

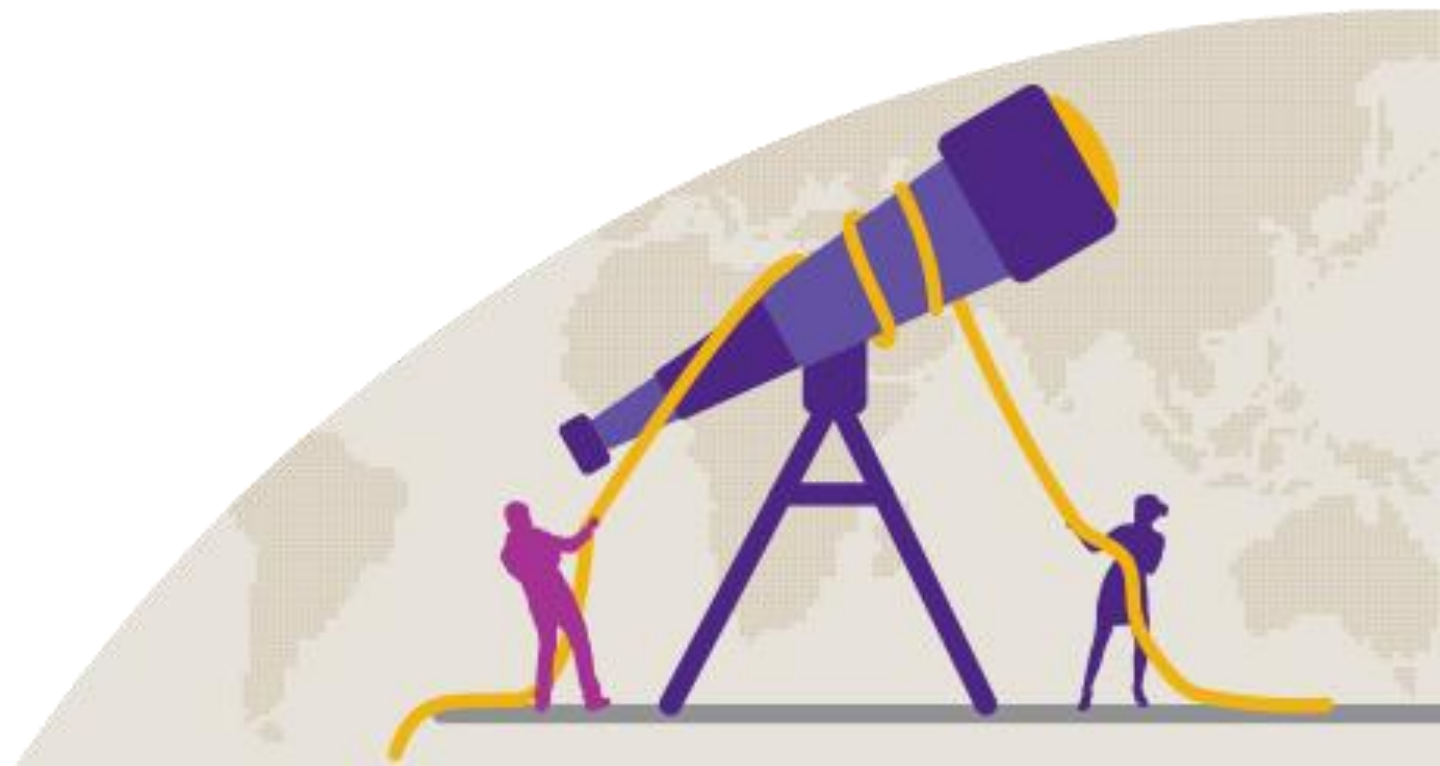
Transfer Pricing Newsletter

Draft decree guiding transfer pricing administration to combat transfer pricing and loss of tax revenue to the state budget

As an effort to enhance Corporate Income Tax administration and especially the transfer pricing issues between related parties, following Circular 66/2010-TT-BTC issued on 22 April 2010 (“Circular 66”) the Ministry of Finance has proposed a new draft Decree that regulates the administration of transfer prices for related party transactions, to combat transfer pricing and loss of tax revenue to the state budget (“Transfer Pricing Draft Decree”).

