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Discussion draft of new transfer pricing decree released

At a glance...

On 11 October, Vietnam's Ministry of Finance released the discussion draft of a new transfer pricing decree: "Guidance on transfer pricing administration to combat transfer pricing and loss of tax revenue to the state budget". This is projected to replace the existing TP regulations (Circular 66/2010/TT-BTC). In line with Vietnam's tax reform plans, as well as the changing global landscape on transparency and anti-tax avoidance (BEPS), this revision of Circular 66 was placed high on the agenda. The draft decree represents the most important development of the TP regime here for the last 10 years.

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Framework and 'spirit of the law'

While it is based loosely on Circular 66, the draft extends the interpretation of existing points and introduces additional concepts and principles from the OECD Guidelines, BEPS and other sources. The preamble sets out the decree's objective of combatting 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 draft.

The draft provides more detailed guidance on comparability analyses (i.e., benchmarking), including the application of the TP methods endorsed by the OECD. However, the decree 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. The draft decree essentially places the burden of proof on the taxpayer to prove that its intercompany transactions are not only at arm's length, but also do not result in a negative effect on the state budget.

In addition, several provisions are included to reduce the compliance burden on taxpayers, notably:

- Various revisions to the definition of related party: the ownership threshold is increased to 25% from 20%. And two companies will be treated as related parties if the transactions between them account for more than 60% of sales or purchases - currently this is 50%.

- Taxpayers are exempt from preparing TP documentation if both net revenue and the value of related party transactions are less than VND 50 billion (total revenue generated in a tax year) and VND 30 billion (total value of related party transactions in a tax year), respectively, or if all transactions are conducted between domestic entities subject to the same corporate income tax rates.

Tax deductibility of intercompany charges

Article 8 of the draft sets out detailed guidance for determining the corporate income tax deductibility of certain intercompany expenses, including:

- Intercompany loans: tax deductibility of interest on intercompany loans is capped at 20% of EBITDA, which is in line with the BEPS recommendations.

- Intra-group services: various criteria for tax deductibility are set out. Expenses will be disallowed inter alia if they are deemed as not related to the business of the taxpayer (e.g., shareholder costs, duplicated services, etc.). And where an affiliate enters into contracts with third parties, and recharges these to the taxpayer, such expenses will be disallowed.

Internal comparable data of the tax authorities

Similar to Circular 66, the draft gives tax officials the power to use an internal database for TP assessment purposes. Specifically, Article 12 provides that the tax authorities can use internal comparable data to impose TP adjustments in cases where a taxpayer is deemed non-compliant with the requirements of the decree. This type of development could clearly give rise to increasingly lengthy disputes that may have to be settled through competent authority mutual agreement procedures, and will likely also encourage increased use of advance pricing agreements.

Some practical concerns

- Deadline for preparing TP documentation: article 10 specifies that annual TP documentation must be prepared before the submission date of the annual tax return, which gives taxpayers just 90 days (from the fiscal year end date) to complete the year's TP documentation. Furthermore, Article 6 provides that comparable data must be *"in the same financial year as that of the taxpayer"*.

- Reliability of comparable data: article 6 requires taxpayers to ensure comparable data is reliable and complies with tax, accounting and statistical standards. This raises concerns as to what taxpayers would in practice do to, and how they would be able to, demonstrate the reliability of their comparable data to comply with the requirements set out in the draft.

- Comparability adjustments: article 6 introduces certain factors to be considered when performing comparability analyses such as location specific advantages (market premium and location savings), group synergies, etc. In practice, the impact of such factors on the taxpayer's business could be highly subjective and often difficult to quantify.

- Introduction of three-tier TP documentation: the draft decree introduces requirements for master file, local file and CbCR. Taxpayers are required to maintain CbCR if the ultimate parent company is also obliged to prepare such documents in a tax jurisdiction which has a double tax treaty in force with Vietnam.

- Thus far, there are no transitional provisions set out.

The takeaway

The finalised version of the TP decree is expected to be released by the end of 2016 and take effect from 1 January 2017. We strongly recommend that taxpayers (especially MNCs) study the draft and actively assess the potential impact on their business and tax controls, and consider implementation plans in advance.

Relevant stakeholders are welcome to submit their comments on the draft decree directly to the Ministry of Finance ("MoF"). Alternatively, you can contact your PwC contact to share your comments and suggestions so that we can incorporate your valuable ideas into PwC's submission to the MoF.

Contact us

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