

**UNIVERSITY OF
TAMPERE**

*STRENGTHENING AUDIT OF TRANSFER FOR
FOREIGN DIRECT INVESTED ENTERPRISES IN
VIETNAM*

THESIS

**FOR THE GRADUATION OF MASTER' 'S
PROGRAM OF PUBLIC POLICY AND FINANCIAL
MANAGEMENT**

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Dear Dr. Hannele Mäkelä and Dr .Kirsi Hasanen,

I would like to declare that this thesis is done by myself under the supervision of Dr. Hannele Mäkelä and Dr Kirsi Hasanen, and the whole content of this research was written in English by myself.

Yours sincerely,

Ha Nguyen Thi Thu

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ABBREVIATION

TP: Transfer pricing

FDI: Foreign direct investment

FDIes: Foreign direct invested enterprises

APA: Advanced pricing arrangement

MAP: Mutual Agreement procedure

MNEs: Multinational Enterprises

CPM: Cost plus method

CUP: Comparative uncontrolled pricing method

RPM: Resale pricing method

PSM: Pricing split method

TNMM: Transactional net margin method

TTP: International tax transfer pricing regime

VAT: Value Added Tax

U.S: The United States

GDT: General Department of Taxation

CIT: Corporate income tax

GDP: Gross domestic product

SOEs: State-Owned enterprises

EBIT: Earnings before interest and tax

ABSTRACT

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Title: "Strengthening transfer pricing audit on foreign direct invested enterprises in Vietnam"

Master's thesis: 88 pages including cover page

Key words: Transfer pricing, Audit, Vietnam

The topic is "strengthening transfer pricing audit on foreign-directed investment enterprises". Transfer pricing is a phenomenon studied in the world over the last few years. It has made a loss of tax revenue of many countries, especially happening in developing countries. Many tax authorities have strengthened transfer pricing audit to prevent the tax loss from foreign invested enterprises.

The thesis attempts to explore the issue by using quantitative method to collect transfer pricing information for analyzing of elements which affect transfer pricing audit such as regulation, administrative aspects and auditing activity. To approach research problems, the specific methods is used such as data collection, case study and analyzing.

The results indicated that the phenomenon has become more common, sofisticated and increased unfair competition in all the world. Vietnam transfer pricing regulations are based in part on the guidelines of international organizations. The organizational structure of Vietnam's transfer pricing audit has formulated as centralized model as in Japan. However, the number of auditor is very limited which does not respond with foreign directed investment enterprises increasing yearly. Vietnamese transfer pricing audit procedure has followed the guidelines of international organizations. The source of information to use in the initial risk assessment is limited and normally used as secret comparative data from tax data system for comparable purpose.

Based on the research result, some recommendation to strengthen transfer pricing audit on foreign invested enterprises are made. Tax offices should finalize the legal framework of transfer pricing regulation and improve the tax policy by adjusting corporate tax rate which is similar to other countries in Asia; Moreover, improving the effectiveness of transfer pricing audit by training and development the human resource and complete relevant tax database system for transfer pricing challenges.

1 INTRODUCTION

1.1 The necessity of the research

Transfer pricing is a phenomenon studied in the world over the last years. These studies focus on multinational companies based on the conditions of the associated companies and the rights of the parent companies to the subsidiary or among the members in a corporation to do transfer pricing of goods or services, which is not market price principle. This action is to distribute profit between associated companies and reduction of paying tax payment to maximize profits of a corporation. Some studies have also provided practical information about the misalignment (determine the transfer price between affiliated members not at market prices) of large companies and the actions of governments in controlling the transfer pricing to ensure the right to tax and avoid loss of taxation (Lall, 1973; Stewart, 1977; Lecraw, 1985; Borkowski, 1997; Kayfetz & Helzel, 1996; Bartelsman & Beetsma, 2003; Moller & Scharft, 2002; Sikka & Willmott, 2010).

The OECD has issued "OECD Transfer Pricing Guidelines for multinational enterprises and tax administrations", as a general principle for determining market prices in transactions of affiliated parties. This principle may limit the transfer pricing for tax evasion in multinational companies, ensuring fairness and fair competition among firms.

In addition, studies suggest that when governments strongly challenge TP, FDIes will try their best to minimize tax obligation and minimize their profit even they will hire consulting firms to do this work (Kayfetz & Helzel, 1996; Bartelsman & Beetsma 2003; Moller & Scharft, 2002; Sikka Willmott, 2010). Due to the characteristics of internal transactions, tax authorities of the countries are very difficult to control and in the struggles between the tax authorities and taxpayers, the taxpayers always win. On the other hand, if a government struggles drastically with transfer pricing, it will affect foreign investment environment and make it would be less attractive. Researchers suggest that transfer pricing can only be controlled to a certain extent, or the government may reduce the corporate income tax rate so that FDIes cannot carry out the transfer pricing. Reducing the difference in corporate income tax rates and import tariffs across countries would also be a motivation for FDIes doing transfer pricing and improve management consistency of tax authorities (Sulman, 1970).

However, international research on this issue usually stops at the description of the information without relevant characteristics of Vietnamese economy. It has not been thoroughly analyzed therefore the experiences for Vietnam to apply or the problems cannot be applied. Because each country has its own political, economic, legal, human and individual characteristics on attracting and using FDI.

In practice, Vietnam foreign directed investment enterprises operate in diverse business sectors. Most of them are members of large multinational enterprises in the world. The foreign directed investment sector has made an important contribution to achieve Vietnam's socio-economic development objectives. It promotes the economic growth and improve efficiency of using resources. In addition, it accelerates economic restructuring in the industrialization and modernization. It creates jobs, improves the quality of human resources, upgrades technological level through technology transfer, improves management capacity of the economy and corporate governance as well as the competitiveness of the economy¹.

Besides the positive achievements, the activities of the foreign directed investment sector have many constraints and many complex economic problems, including transfer pricing to avoid the tax obligations. The transfer pricing signs of these enterprises can be loss declarations (often about 50% of foreign directed investment enterprises operating in Vietnam reported losses, for example Keangnam Vina Co., Coca-Cola Vietnam, Hualon Corporation reported losses for many years and the accumulated losses are up to nearly thousand billions / an enterprise). The consequence of this phenomenon is that Vietnam has lost a large amount of corporate income tax revenue from foreign directed investment enterprises. This phenomenon creates an unfair competition with domestic enterprises. In the last few years, transfer pricing has increased with more cases, with the scale of evasion and avoidance of large tax obligations (calculated separately in 2014 and 2015 through audits enterprises who has taxation risks, the tax departments have cut losses of over VND 15,400 billion, collection, retrieval and fines of more than VND 2,600 billion). This causes considerable hardship in society and creating effective concerns. Authentication of Foreign Directed Investment (FDI) attraction policy that Vietnam is carrying out².

¹ http://www.fetp.edu.vn/cache/MPP8-513-C09V-Chuyen%20gia%20trong%20cac%20doanh%20nghiep%20FDI%20o%20Vietnam--Do%20Thien%20Anh%20Tuan_CV15-13-89.0-2016-05-10-11481712.pdf

² General Department of Taxation, yearly report 2012-2016

As a consequence, Vietnam is still in the process of transitioning to a market economy and integrating into the world economy. We have little experience in dealing with transfer pricing of foreign direct invested enterprises. Recently, anti-transfer pricing solutions of Vietnam government have been deployed but they lack of consistency and low enforcement. The situation of many foreign-invested enterprises reporting losses continuously but still expanding the scale and revenue is more common year by year. Sometimes, the authorities are almost powerless against the transfer pricing status. In such a context, the study of the anti-pricing transfer experience from developed countries aims to "extract" useful lessons of managing on foreign direct invested enterprises more effectively. Base on that fact, I chose the issue "*Strengthening transfer pricing audit on foreign direct invested enterprises in Vietnam*" as the subject of the thesis.

1.2 Research purposes

The purpose of the thesis is to know clearly about international experience of anti- transfer pricing then propose scientific basis solutions in order to strengthen the efficiency of transfer pricing audit. This helps tax administration to be able to cope with transfer pricing behavior in FDIes, limiting the negative impacts of this phenomenon in Vietnam.

1.3 Scope of research

The research object of the thesis is the transfer pricing of FDIes and the experience of response (control, prevention ...) with this phenomenon in some countries and applying this experience which is in response to transfer pricing status of FDIes in Vietnam.

The thesis analyzes the transfer pricing issue of FDI enterprises from the perspective of political economies. This reflected a fact that transfer pricing is mainly considered as socio-economic phenomenon, which contains beneficial relationships between economic entities (multinational corporations, member companies, host states), not as an economic or technical issue; Interpretation of contemporary transposition is linked to the political economy of globalization and the role of multinational corporations in the world economy today. Analyzing international experience in this thesis

will focus on institutional environment, policies and the governing roles of investment recipient countries which are being negatively influenced by transfer pricing movement.

The thesis examines the situation of transfer pricing in the world through specific cases in the UK, the US, Japan, China, Russia; study the anti-transfer pricing experience of OECD, the UK, the US, Japan, China, some ASEAN countries (Thailand, Malaysia, Indonesia) and research on transfer pricing issues in Vietnam.

For the experience of anti-transfer pricing, the thesis will focus on the experience gained so far in the history against transfer pricing of countries to extract useful lessons for Vietnam tax administration. The research thesis in the period of 2001 - 2015, the period of attracting FDI has changed dramatically and Vietnam accelerated international economic integration. However, the phenomenon of transfer pricing has been increasing clearly of FDI sector in Vietnam in the period of 2010 – 2015 and I will focus on this time.

1.4 Meanings of the thesis

In theory, the thesis contributes to supplement and develop theoretical framework on transfer pricing in general and transfer pricing in FDIes in particular. These theoretical contributions further reinforce previous scientific conclusions about the nature of the transfer pricing, the incentives for FDIes to do transfer pricing, the transfer pricing types of FDIes, and the impacts of transfer pricing on FDIes, capital-exporting countries and investment-receiving countries, etc. The theoretical framework may serve as the basis for other studies to refer to or to provide managers with a holistic view of an economic phenomenon that is becoming more prevalent in the globalization trend, to design response solutions that limit the negative effects of transfer pricing.

In practice, the thesis clarifies the transfer pricing situation in the world and Vietnam, assesses the impacts of transfer pricing on Vietnam, provides a practical basis to clarify the conflict of interest between FDI attraction and transfer pricing phenomena in FDIes. The thesis will give the authorities more practical basis with experience from countries in the world that are counteracting the transfer pricing behaviors of MNEs so that they can apply instrument in Vietnam. The recommendation of the solutions in the thesis

will have benefits of complementary, perfecting policy in response to transfer pricing policy in Vietnam in the coming time.

The dissertation can be used as a reference material, for research, transfer pricing or functional agencies that can be consulted for the "fight" against pricing transfer within the FDIes.

1.5 The research questions

The main questions of this study is “What should the Vietnam government do to strengthen the transfer pricing audit on foreign invested investment enterprises and how?”

Sub-questions:

1. What is transfer pricing and transfer pricing audit regimes?
2. Why and how do foreign-invested enterprises do transfer pricing in Vietnam?
3. How Vietnam tax administration do transfer pricing audit on foreign invested enterprises?

1.6 The organization of the research

This research is structured in six chapters. The first chapter consists of: the reason why I decided to choose the subject of transfer pricing; Determining the research purpose of the thesis in order to have specific tasks, determining the research subjects and research scope of the thesis. The second chapter focuses on two main topics: transfer pricing theories (such as transfer pricing concepts, transfer pricing methods); and secondly, transfer pricing audit. The third chapter presents the research methods used in the study of the project, including how to define research methods, methods of data collection and processing; methods of expert interviews, comparative methods, etc. The fourth chapter introduces the current situation of foreign invested enterprises in Vietnam. In this chapter, I have focused on the situation of attracting foreign investment capital in Vietnam in recent years and the situation of transfer pricing of foreign invested enterprises; Common forms of transfer pricing of foreign invested enterprises in Vietnam and pricing transfer audit by tax authorities. The fifth chapter, I presented two cases to analyze the transfer pricing (Keangnam Vina One Member Limited Liability Company and GS Company). The final chapter presents the limitations of this study, providing conclusions and recommendations to the tax authority on the transfer pricing issue of the associated transaction. Specifically, the conclusions and recommendations are provided based on the results of this study and analysis. In addition, contribution to the thesis on practical and theoretical aspects is also presented in this chapter.

2 TRANSFER PRICING AND TRANSFER PRICING AUDIT REGIMES

Transfer pricing auditing is an important function of the tax administration in all countries. To conduct the audit of transfer pricing effectively, there are three factors which impact this activity that is TP regulation, administrative aspects and TP auditing action.

2.1 Transfer pricing regulations

2.1.1 What is transfer pricing

The behavior of determining the transfer pricing at market pricing (wrong transfer) is the most common form of profit transfer technique, which is defined as manipulation of costs and revenues within the multinational enterprises in variable countries with different tax rates, from the high rate place to the lowest place. The transfer of profits in this way is being widely used, so the terms "transfer pricing" and "profit transfer" are often considered the same in the scholarly and legal discussions on the subject.

Transfer pricing is a deliberate collusion between companies within the same group to negotiate price that are not based on market pricings, to transfer profits from one company in a country to another in different countries and to avoid paying full tax, thereby improving the business efficiency of the whole corporation. The basis for establishing such transfer pricing derives from the freedom of doing business. Accordingly, affiliated companies have the power to determine the transaction pricing they deem appropriate (Stone, 2012).

Transfer pricing is an intentional activity of MNEs to minimize the amount of tax payable by setting pricing products and materials among firms within the same corporation, not at market pricings, to maximize profits (Baistrocchi, 2007).

Transfer pricing is understood as the implementation of pricing policy of products (tangible assets, intangible assets, services, loan interest) transferred between related parties not at transaction pricing in the market, to minimize the total amount of tax payable by all global affiliates (OECD, 2010).

2.1.2 Motivations of transfer pricing

A foreign investment company is an affiliate of a multinational corporation that has established TP for its internal and external purposes. On internal motives, different stakeholders within the MNEs are considered separated profit centers, so MNEs use TP to determine the profitability of those entities. MNEs also use TP to measure the internal performance of entities and to motivate business managers. On external motives, because MNEs operate in two or more jurisdictions, tax authorities will impose taxes or duties arising from internal cross-border transactions. Therefore, TP must be assigned to these transactions (Eden 1998 & Abdallah 1989).

2.1.3 The principle of the transfer pricing regime

The principle of the TP regime is to apply the arm's length standard in all transactions of an enterprise. The arm's length standard that all MNEs internal transactions must be valued as if they were generated between unrelated parties in a competitive market (OECD 1995, 3). The arm's length standard requires that the transaction price between related parties would be the market price through negotiation in the competitive market. This standard was first developed in the United States, and later became the basic standard as OECD principles for TP. All members of the OECD, and other non-OECD countries, have adopted the arm's length standard to determine MNE's income and expenses.

2.1.4 Transfer pricing methods

Comparable non-comparable pricing comparison (CUP)

The best method to determine whether a pricing charged for real estate or services at arm's lengths is to compare controlled transactions with uncontrolled transactions. The uncontrolled pricing comparison (CUP) method compares the pricing charged for a property or service that is delivered in a controlled transaction to the pricing charged to the property or service delivered in a non-deal. Comparative control in similar cases. CUP can be extracted to check the transfer pricing used by affiliates in controlled transactions to ensure that the transfer pricing complies with the arm principle. If there is a significant discrepancy between the transfer pricing used by the affiliate and the potential CUP identified, the CUP

may need to replace the transfer pricing used by the affiliates. CUP is the most direct way to determine arm's length (OECD, 2010).

For a trustworthy CUP, the property or service is provided and the circumstances of the terms must be the same as the property or service and the circumstances in the transactions between involved entities. A CUP will be reliable if the difference between uncontrolled and uncontrolled transactions will seriously affect the CUP. If there is any difference, it must be adjusted to make CUP a reliable comparator. If more adjustments are needed to a CUP, this method may not be as reliable as a pricing indication of the arm's length (Cooper, Fox, Loeprick, & Mohindra, 2016).

CUP is the best method but it is difficult to apply as it is not easy to find an independent company outside of MNEs which has the same business characteristics, size, product or membership as MNEs for comparison. Because if there is any minor difference, it will impact the price materially. In fact, this method is just applied when the parent company or its subsidiaries provide the products to each other while providing the uncontrolled company with the same product (Cooper, Fox, Loeprick, & Mohindra, 2016).

Resale pricing method

Resale pricing method (RPM) is used if an entity (reseller) purchases products from related entities in controlled transactions then resells products to independent buyers. In this case, the RPM determines the transfer pricing for a product by starting with the pricing at which the independent buyer pays the product and then deducts a reasonable gross margin for the functions that the seller re-made. Gross profit margin used in RPM is the profit that an independent agent will seek to cover operating expenses and provide appropriate return on the functions performed, assets used and risks (OECD, 2010).

