CIRCULAR 66
PROVIDING GUIDELINES ON
CALCULATION OF MARKET PRICES IN
BUSINESS TRANSACTIONS BETWEEN AFFILIATED PARTIES[1]
Dated 22 April 2010

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MINISTRY OF FINANCE

SOCIALIST REPUBLIC OF VIETNAM
Independence - Freedom - Happiness

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CIRCULAR
PROVIDING GUIDELINES ON CALCULATION OF MARKET PRICES IN BUSINESS TRANSACTIONS BETWEEN AFFILIATED PARTIES[2]

Pursuant to *Law on Corporate Income Tax* 14-2008-QH12 dated 3 June 2008;

Pursuant to *Law on Tax Management* 78-2006-QH11 dated 29 November 2006;

Pursuant to Decree 124-2008-ND-CP of the Government dated 11 December 2008 making detailed provisions for implementation of a number of articles of the *Law on Corporate Income Tax*;

Pursuant to Decree 85-2007-ND-CP of the Government dated 7 June 2007 making detailed provisions for implementation of a number of articles of the *Law on Tax Management*;

Pursuant to Decree 118-2008-ND-CP of the Government dated 27 November 2008 on functions, duties, powers and organizational structure of the Ministry of Finance.

The Ministry of Finance hereby provides the following guidelines for implementation of provisions on calculation of market prices, which shall be used as the basis for declaration and calculation of the corporate income tax obligation of business establishments, in business transactions between affiliated parties:

PART A

General Provisions

Article 1 *Applicability*

Organizations engaged in production and business of goods or services (hereinafter referred to as enterprises), conducting business transactions with affiliated parties shall be obliged to declare and calculate the corporate income tax obligation in Vietnam.

Article 2 *Scope of application*

Transactions of sale, purchase, exchange, lease, transfer or assignment of goods and services during the course of business (hereinafter referred to as business transactions) between affiliated parties except for business transactions between an enterprise in Vietnam and affiliated parties related to products which are subject to price adjustment by the State in accordance with the law on prices.

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[2] Allens Arthur Robinson footnote: Commonly referred to as "transfer pricing".

Article 3 *Definition of Terms*

1. *Market price* means the expression used to indicate the price of products under an objective agreement between non-affiliated parties (independent parties) in a business transaction on the market.

2. *Product* is the term used in general to indicate goods and services which are the object of a business transaction.

3. *Purchase price* or *selling price* is the term used in general to indicate the price of products in transactions of sale, purchase, exchange, lease, transfer or assignment.

4. *Parties* having a related relationship (hereinafter referred to as "affiliated parties") means the expression used to indicate parties having a relationship in one of the following circumstances:

4.1 One party is involved directly or indirectly in administration, control, capital contribution or investment in any form in the other party;

4.2 The parties are directly or indirectly managed or controlled by another [third] party or both or all parties make capital contribution or invest in another [third] party;

4.3 The parties participate directly or indirectly in administration, control of, capital contribution to or investment in any form in another [third] party.

Normally, two enterprises shall be determined to be affiliated parties if they have a business transaction relationship in a tax period in one of the following circumstances:

(a) Either enterprise directly or indirectly holds at least 20% of investment capital of the owner of the other enterprise;

(b) Both enterprises have at least 20% of investment capital of the owner held directly or indirectly by a third party;

(c) Both enterprises directly or indirectly hold at least 20% of investment capital of the owner of a third party;

(d) Either enterprise is the biggest shareholder in terms of investment capital of the owner of the other enterprise directly or indirectly holding at least 10% of investment capital of the owner of the other enterprise;

(e) Either enterprise provides the other enterprise with a guarantee or a loan in any form, provided that such loan is equal to 20% of investment capital of the owner of the borrower enterprise and accounts for more than 50% of the total value of long and medium term loans of the borrower enterprise;

(f) Either enterprise appoints its members to the board of management or inspection committee of the other enterprise, provided that the number of members appointed by the former accounts for more than 50% of the total members of the board of management or the inspection committee of the latter; or a member appointed by the former has the right to make decisions on financial policies or business activities of the latter;

(g) Both enterprises jointly have more than 50% of the number of members of their board of management or jointly have a member of their board of management, who has the right to make decisions on financial policies or business activities, appointed by a third party;

(h) Both enterprises are managed or controlled in terms of personnel, finance or business activities by individuals in any of the following relationships: a husband and a wife, parents and children (irrespective of whether they are natural or adopted children, daughters-in-law or sons-in-law); siblings of the same parents (irrespective of whether they are natural or adoptive parents); paternal grandparents and grandchildren; maternal grandparents and grandchildren; mother's or father's uncles or aunts or grandchildren;

(i) Both enterprises have a relationship concerning the headquarters and permanent establishment or are permanent establishments of a foreign organization or individual;

(j) Either enterprise is engaged in production and trading of products using intangible property and/or intellectual property rights of the other enterprise, provided that the payment for the use of such intangible property and/or intellectual property rights accounts for more than 50% of prime cost (or cost) of the products;

(k) Either enterprise directly or indirectly provides more than 50% of the total value of raw materials, supplies or input products (excluding depreciation of fixed assets) used for production or trading of output products of the other enterprise;

(l) Either enterprise directly or indirectly controls more than 50% of turnover of sales (calculated on the basis of each type of products) by the other enterprise;

(m) Two enterprises have agreed to conduct business co-operation on the basis of a contract.

