

Appendix E: Country Study Vietnam

Contents

1.	Introduction.....	1
1.1.	Overview of Vietnam's economy	1
1.2.	Tax structure	5
1.3.	Foreign Direct Investment in Vietnam	8
2.	Overview of the current Transfer Pricing legislation & audit practices.....	12
2.1.	Overview of the existing Transfer Pricing rules in Vietnam	12
2.2.	TP audit practice	16
2.3.	Dispute Resolution mechanism.....	20
3.	Experiences with TP reform processes	23
4.	Appropriateness of and actions needed to introduce TP legislation.....	27
5.	Recommendation for future donor support.....	28
5.1.	Current scenario.....	28
5.2.	Areas for future donor support	29
6.	Conclusions.....	34
	Appendices	37
	Appendix 1: List of interviewees.....	38
	Appendix 2: References.....	39

Abbreviations and acronyms

ADB	Asian Development Bank
APA	advanced pricing arrangement
ASEAN	Association of South East Asian Nations
BIT	Business Income Tax Act
BT	Build transfer
BTO	Built-transfer-operate
DFID	World Bank Department for International Development
DTAA	double tax avoidance agreement
EIT	Enterprise Income Tax
EITL	Enterprise Income Tax Law
EU	European Union
FDI	Foreign Direct Investments
FIEs	Foreign-invested enterprises
GDP	Gross Domestic Product
GDT	General Department of Taxes
IMF	International Monetary Fund
IFC	International Finance Corporation
IT	information technology
JICA	Japanese International Cooperation Agency
LCI	Law on Credit Institutions
LTO	Large Taxpayers Office
MAP	mutual agreement procedure
MoF	Ministry of Finance
MNCs	multinational companies
NTA	Japanese National Tax Agency
OECD	Organisation for Economic Cooperation and Development
OECD TP Guidelines	OECD transfer pricing guidelines for multinational enterprises and tax administrations
PTS	Propaganda and Taxpayer Service Unit
SBV	State Bank of Vietnam
SOEs	state-owned enterprises
TAMP	Tax Administration and Modernisation Project
TP	transfer pricing

UNDP	United Nations Development Programme
VAS	Vietnam Accounting Standard
VAT	value added tax
VND	Vietnamese dong
WTO	World Trade Organisation

1. Introduction¹

1. Vietnam is often touted as the next Asian economic tiger, with many drawing a parallel to the success story of China. It was one of the fastest growing economies in the East Asia and Pacific region prior to the global economic crisis. However, the speed with which Vietnam's economy is bouncing back from the lows of 2009 appears to be less impressive than that in countries that experienced negative growth in 2010.

1.1. Overview of Vietnam's economy

2. Vietnam has been carrying out economic reforms since 1986 under the 'Doi Moi' ('Renovation') policy, focusing on market-oriented economic management. This includes:²
 - (ii) restructuring to build a multi-sector economy;
 - (iii) financial, monetary and administrative reform; and
 - (iiii) the development of external economic relations.
3. Vietnam's economy is socialist-oriented. Its economic structure can be classified into the following sectors.³
 - (ii) Primary Sector – comprising agriculture, aquaculture, fishery and forestry;
 - (iii) Secondary Sector – comprising auxiliary industries and construction; and
 - (iiii) Tertiary Sector – comprising the services sector: banking, insurance, telecommunications, transportation, tourism and others.
4. Vietnam's economy registered a real gross domestic product ("GDP") of 5.3 % in 2009 and was expected to grow between 6.5 and 6.7% in 2010. The growth slowdown in 2008-09 and subsequent recovery in 2010 is largely attributed to what has been happening to Vietnam's tradable sectors, i.e. manufacturing and commodities. The growth rate of industry and construction fell from 10.2% in 2007 to 6% in 2008 and further to 5.5% in 2009, then recovering to above 7% in 2010. Similarly, agricultural growth fell from 4.7% in 2008 to 1.8% in 2009 and then bounced back to 2.8% in 2010. These large swings in growth rates have coincided with an initial collapse and subsequent recovery in external demand – an indication that, at least in the near-term, growth in Vietnam has been constrained more by a lack of external demand than by supply-side considerations.

¹ Source: 'Taking Stock – An Update on Vietnam's Recent Economic Developments' – A World Bank publication.

² Source: 'Vietnam - A Guide for Business and Investment' (May 2008) – a PwC publication.

³ Source: http://www.economywatch.com/world_economy/vietnam/structure-of-economy.html.

5. The value-added output in the combined agriculture, forestry and fisheries sector expanded by 2.9% in the first nine months of 2010. Similarly, gross industrial output increased by 13.8% in the first eleven months – turnover in the foreign-invested sector rose by 16.9% and the domestic private sector expanded by 14.5%, while that of state-owned enterprises ('SOEs') grew 7.5% year-on-year. Despite the rapid recovery, there remains excess capacity or potential for higher production in selected sectors (e.g. fisheries, rice).
6. The growth slowdown in the service sector has been less visible as has its rebound. The sector recorded a growth rate of 7.2% in the first nine months of 2010, due to the strong performance of retail trade, tourism, transportation and financial services.
7. GDP at current prices by economic sector as extracted from the General Statistics Office of the Vietnamese government website (<http://www.gso.gov.vn>) is provided below both in absolute terms as well as a percentage, to provide an indication of the contribution of the three economic sectors to GDP:

Year	Total	Of which		
		Agriculture, forestry and fishing	Industry and construction	Service
		<i>Bill. dongs</i>		
2000	441,646	108,356	162,220	171,070
2001	481,295	111,858	183,515	185,922
2002	535,762	123,383	206,197	206,182
2003	613,443	138,285	242,126	233,032
2004	715,307	155,992	287,616	271,699
2005	839,211	175,984	344,224	319,003
2006	974,266	198,798	404,697	370,771
2007	1,143,715	232,586	474,423	436,706
2008	1,485,038	329,886	591,608	563,544
Prel. 2009	1,658,389	346,786	667,323	644,280

Year	Total	Of which		
		Agriculture, forestry and fishing	Industry and constructi	Service
		<i>Structure (%)⁹ⁿ</i>		
2000	100.00	24.53	36.73	38.74
2001	100.00	23.24	38.13	38.63
2002	100.00	23.03	38.49	38.48
2003	100.00	22.54	39.47	37.99
2004	100.00	21.81	40.21	37.98
2005	100.00	20.97	41.02	38.01
2006	100.00	20.40	41.54	38.06
2007	100.00	20.34	41.48	38.18
2008	100.00	22.21	39.84	37.95
Prel. 2009	100.00	20.91	40.24	38.85

8. Vietnam's state budget revenue has increased continuously and steadily from about 21% of GDP in 2000 to about 28% of GDP in 2009. At the same time, budget expenditure has also increased, resulting in a persistent deficit of 5% of GDP during the same period. Vietnam's state budget deficit in 2010 stood at VND 109.4 trillion (USD 5.2 billion), equal to 5.6% of GDP. The state budget deficit for 2011 is estimated at VND 120.6 trillion (USD 5.73 billion), equivalent to 5.3% of GDP.⁴
9. Taxes collected in the relevant years as extracted from the MOF website (<http://mof.gov.vn>) are shown below both in absolute terms and as a percentage of GDP:

Year	Tax collections	GDP	% of tax collections / GDP
	Bill. Dongs		
2005	219,438	839,211	26.15
2006	263,864	974,266	27.08
2007	299,096	1,143,715	26.15
2008	392,463	1,485,038	26.43

10. Vietnam became a member of the world trade organisation ("WTO") in January 2007. Vietnam also signed a Trade and Investment Framework Agreement with the United States in June 2007. It is also a member of the ASEAN free trade Area, which was initiated in 1992, and a signatory to the association of South East Asian Nations ("ASEAN") Framework Agreement for Services which is aimed at strengthening cooperation among service suppliers in the ASEAN region, reducing restrictions on trade in services and progressively

⁴ Source: based on the national accounts statistical data available on the General Statistics office of Vietnam's official website and <http://dailynews.vn/news/economy/economy/80112-Vietnam-targets-2011-state-budget-deficit-at-53pct-of-GDP.html>.

liberalising trade in services. Negotiations for the EU-ASEAN Free Trade Agreement commenced in May 2007.⁵

11. In 2010, Vietnam's total exports are expected to have exceeded USD 70 billion, registering annual growth of around 24%. Imports are expected to grow by around 20% in 2010 compared to a negative growth rate of 13% in 2009. Imports for some raw materials and intermediate inputs for manufacturing exports have experienced very high growth rates compared to weak or negative growth in imports of capital goods and inputs for agriculture.
12. China is expected to be Vietnam's largest trading partner, overtaking the ASEAN countries (as a group). In the first 10 months of 2010, Vietnam's trade with China amounted to USD 21.25 billion, compared to USD 21.3 billion with the ASEAN region. Its main import sources are China and other East Asian countries. However, Vietnam continues to rely on industrialised countries for the majority of its exports. Of its trade partners, the United States continues to be Vietnam's biggest export market, accounting for more than a fifth of the nation's total exports. It is followed by the European Union, ASEAN, Japan and China.
13. Vietnam's currency, the dong (VND), has been under pressure since 2008 and has lost nearly one-third of its value against the US dollar during this period. This, together with ballooning inflation, has led to some level of macro-economic instability.
14. The financial market in Vietnam has been developing widely and deeply after 20 years of innovation. The number of new financial institutions has been increasing rapidly. At the end of 2008, the number of credit institutions was up to 90 including three state-owned commercial banks, two state-held joint-stock commercial banks, once social policy bank, one development bank, 37 foreign bank branches, four wholly foreign-owned banks, five joint venture banks and 37 joint-stock commercial banks. In addition, there are approximately 1,000 people's credit funds, nine financial companies, 12 leasing companies, local development funds, investment funds, security companies and insurance companies.⁶ The demand for setting up 100% foreign banks, international joint venture banks and international funds managers has increased since Vietnam signed up to the WTO with effect from January 2007.
15. The way in which the financial markets have developed over the past few years has become more complicated and diversified with moves towards liberalisation and integration embedded in a combination of objective factors from the markets and subjective ones from regulators. Competition in the market has also increased.

