# CIRCULAR No. 117/2005/TT-BTC OF DECEMBER 19, 2005, GUIDING THE DETERMINATION OF MARKET PRICES IN BUSINESS TRANSACTIONS BETWEEN ASSOCIATED PARTIES

*Pursuant to June 17, 2003 Law No. 09/2003/QH11 on Enterprise Income Tax;*

*Pursuant to the Government's Decree No. 164/2003/ND-CP of December 22, 2003, detailing the implementation of the Law on Enterprise Income Tax;*

*Pursuant to the Government's Decree No. 77/2003/ND-CP of July 1, 2003, defining the functions, tasks, powers and organizational structure of the Finance Ministry;*

*The Ministry of Finance hereby guides the implementation of provisions on the determination of market prices in business transactions between associated parties, serving as a basis for determining enterprise income tax liabilities of business establishments as follows:*

A. GENERAL PROVISIONS

I. Subjects and scope of application:

1. Subjects of application: Organizations and individuals producing and/or trading in goods and/or services (hereinafter collectively referred to as business establishments), carrying out some or all of business activities in Vietnam and having business transactions with associated parties, shall be obliged to declare and determine their enterprise income tax liabilities in Vietnam.

2. Scope of application: Transactions of purchasing, selling, exchanging, renting, leasing, delivering, or transferring ownership of, goods or services in the process of doing business (hereinafter collectively referred to as business transactions) between associated parties.

II. Scope of non-application:

Business transactions conducted between Vietnam-based business establishments and associated parties and related to products subject to price control by the State under the Price Ordinance dated December 25, 2001, or legal documents amending, supplementing or replacing this Ordinance.

III. Interpretation of terms:

1. Market price means price of products objectively agreed upon in a business transaction on the market between non-associated parties (also called independent parties).

2. Product collectively refers to goods or services that are objects of business transactions.

3. Buying price or selling price is used to collectively refer to the price in transactions of buying, selling, exchanging, renting, leasing, delivering, or transferring ownership of, products.

4. Parties shall be deemed parties having associated relations (hereinafter collectively referred to as “associated parties”) when:

4.1. One party directly or indirectly participates in the management, control, contribution of capital to or investment in the other party.

4.2. The parties are directly or indirectly subject to the management, control, capital contribution or investment by another party.

4.3. The parties directly or indirectly participate in the management, control, contribution of capital to or investment in another party.

Normally, two business establishments shall be deemed to be associated in a tax period if during such period:

a/ One business establishment directly or indirectly holds at least 20% of shares or total assets of the other business establishment; or

b/ Any business establishment or a third party enterprise directly or indirectly holds at least 20% of shares or total assets in each of such enterprises; or

c/ One business establishment is the biggest shareholder directly or indirectly holding at least 10% of shares or total assets of the other business establishment; or

d/ One business establishment guarantees or gives to the other business establishment loans in any form which account for over 50% of the total value of medium-term and long-term loans of the borrowing enterprise; or

e/ More than half of members of the board of executive directors or members of the control board of one business establishment are appointed by the other business establishment or one executive director or one member of the control board of one business establishment who has power to decide on financial policies or business activities of the other business establishment is appointed by the other enterprise; or

f/ More than half of members of the board of directors or a member of the board of directors who has power to decide on financial policies or business activities, of each of the two business establishments are appointed by the same third party; or

g/ The two business establishments are managed or controlled in personnel, financial and business affairs by individuals being members of a family who have relations between husband and wife, parent and child (regardless of natural, adopted children or children-in-law); siblings of the same parent (regardless of natural or adoptive parent); grandparent and grandchild of the same blood line; aunt or uncle and niece or nephew of the same blood line; or

h/ The two business establishments have the relationship of head office and resident establishment or are resident establishments of the same foreign organization or individual; or

i/ One business establishment manufactures or trades in products using intangible assets and/or intellectual property rights of the other business establishment for which it has to make a payment accounting for over 50% of the cost (or cost price) of such products; or

j/ Over 50% of the total value of raw materials, materials, supplies or input products (exclusive of fixed asset depreciation expenses) used by one business establishment for manufacturing or trading in output products are supplied by the other business establishment; or

k/ Over 50% of products (calculated for each kind of product) sold by one business establishment is directly or indirectly controlled by the other business establishment; or

l/ The two business establishments have reached a business cooperation agreement on a contractual basis.

5. Associated transaction means a business dealing between associated parties.

6. Uncontrolled transaction means a business dealing between non-associated parties within the framework of normal business.

7. Material difference means difference in information and/or data significantly or materially affect the product price.

*Example 1: Enterprise V, an enterprise with 100% foreign capital located in province X, Vietnam, has 2 transactions:*

*(i) Selling 2,000 products to independent enterprise A at the selling price which is the total cost (Z) plus (+) 6% Z on the condition that it delivers goods at enterprise V; and*

*(ii) Selling 2,000 products to its parent company at the CIF price of Z +6%Z on the condition that it delivers goods to country H. At the same time, the parent company agrees to guaranty a loan borrowed by enterprise V from bank N. In fact, the guarantee for this loan is a pledge of trust (no guarantee charge is required).*

*In the above-said transactions:*

*- The difference of the goods delivery condition related to freight and insurance cost from province X to country H is deemed to be material as it considerably affects the selling price.*

- *The difference of guarantee is not deemed to be material as the pledge of trust is free of charge.*

8. Market price range means a combination of values of prices, gross profit ratios or profitability ratios of products, which are determined from uncontrolled transactions selected for comparison, depending on the regulations on methods of determining market prices.

9. Databases of tax offices mean information and data related to the determination of tax liabilities of taxpayers, which are collected, analyzed, stored, updated and managed by tax offices from various sources.

B. GUIDELINES ON THE DETERMINATION OF MARKET PRICES IN ASSOCIATED TRANSACTIONS

Product prices in associated transactions prescribed in this Circular shall be determined on the basis of market prices through comparing similarities between associated transactions and uncontrolled transactions (hereinafter referred to as comparability analysis) so as to select the most appropriate method for price determination.

I. Comparability analysis

1. Principles

1.1. Comparison between an associated transaction and an uncontrolled transaction is understood as the comparison between an associated transaction and an uncontrolled transaction or between a business establishment conducting associated transactions and a business establishment conducting uncontrolled transactions. Comparison shall be made on the basis of selecting and analyzing reliable data, vouchers and documents related to uncontrolled and associated transactions conducted in the same period for use for tax declaration and calculation purposes in accordance with the provisions of law on accounting, statistics and taxation.

*Example 2: Enterprise A, a subsidiary company of transnational company H, and enterprise B, an independent company, both retail HX-brand motorcycles in the year 2xxx. The comparison may be made in either of the following ways:*

- *Comparing the transaction of purchasing motorcycles for sale by enterprise A with the similar transaction of enterprise B.*

- *Comparing enterprise A with enterprise B in the retail of motorcycles.*

1.2. Uncontrolled transactions selected for comparison are those selected from uncontrolled transactions which have transaction characteristics and circumstances (hereinafter collectively referred to as transaction conditions) similar to associated transactions. Then, product prices in uncontrolled transactions selected for comparison shall be used a basis for determining product prices in associated transactions by price determination methods specified in Section II, Part B of this Circular.

1.3. When comparing associated transactions with uncontrolled transactions, the transaction conditions of these associated and uncontrolled transactions are not necessarily identical but must be comparable and have no differences which materially affect product prices. If the transaction conditions of associated transactions and uncontrolled transactions have any material differences, business establishments must reflect them in pecuniary value so that they can adjust and eliminate these material differences. The comparability determination in comparing associated transactions with uncontrolled ones and the elimination of differences shall comply with the provisions of Clause 2, Section I, Part B of this Circular.

1.4. The comparison between associated and uncontrolled ones shall be made on the basis of each transaction in a specific kind of product. However, where transactions cannot be separated or the separation of each transaction in each kind of product is not suitable to the practice of business, business establishments may aggregate many of the following transactions into a single transaction:

1.4.1. Transactions which are closely related and interdependent, such as transactions conducted on the basis of contracts of provision of goods and services under which services constitute an integral part of the contracts; continuous transactions such as the supply or licensing of the rights to use intangible assets associated with the supply of raw materials, materials and semi-finished products for production or processing of finished products.

1.4.2. Transactions in products which have the same production process and the same principal raw materials and materials, or those of the same group or heading according to the criteria for grouping goods and services prescribed in the statistical list of goods and services promulgated by competent state agencies, when analyzing and comparing the criterion of functions performed by business establishments.

