79.

Vietnam

Introduction

Vietnam has been carrying out economic reforms since 1986 under the *'Doi Moi'* (Renovation) policy, which focuses on market-oriented economic management. This reform has included: (1) restructuring to build a multi-sector economy; (2) financial, monetary and administrative reform; and (3) the development of external economic relations.

One of the most important aspects of economic reform in Vietnam has been the encouragement of domestic and foreign private investment with the introduction of the Law on Foreign Investment in 1987. The first tax law was introduced in the early 1990s. Since then the tax system has been subject to various changes and amendments. The first proper transfer pricing regulations were introduced at the end of 2005 and came into force in 2006.

Below is a summary of the historical evolution of transfer pricing regulations in Vietnam, which reflects not only the Vietnamese competent authorities' increasing concerns about transfer pricing issues, but also the progress of their awareness thereon.

On 20 October 1997, the Ministry of Finance (MOF) issued Circular 74-TC/TCT which was the earliest legal document to define related parties from a Vietnamese context. However, the applicability of this circular was limited to foreign-invested enterprises. Circular 89/1999/TT-BTC which was issued on 16 July 1999 also provided guidance on the definition of related parties. However, both these circulars did not specifically stipulate the transfer pricing methods to be used or the documentation requirements

MOF issued Circular 13/2001/TT-BTC (Circular 13) on 8 March 2001 to provide guidelines on the implementation of the Law on Corporate Income Tax applicable to foreign-invested enterprises. This circular specified three traditional transfer pricing methods applicable to the determination of the arm's-length nature of related party transactions as follows:

- Comparable uncontrolled price method.
- Resale price method.
- Cost plus method.

However, Circular 13 did not provide detailed guidelines on the application of the statutory methods or guidance on documentation requirements.

The Law on Business Income Tax (the BIT Law) issued in 2003, which came into force on 1 January 2004, requires all transactions between related parties to be conducted at market prices. Pursuant to the BIT Law, the MOF issued Circular 117/2005/TT-

BTC (Circular 117) in 2006 to provide guidelines on related party transactions and disclosure of documents and information thereof. Circular 117 is applicable to cross-border and domestic related party transactions. Besides the requirement for companies to comply with the arm's-length standard, it also requires companies to submit an annual transfer pricing declaration form and maintain contemporaneous transfer pricing documentation as from 2006 onwards. Non-compliance will be subject to a fine of up to 5 million Vietnamese dong (VND).

On 22 April 2010, the MOF issued Circular 66/2010/TT-BTC (Circular 66), replacing Circular 117. Circular 66 came into force on 6 June 2010.

Similar to Circular 117, Circular 66 retained the main compliance requirements (i.e. requiring corporate taxpayers to comply with the arm's-length principle, submission of annual transfer pricing declaration form, and maintaining contemporaneous transfer pricing documentation). However, Circular 66 also introduced several changes which tightened the transfer pricing requirements. For example, the circular clarifies that the median value of an interquartile range will be used to benchmark against companies' margins for the purposes of transfer pricing adjustments, and greater information is required to be disclosed in the annual transfer pricing declaration form (new categories of related party transactions, nature of related party relationships, related party addresses and tax codes are now required).

Statutory rules

At present, Circular 66 is considered the most comprehensive transfer pricing regulation in Vietnam.

From a technical viewpoint, the Vietnamese transfer pricing regulations under Circular 66 are modeled on the Organisation for Economic Co-operation and Development (OECD) Guidelines. Circular 66 adopts the arm's-length principle and the transfer pricing methods set out in the OECD Guidelines.

Scope of application (Part A, Article 1 and 2)

Persons covered

The provisions of Circular 66 are applicable to organisations that are subject to BIT in Vietnam and are carrying out business partly or wholly in Vietnam with related parties.

Transactions covered

Any transaction which is carried out between related parties (e.g. buying, selling, exchanging, leasing, renting, transferring or concession of goods or services) may come under the scope of Circular 66. However, related party transactions involving products whose price is placed under state control are excluded from the scope of the said circular.

Definition of related parties

The definition of related parties in Circular 66 is much broader than that of the OECD Model. First, the threshold of capital participation of 20%, either directly or indirectly, is much lower than that set out in many other countries. However, the definition of related parties goes beyond ownership/control criteria. It also includes significant business relationships between unrelated parties. For example, when a Vietnamese company's sales or purchases from an independent entity exceed 50% of the total sales

or the sum total of cost of raw materials, materials and supplies or input products, these transactions are regarded as related party transactions.