5. *Related transaction* means a business transaction between affiliated parties.

6. *Independent transaction* means a business transaction between non-affiliated parties.

7. *Significant difference* means the difference concerning information and/or data causing an increase or decrease by at least 1% of the unit price of products traded or the difference concerning information and/or data causing an increase or decrease by at least 0.5% of the gross profit ratio or profitability ratio.

Example 1:

Enterprise V is an enterprise with 100% foreign owned capital in province X in Vietnam and has 2 transactions:

(i) Selling 2000 products to Independent Enterprise A at the selling price being the prime cost of (Z) plus (+) 6% of Z, the delivery term is delivery at Enterprise V;

(ii) Selling 2000 products to its parent company at the selling price being (Z) plus (+) 6% of Z, delivery term is CIF H and freight and insurance costs from Province X to Country H being 3% of Z. At the same time, the parent company agrees to provide a guarantee for a loan obtained by Enterprise V from Bank N. In practice, such guarantee is a guaranty by reputation (i.e. payment of guarantee charges is not required).

In the two above transactions:

- The difference concerning delivery terms related to costs of transportation and insurance from province X to country H has an affect of increasing by more than 1% the price of products, so it is deemed to be a significant difference.

- The difference concerning the guarantee by reputation for which the payment of charges is not required is not a significant difference.

8. *Market price margin* is a collection of values of prices or collection of values of gross profit ratio or collection of values of profitability ratio of products calculated from independent transactions which are selected for comparison.

9. *Tax office's database* means information and data related to the calculation of the tax obligation of enterprises and collected from different sources and analysed, stored, updated and managed by the tax office.

PART B

Guidelines on Calculation of Market Prices in Related Transactions

Price of products in a related transaction stipulated in this Circular shall be calculated in accordance with market prices on the basis of comparison of the similarity between the related transaction and an independent transaction (hereinafter referred to as comparative analysis) to select the most appropriate method of calculation of a price.

Article 4 *Comparative analysis*

1. Principles

1.1 Comparison between a related transaction and an independent transaction shall be construed as a comparison between the related transaction and the independent transaction or as a comparison between the enterprise conducting the related transaction and the enterprise conducting the independent transaction. The comparison shall be carried out on the basis of selection and analysis of data, source documents and materials related to the independent transaction or the related transaction in the same period to ensure their reliability to use for the purpose of tax declaration and calculation in compliance with the laws on accounting, statistics and taxation.

Example 2:

Both Enterprise A being a subsidiary of Multinational Company H and Enterprise B being an independent enterprise retail motorbikes brand HX in year 2xxx. The comparison may be carried out in accordance with one of the two following methods:

- Comparison between the transaction of purchase of motorbikes for sale by Enterprise A and the similar transaction of enterprise B.

- Comparison between enterprise A and enterprise B in terms of retailing activities of motorbikes.

1.2 An independent transaction selected for comparison shall be a transaction selected from independent transactions whose nature and context (hereinafter referred to as transaction conditions) are equivalent to that of the related transaction. Then, the price of products in the independent transaction selected for comparison shall be the basis for calculation of a price of products in the related transaction in accordance with methods of calculation of prices stipulated in article 5 of Part B of this Circular.

1.3 Upon comparison between a related transaction and an independent transaction, the transaction conditions of the related transaction and of the independent transaction selected for comparison need not necessarily be completely identical but they must ensure similarity; they must not have any differences causing a significant effect on the price of products. Where there are significant differences between the transaction conditions of the related transaction and of the independent transaction, the enterprise shall express such significant differences in a monetary value which shall be used as the basis for adjustment and exclusion of such significant differences. Upon comparison between a related transaction and an independent transaction, the similarity shall be determined and differences shall be excluded in accordance with the provisions of clause 2 of article 4 of Part B of this Circular.

1.4 The comparison between a related transaction and an independent transaction shall be carried out on the basis of each transaction for each particular kind of product. However, where transactions cannot be separated or the separation of transactions on the basis of each type of product will not be consistent with business practice, the enterprise may merge the following transactions into one transaction:

1.4.1 Transactions which are closely related to and depend on each other such as transactions on the basis of a contract for supply of goods and services, in which services are an integral part of such contract for supply of goods; chain transactions such as transactions of providing or granting the right to use intangible property associated with the supply of raw materials or semi-finished products for production or processing of finished products.

1.4.2 Transactions with respect to products which have the same procedures for production or use the same main raw materials or which are classified in the same category or sub-category in accordance with the criteria for classification of goods or services into categories and sub-categories stipulated in the statistical list of goods and services issued by the authorized State administrative body upon conducting the comparative analysis of criteria of operational functions of enterprises.

Example 3:

Trading establishment A imports items of goods X, Y and Z from an affiliated party overseas for distribution to local supermarkets. These three items of goods fall within the category of heat equipment for households (under the Vietnam statistical standards).

Where the separation of each transaction on the basis of each type of product X, Y or Z does not conform with its business practice, Enterprise A may merge values of transactions for import of these three types of products together for application of the most appropriate method of calculation of a price.