This method only applies when there is no difference in transaction conditions when comparing independent transactions with associated transactions, which significantly affects the gross profit margin (selling net). Thus, this approach is often applied to transactional cases for simple service products and commercial transactions that have a short selling cycle. On the other hand, the products will be sold that

these is not in a assembly process, which can change the nature of the products associated with the trade mark to increase the value of the product significantly.

Cost plus method

The cost plus method (CPM) determines the arm's length pricing by adding a reasonable gross margin to the cost of producing an affiliated product or service. Gross profit margins must reflect the functions performed by a unit, and include the return on capital used and the risks accepted by the unit. The gross profit margin of a controlled transaction is calculated by referring to the gross margin generated in uncontrolled comparable transactions. Ideally, comparable transactions should be identical or similar to controlled transactions (OECD, 2010).

The comparison in the CPM should reflect the functions performed, the risks involved, and the terms of the contract. When applying CPM, comparable accounting methods are used. If there is a difference between the accounting methods used for controlled and uncontrolled transactions, the data will need to be adjusted to ensure the same costs and cost measures are similar. The gross profit margin of controlled and uncontrolled transactions must be continuously measured to ensure that the uncontrolled comparator is used as a reliable indicator of the selling pricing of the arm.

The OECD shows that CPM is most relevant when selling products between parties, long-term purchase and supply agreements are created, or when the transaction is controlled to provide services.

Profit split method (PSM)

If intercompany transactions are highly integrated, it may not be possible to evaluate individual transactions for TP purposes. The OECD states that, in this situation, independent units will establish partnerships and agree to share profits for business. The profit split method (PSM) defines the profitability of controlled transactions between related entities that will be distributed among the entities involved. This profit is then divided among related units on an economic basis. Profits distributed by this method are theoretically necessary to reflect the profit distribution that unrelated units will use to perform similar functions (OECD, 2010).

The main power of PSM is that it can be applied in the absence of uncontrolled comparison transactions. The profit distribution under PSM reflects the functions performed by the relevant entities. Another major advantage of PSM is that the profits distributed among the related entities will be balanced when the relative contribution of both entities is evaluated. This method is particularly useful in analyzing the relative contribution of intangible assets used in controlled transactions (OECD, 2010).

PSM has some shortcomings. The external data needed to evaluate the functions performed by the related entities will not be tightly coupled to the functionality as when applying the traditional method. This results in the distribution of profits according to functional analysis is arbitrary. Another shortcoming of PSM is that an affiliate entity may not have access to the amount of profit gained from transactions that are controlled by its related entities in another jurisdiction. Even with the information of both entities involved, the usual accounting approaches in both jurisdictions will have to be used to ensure that returns from controlled transactions are measured consistently (UN, 2013).

Transaction net margin method

The most popular TP method is the Transaction net margin method (TNMM). TNMM examines net returns from controlled transactions relative to an appropriate basis, such as revenue, assets or expenses. TNMM is similar to CPM and RPM except for measuring net profit rather than gross profit. One problem with CPM and RPM is that they rely on gross margins, but gross profits are not usually available to taxpayers or tax authorities. On the other hand, net profit margin for comparative purposes is usually more available (OECD, 2010).

TNMM must be applied in a similar way to CPM or RPM so that it is reliable. If a related parties engaging in both uncontrolled and uncontrolled transactions, if these transactions are comparable, then the net profit from the controlled transaction must reflect net profit derived from uncontrolled transactions. In most situations, affiliate businesses will only engage in controlled transactions and therefore a net profit from an unrelated party in related transactions will have to be used for comparison purposes. Like other TP methods, TNMM requires functional analysis to be performed. Functional analysis is required to determine whether uncontrolled transactions are comparable enough to be used as guidance. It is

important to use only profit comparisons derived from uncontrolled international transactions. The main advantage of the method is that net profits are less likely to be affected by transactional differences compared to traditional methods. Differences between functions performed in controlled and uncontrolled transactions should be reflected in operating costs. Another advantage of TNMM is the non-mandatory data from a related entity abroad (UN, 2013).

2.1.5 Types of transfer pricing transactions

Applying the arm's length principle will create specific transactions in certain circumstances of affiliated companies in the same multinational corporation. MNEs carry out these transactions for the purpose of adjusting the profits of affiliated companies in the same group. International studies have identified many indicators of transfer pricing of MNEs all over the world. However, there are 12 most popular types of TP transactions presenting in this section which are summarized in the Transfer Pricing and Developing Economies a Handbook for policy makers and practitioners (Cooper, Fox, Loeprick, & Mohindra, 2016).

Intragroup services

This transaction is the cost that associated companies pay to parent / affiliate companies including management costs, administrative expenses, advertising, marketing and technical services. These transactions are most common in multinational companies.

Financial transactions

The transaction is debt owed by the company/affiliated company in the same corporation to provide loans to other associates. The interest rate on these loans may be higher than that on loans from independent parties.

Intangibles

This is the cost that a parent company supports for a subsidiary in terms of production and marketing; or members of MNEs have to pay the research and development costs to other member companies. The

shortfall in profitability of these companies may be a sign of the fact that MNEs have made unethical transactions.

Cost contribution arrangements

Affiliates in a MNE agree to share the costs and risks of developing, producing or using the same tangible and intangible assets, services intended to benefit participating parties. Transfer pricing is the distribution of profits that do not follow arm's length principle.

Loss –making entities and startup operation

This phenomenon likely happens when affiliates which have been in operation for many years or start-up companies report losses continuously. This circumstance usually occurs in developing countries and tax authorities use this sign as a target for selecting such companies for audit purposes. Cooper, Fox, Loeprick, and Mohindra (2016) showed that numerous countries that use the reporting of persistent losses as a trigger for a transfer pricing review or audit.

For example, the General Department of Taxation (GDT) reported a drop of US\$ 107 million in tax revenue as a result of a recent audit of 107 foreign direct invested enterprises (FDIEs). The General Department of Taxation instructed provincial tax authorities to audit taxes on 870 foreign-invested enterprises, reported losses for the 2008-2010 fiscal years and companies with very low returns. In addition, the corporation will also conduct audits of 40 small and medium-sized enterprises and 82 other domestic corporations based on the list provided by the Ministry of Finance. The survey forms are provided by GDT to selected taxpayers as a means of gathering information on the transfer pricing practices and whether the transfer pricing documentation has been prepared. Expected information will be used as a risk assessment tool for GDT to select companies for auditing (Cooper, Fox, Loeprick and Mohindra, 2016). The TP indicators as follow.

Business restructurings

That is how MNEs restructure their businesses. This transaction needs to be considered in terms of restructuring the business function of transferring assets from one company to another to increase the value of the assets or to be given incentives in the environment.

Location savings

MNEs can achieve location savings thanks to a reduction in the cost of labor and materials. MNEs decided to move production activities to developing countries where labor costs and raw materials costs are low.

Government regulation

Government regulation can be a factor in generating transfer pricing. These regulations are not related to pricing transfer, such as pricing control, payment limitation, interest rate control, market regulation, subsidy or tax increase (antidumping), and the main exchange rate policy. Therefore, it is necessary to consider non-subject transactions in order to apply the above provisions.

Set-off arrangements

A transaction where a company provides benefits to an affiliated company in return will receive a different benefit in two different countries. This transaction can be evaluated by two companies with no difference. Some tax authorities will impose a tax on this transaction including customs duties and contractor tax.

Transfer Pricing and customs valuations

Government regulation can be a factor in generating transfer pricing. These regulations are not related to transfer pricing, such as pricing control, payment limitation, interest rate control, market regulation, subsidy or tax increase (antidumping), and the main exchange rate book. Therefore, it is necessary to consider non-subject transactions in order to apply the above provisions.

TP and value-added tax (VAT)

At present, there are no international guidelines providing detailed guidance on the application of VAT by transfer pricing approach to multinational companies. However, in Chapter IIV of the OECD Guidelines there are guidelines that should be considered from the perspective of arm-length pricings for all inter-company transactions for tax purposes.

Attribution of profit to permanent establishments

OECD Article 7 and the UN model tax conventions guide business profits of a business subject to taxation in the country where the business resides. The same market pricing principle will apply in this case.

2.2 Administrative aspects

Setting up transfer pricing audit and TP auditor is very important for tax authorities of the countries and for doing transfer pricing audit effectively. Because the arrangement of the units involved in the reasonable transfer pricing in the tax administration would help to manage the transfer pricing effectively. There are divisions involved in transfer pricing such as policy development units, transfer pricing risk assessment units, transfer pricing control units and APA units. In addition, tax officers involved in the management of transfer pricing also need expertise in transfer pricing, have good English and are equipped with intensive office skills to meet the demand of their job. They also must be passionate about their work and hard work.

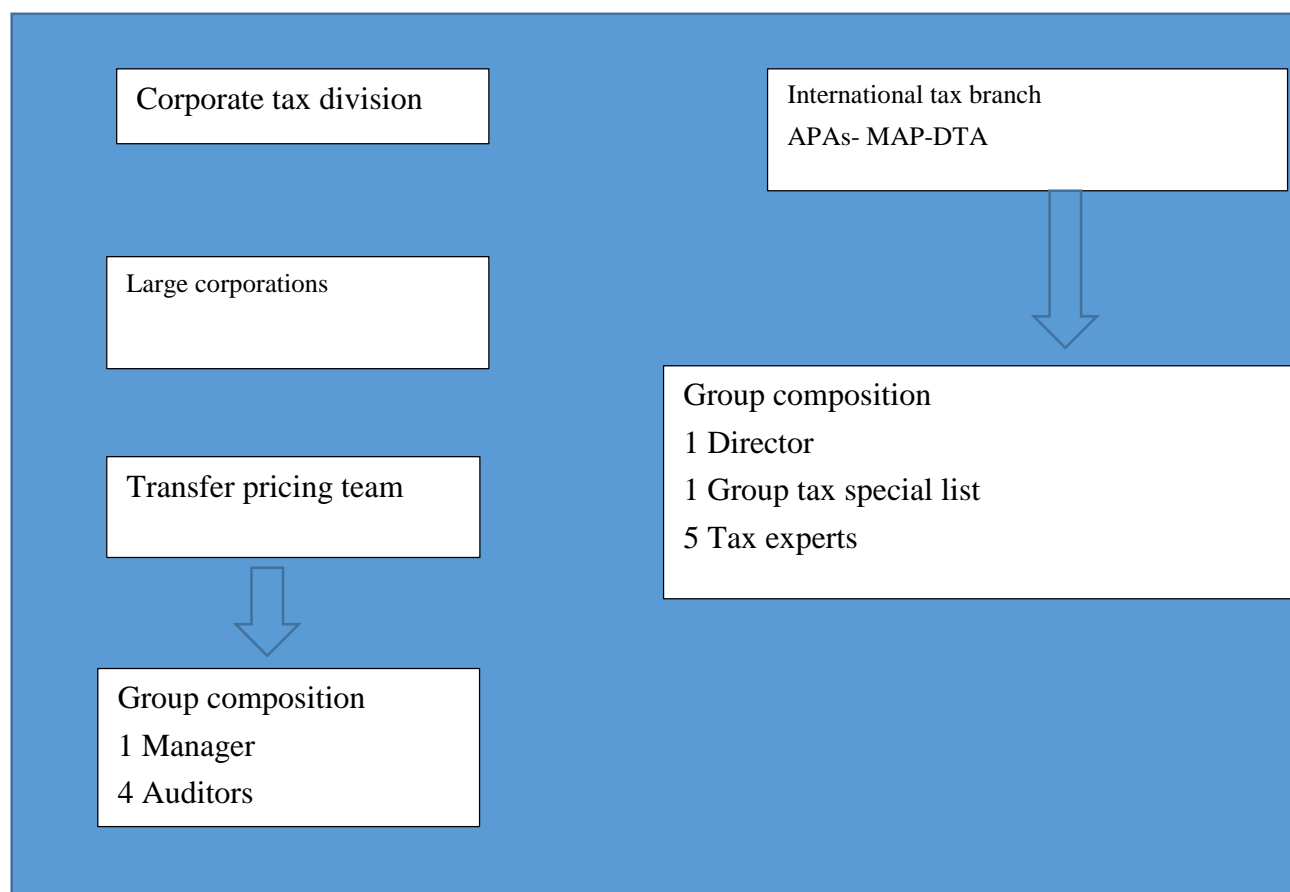
2.2.1 Organization of the transfer pricing units

Normally, creating the organizational structure to implement the issues related to the audit of the transfer pricing will depend on the management objectives of the countries. However, there are two basic patterns of organizational structure that are centralized and decentralized models.

On a centralized basis, there is a single unit of transfer pricing across all sectors and geographies, or a decentralized model, and transfer pricing units established separately by sector or geographic location. Centralized model are beneficial for economic equilibrium in the development, assessment and

application of uniformity. However, the pattern leads to fewer auditors and they may lack the knowledge or ability to enforce the law effectively. For example, the tax TP administration in Singapore is a centralized structure.

Chart 1: Centralized approach to transfer pricing administration in Singapore

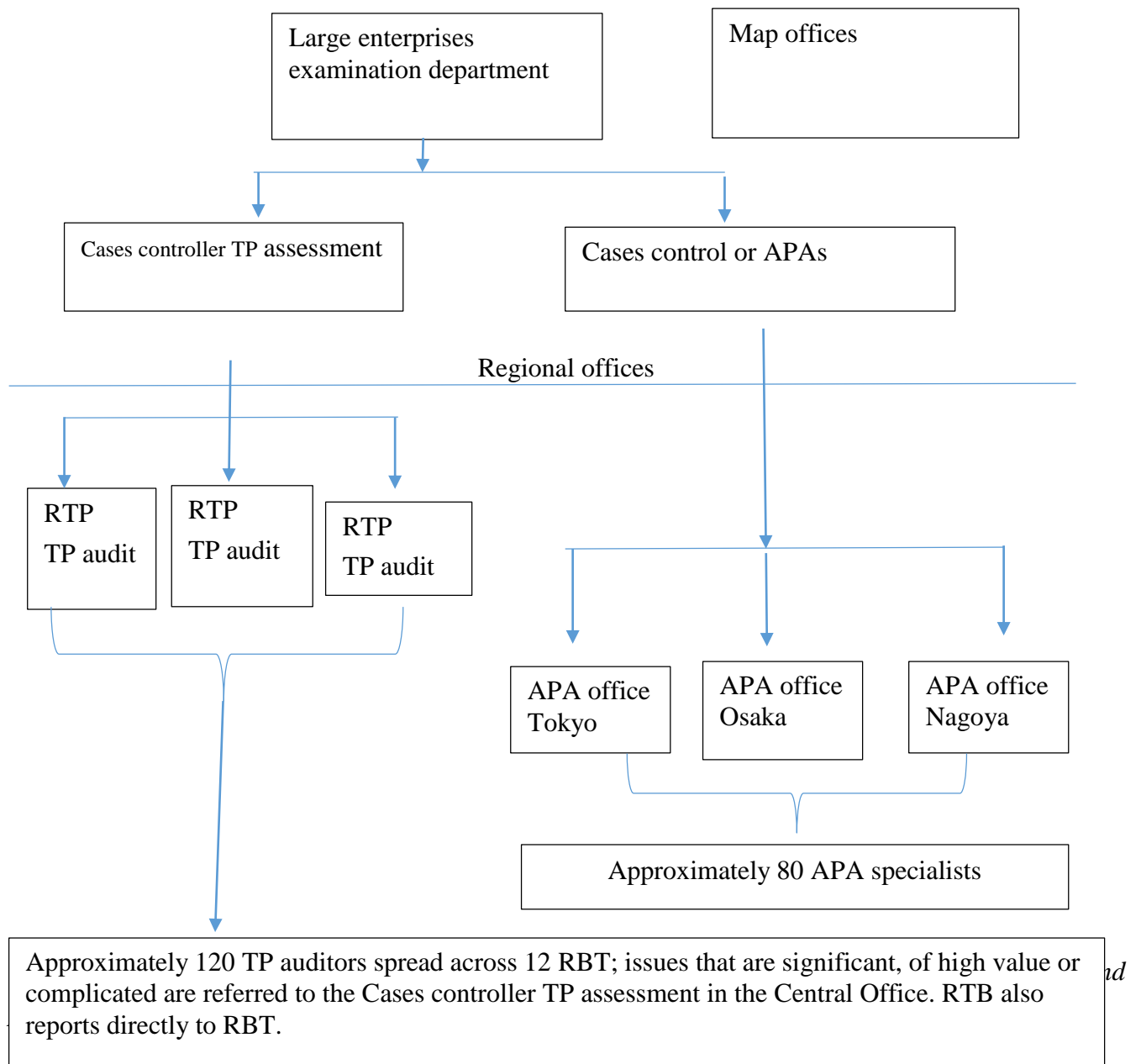


**Source: Transfer pricing and developing economies A Handbook for Policy Makers and Practitioners- Cooper, Fox, Loeprick, & Mohindra, 2016*

Decentralized model

This model is beneficial to shorten the connection gap between auditors, inter-sectorial connections and understanding transfer pricing across sectors. However, following this model, auditors will lack the cooperation and independent vision. The chart below will present decentralized model with an example of Japan’s national tax agency.

