Transfer pricing in Vietnam

Navigating the complexity of transfer pricing rules and practices

TP regulations

The Vietnamese transfer pricing (TP) regulations mandate the application of the arm's length principle and the principle of economic substance of business operations and transactions to govern the transfer prices of related party transactions. The regulations adopted some of the recommendations contained in the Organisation for Economic Co-operation and Development (OECD)/G20 inclusive framework on Base Erosion and Profit Shifting (BEPS) project, including the three-tiered TP documentation approach.

The current TP regulations are governed by Decree 132/2020/ND-CP (Decree 132) which is effective from 20, December 2020 and is applicable for the fiscal year 2020 onwards. Historically, the regulations were introduced with Circular 117/2005/TT-BTC (Circular 117) in 2005, Circular 66/2010/TT-BTC (Circular 66) in 2010 and in 2017 via Decree 20/2017/ND-CP (Decree 20) and Circular 41/2017/TT-BTC (Circular 41).

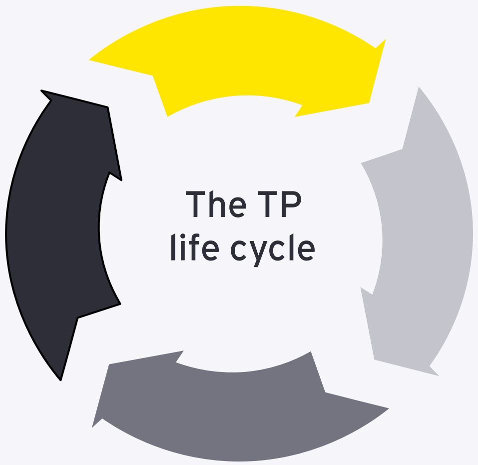
In addition to the above, Decree 126/2020/ND-CP (Decree 126) issued on 19 October 2020, implementing the Law on Tax Administration (effective from 1 July 2020) also includes guidance on implementing certain key articles relating to TP. Guidance on the application of Advance Pricing Agreements (APAs) is provided in Circular 45/2021/TT-BTC (Circular 45) issued in June 2021.

All of these rules and regulations are complex. TP issues can put your company at risk. Taking a proactive approach to address your TP risks and obligations is beneficial for your business as well as other stakeholders and potential investors.

If one or more of the following situations applies to your company, it is likely to be subject to TP requirements:

- Cross-border sale of goods or services with related parties
- Cross-border financing arrangements with related parties
- Domestic transactions with a related party and one of the related parties enjoys corporate income tax preferences

The TP life cycle



Set TP
- TP triggers and analysis
- Transaction categories and methods

Adjust TP
- Ongoing monitoring
- Forecasting

Review and adjustments
- Final TP adjustments
- Audit and financial statements

TP compliance and reporting
- Master file
- Local file
- Country-by-country reporting (CbCR)
- Reportable TP forms
- Other data requests (revenue authorities)

