9 March 2017

Global Tax Alert

News from Transfer Pricing

Vietnam issues new transfer pricing decree effective 1 May 2017

EY Global Tax Alert Library

Access both online and pdf versions of all EY Global Tax Alerts.

Copy into your web browser:

www.ey.com/taxalerts

Executive summary

On 24 February 2017, Vietnam's Government issued Decree No. 20/2017/ND-CP on the tax administration of enterprises with related party transactions (the Decree). The Decree is effective from 1 May 2017.

The Decree introduces various new concepts, including but not limited to:

- Principle of "substance over form"
- Three-tiered transfer pricing (TP) documentation
- Specific guidance on the tax treatment of intra-group service charges, interest, intangibles, purchase of fixed assets and profit allocation to routine functions

The Decree also provides guidance on comparability and benchmarking analysis, introduces certain changes to the annual TP disclosure form and provides certain exemptions with respect to TP compliance obligations.

This Alert outlines the changes and highlights the possible impact on taxpayers' compliance obligations and their business operations.

Building a better working world

Detailed discussion

Related party relationships and transactions

The Decree expands and covers more detailed types of related party transactions subject to TP compliance, including specifically the use of common resources such as group synergies, a shared service center and cost sharing between related parties.

The Decree increases the 20% direct or indirect ownership threshold to 25% when determining whether parties are related. In addition, enterprises are also related if they are under the common control of an individual through that person's contributed capital or direct management.

The Decree removes specific percentages in determining a control element; however, where a company is in substance controlled or managed by the other party, the parties will generally be considered related for TP purposes.

Three-tiered TP documentation and annual TP disclosure

The Decree introduces three-tiered TP documentation requirements in line with the Organisation for Economic Co-operation and Development's Base Erosion and Profit Shifting Action Plan 13 covering:

1. Group business information (or Global Master file)
2. Local TP documentation (or Local file)
3. Report on the transactional profitability results in the form of a Country-by-Country (CbC) Report

The Decree requires taxpayers to prepare their TP documentation before the submission of their annual corporate income tax (CIT) return. Given that CIT returns are due within 90 days of the taxpayer's year-end, preparation of the TP documentation requirements will become extremely challenging.

In addition, taxpayers must submit their TP documentation to the tax authorities within 15 working days upon request during a tax/TP audit, reducing the period from the current 30 working days; accordingly, it is crucial that taxpayers have their TP documentation completed prior to receiving notification of a tax audit.

The revised TP Disclosure Form has some additional information requirements including the quantum of reimbursements and the allocated revenue/expenses to a permanent establishment as well as further detail on the arm's length pricing breakdowns based on the income statement.

Country-by-Country Reporting (CbCR)

The content of a CbC report includes key financial and tax indicators of an international group (such as revenue, profit, taxes payable, number of employees, amount of registered capital and tangible assets) for each jurisdiction in which an international group operates, along with identification details and information on the main business activities/functions of all subsidiaries in the group.

A Vietnamese taxpayer is required to file CbCR information if it has an overseas parent and the ultimate parent company overseas is required to prepare and maintain such report in its country of residence. Where a taxpayer has its ultimate parent in Vietnam and has global consolidated revenue in the tax period of VND18,000 billion or more (US$789 million or more), it is also required to prepare this report.

TP compliance exemption

The following exemptions are provided to a taxpayer that:

- Has sales revenue of less than VND50 billion (US$2.5 million) and the value of its related party transactions is less than VND30 billion (US$1.5 million).
- Engages in simple functions, has revenue of less than VND200 billion (US$100 million) and achieves a ratio of earnings before interest and taxes to revenue of at least 5% for distribution function; 10% for manufacturing function; and 15% for processing function).
- Has signed an Advance Pricing Agreement (APA) and submitted annual APA report(s).

In addition, a partial exemption is available if:

- The taxpayer only has transactions with related parties who are subject to CIT in Vietnam.
- The taxpayer and its related parties apply the same CIT rate and enjoy no CIT incentives.

Substance over form principle

The Decree introduces the "substance over form" principle for deductibility of related party services and interest expense.

Under the Decree, the following requirements and conditions must be satisfied for inter-group service expense to be deductible:

- Services provided must be directly beneficial to the business operation of the taxpayer
- Services from related parties are determined to "have been provided" only if independent companies under similar circumstances pay for such services
- Service fees are paid at arms' length, the TP method or allocation keys are consistently applied among the group members and the taxpayer provides documents to substantiate the receipt of services

The maximum total deductible interest expenses paid to related parties in a tax period is capped at 20% of earnings before interest, taxes, depreciation and amortization.

Application of TP methods

The Decree provides guidance on the application of TP methods as follows:

- Application of the Comparable Uncontrolled Price Method and supporting documents are required for fixed asset purchase transactions
- Direct costs and total costs are distinguished as different cost bases for the application of the Cost Plus Method and Comparable Profit Method (CPM) respectively
- In applying the CPM, a taxpayer with simple functions, low added-value transactions and non-strategic decisions must not incur losses

Benchmarking analysis and TP adjustments

The following guidance applies to comparability analysis and TP adjustments:

- Comparable financial data is generally required to be in the same financial year as that of the tested party
- Hierarchy for the selection of comparable transactions/companies is stipulated
- Comparability analysis of intangible assets with unique characteristics is provided
- Material adjustments must take into account the location-specific advantages
- Conditions for the use of the median of the interquartile range
- Limitation on taxpayer's use of TP adjustments

Implications

The newly introduced three-tiered TP documentation requirement carries a heavy administrative burden for Vietnamese-based subsidiaries. In addition, taxpayers may expect a more aggressive TP enforcement environment in Vietnam.

To respond to the changes and effectively plan and manage TP exposures, multinational companies should assess potential impacts on their business and compliance requirements in Vietnam.

A Circular that provides more detailed guidance and instruction on the Decree will be expected to be issued later this year.

For additional information with respect to this Alert, please contact the following:

Ernst & Young Vietnam Limited, Ho Chi Minh City

- Robert M King +84 8 3824 5252 robert.m.king@vn.ey.com
- Phat Tan Nguyen +84 8 3824 5252 phat.tan.nguyen@vn.ey.com

Ernst & Young LLP, Vietnam Tax Desk, New York

- Anh Nguyen +1 212 773 8994 van.nguyen@ey.com

Ernst & Young LLP (Canada), Vietnam Tax Desk, Toronto

- Nhung Tran +1 416 943 2460 nhung.tran@ca.ey.com

Ernst & Young LLP, Asia Pacific Business Group, New York

- Chris Finnerty +1 212 773 7479 chris.finnerty@ey.com
- Kaz Parsch +1 212 773 7201 kazuyo.parsch@ey.com
- Bee-Khun Yap +1 212 773 1816 bee-khun.yap@ey.com

Ernst & Young LLP, Asia Pacific Business Group, Houston

- Trang Martin +1 713 751 5775 trang.martin@ey.com

EY | Assurance | Tax | Transactions | Advisory

About EY
EY is a global leader in assurance, tax, transaction and advisory services. The insights and quality services we deliver help build trust and confidence in the capital markets and in economies the world over. We develop outstanding leaders who team to deliver on our promises to all of our stakeholders. In so doing, we play a critical role in building a better working world for our people, for our clients and for our communities.

EY refers to the global organization, and may refer to one or more, of the member firms of Ernst & Young Global Limited, each of which is a separate legal entity. Ernst & Young Global Limited, a UK company limited by guarantee, does not provide services to clients. For more information about our organization, please visit ey.com.

Transfer Pricing Group

EYG no. 01103-171Gbl

1508-1600216 NY
ED None

ey.com