Chart 2: Decentralized approach to transfer pricing administration in Japan’s national tax agency



*Source: *Transfer pricing and developing economies A Handbook for Policy Makers and Practitioners*-Cooper, Fox, Loeprick, & Mohindra, 2016

2.2.2 Transfer pricing auditors

Tax auditors play a very important role in tax audits. They are responsible for checking invoices, vouchers and accounting books to assess whether taxpayers comply with the law. Because the transfer pricing is so complex, the tax auditor must be hard-working and competent to handle the transfer pricing. Auditors should have the capacity to perform investigations, determine compliance, analyze financial, accounting and taxation, conduct research and analysis, apply laws, make effective decisions, work effectively, apply workflows and procedures, have the ability to manage work, achieve results and management relationships (OECD, 2006).

Study of Joel Cooper, Randall Fox, Jan Loeprick, and Komal Mohindra (2016) pointed out that in addition to these capacities, auditors also need additional capabilities such as international taxation understanding, negotiation and dispute resolution, assessment, legal understanding and proficient use of English. Tax authorities in developing countries often find difficult to use foreign languages, which limits the effectiveness of the audit of transfer pricing (UN, 2013).

In order to carry out a case of effective transfer pricing, some countries have developed a transfer pricing audit team consisting of economists, auditors, lawyers, accountants, data, business experts (UN, 2013). It is necessary to have English speaking skill to communicate with people in FDI's although developing countries often face this problem as they are non-English speaking country.

2.3 Transfer pricing audit process

2.3.1 What is transfer pricing audit?

Transfer pricing audit means the audit by the tax office of enterprises showing signs of transfer pricings among companies within a corporation aimed at preventing the non-compliance of the provisions of tax legislation. The objective of conducting transfer pricing audits is to increase future tax compliance, indirectly increase the amount of tax payable in the future and protect the tax base of the business; increase the amount of tax paid when a successful transfer of the transfer pricing. It takes a lot of time to carry out a transfer pricing audit, usually 2-3 years or 3 years for a complex transfer pricing investigation (OECD, 2010).

2.3.2 Selection of taxpayer for transfer pricing auditing (risk assessment)

Selection of taxpayer for TP auditing is the process in which tax authorities collect information and available data, analyze and identify the risk of transfer pricing of taxpayers to take TP audit. This is an important stage of the TP auditing process because if tax administration identifies the specific risk indicators, they will select the right case for the audit purpose; Identifying tax risk assessment is challenge of the tax administration. They have to perceive clearly which is TP risk among taxpayers and transactions, which do not to have correct judgements before starting examine a practical audit case.

The appropriate reason for identifying risks is that the tax authorities are limited in resources, and they cannot check all taxpayers to determine the risks, but they have to narrow the subject matter of the audit. In addition, the risk assessment is for the audit team to focus only on the risky and not affect the time of the business. In addition, structured risk analysis will improve the efficiency of tax administrations and improve the quality of audit practice as it will provide auditors with initial guidance on the areas in need. Further investigation and mitigation of weak regulatory decisions leading to the risk of being dismissed in the courts or being unsustainable in an MAP (OECD 2013).

To carry out a transfer pricing assessment, the tax authorities should collect following information: information on declarations such as information on related party transactions; stakeholder information on which transactions are controlled; the nature and number of controlled transactions performed with each stakeholder; analyze the financial results of each controlled transaction; describe the difference between a taxpayer's financial statements and income tax returns (i.e. a difference in books / taxes).

Information on transfer pricing documents is self-described by the taxpayers. This file includes basic descriptions of transactions and operations, describing the most appropriate transfer pricing methodologies used to examine the long-term nature of the transfer pricing. Materials will also include the financial data needed to support economic analysis. If materials are available and carefully prepared, they would support the deep analysis of the information disclosed in transfer pricing forms and tax returns.

Information of results of transfer pricing audit of the previous years such as taxpayers' records kept in tax administration, previous year audit records and tax assessment reports of taxpayers may contain useful information which would help to build a full assessment of the taxpayers' businesses.

Information can also be found from other sources such as the internet, newspapers, magazines, taxpayers' clients, analysts from securities companies, industry insiders, trade data, or taxpayer surveys, in exchanging information with OECD countries, information from industry experts inside and outside (Cooper, Fox, Loeprick, & Mohindra, 2016).

From the above-mentioned information, the tax authorities conduct the analysis and select the riskiest subjects to prepare for the transfer pricing audit. Transfer pricing risk assessment is an interactive process that is carried out throughout the audit and updates the material information at each stage as needed.

2.3.3 Taking audit a transfer pricing case

First, the audit team has to plan for a transfer pricing audit. When TP case is selected, the tax administration sets up a team which includes people who are specialists in tax auditing, economic, international issue, legal of TP, computer Information Technology specialist. On the other hand, they have to prepare to issue examining decision, make examination planning, audit timetable, continuously collect information then approve and sign-off (Dealing Effectively with the Challenges of Transfer Pricing – OECD, 2012).

Second, at the tax office, tax auditors will examine the available information, evaluate/compare taxpayer's ratios (financial, tax revenue) to the standard industry ratios, understanding taxpayer's business, the industry that taxpayer operates in. The manager of TP audit department has to approve the informative analyzed report (OECD, 2012).

Third, when TP case is in process, the auditors have to do some procedures. In order to do the transfer pricing audit effectively, the transfer pricing audit team has to develop a detailing audit plan that includes detailed audit works and audit resources, including additional replacement resources in where the audit case is complex. Then the tax administration notifies to the taxpayer about the TP audit case. Assessing

TP risk is not only conduct to select the TP case also analyses during the audit time by gathering in deep of such information (available at the tax authorities, interview taxpayers, from the internet, foreign tax authorities...) buyers of taxpayers (about taxpayers' business) securities legal agency, journals, tax return of third party who has the same business. Tax audit team should propose to interview taxpayers, visiting business building of them; consequently, audit team conduct analyses data and choose the suitable data applying for the audit case (OECD, 2012).

Forth, following the work on the third, team audit restricts the TP issues. They clarify business, industry, functional business, analyze TP risk of taxpayers and then choose the appropriate TP method to apply for the audit case, notify adjustment proposal to taxpayers and do the adjustment/corrections (the final notice will be issues whether the taxpayer agree or not). The taxpayer will have appealing chance (meeting tax appeal office in case of they do not agree with the adjustment of the audit team) before the audit team give the final decision (OECD, 2012).

Finally, despite of the fact that the taxpayer agrees or not with the adjustment of the audit team, they will be closed the audit case after doing all the stage mention above (OECD, 2012).

2.3.4 Transfer pricing auditing connections with APA

APA is the agreement of applying TP methods between taxpayers and tax administration (APA maybe a bilateral or multilateral). They will choose one of the TP methods which is appropriate method with the specific multinational transactions of the taxpayers. This is not only safe for the taxpayer who wants to avoid double tax between countries but also it limits the argument of tax administrations. The APA may be bilateral or multilateral. In some countries, the FDIes will not be audited if they have an APA agreement with tax administration (Cooper, Fox, Loeprick & Mohindra, 2016).

2.3.5 Database

Databases for comparison purposes are very important in the conduct of pricing transfer audits. Usually the used data includes data taken from the tax authorities, data from the internet, the Securities and Exchange Commission, government agencies managing the area in which taxpayers operate in that sector, with other tax authorities. In Canada and the United States there are the Securities Commission

and the national information exchange. The tax authority may request the committee to exchange specific information of its affiliated company outside its borders with the host country company. In addition to the information above, commercial databases are often used for comparison purposes. These databases are usually provided publicly by reputable, well-known trading companies around the world. In developed countries, the use of this information allows taxpayers to understand the data used by the tax authorities for comparison (OECD, 2013).

In general, some countries have used comparative confidential data. This data is usually not disclosed to the taxpayer and is of a nature only within that country. Using this information for comparison (comparing secrets) is detrimental to the taxpayer, usually in favor of the tax authorities to adjust the pricing of the associated transaction. The OECD Transfer Pricing Guidelines (2010a) provides guidance on the use of information that is not disclosed, and this will create unfairness in determining the amount of tax payable. In this case, the taxpayer will not agree with the audit results and complaint to the tax authorities. Some countries have regulated the secret comparable and applied that regulation in practice because they believe that data used by tax authorities is actually collected from other enterprises. There are 9 countries (Argentina, Australia, Canada, China, Germany, India, Italy, Mexico, and Switzerland) that use the secret comparable data for adjustment. On the other hand there are some do not use secret comparable such as Austria, Belgium, Brazil, Denmark, France, Hong Kong, Ireland, Israel, Luxembourg, the Netherlands, New Zealand, Portugal, Singapore, South Korea, Spain, the United Kingdom, and the U.S³.

In the world, in order to carry out effective transfer pricing audit, some countries have cooperated for joint audit. Tax authorities in two countries will simultaneously audit two affiliated companies within the same group. The objective of this audit for the two tax authorities is to jointly control the operation of each of the affiliates operating in their respective countries. At the same time, they can ensure the appropriate distribution of profits for the taxation of each country.

³ <https://tax.thomsonreuters.com/blog/onesource/transfer-pricing-global-tax-compliance/bloomberg-bna-transfer-pricing-forum-examines-treatment-of-secret-comparables/>

3 RESEARCH METHODOLOGY

The research method used for this study is qualitative research. Qualitative research aims to gather a deep understanding of human behavior and the reasons that affect this behavior. In this study, the author used data collection and analysis to explain the causes of transfer pricing in foreign invested enterprises. Qualitative methods investigate why and how in decision-making, not just answer questions of what, where, when. Qualitative research is self-evident rather than preconceived. Several aspects emerged during qualitative research. Research questions can be changed and be screened when researchers find out what they are going to ask and who to ask. The data collection process can be changed as the door opens and closes for data collection. The general theory and mode of cognition will emerge when it begins with initial symbols, develops into general themes and incorporates them into a fundamental theory or generalization (Creswell, 2003). In this study, on the basis of data and reports the author analyzes the reasons why the foreign invested enterprises have suffered losses while their business scale has high growth rate. Why do other countries have similar happenings? What should the state do to cope with this situation?

3.1 Data collection

I have collected primary and secondary documents including financial statements of some FDI enterprises, reports on results of audit of FDI enterprises' transfer of the total taxation and taxation of some localities, audit conclusions of some FDI enterprises of the Government Inspectorate, legal documents. Additionally, I have collected reports and schemes of the Ministry of Finance, the Ministry of Planning and Investment, the General Department of Statistics, the Vietnam Chamber of Commerce and Industry, the General Department of Taxation and some tax offices localities. Also projects, research works at ministerial level, provincial/ city level; doctoral dissertations, scientific articles, news articles in the country and abroad, etc. related to transfer pricing are used as data. These materials have been processed to systematize the results that have been studied before, identify problems that have been

agreed upon, points that have different opinions, gaps that need further study to deepen the research, find new points of the problem. Finally, I make conclusions according to perspective approach.

The researcher used the survey results by some authorities to increase the persuasiveness and reliability of the arguments and conclusions in the thesis such as the results of a survey conducted by VCCI and USAID on Vietnam's Competitiveness Index 2013, the results of surveys related to VCCI's operations in Vietnam, the survey results of the General Department of Taxation.

In this study, interview is used with targeted sample which is related to transfer pricing in questions. Moreover, the sample size is usually determined on the basis of saturation theory (Mack et al., 2005). Specifically, I chose to interview two audit teams of the General Department of Taxation which have people who have much experience in TP audit on FDIes, directly audited Keangnam vina one member limited liability company and CS Vietnam Company (2 cases of research project). Because of the peer relationships and that they knew my research topic, they were willing to communicate with me in the interviews. I conducted interviews with each member of the audit team. Prior to conducting the interview, I planned a questionnaire for the interview. The questions were: what content do you inspect? what is the source of your data / documents as a basis for comparison with the inspected enterprise; the difficulties of each audit (within 2 cases of my research); what are your suggestions on the tax administration policy for the current associated transactions ?, etc. Before the interviews, I collected documents about these two businesses. The content of the interview is mainly to clarify the points that are not clearly stated in the audit documents and to gain the thoughts and opinions of the inspectors after completing the audit of the transfer pricing. Each interview lasted about 60 minutes, the content of the interview was recorded as the basis for the analysis of data later. Prior to interviews, the author had stated in advance that the content of the interview was used as input to my research, and I pledge to keep the contents of the tax law in Vietnam. Through the interviews with members of the audit team, I have seen legal difficulties, databases that serve the process of fighting with transfer pricing of enterprises with investment capital outside of the tax inspectors.

In addition, during the study, I interviewed a number of experts, scientists, managers and tax officials for comments, remarks and supports for the author in the process of collecting documents, research, information processing, report writing. In particular, the author regularly worked, consulted with the staff of the Department of Reform and Modernization (General Department of Taxation). Moreover, I had

some conversations with some staff working in international cooperation who have many years in the field of cooperation with tax authorities in countries around the world and thus so have much experience and information on transfer pricing issues of the OECD, countries around the world with this problem. They provided me with a lot of information to clarify matters that I had not known.

3.2 Analyzing

In this study, I analyze the data related to the purchase and sale of goods, products, services of cases where FDI enterprises commit the transfer pricing stated in the dissertation, to clarify the transfer pricing tactics of these businesses. As in the case of GS Company (case study), the analysis of data related to business transactions of the business showed that the company has bought and sold with the affiliated parties. However, the proportion of sell transactions with affiliated parties often accounts for a larger proportion than the proportion of buy transactions with affiliated parties. I also analyze some socio-economic situations in Vietnam in the period 2010 - 2015 to see the impacts of transfer pricing in FDI enterprises on the receiving countries.

Since transfer pricing is a sensitive issue, some of the documents that the authorities provide are internal documents, unpublished documents, documents in which information is treated as assets owned by the business. There is a limit to the number of users and documents in the "secret" mode, so when using these documents, the author of the dissertation is required not to disclose the source or name of the business.

In addition, analyzing is used through comparing the provisions of the Vietnamese legal system with OECD and other countries' regulations on tax policy, transfer pricing methodology, experience with anti-pricing transfer and other related issues, thereby considering the current situation of Vietnam and propose recommendations to amend TP regulations to be suitable for Vietnam

3.3 Case study

Case study was conducted to highlight cases of MNCs, typical FDI enterprises (in the world and in Vietnam); the typical country in dealing with the transfer pricing. The purpose of this method is to clarify the current pricing situation in the world and in Vietnam, the tricks of transfer pricing, draw experience in dealing with transfer pricing of some countries in the world.

3.4 Study procedure

This study is conducted according to the following procedure. First of all, I preliminarily collected information relating to transfer pricing issues of foreign invested enterprises operating in Vietnam (performance of foreign invested enterprises, contributions of these enterprises to the economy, outstanding issues of these enterprises after a period of operation, contributions to the state budget, results of audits of a number of enterprises with foreign investment, results of surveys of organizations, associations studied for foreign invested enterprises, etc.) to identify issues to study. The second step is to set research questions that need to be addressed. After studying the original materials, the problem report was refined and formulated to a research question. The third step is the design of this study, as presented in Chapter 1. After the completion of the research design, the literature review was developed by gathering theories of financial performance, performance measurement, Scorecard equilibrium theory, and the results of the studies. The next step to be taken for this study is the qualitative data collection. The details each approach are presented in this Chapter. After the result chapter, I will introduce recommendations in Chapter 6. The final step of the procedure is discussion and conclusions, in which proposals for amendments to the tax policy relating to associated transactions will be provided.

4 TRANSFER PRICING AUDIT ON FOREIGN INVESTED ENTERPRISES IN VIETNAM

4.1 Overview of foreign direct invested capital and transfer pricing in FDI enterprises in Vietnam

4.1.1 The attraction of foreign direct invested capital in Vietnam

After nearly 30 years of implementation of the Law on Foreign Investment (effective since 1987), foreign direct investment in Vietnam increased both in registered capital and disbursed capital. By 31/12/2015, in Vietnam there were more than 20,000 active FDI projects with a total registered capital of 281,882 billion US dollars. Analysis of FDI inflow into Vietnam by location and investment partner which is shown below.