⁵ Source: 'Country Survey – Vietnam' (updated as of 1 March 2011) – an IBFD publication.

⁶ Source: Vietnam Business Annual Report 2008 – a Vietnam Chamber of Commerce and Industry publication.

16. Since 1998, with support from multilateral donor institutions, the government has outlined a comprehensive reform and restructuring programme to improve the efficiency of the commercial banking system. The programme includes four components:
- (i) restructuring joint-stock banks through mergers and closures to reduce the number of joint-stock banks by half;
 - (ii) transforming state-owned commercial banks into independent businesses;
 - (iii) improving and strengthening the supervision and inspection of commercial banks and creating a 'level playing field'; and
 - (iv) establishing asset management corporations as a tool for resolving non-performing loans.⁷
17. A number of important changes in the policies and regulations announced in 2010 are expected to fundamentally reshape the working environment of the banking sector. These changes include the removal of interest caps, revised banking laws (namely the Law on the State Bank of Vietnam (SBV Law) and the Law on Credit Institutions (LCI)), regulation on prudential ratios, a higher minimum capital requirement for banks (VND 3 trillion) and a forthcoming revised regulation on loan classification and provisioning.⁸
18. The insurance services market has been growing rapidly with the participation of state-owned, joint-stock, joint-venture and wholly foreign-owned companies. By May 2008, there were about 38 insurance businesses from all economic sectors operating in the insurance business, of which eight cover life insurance, one is composite, 21 are non-life and eight are in brokerage. In addition, there were approximately 30 representative offices of foreign insurance companies operating in Vietnam. As of 1 January 2008, pursuant to WTO commitments, foreign insurers are allowed to provide compulsory insurance products.⁷

1.2. Tax structure⁹

19. Vietnam imposes enterprise income tax on ('EIT') corporate profits. Effective 1 January 2009, a new Enterprise Income Tax Law ('EITL') was put in place of the old law. Until 31 December 2008, the old law had applied to organisations and individuals engaged in and deriving income from the production of and/or trading in goods and/or services. Besides EIT, there is capital assignment profits tax (tax on gains on the transfer of an interest in a foreign-invested or Vietnamese enterprise). In addition, Vietnam imposes other taxes such as withholding tax, value added tax ("VAT"), import and export tax and some other taxes.

⁷ Source: 'Vietnam - A Guide for Business and Investment' (May 2008) – a PwC publication.

⁸ Source: 'Taking Stock – An Update on Vietnam's Recent Economic Developments' – a World Bank publication.

⁹ Source: 'Country Survey – Vietnam' (updated as of 1 March 2011) – an IBFD publication.

20. Generally each different tax is governed by its own statute; for example, the EITL governs the imposition of enterprise income tax and the Law on Value Added Tax governs the imposition of VAT. These laws are normally supported by decrees, decisions and circulars that detail and guide implementation of the primary legislation. The tax administration agency in Vietnam is the General Department of Taxation ('GDT') which is under the purview of the Ministry of Finance ('MoF').

21. Vietnamese-registered enterprises are taxed on their worldwide income. Foreign-invested enterprises ('FIEs') with a permanent establishment in Vietnam are taxed on worldwide income generated by the permanent establishment, as well as on specified Vietnamese-sourced income that is not related to the permanent establishment. Foreign enterprises without a permanent establishment in Vietnam are taxed only on their Vietnamese-sourced income.

22. The key features of Vietnam's income tax structure are summarised below:
 - (i) In accordance with the Law on Tax Administration, Vietnam operates a self-assessment system where taxpayers are expected to compute their own tax liability. However, the Law also provides for tax assessments where tax administration agencies can determine the amount of tax payable.
 - (ii) The tax administration is handled by the GDT at central level, along with provincial tax departments in each of the provinces of the country.
 - (iii) The corporate tax rate is 25% (reduced from 28% in June 2008) for FIEs and domestic companies; preferential rates apply to entities that have been granted tax incentives.
 - (iv) The tax year is the calendar year. All companies are required to prepare their annual financial statements and submit their tax return in a prescribed form, along with their annual financial statements and other supporting documents within 90 days from the end of the calendar or fiscal year.
 - (v) There are no provisions for any form of consolidated filing or group relief.
 - (vi) Payments of royalties in relation to the transfer of technology by foreign parties and interest on offshore loans are subject to 10% withholding tax, which may be reduced under a tax treaty.
 - (vii) No withholding tax is levied on payments of dividends after tax is paid on corporate profits.
 - (viii) Business activities/industries that are subject to foreign contract withholding include:

- a) trading (including distribution, supply of goods, materials, machinery and equipment in Vietnam) @ 1%;
 - b) services, lease of machinery and equipment, or insurance @ 5%;
 - c) construction (including installation, with or without the supply of materials, machinery or equipment) @ 2%; and
 - d) manufacturing, transportation and other business activities @ 2%.
- (ix) Vietnam has signed 61 double tax avoidance agreement ('DTAAs') and numerous others are at various stages of negotiation and implementation. Notably absent is a DTAA with the United States of America;

23. Most FIEs will generally have to take the following taxes into consideration:

- (i) business income tax;
- (ii) various withholding taxes;
- (iii) capital assignment profits taxes (tax on gains on transfers of interests in a foreign-invested or Vietnamese enterprise);
- (iv) value added tax;
- (v) import duties;
- (vi) personal income tax of Vietnamese and expatriate employees; and
- (vii) social insurance, unemployment insurance and health insurance.

24. The following table shows the trend of tax rates in Vietnam from 2001 to 2010 –

	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010
Enterprise Income tax										
- Standard rate	32%*	32%*	32%*	28%	28%	28%	28%	28%	25%	25%
Personal Income tax										
- Employment income of resident	0%- 50%	0%- 50%	0%- 50%	0%- 50%	0%- 40%	0%- 40%	0%- 40%	0%- 40%	5%- 35%	5%- 35%

*25% for foreign-invested companies and foreign parties to business cooperation contracts (BCCs).

The trend in tax rates in the last ten years clearly indicates that there is a conscious effort by the Vietnamese government to reduce taxes. Moreover, preferential rates apply for entities that have been granted tax incentives.

25. Tax Incentives – Following Vietnam’s accession to the WTO in January 2007, tax incentives have been significantly revised in line with the country’s commitment to the WTO.

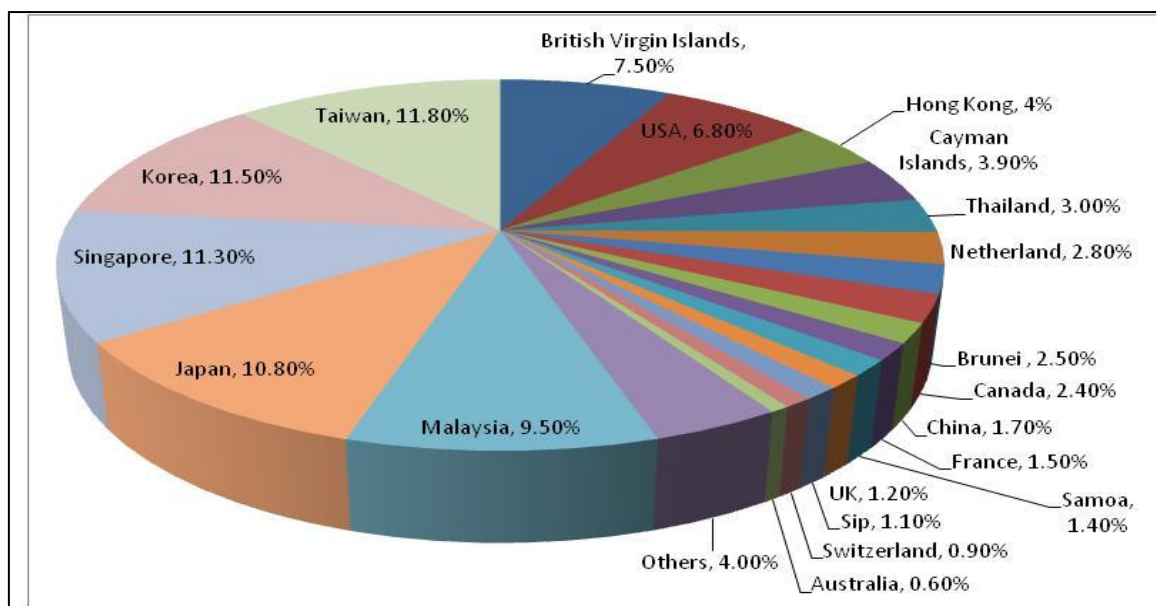
- (i) In accordance with Decree 24/2007/ND-CP, tax incentives are based on the location of the enterprise.
- (ii) Export-based incentives accorded to the textile and garment sectors were abolished in 2007, subject to certain exceptions.
- (iii) Reduced EIT rates of 10% and 20% apply for a 10-15 year period for enterprises set up in encouraged sectors or locations.
- (iv) Tax exemptions are available for two to four years and a 50% reduction for a further period of two to nine years for eligible taxpayers. Following the end of these periods, enterprises are subject to the standard EIT rate.
- (v) Where the taxpayer fails to make a profit within three years from the year of revenue generation, the period of tax exemption and reduction will be calculated from the fourth year.