This draft has regulated the scope of associated enterprises in a more specific manner; it specifies the analysis requirements and hierarchy toward transactions between related parties as well as rights and duties of the tax authorities in transfer pricing administration

December, 2016



In this newsletter, we highlight the key contents of the Transfer Pricing Draft Decree that Grant Thornton Vietnam would like to bring to your attention:

1. International changes
2. Broadening the governing scope and some amendments in the determination of related party relationship
3. “Substance over form” principle
4. Tax deduction with respect to interest and service expenses
5. Hierarchy of comparable analysis
6. Simplification of the declaration procedures of related party transactions
7. Some new requirements for declaration and preparation of compliance documents
8. Full compliance with local Transfer Pricing regulations will assist taxpayers in gaining advantages against the tax assessment from tax authorities
9. Grant Thornton Vietnam’s recommendations



1. International changes

A number of regulatory changes have been proposed in the Transfer Pricing Draft Decree, which support the legal framework in the administration of transfer pricing, in Vietnam, in becoming more in line with the international transfer pricing standards, in particular, the Transfer Pricing Guidelines for Multinational Enterprises and Tax Administration provided by the Organization for Economic Co-operation and Development (“OECD TP Guidelines”) and the *Base Erosion and Profit Shifting (BEPS)*.

Specifically, the Transfer Pricing Draft Decree has proposed some amendments for the disclosure of information regarding the operations and finances at a Group level, aiming to the ease of application for the country-by-country report and possible disclosure of the Advance Pricing Agreements (“APA”) of the Group entities, if any.

2. Broadening the governing scope and some amendments in determination of related party relationship

The draft Decree has broadened the governing scope through the clarification of controlled transactions. Accordingly, the services under the scope of application have included intra-group services and financial services as well as supplementing the transactions relating to tangible and intangible property and resource sharing.

The Transfer Pricing Draft Decree has also proposed some quantitative changes in determination of related party relationships as follows:

For ownership relationship, the condition that entities are considered as related parties in terms of the direct/indirect invested capital is increased from 20% to 25%.

For management relationship, the condition that entities are considered as related parties in terms of management board members is decreased from 50% to 30%; and

For economic controls, the condition that entities are considered as related parties in terms of inputs and outputs are both increased from 50% to 60%.

3. “Substance over form” principle

The Principle of “Substance over form” is considered as a key regulation in this Transfer Pricing Draft Decree in comparison to Circular 66. This principle has been introduced in order to ensure that the related party transactions reflect the factual substance, instead of reliance on the subjective arrangements, as defined in the contractual terms and conditions. The factual substance regarding business of related party transactions would be highly focused and prioritized to apply in transfer pricing audit/inspections.

4. Tax deduction with respect to interest and service expenses

In addition to the introduction of “Substance over form” principle, the draft Decree also proposes the deduction principles in relation to interest and service expenses, which clarifies the conditions and legal requirements for such expenses. The application of the new regulations will allow enterprises to be more proactive in preparation of the appropriate supporting documents, in order to ensure that such expenses are legitimate as well as to prove that the cost allocation basis are reasonable and to substantiate the tax deductibility of these expenses in the annual Corporate Income Tax finalization return.

However, in our opinion, the supplemental regulation regarding the tax deductibility of interest expenses in this Transfer Pricing Draft Decree is inexplicit and ambiguous.



5. Hierarchy of comparability analysis

While Circular 66 only provides definitions and guidance to apply the transfer pricing methods, the new draft Transfer Pricing Draft Decree has proposed an application hierarchy of these methods. Accordingly, the draft Decree has prioritized the application of tested party's internal comparables in the comparability analysis of related party transactions and taxpayers are now required to provide explanations in cases where internal comparable data as well as the respective transfer pricing method are not appropriate to be applied.

For cases using of external comparable data, this draft Decree has prioritized the application of the local comparables, before using the regional comparables, as well as stipulated the databases used for performing the comparability analysis towards related party transactions that are accepted by Vietnamese tax authorities in order to facilitate the application of taxpayers.

6. Simplification of the declaration procedures of related party transactions

One noteworthy point is that this Transfer Pricing Draft Decree proposed the simplification of the declaration procedures for related party transactions, which mainly aims at small and medium-size businesses as well as related party transactions with minimal transfer pricing risks. In particular, taxpayers are obliged to declare the controlled transactions in the Transfer Pricing Disclosure Form but are exempt from the obligation to prepare Transfer Pricing Documentation in the following cases:

Transactions are between related parties in Vietnam and all of them apply the same tax rate of corporate income tax;

Taxpayer's total revenue generated in the tax year does not exceed VND 50 billion and total value of related party transactions does not exceed VND 30 billion.

