Media title: New transfer pricing decree: a step closer to international standards
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New transfer pricing decree: a step closer to international standards

On February 24, 2017, the Vietnamese government released the new transfer pricing (TP) Decree No. 20/2017/ND-CP 'Providing tax administration applicable to enterprises having controlled transactions' (Decree 20), which will take effect from May 1, 2017.

Decree 20 replaces the existing TP regulations (Circular No.66/2010/TT-BTC) and provides new compliance requirements in Vietnam.

While Decree 20 is loosely based on Circular 66, it extends the interpretation of existing provisions and introduces additional concepts and principles from the Organization for Economic Cooperation and Development (OECD) Guidelines and Base Erosion and Profit Shifting (BEPS) Framework.

The preamble sets out the decree's objective of administering transfer pricing in order to prevent the loss of tax revenue to the state budget. It also introduces the concept of 'substance over form' to be applied by tax officials in the administration, examination, and auditing of transfer pricing. This notion forms the basis of the subsequent articles and provisions in the decree.

Salient points of the new decree

Decree 20 introduces a three-tiered TP documentation approach to collect more tax-related information on multinational companies' (MNC) business operations. The new decree follows the approach set out in the BEPS Action Plan 13 (Guidance on TP Documentation and Country-by-Country Reporting). Specifically, a taxpayer is required to prepare and maintain three-tiered TP documentation, including a master file, local files, and Country-by-Country Reporting.

The decree also provides detailed guidance on comparability analysis, including the use of data sources, selection of TP methods, the minimum number of comparable companies required, and other adjustment factors (such as location specific advantages).

Furthermore, Decree 20 introduces a new set of TP declaration forms that require disclosure of more detailed information, including segmentation of profit and loss by related parties and third party transactions. The substantial gap between the margins earned on related and third party transactions may increase taxpayer's risk profile and trigger queries from tax authorities.

Decree 20 extends its scope beyond TP to also provide guidance on the deductibility of intercompany charges. This includes a limitation on the tax deductibility of interest on loans that is capped at 20 per cent of EBITDA. For intercompany services, various criteria for tax deductibility are set out, notably, a taxpayer needs to demonstrate that the services provide economic benefit and provide evidence (supporting documents) on the reasonableness of the service charge calculation method. A tax deduction is disallowed for expenses in which the direct benefit or additional value to the taxpayer cannot be determined, such as duplicated services, shareholder costs, etc.

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Practical challenges

The release of Decree 20 creates a more solid and expansive legal basis for the Vietnamese transfer pricing administration and brings the country closer to international standards with the changes in transparency and anti-tax avoidance efforts.

A key concern, however, is the practicality of applying these international standards in the Vietnamese environment. For instance, there is a lack of comparable local data which taxpayers can use to apply the TP methods in the decree to determine and set their intercompany prices. This raises concerns from taxpayers over broadening the use of comparable data (e.g., using data of other Asian companies) and the acceptance of such approach by tax authorities in practice. Furthermore, Decree 20 gives tax authorities the power to use the government's internal databases for TP assessment purposes in cases where a taxpayer is deemed noncompliant with the requirements of the decree. This type of development could clearly give rise to increasingly lengthy disputes.

Decree 20 also emphasises that the TP method applied must ensure that there is no loss of tax revenue to the state budget, which implies an asymmetry which could be inconsistent with the arm's length principle (e.g. no downward adjustments allowed). In addition, there is no guidance on how adjustments should be done and the potential impact on other taxes (e.g. VAT, import duty, etc.).

Despite some of these concerns, Decree 20 represents the most important development of the TP regime in Vietnam for the last 10 years, as it demonstrates Vietnam's commitment to align with the global tax framework (BEPS) on transparency and anti-avoidance. While the new decree aims to enhance transfer pricing enforcement, it also increases the compliance burden on taxpayers. Although the compliance obligation of the decree will be effective from May 1, 2017, taxpayers should take immediate action to assess the impact not only on local tax compliance, but also on their businesses, considering the new decree has potential implications beyond transfer pricing.

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