*Example 3: Trading business establishment A, an associated party of transnational group X based in a foreign country, wholesales electric home appliances including electric irons, stoves and toasters in Vietnam. Assume that A wholesales these goods items together with providing warranty services. Though these goods items can be sold to A by associated manufacturers in different countries, they are all put in the group of thermal equipment for domestic use (according to Vietnam's statistical criteria). Thus, after analyzing and comparing the criterion of functions performed by the business establishment, the transaction values of these goods items may be treated as one for the application of the most appropriate price determination method.*

1.4.3. Small and separate business transactions which can be aggregated into a complete transaction.

1.4.4. Uncontrolled and associated transactions carried out by a particular business establishment to each of which revenue or related expenses cannot be reasonably apportioned. In this case, the aggregated transaction shall be treated as an associated one and the price of products in this aggregated transaction is the highest price of one of related products.

*Example 4: Business establishment A has 2 contracts:*

*(i) Contract 1: on the provision of the quality supervision service to an associated party being company B; and*

*(ii) Contract 2: on the provision of the quality supervision service and the licensing of a patent to independent company C, in which the revenue from the licensing of the  patent is 5 times that from the provision of the quality supervision service, calculated on the basis of the unit price of products.*

*Assume that the quality supervision services under contract 1 and contract 2 meet all conditions for comparison.*

- *Where business establishment A does not separate revenues (or expenses) related to the performance of these two contracts (covering 3 separate transactions in 2 kinds of product), the total revenue of business establishment A shall be considered revenue from an associated transaction and, depending on the provisions on each market value determination method in this Circular, and the business establishment must re-determine its revenue corresponding to the highest price of the product being copyright.*

- *Where business establishment A separates revenues (or expenses) related to the performance of these two contracts, its revenue from contract 1 shall correspond to the price of the service provided under contract 2.*

1.5. When selecting uncontrolled transactions for comparison, business establishments shall give priority to their own uncontrolled transactions, provided that these uncontrolled transactions are not created or arranged from their associated transactions.

*Example 5: Foreign-based company M has established manufacturing enterprise A in Vietnam. Assume that enterprise A has two transactions:*

*(i) Selling 2,000 products to independent customer A1 at the price of VND 10,000 per product under a contract negotiated and signed directly by enterprise A under its normal business conditions;*

*(ii) Selling 2,000 products to independent customer M1 at the price of USD 0.4 per product under a contract negotiated and signed directly by parent company M with the customer under which enterprise A is*

*designated to deliver the goods to the customer. The proceeds from the sale is directly paid by company M or by customer M1 to enterprise A.*

*Thus, transaction (i) shall be regarded as an uncontrolled transaction of enterprise A; transaction (ii) shall not be regarded as an uncontrolled transaction of enterprise A because, though products are delivered from enterprise A's warehouse and sent to custom M1, and enterprise A and customer M1 are not associated parties, the contract negotiation and signing and payment was joined in and controlled by the parent company.*

1.6. The minimum quantity of uncontrolled transactions selected for comparison after comparability analysis and adjustment of material differences are made shall be as follows:

1.6.1. One transaction - in case there is no difference between an uncontrolled transaction and an associated transaction or there are differences but business establishments have sufficient information and data for eliminating all differences; or,

1.6.2. Three transactions - in case there are differences between an independent transaction and an associated transaction but business establishments have sufficient information and data for eliminating all material differences; or,

1.6.3. Four transactions - in case there are differences between an uncontrolled transaction and an associated transaction but business establishments only have information and data for eliminating most material differences. In this case, the elimination of other differences shall follow the guidance on the standard market price range at Point 1.2, Clause 1, Section II, Part B of this Circular.

This provision is not compulsorily applicable to enterprises which apply the profit split method, the first method guided at Point 2.5.2.1, Clause 2, Section II, Part B of this Circular.

1.7. In case business establishments cannot select uncontrolled transactions for comparison on the principles specified in Points 1.1 thru 1.6, Clause 1, Section II of Part B above due to the uniqueness and distinctiveness of associated transactions, they must give the reasons therefor and follow the guidance in Section III, Part B of this Circular.

2. Comparability analysis and elimination of differences

2.1. When comparing uncontrolled transactions selected for comparison with associated ones, business establishments must analyze and assess affecting criteria and adjust material differences (if any) so as to clarify their similarities according to the following four criteria (hereinafter referred to as four affecting criteria):

2.1.1. Product characteristics: include characteristics substantially affecting the product price. Factors reflecting product characteristics mainly include:

a/ Kind of products (describing the characteristic of product, namely tangible goods, copyright, technological know-how or service, etc.) and physical characteristic of product (component materials, mechanical, physic, chemical characteristics, etc.):

b/ Quality and trademark of products;

c/ Nature of transfer of products  (for example: conditional or unconditional purchase/sale, such as exclusive distribution, licensing, franchising, etc.).

*Example 6: Enterprise A, an independent enterprise, produces assorted cotton towels (100% cotton). The wholesale price (exclusive of VAT) of face towels of 30 cm x 70 cm size is VND 15,000/towel.*

*Company M, a Vietnam-based subsidiary company with 100% foreign capital,  produces assorted cotton towels (100% cotton) for sale (export) to its parent company based in a foreign country. The export (FOB) price of class-A  cotton towels of 32 cm x 70 cm size is USD 0.7/towel.*

*Assume that other factors reflecting the characteristics of these two products are comparable.*

*Thus, cotton products of enterprise A and company M are considered those with comparable product characteristics (the difference of 2 cm in width is considered immaterial).*

2.1.2. Operational functions performed by business establishments, covering factors reflecting the profitability of activities carried out by business establishments and associated with the use of assets, capital and related expenses. When analyzing operational functions (hereinafter referred to as functions), business establishments must reflect their principal functions in the relationship between the use of assets, capital, expenses as well as assumption of risks connected with the investment of such assets, capital and expenses and the profitability associated with the business transactions. The principal functions of business establishments mainly include:

a/ Research and development (R&D);

b/ Designing and development of product models;

c/ Production, manufacture, processing;

d/ Processing, assembly, installation of equipment;

e/ Distribution, circulation, marketing, advertisement;

f/ Management and provision of supplies;

g/ Transport, forwarding and warehousing services;

h/ Provision of occupational services such as brokerage, consultancy, training, accounting, audit, personnel management, labor supply and information collection.

*Example 7 (a): Company N, a Vietnam-based associated party of multinational X, produces pharmaceuticals for sale in Vietnam and for sale (export) to its parent company X. Assume that, according to reports, company N manufactured drugs on a production line invested by itself and under a copyright granted by a company of group X. The goods were exported and sold in quantities under contracts signed at the beginning of the year. At the same time, company N also researched into and developed specific drugs but this research failed and the company suffered from a loss.*

*However, an analysis of the R&D function shows that the company did not use its assets for this function (it did not have a R& D laboratory) and its R&D section has only two employees engaged in testing the standard quality of products put into circulation. In fact, group X carried out in the year this R&D project unsuccessfully and this project was not related to company N. Thus, in fact, company N did not perform the "R&D" function. Therefore, the risk of failure of company N was untrue.*

*So, the manufacturing function of company N is to manufacture under contracts. It does not bear any risk in R&D and, therefore, the function comparison shall be made on the basis of identifying an independent enterprise which has a function similar to that of company N (if this independent enterprise has the R&D function, this difference must be eliminated).*

*Example 7 (b): Using the facts in example 7 (a) above, assume that company N, apart from producing and trading in drugs, also acts as an agent for import and distribution in Vietnam of pharmaceuticals for its parent company. The provision of this agency service was not reflected in the analysis of the operational functions of company N. Though it actually incurred expenses for company N, this activity was not paid any agency charge/commission by the parent company.*

*In fact, this agency activity was an additional function performed by company N for which it incurred expenses and assumed risk but, because of associated relations, company N did not ask for payment of agency charge or commission by its parent company. Therefore, in this associated transaction, company N must calculate the commission payable for the provisions of the agency service so as to account it into its revenue on the basis of the market price determination methods specified in this Circular.*

*Example 8 (a): Company M, a multinational based in a foreign country, has a transaction of wholesaling cell phones T which are up to* *international standards and have been registered in Vietnam to company A, an associated party, and company B, an independent company.*

*In conducting comparability analysis of the operational functions of companies A and B, it is found that:*

*- Company A: Distributing and retailing cell phones T, granting warranty cards for each cell phone sold and directly providing the warranty service.*

*- Company B: Distributing and retailing cell phones T, granting warranty cards for each cell phone sold but not directly providing the warranty service. It has reached an agreement with company A that it will pay USD 5 for each cell phone repaired by company A during the warranty period.*

*Thus, there is a difference between the operational functions performed by company A and company B, namely the provision of the warranty service, in that company A performs more functions, using more resources and has a higher profitability than company B.*

*Therefore, to ensure similarity in comparing the functions performed by companies A and B, the product warranty function will be adjusted by eliminating company A's actual expenses (or revenues) connected with the provision of the warranty service.*

