CHAPTER 6 **TAXATION AND TRANSFER PRICING**

I. TAX ADMINISTRATIVE PROCEDURE REFORM

Relevant authorities: Ministry of Finance (MOF), General Department of Taxation (GDT)

Issue Description

To align with common global trends, attract investment, and create a favourable business environment, the Government has implemented many tax reforms. These have reduced administrative procedures and improved enterprises' performance and productivity, which are greatly welcomed. On 19 October 2020, the Government issued Decree 126[1] to guide the Law on Tax Administration. However, several points appear not to be in line with this.

1. Requirement for amending monthly/quarterly PIT filing

Decree 126 mentions that the taxpayer shall be entitled to submit supplementary dossiers for any incorrect filings. If the annual tax finalisation dossier has been submitted, only supplementation to the annual tax finalisation dossier is required. However, if supplementing the income payer's PIT finalisation return, Decree 126 requires that the relevant incorrect monthly or quarterly tax returns also be supplemented. If the supplemental declaration leads to an increase in the tax payable amount or a decrease in the tax that has been refunded by the State, then the taxpayer shall pay the additional amount or repay the over-refunded amount and late payment interest to the State's budget.

This means that, in addition to the amendment to the annual declaration, enterprises must also correct the monthly and quarterly declarations.

2. Tax payments on behalf of business individuals/households

Decree 126 and Circular 40[2] regulate that organisations paying bonuses, sale support, trade, price and early-payment discounts to dealers being business households or individuals are obliged to withhold PIT and VAT on behalf of the dealer. The move was explained by policymakers as a measure to increase the tax collection from business individuals/households whose taxes are normally based on deemed taxable revenue multiplied by flat PIT and VAT rates varying across different business activities.

Potential gains/concerns for Vietnam

Decree 126 raises concerns in relation to increased administrative procedures leading to costly and difficult compliance and the adoption of tax collection measures in breach of fundamental tax principles. In particular:

1. Requirement for amending monthly/quarterly PIT filing

Most companies understand that the monthly tax declaration is a temporary tax payment which will be recalculated and finalised in the full-year PIT finalisation. There could be several reasons for a difference between the total tax liabilities per monthly/quarterly tax returns and the final tax liability as per the finalisation return. If a company identifies any incorrect declarations and volunteers to amend the tax finalisation return, the requirement to amend the relevant provisional monthly/quarterly tax returns creates a lot of administrative work and costs for the company. It also diminishes the meaning of an annual tax finalisation. A company must spend more time and labour costs to prepare the monthly/quarterly tax returns with the precise tax payable amount to avoid interest and administrative penalties in the future.

Tax payments on behalf of business individuals/households

1 Decree 126/2020/ND-CP dated 19 October 2020 of the Government elaboration of the Law on Tax Administration.
2 Circular 40/2021/TT-BTC on tax management of business households and individuals.

Trade and price discounts are common commercial conditions between sellers and buyers, which reduce the price rather than being income to the buyer. Trade and price discounts are also recorded as sales reductions in the accounting book and on the invoice for the seller. Defining trade and sale discounts as the income of dealers being business households or individuals distorts the nature of such payments and creates a practice of misleading interpretation of taxable events for the pure purpose of tax collection.

Bonus, sale support, or early payment discount are defined as other or financial income to the buyer, and under Decree 209[3] fall into the category of items not subject to VAT. The imposition of VAT in Circular 40 on such payments at the same rate as the underlying goods/services for which the payments are made, misrepresents such payments as the trading revenues of dealers – which is not the case. It also seems to contradict Decree 209. The tax authority should not reclassify the incomes received by business individuals and households for tax-collection purposes only.

Recommendation

We would like to make the following recommendations:

- Amend Point a, Clause 4, Article 7, of Decree 126 so that there is consistency in the requirement on the amendments of the annual finalisation tax returns between the annual PIT withholding tax return and other tax finalisation returns.
- Amend Decree 126 and Circular 40 to exclude trade and sale discount from the group of incomes taxed in the hand of business individuals/households; and to not impose VAT on bonuses, sale support, and early payment discounts.