1.3.Foreign Direct Investment in Vietnam

26. From introduction of the Law on Foreign Investment in 1987 to 21 December 2010, there were 12,213 valid projects (excluding expired or withdrawn projects) with a total registered capital close to USD 192.9 billion.¹⁰ Since 1996, there has been a tendency towards investment in producing goods for export, infrastructure construction, producing import substitutes and in labour-intensive industries. There are some 7,305 projects in the manufacturing and processing industries with a total registered capital of about USD 94 billion, accounting for 49% of registered capital, and roughly 348 projects in the real estate sector with a total registered capital of about USD 48 billion, accounting for 25% of registered capital.

27. The following chart provides the breakdown of FDI in Vietnam from 1990-2010:

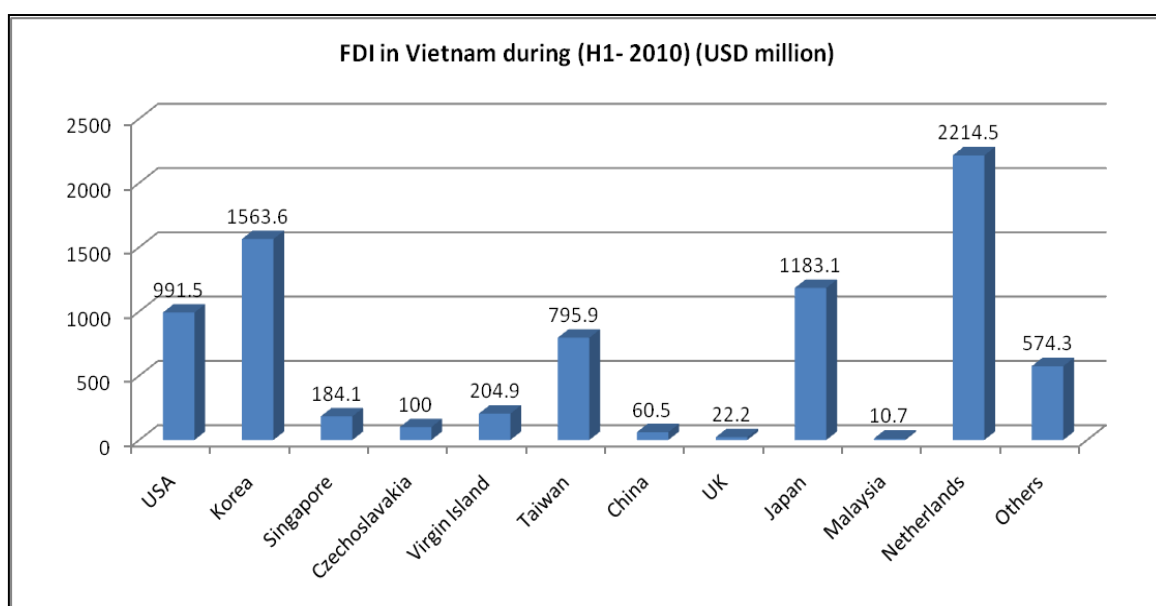
¹⁰ Source: http://vccinews.com/news_detail.asp?news_id=22449.



Source: <http://www.vietpartners.com/Statistic-fdi.htm>

28. As the chart shows, during the period from 1990 to 2010, Taiwan appeared to be the leading investor into Vietnam with 11.80% of total registered capital of USD 192.9 billion, followed by Korea with 11.50% and Singapore with 11.30% of total registered capital.

29. As per the data available in respect of the total FDI of USD 7,905.3 million into Vietnam during the first half of 2010, the Netherlands accounted for the largest contribution (USD 2,214.5 million), followed by Korea with USD 1,563.6 million and Japan with USD 1,183.1 million.¹¹ The table below provides an indication of the major contributors to FDI in Vietnam during the first half of 2010:



¹¹ Source: <http://www.vietpartners.com/Statistic-fdi.htm>.

30. In recent years there has been an increase in projects that are 100% foreign-owned. In 2010, 78.45% of total licensed projects were in 100% foreign-owned form, while joint venture enterprises made up 18.05%, 1.82% were in the form of joint operations, 1.58% joint-stock companies, 0.09% build-operate-transfer ('BOT'), build-transfer ('BT') and build-transfer-operate ('BTO') contracts and the balance in the form of an affiliate relationship.
31. The foreign-invested sector has seen rapid growth, gradually asserting itself as a dynamic component of the economy, and has made an important contribution to enhancing the competitiveness and efficiency of the economy. In recent years, the foreign-invested sector has accounted for a quarter of the country's total investment, 43.6% (2004) of industrial output, 57.2% (2005) of national exports, and 15.9% of GDP.
32. In terms of government revenues, the contributions of the various sectors, including that of FIEs, for the period from 2000 to 2008 is shown in the following table:¹²

	<i>Bill. dong</i>							
	2000	2002	2003	2004	2005	2006	2007	2008
TOTAL	90,749	123,860	152,274	190,928	228,287	279,472	315,915	416,783
Domestic revenue (Exc. oil revenue)	46,233	63,530	78,687	104,576	119,826	145,404	174,298	229,786
Revenue from state owned enterprises	19,692	25,066	28,748	32,177	39,079	46,344	50,371	68,490
Revenue from foreign invested enterprises	4,735	7,276	9,942	15,109	19,081	25,838	31,388	43,848
Revenue from non state sector	5,802	7,764	10,361	13,261	16,938	22,091	31,178	43,524
Agricultural land use tax	1,776	772	151	130	132	111	113	98
Tax on high income earners	1,831	2,338	2,951	3,521	4,234	5,179	7,422	12,940
License tax	934	1,332	1,817	2,607	2,797	3,363	5,690	7,404
Revenue from lottery	1,969	3,029	3,657	4,570	5,304	6,142		
Gasoline fee	2,192	2,995	3,204	3,583	3,943	3,969	4,457	4,517
Fees	2,713	3,021	3,279	4,182	4,192	4,986	4,059	6,653
Revenue from land and houses	2,823	5,486	10,546	17,463	17,757	20,536	33,925	38,202
Other revenue	1,766	4,451	4,031	7,973	6,369	6,845	5,695	4,110
Oil revenue	23,534	26,510	36,773	48,562	66,558	83,346	76,980	88,800
Custom duty revenue	18,954	31,571	33,845	34,913	38,114	42,825	60,381	90,922
Export and import duties, special consumption tax; Surtax on import	13,568	22,083	21,507	21,654	23,660	26,280	38,385	59,927
VAT on imports	5,386	9,488	12,338	13,259	14,454	16,545	21,996	30,995
Grants	2,028	2,249	2,969	2,877	3,789	7,897	4,256	7,275

33. During 2008, revenue from foreign-invested enterprises amounted to VND 43,848 billion of State budget revenue, accounting for 10.52% of the total budget compared to VND 4,735 billion in 2000, when it accounted for 5.22% of total State budget revenue. This indicates that the contribution of FIEs to State budget revenue increased by more than 100% in the period between 2000 and 2008. The contribution of FIEs to State budget revenue for 2011 is forecast to be VND 72,865 billion, accounting for 12.25% of total forecast revenues.¹³

¹² Source: <http://www.gso.gov.vn>.

¹³ Source: Ministry of Finance, Vietnam.

34. As indicated above, the majority of the foreign investments are in the manufacturing and processing sector. Most of these foreign-owned companies operate as contract or licensed manufacturers for foreign parent companies. Typical transactions include the purchase of raw materials, royalty payments for technology, sale of finished goods, payment of fees for management services or other services received from group companies.

35. The typical transactions of service companies include fee payments for consultancy services, procurement services, management service fees, payments for franchise rights/trademark rights and others.

2. Overview of the current Transfer Pricing legislation & audit practices

2.1. Overview of the existing Transfer Pricing rules in Vietnam

2.1.1. Before 2006

36. On 20 October 1997, the MoF issued Circular 74-TC/TCT, which was the earliest legal document to define related parties in a Vietnamese context. However, the applicability of this circular was limited to foreign-invested enterprises. Circular 89/1999/TT-BTC, which was issued on 16 July 1999, also provided guidelines on the definition of related parties. However, neither of these circulars specifically stipulated the TP methods to be used or any documentation requirements.
37. The MoF issued Circular 13/2001/TT-BTC ('Circular 13') on 8 March 2001 to provide guidelines on implementation of the Corporate Income Tax Act applicable to FIEs. It specified three traditional TP methods applicable to determining the arm's length nature of related-party transactions:
 - (i) comparable uncontrolled price method;
 - (ii) resale price method; and
 - (iii) cost plus method.
38. However, Circular 13 did not provide any detailed guidelines on application of the methods or guidance on documentation requirements. The Business Income Tax Act ('BIT Act') issued in 2003, which came into force on 1 January 2004, requires all transactions between related parties to be conducted at market prices (the arm's length principle).

