



## **Tax Alert**

Decree No. 20/2017/ND-CP dated 24 February 2017 guiding tax management on transfer pricing in enterprises

1 March 2017

The Government of Vietnam has officially issued **Decree No. 20/2017/ND-CP dated 24 February 2017** ("Decree 20") guiding tax compliance for enterprises having related party transactions. The Decree will be effective from **01 May 2017**.

In this Tax Alert, Deloitte Vietnam would like to summarise salient features of the Decree 20 and provides insights into the requirements for taxpayers in Vietnam in relation to their transfer pricing ("TP") compliance obligations and implications for the potential realignment of their business models. This Tax Alert covers the following sections:

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## SECTION 1: CHANGES IN RELATED PARTY DEFINITIONS

The term "Related Parties" ("RP") is used to indicate parties having direct or indirect relations in terms of (being subject to) management or control of, contribution of capital to or investment (by) in another party. The Decree 20 classifies such relations into 10 types as compared with Circular 66 which had classified it into 13 types. Below is a summary of the significant changes compared with Circular 66:

*(Note: the numbering follows the exact order as in Circular 66 and Decree 20)*

**Table 1**

Circular 66	Decree 20
<b>Direct related parties – Ownership</b>	
Two parties are considered as related parties if the threshold percentage of investment capital of the owner is <b>20%</b> . In particular: <ol style="list-style-type: none"> <li>a. One enterprise directly or indirectly holds at least 20% of investment capital of the owner of the other enterprise; or</li> <li>b. Both enterprises directly or indirectly hold at least 20% of investment capital of the owner of a third party; or</li> <li>c. A third party directly or indirectly holds at least 20% of investment capital of the owner of both enterprises.</li> </ol>	The threshold percentage of investment capital of the owner is increased to <b>25%</b> . In particular: <ol style="list-style-type: none"> <li>a. One enterprise directly or indirectly holds at least 25% of contribution capital of the owner of the other enterprise; or</li> <li>b. Both enterprises directly or indirectly hold at least 25% of contribution capital of the owner of a third party</li> </ol> Condition (c) has been removed.
<b>Indirect related parties – Borrowings</b>	
Two parties are considered as related parties if the threshold percentage of guarantee or capital funding is <b>20%</b> of investment capital of the owner. In particular: <ol style="list-style-type: none"> <li>e. One enterprise guarantees or gives to the other enterprise loans in any form</li> </ol>	The threshold percentage of guarantee or capital funding is increased to <b>25%</b> of investment capital of the owner. In particular:

Circular 66	Decree 20
<p><i>on the condition that such loans account for at least 20% of investment capital of the owner of the borrowing enterprise and account for over 50% of the total value of medium-term and long-term loans of the borrowing enterprise.</i></p>	<p><i>d. One enterprise guarantees or gives to the other enterprise loans in any form on the condition (including loans from third party guaranteed from finance of related parties and financial transactions having similar nature) with conditions that such loans account for at least 25% of capital contribution of the owner of the borrowing enterprise and account for over 50% of the total value of medium-term and long-term loans of the borrowing enterprise.</i></p>
<p><b>Indirect related parties – Business relationship</b></p>	
<p>Two transacting third parties are deemed to become related in case the total volume of transactions cover 50% purchases or sales made to each other. In particular:</p> <ul style="list-style-type: none"> <li><i>j. One enterprise manufactures or trades in products using intangible assets and/or intellectual property rights of the other enterprise for which it has to make a payment accounting for over 50% of the historical cost (or cost price) of such products;</i></li> <li><i>k. Over 50% of the total value of raw materials, materials, supplies or input products (exclusive of fixed asset depreciation expenses) used by one enterprise for manufacturing or trading in output products are supplied by the other enterprise;</i></li> <li><i>l. Over 50% of products (calculated for each kind of product) sold by one enterprise is directly or indirectly controlled by the other enterprise.</i></li> </ul>	<p>Such basis related party relationship has been removed.</p>
<ul style="list-style-type: none"> <li><i>m. Two enterprises reaching a business cooperation agreement on a contractual basis are considered as related parties.</i></li> </ul>	<p>Such basis of related party relationship has been removed.</p>
<p><b>Other newly added cases in Decree 20</b></p>	
	<p>Under Decree 20, two parties are considered as related parties under the following cases:</p> <ul style="list-style-type: none"> <li><i>i. One or many businesses controlled by an individual through his/her personal contribution capital in those businesses, or directly engaged in business management; or</i></li> <li><i>k. Other cases, in which one enterprise is actually managed or controlled in decision by business activities of another enterprise</i></li> </ul> <p>Although condition (k) is in line with the principle “Substance over form”, it is still vague given there is no detailed guidance at this time</p>