The related party definition also extends to intangible assets/intellectual property and company financing. For example, parties are considered as being related when:

- an enterprise uses intangible assets/intellectual property provided by another party that accounts for more than 50% of its production costs, and
- an enterprise guarantees the other enterprise's loans, or makes a loan to the other enterprise where the loans account for at least 20% of the charter capital of the borrower and more than 50% of the total liabilities of the borrower.

Under Vietnamese transfer pricing regulations, parties with any of the following management or business relationships would also be considered related:

- One party is directly or indirectly engaged in the management, control, contribution of capital to or investment in the other party.
- The parties are directly or indirectly subject to the management, control, capital contribution or investment in all forms by another party.
- The parties directly or indirectly participate in the management, control, capital contribution or investment in another party.
- Two parties have entered into a business cooperation agreement on a contractual basis.

The extension of the related party definition under Circular 66 has rendered many parties, which would otherwise be considered as unrelated, to be classified as related parties for Vietnam transfer pricing purposes.

Similar to the OECD Guidelines, Circular 66 also contains guidelines on the following four key subjects: comparability analysis, transfer pricing methods, selection and application of the most appropriate method, and documentation.

Comparability analysis
Part B, Article 4 of Circular 66 has detailed guidance with respect to the comparability analysis. When comparing a related-party transaction against a comparable unrelated-party transaction, a comparability analysis must be carried out and adjustments made (if necessary) to the following four main influential factors:

- Product property/characteristics.
- Operational functions.
- Contractual terms.
- Economic terms in which the transactions take place.

The priority given to each of the above factors in the comparability analysis varies depending on the most appropriate transfer pricing method selected. Under the comparability analysis, the factors that are considered to be the main influential factors need to be analysed in detail, while the auxiliary factors should be analysed only at a high level.

Transfer pricing methods

Part B, Article 5 of Circular 66 sets out five transfer pricing methods to be used for determining the arm's-length price. These methods are similar of the transfer pricing methods specified in the OECD Guidelines which are as follows:

- Comparable uncontrolled price (CUP) method.
- Resale price method (RPM).
- Cost plus (CP) method.
- Comparable profit method (CPM).
- Profit split method (PSM).

Furthermore, the Vietnamese transfer pricing regulations recommend that preference be given to the comparison of the transfer price or profit margin of transactions with related parties against those with unrelated parties of the same taxpayer (internal method).

Documentation

Vietnamese taxpayers are required to record and maintain contemporaneous documentation, and to submit that documentation to the tax authorities within 30 days upon their request. Transfer pricing documentation under Circular 66 should include:

- General information on the business establishment and related parties.
- The business establishment's transactions.
- The methods of calculation of arm's-length prices.

The taxpayer is required to use data of at least three continuous fiscal years for benchmarking purposes where transfer pricing methods involve the use of profit margins.

Further, at year-end, taxpayers are required to disclose related-party transactions via a transfer pricing declaration form (i.e. form GCN-01/QLT), which is submitted together with the annual BIT return which is filed within 90 days of the end of a taxpayer's financial year end.

Other regulations

In addition to Circular 66, which specifies transfer pricing for tax purposes, the following regulations promulgated by the MOF are also relevant to transfer pricing issues:

In December 2003 the MOF issued a number of Vietnamese Accounting Standards (VAS) including Standard No. 26 'Related-Party Disclosures' which sets out general guidelines on the accounting principles and treatment in the financial statements for related-party disclosures and transactions between a reporting enterprise and its related parties.

This accounting standard provides a definition of related parties, outlines possible related-party transactions and their influences, and specifies required disclosures with regard to related-party transactions. Standard No. 26 also provides guidelines on the determination of price for transactions between related parties (i.e. the CUP method, the RPM and the CP method).

On 16 March 2007, the government also issued Decree 40/2007/ND-CP which provides guidelines on the customs valuation for import duties in the case where buyers and suppliers are considered related parties with respect to capital participation, management, business relationships and family relationships.

Based on this regulation, where the buyer and the supplier are considered to be related parties, the Customs Office uses the following methods to determine the taxable price of goods:

- Transaction value method with identical goods: Comparison with the price of identical goods imported into Vietnam within 60 days before or after the date of delivery.
- Transaction value method with similar goods: Comparison with the price of similar goods imported into Vietnam within 60 days before or after the date of delivery.
- Deductive value method: Calculation of the price of imported goods based on the resale price of similar products after the deduction of reasonable expenses.
- Computed value method: Calculation of the price of imported goods based on material costs, production expenses and profits.
- Fall-back method: Combined or modified version of the above methods.