By 31/12/2015, foreign direct investment is categorized in locations, available in 62 provinces and cities nationwide (Dien Bien province currently does not have any foreign direct investment projects). Foreign direct investment is unevenly distributed, mainly in the South East and the Red River Delta. Specifically, the South East has 13,057 projects with registered capital of 146,569 billion USD, accounting for 51.9% of total registered FDI capital; The Red River Delta currently has 6,186 FDI projects, with a total registered capital of US\$ 72,257 billion, accounting for 21.3% of total FDI registered capital. Ho Chi Minh City is the leading FDI attraction with 5,886 valid projects with a total registered capital of US\$ 42,366 billion, accounting for 15% of the total registered FDI in the country, followed by Ba Ria – Vung Tau, Hanoi, Dong Nai, Binh Duong, Hai Phong, Bac Ninh, Ha Tinh, Thanh Hoa, Hai Duong.

On the other hand, Foreign direct investment is categorized as investment partners. Currently there are 110 countries and territories with investment projects in Vietnam, of which the largest is Korea with 4,970 projects, the total registered capital is 45,191 billion USD, accounting for 16% of total registered FDI; followed by Japan with 29.4 billion dollars, Taiwan ranked third with 2,478 projects, Singapore

ranked fourth with 1,544 projects, but registered capital of Singapore was second with total registered capital \$ 35,148 billion, while Taiwan's is 30.99 billion dollars. The "tax haven" British Virgin Islands has 623 projects with a total registered capital of 19,275 billion dollars ranked the fifth in the total registered capital.

Table 1: Top 12 FDI partners entering Vietnam

No Order	Partner	Number of projects	Total Registered Capital (Million USD)
1	Korea	4,970	45,191.10
2	Japan	2,914	38,973.63
3	Singapore	1,544	35,148.91
4	Taiwan	2,478	30,997.43
5	British Virgin Islands	623	19,275.31
6	Hong Kong	975	15,546.76
7	Malaysia	523	13,420.05
8	US	781	11,301.82
9	China	1,296	10,174.22
10	Netherlands	255	8,264.55
11	Thailand	419	7,727.94
12	Cayman Islands	67	6,392.29

** Source: data of the Foreign Investment Agency, 2015*

4.1.2 Overview of transfer pricing in FDI enterprises in Vietnam

In order to achieve profit in maximum, the FDIes carry out tricks to turn profits into losses or profit margins into low profits to minimize the amount of tax payable. This thing happens coincidentally with the reality of widespread losses phenomenon of FDI enterprises in Vietnam. Vietnam Business Annual Report 2015 announced by VCCI noted that among the three types of enterprises, FDI has the highest rate of business losses, up to 51.2% (2008) or 49.8% (2009); In 2010, 2011, there was a decrease of

44.2% and 45% respectively, but in the last 3 years, from 2012 to 2014, the rate of return increased to approximately 48%. The statistics of the General Department of Taxation in recent years have shown that many FDI enterprises have lost for three consecutive years, even losing a few decades with the loss of the next year higher than that of the previous year. Ho Chi Minh City is the most convenient place for business, but 50% to 60% of FDIes have regularly reported losses for many years and do not pay the income tax. Their indication of TP is buying and selling goods and services with affiliated parties. In Binh Duong province, the number of FDI enterprises reporting losses in the past 10 years ranged from 45 to 58%. In 2007, the number of enterprises reporting losses was 53%, 58% in 2008 and 55% in 2009 is 55 %, in 2010 is 44%, in 2011 is 48%, in 2014 is 45%). In Lam Dong province, 104 out of 111 FDI enterprises reported losses in 2014. In Bac Ninh, 46% of FDI enterprises reported continuous loss for many years. By 2012, 10% of them had accumulated losses greater than their equity. In other provinces, there were similar situations. For example, in Hai Duong in 2008, 57% of FDI enterprises cited losses. In Long An in the period 2006-2010, this figure was 56%. The above is not believable with the advantages of FDI enterprises such as having modern science and technology, high management level and wide connection market, enjoying with many preferential policies on tax, infrastructure, import and export experience. On the other hand, while FDI firms claim losses, most of the domestic firms in the same industry are profitable. Notably, despite big losses for many years, the annual growth rate of revenue of FDI enterprises is still high, their production and business activities are continuously expanded. According to the GDT, this phenomenon is a manifestation of the transfer pricing because the information could not be verified for foreign enterprises, the tax authorities have no basis to consider and handle. This make tax administration has a question about their ability in business. Are the FDI loss or not in practices? Finally, they identified of indication of transfer pricing for the continuously loss enterprises.

The results of the transfer pricing audit by the tax authorities clarify the transfer pricing behavior in FDI enterprises in Vietnam as follow.

First, from 2010 to 2013, the tax branch in the whole country inspected 4,857 FDI enterprises who had transfer pricing signs. The results of audits show that many FDI enterprises have more profit than their declared profits. They are not losses as they declared before. Since then, the tax authorities had to reduce the losses VND 11.000 billion and concluded the collection of VND 4,200 billion income tax. In 2013

alone, through audits of 2,110 enterprises, tax authorities have forced enterprises to reduce losses by VND 4,129 billion; Collection of tax returns and fines of VND 988,1 billion.

Second, in 2014, the tax branch of the country has conducted audit 2,077 enterprises losses, enterprises have signs of transfer pricing who have associated transactions. As a result, companies have reduced losses by VND 5,439.87 billion; Tax authorities collect tax, retrieve taxation and penalty VND 1,607.7 billion.

Third, in 2015, the number of enterprises showing signs of transfer pricing is inspected by the tax department is 4,751. Through audit, tax authorities adjusted the losses VND 10,050 billion. In the case of Metro Cash & Carry transfer after 12 years of operation in Vietnam, tax authorities have collected more than VND 507 billion.

4.1.3 Measurement of transfer pricing of FDI enterprises in Vietnam

Accurately evaluating the size of the transfer is very difficult. Up to now, the General Department of Taxation and the local tax authorities have not been able to measure the transfer pricing in the whole country or in a locality. The current level of transfer pricing data is in a discrete, independent manner, which is the results of audit cases, against transfer pricing between tax authorities and enterprises that have detected transfer pricing behaviors. The VCCI and USAIDS team proposed a method for relatively accurate measurement of the transfer size called the "asymmetric counting technique" (UCT), or the LIST questionnaire. From this method, the research team has estimated the transfer value by the number of FDI enterprises, by profitability as follows.

First, they estimated transfer size by number of FDI enterprises. An analysis of the results of the survey, collecting opinions of 1,609 FDI enterprises from 49 different countries, operating in 13 provinces and cities of Vietnam showed that about 20% of FDI enterprises (out of 1,609 survey) transfer pricing.

Second, they estimated size of transfer pricing according to enterprise profitability. If we classify the margins as very high (20% or more), high (10-20%), average (5-10%), positive performance (less

than 5% but not loss), the pricing transfer is occurring throughout these objects, but the scale is different. Specifically: The proportion of FDI transferring enterprises in the group with very high profit margin is 65%, while the proportion of high-profit FDI enterprises is 44%, the middle-income group average is 12% and the lowest is the group of active business with a rate of 9% transfer pricing. It is interesting to note that 31% of FDI enterprises have lost (from negative (-) 5%) acknowledged transfer pricing. The above results show that it is very likely that high-level FDI enterprises will transfer their pricings, transfer profits into "losses", and push themselves down to profit to avoid corporate income tax.

Table 2: Estimated Rate of Transfer by Profitability (%)

Order	Classified according to the rate of return	Sample number	Estimated rate	Standard error	Low estimate	High estimate
1	More than 20%	39	65.1	10.1	48.9	81.5
2	From 10-20%	105	44.5	6.9	33.5	55.5
3	From 5-10%	262	12.3	9.7	-3.2	27.8
4	From 0-5%	455	9.1	4.8	1.4	16.8
5	Break even	163	19.7	15.2	-4,6	44.0
6	Loss 5-0%	176	30.9	17.4	3.1	58.7
7	Loss 10-5% revenue	76	-2.1	24.6	-41.5	37.3
8	Loss 10% revenue	68	-0.3	20.4	-32.9	32.3

Source Vietnam Competitiveness Index 2013

4.1.4 Forms of transfer pricing in Vietnam

Through the tax administration and the inspection of foreign invested enterprises, the tax authorities have synthesized the following common transfer pricing signs.

First, Pricing transfer through the form of raising the value of assets upon the establishment of FDI enterprises or when contributing investment capital to set up joint ventures in Vietnam

This is a form often used by foreign investors because of the advantages of modern machinery and equipment. On the other hand, due to the lack of capacity, qualifications and lack of information for

valuation of equipment and technology contributed by foreign parties to joint ventures, the JV has to accept the value set by the partner. This form is common in the period when Vietnam opened its economy and "desire" to attract foreign direct investment, but now is still applied by many foreign investors. A study by the VCCI's Business Development Institute (VCCI) found in the "Vietnam Business Dynamics Report for the first 6 months of 2014" found that nearly 25% of surveyed enterprises said that FDI enterprises often use the image Transfer pricing by raising the value of capital assets during the investment process in Vietnam.

Second, transfer pricing through raising input pricings (for the purchase of raw materials, equipment, machinery)

Many FDI enterprises in Vietnam choose to import raw materials from outside because of their abundant source of raw materials and good quality. Even businesses producing animal feeds and alcohol production also import raw materials despite the availability of raw materials in Vietnam. Partners selling raw materials to FDI enterprises are mainly parent companies or associated companies. According to the Institute of Enterprise Development's Vietnam Business Report for the first 6 months of this year, 56% of the respondents said that FDI enterprises use the form of transfer pricing by purchasing raw materials from the parent company. At high pricings and selling products to the parent company at a lower pricing than the actual pricing. In many cases, the input material pricing is pushed up as high as possible. Due to the high cost of such inputs, pre-tax profit of FDI enterprises in Vietnam is low, and losses are slow. With business losses, the FDI enterprises will not have to pay corporate income tax, Vietnam will lose tax revenue; Meanwhile, FDI enterprises have transferred profits to their parent company or associate company.

Third, transfer pricing by lowering the selling pricings of products made in Vietnam to parent companies or overseas affiliate enterprises (regulating the profits from the sale service)

When the parent or affiliated company registers business in a location where the corporate income tax rate is lower than Vietnam, the FDI enterprise will sell its products to the parent or affiliated company at a lower pricing than the market pricing. The cost of the transaction is lower than the cost of capital, which translates into profit for the parent or associate. As with the purchase of raw materials from the parent company or associates at high pricings, this procedure is used by many FDI enterprises.

Forth, transfer pricing through intangible assets transfer, management costs, experts

Intangible assets such as technology, know-how, copyright, trademarks, management techniques are difficult to determine, due to the specific characteristics of each enterprise and less information and resources. To compare, FDI enterprises often take advantage of this feature to pay intangible asset transfer costs to the parent company or affiliates at a very high level, which accounts for a large part of the total cost of FDI enterprises, making it FDI enterprises have no interest, even losses, thereby avoiding the payment of corporate income tax in Vietnam.

Fifth, transfer pricing through financial loans

This behavior is realized through the fact that FDI enterprises in Vietnam borrow from parent company or foreign affiliate companies at higher interest rate than the market interest rate, resulting in higher costs and reduced taxable income, FDI enterprises transfer profits to their parent companies or affiliates.

Sixth, transfer pricing through multiple combinations

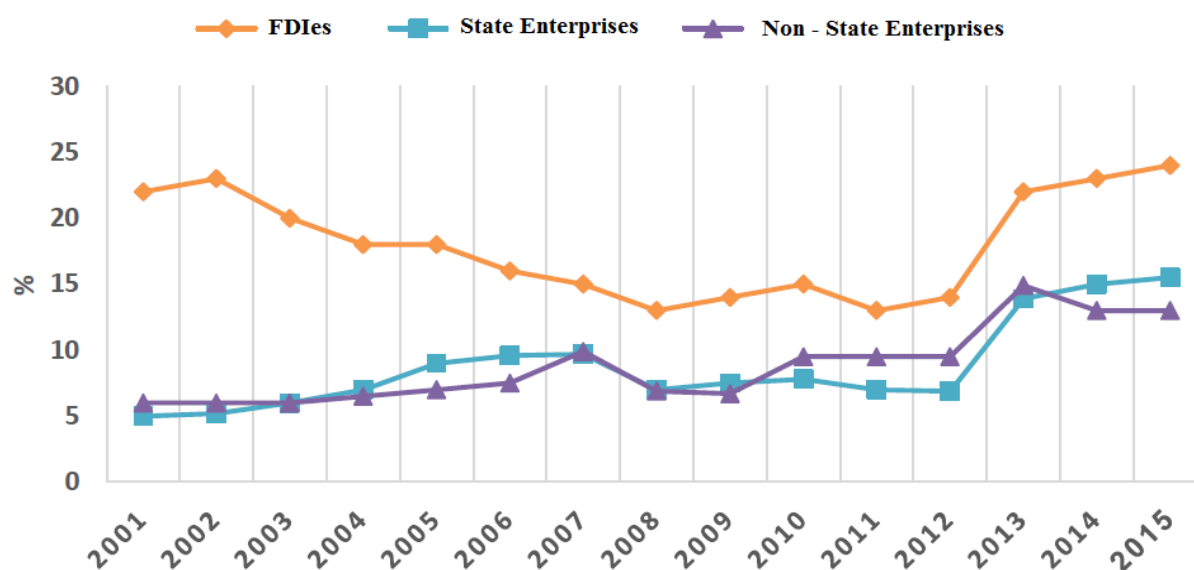
In many cases, FDI enterprises have used several transfer techniques at the same time to achieve the highest efficiency. Combined forms such as FDI enterprises have imported raw materials from the parent company or associates at high pricings, and at the same time sell products back at low pricings, which are lower than cost pricings, Or the FDI enterprises have just calculated the input pricing of raw materials, borrowed money at high cost, paid royalties, management, experts for high pricing associates. The above tactics are aimed at achieving a goal of making FDI enterprises in Vietnam suffer losses, so they do not have to pay corporate income tax.

4.1.5 The impact of transfer pricing of FDI enterprises in Vietnam

The most noticeable loss due to the transfer pricing behavior of FDI enterprises is the loss of state budget, in particular the loss of corporate income tax and the profit transfer tax. In fact, FDI enterprises are increasingly expanding business, increasing investment capital but their business report always get loss. This is not commensurate with the increase. The fact that there is more than 50% of FDI enterprises make

a loss even many of them suffer losses at large scale. However, the TP auditing results on these enterprises often are loss reduction, collection of corporate income tax more than post-declaration of the FDIes. It means that, the state budget deficits related to transfer pricing strongly. In addition, the collection of value added tax from the operation of FDI enterprises is also difficult. When the input pricing is high, the selling pricing (export) is low or high proportion compared to input pricings. The FDI enterprises in Vietnam accounts for about 25% of the total investment capital of the whole society. The FDI enterprises production accounts for more than 40% of the industrial production value export turnover accounts for over 50%, even a year (2015) reached 70% of total export turnover of the country. However, the FDI sector contributes only about 9-10% of total national revenues (excluding crude oil), much lower than that of SOEs and is equivalent to that of non-state enterprises. This may be considered unreasonable and transfer pricing is one reason why the contribution to national budget revenues is not corresponding with what the FDI has received the intensives from Vietnam government.

Chart 3: Contribution to national budgets of economic sectors



**Source: General Statistics Office, 2015*

4.1.6 The causes and conditions that lead to the transfer pricing of FDI

The phenomenon of transfer pricing of FDI enterprises in Vietnam comes from many different reasons. From the subjective perspective of the FDI receiving country, some of the following causes may be outlined:

First, the CIT rate of Vietnam is not attractive.

The difference in the tax policies between countries is the basis for FDI enterprises to devise policies on transfer pricing. They transfer profits from places with high income tax rates to lower places, thereby minimizing the total tax liability of a corporation.

Table 3: Corporate income tax rate of Vietnam and some countries

Country	Basic CIT (%)	Country	Basic CIT (%)
Vietnam	25	China	25
Brunei	22	Taiwan	23
Cambodia	20	Hong Kong	16.5
Indonesia	25	Japan	38
Laos	28	Korea	20-20
Malaysia	25	Montenegro	9
Myanmar	30	Macao	12
Philippines	30	Cyprus	10
Singapore	17	Bulgaria	10
Thailand	28	Andorra	0
Bahamas	0	Bahrain	0
Bermuda	0	British Virgin Islands	0

**Source: Documents of the General Department of Taxation and the websites of the National Tax Authority, 2013.*

In practice, Vietnam shows that there is a link between the loss of FDIes (signs of transfer pricing) and change of corporate income tax rates. Since 2009, there was about 50% of FDI enterprises declared losses and many of which suffered losses for many consecutive years when the corporate income tax rate in Vietnam was at 28%. When the corporate income tax rate decreased to 25% (from 2009 to 31/12/2013) and 22% (from January 1, 2014 to December 31, 2015), the percentage of FDI enterprises declared losses reduced to 42.9% in 2011, 44.7% in 2012, 45.4% in 2014. In 2015, according to a VCCI survey of 1,584 FDI enterprises from 43 different countries, operating in 14 provinces and cities of Vietnam, the percentage of lost FDI enterprises was 37.8%. (If the total number of FDI enterprises had been included, the number of enterprises with losses would have been higher).