2.1.2. Years 2006-2009

39. Pursuant to the BIT Act, the MoF issued Circular 117/2005/TT-BTC ('Circular 117') in 2006 to provide guidelines on related-party transactions and the disclosure of documents and information. Besides laying down the requirement for companies to comply with the arm's length standard, it also requires them to submit an annual TP declaration form and maintain contemporaneous TP documentation from 2006 on. Non-compliance carries a fine of up to VND 5 million.
40. Since the introduction of Circular 117, TP issues have been raised in some general tax audits conducted by provincial tax authorities on various industries (i.e. automotive, garment, electronics, etc.).

41. Over the past few years, the GDT and MoF have raised concerns over multinational companies ('MNCs') making successive losses (i.e. in 2006, 60% of MNCs in Ho Chi Minh City declared losses, and 50% did so in 2008)¹⁴ and have identified TP as the cause of such losses. This has impacted tax collection from these MNCs.

2.1.3. Years 2010 to date

42. The tax authorities have taken the following initiatives since 2010:

- (i) issuance of a new TP circular by the GDT (Circular 66/2010/TT-BTC – Circular 66) to replace Circular 117.
- (ii) companies with related-party transactions and loss-making companies are likely to be targeted for audits;
- (iii) announcement by the MoF that a new TP project is being set up in which tax and customs agencies will work together;⁹
- (iv) increasing number of TP queries raised during normal tax audits;
- (v) compilation of a target list for TP audits, comprising both MNEs and local companies that generate successive losses;
- (vi) a desk review and a focus on factual analyses;
- (vii) requests for TP declaration forms and TP documentation.

43. Circular 66 is considered the most comprehensive transfer pricing regulation in Vietnam to date. From a technical viewpoint, the Vietnamese TP regulations under Circular 66 are modelled on the OECD transfer pricing guidelines for multinational enterprises and tax administrations ('TP Guidelines'). Circular 66 adopts the arm's length principle and the transfer pricing methods set out in the OECD TP Guidelines.

44. The provisions of Circular 66 are applicable to organisations that are subject to EITL in Vietnam and carry on business partly or wholly in Vietnam with related parties. Any transaction carried out between related parties (e.g. buying, selling, exchanging, leasing, renting, transferring or concession of goods or services) may come under the scope of Circular 66. However, related-party transactions involving products for which the prices are under state control are excluded from the scope of the circular.

45. Similar to the OECD Guidelines, Circular 66 also contains guidelines on the following four key subjects: comparability analysis, transfer pricing methods, selection and application of the most appropriate method, and documentation. Part B, Article 4, of Circular 66 also has detailed guidance with respect to the comparability analysis.

¹⁴ Source: 'Vietnam Investment Review – November 22-28, 2010' – a Vietnamese weekly publication.

46. Part B, Article 5, of Circular 66 sets out five transfer pricing methods to be used for determining arm's length prices. These are very similar to the five transfer pricing methods specified in the OECD TP Guidelines. However, the Vietnamese transfer pricing regulations recommend that preference be given to a comparison of the transfer price or profit margin of transactions with related parties against those with unrelated parties of the same taxpayer (internal method).

47. The arm's length principle envisaged in Circular 66 also applies to loans and interest charges. However, at present, there are no rules dealing specifically with thin capitalisation and no set permissible debt-equity ratios.

48. One key difference between Circular 66 and the OECD TP Guidelines is the definition of related parties. The definition adopted in Circular 66 is much broader than that in the OECD TP Guidelines.
 - (i) First, the 20% capital participation of 20%, either direct or indirect, is much lower than that laid down in many other countries.
 - (ii) Second, the definition of related parties goes beyond ownership/control criteria. It also includes significant business relationships between unrelated parties. For example, when a Vietnamese company's sales or purchases from an independent entity exceed 50% of total sales or the sum total of the cost of raw materials, materials and supplies or input products, these transactions are regarded as related-party transactions.

The related party definition also extends to intangible assets/intellectual property and company financing. Parties are considered as being related when:

- (i) an enterprise uses intangible assets/intellectual property provided by another party that accounts for more than 50% of its production costs; and
 - (ii) an enterprise guarantees another enterprise's loans, or makes a loan to the other enterprise, where the loan accounts for 20% or more of the charter capital of the borrower and more than 50% of the total liabilities of the borrower.
-
49. Vietnamese taxpayers are required to record and maintain contemporaneous TP documentation, and to submit it to the tax authorities within 30 days of their asking. Transfer pricing documentation under Circular 66 should include:
 - (i) general information on the business establishment and related parties;
 - (ii) the business establishment's transactions; and
 - (iii) the methods of calculating arm's length prices.

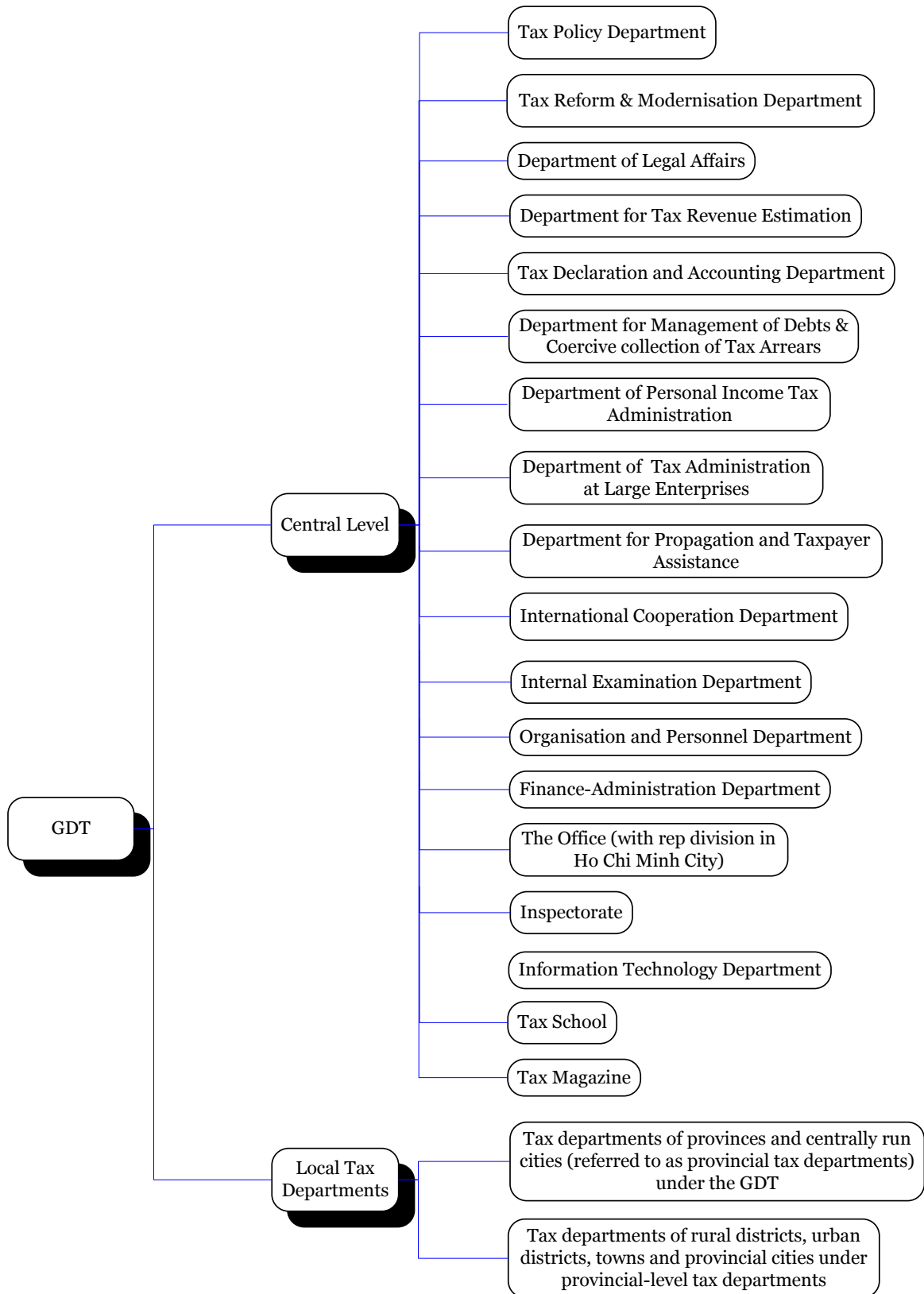
50. Furthermore, within 90 days of the end of a financial year, taxpayers are required to disclose related-party transactions on a standard form (i.e. form GCN-01/QLT), which must be attached to the annual corporate tax return. However, this declaration form is submitted in manual form and currently does not form part of the electronic filing.
51. Moreover, under the Vietnamese TP regulations, no specific provisions are available for Advanced Pricing Arrangements ('APAs'). Nor are any safe harbour rules laid down in the law.
52. Some of the key areas of Circular 66 and considerations in applying it in practice are summarised as follows:
- (i) The definition of related parties is very broad in the TP circular. The definition of related companies goes beyond ownership/control criteria and includes both international transactions and domestic transactions. It also includes significant business relationships between unrelated parties.
 - (ii) The TP circular requires companies to use data from official sources as the basis for comparability analyses or benchmarking studies. However, due to the lack of publicly available corporate financial information in Vietnam, a comparability analysis exercise using purely Vietnamese companies is not feasible in practice. There is also a lack of certainty regarding the acceptability of external comparables data (especially regional comparables data) for the purposes of benchmarking studies.
 - (iii) One of the challenges with the related-party disclosure required in the annual TP declaration form (form GCN-01/QLT) is the extent and type of information needing to be disclosed. It is clear that the purpose of such disclosure is to allow the tax authorities to gather TP information from taxpayers to enable them to monitor taxpayers' TP arrangements and to determine their risk profile for any subsequent audits. However, taxpayers may have difficulty in completing this form since it is transaction-focused.
53. Currently, no specific penalty is provided for in the transfer pricing regulations under Circular 66. However, tax authorities have the right to assess and make appropriate adjustment, as the case may be, to the transfer price, taxable income or tax amount to be paid by an enterprise engaging in related-party transactions in the following cases:
- (i) The enterprise finds on instruments, data and documents that are illegal or unlawful or are of unidentified origin to determine prices, ratios of gross profit or profit-making rates applicable to related-party transactions.