Circular 66	Decree 20
	and may lead to different understandings. Adding this definition and removing definitions in terms of business relationship (i.e. 50% purchase or sale ratios) might trigger challenges from tax authorities for enterprises which have a significant purchase or sale ratio from another enterprise.

## SECTION 2: NOTABLE POINTS IN COMPARABILITY ANALYSIS AND TP ADJUSTMENTS DURING A TAX/ TP AUDIT

Decree 20 provides additional guidance on comparability analysis and TP adjustments as compared to Circular 66. The most significant points are tabulated below:

**Table 2**

Circular 66	Decree 20
<p><b>Comparable companies</b></p> <p>For selection of comparables, taxpayers were free to use any information which is legally sourced and could be verified when requested by the tax authorities to assess the arm’s length nature of related party transactions. As such, there was no geographic limitation of such information regarding the comparables.</p>	<p>For selection of independent comparables, a preferential order of comparable data has been stipulated (and adjustment of material difference if applicable) as follows:</p> <ul style="list-style-type: none"> <li>(i) Internal comparables of taxpayer;</li> <li>(ii) Comparables located in the same country and territory with taxpayers;</li> <li>(iii) Comparables in regions having similar conditions of industry and levels of economic development;</li> </ul>
<p><b>Adjustment Value</b></p> <p>No guidance on value for TP adjustment in comparability analysis.</p>	<p>During comparability analysis, value for TP adjustment is first stipulated as the price of independent comparables (in case Comparable Uncontrolled Price (“CUP”) is applicable) or the median value of interquartile range established by independent comparables (in case other methods rather than CUP are applicable).</p>
<p><b>Deemed TP adjustment</b></p> <p>In case of a tax/ TP audit and the taxpayer is subject to be deemed tax liability, Circular 66 stipulates the value for adjustment as follows:</p> <ul style="list-style-type: none"> <li>✓ <i>The most appropriate value for adjustment of selling price/profit is a value <b>not lower than the median value</b> of the standard market price range determined by tax offices;</i></li> <li>✓ <i>The most appropriate value for adjustment of purchasing price is a value <b>not higher than the median value</b> of the standard market price range determined by tax offices.</i></li> </ul>	<p>Decree 20 allows tax officers to deem tax liability but does not clearly mention a specific value for adjustment. Given the guidance on comparability analysis for value for TP adjustment, the median value may potentially be used as the minimum for deeming the tax liability by tax offices in case of a tax/ TP audit.</p>

## SECTION 3: NON-DEDUCTIBLE EXPENSES ON PAYMENT TO RELATED PARTIES FOR CORPORATE INCOME TAX PURPOSE

The Decree 20 stipulates the following types of related party expenses which could be treated as non-deductible for Corporate Income Tax ("CIT") purpose on the basis of "Substance over Form" principle, including:

**Table 3**

No.	Types of related expenses	Non-deductible related party expenses for CIT purpose
1	Payments made to related parties for use of tangible / intangible assets or other services	<ul style="list-style-type: none"> <li>i. Related parties do not conduct any business activities related to taxpayer's business;</li> <li>ii. Related parties conduct business activities but the related parties' assets, number of employees, and functions is not commensurate with the transaction values;</li> <li>iii. Related parties do not have rights and responsibilities related to assets, goods, services provided to taxpayer; and</li> <li>iv. Related parties are established in a country or territory in which they are not subject to CIT; do not create revenue or added value to taxpayer's business activities.</li> </ul>
2	Payments made to related parties for receipt of services	<ul style="list-style-type: none"> <li>i. Services provided by related parties only serving interests or creating added value for other related parties;</li> <li>ii. Services for the benefit of related parties' shareholders; duplicate service fee provided by many related parties for one type of service, determining no added value for taxpayer;</li> <li>iii. Services are benefit of Group's members granted to taxpayer; and</li> <li>iv. Added expenses by RPs to services provided by third party via intermediaries and RPs contribute no added value to the services.</li> </ul>