*In case the "warranty" function is performed just several times with negligible (i.e. immaterial) expenses (or revenues), it is not necessary to adjust this difference.*

*Example 8(b): Using the facts in example 8(a) above, assume that company A declares that it suffered from loss due to high costs and risks of unsold and outmoded cell phones T. In reality, company A received orders and deposits of customers before requesting company M to deliver the cell phones, while the figures on the warehousing and ex-warehousing and the quantity of cell phones in stock were at normal levels (e.g., the cycle of revenue of goods in stock and sold is 10 days), and there were no documents showing that customers who placed orders but refused to buy cell phones for the reason that these cell phones were outmoded. Thus, the risk cited by company A is untrue and company A's buying price of cell phones T will be compared with company B's buying price of cell phones T for determining an appropriate price (for deduction of the cost of goods sold).*

2.1.3. Contractual terms of transactions, covering provisions or binding agreements on the responsibilities and interests of the parties to business transactions. Contractual terms of transactions (hereinafter referred to as contractual terms) mainly cover:

a/ The quantity and delivery or distribution conditions of products;

b/ The time, conditions and mode of payment;

c/ Conditions of warranty, replacement, upgrading, repair or adjustment of products;

d/ Conditions of exclusive business rights, distribution of products;

e/ Other conditions of economic impact (e.g., services of assistance and consultancy on quality control, use instructions, advertisement supports, trade promotion, etc.).

In all cases (with or without written contracts), the bases for identifying contractual terms are factual events or financial and economic date reflecting the character of transactions.

2.1.4. Economic conditions of transactions, including factors concerning economic conditions on the market at the time of performance of transactions, which affect product prices. Economic conditions of transactions (hereinafter referred to as economic conditions) mainly include:

a/ The size and geographical position of the product production or sale market;

b/ The time and character of transactions on the market (for example: normal transactions of wholesale and retail, exclusive distribution, market segmentation by product consumers);

c/ The competitiveness of products on the market;

d/ Economic factors affecting production and business costs incurred at the place of transactions (e.g., taxes, charges, financial preferences);

e/ The State's market regulation policies.

2.2. The order of priority in conducting comparability analysis of the four affecting criteria stated at Points from 2.1.1 to 2.1.4 above is prescribed for each price determination method specified in Section II, Part B of this Circular. In the course of analysis, detailed analysis is required for priority criteria; for complementary criteria, analysis may not be necessarily detailed but must fully reflect the basic characteristics of these criteria.

*Example 9: Assume that Vietnamese company M (a subsidiary company of international company M) deals in products X which are of class-I quality and have been registered in Vietnam. In the year 200x, the company managed to select uncontrolled transaction A (between Vietnamese company M and an independent party) as a basis for comparison with associated transaction B (between Vietnamese company M and international company M), and these two transactions had the same selling unit price of USD 3. In this case, the four affecting criteria of transactions A and B will be analyzed as follows:*

*(i) Product characteristics: alike (because all products are produced by Vietnamese company M);*

*(ii) Operational functions: alike (functions of Vietnamese company M);*

*(iii) Contractual terms: Assume that this criterion of two transactions is the same, with the exception that the delivery condition in transaction A is at company M's warehouse while in transaction B it is at port X of country Y and the freight from Vietnam to country A is USD 0.5/product incurred by company M.*

*(iv) Economic conditions: Assume that this criterion does not affect the product price (for example: country Y has no policy to control the price of product X, the sale condition in the two transactions is wholesale, and the buyer will pay tax and carry out procedures for import of product X into country Y).*

*Thus, the price comparison shows that the price in transaction B is not similar to that in transaction A (there is a difference of USD 0.5/product).*

*In this case, company M will select the most appropriate price of USD 3.5/product for ensuring the declaration and calculation of tax on revenue from product X in transaction B (instead of the price of USD 3).*

2.3. When conducting comparability analysis, business establishments shall identify material differences in the transaction conditions between associated and uncontrolled transactions. Where there exist no material difference, they shall not have to comply with the provisions of Point 2.4. Clause 2, Section I of Part B below.

2.4. Where there exist material differences, business establishments must determine the pecuniary value of these differences so as to increase or reduce, depending on a case-by-case basis, the value to eliminate these differences.

Where there exists a material difference in the operational functions of business establishments, adjustment shall be made on the following principles:

a/ If expense and/or revenue items related to the difference are separately accounted, adjustment shall be made on the basis of each of such revenue and/or expense items.

b/ If expense and/or revenue items related to the difference are not separately accounted, adjustment shall be made on the basis of apportionment to determine the portions of relevant expense and/or revenue related to such difference.

*Example 10: Assume that there are two transactions of companies A and B which both perform the service of processing garment products. While company A processes products and delivers them at its warehouse, company B processes products and carries out procedures for export abroad.*

*Thus, when comparing the function of processing products of companies A and B, it is found that company B performs an additional function of "carrying out export procedures." This difference will be separated by separately accounting or apportioning in proportion to total expenses or revenue arising from the carrying out of export procedures so as to ensure the comparison of business efficiency based on the comparable product-processing functions of company A and company B.*

*Where company B performed the function of "carrying out export procedures" just several times at the request of customers, involving negligible (immaterial) expense or revenue, it is not necessary to adjust this difference.*

II. Market price determination methods

The methods for determining market prices of products in associated transactions specified at Point 2, Section II, Part B below include:

- The comparable uncontrolled transaction price method;
- The resale price method;
- The cost plus method;
- The comparable profit method;
- The profit split method.

Depending on each of these methods, the market price of products may be used as a basis for directly calculating the unit price of products or indirectly through the gross profit ratio or profitability ratio of products. However, for the methods of indirect price calculation, it is not necessary to calculate specific unit prices when determining business results for income tax declaration and calculation purpose.

1. Principle of application of market price determination methods

1.1. The most appropriate price determination method is the method selected from the aforesaid five methods which is suitable to transaction conditions and has the most sufficient and reliable information, data and figures for comparability analysis.

1.2. Business establishments shall select by themselves the most appropriate value among the values of the standard market price range as a basis for adjusting the corresponding value of associated transactions. Where the product price in associated transactions is not lower than this most appropriate value, business establishments must not make any adjustment.

1.2.1. The most appropriate value is the value reflecting the highest similarity of transaction conditions of uncontrolled transactions selected for comparison with associated transactions.

1.2.2. The standard market price range covers:

a/ The values computed from uncontrolled transactions selected for comparison stated at Points 1.6.1 and 1.6.2, Clause 1, Section I, Part B above;

b/ The values falling within the range from the first quartile to the third quartile of the quartile statistical probability operation, computed on the basis of the market price range of uncontrolled transactions selected for comparison stated at Point 1.6.3, Clause 3, Section I, Part B above. (See Appendix 2, not printed herein).

*Example 11: Enterprise V in Vietnam is a subsidiary company producing and processing products for its parent company and it must pay for a royalty to another subsidiary company within the group an expense of N%/year of net revenue in four periodical installments every year. Assume that enterprise V selected 13 uncontrolled transactions for comparison with data on the royalty-net revenue ratios of these transactions, which are 1; 1.25; 1.25; 1.5; 1.5; 1.75; 2; 2; 2; 2.25; 2.5; 2.75 and 2.3. Assume also that the comparability analysis shows that material differences have been reasonably adjusted and eliminated. Particularly, there is a difference in the payment time limit which may affect the value of the royalty but available information is insufficient for conversion of such difference into money for adjustment. Therefore, the business establishment shall apply the quartile statistical function and select the first and third quartiles for determining the standard range of 1.5-2.25, with the standard range's median number (the median number of the second quartile) being 2.*

*- Assume that enterprise V has the royalty-net revenue ratio of 2.1%, then it shall not have to readjust the declared data on the royalty which is deductible when calculating enterprise income tax.*

*- Assume that enterprise V has the royalty-net revenue ratio of 4%, and at the same time, enterprise V finds that the transaction with the royalty ratio of 2% has transaction conditions closest to its transaction, it shall adjust the declared data on the royalty which is deductible when calculating enterprise income tax by a corresponding level of 2% (namely, multiplying net revenue by 2% for determining the royalty deductible when calculating enterprise income tax).*

1.3. Where business establishments have applied the market price determination methods specified in this Circular but a force majeure event, such as a natural calamity or fire, occurred in the year, affecting the production or business situation or the buying or selling price was affected by the State's policies or regulatory regimes, they may adjust the prices of products which were affected by the practical situation.

2. Market price determination methods

2.1. The comparable uncontrolled transaction price method

2.1.1. The comparable uncontrolled transaction price method is based on the unit price of products in an uncontrolled transaction for determining the unit price of products in an associated transaction when these transactions have comparable conditions.

