



Transfer Pricing

I. Overview

In order to help Vietnam's authorities in their ongoing efforts to continually improve and provide more clarity and transparency to tax system in Vietnam, this paper seeks to examine the current situation on a few key issues and propose our recommendations. To paper will generally follow the below segmentation of the transfer pricing issues. In particular we will address: 1. Tax deduction for expenditures (Services fees and license fees on intangibles, services fees and license fees on inter-company, Safe harbor rules introduction), 2. Advance pricing agreement guidance (in particular Advance Pricing Agreements "APAs"), 3. Transfer pricing in Vietnam (gaps, current guidance, Interaction with other guidance, auditing procedures, documentation and safe harbors), and 4. customs valuation.

II. Tax deduction for expenditures for inter-company services and intangibles and the need for introducing safe harbor rules

Related party transactions, involving the provision of services and the right to use intangibles (both manufacturing intangibles, such as manufacturing know-how, and marketing intangibles, such as trademarks), are necessary in multinationals' business operation. Charging a user- / service fee for transactions to a Vietnamese associated enterprise is necessary to satisfy the "arm's length"-principle in related company dealings for income tax purposes: Foreign tax authorities generally expect companies in their jurisdictions to charge user- / service fees for the outbound provision of services and licenses to the intangibles, failing of which may result in unfavorable presumptive assessment of income tax liabilities for the companies concerned.

Vietnam's current tax and transfer pricing regulations are almost silent on the arm's length pricing of service fees or license fees for intangibles. This is most likely the source of future frequent disputes between taxpayers being associates of MNEs and the local tax authorities over the former's tax deduction for the expenditures. Specifically, with regard to inter-company services, the local regulations are deficient on a range of fundamental aspects for the arm's length determination of service charges, such as the benefit test (i.e. whether the service is rendered and provides economic or commercial benefit that an independent party will be willing to pay in an arm's length situation), allocation of cost-base where two or more enterprises benefit from the services provided by one single related enterprise, and clarity as to the most appropriate transfer pricing method for the determination of service charges.

During recent provincial tax audits, the audited taxpayer companies' deduction for inter-company service fees was rejected by the tax inspectors for income tax purposes. In such cases, no clear justification for the rejection was provided if the argument is on the ground of the general deduction tests in the Law on Corporate



Income Tax (i.e. the expenditure must be related to business or revenue generation and properly supported with documentation).

For certain manufacturing and marketing intangibles, there are specific regulations on technology transfer and the licensing of certain marketing intangibles (e.g. trademark licensing). These regulations generally do not limit the royalties at which a Vietnamese enterprise can pay to the licensor. Also, Vietnam-based subsidiaries of MNCs have over years created the so-called local intangibles through their local manufacturing and marketing activities.

The lack of transfer pricing guidance for the intangibles may be the source of conflicts between the taxpayers and Vietnamese tax authorities in determining appropriate license fees chargeable by European companies (either the headquarter or a designated entity) in a range of sectors to the Vietnamese associated enterprises. In particular, disputes may arise in relation to whether charging a license fee is necessary after a certain period of time, economic ownership, the role of local marketing intangibles, determination of appropriate royalties, etc.

Recommendation: In line with international practice we recommend to introduce a “safe –harbor” rule for service fees or royalties. That means, for transactions which are not significant in volume/amount, the taxpayer may reasonably claim a tax deduction for the expenditures where they are within certain thresholds, with minimal supporting documentation required. This is helpful to reduce the cost of burden of proof on the taxpayer companies incurred in creating and providing evidence that they were dealing at arm’s length in relation to those transactions where the quantum of the transactions does not have a significant impact on corporate profits, hence income tax liabilities.

