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Global Tax Alert

News from Transfer Pricing

Vietnam issues decree amending loan interest deductibility cap and draft decree on related party transactions

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Executive summary

In June 2020, the Vietnam Government issued a decree to amend the loan interest deductibility cap and a draft decree to address related party transactions. This Alert summarizes the provisions under both the Decree and the draft Decree.

Detailed discussion

Amendment to the loan interest deductibility cap under Decree 68/2020/ND-CP dated 24 June 2020

On 24 June 2020, the Vietnam Government (the Government) issued Decree 68/2020/ND-CP (Decree 68) amending Article 8, Clause 3 of Decree 20/2017/ND-CP on tax administration for companies that have transactions with related parties (Decree 20).

Decree 68 is effective from 24 June 2020 and applies for the corporate income tax (CIT) period 2019 onwards. The key amendments are summarized below.

Increase in the loan interest expense cap and change in the method of calculating loan interest expense

The total deductible loan interest expense (after being offset against deposit interest income and loan interest income) is now capped based on the following formula: 30% of the total net profit from business activities within the period + net loan interest expenses (after being offset against deposit interest income and loan interest income) + depreciation expenses incurred in the period.

Carry forward of net loan interest expense to the subsequent CIT periods

To the extent an enterprise has loan interest in excess of the cap in a particular year, it can carry forward the non-deductible interest. If in a future year the deductible loan interest of that period is lower than the cap, it may also deduct the carried forward non-deductible interest up to the cap amount. The time limit to carry forward this excess interest is five years from the year following the year in which the non-deductible interest arises.

Out of scope

Under Decree 20, the loan interest deductibility cap does not apply to taxpayers that fall within the definition of credit institutions under Law on Financial Institution and insurance organizations under Law on Insurance Business. Now Decree 68 also excludes interest under the following types of loans from the cap, including:

- ▶ Loans under Official Development Assistance (ODA)
- ▶ Concessional loans implemented by the Government where the Government borrows from offshore and lends to enterprises
- ▶ Loans to implement specific national programs relating to New Rural and Sustainable Poverty Reduction programs
- ▶ Loans to fund programs and projects implementing national welfare policies (houses for resettlement, for workers, students and other public welfare projects)

Retrospective application for the CIT periods 2017-2018

Decree 68 allows for the retrospective application of the deductibility of loan interest expenses as mentioned above to the CIT periods 2017 and 2018, specifically:

- ▶ Taxpayers are allowed to submit amended CIT finalization dossiers for the CIT periods of 2017 and 2018 to re-determine deductible interest expenses, corresponding CIT payable (if any) in accordance with this regulation before 1 January 2021.

- ▶ If the CIT and any late payment interest paid to the state budget is higher than the re-determined CIT and late payment interest, the difference shall be offset against the CIT payable in the year 2020 and the subsequent years within five years from 2020.
- ▶ If the tax authorities or competent authorities have already examined/inspected a taxpayer and reached a decision for final settlement under the Laws on Tax Administration, the taxpayer can request that the tax authorities redetermine the tax payable and late payment interest to process the offsetting of the difference in accordance with the regulations.

Changes in Transfer Pricing Disclosure Form - 01 (Form 01)

Form 01 regarding information on related party relationships and related party transactions, issued along with Decree 68, shall replace Form 01 provided under the Appendix of Decree 20.

Proposed draft Decree replacing Decree 20 on Tax Administration for companies having transactions with related parties

In addition to the issuance of Decree 68 amending Article 8 Clause 3 of Decree 20 on loan interest expense deductibility, the Vietnam Ministry of Finance (MoF) is finalizing the draft Decree on Tax Administration for companies that have transactions with related parties (Draft Decree).

The following is a summary of the key changes in the Draft Decree dated 4 June 2020 and available at gdt.gov.vn/wps/portal.

The arm's-length range

The definition of the arm's-length range has been changed to a set of values from the 35th percentile¹ (previously 25th percentile under Decree 20) to the 75th percentile with the median value set at 50th percentile value. This is a proposed narrowing of the arm's-length range.

The principle to expand the scope for selection of comparables for benchmarking analysis

The priority of selection of comparables remains unchanged i.e., (i) internal comparables of taxpayers; (ii) comparables residing in the same country and territory with taxpayers; and (iii) comparables in regional countries with similar industry and economic conditions.

However, the Draft Decree proposes an amendment to the principle related to expanding the scope of selection of comparables for specific and unique related party transactions in the absence of independent comparables as detailed below:

- ▶ Prioritizing using comparables in the economic sub-sector with the highest level of comparability in the same zonal area, and extend to provincial zone and then to the whole of Vietnam rather than placing priority on comparables in the similar geographical market
- ▶ Expanding the scope of geography for benchmarking analysis to include countries in the region with comparable industry conditions and economic development level

The use of databases to determine deemed tax adjustments in tax audits

The Draft Decree indicates that the databases, to make a deemed tax adjustment, shall be in accordance with Point a, Clause 2, Article 9 of the Draft Decree. Specifically, these are databases used for declaration and determination of pricing of related party transactions of taxpayers, including:

- ▶ Commercial databases
- ▶ Information publicly released on stock exchanges
- ▶ Information available on domestic and international commodity or service exchanges
- ▶ Information made available to the public by ministries or sectoral departments, or other official information sources

Supplement the transfer pricing (TP) documentation exemption cases

Based on the proposed draft amendments, companies that: (i) only engage in transactions with related party taxpayers in Vietnam; (ii) have the same CIT rate; and (iii) where neither entity enjoys CIT incentives during the CIT period are now exempted from the TP documentation obligations. This is in addition to the exemptions already contained in Decree 20.