2.1.2. The unit price of products in an associated transaction shall be compared with the most appropriate value falling within the standard range of market prices based on the unit price of products for making adjustments in compliance with the principles specified at Point 1.2, Clause 1, Section II, Part B of this Circular.

2.1.3. For this method, when conducting comparability analysis of the four affecting criteria as guided in Section I, Part B of this Circular, the priority criteria shall be product characteristics and contractual terms while the complementary factors are economic conditions and functions performed by the business establishment concerned.

2.1.4. The comparable uncontrolled transaction price method shall be applied on the conditions that:

a/ There is no difference in transaction conditions which materially affects the price of product, when comparing the uncontrolled transaction with the associated transaction; or

b/ There are differences materially affecting the price of products but these differences have been eliminated under the guidance in Section I, Part B of this Circular.

2.1.5. Factors materially affecting the price of products normally include:

a/ Physical characteristics, quality and trademark of products;

b/ Contractual terms on the provision and delivery of products, (e.g., volume (if affecting the price level), time of delivery of products, time of payment;

c/ Product distribution and sale rights affecting the economic value;

d/ The market in which the transaction takes place.

2.1.6. The comparable uncontrolled transaction price method shall normally apply to the following cases:

a/ Separate transactions in each kind of goods circulated on the market;

b/ Separate transactions in each form of service, copyright or loan contract;

c/ The business establishment conducts both uncontrolled and associated transactions in the same kind of goods.

*Example 12: Company V, a Vietnam-based enterprise with 100% capital invested by foreign company S, is engaged in processing textile and* *garment products. In the year 200x, it had two transactions of processing trousers of cat. 347 as follows:*

*- Transaction 1: Processing for parent company S 1,000 dozens of trousers at the price of USD 60/dozen and delivering the goods at port X in Vietnam (S will be responsible for exporting them).*

*- Transaction 2: Processing for country N's company M 1,000 dozens of trousers at the price of USD 100/dozen and delivering the goods in city Y of country N.*

*Assume that company M is not associated with company V and company S and these two transactions are comparable in transaction conditions, except for a material difference which is the freight and insurance cost of USD 3/dozen for the delivery of the goods from port X to city Y.*

*In comparing transaction 1 (associated transaction) with transaction 2 (uncontrolled transaction), it is found that transaction 1 did not accurately reflect the market price. Therefore, company V must adjust the revenue from the transaction with company S as follows: (USD 100 - USD 3) x 1,000 = USD 97,000. Thus, the revenue from two transactions with company S and company M for the year 200x declared by company V was USD 197,000, in which the processing charge received from company S and declared by enterprise V was USD 97,000, instead of USD 60,000.*

2.2. The resale price method

2.1.1. The resale price method is based on the resale price (or selling price) at which products are sold by a business establishment to an independent party for determining the price (cost) at which these products are bought from the associated party.

2.2.2. The price at which products are bought from an associated party is determined by subtracting (-) from the price at which products are sold in the uncontrolled transaction the gross profit and other expenses (if any) included in the price at which the products are bought (e.g., import tax, customs charge, international insurance and transportation expenses).

2.2.2.1. The gross profit is calculated according to the gross profit-selling price (net revenue) ratio and the selling price (net revenue), reflecting the value collected by the business establishment to offset business expenses and earn a reasonable profit margin. The gross profit-selling price (net revenue) ratio is the value difference between the selling price (net revenue) and the cost of bought products divided (:) by the selling price (net revenue).

2.2.2.2. Where the business establishment performs the function of a distribution agent having no ownership over products and enjoying an agency commission expressed as a percentage (%) of the selling price of products, this percentage shall be regarded as the gross profit-selling price (net revenue) ratio. (See Appendix 2, not printed herein).

2.2.3. The gross profit-selling price (net revenue) ratio of the associated transaction shall be compared with the most appropriate value within the standard range of market prices based on the gross profit ratio for making adjustments in compliance with the principles provided for at Point 1.2, Clause 1, Section II, Part B of this Circular.

2.2.4. For this method, in making comparability analysis of the four criteria as guided in Section I, Part B of this Circular, the priority criterion is functions performed by business establishments and the complementary criteria are contractual terms, product characteristics and economic conditions.

2.2.5. The resale price method shall be applied on the condition that:

a/ There is no difference in transaction conditions which materially affects the ratio of gross profit to resale price (net revenue), when comparing the uncontrolled transaction with the associated transaction; or

b/ There are differences materially affecting the gross profit- selling price (net revenue) ratio, which, however, have been eliminated under the guidance in Section I, Part B of this Circular.

2.2.6. The factors which materially affect the gross profit-selling price (net revenue) ratio normally include:

a/ Expenses reflecting the functions performed by business establishments (e.g., exclusive distribution agency, implementation of advertisement, promotional programs, warranty, etc.);

b/ Kind, size, volume and turnover cycle of products bought for resale, and the operational characteristics of the transaction on the market (e.g., wholesale, retail, etc.);

c/ Accounting methods (i.e., ensuring that the components of gross profit and revenue of the associated and uncontrolled transactions are comparable or applied with the same accounting standards).

2.2.7. The resale price method is often applied to transactions in products at the stage of provision of simple services and commercial distribution with short turnover cycles from the time of purchase to the time of resale and less affected by seasonability. At the same time, before resale, products are not added with substantial value due to processing, assembly or alteration of characteristics or labeling.

*Example 13: Enterprise V, a Vietnam-based joint-venture enterprise of foreign company H, deals in distribution of watches supplied by company H. In the year 200x, company H delivered to enterprise V 1,000 watches and requested enterprise V to pay an amount of USD 330,000 (inclusive of*

*CIF price and tax; import tax was paid by company H). At the end of the year, the net revenue earned by enterprise V from the sale of all of these watches to consumers in Vietnam was USD 400,000.*

*Enterprise T, an independent enterprise in Vietnam, also deals in distribution of watches. Enterprise T's financial statement or enterprise income tax declaration for the year 200x showed the following figures:*

*- Net revenue: USD 500,000*

*- Cost of good sold: USD 400,000*

*Assume that enterprise T is eligible for being selected for comparison of the gross profit ratio with enterprise V. Thus, the gross profit ratio shall be determined as follows:*

*[(500,000 - 400,000))/500,000] x 100% = 20%*

*Enterprise V shall have to declare deductible reasonable expenses for the purchase of watches from company H (for the associated transaction) as follows:*

*[USD 400,000 - (USD 400,000 x 20%)] = USD 320,000*

*Thus, enterprise V may only deduct reasonable expenses from the cost of goods of USD 320,000 (total expense for the purchase of watches from company H), instead of the payable amount of USD 330,000 (at the request of company H). (In case it is necessary to calculate the FOB price of watches sold by company H to enterprise V, it will be the total cost of USD 320,000 less expenses incurred after FOB exportation, such as import tax and charge, cost of inland transportation, and international transportation and insurance).*

*The gross profit earned by enterprise V (USD 400,000 - USD 320,000 = USD 80,000) shall be used to cover sale and general management expenses and reach a reasonable profit from trading in watches.*

*In case company H also provided the goods sale consultancy service and requested enterprise V to make a payment for this service (allowed to be accounted as sale expense), this transaction shall be separated and one of the transaction price determination methods stated in this Circular must be used to determine reasonable expenses deductible for this service.*

2.3. The cost plus method

2.3.1. The cost plus method is based on the cost (or cost price) of products for determining the selling price at which such products are sold to an associated party.

2.3.2. The selling price at which products are sold to an associated party shall be the cost (or cost price) of products plus (+) the gross profit.

2.3.2.1. The gross profit shall be calculated on the basis of the gross profit-cost (cost price) ratio and the cost (or cost price), reflecting the reasonable profit corresponding to the functions performed by business establishments and market conditions. The gross profit-cost (cost price) ratio shall be the value difference between the net revenue and cost (cost price) of products divided (:) by the cost or (cost price). The cost (or cost price) of products includes direct and indirect production expenses but does not include financial activity expenses (e.g., royalty and loan interest expenses, etc.). In case a business establishment does not separately account the cost (or cost price), sale expenses and general management expenses, the cost (or cost price) of products used as a basis for calculating the gross profit shall include all of these expenses.

2.3.2.2. Where a business establishment performs the function of product purchase agency, having no ownership over products and enjoying agency commissions expressed as a percentage (%) of product purchase expenses, this percentage shall be considered the gross profit-cost ratio. (See Appendix 2, not printed herein).

2.3.3. The gross profit-cost (cost price) ratio of the associated transaction shall be compared with the most appropriate value falling within the standard range of market prices based on the gross profit-cost (cost price) ratio for making adjustments in compliance with the principles prescribed at Point 1.2, Clause 1, Section II, Part B of this Circular.

