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Global Transfer Pricing

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Vietnam Commences Transfer Pricing Audit Adjustments

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Recently released correspondence between Vietnamese local tax authorities and the Hanoi national office of the General Department of Taxation (GDT) has provided evidence of Vietnam's first documented adjustment of a taxpayer's income under the country's transfer pricing regulations.

The Vietnamese Ministry of Finance issued transfer pricing guidelines in December 2005. Circular 117/2005/TT-BTC, dated 19 December 2005, promulgated the basic transfer pricing rules and documentation requirements under Vietnamese tax law. Although the guidelines are not as detailed as the regulations issued in the United States and other countries, they do adopt a U.S.-style "best method" rule rather than a priority of transfer pricing methods (such as the comparable uncontrolled profits (CUP), resale price, cost plus, comparable profits method (CPM) and profit split methods). The circular also provides for adjustments to the midpoint of the interquartile range when a transfer pricing adjustment is warranted under the rules.

The circular has a very expansive definition of "associated" parties whose transactions are both subject to reporting in a form attached to the annual corporate tax return and subject to adjustment if found to be not at arm's length. For example, ownership of 20 percent of the shares of another entity (or even 10 percent, if that is the largest single shareholding) can make the parties related for transfer pricing purposes. In addition, significant commercial relationships between otherwise unrelated entities can result in classification as "associated" parties. When more than 50 percent of the loans of the Vietnamese party are from another business, or more than 50 percent of its raw materials are purchased from another enterprise, or more than 50 percent of the product sales are to another enterprise, those enterprises would be considered associated and thus subject to the transfer pricing rules on their transactions. Interlocking boards of directors, family relationships, and even the use of intellectual property in certain situations can also result in associated entities status.

The Vietnamese tax authorities' application of the transfer pricing rules has been virtually nonexistent, and many taxpayers have ignored the transfer pricing documentation requirements, and even the filing of the mandatory form for reporting transactions with associated parties. Although the GDT has made adjustments upon audit to items like intercompany service charges, such adjustments have been made under other provisions of the Vietnamese tax law, not specifically under the transfer pricing circular. Audits to collect transfer pricing information have been conducted since the circular was issued, particularly in the automotive industry. In addition, the Vietnamese tax authorities have had training and cooperation from other governments (Japan and Australia, for example) and software was acquired for a transfer pricing database.

New Developments

Correspondence between the Tay Ninh provincial tax authority and the GDT's Hanoi national office has recently been released that clearly indicates an adjustment of tax liability was done under the specific provisions of the transfer pricing circular. The underlying facts are not clearly indicated in the Official Letter (OL No. 3761/TCT-CS, dated 6 October 2008), but the case involves an automotive industry supplier in Vietnam producing tire tubes and components for vehicle interiors for export. The Vietnamese supplier purchased raw materials from foreign related parties and exported its production to the same parties. According to the OL, the Vietnamese company's export sales price was lower than its cost price, resulting in a loss in 2005 and 2006 totaling 77 billion Vietnamese dong (roughly USD \$4.3 million). The OL directs the provincial tax authority to "apply the guidelines of Circular 117" to redetermine the selling and imported material cost prices to "ensure the accurate and sufficient collection" of corporate income tax.

Revised Transfer Pricing Circular

A revised transfer pricing circular is expected to be issued in the third quarter of 2009. It is not clear yet what changes will be made in the new circular, but a new tax form for reporting associated-party transactions is expected to be released with the new circular.

Recommended Taxpayer Actions

Taxpayers with operations in Vietnam or that enter into transactions with "associated" parties in Vietnam should review their transfer pricing exposure in Vietnam. Although there are no transfer-pricing-specific penalties in Vietnam, failure to file the required transfer pricing form and to have documentation (including a comparability study when required) may be considered tax avoidance under general tax law provisions. Tax avoidance can trigger penalties of one to three times the amount of the tax adjustment, in addition to interest on the tax adjustment. Taxpayers most at risk are those with recurring losses, particularly exporters, and those that have not complied with the annual reporting and documentation requirements.

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