1.4.3 Individual small business transactions which can be merged together in order to form a complete transaction.

1.4.4 Independent transactions and related transactions which are conducted by an enterprise but whose turnover or related costs cannot be allocated reasonably to each kind of transaction. In this case, the merged transactions shall be considered as related transactions and the prices of products in the merged transactions shall be the highest price of one of the related products (in the case of sale transactions) or the lowest price of one of the related products (in the case of purchase transactions).

Example 4:

Enterprise A has 2 contracts:

(i) Contract 1 for provision of services of quality control to an affiliated party being Company B; and

(ii) Contract 2 for provision of services of quality control and franchise of the right to use the patent to Independent Company C in which the turnover from franchise of the right to use the patent is 5 times higher than the turnover from provision of services of quality control calculated on the basis of the unit price of products.

Suppose that services of quality control under contract 1 and contract 2 satisfy all conditions for comparison.

Comparative analysis:

- Where Enterprise A does not separate turnover (or costs) related to the performance of these two contracts (including three separate transactions for two types of products), the entire turnover of Enterprise A shall be deemed to be the turnover from the related transaction and subject to the provisions on each method of calculation of a market price set out in this Circular, [and] the enterprise must recalculate turnover on the basis of the highest price of products being copyright.

- Where Enterprise A separates the turnover (or costs) related to the performance of these two contracts, the charge rate under contract 1 shall correspond to the charge rate for provision of services under contract 2.

1.5 When selecting independent transactions for comparison, an enterprise shall give priority to its own independent transactions for selection provided that such independent transaction is not created or re-structured from related transactions.

Example 5:

Company M overseas establishes Production Enterprise A in Vietnam. Enterprise A has two transactions:

(i) Selling 2,000 products to Independent Customer A1 at the price of 10,000 Dong for a product under a contract negotiated and entered into directly by Enterprise A in its normal business conditions;

(ii) Selling 2.000 products to Independent Customer M1 at the price of USD 0.4 for a product under a contract negotiated and entered into directly by Parent Company M which appoints Enterprise A to deliver goods to Customer M1. Company M or customer M1 directly makes payment for goods to Enterprise A.

Comparative analysis:

- Transaction (i) will be an independent transaction of Enterprise A;

- Transaction (ii) will not be considered as an independent transaction of Enterprise A because, even although the products are delivered from the warehouse of Enterprise A to Customer M1 and the two parties do not have a relationship, the parent company has taken part in and controlled the negotiation and execution of the contract and payment.

1.6 After comparative analysis, the minimum number of independent transactions selected for comparison and adjustment of significant differences shall be stipulated as follows:

1.6.1 01 transaction – in a case where there is no significant difference between the independent transaction and the related transaction;

1.6.2 03 transactions – in a case where there are differences between the independent transaction and the related transaction but the enterprise possesses complete information and data which may be used as the basis for exclusion of all of the significant differences;

1.6.3 04 transactions – in a case where there are differences between the independent transaction and the related transaction but the enterprise only possesses information and data which may be used as the basis for exclusion of the most significant differences. In this case, the further exclusion of the significant differences shall be subject to the guidelines on standard market price margins stipulated in sub-clause 1.2 of clause 1 of article 5 of Part B of this Circular.

The application of these provisions is not compulsory in a case where an enterprise applies the method of profit division as the first method of calculation specified in paragraph 2.5.2.1 of sub-clause 2.5 of clause 2 of article 5 of Part B of this Circular.

1.7 Where an enterprise is unable to select any independent transaction for comparison on principles stipulated by sub-clauses 1.1 to 1.6 of clause 1 of article 5 of Part B of this Circular due to the special or exclusive nature of the related transaction, the enterprise shall specify reasons and implement the matter in accordance with the guidelines provided in article 6 of Part B of this Circular.

2. Comparative analysis and exclusion of differences

2.1 Upon comparison between an independent transaction selected for comparison and a related transaction, the enterprise shall analyse and assess influential criteria and adjust significant differences (if any) to make clear the similarity on the basis of the four following criteria (hereinafter referred to as four influential criteria):

2.1.1 Properties of products: including properties which have main effects on the price of products. Elements showing properties of products shall mainly include:

(a) Type of products (describing the nature of products being tangible goods, copyright, technological know-how or services and so on) and physical characteristics of products (materials constituting [*the products*], mechanical, physical or chemical properties and so on);

(b) Quality and trade name of products;

(c) Nature of the transfer of products (for example: sale/purchase with or without conditions such as exclusive distribution, license, franchise and so on).

Example 6:

Enterprise A is an independent enterprise specialized in production of towels of all types (100% cotton fibres), including a towel product of grade A with the dimensions of 120cm x 60cm.

Company M is a subsidiary with one hundred (100) per cent foreign owned capital in Vietnam specializing in production of towels of all types (100% cotton fibres), including towel products of grade A with the dimensions of 121cm x 60cm, for sale (or export) to its parent company overseas.

Suppose that others elements showing properties of two types of towel products of Company A and Company M are similar.

Comparative analysis

The towel products of Enterprise A and Company M will be deemed to be products with similar properties (the difference of 1 cm in width of towels is deemed to be insignificant).