- (ii) The enterprise creates a false independent transaction or rearranges a related-party transaction to make it an independent transaction and uses this as an independent transaction selected for comparison.
- (iii) The enterprise does not declare, or insufficiently declares, related-party transactions arising in the tax year in its form GCN-01/QLT; and it does not comply with the regulations on providing information, data and documents within the regulated time limit to prove the application of market prices to related-party transactions.
- (iv) The tax office doubts whether the enterprise applies or suspects that it intentionally improperly applies the provisions of the circular, and the enterprise cannot prove the contrary within a maximum period of 90 days from the date of receipt of the notice from the tax office.

2.2. TP audit practice

54. The current structure¹⁵ of the various departments within the GDT is shown in the diagram below:

¹⁵ Source: www.mof.gov.vn.



55. The various departments within the GDT that presently handle TP matters are Policy (Tax Policy Department and Tax Reform and Modernisation department), Inspectorate (i.e. inspections department) and International Cooperation (i.e. the international taxation department).
56. TP audits were initiated in 2007 as a part of general tax audits. However, very few (fewer than five) TP audits have been conducted each year. TP issues have, however, been raised and dealt with as part of general tax audits. This has mainly been due to the lack of resources within the GDT and provincial tax departments as well as a lack of TP expertise.
57. The Inspectorate (Inspections/Tax Audits) department within the GDT, along with the provincial tax departments, carries out TP audits as part of its general tax audits. There is no separate team within the GDT specifically to undertake TP audits.
58. There is no specific audit procedure set out for TP. The normal practice is to conduct TP audits as a part of general tax audits. Accordingly, the procedures adopted for general tax audits are also applied for TP audits.
59. No specific methodology is adopted by the GDT/provincial tax authorities for selecting cases/companies for TP audits. Companies are selected based on information submitted together with tax returns (i.e. statutory accounts and forms GCN-01/QLT) as well as specific industries where the TP risk is perceived to be high.
60. Based on discussions with the GDT, there is no formal mechanism to conduct any analysis of data submitted via the online corporate tax return or to carry out a risk assessment in order to select companies for TP audit. Moreover, as the TP declaration form is submitted in manual form, the GDT/provincial tax departments are not able to undertake any analysis of the data as, presently, they do not have the requisite IT infrastructure in place.
61. Moreover, Vietnam Accounting Standard (VAS) no. 26 on 'related-party disclosures' sets out general guidelines on the accounting principles and their effects, and specifies required disclosures with regard to related-party transactions. However, the accounting standard does not have any materiality concept as regards the disclosure of related-party transactions in audited financial statements. The decision to disclose the information lies with the company and its statutory auditors. Accordingly, there is no system to capture data on related-party transactions other than the TP declaration form.
62. As an indication of imminent TP audits, provincial tax departments have recently issued official letters requiring companies to submit TP declaration forms and TP documentation (in Vietnamese) supporting the

arm's length nature of their related-party transactions for past years based on Circular 117. Companies are given 30 days to provide the tax authorities with the forms and documentation.

63. According to a newspaper report in September 2010, in a tax and TP audit of a tobacco company in the Dong Nai province in Vietnam covering the period 2005-2008, the tax authorities disallowed for corporate income tax purposes service fees paid by the company to its foreign related-party on grounds of insufficient supporting documentation. As a result, the provincial tax department made a TP adjustment and recovered overdue taxes in excess of USD 18 million.¹⁶
64. An article published in a local newspaper in March 2010 reported that, in 2008, of 1,254 FDI companies filing tax reports, 708, or approximately 61%, reported losses. They were mostly Asian companies, led by South Korea (upward of 30% of enterprises reported losses), Singapore (12.57%), Japan (9.04%) and Taiwan (7.49%). These companies were mostly in the business of manufacturing, technology, media, clothing and leather shoes.¹⁷
65. Another article published in the Vietnam Economic Times, March 2011 issue, stated that a nationwide survey showed that the majority of FIEs were loss-making in 2009, despite recording increases in annual turnover. Further, most of the companies incurring losses were of Asian origin and from particular countries, which perhaps indicates the adoption of a common business practice.¹⁸
66. These and other similar articles published in local newspapers regarding FDI companies in Vietnam reporting losses over a long period of time have certainly attracted a lot of attention from the authorities.
67. Based on recent communiqués from the Vietnamese tax authorities, the 'losses' reported by FDI companies are partially attributed to tax evasion through unsavoury transfer pricing practices. The GDT has indicated that it will undertake a close scrutiny of the documentation maintained by taxpayers in respect of their related-party transactions to ensure that best practices are being followed and no tax evasion is being committed.
68. These measures are expected to boost tax revenues but the exact impact of such actions has not been measured. Based on our discussions with the GDT, there is no statistical data available with regard to the impact on tax revenues of introducing TP rules. However, a recent article published in the Vietnam Economic Times issue of March 2011 reported that the MoF has inspected 127 foreign-invested enterprises that reported losses for the last three years and discovered illegal reporting valued at VND 1,450 billion (USD 76.3 million), which was then recovered for the State budget.¹⁸

¹⁶ Source: <http://www.thanhniennews.com/2010> - 'Tobacco firm ordered to pay over US\$ 18.2 mil in overdue tax, fines'.

¹⁷ Source: viipip.com/homeen - 'Foreign direct investment (FDI): Declaring loss to avoid taxes'.

¹⁸ Source: 'Brighter Spotlight' - article published in the Vietnam Economic Times, March 2011.

69. However, based on our discussions with a few MNEs, there are legitimate reasons for the losses being suffered.

- (i) Most of these MNEs have made large investments in plant in expectation of increasing demand and growth. However, there continues to be under-utilisation of capacity, leading to huge overheads not being recovered in the pricing.
- (ii) Although the low labour cost is one of the reasons attracting MNEs to Vietnam, the high labour attrition rate results in companies having to incur additional expenses on training and bearing the cost of labour inefficiencies during the initial period.
- (iii) The existing linkages between industries in terms of value chain are very limited. This means that many of the inputs required are still being imported, resulting in higher input costs.
- (iv) Macro-economic instability, the depreciating currency and other factors result in MNEs suffering losses due to reasons such as foreign exchange conversions/translations, etc.

2.3. Dispute Resolution mechanism¹⁹

70. In Vietnam, legal disputes may be settled by negotiation, in court, or by domestic or foreign arbitration. The hierarchy of Vietnamese courts includes:

- (i) the Supreme People's Court;
- (ii) the Provincial People's Courts; and
- (iii) the District People's Courts.

The courts operate in five divisions:

- (i) criminal;
- (ii) civil;
- (iii) administrative;
- (iv) economic; and
- (v) labour.

There is no specific tax court in Vietnam.

¹⁹ Source: 'Vietnam - A Guide for Business and Investment' (May 2008) – a PwC Publication.

71. Unlike common law countries, Vietnam does not follow the doctrine of precedent under which cases decided by judges in the past are used as authority for later cases. Judgements are solely based on legislation and on principles of interpretation of the law.
72. Running parallel to the court systems is the People's Procuracy, which is responsible for supervising the operation of judicial authorities and exercising the power of public prosecution. The People's Procuracy can lodge a protest against a judgment and request its review.
73. To supplement the court system, Vietnam has a system of independent arbitration centres, established under the new Commercial Arbitration Ordinance (2003). An arbitral award given by an arbitration centre or an arbitration panel established by the parties in accordance with the provisions of the Ordinance will be enforceable in Vietnam.
74. Disputes involving foreign investors may be also settled by foreign arbitration. In 1995, Vietnam became a member of the 1958 New York Convention on the Recognition and Enforcement of Foreign Arbitral Awards. An arbitral award determined by a foreign arbitration will be enforceable in Vietnam after it is recognised by a Vietnamese court.
75. No legal cases concerning transfer pricing have been brought to the courts to date. Cases involving disputes on transfer pricing issues have so far been settled out of court and the details have not been published. In order to set an example, it is anticipated that the tax authorities could bring cases involving abuses of transfer pricing to the courts in the future.
76. As TP audits are a part of general tax audits, in the event that the taxpayer considers the administrative action taken by the tax official or the decision issued by the tax authorities (e.g. in relation to tax liability, tax reimbursement, tax exemption/reduction, including the conclusion of the tax audit or suit) is a breach of the taxpayer's rights, the taxpayer is entitled to file a suit or appeal against this act or decision.
77. The authority to resolve appeals follows the administrative hierarchical order from the local office to the MoF. The head of each hierarchical body is responsible for resolving the appeal against the administrative decision issued by his/her office and/or action taken by his/her staff or by him/her.
78. The appeals procedure is the same as that of the general laws on appeals and suits. In practice, where the taxpayer disagrees, for instance, with the conclusion of the tax inspection by the competent authorities, including the MoF, the taxpayer can file a suit in the administrative court against the conclusion in question. However, there is no tax court in Vietnam.