1 | Introduction of new global reporting requirements for TP

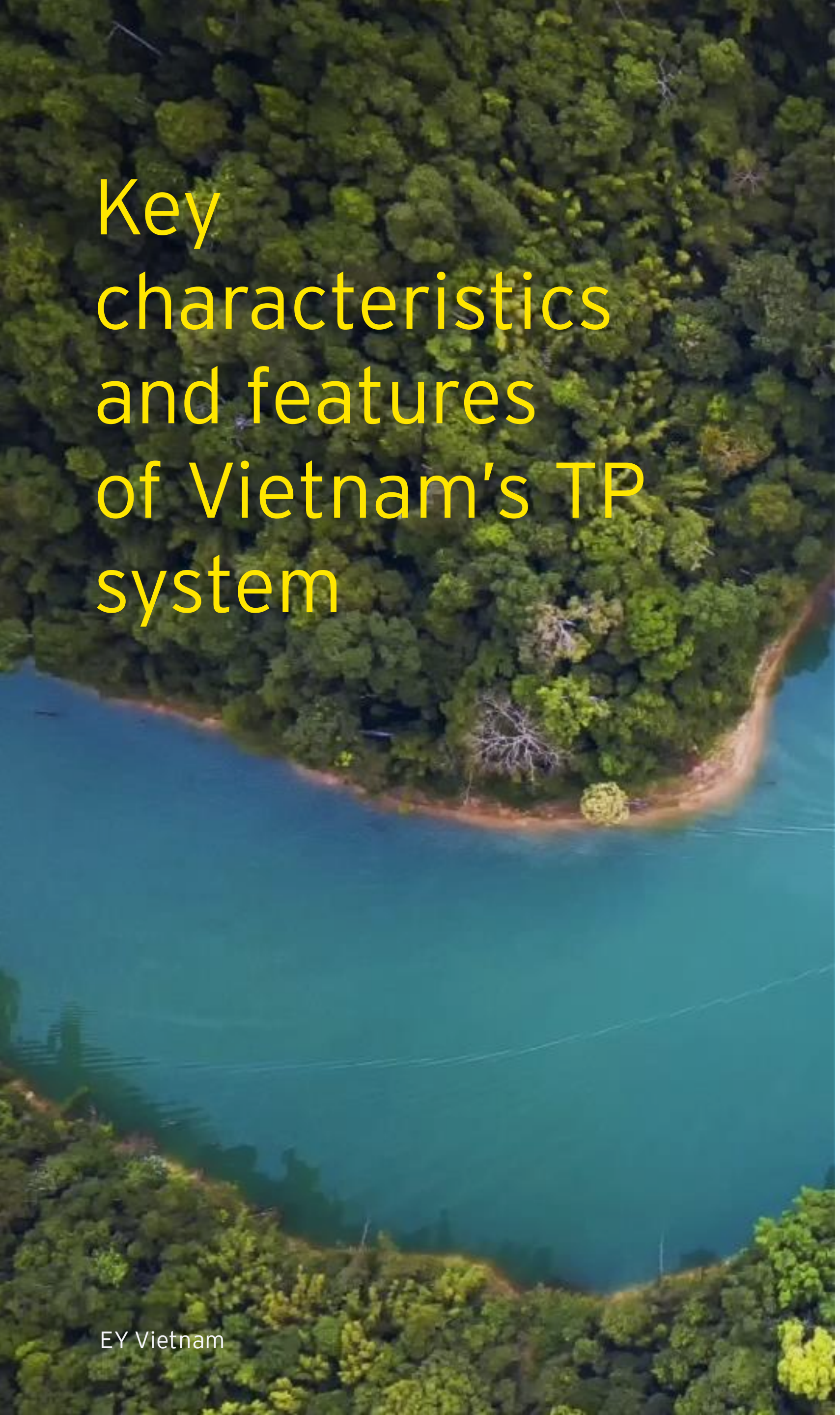
2 | Increased regulatory scrutiny and TP audit risk

3 | Requirements across multiple entities and jurisdictions

Key questions to ask

- Considering the Vietnamese TP regulations, are you compliant and how will you ensure your compliance to mitigate the risk of being scrutinized in a tax audit?
- Are your company's TP policies/practices consistent with the regulations or are you exposed to significant TP risks?
- Have you identified and documented all your related party transactions?
- Have you considered how your business will, or has, evolved and are you aligning your TP policies to keep pace with business changes?
- Do you have sufficient expertise to meet your compliance obligations in-house or do you need expert help?

Key characteristics and features of Vietnam's TP system



Definition of related parties

The definition of related party is similar to that in the OECD Transfer Pricing Guidelines for Multinational Enterprises, 2017 version (OECD TP Guidelines). However, Decree 132 is broader in certain aspects and considers matters such as management, control, capital investment, individual and family relationships, and third-party loans (in specific circumstances).

Selection and application of TP methods

Decree 132 is consistent with the OECD TP Guidelines and allows the use of the following methods to ascertain an arm's length price:

- Comparable Uncontrolled Price (CUP) method
- Resale Price Method (RPM)
- Cost-plus Method (CP)
- Profit allocation Method/Profit split Method (PSM)
- Comparable Profit Method (CPM)/Transactional Net Margin Method (TNMM)

Taxpayers are required to select and apply the most appropriate method to determine whether the TP arrangement is at arm's length.

Decree 132 provides some additional matters a taxpayer in Vietnam must consider in choosing the appropriate TP method. This means the appropriate TP method must be specifically considered for the Vietnam entity rather than simply following the group TP policy.