II. TAXATION OF OFFSHORE INDIRECT TRANSFER OF CAPITAL

Relevant authorities: Ministry of Finance (MOF), General Department of Taxation (GDT)

Issue Description

Certain private rulings have been issued by the Vietnamese tax authorities providing general guidance that transactions of share transfer at the overseas parent/grand-parent level are subject to tax in Vietnam; and the Vietnamese company is obliged to file and pay the tax on behalf of the seller. However, the current tax regulations lack detailed and concrete guidance including (i) the basis of taxation and the specific cases which are covered, as well as (ii) the calculation of tax and the declaration process. This unclear guidance has caused a lot of controversy and difficulty for enterprises where there are indirect transfers of shares occurring or being contemplated.

Potential gains/concerns for Vietnam

We acknowledge that the Vietnamese tax authorities have the right to decide to tax capital gains arising from offshore indirect transfers. However, this should be clearly provided under domestic legislation, which should reflect international tax practice and be feasible to implement.

There should be limitations on which indirect transfers are subject to tax, similar to those in other countries which tax indirect transfers, such as the following exceptions:

- Transactions on overseas stock exchanges where the parent or grand-parent enterprises are listed/public entities;
- Internal group restructuring;
- A de minimus test for the transfer to be taxable[4], and;

3 Decree 209/2013/ND-CP dated 18 December 2013 of the Government detailing and guiding implementation of a number of articles of Law on Value-Added Tax.

4 For example, where the value of the Vietnam assets is over a certain monetary level and represents 50 per cent or more of the total value of the assets transferred by the overseas party.

- The rules do not apply where there is a reasonable commercial purpose for the indirect transfer.

The inclusions of these exceptions will enhance the enforcement of indirect capital transfer tax. With no limitation of the coverage of the tax, as is currently in place, the law is undermined because implementation in various cases is unfeasible.

Recommendation

We would like to make the following recommendation:

- Develop concrete and detailed guidance on the taxation of indirect transfers of shares as soon as possible to enhance the transparency of the tax environment in Vietnam.

III. IMMOVABLE PROPERTY RATIO DETERMINATION IN DOUBLE TAX TREATY APPLICATION

Relevant authorities: Ministry of Finance (MOF), General Department of Taxation (GDT)

Issue Description

Under numerous Double Tax Treaties (DTT) to which Vietnam is a signatory, the taxing right on income from alienation of shares in a company will belong to the Contracting State of which the alienator is a resident if the assets of the company do not consist wholly or principally of immovable property. Circular 205[5] states that, where the treaty does not specify the ratio to be considered as "consisting principally of immovable property", a ratio of 50 per cent based on the balance sheet of the company at certain milestones will be used. Yet, in determining the immovable property ratio, the tax authorities have tended to include the value of machinery and equipment (M&E) for the calculation of the ratio. In several cases, the inclusion of M&E seemed to have been conducted arbitrarily to deny the right to claim DTT benefit of the alienator.

Potential gains/concerns for Vietnam

As per official guidance documents issued by the GDT, immovable properties also include "auxiliary assets accompanied to immovable properties or assets attached to land". In addition, Official Letter 2345[6] clarified that M&E and molds which are "not attached to the factory building permanently" and could be moved in/out of the factory to manufacture products are not immovable property. Some local tax authorities have relied on OL 2345 to interpret that any M&E affixed to the floor of the factory in a permanent and solid manner – either through concrete foundation or connection to a synchronised M&E line – is immovable property.

However, this interpretation disregards the fact that factories are designed for specific purposes with a technically optimal lay-out, which inherently brings with it a degree of permanence. M&E brought in for manufacturing purposes generally do not constitute a part of nor are they attached to the building. Yet, in some circumstances, the M&E system could be considered equivalent to immovable property. For example, heavy M&E erected on land the dismantling of which could destroy its functionality. In international practice, in order to determine if certain M&E is immovable, an economic test to compare the dismantling, moving, and erection of the M&E to a new location vs. the acquisition cost of new M&E of the same quality should be performed. If it is more economical to relocate the existing M&E to a new location than acquire new M&E, the M&E should not be considered immovable.

