

Technical Update

May 2010

Vietnam's new transfer pricing regulations

The Ministry of Finance has issued new transfer pricing regulations (Circular 66/2010/TT-BTC dated 22 April 2010). Circular 66 replaces Circular 117/2005/TT-BTC dated 19 December 2005 and takes effect from 6 June 2010. The key requirements and amendments made under Circular 66 are highlighted below.

Overall, Circular 66 provides a comprehensive set of regulations containing the following key elements: arm's length principle, alternative criteria defining related party relationship, material differences, arm's length range, principles of comparability analysis, transfer pricing methods (with the five (5) commonly used methods provided: Comparable Uncontrolled Prices Method, Resale Price Method, Cost Plus Method, Comparable Profits Method and Profit Split Method), benchmarking standards, database, transfer pricing documentation and record retention requirements, triggers of the tax authority's transfer pricing adjustments, and annual declaration requirements.

Key compliance requirements

Companies having related party transactions (RPTs) are basically required to comply with the following key requirements:

- Determine transfer prices for RPTs in accordance with **the arm's length principle** under which prices should be negotiated and agreed upon as if the transactions were carried out between unrelated (independent) parties. Note, Circular 66 is primarily for Corporate Income Tax (CIT) purposes.
- Create and maintain contemporaneous **transfer pricing documentation** as supporting evidence of the compliance with the arm's length principle. As such, the onus is on corporate taxpayers to primarily provide evidence of arm's length dealings. Penalties and arbitrary assessment of transfer prices or profits for CIT purposes may apply where a corporate taxpayer fails to have documentation or provide documentation within the prescribed timeline (30 working days of the tax authority's written request).
- Submit annual **declaration of RPTs and related transfer pricing methods** in Form GCN-01/QLT when filing annual CIT return. Amendments are provided in Circular 66 to require companies to declare their different categories of RPTs detailed by individual related parties, the nature of related party relationship and related transfer pricing methods.

About KPMG

KPMG is a global network of professional firms providing Audit, Tax and Advisory services. We operate in 144 countries and have 137,000 people working in member firms around the world. The independent member firms of the KPMG network are affiliated with KPMG International Cooperative (“KPMG International”), a Swiss entity. Each KPMG firm is a legally distinct and separate entity and describes itself as such.

KPMG in Vietnam

KPMG in Vietnam is one of the leading professional services firms, with over 800 staff working from our offices in Ho Chi Minh City and Hanoi. We work with our colleagues across Asia and around the world to provide a broad range of services.

KPMG’s Global Transfer Pricing Services

KPMG’s Global Transfer Pricing Services (GTPS) network comprises over 1,000 professionals from KPMG member firms around the world who work together to provide local knowledge, experience, and global analysis to help multinational companies address their transfer pricing responsibilities. KPMG’s GTPS practice includes economists, tax practitioners, and financial analysts. We use knowledge of local rules and how they interact to help member firm clients find tax-efficient pricing routes through an increasingly complex international web of transfer pricing rules.

Major technical amendments

Some of the important technical amendments are observed from Circular 66, which overall tighten application of the regulations:

- The thresholds of “material differences” are now prescribed to be 1% of transfer prices or 0.5% profit margin (either on a gross margin or net margin basic). The definition of “material differences” thresholds has far reaching implications for a number of important aspects of transfer pricing analysis and how the analysis should be conducted in accordance with the regulations, particularly the number of comparables to be selected, benchmarking, etc.
- The median value of an inter-quartile range is now used for purposes of benchmarking and transfer pricing adjustments in certain cases. Our observation from the international practice is that using the median value strictly results in significant disputes between taxpayers and tax authorities in transfer pricing audits and negotiations for advance pricing agreements.

Practical issues

Since the application of the local transfer pricing regulations (i.e. Circular 117 from the year 2006), a number of high transfer pricing risk transactions and “red flags” can be highlighted from the local practice as follows:

- prolonged loss making in one or a combination of the following cases: business expansion (as indicated by revenue and investment) associated with prolonged loss makings and suspected less than arm’s length transfer prices of tangible goods involving raw materials, fixed assets and manufactured products
- operating loss making at companies which perform routine functions and assume low risks in contract manufacturing or export processing (toll manufacturing)
- disallowed deduction for certain business expenses on the rationale of risk allocation between the Vietnamese company and international related parties
- rejected CIT deduction for related party payment of service fees, where the expenditures were not adequately substantiated in terms of service levels and transfer price setting
- inconsistency between the use of intangible assets (as evidenced by the payment of user’s fee) and business profits
- inconsistency between documented transfer pricing policy and actual business results, setting aside the impacts of external factors.

Recommended way forward

In the various recent headlines, the local tax authorities have expressly indicated concerns over transfer pricing practice in a number of sectors and their intentions of scrutinizing transfer pricing matters in their upcoming tax audits. Proper planning and compliance with the local requirements is now high on the corporate agenda for tax governance. Particular attention should be paid to the following areas:

- maintain contemporaneous transfer pricing documentation (i.e. at the time RPTs are carried out, rather than after the facts)
- consider arm’s length transfer pricing in every business decisions on dealings with related parties, including supply chain related issues
- review the results of application of transfer pricing policy and maintain necessary explanatory information for the results.

Contact us

Warrick Cleine

Chief Executive, Tax Managing Partner

Tel: +84 8 3821 9266 (ext 8200)

Fax: +84 8 3821 9267

e-Mail: warrickcleine@kpmg.com.vn

Hoang Thuy Duong

Tax Partner, Head of Global Transfer Pricing Services

Tel: +84 4 3946 1600 (ext 6406)

Fax: +84 4 3946 1601

e-Mail: dthoang@kpmg.com.vn

Ta Hong Thai

Tax Partner

Tel: +84 8 3821 9266 (ext 8240)

Fax: +84 8 3821 9267

e-Mail: thta@kpmg.com.vn

The information contained herein is of a general nature and is not intended to address the circumstances of any particular individual or entity. Although we endeavour to provide accurate and timely information, there can be no guarantee that such information is accurate as of the date it is received or that it will continue to be accurate in the future. No one should act upon such information without appropriate professional advice after a thorough examination of the particular situation.

© 2010 KPMG Limited, a Vietnamese limited liability company and a member firm of the KPMG network of independent member firms affiliated with KPMG International Cooperative ("KPMG International"), a Swiss entity. All rights reserved. KPMG and the KPMG logo are registered trademarks of KPMG International, a Swiss cooperative.