TP declaration and document obligation

A. TP Documentation

Decree 132 requires Vietnamese taxpayers with related party transactions to prepare TP documentation before the submission of their corporate income tax (CIT) finalization returns and to provide the documentation to the tax authorities in a timely manner upon request. The following TP documents are required:

- Local File – The Local File is a document that focuses on the local entity in Vietnam and documents its related party transactions, the amounts involved in those transactions, and the analysis of the TP determinations and conclusions regarding those transactions.
- Master file – The Master File is a broader document of a multinational group which provides high-level information on the global business operations and TP policies of the group.

There are some differences relating to the content of local file and master file as per Decree 132 when compared to the standard format in the OECD TP Guidelines.

B. TP Disclosure Appendices

In addition to the obligation to prepare TP documentation taxpayers are also required to submit the following TP disclosure appendices together with their CIT finalization returns:

- **Appendix I – Information on related parties and related party transactions**
- **Appendix II – Checklist of information and documents required for the Local file**
- **Appendix III – Checklist of information and documents required for the Master file**

C. Obligation of Country by Country Report (CbCR)

The CbCR is an annual document that provides certain financial information for each of the jurisdictions in which a multinational group does business.

A Vietnam company that is the ultimate parent company of a group with global consolidated revenue in a tax period of VND 18,000 billion or more, is required to prepare and submit the CbCR (Appendix IV) within 12 months from the fiscal year end.

Where a Vietnam company is not the ultimate parent company, but is a subsidiary of a multinational group, and the ultimate parent company is required to prepare a CbCR in their country of residence, the Vietnam subsidiary is required to obtain and submit a copy of the CbCR of their ultimate parent company within 12 months from the fiscal year end. The Vietnam tax authorities shall directly obtain the CbCR via the automatic exchange with foreign tax authorities under international tax agreements once this mechanism is brought into effect in Vietnam.

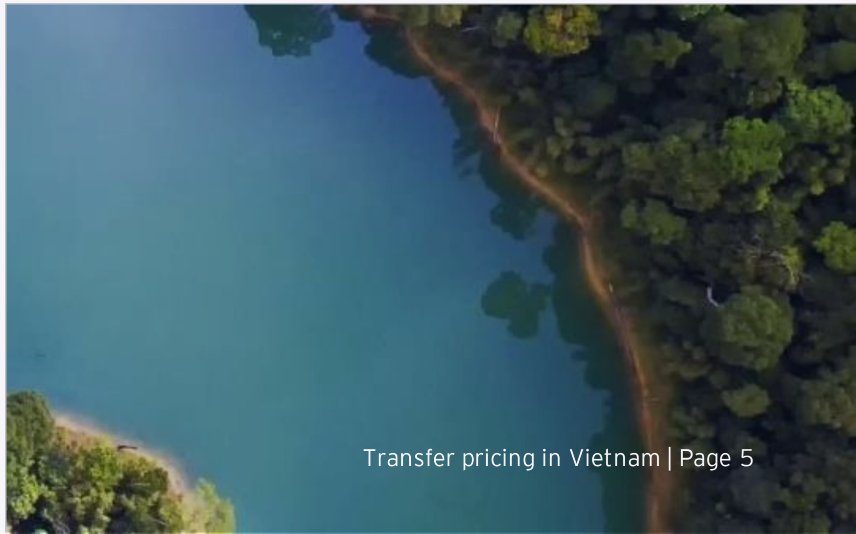
TP compliance exemptions

A taxpayer must declare its related party transactions in Appendix I of the annual CIT finalization return. However exemptions to TP documentation requirements apply in the following circumstances:

- The taxpayer is engaged in related-party transactions, but its total revenue generated within the tax period is less than VND50 billion and the total value of its related-party transactions is less than VND30 billion.
- The taxpayer has signed an APA and submitted the annual APA report.
- The taxpayer is performing routine functions, does not derive any revenue or incur any costs from the exploitation, use of intangible assets and has sales revenue of less than VND200 billion and meets the following required ratio of operating profit relative to revenue:
  - Distribution business: at least 5%
  - Manufacturing business: at least 10%
  - Toll manufacturing or processing business: at least 15%
- Taxpayers are also exempted from preparing TP documentation where they are involved in transactions only with related parties within Vietnam and both entities have the same CIT rate and neither of them are entitled to CIT incentives during the CIT period.

