A. Vietnam transfer pricing environment

The transfer pricing environment in Vietnam has rapidly changed over the past five years. The number of transfer pricing audits of companies in various industries has been rising since the issuance of Vietnam's revised transfer pricing regulations in 2010 or Circular 66/2010/TT-BTC ("Circular 66"), which replaces Circular 117/2005/TT-BTC ("Circular 117"), introduced in2006. This trend continued to increase when the Vietnam government implemented the 2012-2015 National Action Plan, which sets out an expectation that 20% of annual tax audit cases would be devoted to transfer pricing reviews/audits.

Since the introduction of the National Action Plan, several audits focused on related party transactions were conducted both by the provincial tax departments and the General Department of Taxation ("GDT"). A special team within the Tax Modernization Department of the GDT was tentatively created and assigned to conduct official transfer pricing audits and support provincial tax auditors in conducting their own audits. The team only announced a few transfer pricing audits but the impact in each case was significant. In the period Q4 of 2013 to Q4 of 2015, 29 cases were completed with total adjustments of around VND 6,700 billion (appx. USD 319 million), or an average of USD11 million per case.

In September 2015, the GDT established official Transfer Pricing Inspection teams in the GDT and in four major provinces: Hanoi, Ho Chi Minh City, Binh Duong and Dong Nai. This marked the transition from the trial period of transfer pricing enforcement to an official and more methodical approach to tax scrutiny and revenue collection. This indicates the determination and aggressiveness of Vietnam's tax authorities in bridging "gaps" in transfer pricing enforcement.

B. Compliance requirements

1. Determination of related party

Besides ownership and management control criteria, the Vietnam transfer pricing regulations also include the economic control criteria under which two entities shall be deemed to be "related" if one entity controls, directly or indirectly more than 50% of the total value of raw materials, supplies or inputs used for production or trading of output of the other entity; or controls, directly or indirectly more than 50% of turnover of any product type of the other entity; or two entities have agreed to conduct business co-operation on the basis of a contract.

2. Tax return disclosures

Enterprises are required to submit an annual transfer pricing declaration form together with the annual corporate income tax return, within 90 days from the end of the financial year.

The required disclosures in the transfer pricing declaration form include the types and values of transactions, transfer pricing method/s, name/s of related party/ies, nationality, tax code (if applicable) and addresses. In the latest form effective 1 January 2014 (Form 03-7/TNDN), self-assessed adjustments are required. While the information in the form is rather straightforward, the documentation required to support the information disclosed may be complicated.

Effective from 2006, lodging the annual transfer pricing declaration form is compulsory for all operational years. Compliance with this requirement is crucial for enterprises preparing for transfer pricing audits.

3. Contemporaneous transfer pricing documentation

In addition to the transfer pricing declaration form, enterprises are required to maintain sufficient transfer pricing documentation to support the pricing of their intercompany transactions. This documentation normally includes company and related party information, industry information, functional analysis and selection and application of the most appropriate transfer pricing method. It should be prepared contemporaneously i.e. at the time the related party transactions occur. It also serves as the basis of the disclosures made in the annual transfer pricing disclosure form and is the first line of defense in a tax/transfer audit.

A company's transfer pricing documentation is required to be submitted to the tax authorities only upon written request and in Vietnamese (language). Submission is within 30 days from receipt of the written request, subject to a one-time extension of 30 days. In practice, the actual required time for submitting the transfer pricing documentation and other supporting documents during a transfer pricing audit can be shorter.

In addition, maintaining other supporting documents for each related party transaction is also important in defending the transfer pricing position of an enterprise. These supporting documents can be very detailed and may include agreements, reports, payment vouchers and other documents related to tax calculation, tax payment, and tax settlement.

C. Advance Pricing Agreement ("APA")

The detailed regulations on APAs are contained in Circular 201/2013/TT-BTC, which became effective on 5 February 2014 (Circular 201).

Under an APA, a taxpayer agrees with the tax authorities, in advance, the method and arm's length pricing of related party transaction/s for a period of not more than five years. The APA can be extended for another five years and can be unilateral (negotiated with one tax authority), bilateral (negotiated with tax authorities from two jurisdictions) or multilateral (negotiated with tax authorities from three or more jurisdictions).The bilateral and multilateral APAs can be entered into based on negotiation with the authorities of countries with which Vietnam has signed a tax treaty.

Circular 201 also outlines the policies and procedures in the Vietnam APA program. There is no fee for filing an APA request. In practice, the overall timeline for the APA application process (including pre-filing consultation) may take nine months to more than a year, subject to the available information. During the term of the APA, the taxpayer is required to submit (together with the annual corporate income tax and the annual transfer pricing declaration form), an annual APA report as proof of compliance with the agreed APA terms and conditions. Submission of ad-hoc reports may also be required from the taxpayer.

Several APA cases were submitted and currently under discussion with the designated APA team within the GDT.

