VIETNAM

NAM NGUYEN
Nam Nguyen Consulting

Transfer pricing in Vietnam: Potentially high cost of overlooking local norms

This article provides practical insights on transfer pricing (TP) audits in Vietnam. It explains why MNCs in Vietnam invest considerable resources in preparing their TP documentation, yet often still end up paying significant amounts of tax and penalties associated with their related party transactions.

As COVID-19 continues to affect people and businesses around the world, and governments are providing relief packages to address the economic impacts of the pandemic, plans may be underway to recoup government spending through taxation. In Vietnam, apart from hard-hit sectors such as airlines and tourism, most affected businesses are medium and small businesses, which have been granted a 5-month deferral of tax payment and 30% corporate tax reduction in 2020.

This leniency to affected businesses is likely to continue. To compensate for this, tax authorities in Vietnam will probably focus on large local and multinational companies (MNCs) – especially TP, which has been audited more closely since the major reform of Vietnam's TP regulatory framework in 2017.

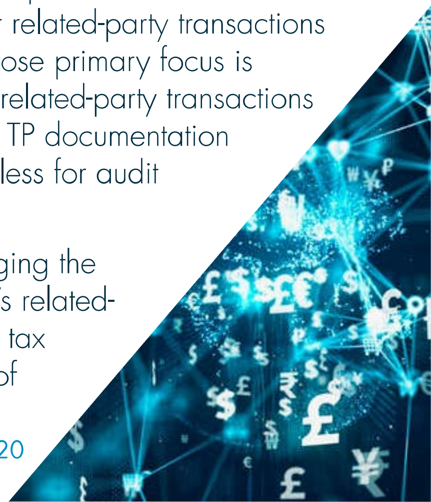
Transfer pricing – the pricing of intragroup transactions (mostly cross-border) within and between enterprises under common ownership or control ('related parties') – is not illegal. It is only unacceptable to tax authorities when a related-party transaction is not considered by tax auditors as a legitimate transaction, or is not conducted at arm's-length (i.e. at a fair market price).

Vietnam's first TP regulatory framework in 2017 was widely regarded by finance and tax specialists as a comprehensive set of rules that align well with international practices, closely following the OECD's TP guidelines. Many MNCs in Vietnam invest heavily in their preparation of TP documentation, to defend their TP practice if challenged by tax auditors. However, unless this adheres to local norms of transaction recording and documentation, MNCs can still face heavy penalties, including:

- A 20% tax penalty on the amount of corporate income tax adjustments resulting from the disallowed tax deductions of related-party charges;
- A 0.03% daily accruing interest penalty on the tax in arrears, in addition to the tax claw-back arising from TP adjustments;
- Foreign contractor withholding tax, which applies when a company in Vietnam makes a contract payment to a overseas related party (e.g. loan interest, service charges, cost reimbursements, royalty fees). This cost (which represents the foreign contractor's deemed corporate income tax) ranges from 1% to 10% of the gross amounts of the contract payments.

Companies would be wrong to assume that having proper TP documentation in place means that the arm's length nature of their related-party transactions will satisfy TP auditors, whose primary focus is legitimacy. If a taxpayer's related-party transactions fail the legitimacy test, the TP documentation dossier could become useless for audit purposes.

In practical terms, challenging the arm's-length of a taxpayer's related-party transactions requires tax auditors to research a lot of



KRESTON

Transfer pricing in Vietnam: Potentially high cost of overlooking local norms continued

information (e.g. identifying or developing their own comparables). And it is not difficult for taxpayers to prove the legitimacy of related-party transactions with tangible exchanges of resources (e.g. loans, sale/purchase of goods, contract/toll-manufacturing). It is much easier for tax auditors to apply the legitimacy test to transactions involving less tangible exchanges of resources, such as shared services (e.g. tax, accounting, HR, legal, IT support), strategic management services, R&D services, intellectual property licensing, cost-sharing arrangements, secondment of personnel, and so on.

Taxpayers can be surprised by what tax auditors look for when applying a legitimacy test. They might look for little things, such as a missing document named 'invoice' (MNCs often use 'debit note' instead), a formal statement of work, a service level agreement (master services agreements alone are often insufficient), service charge allocation keys, evidence of specific service requests, proofs of services rendered, sample of service deliverables, service completion and handover reports, independent auditor's verification report of the service charges, and so on.

Many MNCs do not have all of these formal documents to support their related-party transactions because related parties are usually unlikely to have a legal dispute over an intragroup transaction, and because paperwork is streamlined for administrative efficiency. However, although email communications are now a prevalent mode of doing business, tax auditors rarely accept them as substitutes for formal paper documents. A taxpayer with a clear email trail proving the legitimacy of its related-party transactions could still end up being denied tax deductions of related-party expenses by tax auditors.

While Vietnam's tax system is moving fast to digital tax administration (e.g. online tax filings, e-invoices, etc), tax auditors have yet to move on from the traditional norms of working with paper-based transaction documents

Tax auditors also insist that almost everything concerning related-party charges must be substantiated by formal paperwork: only originals or certified photocopies are accepted as transaction evidence for tax deduction purposes. Furthermore, if the transaction evidence is in another language, a Vietnamese full or summary translation must be provided.

While Vietnam's tax system is moving fast to digital tax administration (e.g. online tax filings, e-invoices, etc), tax auditors have yet to move on from the traditional norms of working with paper-based transaction documents. Until this changes, taxpayers in Vietnam (especially MNCs) are advised to beware of these local norms: overlooking or ignoring them could have costly consequences.