III. The need for Advance Pricing Agreement guidance and program

Apart from transfer pricing documentation and tax treaties (including those to which Vietnam is a signatory), Advance Pricing Agreements (“APAs”) are becoming increasingly popular as a tool for MNCs given its ability to provide predictability and certainty. This is evidenced by an increasing number of MNCs’ applications for APAs, including in the Asia Pacific region (especially China, Thailand and several other countries). An APA is a unilateral, bilateral or multilateral agreement between a taxpayer company (normally a MNC) and the tax authorities on transfer pricing of a specific category of related party transactions. Among others, the agreement sets out the category of transactions being its subject matter, circumstances and conditions of the transactions, and the agreed upon (in advance) transfer pricing and price setting method for the transactions, which will be valid for a specific period of time.

An APA eliminates the risk of transfer pricing adjustments for an MNC where it is strictly followed, and also time consuming transfer pricing audits which normally happen otherwise. The enterprise concerned also may not have to maintain transfer pricing documentation, thus saving cost for the tax compliance. Above all, an APA provides predictability and certainty over transfer pricing related tax treatment for an



MNC which is required in conjunction with making a significant investment commitment. To date, Vietnam does not have any APA guidance or any APA program. In practice, commitments to having an APA were established with a limited number of MNCs which have significant investment in Vietnam. These commitments are discreetly agreed upon, private and confidential.

Recommendation: To remain attractive and competitive, the Vietnam Government should provide APA programs and guidance so that eligible MNCs can include this as part of their overall planning for investment in Vietnam. APAs will not only help MNCs in predictable and consistent tax- and business planning, but also greatly reduce the workload of Vietnamese Tax Authorities, thereby resulting in a classical win-win situation for all parties involved.

IV. Transfer Pricing in Vietnam: Remaining Gaps

Most companies see transfer pricing documentation compliance as a troublesome area in Vietnam. One reason for inconsistent levels of compliance may be due to a lack of clarity as to what the actual audit risk is and how businesses can make informed decisions about allocating their limited resources to increase their compliance in this area and reduce their risks. Whilst it is clear that transfer pricing rules exist in Vietnam, the actual procedures for an audit of a company's compliance with these rules and the specific penalties they may face in relation to transfer pricing adjustments are less clear. The main reason for this is that such rules are not clearly stated in the current guidance nor are they stated in the new draft circular on Transfer Pricing. It is inconsistent to provide so much technical guidance on transfer pricing on the one hand, but to stop short of specifically addressing auditing procedures and penalties on the other hand. As a result, tax payers are often left with questions regarding specific compliance expectations and potential risks. Finally, we note that the current rules in Vietnam state that documentation for transfer pricing methodology should be contemporaneous. However, in practice it appears this requirement has been difficult to meet.

Recommendation: We recommend that the Vietnamese Government provides clear guidance in relation to transfer-pricing related audit procedures and potential penalties in the new draft circular on Transfer Pricing. In particular, it is not completely clear if the audit procedures will be exactly the same as a tax audit or if they may differ in material respects. Most tax payers believe that audits should typically be carried out in much the same manner as they are for other tax issues. We therefore strongly recommend specifying the exact procedures for audits in relation to transfer pricing. Finally, to encourage increased compliance with documentation requirements, we recommend that the authorities allow some form of safe-harbor provisions for late preparation of transfer pricing documents, provided they are made available to the tax authorities within the normal period allowed during an investigation. Only by providing such guidance, clarification and safe-harbor, the business community in Vietnam will be able to effectively comply with the current transfer pricing regime in Vietnam.



V. Customs Valuation

A number of European companies have commented on an area of concern regarding valuation for customs purposes and while the focus of this white paper is transfer pricing and not customs, the two are clearly related. Whilst we do not wish to raise detailed technical issues, we believe it is appropriate that clear and consistent customs valuation mechanism be adapted by the relevant authorities.

Recommendation: We recommend to the government a coordinated approach with regards to coordinating customs valuations with other valuations, thereby linking the guidance of various authorities so that businesses are not being given different valuations by different government entities. Many other countries successfully resolve this potential conflict by issuing a formal ruling or regulations to the effect that the value used for one part of the government should serve a specific reference point for the valuation used by other ministries in the government. We believe such practical approach should also be implemented by the Vietnamese government.