Tax Alert

Circular No. 41/2017/TT-BTC dated 28 April 2017 guiding certain articles of Decree No. 20/2017/ND-CP dated 24 February 2017 on tax management of transfer pricing in enterprises

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GUIDANCE ON SEVERAL ARTICLES REGARDING TAX ADMINISTRATION OF TRANSFER PRICING IN ENTERPRISES

On 15 June 2017, the Ministry of Finance officially issued **Circular No. 41/2017/TT-BTC dated 28 April 2017** ("Circular 41") providing detailed guidance on the implementation of Article 6, 7, 10, 11 of Decree 20/2017/ND-CP dated 24 February 2017 issued by the Government on transfer pricing in enterprises ("Decree 20"), attached with 03 Appendices:

- Appendix I – Formula of Interquartile range calculation and the median value;
- Appendix II – Detailed guidance to declare Form 01 of Decree 20 – Information on related party relations and related party transactions; and
- Appendix III – Detailed guidance to declare Form 04 of Decree 20 – Declaration on reported information about transnational profit.

Circular 41 takes effect on 1 May 2017, replacing Circular 66/2010/TT-BTC dated 22 April 2010 ("Circular 66") of the Ministry of Finance providing information on the determination of market prices in business transactions between related parties and Form 03-7/TNDN enclosed with Circular 156/2013/TT-BTC dated 06 November 2013 of the Ministry of Finance.

In this alert, we highlight the important guidance and requirements in Circular 41 to which taxpayers should pay attention to ensure compliance with transfer pricing regulations:

SECTION 1: HIGHLIGHTS ON THE COMPARABILITY ANALYSIS AND SELECTION OF COMPARABLES

1.1 Principle in determining the nature of related party transactions

Circular 41 clarifies the principle of "Substance over form" stated in Article 6, Decree 20. Accordingly, when conducting comparability analysis, related party transactions need to (i) be reviewed and compared between the transaction agreement with the nature and practice of business activities, the functions performed by the involved parties with sufficient supporting documents; and (ii) compared with the business decisions made between independent parties under similar conditions.

The principle for the review and comparison process applied in comparability analysis is based on the nature and practice of business activities and risks born between related parties rather than contracts/agreements.

The principle of independent transactions and the principle of substance-over-form will be applied to adjust related party transactions and risks born by each related party involved in such transactions.

1.2 Criteria for Comparability analysis

Circular 41 provides detailed guidance for Point 3a and 3đ of Article 6, Decree 20 regarding the criteria used in comparability analysis for the selection of comparables as follows:

i. **Characteristics of the product** are those which would affect the product’s price including characteristics of tangible goods, services rendered and intangible assets.

ii. **Functions performed, risks born and assets utilized** by the parties engaged in relation to the opportunity costs, economic conditions, industry conditions, business sectors and geographic location to be analyzed to identify factors reflecting taxpayers’ profitability.

iii. **Contractual terms** include the transaction volume, terms of delivery, payment terms, product guarantee, exclusive rights, support in advertising and promotion, etc.

iv. **Economic conditions of the transaction and market conditions** at the time the transaction occurred that affect the pricing, profit level indicator, profit split ratio among parties involved.

Elimination of material differences based on quantitative and qualitative screening in order to search and select independent comparables.

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1.3 Basis for making adjustments in comparability analysis

- **Adjustment principle conducted by taxpayers:**

  Based on comparability factors such as functions, assets, risks, economic and market conditions, quantitative and qualitative screening, taxpayers conduct comparability analysis and make adjustments based on the following principles:

  ➢ In the event the taxpayers' related party transaction price, profit level indicator or profit allocation ratio **fall within** the arm's length range, taxpayers **have no obligation to adjusting** the related party transaction price, profit level indicator or profit allocation ratio;

  ➢ In the event the taxpayers' related party transaction price, profit level indicator or profit allocation ratio **do not fall within** the arm's length range, taxpayers **are responsible for adjusting** the related party transaction price, profit level indicator or profit allocation ratio based on the most comparable value of the arm's length range and on the basis of not decreasing the tax liabilities.