Vietnam has implemented the corporate income tax reduction schedule since 1 January 2016 with the base tax rate of 20%. However its corporate income tax rate is still higher than that of other countries not only in the Asian but also all over the world, not to mentioned tax havens such as Andorra, Bahamas, Bermuda, Bahrain, British Virgin Islands, etc. with a tax rate of 0%. In 2013, among the 12 countries and territories with the highest FDI inflows to Vietnam, two countries with higher corporate income tax rates than Vietnam are USA and Japan. This tax rate in China is equal to Vietnam. The rest of nine countries or territories with lower corporate income tax rates than Vietnam are Singapore, Hong Kong, Taiwan, the Netherlands, Thailand, the British Virgin Islands, etc. The British Virgin Islands is ranked the fifth in terms of FDI (\$ 19.20 billion), although GDP of this country is only \$ 1 billion. When FDI enterprises in Vietnam conduct transactions among affiliated parties in the above-mentioned countries or territories, they make opportunities for transfer pricing arising. The report by Edmund Malesky (2013) shows that nearly a half of FDI enterprises (out of total of 1,600 FDI enterprises surveyed) invest in Vietnam are from countries that have lower corporate income tax rates than Vietnam and that 36% of the companies carry out the transfer pricing. Even in the case where the countries of origin of FDI enterprises have a higher corporate income tax rate than that of Vietnam (such as Japan or the U.S), this does not mean that there is no transfer pricing in FDI firms. Because these FDI enterprises have affiliated companies operating in countries with lower corporate income tax rate than Vietnam. Malesky has recommended that Vietnam should adjust its corporate income tax rates corresponding to its competitors.

Secondly, the legal system relating to the TP in Vietnam is incomplete, incomprehensible and not up to date with international standards and trends. The legal elements effected TP behaviors strongly. For a

long time, the transfer pricing regulation has been incomplete and unclear. Currently although the legal system related to transfer pricing has been more developed but still inadequate. It should have been studied and developed continuously. Vietnam has no separate TP Law and Decree and the contents related to this issue are scattered in a number of Laws and Decrees. The circular 66/2010/TT-BTC dated 22/4/2010 of the Ministry of Finance has guided the determination of market pricings in transactions between related parties (hereinafter referred to as circular 66). The content will be analyzed in detail later.

On the other hand, Vietnam has no legal document regulating coordination between the domestic and foreign tax agencies. This would help tax administration collect international information to implement TP managing activities. In addition, Vietnam has no budget for purchasing information, and the costs of investigating and verification are not clearly defined.

Thirdly, the policy of attracting foreign investment and tax incentives has been creating favorable conditions for FDI enterprises which have transfer pricing in Vietnam. Some forms of tax incentives in Vietnam now include corporate income tax rate of 10% for 15 years from the first year of taxable income; tax exemption for the first 4 years, 50% tax reduction for the next 9 years; allow losses within 5 years; tax refund for reinvestment profits; accepted fast depreciation, for investment projects in a number of sectors where investment is encouraged (VietnamTax Coporation Law 2008). Such incentives may become a "loop hole" for FDIes to carry out transfer pricing and to avoid taxation. MNEs will exploit such incentives to set up and dissolve enterprises that will receive preferential treatment and set up other enterprises in order to extend tax exemption or reduction duration. At the end of the tax incentive period in locality A, a new project in locality B will be opened to receive incentives (for new projects) and the income from the non-preferential project will be transferred to the preferential project. Some researches and surveys in the country show⁴ that among factors affecting the investment decision, the tax incentive factor of the receiving country is not the key one influencing investment decisions of foreign investors. This conclusion is to suggest practically that Vietnam should consider in implementing tax incentives in the coming time.

⁴ <http://tapchitaichinh.vn/nghien-cuu--trao-doi/trao-doi-binh-luan/chinh-sach-uu-dai-thue-doi-voi-hoat-dong-dau-tu-nuoc-goai-81212.html>

On the other hand, for a long time, many localities in Vietnam seem to have attracted foreign investment at any costs. They concentrate on the number of FDI projects and the FDI registered capital rather than the result of the businesses. Inter-provincial competition also attracts investment, leading to being afraid of audit, including transfer pricing audit. They think that it may affect their investment environment.

Fourthly, Vietnam's supporting industries have been slowly developed and their competitiveness is still low and the growth has been slow. Although most of FDI enterprises have been looking for Vietnamese partners to order processing goods, components, materials and intermediary products for their production process, they have failed to achieve their targets. For example, Samsung Vina (a Korean FDI company specializing in mobile phone manufacturing with factories in Bac Ninh, Thai Nguyen and other parts of Vietnam) imports a large quantity of components each year, up to \$ 19.8 billion (in 2014), but out of nearly 100 partners in nine countries supplying components to their Thai Nguyen and Bac Ninh factories, there are only seven Vietnamese companies⁵. It is not possible for Vietnamese companies to produce types of screws and chargers that Samsung ordered, and foreign suppliers still hold important positions for FDI enterprises in Vietnam. According to the VCCI study (2014), 8.1% of FDIes in Vietnam buy all or part of their inputs and services through parent companies, 54% buy products from countries that have FDI into Vietnam and 34% from third country suppliers, which in turn push FDIes to transfer pricing to maximize benefits. This also contributed to the concerns of the Government of Vietnam on the risk of transfer pricing in Vietnam.

Fifthly, the awareness, capacity, experience and organizational structure of the audit and control of transfer pricing are weak and limited. Although the phenomenon of transfer pricing in FDI enterprises has become more popular in many years, until October 2015, the General Department of Taxation officially established the TP Audit Division (directly under Audit Department) at the Headquarter of the GDT and four provincial taxations in Hanoi, Binh Duong, Dong Nai and Ho Chi Minh City. This is the specialized human resource to directly carry out anti-pricing transfer duty. However, the staff of this division does not have enough experience and skills of TP auditing. Even for the taxation agency in Ho Chi Minh City which has a large number of FDI enterprises, the TP auditing division has only 10 people, most of whom have not been equipped with in-depth knowledge of transfer pricing. In other localities,

⁵ https://kinhdoanh.vnexpress.net/tin-tuc/quoc-te/samsung-nguy-co-mat-hang-ty-usd-tien-thue-3034145.html?ctr=related_news_click

there is no specialized team to carry out the task of inspecting and examining transfer pricing behaviors. This shows that the transfer pricing issue has not really received the full attention of MOF. The lack of capacity and experience in transfer pricing control by tax officials is one of the obstacles (Nguyen Tan Vinh, Duong Van An., 2016). In a research show that “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”⁶.

On the other hand, the coordination between the tax authorities and relevant authorities in tax collection management and response to transfer pricing is not synchronous and does not create the power to respond effectively to the transfer pricing. Thus FDI enterprises has taken the advantage of this limitation to do more TP.

Sixthly, for FDI enterprises, they have many motivations to do transfer pricing and sometimes TP has become their strategies. Their motivations are to maximum profit engines, create competitive advantage, dominate the market, acquire joint venture capital, preserve capital against foreign exchange risks or other adverse effects.

4.2 Regulations of transfer pricing in Vietnam

The legal content related to responding to transfer pricing in Vietnam was first recognized in circular 74-TC/TCT (circular 74) which guided the implementation of tax regulations for investment forms under the Foreign Investment Law in Vietnam, issued by the Ministry of Finance in 1997. In 1999, the Ministry of Finance issued circular 89/1999/TT-BTC (Circular 89) which guided the implementation of tax regulations in various forms of investment under the Law on Foreign Investment in Vietnam, replacing circular 74. In 2001, the Ministry of Finance promulgated circular 13/2001/TT-BTC (Circular 13) which guided the implementation of tax regulations on investment formed under the Law on Foreign Investment in Vietnam, replacing circular 89. Transfer pricing mentioned in these circulars focuses on two main issues that is transactions of affiliated firms and determination of market pricings for transactions between affiliated enterprises. Although the Ministry of Finance issued three circulars with contents directly related to the transfer pricing within four years, there were no significant changes in the circulars. For example, Circular 89 only clarified the concept of non-market trading contract and the concept of enterprise or associate in comparison with Circular 74. Moreover, in Circular 74 and Circular 89, the

⁶ https://ec.europa.eu/taxation_customs/sites/taxation/files/docs/body/trpr_dev_count_app_e.pdf

term of anti-transfer pricing is called anti-transfer measures (Section IV), Circular 13 is amended by measures to determine market pricings in transactions between associated enterprises. Under the provisions of these circulars, if any unreasonable pricing or profit margin is found in transactions between affiliated companies, the tax authorities shall apply three methods to determine the correctness. Corporate income tax includes the method of comparable transaction, the method used to determine the purchase pricing and taxable income. In case of detecting the disadvantage of reasonable pricing without conditions to apply the above measures, the circular has provision to permit the local tax authorities to notify the enterprise to produce documents, and request the enterprise to undertake in writing the legality of the documents provided. In general, the legal efficiency of circulars 74, 89, 13 were not as high as the Law on Enterprise Income Tax (effective from January 1, 2004), the Ministry of Finance issued circular 117/2005/TT-BTC (Circular 117) which guided the determination of market pricings in business transactions between affiliated parties. This circular regulates three methods of determining the market pricing in transactions between affiliated companies mentioned in Circular 117 and added two new methods. Finally, this Circular has five methods of determining market pricings in transactions between affiliated companies as follow.

First, CUP is based on product unit pricing in independent transactions to determine product unit pricing in associated transactions when these transactions have equal transaction conditions.

Second, RPM is based on the resale pricing (or selling pricing) of the product sold by the business to the independent party to determine the purchase pricing (cost) of that product from the affiliate.

Third, the CPM is based on the cost pricing (or pricing) of the product to determine the selling pricing of that product to the affiliate.

Forth, the method of profit comparison is basically of TNMM and it is based on the profitability of the product in independent transactions selected for comparison as the basis for determining the profitability of the product in the associated transaction when this transaction has similar trading conditions. This is considered an extension of the resale pricing method and the cost plus margin, which can be applied in the event of similar conditions.

Fifth, PSM is based on the profit from an associated transaction carried out by associated companies to determine appropriate profit for each business. Associated companies will share profits in the same way with unassociated ones for equivalent transactions. An aggregated linkage transaction involving many affiliated businesses is a unique transaction that includes multiple, closely related, interrelated transactions of toxic products, right or associated transactions between affiliated parties.

In 2010, the Ministry of Finance issued circular 66 which guided the determination of market pricings in business transactions among affiliated parties. This circular replaced Circular 117. Circular No. 66 is considered as a relatively comprehensive legal framework, built on OECD guidelines on transfer pricing. Basically, this Circular has adjusted the transfer pricing behavior of the affiliated parties. For example, the stipulation of affiliated companies in this circular is clearer, more specific than that in previous regulations. Regulations on sources of information and data that the tax authorities are permitted to use to analyze and compare transfer pricing basically meet the requirements of determining the market pricings, both for enterprises and tax authorities. A survey of 533 enterprises, 58 local tax authorities and 854 tax officials carried out by the General Department of Taxation showed that 90% of enterprises, 85.96% local tax offices, 82.27% the tax officers can analyze, compare and calculate market pricings thanks to the provision of information and data sources in accordance with circular 66. The regulation is complete, feasible and have positive effects on tax administration. Other provisions are more specific, such as regulations on material differences in comparable transactions associated with independent transactions that have been quantified rather than qualitative as defined previously, as a basis for understanding and uniform application between tax authorities and taxpayers and between tax authorities. There is also guidance on the determination of the market pricing which has been specifically prescribed for the case of purchase and the case of sale, ensuring consistency between general principles and specific guidance on the determination of market pricings; forms for declaration of associated transaction information are more specific, clearer and convenient for taxpayers' declaration.

Circular 66 marked an important step in the management of transfer valuation of FDI enterprises in Vietnam, contributing to limiting pricing transfer, evasion of taxation, protecting the interests and taxing rights of Vietnam and ensuring equity in the performance of tax obligations among enterprises. In addition, some regulations related to transfer pricing (such as transfer contracts, determination of transfer pricing of land use rights, etc.) are also scattered in some other legal documents.

At the legislative level, the National Assembly of the Socialist Republic of Vietnam has promulgated the Law on Amendment of and Addition to a Number of Articles of the Law on Tax Administration, effective from 1 July 2013, which has some new regulations as follow.

Firstly, additional provisions on mechanism for implementation of "Advanced Pricing Arrangement" (APA) has facilitated the collection of taxes, resulting in the increase of tax revenue, and the initiative of FDI enterprises to make business plans and fulfill their tax obligations.

Secondly, increasing the statute of limitation for dealing with tax law violations: Before July 1, 2007, regulations on tax administration which deal with tax law violations were stipulated in laws, In the Law on Value Added Tax, the Law on Corporate Income Tax (2003) stipulates that the statute of limitation for retrospective tax collection is five years or earlier. However, the Law on Amendment of and Addition to a Number of Articles of the Tax Administration Law (2013) has increased the time limit for applying retrospective tax collection for 10 years from the date of audit and raised the sanctioning level for acts of making incorrect declarations which led to the shortfall of payable tax amounts or the increase of refundable tax amounts from 10% to 20%.

Thirdly, allowing the tax offices to conduct tax examination at taxpayers' offices according to risk assessment criteria, thematic, annual plan.

Fourthly, allowing the tax authorities to collect information from the tax authorities of the countries that have signed the tax treaty with Vietnam.

The addition of some new and important content to deal with transfer pricing in the Law on Amendments and Supplements to a number of articles of the Law on Tax Administration (2013) facilitates the tax administration, improves its ability to cope with pricing changes, and to create initiative for FDI enterprises to make business plans and fulfill tax obligations. In addition, Vietnam has signed double tax treaties with more than 50 countries. This is an important legal condition for enhancing the ability to cope with pricing changes.

In conclusion, Viet Nam already has regulations to manage transfer pricing activities of foreign invested enterprises. These regulations are based on OECD's general principles of transfer pricing. However, according to the assessment of the tax authorities, the new regulations are at the circular level, not at compulsory level as law.

4.3 Vietnam's administrative aspects

Responding to the more and more popular TP status of FDI enterprises in Vietnam is a fierce and difficult "fight". In recent years, the tax administration has invested in many aspects to improve the ability to challenge the transfer pricing.

Regarding the human resources, the tax department of Vietnam has strengthened the training, fostering and organization for tax officials at all levels to study and improve their knowledge on taxation and transfer.

Regarding the organization of law enforcement, the tax department of Vietnam has set up a specialized section on transfer pricing audit and implemented audit and examination of FDI enterprises with signs of transfer pricing at the level of the General Department of Taxation. There are many risks associated with transfer pricing in Ho Chi Minh City, Hanoi, Binh Duong and Dong Nai.

Regarding the audit and examination activities, tax authorities at all levels regularly carry out specialized audit on transfer pricing, thereby detecting enterprises with signs of transfer pricing to fight and re-determine the transfer price in accordance with the law, reducing the "number" of the enterprises with losses, collecting enterprise income tax and sanctioning the transfer enterprise. Only in three years since the General Department of Taxation set up transfer pricing team (2012) who detected many transfer cases with a large adjustment. For example, in a specialized "transfer" campaign on transfer pricing in 29 FDI enterprises implemented in 2014, tax authorities have forced FDI enterprises to reduce loss of nearly 9,000 billion VND, the average loss reduction nearly VND 300 billion/enterprise, collected arrears of nearly VND 20 billion/case of transfer pricing. Typically, in the case of Hualon Textile Company in Dong Nai province, the loss of nearly VND 1,200 billion was reduced, VND 78 billion was collected into the budget, or the case of Keangnam Vina as mentioned above.

General Department of Taxation also had a program of action to control transfer pricing in the period 2012-2015 with focus on risk analysis in the management of transfer pricing; to collect information for tax administration work for pricing transfer and archiving of dossiers according to regulations; to collect and research the pricing signals conducted by business subjects in Vietnam. In addition, the General Department of Taxation has been directing the extension of pricing transfer audit, including "big companies" with large investment capital and signs of transfer pricing, enterprises have large VAT refund, enterprises are entitled to investment incentives, and enterprises are likely to be subject to tax the contractor.

4.4 Transfer pricing auditing procedure on FDI enterprises in Vietnam

In Vietnam, there is no perspectival TP auditing procedure. Currently, we have implemented in accordance with the regular audit procedures. In Vietnam, tax audit activity of tax authority is not only the subject of the Law of tax administration but also the subject of the regulations of the Government inspection office.