79. To date, Vietnam has entered into DTAA's with 61 countries and most of these DTAA's provide for the initiation of a Mutual Agreement Procedure ("MAP") in the event of double taxation as a result of TP adjustments. Circular 66 also provides for application of the DTAA in the event the income subject to dispute is covered by the DTAA. However, presently, no formal process or guidance is available for the initiation of a MAP. Accordingly, there are no instances of MAPs being initiated in Vietnam or of a foreign treaty partner initiating a MAP in relation to transactions with Vietnam.

3. Experiences with TP reform processes

80. Circular 117 was introduced in 2005, effective in 2006, and was superseded by Circular 66 in 2010. However, the tax authorities within the GDT and the provincial tax departments are still in the process of building up capacity in terms of TP expertise for effective implementation of the circular and ensure compliance with it by taxpayers.

81. In this direction, though the GDT has received support from a few donor institutions in the past few years, there is still a lot to be done in this area. The various steps taken by the GDT to build capacity internally as well as educating the public on TP with the support of the donor institutions are summarised below:

A. *Training for tax officials*

- (i) Organising training for tax officials within the GDT and few tax officials from the larger provincial tax departments with the support of donor agencies like the Japanese International Cooperation Agency ('JICA') and the Asian Development Bank ('ADB').
- (ii) The JICA is assisting the GDT in conducting training where one or two TP experts from the Japanese National Tax Agency ('NTA') come to Vietnam to train the tax officials. The JICA also supports the GDT by funding study tours for tax officials in Japan. These study tours can take the form of one week's intensive on-the-job training or three months' on-the-job training at the NTA's office locations. Further, the JICA has also carried out training for some GDT tax officials who, in turn, have provided TP training to officials at provincial tax departments.
- (iii) The ADB has also assisted the GDT in conducting training classes for tax officials at the time when the TP circulars were introduced. However, there has been no further support from ADB on this aspect.

B. *Taxpayer publicity/education*

- (i) The GDT has identified taxpayers who would be covered within the scope of the circulars and has taken steps to inform them about the TP rules.
- (ii) Training materials on TP have been uploaded onto the GDT website, which can be accessed by the taxpayers.

- (iii) The GDT has supported provincial tax departments in announcing the TP rules in their territories via media/the GDT website. In this regard, the Propaganda & Taxpayer Service Unit ('PTS') within provincial tax departments were assigned the task of informing the public/taxpayers on the TP rules. Queries from taxpayers on TP were collected by these PTS units and passed on to the GDT for further action.
 - (iv) The GDT has conducted workshops in the larger provinces (Hanoi in September 2010 and Hai Phong in December 2010) to share with taxpayers and tax advisers the GDT's expectations in terms of compliance and transfer pricing documentation requirements.
- C. *Despite the above measures being taken by the GDT, a lot of challenges are still faced by the GDT in successfully implementing the TP rules. These are discussed in detail below.*
- D. *Challenges currently faced in successfully implementing the TP rules*
- (i) First and foremost, Circulars 117 and 66 issued by the MoF are only guidance/guidelines for the implementation of TP. There is, as yet, no specific provision relating to TP in the EITL or the Tax Administration Law. This makes the administration of and compliance with TP requirements in Vietnam a challenge. Accordingly, there is a need to amend the EITL or the Tax Administration Law to ensure that specific, comprehensive legal provisions on TP are in place.
 - (ii) Currently, TP audits are covered under the general tax audit procedures. There is a need to distinguish TP audits from general tax audits in order to have a greater focus with the requisite expertise to handle TP issues.
 - (iii) The GDT and the provincial tax departments are also faced with the problem of limited trained, experienced personnel to deal with TP matters. TP is still being administered as a part of general tax audits despite the increased focus in the past few months.
 - (iv) Currently, there is a lack of a structured TP training system for tax officials. Training is conducted on an ad hoc basis and to a large cross-section of tax officials rather than being focused on a smaller group in order to build up TP expertise. Hence, it is difficult to determine whether competent resources are available to deal with TP issues across the country. A related cause of concern is that the GDT does not have its own training facility. Presently, some of the donor agencies support the GDT in training tax officials on TP.
 - (v) Given that TP has only recently come into force, many MNCs are still unaware of what is expected of them locally and whether internationally accepted practices in areas such as documentation and

comparables will be appropriate in meeting the expectations of the tax authorities in Vietnam. This is further complicated by the fact that approaches may differ from one province to another.

- (vi) Similarly, local Vietnamese companies are also unsure how the TP rules as laid down in Circular 66 affect them as Circular 66 covers not only cross-border related-party transactions but also domestic ones.
- (vii) Currently, the information collected via form GCN-01/QLT at the level of provincial tax departments is not further analysed for the purposes of TP audits as the relevant tax officials at the provincial tax departments do not possess the requisite TP expertise to carry out the analysis. Moreover, the lack of IT infrastructure also poses a challenge for analysing the information contained in forms GCN-01/QLT. As a result, there is no exception reporting or risk assessment tool for selecting companies for TP audits.
- (viii) Another challenge faced by both the GDT and taxpayers is the non-availability of a database of comparable companies. Presently, there is no publicly available database of companies in Vietnam. The only audited financial statements available in the public domain are those for public limited companies. Moreover, due to the peculiarities of the Law of the country, international databases of comparable companies may not be recognised as a legal/official documents, and this means that the existing Circular 66 will have to be amended.

E. Initiatives taken by the GDT for successful implementation of the TP rules

- (i) There has been an internal restructuring of the GDT with a change from an official assessment system to a self-assessment system. The various departments under the restructured set-up involved with TP and their relevant responsibilities are given below:

Department	Responsibility
Tax reforms and modernisation	Formulation of the TP Law and reforms
Tax audits/inspections	Undertake TP audits along with general tax audits – actual execution of the audits will remain a responsibility of the provincial tax departments
International taxation	Formulation and implementation of DTAAs as well as dealing with bilateral issues

- (ii) One of the steps taken by the GDT, though not specifically TP-related, was setting up the Large Taxpayers Office ('LTO') within the GDT for the administration of large taxpayers in Vietnam. With the

increased focus on TP, the LTO's role is perceived to be important for efficient administration of tax matters including TP issues relating to large taxpayers. The GDT is planning to have a central LTO at the GDT and sub-departments in the main provinces where there are significant MNC operations.

- (iii) The GDT is also receiving assistance from some donor agencies on matters relating to training, IT infrastructure and others. Below is a list of donor agencies and the support provided by each of them.

Donor Agency	Support provided to GDT
World Bank	Tax administration and modernisation project comprising setting up a tax database and developing the IT infrastructure
International Monetary Fund	Developing and modernising the administrative infrastructure including the IT infrastructure
JICA	Ongoing TP training to tax officials, assistance in developing manuals for TP audits, assistance in improving taxpayer service, funding study tours for tax officials to Japan for on-the-job training etc
ADB	TP training to tax officials during the introduction of Circular 117
International Finance Corporation	Developing models/techniques for ratio analysis of unincorporated businesses; risk-based auditing techniques for tax audits
US Embassy	Assistance in areas of improving collections & auditing; banking money supervision & anti-money laundering

However, only the JICA and ADB have provided assistance in the specific area of TP.

- (iv) From the GDT's perspective, the following are the key areas of focus moving forward:
- a) capacity-building, both in terms of numbers of personnel and technical capability to carry out audits and review the TP arrangements of taxpayers;
 - b) amending the tax laws to include specific provisions on TP and APAs;
 - c) introducing safe harbour rules to provide further guidance to taxpayers on some of the more common transactions; and
 - d) introducing rules and guidelines to enable taxpayers to enter into APAs.

4. Appropriateness of and actions needed to introduce TP legislation

82. Based on discussions with the GDT, we understand that there is no statistical data available to measure the impact on the tax revenues of introducing the TP rules. Accordingly, we are not in a position to provide any estimate of the likely costs and benefits of enhancing the TP rules and their implementation in Vietnam.
83. However, based on our analysis of the current TP environment in Vietnam and the various areas for improvement highlighted in the previous sections of this report, it is evident that a substantial investment requires to be made by way of financial and technical assistance to ensure that the TP rules in Vietnam are adequately implemented in order to facilitate effective compliance by taxpayers.
84. If a recent article published in a local magazine can be relied upon, the MoF has inspected 127 foreign-invested enterprises who reported losses for the last three years and discovered illegal reporting valued at VND 1,450 billion (USD 76.3 million), which was then recovered for the State budget.²⁰ This would imply that further donor support either in the form of financial assistance or technical assistance to the GDT/ MoF would only result in efficient implementation of and compliance with the TP rules, which, in the long run, could lead to increased tax revenues.