- **Adjustment principle conducted by tax authorities:**

  The value used by tax authorities to adjust or deem taxpayers' related party transaction price, profit level indicator or profit allocation ratio is the median value of the interquartile range (*).

(*) Note: The interquartile range is determined by the statistical probability method using the interquartile function. Accordingly, the interquartile range is the range from the first quartile to the third quartile, the value in the interquartile range is any value counted from the first quartile to the third quartile. The second quartile is the median of the standard arm's length range.

SECTION 2: TAXPAYERS' OBLIGATIONS IN THE DECLARATION OF RELATED PARTY TRANSACTIONS AND THE PREPARATION OF TRANSFER PRICING DOCUMENTATION

Circular 41 has stipulated the compliance requirements regarding the declaration of related parties, related party transactions and the preparation of Transfer Pricing documentation reports based on Article 10, Decree 20 as follows:

Compliance requirements	Taxpayer having Global ultimate parent ("GUP") in Vietnam	Taxpayer having GUP outside Vietnam
A. Compliance requirements for declaration of related party relations, related party transactions		
Declaration Forms	➢ **Form 01** – Information on related party relations and the related party transaction	➢ **Form 01** – Information on related party relations and the related party transaction
	➢ **Form 02 –** List of information and documents to be provided in the Local report. The taxpayer must confirm that the local report (local file) has been prepared and contains the listed information.	➢ **Form 02 –** List of information and documents to be provided in the Local report. The taxpayer must confirm that the local report (local file) has been prepared and contains the listed information.
	➢ **Form 03 –** List of information and documents to be provided in the Global report. The taxpayer must confirm that the global report (master file) has been prepared and contains the listed information.	➢ **Form 03 -** List of information and documents to be provided in the Global report. The taxpayer must confirm that the global report (master file) has been prepared and contains the listed information.
	➢ **Form 04 –** Declaration of reported information on transnational profit of the GUP in Vietnam which has a consolidated turnover of VND 18.000 billion and above, and operates in many countries and territories.	➢ guidance regarding **Form 04 -** Declaration of reported information on transnational profit of the GUP outside Vietnam.
Deadline for submission	Attached with CIT finalization Form 03/TNDN **within 90 days from the end of fiscal year.**	
B. Compliance requirements for Transfer Pricing Documentation report ("TPD")		
Required documentation	➢ Local report based on the checklist in Form 02 ➢ Global report based on the checklist in Form 03 ➢ A copy of Country by Country report ("CbC report") of the foreign GUP(*)	
Deadline for TPD submission according to Decree 20	Taxpayers have the obligation to prepare and maintain the TPD before submission of the CIT finalization returns, and provide it upon the tax authority's request based on the timeline below: ➢ During the tax audit: the deadline to submit the TP Documentation is **no later than 15 working days** upon the tax authority's request. ➢ During the consultation period before the tax audit: the deadline to submit the TP Documentation is no later than **30 working**	

Compliance requirements	Taxpayer having Global ultimate parent ("GUP") in Vietnam	Taxpayer having GUP outside Vietnam
	days upon request for the document from the tax authority, only one extension of **15 working days** is accepted.	

(*) Note:

- *In case the taxpayer is not able to provide a copy of the GUP's CbC report for the tax period corresponding to the taxpayer's period, the taxpayer will be obliged to prepare and provide documents as follows:*

  i. *GUP's CbC report of the fiscal year prior to the filing year of taxpayer; and*
  ii. *An explanation letter as to why the taxpayer is unable to provide its GUP's CbC report for the tax period corresponding to tax finalization period of the taxpayer.*

- *In case the taxpayer cannot provide a copy of the GUP's CbC report for the current or prior year, the taxpayer will be obliged to prepare and provide a letter explaining why as an attachment with TPD.*

- *In case the taxpayer has more than one GUP and the taxpayer's financial statements have been used to prepare the consolidated financial statements for several corporations, the taxpayer must provide Global reports of all corporations and maintain copies of all CbC reports of its GUPs.*

SECTION 3: CHANGES IN TRANSFER PRICING DECLARATION FORM

The table below summarizes the new requirements of Form 01 which replace Form 03-7/TNDN:

Contents	Form 03-7/TNDN	Form 01
1. Declared value with regard to the purchase of products forming fixed assets	Depreciation values of fixed asset	Purchase values
2. Declared value with regard to the purchase of products not forming fixed assets	Corresponding expenses recorded in the profit and loss in the financial year	Purchase values
3. Transfer pricing methods	• **PP1:** Comparable uncontrolled price method	• **PP1.1:** Comparable uncontrolled price method

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Contents	Form 03-7/TNDN	Form 01
		• **PP1.2:** Comparable uncontrolled price method to products listed on domestic and international markets of goods and services
	• **PP2:** Resale price method • **PP3:** Cost-plus method • **PP4:** Comparable profit method	• **PP2.1:** Resale price method • **PP2.2:** Cost-plus method • **PP2.3:** Comparable profit method
	• **PP5:** Profit split method	• **PP3:** Profit split method
	• **PP6:** Other method	• Not applicable

SECTION 4: GUIDANCE ON THE ALLOCATION OF REVENUES AND EXPENSES TO CALCULATE THE OPERATING MARGIN FOR EXEMPTION FROM PREPARATION OF TRANSFER PRICING DOCUMENTATION

Circular 41 provides guidance on applying operating income before interest expense and corporate income tax ((excluding the difference between financial income and financial expenses from financial activities) as the operating margin to determine is the taxpayer is exempted from preparing TP documentation in case the taxpayer performs simple business functions (i.e. distribution, manufacturing, processing).

In case the taxpayer performs more than one simple function, the taxpayer needs to keep separate accounting records of each function to calculate the operating income before interest and corporate income tax of each function.

In case the taxpayer is unable to keep separate accounting records for each function:

- If the taxpayer only separates the revenues, but can not separate the expenses: the taxpayer shall allocate the expenses based on the revenue proportion of each function.

- If the taxpayer cannot separate either the revenues or expenses of each function: the highest operating margin before interest and corporate income tax will be applied on an aggregation basis.

SECTION 5: DELOITTE VIETNAM'S POINT OF VIEW

Circular 41 provides detailed guidance on certain articles of Decree 20 so that taxpayers have a sufficient and reasonable basis to determine the arm's length nature of its related party transactions. However, some aspects have not been addressed under Circular 41:

- **Obligation to declare Form 04 - Declaration on reported information about transnational profit of the GUP outside Vietnam**: Circular 41 does not provide guidance on the declaration and deadline to submit Form 04 in this case. We will keep you updated of any further formal guidance from the authorities regarding this issue.

- **Timeline for the preparation of Transfer Pricing Documentation:** Pursuant to the provisions of Decree 20, taxpayers have an obligation to prepare the TP Documentation report prior to the submission of the annual Corporate Income Tax declaration. Circular 41 does not discuss this issue, however it can be implied by the fact that Form 02 and Form 03 require confirmation by the taxpayer that the TP documentation has been prepared. Therefore, in our view, such an requirement will create a lot of pressure and burden for taxpayers due to a significant volume of required information in the TP Documentation.

- **The operating margin applied under comparable profit method:** According to Decree 20, for taxpayers operating in manufacturing, trading and service sectors, the operating margin is defined as the operating income before interest expense and corporate income tax (excluding the difference between financial income and financial expenses from financial activities) over revenue (or net revenue); over cost (or total cost); over assets (or fixed assets).

  However, based on our observation of tax authorities' current practice during TP audit cases as well as the guidance under Official Letter No. 5545/TCT-CC dated 11 December 2014 ("Official Letter 5545") issued by General Department of Taxation in response to Deloitte Vietnam on the implementation of Circular 66, the operating profit margin (excluding the difference between financial income and financial expenses as well as the difference between other income and other expenses) is applied to reflect the business results and eliminate the distortion of non-operating factors (i.e. financial income, financial expenses, other income, and other expenses) to assess the arm's length nature of taxpayers' related party transactions.

  Accordingly, Deloitte Vietnam will keep you updated of any further formal guidance from the authorities in this area.

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