2.1.2 Operational functions of an enterprise: including elements showing the profitability of activities conducted by the enterprise attached to the use of property, capital and related costs. Upon analysis of the operational functions (hereinafter referred to as "functions"), the enterprise must show main functions in the relationship between the use of types of property, capital and costs as well as risks attached to the investment of such property, capital and costs and the profitability [*of activities*] which are conducted by the enterprise in relation to the business transactions. Main functions of an enterprise shall mainly include:

(a) Research and development;

(b) Design and formation of products;

(c) Production, manufacture and process;

(d) Processing, assembly and instalment of equipment;

(e) Distribution, circulation, marketing and advertising;

(f) Management and supply of materials;

(g) Transport and delivery, provision of warehousing services;

(h) Provision of professional services such as brokerage, consultancy, training, accounting, auditing, personnel management, labour supply and information collection.

Example 7 (a):

Company N is an affiliated party in Vietnam of Multinational Company X; and in the year of 200x conducts the following:

- Produces medicines on the production line invested in by the company under licence granted by a company of Group X.

- Sells (exports) to Company X under signed contracts which have been stable since the beginning of the year.

- Does not conduct research and development of any product.

Upon comparison between the related transaction (with Company X) and the independent transaction, Company N must conduct comparative analysis of functions with an independent enterprise which has similar functions to those of Company N aimed at excluding differences. As the production of medicines always attaches to research and development of new products, in the case where the selected independent enterprise has the research and development function, Company N must exclude such difference.

Example 7 (b):

Continued from the above example 7 (a). Suppose that in addition to the production and trading of medicines, Company N also acts as an import and distribution agent for pharmaceutical products in Vietnam for its parent company X.

This provision of agency services is an additional function which company N has performed, it has incurred expenses and taken risks of the business of agency services. This provision of agency services is a related transaction of Company N. In this case, Company N must calculate and declare turnover from agency commissions in accordance with the methods of calculation of market prices specified in clause 2 of article 5 of Part B of this Circular.

Example 8:

Company M is a multinational company overseas and conducts a transaction of wholesale of T mobile phones, which was in accordance with the international quality standard registered in Vietnam, with Company A being an affiliated company and Company B being an independent company.

Company A distributes and retails T mobile phones, issues a warranty card to each mobile phone sold and directly provides warranty services.

Company B distributes and retails T mobile phones, issues a warranty card to each mobile phone sold but it does not provide warranty services, instead of that it agrees to pay $5 to Company A for each mobile phone repaired by Company A in the warranty period.

Upon comparative analysis of the related transaction (between A and M) and the independent transaction (between B and M), Company A must conduct the comparative analysis of functions of company A and of company B and exclude differences:

- The operational functions of the two companies are different in terms of the provision of warranty services for which Company A performs more functions, uses more labour resources and has higher profitability than Company B.

- Company A must adjust the warranty service function by way of excluding actual costs and turnover related to the warranty services provided by Company A.

- Where the warranty service function was only performed on several occasions with inconsiderable (insignificant) costs and turnover, it is not necessary to adjust this difference.

2.1.3 Contractual conditions when conducting transactions: including provisions or agreements on responsibilities and rights of parties when they are involved in the business transaction. Contractual conditions when conducting a transaction (hereinafter referred to as "contractual conditions") shall mainly include:

(a) Quantity, delivery or distribution terms for products;

(b) Period, conditions for and method of payment;

(c) Conditions for warranty, replacement, upgrading, repair or correction of products;

(d) Terms for exclusive trading or distribution of products;

(e) Other conditions having an economic effect (for example: supportive services, consultancy on quality inspection, instructions for use, support for advertising and promotion and so on).

In all cases, (whether or not the contract is made in writing), the basis for determination of contractual conditions shall be actual facts or financial or economic data showing the nature of the transaction.

2.1.4 Economic conditions when a transaction is conducted: including elements concerning economic conditions, on the market at the time when the transaction is conducted, affecting the price of products. Economic conditions at the time when the transaction is conducted (hereinafter referred to as "economic conditions") shall mainly include:

(a) Size and geographical position of the production or sale market;

(b) Time and nature of activities of the transaction on the market (for example: transaction of wholesale, normal retail, exclusive distribution, market segment on the basis of product consumers);

(c) Competition between products on the market;

(d) Economic elements which affect costs of production or business arising at the place of transaction (for example: taxes, charges, financial incentives);

(e) State policy regulating the market.

2.2 Upon comparative analysis of the four influential criteria referred to in paragraphs 2.1.1 to 2.1.4 of sub-clause 2.1 of clause 2 of article 4 of Part B of this Circular, the priority order shall be specified with respect to each method of calculation of a price stipulated in article 5 of Part B of this Circular. During the course of analysis, the priority criteria shall be analysed in detail; subordinate criteria may not be required to be analysed in detail, but [*such analysis*] must ensure it shows all basic characteristics of such criteria.

Example 9:

Suppose that Company M Vietnam (being a subsidiary of International Company M) specializes in trading of product X whose quality meets standards grade I which have been registered in Vietnam. In year 200x, the Company selected an independent transaction A (between Company M Vietnam and an independent party) to use as the basis for comparison with related transaction B (between Company M Vietnam and International Company M). The unit selling price in both transactions is USD3. In this case, analysis of the four influential criteria of transactions A and B shall be conducted as follow:

(i) Properties of products: they are identical (because they are products produced by Company M Vietnam);

(ii) Operational functions: they are identical (because they are the operational functions of Company M Vietnam)

(iii) Contractual conditions: suppose that this criterion of two transactions is identical except that the delivery terms are at the warehouse of Company M Vietnam in transaction A and at port X of country Y in transaction B and Company M Vietnam is responsible to pay the freight from Vietnam to country Y being USD0.5 for a product.