2.3.4. For this method, when conducting comparability analysis of the four affecting criteria as guided in Section I, Part B of this Circular, the priority criterion is functions performed by business establishments and the complementary criteria are contractual terms, product characteristics and economic conditions.

2.3.5. The cost plus method shall apply on the condition that:

a/ There is no difference between transaction conditions which materially affects the gross profit-cost (cost price) ratio, when comparing the uncontrolled transaction with the associated transaction; or

b/ There are differences materially affecting the gross profit-cost (cost price) ratio, which have, however, been eliminated under the guidance in Section I, Part B of this Circular.

2.3.6. Factors materially affecting the gross profit-cost (cost price) ratio normally include:

a/ Expenses reflecting the functions performed by the business establishment (e.g., production under contracts, research and development of new products, the proportion of added value to investment or business scope);

b/ Obligations to perform the contract (e.g., time of delivery of products, quality control and storage expenses, payment conditions);

c/ Accounting methods (ensuring that the components of the cost (or cost price) of the associated and uncontrolled transactions are similar or applied with the same accounting standards).

2.3.7. The cost plus method shall normally apply to the following cases:

a/ Transactions at the stage of production, assembly, manufacture or processing of products for sale to associated parties;

b/ Transactions between associated parties to perform partnership or business cooperation contracts to produce, assemble, manufacture or process products, or agreements on the supply of input elements for production and factoring of output products;

c/ Transactions of provision of services for associated parties.

*Example 14: Vietnam-based enterprise A, a subsidiary company of group T, processes shoes for export. The parent company is responsible for supplying input materials and auxiliary materials and quality inspectors, and paying for international transportation and insurance. Enterprise A shall be paid processing charges according to product units and bear all expenses incurred in the processing of products according to the designs and models assigned by its parent company.*

*Accounting data of enterprise A are as follows:*

- *Net revenue (processing charge): VND 15 billion*

- *Cost of goods sold: VND 13 billion*

- *Sale and enterprise management expense: VND 1.8 billion.*

*At the same time, there are some other independent enterprises also producing and processing shoes for foreign organizations and individuals and receiving a processing charge being the sum of total cost (= cost of goods sold + enterprise management expense + sale expense) and 7% of total cost. Assume that this independent transaction is eligible for being selected for comparison.*

*Enterprise A must declare revenue from the processing of shoes as follows:*

*Revenue from the associated transaction = (13 billion + 1.8 billion) + [7% x (13 billion + 1.8 billion)] = VND 15.836 billion.*

*Thus, enterprise A must declare its revenue of VND 15.836 billion (instead of the previous figure of VND 15 billion).*

2.3.8. The cost plus method may be applied to re-determining the cost (or cost price) involving elements of an associated transaction of a business establishment based on the price of goods sold already determined on the basis of the market price and the gross profit-cost (cost price) ratio.

*Example 15: Vietnam-based enterprise V, a subsidiary company with 100% capital of multinational P, producing detergents for household use. Input materials (soap base and other cleansing chemicals) is supplied by Y, another subsidiary company of P. In the year 200x, enterprise A sold 100 tons of goods, including:*

*- Transaction 1: 60 tons, sold to another subsidiary company of group P at the FOB price of USD 650/ton.*

*- Transaction 2: 40 tons, sold to domestic supermarkets at the VAT-exclusive price of USD 700/ton.*

*The enterprise's accounting records reflected the following figures in the period:*

*- Net revenue: USD 67,000*

*- Total cost: USD 65,000*

*Assume that transactions 1 and 2 meet all conditions for enterprise V to apply the method of comparison of independent market prices and that the gross profit-total cost ratio of independent enterprises engaged in producing household detergents is 15%. Enterprise V shall declare its revenue and expenses for calculation of enterprise income tax as follows:*

*- Readjusting the selling price in the associated transaction according to the selling price in the uncontrolled transaction:*

*USD 700 x 60 tons = USD 42,000*

*- Re-determining net revenue:*

*USD 42,000 + USD 700 x 40 tons = USD 70,000*

*- Readjusting total cost (connected with the associated transaction):*

*= [USD 42,000 + (USD 700 x 40 tons)] / (1 + 0.15) = USD 60.870*

*Thus, enterprise V shall have to declare tax on the basis of the net revenue of USD 70,000 (instead of the previous figure of USD 67,000) and total cost of USD 60,870 (instead of the previous figure of USD 65,000).*

2.4. The comparable profit method

2.4.1. The comparable profit method shall be based on the profitability ratio of products in an uncontrolled transaction selected for comparison, serving as a basis for determining the profitability ratio of products in an associated transaction when these transactions have similar transaction conditions.

2.4.2. The profitability ratios are calculated by dividing net pre-enterprise income tax profit (income) by net revenue, expenses or assets of production and business activities according to the regulations of the regime of accounting and financial statements. Net pre-enterprise income tax profit (income) may be added (+) with loan interests or fixed asset depreciations for determining the production and business efficiency before payment of these expenses. Profitability ratios often used include:

2.4.2.1. Ratio of net pre-enterprise income tax income to net revenue from production and business activities.

*Example 16: Enterprise L, a Vietnam-based enterprise invested by two foreign companies N and S, operates in the domain of manufacture and assembly of 4-seat cars of marks N and S, of which cars of mark N are sold to independent parties while cars of mark S are all sold to enterprise L1, a company with 100% capital invested by enterprise L. Meanwhile, company L1 provides company L a loan bearing an interest of USD 100 at the market interest rate. In the year 200x, enterprise L's accounting statistics were as follows:*

*+ Net revenue from the sale of cars of mark N was USD 18,000 (an associated transaction)*

*+ Net pre-tax profit from the sale of cars of mark N was USD 2,000*

*+ Net revenue from the sale of cars of mark S was USD 25,000 (an associated transaction)*

*+ Net pre-tax profit from the sale of cars of mark N was USD 1,800*

*The ratio of net pre-tax profit to revenue for cars of mark N: 2,000/18,000 x 10% = 11.1%*

*The ratio of net pre-tax profit to revenue for cars of mark S: 1,800/25,000 x 10% = 7.2%*

*Assume that material differences between two transactions of selling cars of mark N and mark S have been adjusted so that the result of the transaction with company L achieves the ratio of 11.1% of net profit before tax and before payment of interest to revenue, with the subtraction of an interest expense of USD 100. Thus, enterprise L must declare a net pre-tax profit over revenue from the sale of cars of mark S as follows:*

*Net profit from the sale of cars of mark S: USD 25,000 x 11.1% = USD 2,775*

*Increase of cost (due to payment of an interest, adjusted from the transaction with company L1): USD 100*

*The result of net profit from the manufacture and sale of cars:*

*2,000 + (2,775 - 100) = USD 4,675*

*(instead of the previous figure of USD 3,800 (2,000 + 1,800) in accounting books).*

2.4.2.2. The ratio of net pre-enterprise income tax income to total cost for production and business activities

*Example 17: Enterprise AVN, a subsidiary company of company ANB, acts as a forwarding service agent for ANB. Enterprise B, an independent enterprise, exclusively deals in the provision of forwarding services (for many independent customers). Figures on revenues and expenses of AVN and B are as follows:*

| | *AVN* | *B* |
|---|---|---|
| *Total cost* | *1,500* | *2,000* |
| *Total revenue* | *1,650* | *2,500* |

*Assume that B meets all conditions for being selected for comparison with AVN in the net pre-tax income-total cost ratio. The ratios will be calculated as follows:*

*- The profit-total cost ratio of AVN = (1,650 - 1,500): 1,500 = 10%*

*- The profit-total cost ratio of B = (2,500 - 2,000): 2,000 = 25%*

*Thus, enterprise AVN must declare its profit from the associated transaction according to the profit-total cost ratio corresponding to that of 25% of enterprise B.*

2.4.2.3. The ratio of net pre-enterprise income tax income to assets of production and business assets. This ratio is used in cases where business establishments have fixed assets accounting for a significant proportion in total investment capital (e.g., enterprises in the manufacturing or mining industries).

The value of assets is the median value of the balances at the beginning and the end of the period, including fixed and liquid assets but excluding assets used for investment and contribution of joint venture or cooperation capital (e.g., purchase of public bonds or shares).