Legal cases

No legal cases concerning transfer pricing have been decided by the courts to date. Any cases involving disputes on transfer pricing issues have so far been settled out of court and the details have not been published. In order to set examples, it is anticipated that the tax authorities could bring cases involving abuses of transfer pricing to the courts in the future.

Burden of proof

In accordance with prevailing regulations in relation to transfer pricing and tax administration, the taxpayer is obliged to satisfy the burden of proof by:

- disclosing related-party transactions on a transfer pricing declaration form accompanied by the annual BIT return, and
- documenting and reporting information/evidence regarding related-party transactions and the relevant related parties in a transfer pricing documentation demonstrating that the related-party transactions are consistent with the arm's-length principle set out in the transfer pricing regulations.

The record keeping and documentation requirements under Circular 66 are onerous. The taxpayer is required to submit transfer pricing documentation within 30 days from the date of the request. A one-time extension of another 30 days may be accepted if it is considered reasonable.

Tax audit procedures

In accordance with prevailing tax administrative regulations under Circular No. 60/2007/TT-BTC issued by the MOF on 14 June 2007, a tax audit can be conducted at the tax office or at the taxpayer's premises. Based on the result of the tax audit at the tax office, the tax authorities may decide to conduct a tax audit at the taxpayer's premises and will then issue the audit decision to the relevant taxpayer.

Tax audit procedure at the tax office (desk review)
Tax officials examine the tax declaration dossier filed by the taxpayer to verify whether the tax amount assessed and declared by the taxpayer is appropriate based on a comparison with relevant data available to the tax authorities. In the case of an abnormality in the declared tax amount or missing information which could point to tax evasion or the underdeclaration of taxes, the relevant taxpayer is required to provide an explanation and additional information/evidence within ten days from the date of receipt of the authorities' first request. If further information is still required by the tax authorities, the taxpayer has five days from the date of receipt of the second request of the tax authorities to provide information to justify his/her tax liability assessed and declared in the tax return.

After the second request, if the taxpayer fails to justify the appropriateness of his/her tax liability declared either with or without additional information/explanation, the tax authorities are entitled to:

- Assess the tax liability of the taxpayer in question based on the information/data available to the tax authorities.
- Issue a decision to carry out a tax audit at that taxpayer's premises if the information/data available to the tax authorities is not considered adequate to issue an assessment of the tax liability as above.

Tax audit procedure at taxpayer's premises
The execution of the tax audit must be carried out within 10 working days from the date of the issuance of the decision to perform a tax audit at the taxpayer's premises. However, the decision on such a tax audit shall be cancelled if, before the tax audit starts, the taxpayer can justify the appropriateness of the declared tax liability or accepts and pays the tax amount assessed by the tax authorities.

The duration of a tax audit at a taxpayer's premises should not exceed five working days. A one-time extension of another five days is permissible if necessary.

At the end of a tax audit, a report must be issued describing the findings and conclusions of the tax auditor team. The taxpayer has the right to make a formal objection to the conclusion of the tax audit team.

If the result of the tax audit raises concerns on potential tax evasion or fraud, the case is reported to the head of the relevant tax authority for further investigation and/or inspection.

Tax inspection
In practice, tax inspections are normally conducted on the basis of an annual plan developed by the tax authorities, except where there are signs of tax evasion and/or fraud, for the purpose of resolving appeals, or at the request of the heads of tax administration bodies at all levels or by the Minister of Finance. A taxpayer can be subject to tax inspection not more than once per year.

Where the tax law has been infringed, a tax inspection can be conducted only if the tax authorities have evidence of tax underpayment, tax evasion, or tax fraud.

A decision on tax inspection has to be communicated to the taxpayer within 15 days from the date of issuance. The duration of a tax inspection cannot exceed 30 days. A one-time extension of another 30 days may be permitted under certain conditions.

At the end of a tax inspection, a report must be issued to document the findings, including the opinion of each inspection team member. The taxpayer has the right to make a formal objection to the inspection team's observations.

Within 15 working days from the date of receipt of the inspection report, the head of the relevant tax authority must issue a letter specifying the result of the tax inspection. If the taxpayer still disagrees with the conclusion of the tax authorities, he/she can file an appeal following the procedure stipulated in the law on appeals.

As there is no audit procedure set out specifically for transfer pricing, a transfer pricing audit could be implemented separately or in conjunction with a tax audit adopting the said procedures. The tax authorities have increased their focus on transfer pricing by undertaking the following initiatives:

- Companies with related party transactions and loss making companies are likely to be targeted for audits.
- Increasing number of transfer pricing queries raised during normal tax audits.
- Compilation of a target list for transfer pricing audits, comprising both multinational enterprises and local companies that generate consecutive losses.
- Carry out desk reviews and focus on factual analysis.
- Request for transfer pricing declaration forms and transfer pricing documentation from taxpayers.