²⁰ Source: 'Brighter Spotlight' – article published in the Vietnam Economic Times, March 2011.

5. Recommendation for future donor support

5.1. Current scenario

85. Many donor agencies including the United Nations Development Programme ('UNDP'), the Japanese International Cooperation Agency ('JICA'), the World Bank, the Department for International Development ('DFID'), the UK, the International Finance Cooperation ('IFC'), the Asian Development Bank ('ADB'), the International Monetary Fund ('IMF'), the Office of the EU Delegation in Vietnam, the US Treasury, the US Trade and Development Agency, as well as individual countries including Germany, France and Luxembourg are providing support in the form of funding/technical assistance etc. to the MoF/GDT in Vietnam on a host of issues ranging from macroeconomic reform, capital markets development, public finance management, customs modernisation to tax administration and modernisation. However, so far, only two of the donor agencies (i.e. the ADB and JICA) have provided active support to the GDT/MoF specifically in the area of TP.
86. During the introduction of Circular 117, the ADB assisted the GDT in conducting training classes for tax officials.
87. The JICA is the only donor agency which has provided, and continues to provide, significant support to the GDT in the area of TP. The JICA, with the NTA, has initiated a project for supporting the GDT called 'The Project on Tax Administration Reform'. Under this project, support is provided over three phases –
- (i) Though Phase I (started in 2005 and completed in 2008) of this project was largely targeted at providing technical assistance and training to tax officials on general tax implementation so as to ensure better taxpayer service, the JICA also assisted the GDT in training tax officials on TP. The assistance took the form of funding study tours for tax officials in Japan, sometimes for one week's on-the-job training on TP audit cases or three months' intensive training at the NTA offices in Japan on general tax matters. The JICA is also bringing NTA officials to some of the larger provinces in Vietnam to provide TP training to provincial tax departments.
 - (ii) Under Phase II (started in 2008 and expected to be completed in July 2011), apart from providing training to tax officials to strengthen the management capacity of the tax administration, the JICA is also assisting GDT in writing manuals (basic documents) on TP audits. This is currently in progress. The JICA is also continuing its support by way of funding TP study tours for tax officials on an annual basis.

- (iii) Phase III of the project, which is yet to be rolled out, is targeted at providing further training to tax officials on implementation of the TP rules.

It should be noted that there is a JICA team specifically appointed as advisers to the GDT, which has been supporting it on the above initiatives specifically in the area of TP during the last 3 years.

- 88. The JICA has also conducted TP training sessions for Japanese MNCs in Vietnam.
- 89. As a part of the Tax Administration Modernisation Project ('TAMP'), World Bank is assisting the GDT in setting up a centralised tax database to assist the GDT in strengthening governance in tax administration and to increase the level of voluntary compliance with the tax system by improving the effectiveness, efficiency, transparency and accountability of the tax administration. Though this project is not directly related to TP, in the longer run it should also encompass TP administration. As a part of this project, World Bank is also assisting the GDT in developing its IT infrastructure. The TAMP is expected to be completed by June 2013.
- 90. The IFC is another institution which is providing technical assistance to the GDT in developing models/techniques for tax ratio analysis of unincorporated businesses. It is also assisting the GDT in developing models/techniques for risk-based auditing – selecting companies for tax audits. Although, there is no support yet specifically on TP, the risk-based auditing technique can very well be used for TP audits in the future. With increasing focus on TP in the past few months in Vietnam, the IFC is also keen to play a role in Vietnam's TP environment. Towards this, it is working on developing TP expertise internally in order to be in a position to provide assistance.

5.2. Areas for future donor support

- 91. As highlighted in the earlier section, only two donor organisations have directly provided support/assistance to the GDT specifically in the field of TP. Only one of them, the JICA, has continuously provided support to the GDT on TP, in terms of both funding and technical assistance. Furthermore, there are no concrete plans by any of the donor organisations (other than the ongoing project by the JICA) to extend assistance specific to the area of TP.
- 92. Based on our discussions with various donor organisations, trade organisations, the GDT and MoF and other stakeholders having an interest in Vietnamese TP, we have identified the following areas which require donor support in the form of either financial assistance or technical assistance.

93. Legislative changes: First and foremost, there is a need for a comprehensive law on TP. This would provide the GDT/provincial tax departments with the requisite authority to implement TP rules/guidelines introduced via Circular 117 and Circular 66. At the same time, a comprehensive provision for APAs also needs to be included in the EITL or the Tax Administration Law. This will help bring about certainty over TP implementation for taxpayers, thereby reducing tax audit costs, a condition that would likely lead to increased investment opportunities.

In this direction, the areas for future assistance include the following:

- (i) The MoF/GDT requires assistance in drafting the necessary legislation on TP plus APAs by way of an amendment to the EITL or Tax Administration Law. In this regard, assistance is required in understanding the different models that have been used in other countries, to enable the MoF/GDT to select the most appropriate form of legislation to include.
 - (ii) Along with the amendment to the EITL or Tax Administration Law, Circular 66 may also need amending to reflect ground realities, especially in respect of comparable data to be used. One current limitation for both the tax authorities and taxpayers is the lack or near absence of official data which can be used to determine and justify an arm's length price.
 - (iii) Similarly, the sharing of issues and experience in relation to implementing the new TP laws would shorten the learning curve and ensure minimum hiccups.
94. Building TP expertise: There is a need to build capacity within the GDT and the provincial tax departments to deal with TP issues in terms of TP policy, compliance and technical expertise. Such capacity-building is needed in terms of both the appropriate number of personnel to deal with TP matters and the right level of subject-matter expertise.

In this regard, based on some of the experience from previous training sessions, we summarise below the areas for future donor support:

- (i) Training has been on an ad hoc basis and may not be at the appropriate level bearing in mind the knowledge and experience of the attendees. Also, it may not be part of any structured training whereby the different aspects of TP will be covered in detail on a module basis which each selected official will have to go through.

- (ii) Due to language limitations, training may need to factor in the need for translation. Similarly, it is important to ensure that some of the more basic concepts around accounting and TP are addressed to ensure that the training is pitched correctly and the participants derive maximum benefit from it.
 - (iii) Considering the complexities of the TP regulations themselves, as well as in their implementation and compliance, there is a need for structured training to educate tax officials. A suggested two-pronged approach could be:
 - a) General awareness training to a larger section of tax officials in order to provide them with a general level of awareness of the TP regulations, their implementation and compliance, training to spot TP issues during general tax audits and ask relevant questions etc.
 - b) Second, comprehensive training to a selected group of tax officials on conducting TP audits, the analysis required to be carried out for selecting TP audit cases, the actual TP audit process and handling complicated TP issues.
 - (iv) Proper, structured training over a period of time covering the key knowledge and experience-sharing components will be most beneficial in building TP capacity. Thus, in order to pull together the existing training (conducted on an ad hoc basis internally within the GDT and that provided by the JICA), a proper programme needs to be developed and implemented.
 - (v) Assistance by way of seconding tax officials at the GDT/provincial tax departments to developing or developed countries for on-the-job training on live audit cases.
 - (vi) On a broader tax training note, there is a general lack of proper dedicated physical infrastructure (e.g. tax academy) managing and carrying out training activities. In this regard, a tax academy or similar structure would go a long way in providing structured training courses to GDT personnel.
95. Sharing of experience by other tax administrations: In order to ensure successful implementation of the TP guidelines introduced via Circular 66, the GDT requires support in the form of a sharing of experience by the tax administrations of countries where TP rules have been implemented successfully, especially in countries with similar taxpayer profiles.

This can be best affected by the tax administrations of other countries, developing and developed, sharing practical examples and best practices.

Joint investigations are another option where tax authorities of other countries can participate along with the GDT/provincial tax departments in audits in Vietnam to impart on-the-job training.

96. IT infrastructure support: The lack of IT infrastructure is another cause of concern to the GDT/provincial tax departments. Though there are ongoing projects by some donor agencies relating to IT infrastructure modernisation support, there is no support specifically provided in respect of TP.

The steps required in this direction include:

- (i) First, the electronic corporate return form should be modified so as to include form GCN-01/QLT. This will ensure collation of requisite data electronically.
 - (ii) The GDT requires assistance in developing techniques/models for data-gathering from form GCN-01/QLT and corporate tax returns, data analysis and using the data for risk-based assessment analysis for the purpose of selecting cases for TP audits.
 - (iii) The GDT also requires training in the use of IT infrastructure and other software in undertaking the above analyses so as to bring about efficiency in the whole process.
97. Comparable companies' database: Presently, there is no database of comparable companies which tax officials can resort to for carrying out benchmarking analyses during TP audits. Moreover, data on actual transacted prices between independent parties (which has been the main focus of the tax authorities) is difficult to obtain and apply.

In this direction, donor support could take the form of either financial assistance to the GDT to subscribe to any international databases maintained by third-party agencies or financial assistance to the GDT to appoint a third party (e.g. a university) to identify sources of data which can be developed into a repository of company data.

98. Introduction of APA mechanism: The GDT and taxpayers are keen to have an APA programme in order to bring about an environment of certainty in the implementation of TP. This can also help increase the level of consistency in applying TP principles to reduce tax administration costs for the GDT/provincial tax departments and reduce tax audit costs for taxpayers.