*Example 18:*

*- N, a Vietnam-based subsidiary company of group P, is specialized in producing rice alcohol. The parent company supplies most of input production elements and factors all output products. In the year 200x, enterprise N has a net profit-assets ratio of 3%.*

*- V, an independent company, is specialized in producing assorted beverages. Some of its workshops produce rice alcohol, beer and other aerated beverages. In the year 200x, company V had a profit-assets ratio of 7% for the whole company while its workshops producing wine alcohol have this ratio of 7.5%.*

*Assume that V meets all conditions for being selected for comparison with N in the net pre-tax income-assets ratio. In this case, N must adjust taxable income according to the net profit-assets ratio of 7.5%.*

2.4.3. Business establishments shall select one of the above-mentioned profitability ratios for comparing the profitability ratios of the associated and uncontrolled transactions and may use one or more other profitability ratios prescribed by the regime of financial statements to verify the accuracy of the selected ratio. The selection of profitability ratios calculated on the basis of revenue, cost or assets shall depend on the economic nature of transactions (see Appendix 2, not printed herein).

*Example 19:*

- *Assume that the business establishment has an associated transaction at the stage of sale of products, it must not use the profit-revenue ratio because the figure on revenue from the associated transaction falls within the scope of adjustment for determining the market price.*

- *Assume that the business establishment provides services, it must not use the profit-assets ratio.*

2.4.4. The profitability ratio of the associated transaction shall be compared with the most appropriate value falling within the standard range of market prices based on the profitability ratio for making adjustments in compliance with the principles stated at Point 1.2, Section II, Part B of this Circular.

2.4.5. For this method, when conducting comparability analysis of the four affecting criteria as guided in Section I, Part B of this Circular, the priority criterion is functions performed by business establishments and the complementary criteria are contractual terms, product characteristics and economic conditions.

2.4.6. The comparable profit method shall be applied on the condition that:

a/ There is no difference between transaction conditions which materially affects the profitability ratio, when comparing the uncontrolled transaction with the associated transaction; or

b/ There are differences materially affecting the profitability ratio, which have, however, been eliminated under the guidance in Section I, Part B of this Circular.

2.4.7. Factors materially affecting the profitability ratio normally include:

a/ Assets, capital and expenses for the performance of main functions of business establishments (e.g., producing and processing by machines invested by business establishments may bring about a higher profit than producing and processing by machines borrowed from other establishments);

b/ Characteristics of the operation, group of products and stage of production or sale (e.g., finished products made from crude materials or raw materials or from semi-finished products);

c/ Accounting methods and structure of expenses of products (e.g., products in the period of rapid depreciation compared to routine depreciation).

2.4.8. The comparable profit method is considered an extended version of the resale price method and the cost plus method. Therefore, the comparable profit method is widely applied in the cases cited at Points 2.2.7 and 2.3.7, Clause 2, Section II, Part B of this Circular.

2.5. The profit split method

2.5.1. The profit split method is based on the profit earned from a combined associated transaction conducted by many associated business establishments (or parties) so as to determine an appropriate profit of each of such business establishments (or parties) in such a way that the independent parties share profits in comparable uncontrolled transactions.

A combined associated transaction participated by many business establishments (or parties) is a transaction of unique and distinctive character, consisting of many closely interrelated associated transaction in exclusive products or associated transactions conducted between related associated parties.

2.5.2. The profit split method involves two ways of calculation:

2.5.2.1. The first way of calculation: To allocate the profit to each associated party on the basis of contribution of capital (sharing of cost), by which the profit of each participating business establishment (or party) shall be determined on the basis of allocating the total profit earned from the combined associated transaction in proportion to the capital (cost) used in the associated transaction of such business establishments within the total investment capital to create end products (see Appendix 2, not printed herein).

*Example 20: Vietnam-based enterprise A and foreign-based enterprise B are member companies of group T engaged in producing electronic products. A and B participate in producing a new product of LCD televisions. A is responsible for designing and manufacturing television cabinets and picture tubes and delivering them to B for assembly with other parts (circuits, electronic chips, etc.) invented and manufactured by B. Finished products will then be sold to C, an independent distributor, at the price of USD 550 per set. The total cost price per product delivered by A to B is USD 300 while the cost incurred by B for further manufacture is USD 150.*

*- The profit allocated to A is calculated as follows: [(550 - (300 + 150)):450] x 300 = USD 66.66*

2.5.2.2. The second way of calculation: To share the profit in the following two steps:

2.5.2.2.1. The first step: To share the basic profit: Each of business establishments (or parties) participating in the associated transaction shall receive a portion of basic profit corresponding to their functions. This portion reflects the value of profit of the combined associated transaction earned by each business establishment from the performance of their functions without taking into account unique and sole factors (e.g., exclusive ownership or use of intangible assets or intellectual property rights).

The portion of basic profit shall be calculated on the basis of the gross profit ratio or the profitability ratio corresponding to the most appropriate value within the standard range of market prices based on the gross profit ratio or profitability ratio as guided at Points 2.2, 2.3 and 2.4, Clause 2, Section II, Part B of this Circular.

2.5.2.2.2. The second step: To share the residual profit: Each of business establishments (or parties) participating in the associated transaction shall further receive a portion of residual profit corresponding to the percentage of sharing related to the total residual profit (i.e. the total earned profit minus (-) the total basic profit already shared at the first step) of the combined associated transaction. This portion of residual profit reflects the profit of the combined associated transaction earned by business establishments in addition to the portion of basic profit thanks to unique and sole factors.

The portion of residual profit earned by each business establishment shall be calculated by multiplying the total residual profit earned from the combined associated transaction by each business establishment’s percentage of sharing of the following expenses or assets:

a/ Expenses for product R&D; or

b/ Value (after subtracting depreciated amounts) of intangible assets or intellectual property rights used for producing or dealing in products.

Expenses for product R&D or the value of intangible assets or intellectual property rights must be determined on the basis of market prices (using the methods prescribed in this Circular) or actual expenses shared by each party in compliance with accounting principles applicable to such expenses or assets.

*Example 21: Companies H and M belong to the same group manufacturing cell phones. H manufactures assemblies while M assembles* *and installs software into complete cell phones for sale to independent distributors. Accounting figures of enterprises H and M related to the associated transaction of manufacturing cell phones are as follows:*

| | *H* | *M* |
|---|---|---|
| *Net revenue* | *200* | *500* |
| *Cost of goods sold, including:* | | |
| *- Cost of input materials* | *100* | *200* |
| *- Cost of production* | *50* | *150* |
| *R&D cost* | *30* | *50* |
| *Sale and general management cost* | *10* | *50* |
| *Profit* | *10* | *50* |

*Way of calculating profits of H and M by the profit split method:*

*Step 1: Share the basic profit*

*- Re-calculate figures on the combined business result:*

| | |
|---|---|
| *Net revenue* | *500* |
| *Cost of goods sold* | *300* |
| *R&D cost* | *80* |
| *Sale and general management cost* | *60* |
| *Profit* | *60* |

*- Assume that H's and M's profit-to-cost ratios have been determined to be 10% and 8% respectively under the guidance at Point 2.3, Section II, Part B of this Circular.*

*- Calculate H's and M's profits according to the following formula:*

*Profit = profit ratio x cost price*

*Cost price = cost of goods sold + R&D cost + Sale and general management cost*

*+ H's profit = 10% x (100 + 50 + 30 + 10) = 19;*

*+ M's profit = 8% x (300 + 80 + 60 - 190) = 20*

*After the sharing of the basic profit, the residual profit is 60 - 19 - 20 = 21*

*Step 2: Share the residual profit on the basis of the percentage of sharing of R&D cost*

*- Calculate the proportion of sharing of R&D cost by each party:*

*+ H = 30/80 x 100% = 37.5%;*

*+ M = 62.5%*

*- Calculate H's and M's portion of residual profit:*

*+ H: 21 x 37.5% = 8.87*

*+ M: 21 - 8.87 = 12.13*

*Conclusion:*

*- H shall declare its profit earned from the associated transaction as follows: 19 + 8.87 = 27.87, in replacement of the previous figure of 10; and*

*- M shall declare its profit earned from the associated transaction as follows: 20 + 12.13 = 32.13, in replacement of the previous figure of 50.*

2.5.3. For this method, the comparability analysis of the four affecting criteria as guided in Section I, Part B of this Circular and the application conditions shall comply with the provisions applicable to the resale price method, the cost plus method or the comparable profit method, depending on a case by-case basis, under the guidance at Point 2.5.2.2.1, Clause 2, Section II of Part B above.

2.5.4. The profit split method is normally applied to the cases where the associated parties jointly participate in researching into and developing new products or developing products being exclusive intangible assets or in transactions within the process of transitional production and business among the associated parties from the stage of materials to that of end-products for circulation of products in association with the sole ownership or use of intellectual property rights.