(iv) Economic conditions: suppose that this criterion does not effect the price of products (for example: country Y does not apply the policy on price control to the trading of product X; sale terms are wholesale; import duty is paid by and procedures for import of product X are performed by the purchaser).

Thus, the comparison of prices shows that the price in transaction B is not similar to the price in transaction A (there is a difference of USD0.5 per product)

Then Company M Vietnam will select the most appropriate method of calculation of a price to ensure the declaration and payment of tax in respect of turnover from sales of products X in transaction B being equivalent to USD3.5/product (in place of the previous unit price of USD3).

2.3 After comparative analysis, the enterprise shall identify significant differences in transaction conditions between the related transaction and the independent transaction. Where there is no significant difference, the provisions of sub-clause 2.4 of clause 2 of article 4 of Part B of this Circular shall not apply.

2.4 Where there are significant differences, the enterprise shall express such significant differences in a monetary value for adjustment. Subject to each specific case, there may be an increase in or a decrease of the value in order to exclude such significant differences.

Where there are significant differences in operational functions between enterprises, the adjustment shall be made on the following principles:

(a) Where the costs and/or turnover related to the significant difference in functions are separately accounted for, the adjustment shall be made on the basis of each item of the turnover and/or costs related to such significant difference.

(b) Where the costs and/or turnover related to significant differences in functions are accounted for together, the adjustment shall be made on the basis of allocation in order to calculate the relevant share of costs and/or turnover corresponding to such significant difference.

Example 10:

Suppose that there are two transactions of Company A and Company B, which both provide services of processing of garment products, in which Company A processes and delivers the products at its warehouse and Company B processes and carries out procedures for export of the products.

Thus, upon comparison between the processing function of A and of B, we see that Company B performs the additional function of "performing procedures for export". This difference will be separated by way of separately accounting or allocating on the basis of the ratio of costs or turnover arisen from the performance of the procedures for export [to the total costs or turnover] in order to ensure that the comparison between business efficiency in respect of processing functions of Company A and of Company B will be equivalent.

Where company B only performs the function of performing the procedures for export on several occasions at the request of customers with inconsiderable (insignificant) costs or turnover, the adjustment of this difference is not required.

Article 5 *Methods of calculation of market prices*

Methods of calculation of market prices of products in related transactions specified in clause 2 of article 5 of Part B of this Circular shall comprise:

- Method of comparison of prices in independent transactions;

- Method of reselling prices;

- Method of prime cost plus profits;

- Method of profit comparison;

- Method of profit division.

Subject to each specific method mentioned above, the market price of products may be directly calculated on the basis of the unit price of products or indirectly via gross profit ratio or profitability ratio of products. However, in respect of methods of indirect calculation of prices, when calculating business results for the purpose of declaration and payment of corporate income tax, it is not necessary to calculate a specific unit price.

1. Principles of application of methods of calculation of market prices

1.1 The most appropriate method of calculation of a price shall be the method which is selected from amongst the five above methods and conforms with transaction conditions and has the most reliable and complete information and data sources for comparative analysis.

1.2 The enterprise shall itself select the most appropriate value among values of the standard market price margin to use as the basis for adjustment of the relevant value of the related transaction. Where the price of products in the related transaction is different to such most appropriate value, but [such difference] does not result in any decrease in taxable income of the enterprise, the enterprise shall not be required to make any adjustment.

1.2.1 The most appropriate value is the value showing the highest similarity in transaction conditions of the independent transaction selected for comparison with the related transaction.

1.2.2 Standard market price margin is:

(a) Values falling among values calculated from independent transactions selected for comparison referred to in paragraphs 1.6.1 and 1.6.2 of sub-clause 1.6 of clause 1 of article 4 of Part B of this Circular;

(b) Values falling between the first quartile and the third quartile of the statistical operation of probability of quartile or values falling between the twenty fifth percentile and the seventy fifth percentile of the statistical operation of probability of percentile calculated from the market price margin of independent transactions selected for comparison referred to in paragraph 1.6.3 of sub-clause 1.6 of clause 1 of article 4 of Part B of this Circular. (*see Section C of Part C of Appendix 2-GCN-CC on methods of quartile or percentile calculation*)

Example 11:

The following is the relevant information regarding Enterprise V in Vietnam:

- It is a subsidiary company specialized in production and processing of products for its parent company and has to pay annual royalties to another subsidiary company of the group at the rate of N% of the net turnover by four instalments per year.

- Enterprise V has selected 13 independent transactions for comparison with the data on the percentage (%) of royalty to the net turnover of such transactions as follows: 1; 1.25; 1.25; 1.5; 1.5; 1.75; 2; 2; 2; 2; 2.25; 2.5; 2.75; 3.

- The comparative analysis shows that significant differences have been reasonably adjusted to enable them to be excluded. With respect to the period of payment, there is a difference which may affect the value of royalties but information is insufficient to convert such difference into a monetary value for adjustment.