4.4.1 Risk assessment for selected TP audit cases

Tax Inspectorate collects taxpayer information from the following sources:

First, taxpayers' information resources, data on taxpayers' databases (including computerized databases and other data) including tax returns, records report on invoices and other types of records. Other information related to the declaration as financial statements of taxpayers, information on financial situation, production and business of taxpayers; Information on the observance of the tax law by taxpayers: The situation of tax declaration and payment; tax examination results of the previous year; the situation of tax exemption and reduction; Other information (if any).

Second, data source for taxpayers outside the tax branch (if any): Information from the Vietnam State Audit; Government audit office; the management agencies under the Ministry, branches, business

associations; Information from the media, radio, television, newspapers; Information from tax evasion denunciations.

From the information above, the tax authority determines the risk of transfer pricing to select FDI taxpayers to audit.

4.4.2 Prepare and issue an audit decision according to the following steps

Step 1, collecting the document and determining issues of the TP audit case

Basing on the annual audit plan, the audit section's head shall assign the inspecting officer to collect documents, analyze and determine the contents of the transfer pricing risks for audit. The inspectorate may not request taxpayers to supply information and documents but exploit information and documents already available at the levying agencies such as documents and dossiers on tax registration, declaration and payment, the report on the use of taxpayers' invoices has been submitted to the tax office.

Step 2, issuing the audit decision

Base on the results of defining audit contents, the section shall report to the leader of the inspectorate on the establishment of an audit team consisting of tax inspectors (or regular tax inspectors or transfer pricing inspectors). The audit decision shall include documents such as the submission to the tax office's leadership, the draft audit decision stating the contents, the scope of audit and audit duration (usually between 45-70 days), the report includes basic information about taxpayers, other relevant documents such as financial reports, analysis of financial indicators. The tax office shall send the audit decision to the taxpayer by certified mail which would notify the tax office within 3 (three) working days from the issuance of the audit decision.

4.4.3 Selecting a transfer pricing case for auditing

Firstly, the audit team of the transfer pricing must develop an audit plan including the contents as the purpose; the requirements, scope, contents, objects, period and time limit for audit. The audit plan also consists of the method of audit, the progress of implementation, the regime of information, reports, means, equipment, funding and other necessary material conditions for the operation of the audit team to

organize the implementation of the audit plan. This audit plan will be reported to the person who signed the audit decision for approval.

Secondly, the audit team carries out audits at the taxpayer's premises as follows.

One, the head of the audit team and the members of the audit team request taxpayers to provide dossiers and documents related to the inspected contents such as accounting books, accounting vouchers, explanatory notes. In order to avoid inconvenience for taxpayers, audit teams may not request taxpayers to supply information and documents already available in the tax system and information not related to audit contents or information classified as a State secret.

Two, based on accounting books and documents supplied by taxpayers and tax declaration dossiers submitted by taxpayers to the tax offices, the audit team will examine and compare documents supplied by taxpayers with the tax identification number declared with the tax authorities. The audit team shall compare data recorded on accounting vouchers, accounting books, accounting reports, financial statements and explanatory reports in order to detect the increased or decreased difference compared to the tax declaration dossiers. At the same time, the tax inspectors use the expertise to conduct audit of contents showing signs of pricing transfer which are need to be inspected.

Three, for unclear matters, the audit team shall request taxpayers to explain in writing or organize dialogues with taxpayers to clarify the issues.

Four, for affiliated transactions of the production units, the audit team can visit the line of production and assembly of products to evaluate the assets.

Five, the audit team compares the associated transaction of the audit case with the independent transactions which are in the same company or transactions of other companies who has no material difference of size, functions, business activities and industry.

Thirdly, the team limits issues, selects the adequate TP method and adjusts the associated transactions following arm's length principle. They continue to collect in-depth data on independent transactions and

perform analysis of the business model, business functions and product characteristics. The audit team then sums up the analysis of the taxpayers and reports to the leaders of the Tax Department or leaders of the General Department of Taxation (depending on the fact that the audit team belongs to the tax office or the General Department of Taxation) to review. For complex cases, local tax offices may send reports on the situation of the companies they are auditing to the General Department of Taxation. The information used for the correction is confidential, used within the tax authorities.

Finally, the auditing case will be closed. After the head of the audit department approves the market pricing to adjust the associated transaction, the taxpayer will be notified of the adjustment. If the taxpayer disagrees with the tax authorities' adjustment, the taxpayer will be entitled to file a complaint about the adjustment of the audit team. However, the audit team still has the right to adjust the market pricing in a reasonable way if the taxpayer disagrees.

4.4.4 APA and TP Audit

In 2013, the Vietnamese Tax Law allows businesses to apply APA if they request so. During the application of APA, taxpayers are not subject to tax audits. Since the issuance of this regulation, no FDI enterprises have applied APA.

4.4.5 Database for audit of transfer pricing

The Vietnam tax administration has been gradually establishing a database of enterprises without linkages (independent enterprises) to serve the audit of transfer pricing for high-risk industries. Abuses of corporate income tax are common in industries such as apparel, footwear, beverage production, fish feed production, electronic components production. However, in order to build a database for each sector, the tax branch must conduct a manual review. The tax administration database construction effort has not really met the demand of using the database for the purpose of TP audit. Currently, the tax industry is also researching the trial exploitation of commercial databases of some international organizations such as Beure van Dijk, Thomson Reuter. After finishing the trial, the review, evaluation and proposal for a commercial database will be considered on the basis of the cost and efficiency of commercial databases.

In conclusion, the steps of Vietnam TP auditing on FDI enterprises are also carried out as international TP procedures such as evaluating the risks to select the inspected subject, developing an audit plan for enterprises at risk of transfer pricing from the beginning of the year, collecting data. There are also other TP procedures, for example, building a team to inspect the transfer pricing case and to do business information analysis, comparative data collection, functional analysis, overall analysis, method selection, use of independent data (often taxpayers disagree with this data); informing taxpayers of adjustment by the tax authority, submitting and making a final decision. However, some steps are still not as complete as in OECD general guidelines. For example, choosing of auditing the transfer pricing is mostly based on information from the tax authorities.

5 CASE ANALYSIS

5.1 Case study 1: Keangnam Vina Co., LTD

5.1.1 General Information

Keangnam Vina Co., LTD. is a wholly foreign-owned company under Korea's Keangnam Group, established in accordance with Investment Certificate No. 011043000161 issued by the People's Committee of Hanoi on 29 June 2007. Keangnam enterprise Co., Ltd. has been leased land by the People's Committee of Ha Noi City to implement the investment project of Keangnam Hanoi Landmark Tower project on an area of 46,008 m² located on Pham Hung street. (Nam Tu Liem District, Hanoi) which consists of a 70-storey building, two 47-storey buildings, including hotels, high-grade apartments and other supporting facilities. Keangnam Vina Co., LTD is responsible for implementing the procedures for investment, land allocation and construction of project infrastructure and project items.

Keangnam enterprise Co., Ltd. (a subsidiary company) is established and operated by the parent company abroad, Korea Keangnam Corporation, as a general contractor (EPC) and contracted for construction. Total project with investor (Keangnam Vina Co., Ltd) in the form of turnkey has the total contract value

of \$ 871 million (the value of this contract after audit shows that the pricing is higher than market pricing). According to this contract, Keangnam enterprise Co., Ltd will survey, design the project, provide equipment and construction, and provide both financial consulting and loan arrangements for Keangnam Vina Co., Ltd.

With the above operation model, Keangnam enterprise Co., Ltd registered to pay tax by the deduction method with the EIT rate of 25%. Keangnam enterprise Co., Ltd is allowed to register to pay the foreign contractor tax according to the mixed method of paying VAT by the method of deduction and payment of fixed income tax at the rate of 2% calculated on the turnover of the construction contract between the contractor and Keangnam Vina Co., Ltd liability company. Thus, through the model of association and organization of activities, Keangnam corporation has coordinated the income from Keangnam enterprise Co., Ltd from the real estate business of the investor to the construction activities. By contractual relations between the investor and the construction contractor, the common enterprise income tax payable in Vietnam was reduced and profits were transferred from Vietnam to Korea.

5.1.2 Information on transactions between affiliated companies in the period 2007-2011

Keangnam Vina Co., Ltd. had the following related transactions as follow.

First, they signed the contract of building turnkey contract with Keangnam enterprise Co., Ltd, specific as follow: Contract object: Construction of Keangnam Hanoi Landmark Tower at E6, Me Tri commune, Nam Tu Liem district, Hanoi with contract value: USD 871 million (equivalent to VND 11,618,194 billion) and contract performance: By the end of 2011, the total value of construction and installation volume was VND 18,756 billion, total paid amount was VND 14,948.759 billion.

Second, regarding the loan transactions of affiliated parties, they had the loan agreement dated May 10, 2007 between Keangnam Vina Co., Ltd. and Keangnam enterprise Co., Ltd, amounting to USD 10 million, 3-month LIBO loan interest rate + 1.1%, the actual amount disbursed to 31/12/2011 is \$ 2 million.

Loan contract dated November 29, 2007 between Keangnam Vina Co., Ltd. and Woori bank Hanoi Branch (the main domestic lender - domestic correspondent bank); Woori bank (Settlement - Lending Agent's bank), amounting to \$ 50 million. Interest rate that is agreed as the interest rate for each loan in

each interest period will be the marginal interest rate applicable to that loan plus the applicable CD interest for that interest period, the amount actually disbursed as of 31 December 2011 was US \$ 50 million, equivalent to VND 1,041 billion;

Credit contract dated November 29, 2007 between Keangnam enterprise Co., Ltd. with Kookmin bank (Head office at 9-1, Namdaemun 2-ga, Jung-gu, Seoul, South Korea) - as a trustee of Woori Trust Funds Trust 12 & 13, Credit Suisse Woori Asset Management Company), Woori bank (Headquarters at 203, Hoehyon-dong 1-ga, Jung-gu 100-792, Seoul, South Korea - as arranging party), Woori bank, Hanoi branch (as the lead bank in the country); The loan amount is 350 billion won, divided into two components: component A is 250 billion won, component B is 100 billion won with interest rate: "The interest rate for each loan in each interest period will be the marginal interest rate applicable to that loan plus the applicable interest rate for the interest period." As of 31/12/2011, the total amount of the company's debt was VND 6,582 billion. The total borrowing cost of loan from 2007 to 2011 of Keangnam enterprise Co., Ltd. was VND 1,543 billion.

Third, transaction of financial services, loan arrangement of Keangnam enterprises Co., Ltd specifically, on September 30, 2007, this company signed a service contract with Keangnam Co., Ltd. (a company established and operating under Korean law) with the terms "financial arrangement and Consultancy services include investment approval, land purchase, finance, advertising", for the project. Service fee under the contract was US \$ 30 million, as of 31/12/2011 total amount paid to Keangnam Co., Ltd was over 485 billion.

Thus, according to Circular 66, independent transactions and associated transactions which are executed by an enterprise cannot be distributed revenue or related costs for each type of transaction; In this case, the aggregated transaction is considered to be an associated transaction and the pricing of the aggregate traded product will be the highest pricing of one of the related products (if transaction is sold out) or the lowest pricing of one of the related products (if purchased), then all transactions are included into a linked transaction and compared to independent companies.

5.1.3 Result of applying arm's-length for transfer pricing at Keangnam enterprise Co., Ltd for the period of 2007 – 2011

Select the method of determining the market pricing for taxpayers in the case of tax assessment under Circular 117 and 66. Keangnam Vina Co., Ltd. incurred an acquisition transaction from a related party, including construction contract, interest expense, loan arrangement fee. Consequently, the way that the cost of goods sold by this company is accounted for in the accounting books as the cost of capital is not reliable and is a factor that needs to be applied arm's length principle according to each specific transaction of goods and services from the affiliated party under market pricing. The TP audit followed these steps.

Firstly, the team chose the TP method for construction contracts with Keangnam enterprises Co., Ltd which was based on the data of Keangnam Vina Co., Ltd. In this case, CPM was not applicable because the input and output products were different. The CPM could not be applied to recalculate the cost of capital of this company. CUP was not applied because it was not possible to apply net pre-enterprise income tax rate to total expenses or assets because the total cost and total assets of Keangnam Vina Ltd. Co. were mostly derived from the associate (not reliable). Moreover, the reported revenue of Keangnam Vina Ltd. Co. was the reliable revenue generated by the sale of the product to the independent parties and the selling pricing of the product was determined in accordance with the market pricing at 2008 (the company gradually collected money from customers in 2008). Therefore, it was possible to apply net income before tax to net sales. However, according to the CIT declaration, the company did not generate revenue in 2008-2010 but mainly in 2011. Therefore, it was not possible to compare the profitability of the Company in FY2011 with the profitability of other companies in FY2011 due to the fact that the selling pricing of the products to the independent parties was not determined at the time of 2011 but was firmly and clearly determined at the time of 2008 as stated above. Therefore, if this ratio is used, the gross profit for the whole fiscal year (from the year of determining the unit pricing) must be compared with that in the fiscal year 2011.

Then, the team determined the price through the data of Keangnam enterprises Ltd. and selected the adequate method for this transaction. CUP was not a method of determining the market pricing which was appropriate to the nature of each construction work due to the use of different materials, so there are big differences. RPM could not be applied due to the following reasons.

The net income before income tax on net sales could not be applied because net revenue was untrusted revenue due to transactions between affiliated companies, therefore such transactions need to be predetermined; Secondly, net income before corporate income tax should not be applied to total expenses. According to financial reports of Keangnam enterprises Ltd., the cost of corporate management of this company was very high. This fee was not commensurate with the true nature and needed to be redefined; Thirdly, the application of the net income tax return on assets should only be applied to enterprises using a large number of fixed assets derived from an independent party. This was for Keangnam enterprises Co. Ltd. Consequently, the CPM was registered by Keangnam enterprises Co. Ltd with the Ministry of Finance and approved by the Ministry of Finance to apply the Vietnamese accounting system and the company reported to the Hanoi tax authority on the company's implementation of the Vietnamese accounting system. Therefore, the CPM is the most suitable method to determine the output of Keangman enterprises Ltd. (the input of Keangnam enterprise Co. Ltd.).

Moreover, these are methods of determining the interest on loan transactions of affiliated parties. The loan from Keangnam Enterprises Ltd. This loan of \$ 2 million was not used for production and business activities of Keangnam enterprises Co., Ltd. Therefore, all loan interests corresponding to this loan must be excluded. There is no need to re-determine the interest rate at market interest rates in accordance with Circulars 117 and 66.

Secondly, the loan from Kookmin bank. This is an associated transaction. Reasonableness of payment schedule for Keangnam enterprises Co. Ltd should be re-determined. Two cases can occur as in this situation. For example, if the payment schedule for Keangnam enterprises Co. Ltd was irregular, the entire interest would be sufficiently determined to be unrelated to the operation of the EPC contract and would not be included in the cost except for CIT calculation. There is no need to re-determine the interest rate at market interest rates in accordance with Circulars 117 and 66. On the other hand, if the payment schedule for Keangnam enterprises Co., Ltd is reasonable, the interest rate of the loan at market interest rate would be re-determined in accordance with Circulars 117 and 66, the CUP may be applied. However, considerations should be given to choosing a geographically appropriate independent transaction. If Keangnam enterprise Co., Ltd can borrow money from other banks or organizations in Vietnam, priority would be given to the selection of independent domestic similar transactions as a basis for comparison.

In contrast, if Keangnam Vina Co., Ltd cannot borrow money from other banks or organizations in Vietnam but could only borrow money from Kookmin bank, information of Kookmin bank for independent borrowers would be collected as a basis for comparison.

Thirdly, it is necessary to determine that the nature of this loan is to borrow USD or Won loan to calculate the loan interest rate to suit the loan currency. If the loan is in Won, debt repayment must be in Won, only in USD or other foreign currencies when agreed by the lender. If the lender obliged the borrower to pay in USD, the nature of the loan was not a Won loan, so it was not calculated on the Won interest rate, but on the USD interest rate.

Fourthly, the loan from Woori bank. This is an associated transaction. Reasonableness of payment schedule for Keangnam enterprises Co., Ltd should be re-determined. Two cases can occur in this transaction. If the payment schedule for Keangnam enterprises Co., Ltd was irregular, the entire interest would be sufficiently determined to be unrelated to the operation of the EPC contract and would not be included in the cost except for CIT calculation, there is no need to re-determine the interest rate at market interest rates in accordance with Circular 117. On the other hand, if the payment schedule for Keangnam enterprises Co., Ltd is reasonable, the interest rate of the loan at market interest rate would be re-determined in accordance with Circulars 117 and 66. In this case, the CUP may be applied. The tax department collects independent transaction information of Hanoi Woori bank branch which is the same conditions for trading with Keangnam enterprise Co., Ltd as a basis of comparison. If you cannot find a similar independent transaction from this bank, the Tax Department contacts other banks to find similar transactions (contracts of domestic enterprises loans foreign banks, Vietnamese banks' contracts to borrow foreign banks) to determine the market interest.

