

Provincial tax authorities have increased scrutiny of tax deduction for payments for technology transfer and intra-group services

Transfer Pricing Alert

October 2017

Following the guidance in Government Decree 20/2017/ND-CP of 24 February 2017 (“**Decree 20**”) on transfer pricing management, particularly the specific rules for deductibility of intercompany charges between related parties, and the recent Law on Technology Transfer No. 07/2017/QH14 (“**LTT 2017**”) of 19 June 2017 on State management of technology transfer transactions, some of the provincial tax authorities will now increase their focus on reviewing and challenging historical Corporate Income Tax (“**CIT**”) deductions for royalties and service fee payments to related parties of Vietnamese taxpayers. Specifically, the tax authorities have requested companies to provide details of expenses paid to related parties and relevant supporting documents, and self-assess and amend historical CIT returns to pay additional CIT in accordance with the rules provided under Decree 20.

Technically, Decree 20 is applicable from 1 May 2017, and LTT 2017 does not impact technology transfer agreements that were executed prior to 1 July 2018 except in cases of amendment or extension (where applicable). For the past few years, tax administration and transfer pricing regulations (namely Circular 117/2005/TT-BTC of 19 December 2005 and Circular 66/2010/TT-BTC of 22 April 2010) allowed the tax authorities to reject related party transactions (“**RPTs**”) that are not conducted at “**arm’s length**”, though specific guidance on the arm’s length nature of intangibles and intra-group services transactions was not provided. During recent tax audits and inspections, the tax authorities have been seen to apply the new “**substance over form**” principle of Decree 20 as a basis to implement the management, examination and inspection of taxpayers’ RPTs for the past few years. Based on this principle, RPTs that are inconsistent with the arm’s length principle or do not provide direct economic benefits and add value to the business activities of taxpayers will be rejected. For example:

- Royalties paid to related parties with regard to technology transfer but the taxpayer fails to prove the technology has in fact been transferred;
- Royalties paid to related parties by a Vietnamese contract manufacturing subsidiary based on a percentage of net sales made to related parties;
- Intra-group services which are seen as not providing the local taxpayer with direct economic or commercial value to enhance or maintain its business position;



- Intra-group services which benefit related parties’ shareholders;
- Duplicative services which are provided by several related parties; and
- Services that provide benefits to the taxpayer because the taxpayer is an entity of the group.

The new Law on Technology Transfer reinstates the statutory requirement of companies to register their technology transfer agreements with the relevant State body and, for the first time, enables an audit of pricing of inbound technology transfers.

It is recommended that companies that have RPTs involving intangibles or intra-group services review their transactions and prepare all necessary supporting documentation.

The following may be considered to ensure defensive or proactive tax management in relation to the afore-mentioned transactions:

1. Review and ensure consistency among the Master File, Local File, Country-by-Country Report and statutory disclosures of the transactions in accordance with the guidance under Decree 20.
2. Review of the companies' intercompany agreements supporting the payments for intangibles and/or intra-group services;
3. Review and register technology transfer agreements with the relevant authorities
4. Seek subject matter expertise during the audits or inspections conducted by the competent authorities, or to resolve disputes or controversies; and
5. Apply for an Advanced Pricing Agreement ("**APA**") with the competent authority in respect of complex transactions for certainty on tax treatment.

For more detailed information and tailored advice, please contact KPMG.

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