D. High-risk areas

1. Potential high transfer pricing risk targets

Enterprises may be selected as targets for tax and transfer pricing audits through manual selection by tax officers and/or via tax risk assessment software. The latest set includes 20 quantitative and qualitative criteria under five categories. Each enterprise will be marked from 1 to 4 by the local tax office and these scores will be inputted into the system for risk grading purposes. In addition to the automatic grading, the manual selection is largely conducted by a tax audit officer through desk review and information collected within the local tax office.

With the intense pressure of tax collection and a number of cases audited, a local tax office may select any enterprise for transfer pricing audit at any point in time during the financial year. The focus areas of such audits vary but normally transfer pricing is included if an enterprise is considered to have high transfer pricing risk.

Targets for transfer pricing audit cases may include but not limited to:

- key industry players;
- enterprises which have persistent losses and are still expanding;
- enterprises which have high VAT refunds;
- enterprises which have not been audited for a long period;
- Enterprises with high tax incentives; and
- Enterprises which have had several tax issues or high adjustments during previous audits.

Companies which are key players in their industry and have continuous losses but are expanding their businesses are normally on top of the target list. However, there are several cases where even profitable enterprises were challenged and had adjustments in a transfer pricing audit. The industries that have recently been subject to transfer pricing audits included garments, manufacturing, software services, real estate, financial services and trading.

2. Intra-group service charges

Service fees are deductible in Vietnam provided that they are necessary and reasonable to the business operations and are supported by valid invoices, contracts, and other relevant supporting documents. The Vietnam tax authorities have challenged service fees not just from a corporate income tax (i.e. deductibility) perspective but also from a transfer pricing perspective (i.e. arm's length basis). Thus, proof showing not only actual receipt and benefit of the service but also the basis of the charges (e.g. benchmarking study or transfer pricing documentation) has been requested from taxpayers.

Service fees paid to non-residents are deductible (assuming supporting documents are in place) but are subject to withholding tax (unless exempt under a relevant tax treaty).

3. Royalties

Royalty transactions may be challenged when they are of high-value (i.e. above the median) and/or not supported by a benchmarking study.

Arm's length royalties paid to non-residents are deductible but are subject to withholding tax (unless lowered under a relevant tax treaty).

4. Management fees

Deductibility of management fees paid by a Vietnam permanent establishment to an overseas company is subject to an allocation formula under the Corporate Income Tax (CIT) regulations. If there is a service transaction involved, it is generally advisable to use the term “service fee” rather than “management fee” as the latter may attract more scrutiny from the Vietnam tax authorities because of the said allocation formula and the fact that in practice, management fees have been typically associated with limited sectors only such as hotels, restaurants, and casinos.

E. Highlights of transfer pricing audit

1. Period covered under audit

The period covered by many recent transfer pricing audits ranges from the company’s establishment date to the last 3-5 years. There were also some that covered periods since 2006 and overlapped with tax audits that were previously completed.

2. Tax impact and penalties

The tax impact of the adjustments from a transfer pricing audit can be significant. The direct impact may include the imposition of additional income tax, loss reduction, change of the tax incentive’s counting period and/or tax incentive regime, among others. There could also be indirect impacts which can be significant based on recent audit cases. The indirect impact may include rejection of claims for VAT refunds, reduction of VAT credits, capital transfer tax as well as customs audit and adjustments. Late payment and tax penalties are determined on a case-by-case basis.

There could also be criminal proceedings against taxpayers once it is proven that significant tax evasion exists. If the underpaid tax amount is VND 300 million (approximately USD 15,000) or more, the taxpayer may be subject to tax penalties under criminal proceedings.

3. Secret local comparables

The GDT has a database of profit margins for certain industries, using local companies. This has been used in negotiations with enterprises and in the determination of adjustments during several transfer pricing audits.

4. Handling transfer pricing audit and negotiation process

In practice, careful preparation and practical experience in negotiating with the tax authorities are critical factors in successfully and efficiently concluding a transfer pricing audit. Preparation includes pre-audit planning and thorough review and enhancement (where necessary) of the existing documentation system in order to make timely submission of information during the actual audit.

F. Our recommendations

It is recommended that enterprises in Vietnam should keep themselves constantly updated with the fast changing practices and developments in the Vietnam transfer pricing regulatory landscape and proactively take steps to manage potential transfer pricing risk and scrutiny from the Vietnam tax authorities.At a minimum, enterprises should ensure the following:

- Timely lodgment of the annual transfer pricing disclosure form;
- Preparation/maintenance of contemporaneous transfer pricing documentation in accordance with Circular 66;
- Review and redesign (where necessary) of current transfer pricing policy or structure to ensure that it is consistent with the Vietnam transfer pricing regulations and international best practices.

DFDL Vietnam provides legal and tax services across all sectors and practice areas. In relation to transfer pricing services, DFDL works with its strategic alliance partner Quantera Global. Together we are ready to discuss with you, your company’s transfer pricing needs and requirements and provide you with best practice and highly cost effective solutions

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