The Decree 20 also stipulates a cap for interest expenses deduction in which total deductible interest expense incurred during the tax period does not exceed 20% of net profit before tax, loan interest and depreciation expenses (EBITDA). This requirement is not applicable for tax payers who are subject to the Law on credit organizations and Law on insurance business.

Although the clause is more inclined towards CIT than TP, from TP perspective, it can be understood that the government is making efforts to limit using interest expense as a conduit to remit cash outside Vietnam as a tax planning technique. Therefore, taxpayers should reassess the debt equity ratio and the ratio between related-party and third-party debt.

## SECTION 4: CASES FOR EXEMPTION FROM TP DOCUMENTATION AND DECLARATION

Under Decree 20, some relaxation criteria for exemption for preparation/ declaration of related party transactions are introduced as below:

**Table 4**

Relaxation	Exemption cases
<b>Exemption from preparation of declaration on Section III and IV under Form 01</b>	<ul style="list-style-type: none"> <li>i. In case the taxpayer only transact with related parties, which are subject to CIT in Vietnam; and</li> <li>ii. Both parties have the same tax rates and neither of them are entitled to tax incentives during the tax period.</li> </ul>
<b>Exemption from preparation of TP Report</b> <i>(the TP Forms still need to be filled)</i>	<ul style="list-style-type: none"> <li>i. Taxpayer having related party transactions having sales revenue less than VND 50 billion and the total value of related transactions does not exceed VND 30 billion.</li> <li>ii. Taxpayer who signed Advanced Pricing Agreement ("APA"), submitted Annual Report in accordance with legal regulation in relation to APA (only applicable to related party transactions covered by APA)</li> <li>iii. Taxpayer performs simple business function, creating no revenue and expenses from exploitation and usage of intangible assets, having sales under VND 200 billion, apply the operating margin (operating income before interest and tax/net sales) including the following sectors:               <ul style="list-style-type: none"> <li>- Distribution: 5% and above;</li> <li>- Manufacturing: 10% and above;</li> <li>- Processing: 15% and above</li> </ul> </li> </ul>

## SECTION 5: INTRODUCTION OF THE NEW TP FORMS

The Forms attached with the Decree 20 includes four (04) forms which require substantial information to be prepared as compared to those in the TP Declaration Form under Circular 156/2013/TT-BTC ("Circular 156") guiding the determination of market prices in business transactions between associated parties. Taxpayers should prepare and maintain Transfer Pricing documentation report including:

- ❖ Information on related party relation and related party transactions attached with CIT finalization return No. 03/TNDN based on Form No. 01
- ❖ Local Report with required contents in Form No. 2
- ❖ Group information report with required contents in Form No. 3
- ❖ Declaration on reported information about transnational profit of the Ultimate Parent Company based on Form No. 4 (\*)

*(\*) Definition of the Ultimate Parent Company in Decree 20 implies that it is a legal entity which has direct or indirect ownership of other entities in a multi-nations-corporation. The Ultimate Parent Company is not owned by any other legal entity; and its consolidated financial statements would not be further consolidated in any other legal entity in the world.*

Form No. 04 is required to submit only in the following cases:

- ✓ When a taxpayer is the ultimate parent company incorporated in Vietnam and its group consolidated revenue in the tax period exceeds VND 18 thousand billion.
- ✓ When a taxpayer has the ultimate parent company incorporated in overseas country and the ultimate parent company has to submit Report of profitability results of the entire group to the

jurisdiction where it is incorporated, a copy of this Report or the report under Form No. 04 is required to submit. Otherwise, taxpayer must have official statement as the clarification of causes, legal base and explanatory notes for specific regulations of domiciled country, which do not allow the taxpayers to provide such Report.