On 21 May 2012 the MOF released guidance on action plans concerning transfer pricing for the period 2012 to 2015 via issuance of Decision 1250 / QD – BTC. The General Department of Taxation (GDT) will primarily be responsible for implementation of the transfer pricing action plan.

Such action plans are not intended to create an aggressive transfer pricing/tax regime for inbound investments but focuses on transfer pricing audits and 'abusive' transfer pricing practices. Under the action plan, the focus is on five key elements:

1. Transfer pricing audits in 20% of annual tax audits / inspections at both the central and provincial levels, with a transfer pricing audit manual to be developed:

   Under the said Decision, at least 20% of annual tax audits / inspections at both central and provincial levels will be carried out for transfer pricing purposes. In conjunction with such efforts, a formal transfer pricing audit manual will also be developed.

   In addition audits will likely be carried out on companies with significant related parties or those which carry out transactions deemed high transfer pricing risks.
2. Enhance transfer pricing regulations by introducing specific guidance on managing abusive transfer pricing practices:

   GDT will introduce specific guidance on management of abusive transfer pricing practices. As such, the requirements of taxpayers' statutory transfer pricing disclosures will also be increased.

3. Enhance capacity of transfer pricing auditors, by building on practical audit experience and international practices:

   To set up specialised transfer pricing task force team at the GDT. Such efforts will also be replicated at provincial level.
4. Creation of a database of companies operating in 'high' transfer pricing risk sectors and of prices for certain products:

   A database comprising of both secret comparables (to be collected internally within the revenue authorities and from different ministries) and external sources (including independent databases and foreign tax authorities via an exchange of information) will be set up by the GDT.
5. Coordination among government ministries and international cooperation with foreign tax authorities:

   Enhance exchange of information and technical capabilities for implementation of Agreement for the Avoidance of Double Taxation and Prevention of Fiscal Evasion among government ministries and foreign tax authorities for the purpose of transfer pricing management.

   Other initiatives include educating taxpayers in respect of transfer pricing compliance. Tax officers will also be educated on identifying and analysing transfer pricing abuses by taxpayers.

Revised assessments and the appeals procedure

In the event that the taxpayer considers the administrative action taken by the tax official or the decision issued by the tax authorities (e.g. in relation to tax liability, tax reimbursement, tax exemption/reduction, including the conclusion of the tax audit) is a breach of the taxpayer's rights, the taxpayer is entitled to file an appeal against this decision.

To resolve appeals the authorities follow the administrative hierarchical order from the local office to the MOF. The head of each hierarchical body is responsible for resolving the appeal against the administrative decision issued by his/her office and/or action taken by his/her staff or by him/her.

The appeals procedure is the same as that of the general laws on appeals. In practice, where the taxpayer disagrees with the conclusion of the tax inspection of the competent authorities, including the MOF, the taxpayer can file an appeal in the administrative court against the conclusion in question. However, there is no tax court in Vietnam.

Additional tax and penalties

Currently, no specific penalty is provided for in the transfer pricing regulations under Circular 66. However, tax authorities have the right to assess and make appropriate adjustment, as the case may be, to the transfer price, taxable income or tax amount payable where they have evidence that the taxpayer has committed tax evasion or fraud by manipulating transfer prices with related parties. In this case, the adjustment to be made is established by transfer prices or profit margins established by unrelated parties. The value of transfer prices or profit margins used for tax authorities' assessment is not to be lower than the median of the arm's-length range.

Further, in accordance with the Law on Tax Administration and its implementing guidelines, noncompliance subjects the taxpayer to the following categories of penalty:

- Non compliance with tax filing procedures and/or submission of incomplete returns could be subject to a penalty of up to VND 5 million.
- Late payment of tax is subject to interest of 0.05% per day of the outstanding tax amount.
- Underreporting of tax liabilities could be subject to a penalty of up to 10% of the underpaid amount, regardless of whether the taxpayer keeps all related supporting documents and presents them to the tax authorities upon request.
- Tax evasion could be subject to a penalty of up to three times the outstanding tax liability.

Resources available to the tax authorities

The various departments within the GDT that are presently handling transfer pricing matters are the Policy, Tax Reform and Modernisation department), the Inspectorate (i.e. Inspection department) and the International Cooperation (i.e. the International Taxation department).