III. Provisions on determination of market prices in some special cases:

Where, due to the unique or distinctive characteristics of associated transactions, business establishments are unable to select uncontrolled transactions for comparison under the guidance at Points 1.1 thru 1.6, Clause 1, Section I, Part B of this Circular and on the basis of the market price determination methods stated in Section II, Part B of this Circular, business establishments must give the reasons (including information on their business activities) and apply one of the following measures:

1. Combined measures

1.1. To expand the scope of selection of uncontrolled transactions (or independent business establishments) to other sub-sectors of the national economy (according to the list of national economy sectors promulgated by a competent state agency) than the sub-sector in which the business establishments are operating for comparison with conditions of business establishments conducting such uncontrolled transactions which have functions similar to those performed by the former; analyze the four affecting criteria and eliminate material differences on the basis of economic criteria used in the sub-sector so as to objectively reflect investment and business efficiency, economic growth or added value of products. The number of uncontrolled transactions or independent business establishments to be selected for comparison shall be 5 (five) at least;

1.2. To determine the market price range by the ways of calculation under the most appropriate price determination method stated in Section II, Part B of this Circular; use the quartile math-statistics function or similar math-statistics functions (e.g. percentile function) for determining the appropriate standard market price range and median value (see Appendix 2, not printed herein).

1.3. Where the product price, gross profit ratio or net profit ratio of products in the associated transactions is not lower than this median value, business establishments shall not have to make adjustments for the associated transactions. Where the price, gross profit ratio or net profit ratio of products in the associated transactions is not lower than this median value, business establishments shall make adjustments according to the most appropriate value within the standard market price range, which, however, must not be lower than the median value reflecting the corresponding price, gross profit or net profit portion.

1.4. On a case-by-case basis, business establishments may use a combination of price determination methods stated in Section II, Part B of this Circular (see example 15) or simultaneously apply two price determination methods to additionally verify the accuracy and objectivity of the price, gross profit ratio or net profit ratio of products in the associated transaction.

1.5. Particularly for the profit split method, the second way of calculation and guidelines at Points from 1.1 to 1.3, Clause 1, Section III of Part B above shall be considered grounds for making adjustments for the basic profit; business establishments may continue to share the residual profit as guided at Point 2.5.2.2.2, Clause 2, Section II, Part B of this Circular.

Example 22: Company X manufactures electronic integrated circuits and exports all products to its foreign-based parent company at the sale price (revenue) equal to 1.1 of total cost. Assume that in this domain of manufacture there is no uncontrolled transaction or independent enterprise selected for comparison in the sub-sector of manufacture of electronic products (according to Point 1.4.2, Section I of Part B) which has a profit-revenue ratio of 30% (this figure is calculated from 10 enterprises operating in the sub-sector of electronic product manufacture). Assume that an analysis of economic criteria reflecting the investment efficiency of the sub-sector shows that the profit-revenue ratio of 30% is suitable to the actual operation of company X (namely, there is no material difference which must be adjusted).

Thus, company X may examine its price determination to ensure that the profit-revenue ratio of 30% is reached, or base itself on the profit-revenue ratio for re-calculating the profit-total cost ratio for comparison and adjustment (the way of re-calculation may be as follows: profit/revenue = (revenue - cost)/revenue = 0.3 => revenue = 1.429 times of cost).

2. Method of application of figures between periods

Business establishments may apply comparable associated transactions conducted between periods (not exceeding 5 years, calculating from the time of arising of the associated transaction), for which the market prices have been determined under the guidance of this Circular, compile dossiers for comparability analysis of the four affecting criteria among the transactions, make adjustments for material differences and use objective grounds for adjusting economic values in different periods of time (e.g., average price increase rate, interest rate, inflation rate, economic growth) for determining the suitable price of products, gross profit ratio or profitability ratio of the associated transaction arising in the period of declaration and payment of enterprise income tax.

Example 23: Enterprise A, a Vietnam-based enterprise with 100% foreign-invested capital, is the sole enterprise engaged in exploiting and processing metal X ore for export. In the year 2xx1, it conducted both associated and uncontrolled transactions. For associated transactions, it applied the method of comparing the price of uncontrolled transactions and determined the unit price of USD 800 per ton of ore containing 35% of metal X.

Assume that in the year 2xx2, enterprise A exported 100% of its products to its parent company (there was no uncontrolled transaction for comparison; the international market price of metal X in the year 2xx2 increased by 20% over 2xx1; other factors affecting the price of products (content of metal, delivery and payment terms, etc.,) remained unchanged.

Thus, enterprise A would declare and calculate tax for the year 2xx2 based on the revenue from the sale of metal X ore at the unit price of not lower than USD 960/ton.

IV. Storage and supply of data and vouchers on market price determination methods

1. Selection of data and vouchers

1.1. Data, vouchers and documents used as grounds for comparability analysis must are of clear sources so that they can be examined and verified by tax offices. Business establishments may use information and data from the following sources:

a/ Information and data publicized or supplied upon request by state agencies, departments or branches, research institutes, associations and specialized international organizations recognized by the State;

b/ Information and data certified or publicized by licensed organizations and individuals operating in independent services or occupations (e.g., independent audit organizations, register offices or quality registration offices, organizations engaged in classifying or ranking the credit of enterprises);

c/ Annual or periodical financial statements and investment reports of companies listed on the securities markets, which are publicized according to the regulations and operation rules of these securities markets;

d/ Data, vouchers and documents relating to business transactions for tax declaration and payment purposes, which business establishments supply and are responsible for.

Data, vouchers and documents originating from unofficial or unidentified sources shall be used for reference only.

1.2. When selecting transactions for comparability analysis and calculation of gross profit ratio or profitability ratios, business establishments must reflect data in comparable forms within a period of at least 3 consecutive financial years. For business establishments which have existed for less than 3 financial years or carry out seasonal business activities which do not take place throughout the year, such period may be a month, a quarter or a season as appropriate.

1.3. When calculating relative figures (e.g., ratios expressed in a percentage (%) of absolute figures, business establishments shall round such figures to the third digit following the decimal point. Where a relative figure is a publicized one with no accompanying absolute figures and complying with this principle on rounding, the publicized figure shall be used.

*Example 24:*

- *If using absolute figures for calculating the gross profit ratio, a value of 5.2856% is obtained, this relative figure shall be rounded to 2,286%.*

- *If the publicized figure of economic growth is 7.8%, this figure must not be rounded.*

- *If the publicized figure of interest rate is 4.9854%, this figure shall be rounded to 4,985%.*

2. Requirements on storage and supply of information, documents and evidence

2.1. Business establishments having associated transactions shall have the obligation as well as responsibility to store and produce information, documents and evidence already used as grounds for the application of methods or determining the market price of products in such associated transactions at the request of tax offices when conducting examination or inspection. Information, documents and evidence related to production and business activities and methods of determining market prices of associated transactions must be established at the time of arising of associated transactions, updated and supplemented throughout the time of performance of the transactions and preserved in accordance with the provisions of accounting, statistics and tax laws regarding preservation of accounting vouchers and books.

2.2. When making settlement of enterprise income tax, business establishments shall be responsible for declaring their associated transactions according to form GCN-01/TNDN. The deadline for submission of this form shall be also the deadline for submission of the enterprise income tax settlement declaration.

2.3. Business establishments shall have the obligation to compile and preserve records of information, documents and vouchers related to associated transactions as follows:

2.3.1. General information in business establishments and associated parties:

a/ Information on association relationships between associated parties and business establishments;

b/ Updated documents and reports on strategies for development, management and control among associated parties; policies on establishment of transaction prices of each group of products in line with general orientations set by associated parties and business establishments;

c/ Documents and reports on the process of development, business strategies, investment, production and business projects and plans; regulations and processes for business establishments and associated parties to make financial statements and conduct internal control;

d/ Documents describing the organization and functions of operation of business establishments and associated parties participating in transactions.

2.3.2. Information on transactions conducted by business establishments:

a/ Plans and descriptions of transactions, including information on transaction parties, order and procedures for payment and delivery of products, etc.;

b/ Documents describing characteristics and technical specifications of products; a detailed list of expenses (costs) per unit product, selling price of product, total quantities of products produced, traded in and sold in each period (by associated transaction and uncontrolled transaction (if any)); quantities of products;

c/ Information, documents and vouchers on the process of negotiation, signing, performance and liquidation of economic contracts/agreements related to transactions (normally including description of product, place of transaction, form of transaction, value of transaction, payment conditions and documents, time of implementation, work minutes or directives of management related to the process of negotiation, signing and performance of transactions);

d/ Information, documents and evidence related to economic circumstances of the market at the time of performance of associated transactions which affect the method of determining transaction prices (e.g., changes in foreign exchange rates, government policies affecting transaction prices, financial preferences, etc.).

2.3.3. Information on methods of determining market prices:

a/ Business establishments' policies on establishment of buying and selling prices or exchange of products, process of control and approval of prices, price tariffs of products on different sale markets;

b/ Information, documents and evidence used as grounds to prove the selection and application of methods of determining the most appropriate prices in associated transactions of business establishments, including information, data and vouchers used for comparability analysis and adjustment of material differences, the table of calculation of transaction prices based on the price determination method applied by business establishments and reasons for the application of such method;

c/ Other information, documents and evidence for reference which are related to the selection and application of methods of determining prices in associated transactions (if any).