Recommendation

We would like to make the following recommendation:

- Issue clear guidance on the determination of immovable property ratio to all local tax authorities based on an economic test.

5 Circular 205/2013/TT-BTC dated 24 December 2013 of the Ministry of Finance guiding the implementation of the Agreements on Double taxation avoidance and prevention of tax evasion with respect to taxes on income and property between Vietnam and other states or territories and in force in Vietnam.

6 Official Letter 2345/TCT-HTQT dated 16 June 2015 of the Ministry of Finance on determination of value of immovable assets in the total value of company (OL 2345).

IV. CORPORATE INCOME TAX AND NON-DEDUCTIBLE EXPENSES

Relevant authorities: Ministry of Finance (MOF), General Department of Taxation (GDT)

Issue Description

Current Corporate Income Tax (CIT) regulations state that, except for certain non-deductible expenses specifically mentioned in the regulations, enterprises can deduct all expenses if they satisfy three conditions: (i) actually incurred in relation to the business operations; (ii) supported by legitimate invoices and documents; (iii) supported by non-cash payment in respect of invoices having a minimum value of VND 20 million inclusive of VAT.[7] However, in practice, the tax authorities seem to be increasingly using non-compliance by companies relating to non-tax regulations as reasons to deny deductibility of expenses, even though the issue has already been remedied.[8]

Potential gains/concerns for Vietnam

Companies operating in Vietnam are subject to various non-tax compliance requirements. If they fail to comply, they should be subject to administrative penalties.

Under the current CIT regulations, administrative penalties are non-deductible expenses.[9] However, the tax authorities have in our view arbitrarily interpreted the regulations to reject the associated expenses of transactions which are non-compliant with regulations other than tax. Such treatment effectively imposes an additional penalty for non-compliance for actions already penalised under other laws and regulations, creating uncertain tax risks and distorting economic transactions.

Recommendations

We would like to make the following recommendations:

- Clearly state in future CIT regulations the types of expenses which shall be treated as non-deductible where related compliance requirements in non-tax regulations are not met.
- In the meantime, ensure that unless tax regulations specifically govern the matter, any non-compliance with non-tax regulations which only give rise to an administrative fine are not a reason to reject an expense's deductibility.

V. DECREE 132 AND COVID-19 IMPACT

Relevant authorities: Ministry of Finance (MOF), General Department of Taxation (GDT)

Issue Description

Decree 132[10] does not contain specific guidelines for comparability analysis, adjustment, and quantification for operating expenses for enterprises impacted by COVID-19.

Potential gains/concerns for Vietnam

Currently, many enterprises are incurring operating losses, sometimes leading to bankruptcy or insolvency, because of COVID-19. Even though Decree 132 was released after the outbreak of COVID-19, there is no guidance about the comparability analysis, adjustment, and quantification for operating expenses. Decree 132 states that taxpayers are not required to adjust prices and profit margins if they fall within the arm's-length range from the

7 Article 11 of Circular 78/2014/TT-BTC of Ministry of Finance dated 18 June 2014 guiding the implementation of the Government's Decree 218/2013/ND-CP of 26 December 2013 detailing and guiding the implementation of the Law on Corporate Income Tax which has been amended from time to time.

8 For example, late registration of loan contract, technology transfer contract or late work permit will result in non-deductible of related expenses during the period of late registration. Non-compliance of promotional program notification also result in the non-deductible promotion expenses, just to name a few.

9 Point 2.36, Article 6 of Circular 78/2014/TT-BTC.

10 132/2020/ND-CP dated 5 November 2020 of the Government prescribing tax administration for enterprises having related-party transactions.

35th to the 75th percentile. This regulation leads to taxpayers having to achieve profit margins within the arm's-length range but does not consider the effects of COVID-19. In practice, enterprises struggle to justify the financial performance in 2020 during transfer pricing audits.

The impact of the under-capacity utilisation or registered capacity according to the investment certificate should be adjusted. The stagnation and fixed costs incurred without corresponding revenue, extraordinary expenses incurred due to the pandemic, the differences in revenue between 2020 and 2019 for the same period as the basis to increase the profit margin of the taxpayers in comparison with the comparable companies should also be adjusted. If the profit margin of the taxpayer after quantification of these effects is within the standard arm's-length range, then no further adjustment of the price and profit rate for the purpose of tax declaration should be required.