The Inspectorate department within the GDT, along with the provincial tax departments, carries out transfer pricing audits as part of the general tax audits. In an attempt to reinforce transfer pricing audit capacity at the provincial level, the GDT has recently organised transfer pricing audit trainings for tax officials.

At the local level, each provincial tax department has a number of transfer pricing specialists who are responsible for information gathering and reporting transfer pricing compliance periodically to the GDT in addition to participating in transfer pricing audits conducted by the GDT team.

In addition to the sponsorship by international organisations, the Vietnamese tax authorities also receive support from other tax authorities in the region to build capacity internally as well as educating the public on the transfer pricing regulations.

Use and availability of comparable information

The Vietnamese transfer pricing regulations state that only the databases recognised formally by the government are acceptable to be used for benchmarking purposes. However, to date no such recognised databases that are available in Vietnam are suitable to use for benchmarking purposes. Currently in performing a comparability search, companies rely on Asia-Pacific regional comparable companies as a comparative benchmark.

Over the last couple of years, the Vietnamese tax authorities have gathered information on financial information of companies in order to establish its own database of comparable information. Once it is ready, this database will be used for tax assessment by the tax authorities.

Risk transactions or industries

Formally, no industry or transactions are classified as particularly high risk from the transfer pricing audit or investigation perspective. However, companies producing high-value goods and having significant related party transactions, such as in automobile and motorbike manufacturing and related parts manufacturing, would

likely be a high-risk industry. In practice, a company which posts continuous losses (e.g. for three continuous years) and/or large companies with significant related-party transactions are likely to be challenged by the tax authorities, in particular where the company carries out business with related parties located in a tax haven/harbour.

Limitation of double taxation and competent authority proceedings

Vietnam has more than 60 DTAs concluded with other countries and territorial areas. Most DTAs contain an 'Associated Enterprise' Article modeled on the OECD convention. However, a large number of DTAs exclude the provision which permits the respective tax authorities to adjust the profit of an entity where the transaction is judged not to be at arm's length (paragraph 2 of Article 9 of the OECD convention model). On the other hand, a number of DTAs include the previously mentioned provision but exclude the accompanying provisions in the article requiring one contracting country to reduce the amount of tax charged to offset the increased tax liability imposed by the other contracting country as a result of the arm's-length adjustment. Currently, there is no set procedure laid out for the initiation of an Mutual Agreement Procedure in event of double taxation as a result of transfer pricing adjustment or otherwise.

Advance pricing agreements (APAs)

Currently, there is no provision for APAs in the Vietnam Tax Legislation. The amendment to the law on tax administration is expected to include provisions that will serve as a legal basis for the application of APAs in Vietnam. The MOF is launching a pilot APA program to enter into bilateral APAs with a few large foreign investment companies operating in Vietnam in order for MOF to gain practical experience and form a basis in adopting appropriate approaches, before promulgating the formal APA regulations.

Anticipated developments in law and practice

Subsequent to the issuance of the first transfer pricing circular (Circular 117), the tax authorities have become more aware of the importance of transfer pricing issues and have attempted to improve transfer pricing compliance management by improving transfer pricing knowledge and auditing skill of tax inspectors, and by amending the transfer pricing regulations, such as the issuance of Circular 66 in April 2010.

Liaison with customs authorities

In 2002 the customs authorities (the GDC) were merged into the MOF. As a result, the cooperation between the GDT and the GDC has improved significantly. To date, each taxpayer is assigned a unique tax identification number (TIN) which is used for both domestic tax and customs duty declaration.

The GDT and GDC are now working to improve information exchange. The objective of the project is for taxpayers' information to be exchanged automatically on a regular basis between the GDT and the GDC.

OECD issues

Vietnam is not a member of the OECD. However, the Vietnamese transfer pricing regulations has adopted the arm's-length principle and the transfer pricing methodologies endorsed by the OECD Guidelines. However, the OECD Guidelines are not formally referred to in the Vietnamese transfer pricing regulations. Also, a

transfer pricing policy that is acceptable in an OECD country will not necessarily be accepted in Vietnam (e.g. besides the absence of an APA mechanism as mentioned above, the Vietnamese transfer pricing regulations do not adopt safe harbour principles recommended in the OECD Guidelines).

Joint investigations

So far, no joint investigations have been undertaken by the Vietnamese tax authorities in conjunction with other tax authorities. However, in accordance with the provision of the exchange of information of the DTAs, the GDT has actively participated in information exchange with other tax authorities.

Thin capitalisation

The arm's-length principle applies to loans and interest charges. However, at present, there are no rules dealing specifically with thin capitalisation and no set permissible debt-to-equity ratios.