Furthermore, methods of calculation of transfer pricing of financial services, loan arrangement of Keangnam enterprises Ltd. The team had to check some expenses that are due to the arrangement to rationalize the vouchers which actually did not incur this expense. It is necessary to consider the economic nature of these expenses to subtracted from the total cost of business. Therefore, the increased taxable income due to the exclusion of this cost will be taxed and fined by the act of tax evasion. A number of expenses higher than the market pricing were needed to be re-determined according to the arm's length principle as stipulated in Circulars 117 and 66.

In conclusion, with regard to construction contracts and transactions with other associated parties, after analyzing the factors and on the basis of collected information, the tax authority did not separate the activity of an enterprise into individual activities, instead the activities of the enterprise were combined according to the regulations of Circulars 117 and 66. The tax authorities collected and analyzed information to select similar cases and used the method of costing plus interest to determine the market pricing in the transaction between the associated parties. Then the tax authorities determine that the buying pricing of the Keangnam enterprise Co., Ltd were the main contractor of Keangnam enterprises Co., Ltd. for determining the market pricing as the sale pricing of Keangnam enterprises Co., Ltd and its associated Keangnam enterprise Co., Ltd, is determined based on the cost of construction of the project by the main contractor plus (+) gross profit of the house main contractor.

In order to determine the arm's length principle of the transactions between the principal contractors and investors, the tax agencies shall deploy the parallel bars concurrently. The investor Keangnam enterprise Co., Ltd and the main contractor had the basis for determining the cost of construction purchased by the independent party.

5.1.4 Results of audit and determination of payable enterprise income tax amounts

About the audit results at the main contractor is Keangman enterprises Co., Ltd

After the audit in 2014 , the tax agency eliminated the unlawful expenses of the main contractor (the parent company is an affiliated party) of USD 29,455,759 (VND 568,896,523,489); Collection and punishment of tax obligations of foreign contractors were VND 6.5 billion.

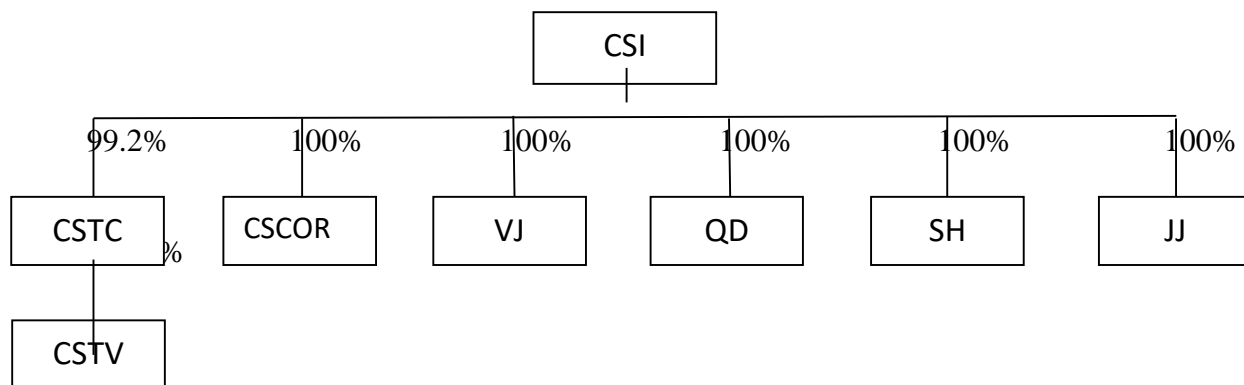
About audit results at Keangnam Vina Co., Ltd

After the audit, the tax office reduced the project construction cost to VND 1,252,720,287,516: Reducing the cost of real estate transfer of 408,637,357,788 and decreased value of fixed assets investment of VND 844,082,929,728. Furthermore, the tax authorities forced enterprises to reduce losses by 238,806,416,560 VND; state budget revenue (CIT) was increased by VND 91 billion.

5.2 Case study 2: CS Company LTD Vietnam

5.2.1 Map of the relationship between the parent company and member units in the period of 2006 – 2012.

Chart 4: The relationship between the parent company and member units in the period of 2006-2012



CS: CS Inc.

CSTC: CS Technology Company

CS COR: CS Corporation

VJ: CS Vietnam Company Limited

QD: QingDao CS Shoes Co., Ltd
 SH: SH Company
 JJ: CS Indonesia Limited
 CSTV: CS Vietnam Technology Company Limited

5.2.2 The enterprise's origin, operation functions of members, products and services

Table 4: The Origin, operation functions of members, products and services of CS company

Company	Nation	Main activities
CS Group Inc	Korea	Trading in sports shoes
CS Technology Company(*)	Korea	Research and design shoes
CS Corporation(*)	Korea	
QingDao Chang Shin Shoes Co.Ltd	China	Manufacture of finished shoes and semi-finished products
CS Indonesia Company Limited	Indonesia	Manufacture of finished shoes and semi-finished products.
CS Vietnam Technology Company Limited	Vietnam	- Processing shoe soles; - Repair molds, molding machines; - Provide tools; knife, shoe mold.

(*) In 2008, CS Technology Company and CS corporation in Korea merged into CS Technology Corporation.

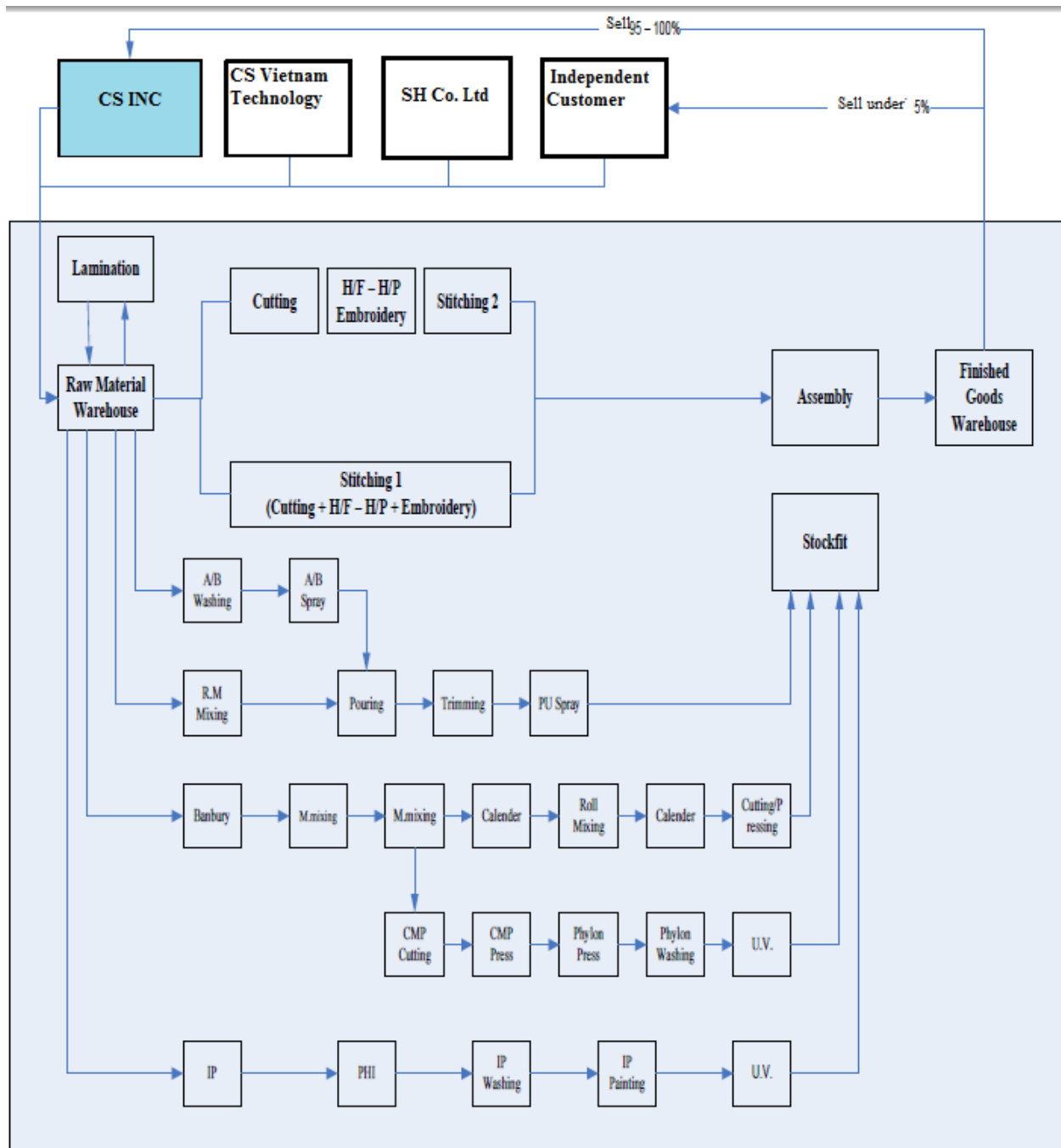
5.2.3 Overview Co., Ltd. CS Vietnam

General information

Main business activities are production and trading of sports shoes, manufacture of semi-finished sports footwear (uppers and headgear), export garment production; Established information: CS Vietnam Co., Ltd is a 100% foreign owned company established in Vietnam since 1994.

A diagram describing the linkage and involvement of each stakeholder in each step of the process in the period 2006 - 2012

Chart 5. The linkage and involvement of each stakeholder in each step of the process in the period 2006 - 2012 of CS Company



Information about the sale of goods and products of the Company

Table 5 : The sale of goods and products of the CS Company

Year	Object	Type of goods or services	Turnover, other income	Proportion (%)
	a. Affiliates:		128,340,254.01	99.88%

2006	CS Inc. Company	Finished shoes	128,334,651.01	99.87%
	- CS Inc. Company	Mold	150.00	0.0001%
	QingDao CS Shoes Co.Ltd	Mold	5,450.00	0.0037%
	b. Independent parties (general)	TP sales, processing	157,481.88	0.12%
	Total Revenue (a+b)		128,497,735.89	100%
2007	a. Affiliates:		147,195,696.13	99.90%
	CS Inc. Company	Finished shoes	147,191,196.13	99.89%
	- SH Company	Mold	200.00	0.0001%
	QingDao CS Shoes Co.Ltd	Mold	4,300.00	0.0029%
	b. Independent parties (general)	Semi-finished products	151,406.57	0.10%
	Total Revenue (a+b)		147,347,102.70	100%
2008	a. Affiliates:		181,507,163.56	99.56%
	CS Inc. Company	Finished shoes	181,503,913.56	99.55%
	QingDao CS Shoes Co.Ltd	Semi-finished products	3,250.00	0.002%
	b. Independent parties (general)	Semi-finished products, Mold	810,937.73	0.44%
	Total Revenue (a+b)		182,318,101.29	100%
2009	a. Affiliates:		179,379,945.95	97.17%
	CS Inc. Company	Finished shoes	179,349,316.96	97.15%
	- QingDao CS Shoes Co.Ltd	Semi-finished products	3,599.49	0.002%
	QingDao CS Shoes Co.Ltd	Mold	27,029.50	0.015%
	b. Independent parties (general)	Semi-finished products, Mold, Shoes	5,230,172.30	2.83%
	Total Revenue (a+b)		184,610,118.25	100%
	a. Affiliates:		231,848,906.51	97.29%

2010	CS Inc. Company	Finished shoes	231,848,906.51	97.29%
	b. Independent parties (general)	Semi-finished products, Finish shoes	6,465,096.73	2.71%
	Total Revenue (a+b)		238,314,003.24	100%
2011	a. Affiliates:		290,286,705.75	98.28%
	CS Inc. Company	Finished shoes	290,204,283.49	98.25%
	QingDao CS Shoes Co.Ltd	Semi-finished products	82,422.26	0.03%
	b. Independent parties (general)	Semi-finished products, finish shoes	5,080,699.70	1.72%
	Total Revenue (a+b)		295,367,405.45	100%
2012	a. Affiliates:		274,226,559.36	95.30%
	CS Inc. Company	Finish shoes	272,778,667,60	94.8%
	- CS Indonesia Company	Semi-finished products	528,00	0.00%
	QingDao CS Shoes Co.Ltd	Semi-finished products	1,447,363.76	0.503%
	b. Independent parties (general)	Semi-finished products, finish shoes	13,510,015.89	4.70%
	Total Revenue (a+b)		287,736,575.25	

According to the analysis of business transactions, CS Vietnam Co., Ltd has just bought and sold to associated parties. The proportion of selling transactions with affiliated parties often accounts for a larger proportion than the proportion of buying transactions with affiliated parties.

Table 6: Statement of pre-tax profit and loss as reported by the company in USD

Oder	Fiscal Year (ended December 31)	Interest (+), Lot (-) business operations	Interest (+), Loss (-) financial activities	Interest (+), Loss (-) financial activities	Taxable income
1	08/08/2014 31/12/1995	(370,678)	-	-	(1,472,864)
2	1996	1,012,358	(1,033,236)	(3,504)	(2,477,697)
3	1997	3,936,735	(1,287,189)	48,988	203,036
4	1998	4,047,271	(1,173,112)	131,592	848,433
5	1999	5,069,622	(1,158,188)	(9,146)	1,024,401
6	2000	5,411,770	(1,017,743)	352,018	2,353,135
7	2001	6,553,975	(699,907)	(8,334)	3,323,331
8	2002	9,608,614	(272,514)	1,037	6,694,274
9	2003	10,925,756	(179,146)	(69,781)	7,456,294
10	2004	5,410,895	(362,264)	9,610	1,356,084
11	2005	(302,846)	(1,729,532)	121,280	(6,147,115)
12	2006	5,008,229	(4,295,628)	38,474	(5,840,698)
13	2007	1,105,164	(5,238,655)	444,975	364,565
14	2008	10,525,705	(3,499,570)	182,077	56,894
15	2009	10,077,305	(2,462,920)	562,688	1,324,299
16	2010	12,262,246	2,025,290	317,143	1,268,520
17	2011	14,549,669	(1,778,884)	287,126	1,538,753
18	2012	13,332,630	(2,901,646)	2,714,749	1,641,131

5.2.4 The results of re-determination of the transfer pricing in the associated transaction of CS Vietnam company Limited by the tax agency in the period of 2006 – 2012

Analyses showed that the company produces shoes, semi-finished shoes for selling to affiliated companies are mainly. According to the company's data, most of actual costs of main business are derived from independent parties. Because the materials are purchased frequently from affiliated parties, they always have a large number of transactions for many different types of materials. The tax authorities

temporarily accept the determination of the purchase pricing of raw materials from the associated company which has a reliable unit pricing, consistent with the unit pricing of independent transaction. If the competent state body detects that these expenses are inconsistent with the market pricing, that there is sufficient information to re-determine the market pricing, and that there is further increase of the payable CIT from the adjustment of the pricing mentioned at this point, the competent state agency will continue to adjust the pricing and the CIT for the company.

The tax authorities determine that most of the company's revenues are from selling to affiliated companies. According to the results of risk analysis, the revenue data recorded in the annual financial report is not reliable. The company did not re-determine the unit pricing of goods sold to affiliated parties at market pricings in accordance with Circular 117, Circular 66 and did not declare associated transaction information in accordance with the regulations. Based on the actual business activities of the above-mentioned company, the RPM, the PSM, the CUP (using the income ratio net profit before tax on net sales or using net income before tax on assets) are not appropriate methods to determine the unit selling pricing of products sold to related parties.

In order to collect information and select similar independent enterprises which help determine the ratio of EBIT as a basis for comprising, the tax authority has consulted with a number of international organizations and found that most of the companies operating in the footwear sector in the data system are foreign-owned enterprises operating different countries. Therefore, there are many differences that have a significant impact on the ratio of EBIT as labor costs, the difference between the cost of production and the main business compared to earnings before interest and taxes (EBIT), management costs, differences in terms of delivery and economic conditions, function. Moreover, the search for the standard footwear enterprises which are fully independent enterprises regulated by Vietnam (not affiliated enterprises according to Circular 117 and Circular 66) in the data system of the above international organizations is very difficult. On the other hand, information on the results of production and business activities of enterprises in the footwear industry in the data system of the above-mentioned organizations is the general business result from many other production and business activities. (These enterprises also have other business activities besides footwear production). Thus, the ratio of EBIT of the above foreign enterprises is not similar to that of CS Vietnam.

Tax authorities have collected information on characteristics, functions, production and business performance and results of production and business activities from 2006 to 2012 from more than 1,000 enterprises with the same industry code with the code of CS Vietnam company limited on the data system of tax information and other sources. The audit team has analyzed and excluded associated and independent enterprises which are not relevant in footwear production and the ratio of EBIT calculated for shoe-making activities slippers of these independent enterprises. Base on that, the tax authorities have determined the ratio of EBIT that is most suitable for business activities of CS Vietnam.