The GDT requires assistance in the form of a sharing of experience by tax administrations of countries where APA programmes have successfully been implemented so as to emulate them in Vietnam.

99. Introduction of safe harbour rules: The GDT is keen to introduce safe harbour rules in order to provide further guidance to taxpayers on some of the more common transactions. Experience in other jurisdictions would be very helpful in guiding the authorities through the process.

100. Proper procedures for initiation of a MAP: Though there is a provision for the initiation of a MAP for the avoidance of double taxation in some of the DTAA's signed by Vietnam, there is no transparent policy laying out the procedure to be followed for initiating MAP.

In this direction, donor support could take the form of a sharing of experience/best practices from countries that have procedures/policies in place for initiating a MAP that the GDT refers to for framing its policy. Donor support may also be required in terms of financial assistance for administration and implementation of the procedures/policy for MAP as well as requisite training to the competent authority on negotiating and concluding MAPs.

6. Conclusions

101. The TP environment in Vietnam is still in its nascent stage. Though the first reference to related parties can be found in Circular 74-TC/TCT, introduced in 1997, it is Circular 66, introduced in 2010, which is regarded as the most comprehensive set of TP regulations in Vietnam.
102. From a technical viewpoint, the Vietnamese TP regulations under Circular 66 are modelled on the OECD TP Guidelines. Circular 66 adopts the arm's length principle and the transfer pricing methods set out in the OECD TP Guidelines.
103. With the introduction of Circular 66, the Vietnamese tax authorities have increased their focus on TP. Both the MoF and the GDT have taken several initiatives for TP implementation and compliance. There has been an increase in the number of TP queries during normal tax audits.
104. The current TP environment in Vietnam is characterised by the following:
- (i) There is no specific provision relating to TP or APAs in the EITL or the Tax Administration Law.
 - (ii) A wider definition of 'related party' that includes significant business relationships between unrelated parties.
 - (iii) There is general lack of awareness of TP among taxpayers. Most taxpayers are unsure about actual implementation of the TP rules provided in Circular 66.
 - (iv) Tax officials do not have significant TP expertise to carry out TP audits. Donor agencies like the JICA and ADB are currently supporting the GDT in providing training to tax officials at the GDT and provincial tax departments.
 - (v) There is no tax court in Vietnam. The appeals procedure is the same as under the general law on appeals and lawsuits.
 - (vi) There is no systematic procedure in place for selecting taxpayers for TP audits. The GDT/provincial tax departments lack the necessary IT infrastructure for data-gathering and conducting analyses such as risk-based assessment for selecting taxpayers for TP audits.
 - (vii) TP audits are carried out by the Audit/Inspections department within the GDT along with the provincial tax departments. There is no separate team within the GDT/provincial tax departments to handle TP matters and most audits are part of general tax audits.
 - (viii) There is no publicly available database of comparable companies. Taxpayers resort to international comparable databases for preparing their TP documentation.
 - (ix) Currently, there is no set procedure laid out for initiation of a MAP in the event of double taxation as a result of a TP adjustment or otherwise.
 - (x) There are presently no APA rules in Vietnam.
 - (xi) There are presently no safe harbour rules in Vietnam.

105. Based on the above, we have highlighted the key areas for future donor support, by way of either technical assistance or financial assistance:

- (a) **Change in the legislation –**
 - (i) Assistance in drafting the necessary legislation relating to TP and APAs in the EITL or the Tax Administration Law to ensure effective implementation of and compliance with Circular 66.
 - (ii) Circular 66 to be amended to reflect current realities in respect of availability of official comparable data.

- (b) **Building TP expertise –**
 - (i) Two-pronged approach: general awareness training to a large cross-section of tax officials to spot TP issues; and comprehensive training to a selected group of tax officials on conducting TP audits and handling complicated TP issues.
 - (ii) Properly structured training over a period of time covering the key knowledge and experience-sharing components.
 - (iii) Seconding tax officials from the GDT/provincial tax departments to developing or developed countries for on-the-job training on live audit cases.

- (c) **Sharing of experience by other tax administrations –**
- (d) Vietnamese tax officials can benefit greatly from sharing the practical experience and best practices of tax administrations in other countries, developing and developed. Another option would be on-the-job training through joint audits.

- (e) **IT infrastructure support –** The GDT/provincial tax departments require assistance in modernising their IT infrastructure in order to ensure efficient TP data-gathering and data-analysis as well as assistance in developing techniques/models for undertaking a risk-based assessment of taxpayers for the purpose of selecting companies for audit and the efficiency of the overall process.

- (f) **Comparable database –** Presently, as there is no publicly available local comparable companies data, the GDT needs assistance in terms of access to international company databases maintained by third-party agencies.

- (g) **Introduction of APA mechanism –** The GDT needs assistance in terms of sharing the experience of tax administrations of other jurisdictions on developing an APA mechanism.

- (h) **Introduction of safe harbour rules –** The GDT also needs assistance in terms of experience in other jurisdictions regarding the introduction and implementation of safe harbour rules.

- (i) **Procedure for implementation of a MAP mechanism** – Though there is a provision in the law for initiating a MAP mechanism, there is no proper procedure laid out for its implementation. The GDT requires assistance in developing a mechanism for the implementation of a MAP in order to handle disputes resulting in double taxation owing to TP adjustments or otherwise.

106. There are certain issues that need to be borne in mind in determining any future support. These include –

- (i) The language of communication could be a major hurdle in any kind of support to be provided to Vietnamese tax officials. Most tax officials in Vietnam are not conversant in English. Accordingly, it should be ensured that any kind of training or other technical assistance is translated into Vietnamese.
- (ii) Second, any kind of training should be imparted over a period of time. This would mean that there should be a comprehensive training programme designed to cover different aspects of TP in detail. Moreover, this training programme should be conducted over a certain period of time.

Appendices

Appendix 1: List of interviewees

Name	Position
Mr Benedict Bingham	International Monetary Fund (Senior Resident Representative)
Mr Deepak Mishra	World Bank (Lead Economist, Poverty Reduction and Economic Management Unit)
Dr Matthias Duhn	European Chamber of Commerce in Vietnam (Executive Director)
Mr Pham Minh Tu	International Finance Cooperation (Project Officer, Investment Climate Advisory Services in the Mekong)
Mr Nguyen Van Lan	International Finance Cooperation (Vietnam Projects Manager, Investment Climate Advisory Services in the Mekong)
Mr Sotaro Nishikawa	Japanese External Trade Organisation, Hanoi, Representative Office (Director)
Mr Sion Morton	Delegation of the European Union to Vietnam (Programme Officer, Budget Support)
Mr Adam Ross	US Embassy (Economic Officer)
Mr Ray Ucida	Japanese International Cooperation Agency (Senior Aid Coordination Advisor – Ministry of Planning and Development)
Mr Koichiro Ito	Japanese International Cooperation Agency (Chief Advisor to the General Department of Customs)
Mr Takanoru Hasegawa	Japanese International Cooperation Agency (Chief Advisor, Tax Administration – GDT)
Mr Nguyen Duc Thinh	General Taxation Department (Director, International Taxation Department)
Mr Thanh Xuan Ly	General Taxation Department (Deputy Director, Tax Reform and Modernization Department)
Mr Vinh	General Taxation Department (Inspector, Inspection Department)
Mr Viet	General Taxation Department (Senior Officer, Large Taxpayer Office)

In addition, interviews have been conducted with people operating in the following business sectors (disclosure of full information is not possible due to confidentiality reasons):

- provision of financial and administrative support to groups of companies in Vietnam;
- manufacturer in the automotive segment;
- manufacturer and distributor of pharma products.

Appendix 2: References

- 1) Taking stock – An Update on Vietnam’s Recent Economic Developments (2010) – a World Bank publication
- 2) Vietnam – A Guide for Business and Investment (May 2008) – a PwC publication
- 3) Vietnam Business Annual Report 2008 – a Vietnam Chamber of Commerce and Industry publication
- 4) Country Survey – Vietnam (updated as of 1 March 2011) – an IBFD publication
- 5) Government websites referenced –
 - a) General Statistics Office of Vietnam - <http://www.gso.gov.vn>
 - b) Ministry of Finance Vietnam - <http://www.mof.gov.vn/>
- 6) Newspaper articles referenced –
 - a) http://www.economywatch.com/world_economy/vietnam/structure-of-economy.html
 - b) Vietnam targets 2011 state budget deficit at 5.3 pct. of GDP –
<http://dailynews.vn/news/economy/economy/80112-Vietnam-targets-2011-state-budget-deficit-at-53pct-of-GDP.html>
 - c) Vietnam’s Foreign Direct Investment to December 21, 2010 –
http://vccinews.com/news_detail.asp?news_id=22449
 - d) Vietnam FDI Statistic – <http://www.vietpartners.com/Statistic-fdi.htm>
 - e) Vietnam Investment Review – November 22-28, 2010 – a Vietnamese weekly publication
 - f) Tobacco firm ordered to pay over US\$ 18.2 mil in overdue tax, fines – a newspaper article –
<http://www.thanhniennews.com/2010>
 - g) Foreign direct investment (FDI): Declaring loss to avoid taxes – a newspaper article –
viipip.com/homeen
 - h) Brighter Spotlight – article published in the Vietnam Economic Times, March 2011