Key considerations for local TP compliance

- The CUP method is mandatory for financial transaction (e.g. inter-company borrowing) and intangible transactions (e.g. royalty, trademark).
- TP analysis based on an aggregated approach is also accepted under the local regulations.
- The arm's-length range is defined to be set of values from the 35th percentile (as compared to 25th percentile under OECD TP guidelines) to the 75th percentile.
- Local comparables are preferred over regional comparables and the comparable companies should be publicly listed. Efforts made to search for local comparables must be indicated in the economic analysis of the Local file.
- A taxpayer should test a particular financial year results against the comparable companies results of the same financial year. This is different from the OECD TP Guidelines which allow an averaging method.
- Tax authority tends to evaluate transfer price or profit margins using internal data where available.
- TP adjustments should not result in a reduction of taxable income in Vietnam. This means that downward TP adjustments are not allowed.
- Tax authorities scrutinize inter-company service charges and request comprehensive supporting documents, supporting evidence in addition to a benchmarking study and a benefits test analysis. Furthermore there are specific additional conditions for inter-company services charges to be deductible.



Increased TP enforcement

The Vietnamese tax authorities closely scrutinize a company's TP compliance in tax audits. There are also a growing number of TP specific audits and resulting adjustments. A company with some or all of the following characteristics is likely to draw the attention of the tax authorities in terms of a transfer pricing audit:

- Failure to file the TP Appendices
- Not audited for tax/TP for a number of years
- Significant related party transactions
- Loss making entities performing routine functions bearing low risk and not involved in making strategic decisions
- Highly fluctuating financial results or consecutive losses over a long period of time
- Different pricing/margins while selling the same or similar products to both related and independent parties
- Significant payments of intercompany service charges and royalties

Consequences of TP non-compliance

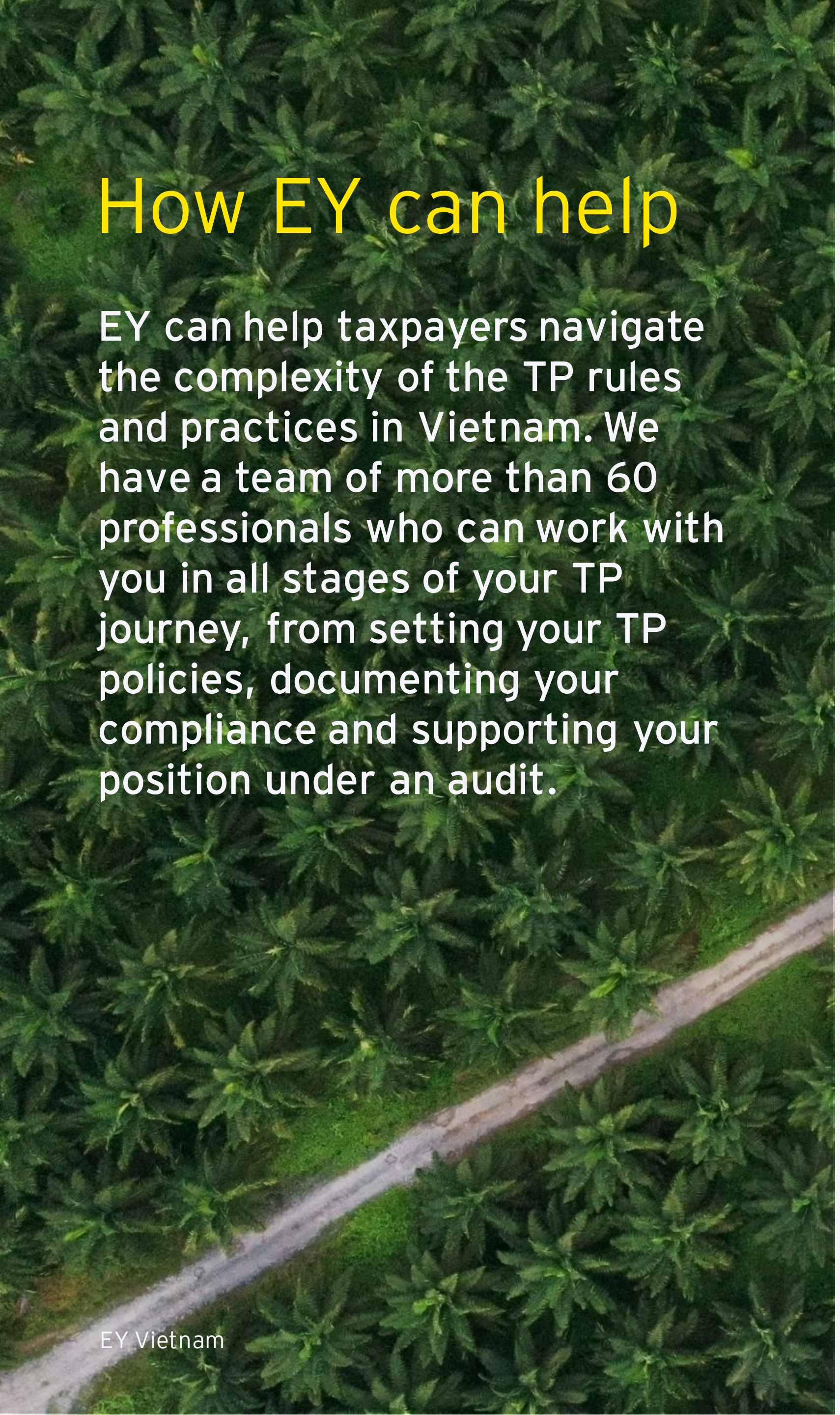
Under the current tax regulations, the tax authorities are empowered to make TP adjustments and collect understated tax payable plus interest over the period of last ten years in cases where the taxpayer:

