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Transfer Pricing Audits in Vietnam

By Nguyen Dinh Du and Do Vu Bao Khanh

Transfer pricing (TP) has become more and more critical in Vietnam's tax audit and inspection activities. It is understood that one of the most important missions of the Vietnamese tax authority is enforcing the national TP regime and taking proper action to counter illegal TP acts or conduct in Vietnam. In fact, statistics show 72 Vietnamese taxpayers have been subject to specific TP audit as well as 212 billion Vietnamese dong ($9.16 million) of TP arrears and 1,367 billion Vietnamese dong of loss reduction in TP matters in the first half of 2020 alone.

In view of the above, this article will set out our observations on the potential challenges during a tax audit as well as our recommendations to proactively mitigate the TP risk prior to or during audit.

Transfer Pricing Audit is Not an Exclusive Audit

There is a mistaken belief among taxpayers in Vietnam that a TP audit must be a single take, that is, that the audit could only occur within a very TP-specialized scope. This belief was indeed correct in the past, before there was a restructuring of the Vietnamese tax authority: the tax authorities at general department level and large provinces such as Hanoi, Ho Chi Minh City, Dong Nai and Binh Duong used to establish and maintain specialized units for TP audit and inspection. However, the dispersal of such TP units on a large scale in 2017 made this understanding by taxpayers inaccurate.

Having heard about this development, the question arose for foreign direct investment entities in Vietnam as to whether TP was no longer an area of focus. Unfortunately, the answer is no. Even though such specialized TP units have been disbanded, their personnel were relocated into every single tax audit unit, ensuring that TP matters would definitely be covered once the notice for a tax audit had been issued to taxpayers. Nonetheless, since TP is considered a part of corporate income tax, many audit notices have not explicitly stated as such, with the result that taxpayers have been surprised when documents relating to their controlled transactions have been singled out, even in the first phase of audit.

In light of the above, it is recommended that it is indeed the right time for taxpayers to consider completing their tax-compliant dossiers; bearing in mind that cost-cutting at this moment could lead to a substantial amount of adjustments, penalties and re-collection, as well as a negative reputation not only for the Vietnamese subsidiary but also for the group as a whole.

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Why Were My TP Compliance Documents Rejected?

Rejection of TP compliance documentation is no longer an unusual observation in Vietnam. Although it has been seen that there is significant improvement in the essence of compliance awareness by Vietnamese taxpayers in TP matters, the rejection rate of compliance documentation has gone in the opposite direction and has been rising sharply in recent years. There can also be observed an erroneous belief that as long as a taxpayer has something to submit to the tax authority, no further challenges will be made.

We will discuss below common areas of negligence that would lead to a rejection of documentation as described above.

Late Preparation Late preparation is one of the most common issues that could substantially lead to the rejection of the compliance documents. In fact, the current Vietnamese TP regulations state that compliance documents must be prepared (i) on an annual basis, and (ii) prior to corporate income tax finalization; failure to meet either of these conditions will consequentially be a violation.

It has also been observed that the Vietnamese tax authority, following the improvements in TP audits, now requests the submission of the TP service contract, examines whether the date of the contract is legitimate or not, and rejects in the very first instance any compliance document that is prepared late.

From our observations, many compliance documents, regardless of how sophisticated or costly to prepare, have been unnecessarily rejected without a glance at the content, and in addition there is absolutely no warranty that any further explanation for the lateness will be accepted by the Vietnamese tax authority. Therefore, taxpayers, as a very first consideration, should be more aware of such requirements and ensure their necessary compliance, in order to mitigate the risk.

Inconsistent Information Inconsistent information could also lead to the rejection of compliance documents and significantly contribute to a considerable amount of annual TP arrears. In general, taxpayers engaging in TP matters via entering into controlled transactions are required to:

- prepare the annual disclosure form;
- prepare the annual TP compliance report; and
- supplement the above with sufficient supporting documents (i.e. financial data, accounting records, legal materials, etc.).

Any inconsistency that might occur between these disclosure elements will most likely be the cause of dispute between the tax authority and taxpayer during audit and, most importantly, the rejection of everything that has been carefully prepared.

From our observations, the most common case of inconsistency that has occurred is when the taxpayer has prepared the disclosure form in-house and engaged a service provider to prepare the annual TP compliance report without having these materials reviewed. This could cause inaccuracy and inconsistency in disclosure versus analysis.

The second most common issue of inconsistency arises from improper delegation, in which a taxpayer, in this case as the client, sometimes entrusts the entire ledger without any instruction to the service provider, leading to unnecessary time and effort not only for the tax agent in filtering through the entire load of data but also for the client in going through everything again and again during its review. This carries a risk of huge consumption of time as well as inaccurate disclosure to the taxpayer itself.

In light of the above, review and consolidation are essentially important processes in the post-preparation phase of compliance documents. Redeeming actions, in this case amendment of compliance documents, are always free of charge as long as submissions are made prior to a tax audit.

Lack of Policy, Proactive Planning and Consultation Last but not least, lack of planning and consultation could be considered a potential risk to taxpayers. It is noteworthy that the preparation of compliance documents is always based on historical data, in other words, things that have already occurred. In this respect, the taxpayer would be exposed to a very high risk if there is any transaction which unintentionally violates the TP regulations. Risks could also arise when there is any unexpected event that could lead to a decrease in the taxpayer's profit margin and make such margin lower than its peers.

Working for most of the time on historical data, it could be too late for any adjustment to be suggested by the tax adviser, since the books are closed and transactions are already settled. As a consequence, the tax authority reserves the right to challenge the TP position of the taxpayer, as any improper explanation could lead to the rejection of compliance documents. The taxpayer in this situation should have taken more action in order to protect itself from this type of risk, rather than later regretting when matters had gone too far.

Planning Points

In view of the above, it is recommended that a taxpayer should take more proactive action on TP matters. More specifically, a uniform TP policy is the ideal guidance to prepare and apply, which can take into consideration TP regulations in each home jurisdiction and ensure the compliant status of every party involved. In addition, ad hoc planning and consultation is also highly recommended, in which every prospective action and/or transaction can be carefully reviewed for the best guidance as well as maintaining operational efficiency.

In summary, TP matters need more attention from Vietnamese taxpayers in order to protect themselves from exposure to unnecessary risk, leading to significant penalties and arrears. For the purposes of risk mitigation, Vietnamese taxpayers engaging in controlled transactions are recommended to establish a proper action schedule in preparation of their compliance documents, engage in proper planning and consultancy activities, and complete a transfer pricing policy, to not only satisfy the compliance requirements but also to create a sustainable tax operation framework.

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