

Vietnam issues guidance on related party transactions and transfer pricing

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Executive summary

The Vietnam Government (the Government) issued, on 5 November 2020, Decree 132/2020/ND-CP (Decree 132) on tax administration for transactions with related parties.¹ Decree 132 is effective from 20 December 2020 and is applicable for the corporate income tax (CIT) period 2020 and future years.

Also, following the enactment of the Law on Tax Administration No. 38/2019/QH14 effective from 1 July 2020 (Law on Tax Administration), the Government issued Decree 126/2020/ND-CP dated 19 October 2020 (Decree 126)² to provide guidance on the implementation of a number of articles of the Law on Tax Administration, including guidance on transfer pricing (TP).

This Tax Alert outlines the key changes in tax administration relating to TP in Decree 132, the Law on Tax Administration and Decree 126.

Detailed discussion

Introduction of certain TP principles and concepts into the Law

The arm's-length principle and the principle of substance of business operations and transactions were introduced into the Law on Tax Administration to strengthen the legal basis for TP administration. These principles are also included in Decree 132.

In addition, the Law on Tax Administration specifies that TP declarations and adjustments are based on the arm's-length principle, provided that such adjustments do not result in a reduction of taxable income in Vietnam. Accordingly, the disallowance of downward TP adjustments has been introduced into the Law.

Deductibility of loan interest expense for transactions with related parties

Decree 132 sets forth regulations on the deductibility of loan interest expense, providing:

- ▶ An increase in the deductible loan interest expense cap to 30% of the total net profit from business activities within the period plus (+) net loan interest expenses (after offsetting deposit interest income and loan interest income) plus (+) depreciation expenses incurred in the period
- ▶ The ability to carryforward net loan interest expenses that were not deductible due to the above-mentioned interest expense cap, for a subsequent five years
- ▶ Retrospective application of the deductibility of loan interest expenses to the CIT periods 2017 and 2018
- ▶ The types of loans excluded from the above cap

These provisions on the loan interest expense deductibility cap are similar to the rules of Decree 68 which were summarized in EY Global Tax Alert, [Vietnam issues decree amending loan interest deductibility cap and draft decree on related party transactions](#), dated 31 July 2020.

In addition, according to Decree 132, taxpayers who are exempted from TP declaration or TP documentation obligations are still required to comply with the above cap.

Broadening the definition of related parties

Decree 132 broadens the definition of related party relationships to encompass more cases where companies are both under the management or control of individuals with close relationships in the same family.

In addition, companies and individuals are also considered to be related parties under Decree 132 if:

- ▶ A company is engaged in capital transfers, receipts of capital transfer of at least 25% of the contributed capital in the tax period with an individual who manages or controls the company or who has family relationships as prescribed in the Decree.

Or

- ▶ A company is engaged in borrowing, lending at least 10% of the contributed capital at the time of transaction with an individual who manages or controls the company or who has family relationships as prescribed in the Decree.

Narrowing the arm's-length range

In accordance with Decree 132, the definition of the arm's-length range has been changed to a set of values from the 35th percentile (previously 25th percentile under Decree 20 and Circular 41³) to the 75th percentile with the median value set at the 50th percentile. This accordingly narrows the arm's-length range and may impact the result of a taxpayer's TP analysis compared to the rules of Decree 20 and Circular 41.

The principle to expand the scope for selection of comparables for benchmarking analysis

The priority of selection of comparables remains unchanged. That is, the comparables selected should be in the following order: (i) internal comparables of taxpayers; (ii) comparables residing in the same country and territory with taxpayers; and (iii) comparables in regional countries with similar industry and economic conditions.

However, Decree 132 includes some amendments to the principle related to expanding the scope of selection of comparables for specific and unique related party transactions in the absence of independent comparables as detailed below.

- ▶ Prioritizing using comparables in the economic sub-sector with the highest level of comparability in the same zonal area, and extended to the provincial zone and then to the whole of Vietnam rather than prioritizing on comparables in the similar geographical market
- ▶ Expanding the scope of geography for benchmarking analysis to include countries in the region with comparable industry conditions and economic development levels

Changes in TP disclosure forms

Appendices are included in Decree 132 relating to TP disclosures for taxpayers to declare and submit together with their CIT finalization returns. The appendices include:

- ▶ Appendix I - Information on related parties and related party transactions (replacing Form 01)
- ▶ Appendix II - Checklist of information and documents required for Local file (replacing Form 02)
- ▶ Appendix III - Checklist of information and documents required for Master file (replacing Form 03)

Compliance obligations regarding Country-by-Country (CbC) Reporting (CbCR)

Decree 132 provides detailed guidance on taxpayers' obligations relating to CbCR as follows:

- ▶ A Vietnamese Ultimate Parent Entity (UPE) with global consolidated revenue in a tax period of VND18,000 billion or more must prepare Form 04 (CbCR) and submit it to the tax authority no later than 12 months from the financial year end of the UPE.
- ▶ For a Vietnamese taxpayer whose overseas UPE is required to submit a CbC report in its country of residence, the Vietnamese tax authority will obtain that CbC report by engaging in the Automatic Exchange of Information (AEOI) in accordance with its commitment under the International Tax Agreement of Vietnam.
- ▶ A Vietnamese taxpayer must submit a CbC report to the Vietnamese tax authority in the following cases:
 - The jurisdiction of residence of the UPE has signed an International Tax Agreement with Vietnam but there is no Multilateral Competent Authority Agreement (MCAA) for AEOI in place at the time of the CbCR submission deadline
 - The jurisdiction of residence of the UPE has joined the MCAA with Vietnam but suspended the AEOI or cannot automatically provide the CbC report to the Vietnamese tax authorities
 - If there is more than one taxpayer in Vietnam, the UPE provides a written notification to the Vietnamese tax authority on the appointed organization for submission of the CbC report on its behalf no later than the financial year end of the UPE
- ▶ A Vietnamese taxpayer is not required to submit a CbC report to the Vietnamese tax authority if the UPE appoints an organization to submit the CbC report to the tax authority of the host country on its behalf (appointed organization) no later than 12 months from the financial year end of the UPE and the following conditions are met:
 - The jurisdiction of residence of the appointed organization has the following regulations:
 - ▶ Legally requires the submission of the CbC report
 - ▶ Has an MCAA with Vietnam to which such jurisdiction is a signing party at the time of the CbCR submission deadline
 - ▶ Does not suspend the AEOI and can provide a CbC report to the Vietnamese tax authorities