- Fails to declare, determine transfer prices or provide documentation or information in accordance with the Vietnamese TP regulations
- Engages in transactions that do not truly reflect the economic substance and reality of transactions for the purpose of reducing the tax liability.

For a TP assessment, the tax authorities are entitled to use both commercial databases and secret comparables in cases of non-compliance and the burden of proof rests on the taxpayers. If a TP adjustment is made as a result of incorrect declaration resulting in an understated tax payable, a taxpayer is subject to a penalty equal to 20 percent of the understated amount and the statutory limitation is five years.

Advance pricing agreements

Taxpayers may negotiate and enter into APAs with the Vietnam tax authorities to achieve certainty of tax treatment for related party transactions including TP methods and the arm's length prices or profit margin of the covered transactions for a specific period up to three years. The types of APAs available in Vietnam include unilateral, bilateral and multilateral APAs. Decree 126 and Circular 45 sets forth conditions and processes for the application of APAs.



How EY can help

EY can help taxpayers navigate the complexity of the TP rules and practices in Vietnam. We have a team of more than 60 professionals who can work with you in all stages of your TP journey, from setting your TP policies, documenting your compliance and supporting your position under an audit.

Diagnostics

- Advise the list of parties/transactions subject to TP compliance
- Review existing TP policies, undertake brief functional analysis and confirm the appropriate TP method
- Understand existing pricing processes and parties/participants involved
- Perform TP risk assessment and identify risk and gaps
- Develop an action plan to manage TP risks

Design

- Develop targeted TP operating model/supply chain and transaction, including restructuring and associated re-allocation of functions, risks and assets
- Undertake TP Analytics using various benchmarking tools
- Perform benchmarking analysis to design an appropriate TP policy/policies
- Align TP business-processes as per the TP policy/policies

Implementation

- Implement recommended TP policies
- Monitor consistent application of TP policies
- Revise transfer prices if and when required
- Amend intercompany agreements to respond to the recommended TP set up

Documentation

- Prepare the TP Appendices (I, II, III) of the CIT returns
- Prepare contemporaneous TP documentation (Master-file, Local file and CbCR) and required CbCR notifications

Controversy

- Address controversy readiness
- Develop an appropriate approach to protect the TP model and pricing policy
- Defend TP documentation and related issues during audits and disputes
- Assistance in applying for APA and Mutual Agreement Procedure (MAP)

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