The results of TP audit of the determination of the increasing CIT payable to the State budget.

Base on the results of the determination of EBIT that is most appropriate to the business operations of the above CS Vietnam Co., Ltd, the tax authority has fixed net taxable income of the main business activities of the company as follow.

Firstly, the increase in EIT income from 2006 to 2012 is USD 47,914,667

**Table 7: The increased result in EIT income from 2006 to 2012
after auditing at CS company**

Unit: Thousand usd

Year	2005	2006	2007	2008	2009	2010	2011	2012
Increase in EIT income	5,544	1,065	3,625	4,786	8,949	12,287	11,655	5,544

All losses which incurred in 2005 and carried forward to FY 2007 and 2008 were USD 3,948,653; All losses incurred in 2006 were USD 2,209,381;

Secondly, the increase of CIT payable for the period from 2006 to 2012 was USD 4,397,728.

Table 8: The increased result of CIT payable for the period from 2006 to 2012 after auditing.

Unit: Thousand usd

Year	2005	2006	2007	2008	2009	2010	2011	2012
Increase in EIT income	5,544	342.5	totally offset loss of the year 2005 so arising the payable tax	364.2	415.4	573.4	1,129	1,572

However, the tax office does not handle the arrears of corporate income tax arisen in the year 2006 of USD 342,563 (VND 5,515,606,863) due to the expiry of the statute of limitations for taxation as stipulated in Law on enterprise income tax 09/2003 /QH11 dated 17/06/2003. As a result, the amount of corporate income tax was increased by USD 4,055,165 (VND 80,731,989,744), specifically: Year 2008 was 364,286 USD (VND 6,184,483,422); Year 2009 was 415,487 USD (VND 7,454,252,267).

In conclusion, through the inspection of 02 FDIes, I have some comments as follows:

Firstly, the two audited cases had signs of consecutive loss in many years and they had associated transitions between parent company and affiliated party. In case 1, the TP indicators are financial loans and these loans have interest rate higher than uncontrolled loan transaction. In case 2, the TP indicator is input pricing rise (transactions of raw materials, equipment, machinery).

Secondly, on the administrative side: To set up 02 inspection teams in 02 companies, the tax authorities employed tax officers who have experience in managing foreign invested enterprises and speak fluent English. Therefore, they can work directly with the companies' foreign employees.

Thirdly, on the application of inspection procedures in Vietnam, the inspection team has followed the inspection procedures in Vietnam. However, during the process of using the data for analysis, the inspection team has difficulties because GDT information system is limited. In addition, the state budget is not available to purchase commercial databases from third parties. Therefore, the negotiation to choose to apply in these two cases is limited and not really objective.

Fourthly, regarding the application of transfer pricing regulations, the inspection team has applied five Vietnamese methods and based on the records as well as the nature of each transaction to perform the analysis and application of the most appropriate method for each company attempts to limit complaints after inspection.

Thus, although there are certain limitations, the tax authorities have increased the amount of tax payable after the inspection of the transfer pricing of these two FDIes.

6 CONCLUSION, RECOMMENDATIONS AND CONTRIBUTIONS

6.1 Limitations of the research

The limitation of this study is that the study of transfer pricing of foreign investment enterprise which is a subsidiary of multinational corporations. Therefore, the sample is limited to foreign-invested enterprises belonging to multinational corporations. These foreign-invested enterprises have cross-border transactions from Vietnam to other countries or transactions between companies in the same corporation operating in Vietnam but different provinces where the CIT rate is varied.

Following the international guidelines, the transfer pricing is regarded as transfer pricing between the associated companies for the purpose of reducing the amount of tax payable to the tax authority and maximizing the profits of the investor. In reality, there are state owned corporations or private corporations in Vietnam. In terms of size, these corporations also have the same asset/turnover values as some multinational companies. In addition, according to the trend of globalization, they structure affiliated companies in separate functions and are located in areas where the CIT rate is lower than the common tax rate; or they organize business activities which are entitled to CIT incentives/ exemptions. As such, research will not be able to obtain recommendations aimed at improving the transfer pricing practices of state and private corporations. According to my personal assessment, these taxpayers are likely to earn higher business profits than foreign invested enterprises because they have the advantage of local knowledge or infrastructure advantages, material/ customer relationships. Therefore, I hope that on the basis of my research there would be upcoming research which will continue to research into

Vietnamese state-owned and private corporations to come up with solutions to improve the audit of transfer pricing in Vietnam.

6.2 Conclusion and recommendations:

6.2.1 Conclusion

Transfer pricing which is to reduce the tax liability of FDIes has become more common and sophisticated in the context of trade liberalization and increased competition for resources. Transfer pricing is based on the internal pricing mechanism between different divisions within the same enterprise on the principle of internal cost accounting. When an enterprise exists in the form of a multinational company, there are subsidiaries and affiliates operating in different countries such as related parties, facing policies and procedures. Internal transfer pricing can be transformed into transfer pricing, to minimize tax obligations and to increase the overall profitability of the entire company. This activity is driven by and has exploded in the context of globalization.

FDIes in Vietnam has carried out transfer pricing as an indispensable objective to maximize profits. In the context of Vietnam's increasing investment attraction, many preferential policies have been implemented so that many multinational corporations have established associate companies in Vietnam. Some MNEs have used CIT incentives to arrange for profit maximization transactions. In order to strengthen the management of tax collection for FDIes, the tax authorities of Vietnam have been aggressively inspecting the transfer pricing of FDIes. However, the number of audits as well as the effectiveness of the transfer pricing survey are still not high. In order to assess the whole transfer pricing auditing activities, it is necessary to evaluate three main factors which are transfer pricing regulation, auditors and auditing process in Vietnam.

TP Regulation

Vietnam TP regulations are based in part on the guidelines of international organizations such as the OECD, United Nation and regulations of some developed countries in the world such as the United States, Japan or Korea with the aim of meeting international standards. However, as the economy is a developing

economy, multinational corporations will take advantages of unconventional international regulations in Vietnam to arrange transfer pricing transactions.

Organizational structure of TP auditors

The organizational structure of Vietnam's transfer pricing audit was partially formulated in the centralized model as in Japan. However, the Vietnamese tax authorities have set up new transfer pricing audit separately since 2016. Previously, the inspectors conducted regular audits and also carried out transfer pricing audit. Most of them were regular audits and people conducting the TP audit were not fixed. Since the transfer pricing unit in Vietnam has been established, transfer pricing inspectors are clearly defined. They are knowledgeable about finance, accounting, and taxation. However, the number of about 10 is very small compared to the that on foreign invested enterprises. Besides the technical factors, foreign language skills are still a challenge. Furthermore, under a general guideline, a transfer pricing audit team will consist of auditors and experts in other fields. However, in Vietnam there has not been an audit team including these specialists.

TP Audit Procedure

Regarding the order of inspecting transfer pricing, the tax authorities of Vietnam have followed the guiding steps of international organizations. At the risk assessment stage, the tax authorities use information primarily based on the tax database, internet information and the Securities and Exchange Commission. Therefore, the source of information to use in the initial risk assessment is limited, leading to the selection of cases where the transfer pricing is not correct.

The determination of TP methods has been applied to adjust associated transaction pricings for enterprises when carrying out pricing transfer audit as follows: 13 companies applied the method of comparison of pricings of independent transactions. 45 enterprises applied the resale pricing method; 06 enterprises applied cost plus method. 40 enterprises applied the profit comparison method. 02 enterprises applied two methods (each applied a different method) and 20 enterprises applied the integrated measure.

Tax authorities mostly use secretive database for comparison from their system. From the viewpoint of management of the tax office, in the process of carrying out the audit of transfer pricing at enterprises, the tax agencies use the internal database of the tax branch. The database provides the data of the independent enterprises reporting the taxpayers shall make taxable incomes according to the prescribed regime and send them to the tax offices for use as basis for fixing the taxable incomes of the enterprises. When carrying out the audit, the audit team wants to publicize the enterprise name and business results data as evidence and bases to convince the enterprise. However, it is the responsibility of the tax office to protect confidential information of taxpayers, which is in accordance with the Law on Tax Administration. Commercial databases (purchased from companies with trading functions) have not been purchased yet and there is no survey on these database sources.

6.2.2 Recommendations

Finalizing the legal framework related to transfer pricing

Transfer pricing arising from variety causes, including not perfect legal system, and FDIes take advantage of loop holes to do transfer pricing. Therefore, the legislation is needed to be built concretely, facilitating both the authorities and the tax payers on the principle of publicity, transparency, international practices and standards. This is the most important solution which should be a priority in both immediate and long term. Experience of the United States, Britain, Japan, China, Thailand, etc. shows that if the legislation is clear, the compliance of the business will be better. Tax office will have more advantages to control transfer pricing. Therefore, the establishment of legal basis related to control transfer pricing is a top priority and these regulations must be written into law. In Vietnam, the legal basis includes the Law, the documents under Laws such as Decrees, Decisions, Circulars, Sanctions for Violations, etc. The completion of the legal basis mentioned above focuses on the following issues.

Firstly, on the level of legal normative documents, it is necessary to study countries with separate anti-transfer pricing law or add some specific provisions relating to transfer pricing to Laws, such as the Law on Corporate Income Tax, Law on Tax Administration, Law on Investment, etc. Content of the provisions of the Law on anti-transfer pricing (or Laws) needs to catch up with international practices and common OECD guidelines. For example, the implementation mechanism of the APA needs to broaden the scope

of the object because it is more stable; instead of the Law amending and supplementing some articles. The Law on Tax Administration and the Decree guiding the implementation of this Law have yielded the right to take the initiative of enterprises when regulating the application on the basis of a taxpayer's request and allow APA to stop negotiating or terminate validity at any time prior to termination. Officially at the request of taxpayers or tax authorities. This will help Vietnam to come closer to international practices and respond better to transfer pricing.

Secondly, there is a need for more flexible regulations, in the direction of simplification to apply the arm's length principle in the transfer pricing method to make it more feasible. In certain cases, the pricing or profit margin / reasonable margin suitable should be given for each sector, as a basis for determining transfer pricing judgments which is closer to the market pricing. Direction of such simplification can also be applied to relevant regulations. The voucher data that must be kept by the taxpayer or the tax office to collect the documents, as well as establishment of principles that tax authorities identify enterprises which must declare associated transactions or in the case of tax authorities have the right to set rates to declare or calculate CIP payable.

Thirdly, there should be additional regulations on security mechanisms and corresponding responsibilities of the relevant tax officials for confidential information (such as know-how technology, technology) that the enterprises are associated with obligation to provide to tax authorities.

Fourthly, it is necessary to develop and regulate the coordination mechanism among competent authorities (diplomatic missions, embassies, investment management agencies, banks, tax authorities, customs, police, courts, procurators, inspectors, etc.). There are activities that are related to state management of FDI enterprises such as licensing, supervision of investment, production and business activities, tax administration; tax examination and audit; transfer pricing inquiry; handling disputes, pricing frauds, etc. Such activities are to respond to the transfer pricing as well as to improve state efficient management of FDIs.

Improve the tax policy

The tax rate, especially in the case of high corporate income tax rate, provides incentives for transfer pricing. After many adjustments, Vietnam's corporate income tax rate dropped to 20% (from 1 January 2012) which is not too high compared to many other countries. If corporate income tax rate is further decreased, the state budget from the tax base will be lower theoretically, however FDIes will have less motivation for transfer pricing.

International experience shows that the United States, Japan, China, Thailand and Malaysia are implementing the reduction of corporate income tax rates. This is also a suggestion for Vietnam to study the adjustment of corporate income tax rates in a gradual and competitive manner with other countries in the region. In addition, the maintenance of high tariffs in other taxes (import tax, excise tax) still provides incentives for FDI enterprises to transfer pricing. Therefore, Vietnam needs to review the overall tax system to regulate the tax law being suitable to the Asian regulation.

Strengthening and improving the effectiveness of audit and examination; concentrating on the objects of high risk transfer pricing.

Experience shows that the audit of transfer pricing is considered the key task of the tax administration. Therefore, Vietnam also needs to strengthen and improve the task efficiency. To do that, on the one hand, the state needs to properly invest in necessary resources (operating budget and staff integrity) for doing transfer pricing audit. On the other hand, there should be tight coordination between the audit department and the tax administration department for the FDI enterprises. This coordination must focus on information exchange and establishing the database on foreign invested enterprises. Criteria for risk assessment must be in accordance with the characteristics of transfer pricing. Due to the complexity and specificity of audit and transfer pricing, the process and time of inspecting and checking the transfer pricing should be regulated in a more prolonged manner than the regular tax audits.

In addition, in order to ensure the effectiveness of transfer pricing audit, objects audit, audit should focus on the high risk of pricing transfer or suspicious transaction. Vietnam needs to concentrate on businesses with continuous losses; the firms have a small loss or break even, but still significantly expand the scale of investment or market share; enterprises with significant transactions within the same group and related company's low profitability compared to competitors; businesses has transactions related to a patent or

trademark of great value, like the way in which China, Japan, Thailand and some other countries have done.

Establishing and completing relevant database

In order to effectively combat the transfer of pricings, the tax branch needs to invest in constructing and reimbursement of the information database system. Experience from other countries suggests that this is a priority because going through this system will help to minimize the costs of information gathering and help the tax administration to make accurate decisions as well as reduce the number of disputes that can occur. This system must include information about taxpayers and other relevant information (updated information on the tax policy of the countries, on the technical standards, techniques in the important economic sectors, pricings of goods and services can be referenced in world markets, especially high-tech goods or invisible goods form, etc). Therefore, the tax administration should expand the source of information collection by professional activities of functional units of the tax office. On the other hand, the process that E-government should focus on linking and exchanging information between tax authorities and other state management agencies such as police, planning, investment, natural resources and the environment, etc. should also be accelerated.

In addition to the information in the tax industry, information in the enterprise, information of other relevant partners in the country and especially abroad is also needed to be collected. Therefore, cooperation and exchange of information and data at the international level is necessary.

Paying attention to resource investment, especially strengthening the training and development of the human resources for transfer pricing challenges.

The General Department of Taxation has set up a division for audit of attached transfer pricing Audit Department of the General Department and Department of Audit of transfer pricing under local tax authorities which have many risks related to the transfer pricing in the city of Hanoi, Ho Chi Minh City, Binh Duong Province and Dong Nai Province. However, tax administration should need invest both in human resource and funding as well as in measures to cope with the increasing transfer pricing behavior and with more sophisticated players.

First, investment in funding for activities to cope with the transfer pricing is commensurate with the benefits that it can bring and by the inherent complexity of this activity. The British experience shows that the British Government has spent a huge finance for control the transfer pricing and the expectation of gaining more tax revenue through limiting the status of doing transfer pricing to avoid taxation.

This finance can be used to invest in database construction (as discussed above); to train the tax staff and specialists performing the work directly; control transfer pricing, as well as cover operating costs; communication work; information, propaganda of compliance with tax policies.

Second, tax office should be strengthened in terms of assurance quantity and quality. The US and China governments did not hesitate provide human resource to tax authorities at all levels to enhance transfer pricing control. In addition to quantity, quality should be improved through reinforcement training in transfer pricing management skills and knowledge in sectoral and technical economics of market valuation, computer skills, foreign language skills, legal knowledge law for tax officials and managers. Organizing survey, gaining experience in inspecting and controlling transfer pricing in countries with much richer experience in tax administration for transfer pricing should be considered.

Third, study the establishment of a special anti-transfer pricing agency in the General Department of Taxation on the basis of developing, adding functions, tasks and human resource for The Department of Audit of Transfer Pricing under the Inspectorate Department of the General Department of Taxation and improve the professionalism in the operation of this agency. This agency does all the functions which are relevant to TP such as research, policy advisory, directly inspecting FDI enterprises who have signs of transfer pricing and supporting localities in this activity.

Fourth, the General Department of Taxation should strengthen specialized training courses on transfer pricing auditing for tax officials of local tax authorities to improve professional skills for this team, to meet the requirements of mission work. In addition, it is necessary to issue a professional tax audit manual to help tax auditors do TP audit efficiently. Organizing workshops on the topic of transfer pricing should also be considered to create opportunities of exchanging information, sharing experience in the tax administration.

Thus, this research helps to supplement, develop and perfect transfer pricing theory in FDIes. It also synthesizes and provides reliable sources of transfer pricing of MNEs and FDIes in Vietnam and clarifies the possible negative effects of the transfer pricing behaviors of FDIes on Vietnam. It has assessed the current situation of policies, laws and the responses of Vietnam to pricing transfer in FDIes and systematized the experience of some countries in responding to pricing changes in each group and drawn some meaningful conclusions. Finally, it has also proposed the scientifically background solutions to strengthen Vietnam's resilience to pricing movements in FDIes.

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