- The appointed organization provides a written notification on the appointment to submit a CbC report to the jurisdiction of its residence no later than the financial year end of the UPE
- The Vietnamese taxpayer submits the written notification to the Vietnamese tax authority

Decree 132 also indicates that the Vietnamese tax authorities will annually post on their tax web portal the list of foreign tax authorities that engage in the AEOI with respect to CbC reports.

Addition to the list of TP documentation exemption cases

In addition to the exemption from the TP declaration in Section III and IV of Appendix 01 as stipulated in Form 01 of Decree 20, Decree 132 states that companies are also exempted from TP documentation obligations where the Vietnamese taxpayers involved in the related party transactions satisfy all of the following conditions:

- ▶ They only engage in transactions with related party taxpayers in Vietnam.
- ▶ Both entities have the same CIT rate.
- ▶ Neither entity enjoys CIT incentives during the CIT period.

Deadline for submission of TP documentation

The deadline for submission of the TP documentation upon request in an audit is now subject to the Law on Inspection from the date of receipt of the tax authority's request. Accordingly, the Law on Inspection provides that inspected entities are required to provide timely, sufficiently and accurately the information and documents regarding the inspection contents upon request in an audit. Thus, TP documentation must be submitted upon the tax authority's request in a timely manner during an audit, instead of within 15 working days as prescribed in Decree 20.

Cases subject to deemed tax adjustment

The Law on Tax Administration and Decree 126 specify certain cases where taxpayers are subject to a deemed tax adjustment relating to TP as follows:

- ▶ Failure to determine, declare transfer prices in accordance with the TP regulations
- ▶ Failure to provide information, documentation in accordance with the TP regulations

- ▶ Engaging in transactions that do not truly reflect the economic substance and reality of transactions for the purpose of reducing the tax liability

Deemed tax adjustments

In accordance with the Law on Tax Administration, Decree 132 and Decree 126, the database of the tax authorities and commercial databases are used for making deemed tax adjustments, including TP adjustments.

Decree 126 also includes a provision on the tax authority's purchase of information, materials and data from database providers to serve the tax administration, including the purchase of a commercial database for TP administration.

Thus, in addition to the tax authorities' own database, commercial databases are now stipulated in the Law on Tax Administration as an official source of data that may be used as the basis for TP comparability analysis and deemed tax adjustments. However, it is important to note that the tax authorities will likely use their own database to evaluate and make TP adjustments in the event of a taxpayer's violation of the tax regulations.

Administrative penalties for TP

The Law on Tax Administration stipulates specific penalties relating to non-compliance on TP as follows:

- ▶ Taxpayers filing inaccurate TP declarations and TP documentation, thereby reducing the tax liability based on the inspection/audit conclusions of competent authorities, are subject to pay a penalty equal to 20% of the understated amount.
- ▶ Taxpayers using invoices or documents which do not truly reflect the substance of the transactions or the actual values and thereby incorrectly determine the tax payable, tax exemption, tax deduction tax refund or that no tax is payable, are subject to a penalty ranging from one to three times of the evaded tax amount.

Appeal against conclusions of State inspectorate, recommendations of State auditor

In accordance with the Law on Tax Administration, taxpayers are entitled to appeal against recommendations of the State auditor and conclusions of the State inspectorate, if the State auditor and State inspectorate directly conduct the audit on the taxpayer and the taxpayer disagrees with such recommendations and conclusions.

Advance Pricing Agreements (APAs)

Decree 126 introduces new forms that are to be used for applying for an APA and sets forth a list of information required for the final draft APA. Decree 126 also provides guidance on extensions, amendments, cancellation and withdrawal of APAs.

Decree 126 also states that the application of an APA must be approved by the Minister of Finance before implementation. For bilateral and multilateral APAs, the Ministry of Finance is required to seek an opinion from the Ministry of Justice, the Ministry of Foreign Affairs and other relevant authorities. It is also required to submit the case to the Government and the Prime Minister for their opinion regarding concluding the APA.

Implications

The introduction of the Law on Tax Administration, Decree 126 and Decree 132 has enhanced the Vietnamese legal system with regard to TP administration.

In light of the above developments, companies should carefully review the new regulations on compliance obligations in Vietnam and proactively assess the possible impact of such changes on their business operations for effective planning and compliance. In addition, companies should review the new rules on the accepted arm's-length range and selection of appropriate independent comparables for TP declaration and documentation purposes to mitigate relevant exposures.

Endnotes

1. This Decree replaces Decree 20/2017/ND-CP dated 24 February 2017 (Decree 20) and Decree 68/2020/ND-CP dated 24 June 2020 (Decree 68).
2. Decree 126 is effective from 5 December 2020.
3. Circular No. 41/2017/TT-BTC provides guidance on the implementation of Decree 20.

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