Compliance obligations regarding Country-by-Country (CbC) Reporting (CbCR)

The Draft Decree proposes amendments regarding taxpayers' obligations relating to CbCR as summarized below:

- ▶ A Vietnamese Ultimate Parent Entity (UPE) with global consolidated revenue in a tax period of VND18,000 billion or more must prepare Form 04 (CbCR) and submit it to the tax authority no later than 12 months from financial year end of the UPE.

- ▶ For a Vietnamese taxpayer whose overseas UPE is obliged to submit a CbC report in its country of residence, the Vietnamese tax authority will obtain that CbC report by engaging in the Automatic Exchange of Information (AEOI) in accordance with its commitment under the International Tax Agreement of Vietnam.
- ▶ A Vietnamese taxpayer must submit a CbC report to the Vietnamese tax authority in the following cases:
 - Overseas UPE is not obliged to submit a CbC report in its country of residence.
 - The jurisdiction of residence of the UPE has signed an International Tax Agreement with Vietnam but there is no Multilateral Competent Authority Agreement (MCAA) for AEOI in place at the time of the CbCR submission deadline.
 - The jurisdiction of residence of the UPE has joined the MCAA with Vietnam but suspended the AEOI or cannot automatically provide the CbC report to Vietnamese tax authorities.
 - If there are more than one taxpayer in Vietnam, the UPE provides a written notification to the Vietnamese tax authority on the appointed organization for submission of the CbC report on its behalf no later than the financial year end of the UPE.
- ▶ A Vietnamese taxpayer is not obliged to submit a CbC report to the Vietnamese tax authority if the UPE appoints an organization to submit the CbC report to the tax authority of the host country on its behalf (appointed organization) no later than 12 months from the financial year end of the UPE and fulfill the following conditions:
 - The jurisdiction of residence of the appointed organization has the following regulations:
 1. Legally requires the submission of CbCR
 - Has an MCAA with Vietnam to which such jurisdiction is a signing party as on the CbCR submission deadline
 - Does not suspend the AEOI and can provide a CbC report to Vietnamese tax authorities
- ▶ The appointed organization provides a written notification on the appointment to submit a CbC report to the jurisdiction of its residence no later than the financial year end of the UPE.

- ▶ The Vietnamese taxpayer sends the written notification to the Vietnamese tax authority, including:
 - Notification of the appointment of organization to submit a CbC report
 - Notification of the name, tax code and country of residence of the UPE or the appointed organization no later than the financial year end of the UPE

According to the Draft Decree, the tax authorities use CbCR for risk management and information exchange in accordance with regulations and commitment of Vietnam under relevant International Tax Agreements. However, CbCR is not used for deemed tax adjustment purposes.

The Draft Decree also indicates that the Vietnamese tax authorities annually announce on their tax web portal the list of foreign tax authorities that engage in the AEOI with respect to CbCR.

Currently, Vietnam is a member of the Inclusive Framework on Base Erosion and Profit Shifting project but has not yet joined the MCAA. However, given the proposed regulations on AEOI of CbCR in the Draft Decree, it is expected that Vietnam would join the MCAA in the future.

Implications

The release of Decree 68, together with the proposed issuance of the Draft Decree replacing Decree 20 clearly indicates that the Government is focusing on enhancing the TP regulatory framework to better reflect the actual situation and circumstances in Vietnam as well as to cooperate in addressing issues of taxpayers.

Accordingly, taxpayers should carefully review and comply with Decree 68 and effectively plan and manage relevant risks. In addition, taxpayers need to regularly monitor and keep updated on aforementioned proposed amendments to proactively assess the impacts of such changes on their business operations and better comply with the regulations once the Draft Decree is officially released.

Endnotes

1. A percentile is a statistical measure indicating the value below which a given percentage of observations in a group of observations falls.

For additional information with respect to this Alert, please contact the following:

Ernst & Young Vietnam Limited, Ho Chi Minh

- ▶ Robert King, *Indochina Tax Market Leader*
- ▶ Phat Tan Nguyen, *Transfer Pricing Leader*
- ▶ Takahisa Onose, *Japanese Business Services*
- ▶ Cheon Ju, *Korean Business Services*

robert.m.king@vn.ey.com
phat.tan.nguyen@vn.ey.com
takahisa.onose@vn.ey.com
cheon.ju.lee@vn.ey.com

Ernst & Young Vietnam Limited, Hanoi

- ▶ Huong Vu, *Hanoi Tax Leader*
- ▶ Long Ngoc Pham, *Transfer Pricing*
- ▶ Junichi Harada, *Japanese Business Services*
- ▶ Kyung Hoon Han, *Korean Business Services*

huong.vu@vn.ey.com
long.ngoc.pham@vn.ey.com
junichi.harada@vn.ey.com
kyung.hoon.han@vn.ey.com

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