's length nature of the related party transactions, in compliance with the transfer pricing regulations, so as to mitigate the risks of being challenged and be more proactive in working with tax authorities. Transfer pricing files, both local and master ones, should be prepared in full for every year, in which related party transactions occurred.
- Review the transfer pricing disclosures for recent years, so as to ensure the proper disclosures were done as might be required by prevailing regulations. Especially, consistency of information disclosed, in disclosure forms and those presented in the transfer pricing documentation reports should be ensured. Such information should include, but not limited to, related parties, related party relationships, types and values of related party transactions, as well as selected transfer pricing methods.
- Please be aware that transfer pricing adjustments might be imposed by tax authorities based on the results of their tax audits and inspections in general, and not only based on those of transfer pricing audits.
- Notify and collaborate with parent companies as well as the whole Group in preparing and maintaining the required financial information at Group level, so as to enable the preparation of country-by-country reports, international documentation reports or so-called master files, which might be required by the prevailing regulations of Vietnam and countries related to the whole value chain.
- Possibly appoint personnel with adequate experience in tax and transfer pricing to efficiently review the process of annual transfer pricing disclosures, as well as corporate income tax finalization. By doing so, sufficient information can be available for on time provision to the authorities.
- Contact with a professional tax advisor for support, if so desired, to ensure that you are updated with the compliance requirements, and have on time preparation of disclosures and files as well as proper planning for sustainable growth.

Please contact the professional consultants of Grant Thornton Vietnam for a full range of practical advices to be available on a timely basis.

Contacts

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