Vietnam releases new transfer pricing decree

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In brief

On February 24, 2017, the Vietnamese government released transfer pricing 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. The new decree includes substantial changes to the existing transfer pricing regulations, including three-tiered transfer pricing documentation requirements, new transfer pricing declaration forms, and guidance on the deductibility of related-party expenses and interest.

In detail

In line with Vietnam’s tax reform plans, as well as the changing global landscape on transparency and combatting tax avoidance, the issuance of Decree 20 was placed high on the government’s tax reform agenda.

Decree 20 replaces the existing transfer pricing regulations (Circular 66/2010/TT-BTC). It provides new transfer pricing compliance requirements — including three-tiered transfer pricing documentation, new transfer pricing declaration forms, and guidance on the deductibility of related-party expenses and interest — all of which are substantial changes to the existing rules.

While Decree 20 is loosely based on Circular 66, Decree 20 extends the interpretation of existing provisions and introduces additional concepts and principles from the Organisation for Economic Co-operation and Development’s (OECD’s) Transfer Pricing Guidelines and Base Erosion and Profit Shifting (BEPS) Action Plan. 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 audit of transfer pricing. This notion forms the basis of the subsequent articles and provisions in the decree.

We summarize below the relevant points of the decree.

Related party definition
The ownership threshold is increased to 25% from the current 20%. In addition, two entities no longer are treated as related parties by virtue of having transactions between them accounting for more than 50% of sales or purchases. Decree 20 also provides some relief to small businesses, which may be eligible for exemptions from transfer pricing documentation under certain facts.

Transfer pricing documentation, new form
Decree 20 introduces a three-tiered transfer pricing documentation approach to collect more tax-related information on the business operations of multinational companies (MNCs). The new decree follows the approach set out in BEPS Action 13 (guidance on transfer pricing documentation and country-by-country reporting). Specifically, an affected taxpayer must prepare and maintain a master
file, a local file, and country-by-country (CbC) report.

The taxpayer must maintain CbC reporting if (1) the ultimate parent company also is obliged to prepare and submit such documents in its respective tax jurisdiction or (2) the taxpayer is a Vietnamese ultimate parent company with worldwide consolidated revenue in a fiscal year exceeding VND 18 trillion. If a taxpayer cannot provide the report, the taxpayer must provide a written explanation for the reason, the legal basis, and reference to specific provisions from the law of the counterparty jurisdiction that prohibits the taxpayer from providing a copy of the CbC report.

A taxpayer is exempt from preparing transfer pricing documentation (but not from all other aspects of Decree 20) if one of the following conditions is met:

- The taxpayer has revenue below VND 50 billion and the total value of related-party transactions is below VND 30 billion in a tax period;
- The taxpayer concludes an APA and submits annual APA reports; or
- The taxpayer has revenue below VND 200 billion and performs simple functions and achieves at least the following ratios of earnings before interest and tax to revenue on its respective business: distribution (5%), manufacturing (10%), processing (15%).

The three-tiered transfer pricing documentation must be prepared before the submission date of the annual tax return.

Observation: This gives taxpayers just 90 days (from the fiscal year-end date) to complete the year’s transfer pricing documentation.

Decree 20 introduces a new transfer pricing declaration form that requires disclosure of more detailed information, including segmentation of profit and loss by related-party and third-party transactions. Any gap between the margins earned on related-party and third-party transactions may increase the taxpayer’s risk profile and trigger queries from tax authorities.

Taxpayers engaged in related-party transactions solely with domestic related parties may be exempt from disclosing information on such transactions in the new transfer pricing declaration form, under the condition that both parties have the same tax rate and neither party enjoys tax incentives.

Deductibility of expenses

According to Decree 20, the tax deductibility of interest on loans is capped at 20% of earnings before interest, tax, depreciation, and amortization (EBITDA). While this provision is included in Decree 20, it applies to both related-party and third-party loans. There are no carry-forward or carry-back provisions.

For intercompany services, various criteria for tax deductibility are set out. Notably, a taxpayer must demonstrate that the services provide economic benefit and to provide evidence (supporting documents) on the reasonableness of the service charge calculation method. A tax deduction will not be allowed for expenses where the direct benefit or additional value to the taxpayer cannot be determined, such as duplicated services or shareholder costs. Further, the mark-up portion of third-party expenses that are recharged to a Vietnam taxpayer are not deductible.

Benchmarking

Decree 20 provides detailed guidance on comparability analysis, including the use of data sources, selection of transfer pricing methods, minimum number of comparable companies, and other adjustment factors (such as location-specific advantages). Comparable data needs to correspond with the same financial year as the tested party/transactions. However, preceding-year data can be used if current information is not available in the database at the time the benchmarking analysis is conducted.

Decree 20 gives tax authorities the power to use internal databases for transfer pricing assessment purposes in cases where a taxpayer is deemed noncompliant with the requirements of the decree.

Observation: This type of development clearly could give rise to increasingly lengthy disputes.

Other observations

- Decree 20 emphasizes that the transfer pricing method applied must ensure that there is no loss of tax revenue to the state budget. This implies an asymmetry that may be inconsistent with the arm’s-length principle (e.g., no downward adjustments allowed). In addition, there is no guidance on how adjustments (e.g., upward) should be done and the potential impact for other taxes (e.g., value added tax and foreign contractor tax).

- A taxpayer that performs routine functions, including manufacturers and distributors that bear no market and inventory risks and do not engage in strategic decision-making activities, shall not incur losses. The interpretation of companies falling into the category
of ‘routine’ functions could be highly subjective, and consequently could give rise to disputes on losses and the characterization of entity.

**The takeaway**

Decree 20 represents the most important development with respect to Vietnam’s transfer pricing regime in the last 10 years. It demonstrates Vietnam’s commitment to aligning 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 burdens on the taxpayer. Although the compliance obligations 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 the business, considering that Decree 20 has potential implications beyond transfer pricing.

**Let’s talk**

For a deeper discussion of how this issue might affect your business, please contact:

**Transfer Pricing**

Joseph Vu  
+84 4 3946 2246, Ext. 1506  
joseph.vu@vn.pwc.com

Monika Mindszenti  
+84 8 3823 0796, Ext. 1506  
monika.mindszenti@vn.pwc.com

**Transfer Pricing Global and US Leaders**

Isabel Verlinden, *Brussels*  
Global Transfer Pricing Leader  
+32 2 710 44 22  
isabel.verlinden@be.pwc.com

Horacio Peña, *New York*  
US Transfer Pricing Leader  
+1 646 471 1957  
horacio.pena@us.pwc.com

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