Please refer to Appendix for further details of each Form.

## SECTION 6: DEADLINE FOR COMPLIANCE AND REPORTING REQUIREMENTS

Under the guidance of the Decree 20, the timeline for preparation-maintaining-submission of TP Documentation is:

- Preparation of TP Documentation prior to submission of annual CIT declaration
- The timeline for providing information in TP Documentation:
  - ✓ During the tax audit, the deadline for submission of TP Documentation is no later than 15 working days upon tax authority's request.
  - ✓ During the consultation period before the tax audit, the deadline for submission of TP Documentation is no later than 30 working days upon request in document from the tax authority, only one-time extension of 15 days is accepted.

Based on the above, it could be understood that multiple years TP Documentation may violate the above compliance and would no longer be accepted.

## SECTION 7: RIGHTS OF TAX AUTHORITIES IN TRANSFER PRICING MANAGEMENT

Tax authorities might deem tax liabilities by following scheme:

- **Where taxpayers fully implemented accounting regime, invoices, vouchers:** deeming of revenues, expenses or assessable income to determine the tax liability shall comply with the principles of comparability analysis, transfer pricing methods and databases used in the management of the related party transaction prices specified in Decree 20.
- **Other cases:** deeming of tax liability shall be conducted on the basis of databases of tax offices under regulations on tax assessment applicable to enterprises which have not fully implemented the regime of accounting, invoices and evidence or under regulations on handling of tax-related violations.

The tax authorities have the right to deem prices; profit margins; profit allocation ratio used to declare tax, deem the assessable income or corporate income tax liability to a taxpayer in following cases:

- Fail to declare or declare insufficient information of related party transactions or do not submit Form No. 01 as stipulated in Decree 20;
- Provide insufficient information in relation to transfer pricing documentation as stipulated in Form No. 02 and Form No. 03 or do not present transfer pricing documentation and data, evidences and documents used as the basis of comparability analysis.
- Utilize unreliable, impractical information in order to perform comparability analysis, declare controlled price in related party transaction or rely on illegal or invalid documents, data and evidences or fail to specify the sources used for determining prices, profitability ratios or profit allocation percentages applied to related party transactions;
- Have breaching behaviors to the regulation of transfer pricing.

## SECTION 8: THE WAY FORWARD

The Decree 20 provides detailed guidance on the determination of arm's length principle for related party transactions in line with the OECD Base Erosion & Profit Shifting (BEPS) Action Points, which also makes the existing regulations more comprehensive. In terms of compliance, the Decree 20 requires coordinated effort between taxpayers and its parent company to obtain and prepare substantial information to be provided to tax offices in Vietnam within a statutory timeline since certain data might not be available to taxpayers at the local level.

Regarding to some safe harbour terms as mentioned in Section 4, taxpayers are recommended to reassess their business model to see if there is any change required in light of the new regulations or whether taxpayers might enjoy exemptions for TP compliance. To do so, taxpayers may consider but not limited the following:

- Review/ reassess the existing business model – are there any changes required in light of the new regulations? Would it be advantageous from a tax perspective to tweak the existing business structure?
- Review inter-company agreements and align them with the new regulations.
- Review the substance of group companies receiving payments for intra-group services.
- Examine the possibility of availing the exemption threshold
- Review the identification of related parties under the new regulations.
- Whether the annual TP compliance is completed within timeline?

As the Decree 20 will take effective from 01 May 2017, taxpayers who have financial year ended 31 March 2017 and have filing deadline by end of June 2017 should in our view be able to follow the guidance in the current regulations. However we expect confirmation of the application by the tax authorities and will update you accordingly.