7. Some new requirements for declaration and preparation of compliance documents

This draft Decree has provided a number of new and stringent provisions that require the taxpayers to comply with the declaration procedures and determining transfer prices of the controlled transactions in line with the arm's length principle as follows:

Form 01/ND-GCN attached in this draft Decree, replaces Form 03-7/TNDN which was attached in Circular 156/2013/TT-BTC regarding the disclosures of related party transactions;

Transfer Pricing Documentation reports need to be prepared before filing the annual Corporate Income Tax finalization return and submitted to the tax authorities within 15 working days with a maximum extension of another 15 days (instead of 30 working days as regulated in Circular 66) upon receipt of the written request by tax authorities;

Provision of country-by-country report;

In comparison with Circular 66, this draft Decree regulates in a more specific and detailed manner the requisite information/documents that taxpayers are obliged to declare. Particularly, taxpayers are required to provide information in relation to Group companies, such as financial results, intangible assets, material services and intra-group financial results. This requirement would facilitate tax authorities in understanding the specific operations, functions as well as financial criteria in the Group but increase the burden of proof and documentation toward taxpayers.



8. Full compliance with local Transfer Pricing regulations will assist taxpayers in gaining advantages against the tax assessment from tax authorities

This draft Decree has proposed two (2) circumstances to conduct tax assessments as follows:

For cases where the taxpayers fully comply with the transfer pricing requirements for controlled transactions as well as the regime of accounting, invoices and evidence, the adjustments are in accordance with the principle of comparability analysis and transfer pricing method on a case-by-case or industry-by-industry basis. This means taxpayers will have more opportunities to discuss and negotiate on the prices used for tax assessment based on the Transfer Pricing Documentation prepared by taxpayers in the event of a challenge from tax authorities during tax audits.

In the other scenarios (i.e. non-compliance cases), the assessment of tax shall be conducted based on the internal database of the tax authorities. This means that taxpayers will not be able to defend themselves and have to rely on the undisclosed comparable companies' information and financial data provided by the tax authorities in order to conduct the tax assessment, which can be seen as a huge disadvantage for taxpayers.

9. Grant Thornton Vietnam's recommendations

As mentioned in the previous Newsletter, the Transfer Pricing Inspection Divisions have been established at the General Department of Taxation as well as in Hanoi, Ho Chi Minh City, Binh Duong and Dong Nai Tax Departments. Given the fact that the tax authorities are enhancing inspections towards transfer pricing issues as well as improving the legal framework of transfer pricing administration regarding related party transactions, the publication of Transfer Pricing Draft Decree has raised a signal to show that the tax authorities are seriously focusing on transfer pricing administration and inspections of taxpayers, especially foreign-investment entities, with the aim of combating against tax evasion and loss of revenue to the State budget.

Based on our observation, beside the improvement of legal frameworks, the tax authorities are also putting efforts to establish the databases applied in the determination of prices in controlled business transactions according to the arm's length principle. We forecast that in the near future, transfer pricing audits and inspections will be conducted in a stricter and more sophisticated manner in terms of transaction amount, insight and business models from not only taxpayers

themselves but also at a Group level.

Therefore, Grant Thornton Vietnam recommends that enterprises with related party transactions should note the followings:

Boards of Director and Management should actively prepare sufficient documents to support testing the arm's length nature of the related party transactions and comply with the transfer pricing regulations and thus, mitigate the risk of being challenged and be more proactive in negotiation with the tax authorities. The preparation of such supporting documents is not limited to the current tax year but includes all tax years from 2006 onward, if related party transactions were incurred in these years.

Enterprises should review the declaration of information in the Transfer Pricing Disclosure Form in recent years as well as prepare the Transfer Pricing Documentation report in order to ensure that such disclosures are accurate, sufficient and consistent in terms of both transactional values and the applied transfer pricing methods. Note that the tax assessment towards the controlled transaction can be conducted even in non-TP audits/inspections.

Enterprises should notify their parent companies as well as the Group regarding the disclosure requirements of the Country-by-country reports as well as financial information at Group level.

In addition, it is necessary to appoint personnel with adequate experience in tax and transfer pricing to review the declaration procedure of related party transactions/ transfer prices in particular and the annual Corporate Income Tax finalization return in general and ensure the provision such information to the transfer pricing auditors/inspectors in a timely manner.

Please contact the professional consultants of Grant Thornton Vietnam if you need any objective, realizable and timely advices with respect to the Transfer Pricing Documentation for your related party transactions.



Contact

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