- The enterprise shall apply the quartile statistical function to select the first quartile and the third quartile to calculate the standard margin being 1.5 – 2.25; the average value belonging to the second quartile of the standard margin has the value of 2.

Adjustment of the declared data:

- Where the proportion of royalty to the net turnover of Enterprise V is 2.1%, Enterprise V shall not be required to re-adjust the declared data on royalties which is deductible upon calculation of corporation income tax.

- Where the proportion of royalty to the net turnover of Enterprise V is 4% and at the same time, Enterprise V considers that the transaction with the proportion of royalty being 2% has transaction conditions which are closest to its transaction, Enterprise V will re-adjust the declared data on royalties which is deductible upon calculation of corporation income tax at the rate of 2% of the net turnover.

1.3 Where the enterprise has applied methods of calculation of market prices in accordance with the provisions of this Circular but there has been an occurrence of an event of force majeure in the year such as a natural calamity, fire or explosion affecting its production or business; or the purchase or selling price has been affected by State policies or regulations, the enterprise may adjust the price of affected products to accord with the actual situation.

2. Methods of calculation of market prices

2.1 Method of comparison of prices in independent transactions

2.1.1 The method of comparison of prices in independent transactions shall use the unit price of products in an independent transaction as the basis for calculation of a unit price of products in related transactions when such transactions have equivalent transaction conditions.

2.1.2 The unit price of products in a related transaction shall be compared with the most appropriate value which falls within the standard market price margin for the unit price of products in order to make an appropriate adjustment on the principles provided in sub-clause 1.2 of clause 1 of article 5 of Part B of this Circular.

2.1.3 With respect to this method, upon comparative analysis of four influential criteria in accordance with the guidelines provided in article 4 of Part B of this Circular, the priority criteria shall be properties of products and contractual conditions and the subordinate criteria shall be economic conditions and functions of the enterprise.

2.1.4 The method of comparison of prices in independent transactions shall be applicable on one of the following conditions:

(a) There is no difference which causes a significant effect on prices of products in transaction conditions upon comparison between an independent transaction and a related transaction;

(b) There are differences causing a significant effect on the prices of products, but these differences are excluded in accordance with the guidelines provided in article 4 of Part B of this Circular.

2.1.5 Elements significantly affecting prices of products such as:

(a) Physical properties, quality and trade names of products;

(b) Contractual conditions on supply and delivery of products (such as: volume (if it affects the price), period of delivery of products, period of payment) etc.;

(c) Right to distribute and sell products resulting in an effect on the economic value;

(d) Market in which the transaction is conducted.

2.1.6 The method of comparison of prices in independent transactions is usually applied in the following cases:

(a) Individual transactions concerning each type of product distributed on the market;

(b) Individual transactions concerning each form of service, copyright, loan agreements;

(c) An enterprise conducting both independent transactions and related transactions concerning the same type of product.

Example 12:

Company V in Vietnam is an enterprise with 100% capital funded by Foreign Company S engaged in processing of garment and textile products. In year 200x, Company V conducted two transactions of processing of trousers, category code 347 as follows:

- Transaction 1: Processing 1,000 dozen trousers for Company S at the price of USD60 per dozen on delivery terms X port of Vietnam (Company S was responsible for export).

- Transaction 2: Processing 1,000 dozen trousers for Company M in Country N at the price of USD100 per dozen on delivery terms port Y of Country N.

Suppose that:

- Company M does not have any relationship with Company V and Company S.

- The aforesaid two transactions are equivalent in terms of transaction conditions except that the significant difference is costs of transport and insurance for shipment of goods from port X to city Y in Country N being USD3 per dozen.

Comparative analysis:

- The comparison between transaction 1 (related transaction) and transaction 2 (independent transaction) indicates that transaction 1 did not correctly show the market price. In this case, the turnover from the transaction with Company S shall be recalculated as follows:

  (USD100 minus (–) USD3) multiplied (x) by 1,000 = USD97,000.

  Company V must declare the turnover from processing received from Company S being USD97,000 in place of USD60,000.

2.2 Method of reselling prices

2.2.1 The method of calculation of a reselling price shall use reselling prices (or selling prices) of products sold by the enterprise to independent parties as the basis for calculation of the purchase price of products paid by the affiliated party.

2.2.2 Purchase prices of products paid by the affiliated party shall be calculated on the basis of the selling price of products in independent transactions minus (-) gross profit minus (-) other expenses (if any) included in the price of purchased products (for example: import duty, customs charges, insurance and costs of international transport).

2.2.2.1 The gross profit shall be calculated on the basis of the ratio of gross profit to the selling price (net turnover) and selling price (net turnover), and shall show a value earned by the enterprise to cover costs of business activities and to earn a reasonable amount of profit.

The ratio of gross profit to the selling price (net turnover) shall be calculated on the basis of the different value between the selling price (net turnover) and the prime cost of the purchased products divided by the selling price (net turnover).

2.2.2.2 Where the enterprise has a function of acting as a distribution agent without ownership of products and is entitled to agency commission at a percentage (%) of the selling price of products, such percentage shall be deemed to be the ratio of gross profit to the selling price (net turnover).