Other countries in Asia-Pacific[11] provide detailed guidelines for enterprises to assess the compliance with Transfer Pricing Regulations in the context of the economy affected by COVID-19.

Recommendations

We would like to make the following recommendations:

- Issue detailed guidelines for adjustments of the operating expenses.
- If this retroactively results in an overpayment, allow the carry forward and offsetting the overpaid amount with the tax payable amounts of subsequent years to maximise support for enterprises.

VI. SELECTION OF INDEPENDENT COMPARABLE COMPANIES

Relevant authorities: Ministry of Finance (MOF), General Department of Taxation (GDT)

Issue Description

Regarding transfer pricing, the selection of comparable companies is critical to assess the compliance of an enterprise and it forms the basis to determine tax obligations. However, the criteria for selecting comparable companies under Decree 132 is not clear.

Potential opportunities/challenges for Vietnam

The GDT confirmed that there will be no Circular to provide further guidance. However, Decree 132 only provides a general procedure for the comparability analysis without specifying the criteria set nor respective examples. This leads to disagreements between taxpayers and tax officers during transfer pricing inspections. Local tax authorities look for reasons to reject the comparability analysis presented in the files of the taxpayers[12] with the purpose to impose a transfer pricing adjustment by using databases of the tax authority that are not available to taxpayers, instead of taking account of taxpayers' justifications and efforts to be compliant.

Recommendation

We would like to make the following recommendation:

- Issue detailed guidelines about the criteria used for selecting comparable companies to generate a transparent tax policy, as well as remove burdens/difficulties for tax officers and taxpayers in interpreting regulations for the compliance purposes and transfer pricing inspections.

11 Such as Japan, Australia, or Singapore.

12 For example, non-comparable companies, significant business scales in comparison with the taxpayers, the expense ratio reflects the functions or comparable companies incurred some related-party transactions but insignificant and did not affect the profit margin of the companies, etc.

VII. TRANSFER PRICING ADJUSTMENT BY LOCAL TAX AUTHORITIES

Relevant authorities: Ministry of Finance (MOF), General Department of Taxation (GDT)

Issue Description

The imposition of transfer pricing adjustments is based on a company's overall financial result, rather than using a separate segmented result for related-party transactions only (which comprise a small portion compared to the transactions with third parties). This adjustment practice is unreasonable when the subject of Decree 132 (and Decree 20 previously) is related-party and not third party transactions.

This is generating inconsistencies in the enforcement of regulations between local tax authorities as well as the tax officers.

Potential opportunities/challenges for Vietnam

The current practice results in inconsistent enforcement of regulations by local tax authorities or individual tax officers. It also causes issues related to transparency/reasonableness in the application of the regulations in tax inspections. In case it is not possible to segment the profit and loss, tax officers and taxpayers should try to agree on the most appropriate allocation method regarding revenue/cost reflecting the actual business activities and the risks assumed in the related-party transactions.

Recommendation

We would like to make the following recommendation:

- Issue detailed guidance on the calculation of transfer pricing adjustments in transfer pricing examinations/ inspection, in which it is clearly stated that the calculation of the additional tax obligation or loss reductions is based on the segmented financial result for related-party transactions and not the overall company financial results (including third-party transactions).

VIII. ACCOUNTING PRINCIPLES FOR IMPORT DUTY REFUNDS

Relevant authorities: Ministry of Finance (MOF), General Department of Customs (GDC)

Issue Description

For the purpose of export production, companies usually purchase material from foreign and domestic suppliers. Under the prevailing laws on import duties, the paid import duties associated with the imported materials/ components (imported under A11/A12 type) are entitled to be refunded if such imported material is used for the production of exported goods. For the import duties claimed for refund, companies have to specify which imported materials/components they are associated with and their original import declarations.

However, in practice, for consistency and ease of management, companies monitor identical production material under a uniform SKU code (i.e. commodity code) regardless of the source of the material and as a result, companies generally cannot distinguish which materials/components are imported (and are covered under which import declarations) and which are purchased domestically to present details in the duty refund dossiers, when the materials/components have been used to produce the exported goods.