\* \* \* \* \*

## APPENDIX - SUMMARY OF EACH FORM ATTACHED WITH DECREE 20

### 1. Form No. 01 – Information on related party relation and related party transactions

Form No. 01 is proposed on the basis of the TP Declaration Form under Circular 156. However, Form No. 01 requires some additional contents as below:

- **Section I – Information on related parties** include name, country, tax registration number and related party category.
- **Section II – Cases for exemption from obligation of declaration and submission of transfer pricing documentation report:** This section requires taxpayers to declare its circumstance to be exempted from preparation of declaration on Section III and IV of Form No. 01 and preparation of Transfer Pricing Documentation Report as mentioned above.
- **Section III - Related party transaction declaration:** Beside previous requirements for declaration of related party transaction, this section also requires taxpayers to declare payment on behalf and allocation value in terms of income and expense for permanent establishment in column (12). In column (13) of this section, taxpayers are required to declare whether transactions with related parties are under the scope of application of Advanced Pricing Agreement (APA).
- **Section IV - Business performance upon transfer pricing adjustment:** This section is a new requirement under Decree 20. Section IV stipulates for 3 types of taxpayers: (i) taxpayers belong to industries of manufacturing, trading and service; (ii) taxpayers belong to bank and credit industries; and (iii) taxpayers belong to security companies and security fund management companies. To each type of taxpayer, it requires taxpayers to declare profit and loss statement with values recorded from both related party and third party transactions separately. For the values recorded from related party transactions, taxpayers shall declare values determined according to TP Documentation Report and APA.

### 2. Form No. 02 – List of information, documents required for Local Report

- (i) General information about taxpayer, including information about organization and management structure, detailed information about business activities, business strategy, information about main competitors.
- (ii) Information about significant related party transactions: type of transactions, transaction description, relationships among related parties, functional analysis, transfer pricing methodology, material assumptions, comparability adjustment performed, copies of contracts/ agreements with related parties, etc.
- (iii) Financial information: taxpayer's financial statements of declared year, relevant financial data used in comparability analysis, explanation on causes for enterprises incurring losses for more than 03 years, etc.

### 3. Form No. 03 – List of information, documents required for Global Report

- (i) Organization structure of the Group, such as ownership structure, geographical location of the Group's active subsidiaries.
- (ii) Information about the Group's business activities such as channels generating business profit, description about supply chain of five largest products and/ or services of the Group in terms of revenue and any products and/ or services that contribute more than 5% of the Group's revenue including information about key geographical markets of these goods/ services, description of significant service agreements, etc.
- (iii) Information about the Group's intangible assets such as location of Research & Development (R&D) centers, list of intangible assets and important agreements, etc.

- (iv) Intra-Group financial activities, such as general description about financial allocation scheme of the Group, transfer pricing policy, etc.
- (v) Business results and tax obligation of the Group such as consolidated financial statements for the declared year, tax rates used for determining tax obligation corresponding to profit obtained from business activities of such related parties having transaction with the tax payer, agreements on APA, etc.

#### **4. Form No. 04 – Declaration on reported information about transnational profit**

- (i) Overview of allocation of income, taxation and business activities by tax jurisdiction of residence including information such as revenue from the Group's third parties and related parties, total amount of corporate income tax accrued and paid, stated capital, accumulated earnings, number of employees, tangible assets (other than cash and cash equivalents).
- (ii) List of the Group's subsidiaries by tax jurisdiction of residence.

\* \* \* \* \*

Should you have any further inquiries, please contact us.

## Contacts

For more information, please contact:

**Thomas McClelland**

Tax Leader

+84 (8) 3910 0751

tmcclelland@deloitte.com

**Bui Ngoc Tuan**

Tax Partner

+84 (4) 6268 3568

tbui@deloitte.com

**Bui Tuan Minh**

Tax Partner

+84 (4) 6268 3568

mbui@deloitte.com

**Phan Vu Hoang**

Tax Partner

+84 (8) 3910 0751

hoangphan@deloitte.com

**Dion Thai Phuong**

Tax Partner

+84 (8) 3910 0751

dthai@deloitte.com

**Dinh Mai Hanh**

Tax Director

+84 (4) 6268 3568

handinh@deloitte.com

**Joy Mukherjee**

Tax Director

+84 (8) 3910 0751

joybmukherjee@deloitte.com

Website: [www.deloitte.com/vn](http://www.deloitte.com/vn)

Email: [deloittevietnam@deloitte.com](mailto:deloittevietnam@deloitte.com)

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