2.4. Business establishments shall, at the request of tax offices, be obliged to supply information, documents and evidence within 30 working days after the date of receipt of written requests of tax offices. Where business establishments have plausible reasons, this time limit may be prolonged only once for 30 days, counting from the date of its expiration.

2.5. Information, documents and evidence supplied by business establishments to tax offices must be in the written form, originals or copies in compliance with the provisions of law on notarization and authentication. Where business establishments use e-evidence, the supply thereof shall comply with the Accounting Law and relevant guiding documents regarding e-evidence.

Information, documents and evidence in a foreign language must be translated into Vietnamese and their Vietnamese translations must be notarized or authenticated according to current regulations. Where notarization is not required by law, business establishments shall be accountable for the translations.

C. RIGHTS AND OBLIGATIONS OF TAXPAYERS; RESPONSIBILITIES OF TAX OFFICES, AND OTHER PROVISIONS

**1. Rights and obligations of business establishments:** Apart from exercising the rights and performing the obligations under the provisions of legal documents on taxation and of this Circular, business establishments shall also have the following rights and obligations:

1.1. To request tax offices to keep confidential information they have supplied to tax offices to serve the determination of market prices in business transactions among associated parties for taxation purposes.

1.2. To be obliged to fully produce necessary data, documents and evidence to prove the selection and application of methods of determining the most appropriate prices for associated transactions.

2. Responsibilities and powers of tax offices

2.1. To keep confidential information supplied by business establishments in relation to the determination of market prices in business transactions among associated parties for taxation purposes defined in this Circular when such information does not come from publicized sources. The supply of confidential information by taxpayers to relevant state agencies shall comply with the provisions of law.

2.2. To fix prices to be used for tax declaration and calculation, fix taxable incomes or payable income tax amounts (collectively referred to as to fix tax) for business establishments which perform associated transactions in the following cases:

a/ Business establishments have based themselves on unlawful or invalid documents, data and evidence or fail to specify the sources of documents, data and vouchers they have used for determining prices, gross profit ratios or profitability ratios applied to associated transactions.

b/ Business establishments have forged uncontrolled transactions or arranged associated transactions into uncontrolled ones so as to select these transactions as uncontrolled transactions for comparison.

c/ Business establishments fail to declare or fully declare information in Appendix GCN-01/HTQT for associated associations arising in the year of settlement of enterprise income tax; fail to supply upon request within the time limit information, data and documents to prove the declaration and accounting market prices for associated transactions.

d/ Tax offices suspect that business establishments fail to apply or apply improperly in a deliberate manner the provisions of this Circular and business establishments fail to prove within 90 days after receiving notices of tax offices.

2.3. The General Department of Taxation shall base itself on information on tax liabilities declared by business establishments having associated transactions and databases of tax offices to guide the fixing of taxes on the following principles:

a/ Where business establishments have fully implemented the regime of accounting, invoices and evidence, the fixing of revenue, cost or taxable income for determining tax liabilities shall be effected under market price determination methods specified in Clause 2, Section II and Section III, Part B of this Circular on the basis of prices, gross profit ratio or profitability ratios determined by tax offices suitable to each case or each business line.

b/ In other cases, the fixing of tax shall be effected on the basis of databases of tax offices in accordance with the provisions of tax fixing applicable to business establishments which have not fully implemented the regime of accounting, invoices and evidence or with the provisions on handling of tax-related violations.

c/ In case of tax fixing related to the standard market price range, the most appropriate value for determining prices, gross profit ratio or profitability ratios applicable to business establishments having associated transactions subject to tax fixing shall be a value not lower than the median value of the standard market price range determined by tax offices.

2.4. The General Department of Taxation shall guide the examination and inspection of business establishments in their implementation of the provisions of this Circular.

3. Handling of violations and settlement of complaints

3.1. Business establishments, organizations, tax officers and other individuals that violate the guidelines in this Circular shall, depending on the nature and severity of their violations, be handled according to the provisions of law.

3.2. Business establishments may lodge complaints within the time limit and according to procedures for complaint and the competence to settle complaints in accordance with the provisions of law on complaints and other relevant legal provisions. Pending the settlement of complaints, business establishments shall still have to strictly abide by decisions of tax offices on the payment of tax and fines (if any).

Where business establishments are resident establishments of Vietnam and/or countries which have signed double taxation avoidance agreements with Vietnam which have incomes falling within the scope of regulation of such agreements, they may lodge complaints according to the provisions of such agreements.

4. Organization of implementation

4.1. This Circular takes effect 15 days after its publication in “CONG BAO.”

4.2. In the course of implementation of this Circular, any arising problems should be reported by business establishments, agencies and individuals to the Finance Ministry for study and timely settlement.

For the Minister of Finance
Vice Minister
*TRUONG CHI TRUNG*

**Appendix 1**

## INSTRUCTIONS ON DECLARATION OF FORM GCN- 01/TNDN: INFORMATION ON RELATED TRANSACTIONS

The contents and methods of filling figures in the items on Form GCN-01/TNDN- Information on transfer price is as follows:

### PART A. INFORMATION ON RELATED TRANSACTION VALUE

### I. Total turnover, other revenues from business activities:

**Column (3) - "Turnover, other incomes"**

Figures filled in this item are based on the reporting year's Credit cumulative figures on the detailed accounting books of Account 511 - Turnover from goods sale and service provision, Account 515 - Turnover from financial activities and Account 711 - Other incomes.

If there are deductions from gross sales which relate to sales discounts, sales allowances, sales returns , the reporting year's turnover is the net value (net sale) = {gross sale less deductions }.

**Column (4) - "Expenses"**

Figures filled in this item are based on the reporting year's Debit cumulative figures on the detailed accounting books of Account 632 - Cost of goods sold, Account 635 - Financial expenses, Account 641 - Sale expenses, Account 642 – Enterprise management expenses, Account 811- Other expenses and other related accounts (if any). These expenses have been subtracted with allowable deductions and used for determining the reporting year's business results.

### II. Total turnover, other incomes derived from related transactions:

**Column (3) - "Turnover, other incomes"**

Figures filled in this item are based on the reporting year's Credit cumulative figures on the detailed accounting books of Account 511 - Turnover from goods sale and service provision, Account 515 - Turnover from financial

**Appendix 2 – GCN/HTQT**

## REFERENCE FORMULAS FOR APPLICATION OF METHODS OF DETERMINING MARKET PRICES

*(Issued together with Circular No. 117  /2005/TT-BTC of December 19, 2005)*

## A. PRINCIPLES FOR APPLICATION OF FORMULAS:

The formulas described in this Appendix reflect the most basic way of calculation using accounting figures conformable with Vietnamese accounting standards. When conducting comparable analysis and adjusting differences, business establishments may add (+) or substract (-) some criteria which constitute turnover, expense or asset in the denominator or numerator in the formula of calculation but must ensure the components of the numerator and denominator of the formula of calculation of the ratio of a related transaction similar to the components of the numerator and denominator in the formula of calculation of the ratio of an independent transaction selected for comparison. The amounts added or subtracted must be clearly accounted according to regulations of the accounting regime.

*Example: Assume that enterprise A is a related enterprise and enterprise B is an independent enterprise with accounting figures used for ratio comparison as follows:*

| | A | B |
|---|---|---|
| *Net turnover* | *800* | *900* |
| *Cost of goods sold* | *550* | *600* |
| *Selling  expenses* | | *60* |
| *General and administration expenses* | | *100* |
| *General sale and administration expenses (generally accounted)* | *150* | |
| *Interest expenses* | *50* | *0* |
| *Net profit* | *50* | *140* |

*Assume that when it is necessary to compare the ratios related to cost of goods sold and gross profit, as there is no difference between the values of gross profit (equal to net turnover minus cost of goods sold) of A and B, it is possible to use the basic formula for calculation.*

*Assume that it is necessary to compare the profitability ratios (production and business effectiveness) between A and B, due to the difference regarding that A must pay interest expenses, when calculating the ratio of net profit to turnover, business establishments may make adjustments to calculate the net profit ratio before paying interest expenses as follows:*

- *A's net profit/turnover ratio before payment of interest expenses:*

*(50 + 50): 800 x 100% = 12,5%*

- *B's net profit/turnover ratio before payment of interest expenses:*

*140: 900 x 100% = 15,556%*

## B. FORMULA FOR CALCULATING RATIOS ACCORDING TO EACH METHOD OF DETERMINING THE PRICE:

"20_TT
117_Appendix 1.xls"