Potential gains/concerns for Vietnam

Due to the fact that the above-mentioned material is the same, with the same commercial quality and technical specifications, it can be used interchangeably for manufacturing goods for export. Once they are mixed and combined to create a finished product, it is no longer possible to distinguish the imported material from the domestically sourced ones for purposes of duty refunds.

Recommendation

We would like to make the following recommendation:

- Allow companies to apply the accounting principles (e.g. FIFO or pro-rata basis) to identify the number of imported materials/components used for exported goods and the corresponding amount of import duties to be refunded by the customs authorities.

IX. LATE SUBMISSION OF PAYMENT PROOF IN DUTY REFUNDS

Related authorities: Ministry of Finance (MOF), General Department of Customs (GDC)

Issue description

Paid import duties associated with imported material (under A11/A12 type) can be refunded if it is used for the production of goods for export. One of the documents companies have to submit to customs authorities to claim this refund is the payment evidence relating to the exported-imported goods.

However, payments between companies and foreign clients can be arranged via a Letter of Credit (L/C) or Telegraphic Transfer (T/T) 90 days from the date of the exportation of goods. Therefore, when companies submit the duty refund dossier to the customs authorities, companies cannot provide a copy of the payment proof. As a result, the duty refund claim is automatically classified as high-risk. This will require an on-site audit conducted by the customs authorities to verify the declared refund data before a refund decision can be issued (also known as "Audit First - Refund Later").

Potential challenges/opportunities for Vietnam

The classification of duty refund claims into an Audit First – Refund Later mechanism will prolong the refund timeline from one to three months before the company can obtain the refund decision. This can significantly affect the cash flow of companies.

Recommendation

We would like to make the following recommendation:

- Allow exporters to submit refund dossiers (and get Refund First – Audit Later) where there is a payment arrangement between exporters in Vietnam and their offshore buyers if they hold the evidence of either:

  An "irrevocable L/C" showing the exporter as the beneficiary; or

  Under TT arrangement, a confirmation issued by the exporter's bank, that payment from the buyer has been received.

X. NO PENALTY FOR FIRST-TIME INCORRECT HS CLASSIFICATION

Relevant authorities: Ministry of Finance (MOF), General Department of Customs (GDC)

Issue Description

In the past, under Decree 127 and Decree 45[13], administrative penalties were not applied on first-time HS code classification of exported/imported goods provided that the description of the goods was declared precisely. However, according to the current regulations promulgated under Decree 128[14] this is no longer applicable.

13 Decree 127/2013/ND-CP dated 15 October 2013 of the Government on penalties for administrative violations and enforcement of administrative decisions pertaining to customs controls. Decree 45/2016/ND-CP dated 26 May 2016 of the Government amendments to some articles of the Government's Decree 127 dated 15 October 2013 of the Government on penalties for administrative violations and enforcement of administrative decisions pertaining to customs controls.

14 Decree 128/2020/ND-CP dated 19 October 2020 of the Government on penalties for administrative customs offences.

Potential opportunities/challenges for Vietnam

This seems to be a backward step in customs policy, as this violation can easily occur when companies import new goods.

Recommendation

We would like to make the following recommendation:

- Restore the tolerance treatment in terms of HS classification to what was applied under Decree 127 and Decree 45 and provide clear implementation guidance.

ACKNOWLEDGEMENTS

EuroCham Taxation & Transfer Pricing Sector Committee.

FOR MORE TAX-RELATED ISSUES PLEASE ALSO READ

EuroCham Taxation & Transfer Pricing Sector Committee.

› Chapter 8	Transport and Logistics	Section II. Customs, 5. Transfer Price Adjustments
› Chapter 12	Women in Business	Section I. Labour Regulations Affecting Female Employees, 2. Set out clear, concrete incentives encouraging employers to implement female-friendly policies
› Chapter 14	Automotive	Section I. Taxation Issues
› Chapter 15	Motorcycles	Section II. Registration Fee
› Chapter 17	Wine and Spirits	Section I. Special Consumption Tax