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Vietnam: Transfer Pricing in the Spotlight

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Vietnam has been on an impressive economic growth trajectory for some years. It has drawn in significant foreign investment from the world's largest companies and is increasingly seen—along with Thailand, Indonesia and Malaysia—as an alternative manufacturing base to China for US, European, Japanese and Taiwanese companies. While such investment is stimulating growth and creating employment, there is growing recognition that such companies are not always profitable and therefore contributing corporate income tax. The answer, in the view of the General Department of Taxation, lies in transfer pricing compliance and enforcement.

The Global Picture

On a global scale, transfer pricing has never been more relevant than it is today. The Organization for Economic Cooperation and Development (OECD) has been leading the way in terms of tightening up the framework of transfer pricing and information exchange in order to address the many challenges of transfer pricing compliance and enforcement as well as other tax planning. The Base Erosion and Profit Shifting (BEPS) initiative of the OECD has created a global template for further action in this area and encouraged a broad range of individual initiatives within and between countries, such as bilateral information exchange, double tax agreements and tightening of treaty shopping, beneficial ownership and transfer pricing rules.

High profile cases include Apple being called before a Senate sub-committee in the US to explain its tax position; Google facing unprecedented scrutiny in the US, France, Australia and other countries as a result of aggressive transfer pricing and tax planning schemes; and Starbucks facing a boycott of its stores in the UK due to a perception that it was not paying its "fair share" of tax to the UK revenue authority.

The Vietnam Response

In transfer pricing terms, Vietnam has been one of the fastest evolving jurisdictions in Asia in recent years. A framework has been established and the tax authorities are now actively applying this to crack down on multinationals considered to be profit shifting at the expense of the Vietnamese tax revenue.

Since 2010 transfer pricing has been governed primarily by Circular 66/2010/TT-BTC (Circular 66). This circular reinforces the contemporaneous documentation requirement as well as the requirement to submit the annual declaration form. A requirement to report on related party transactions and prepare documentation is not new or unique; however, what is of interest is the vigor by which the circular is being enforced by the Vietnam General Department of Taxation (GDT). Recent data indicates that 122 Foreign Invested Enterprises (FIEs) have been audited and found to be in breach of the transfer pricing rules, leading to additional tax payments of VND214 billion (USD10.1 million). At this stage, Hanoi is the leading jurisdiction in terms of enforcement, with Ho Chi Minh City ranked second. Other cities such as Thai Binh, Quang Ninh, Lam Dong and Hai Phong VND are also collecting significant additional tax revenue from transfer pricing adjustments.

Notable foreign brands making news in Vietnam for suspected transfer pricing abuses include Coca Cola, Pepsi, Metro, Unilever, British American Tobacco and Adidas. In the case of Coca Cola, the company has reported losses in Vietnam for the last decade amounting to US$180 million. Although it has not been proven, the assumption of the tax authorities has been that this is a result of non-arm's length transfer pricing policies. The company argues it is close to making a profit, that the Vietnam market has required considerable investment due to various unique characteristics, and furthermore that it is in investing a further US$300 million to expand sales and achieve profitability. The most recent development has been the introduction of a new draft circular on the Advance Pricing Arrangement (APA) program. APAs enable taxpayers to agree a level of profitability in advance with the tax authorities and therefore, assuming the agreed profit level is achieved, avoid scrutiny or compliance obligations during that period. It has been reported that companies such as Samsung are already involved in the pilot APA program.

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What Do You Need to Do?

The development of transfer pricing in Vietnam has to date mirrored that of China, with a lag of around five years. Firstly, disclosure obligations and documentation requirements are used to gather information and perform risk assessments. Secondly, specific transfer pricing audits are undertaken, targeting loss makers, high risk transactions or specific industry groups. This is complemented with an APA scheme to provide, for select taxpayers, a possible path to transparency and certainty on both sides.

If the China experience continues to be a reliable barometer, the transfer pricing challenge for multinationals is not going to disappear, as the Vietnam GDT continues to seek tax revenue to fund infrastructure and social services in a difficult global climate. The initiatives of the OECD will continue to provide the tools while also ensuring that transfer pricing is viewed as a global problem that needs to be addressed holistically, in addition to local country enforcement.

It is important for multinationals doing business in Vietnam to be aware of these developments and of the global as well as local picture, to analyze their transfer pricing systems and proactively address how best to manage their risk and compliance obligations going forward. Such an approach is always more efficient and cost effective than waiting for an audit and then being on the back foot in seeking to defend a position. Taxpayers can now also consider APAs as a means of establishing a model of cooperation with tax authorities and efficiently managing future tax positions.

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