(*See Section B.1 of Appendix 2-GCN-CC on the formula of calculation of market prices in accordance with the method of reselling prices*).

2.2.3 The ratio of gross profit to the selling price (net turnover) in the related transaction shall be compared with the most appropriate value which falls within the standard market price margin for the gross profit ratio in order to make an adjustment in compliance with the principles stipulated in sub-clause 1.2 of clause 1 of article 5 of Part B of this Circular.

2.2.4 With respect to this method, upon comparative analysis of four influential criteria in accordance with the guidelines provided in article 4 of Part B of this Circular, the priority criterion shall be the operational functions of the enterprise and the subordinate criteria shall be contractual conditions, properties of products and economic conditions.

2.2.5 Method of reselling price shall be applicable on one of the following conditions:

(a) There is no difference in transaction conditions which causes a significant effect on the ratio of gross profit to the selling price (net turnover), upon comparison between an independent transaction and a related transaction;

(b) There are differences causing a significant effect on the ratio of gross profit to the selling price (net turnover) but such differences are excluded in accordance with the guidelines provided in article 4 of Part B of this Circular.

2.2.6 Elements significantly affecting the ratio of gross profit to the selling price (net turnover) such as:

(a) Costs expressing the functions of the enterprise (for example: exclusive distribution agent, performance of advertising or promotion programs, warranty and so on);

(b) Type, size, volume, cycle of products purchased for resale and nature of activities of the transaction on the market (for example: wholesale, retail and so on);

(c) Method of cost accounting (i.e. it must ensure that items constituting the gross profit and turnover from the related transaction and from the independent transaction are equivalent and subject to the same accounting standards).

2.2.7 Method of reselling price is usually applied to transactions in respect of products in the phase of provision of simple services and commercial distribution which have a short cycle from purchase to sale and rarely suffer seasonal changes. At the same time, before the products are sold, they are not processed, assembled, changed in their nature or do not bear a trade name in order to considerably increase their value.

Example 13:

The following is the relevant information regarding Enterprise V in Vietnam being an affiliated party of Company H overseas, conducting trading and distribution of watches supplied by Company H:

- In year 200x, Company H delivered 1,000 watches to Enterprise V and requested the latter to pay USD330,000 (including CIF plus (+) import duty and charges incurred by Company H).

- At the end of 200x, the net turnover earned by Enterprise V from sales of the whole amount of such watches to consumers in Vietnam is converted into USD400,000.

- Enterprise T is an independent enterprise in Vietnam engaged in trading and distribution of watches. In 200x, the gross profit ratio of Enterprise T reaches 20%.

  Suppose that Enterprise T satisfies all conditions for it being selected for comparison with the gross profit ratio of Enterprise V, Enterprise V will declare and calculate reasonable expenses which are deductible for the purchase of watches from Company H as follows:

  [USD400,000 minus (–) (USD400,000 multiplied (x) by 20%)] = USD320,000

  Enterprise V is only entitled to deduct reasonable expenses from the prime cost of goods sold being USD320,000 instead of USD330,000.

  Where Company H provides sale consultancy services and requests Enterprise V to make a payment for such expenses (which are included in selling expenses), this transaction will be separated and will be subject to one of the methods of calculation of transaction prices stipulated in this Circular in order to calculate the reasonable costs deductible for sale consultancy services.

2.3 Method of prime cost plus profit

2.3.1 The method of prime cost plus profit shall use the prime cost (or cost) of products that the enterprise purchases from an independent party as the basis for calculation of the selling price of such products sold to an affiliated party.

2.3.2 The selling price of products sold to the affiliated party shall be calculated as the prime cost (or cost) of products plus (+) gross profit.

2.3.2.1 The gross profit shall be calculated on the basis of the ratio of gross profit to the prime cost (or to the cost) of sold products and the prime cost (or cost) of sold products, showing a reasonable profit corresponding to the operational functions of the enterprise and market conditions.

The ratio of gross profit to the prime cost (or to the cost) shall be calculated as the difference between net turnover and prime cost (or cost) of products divided (:) by the prime cost (or the cost). The prime cost (or cost) of sold products shall comprise direct or indirect costs of production and shall not include costs for finance activities (such as royalties, loan interest, and so on).

Where the enterprise is unable to account separately for the prime cost (or the cost) of sold products, selling expenses and overhead costs, the prime cost (or the cost) of sold products used as the basis for calculation of gross profit shall comprise all of these costs.

2.3.2.2 Where the enterprise has the function of acting as a purchase agent without ownership of products and is entitled to agency commission at a percentage (%) of expenses for purchase of products, such percentage shall be considered as the ratio of gross profit to the prime cost.

(*See Section B.2 of Appendix 2-GCN-CC on formula of calculation of market prices in accordance with the method of prime cost plus profit*).

2.3.3 The ratio of gross profit to the prime cost (or to the cost) of the related transaction shall be compared with the most appropriate value which falls within the standard market price margin for the ratio of gross profit to the prime cost (or to the cost) in order to make an adjustment in compliance with the principles stipulated in sub-clause 1.2 of clause 1 of article 5 of Part B of this Circular.

2.3.4 With respect to this method, upon comparative analysis of four influential criteria in accordance with the guidelines provided in article 4 of Part B of this Circular, the priority criterion shall be operational functions of the enterprise and the subordinate criteria shall be contractual conditions, properties of products and economic conditions.

2.3.5 The method of prime cost plus profit shall be applicable on one of the following conditions:

(a) There is no difference which causes a significant effect on the ratio of gross profit to the prime cost (or to the cost) in transaction conditions upon comparison between an independent transaction and a related transaction; or

(b) There are differences causing a significant effect on the ratio of gross profit to the prime cost (or to the cost) but such differences are excluded in accordance with the guidelines provided in article 4 of Part B of this Circular.

2.3.6 Elements significantly affecting the ratio of gross profit to the prime cost (or to the cost) usually include:

(a) Costs showing the operational functions of the enterprise (for example: production under a contract, research and development of new products, proportion of added value of the product to the scale of the investment in business);

(b) Obligations to perform contracts (for example: period for delivery of products, costs for quality control, storage or payment terms);

(c) Method of cost accounting (i.e. it must ensure that items constituting the prime cost (or the cost) of the related transaction and of the independent transaction are equivalent to each other or are subject to the same accounting standards).

2.3.7 The method of prime cost plus profit is usually applicable in the following cases:

(a) Transactions in the phase of production, assembly, manufacturing or processing of products for sale to affiliated parties;

(b) Transactions between affiliated parties in order to perform a joint venture contract or business co-operation contract for production, assembly, manufacturing or processing of products or to implement agreements for supply of inputs of production and for off-take of output products;

(c) Transactions of provision of services to affiliated parties.

Example 14:

Enterprise A in Vietnam being a subsidiary company of Parent Company T (in Country Y) conducts processing of shoes for export in accordance with the design or model provided by Company T. The parent company is responsible for supply of input raw materials, technicians in charge of quality control, costs of transportation and international insurance. Enterprise A will be paid processing charges on the basis of a product and will bear costs arising during processing of products. In 20xx, information on processing of Enterprise A is as follows:

- Net turnover (processing charges): 15 billions dong

- Prime cost of goods sold: 13 billions dong

- Selling expenses and overhead costs: 1.8 billions dong

Suppose that:

- A number of other independent enterprises also conduct processing of shoes for foreign organizations or individuals and processing charges are calculated on the following basis: processing charges equal (=) to the total cost (equal (=) to the prime cost of goods sold plus (+) overhead costs plus (+) selling expenses) plus (+) 7% of the total costs.

- The independent transactions of such enterprises satisfy all conditions for being selected for comparison with the transaction of Enterprise A.

  In this case the turnover from the processing of shoes will be re-calculated as follow:

(13 billion plus (+) 1.8 billion) plus (+) [7% multiply (x) by (13 billion plus (+) 1.8 billion)] = 15.836 billion dong.

Enterprise A must declare its turnover of 15.836 billion dong in place of the previous figure being 15 billion dong.

2.3.8 The method of prime cost plus profit may be used to recalculate the prime cost (or the cost) involved in related transactions of an enterprise on the basis of the price of products sold which have been calculated on the basis of the market price and the ratio of gross profit to the prime cost (or to the cost).

Example 15:

Enterprise V in Vietnam being a subsidiary company with 100% capital funded by Multinational Company P is specialized in production of household detergent. Input raw materials (namely blank soap and other detergents) are supplied by Subsidiary Company Y. Output of sales of Enterprise V in 200x was 100 tons of which:

- Transaction 1: 60 tons were sold to another subsidiary company of Group P at FOB of USD650 per ton,
- Transaction 2: 40 tons were sold to domestic supermarkets at the price (VAT exclusive) of USD700 per ton.

Books of account of the enterprise in the period show the following data:

- Net turnover: USD67,000
- Total cost: USD65,000

Suppose that:

- Transactions 1 and 2 satisfy all conditions for Enterprise V to apply the method of comparison of independent market prices.
- The data on ratio of gross profit to the total cost of independent enterprises operating in the household detergent production industry is 15%.

Enterprise V will declare its turnover and expenses for calculation of corporate income tax as follows:

- Re-adjusting the selling price in the related transaction in accordance with the selling price in the independent transaction:

  USD700 multiplied (x) by 60 tons = USD42,000

- Re-calculating the net turnover:

  USD42,000 plus (+) USD700 multiplied (x) by 40 tons = USD70,000

- Re-adjusting total cost:

  USD70,000 plus divided (:) by (1 plus (+) 0.15) = USD60,870.

So Enterprise V must declare and pay tax on the basis of the data on net turnover being USD70,000 in place of the previous data being USD67,000 and total cost being USD60,870 in place of the previous data being USD65,000.

2.4 Method of profit comparison

2.4.1 The method of profit comparison shall use the profitability ratio of products in independent transactions selected for comparison as the basis for calculation of a profitability ratio of products in related transactions when the transaction conditions of such transactions are equivalent.

2.4.2 Profitability ratios shall be calculated as a ratio of before-tax profit (income)[3] to net turnover, costs or assets for production or business activities in accordance with the regulations on accounting and financial reporting. Any loan interest or depreciation for fixed assets may be included in the before-tax profit (income) of an enterprise in order to calculate results of production or business before payment of such costs. Profitability ratios which are usually used shall include:

2.4.2.1 The ratio of before-tax income[4] to net turnover from production or business activities.

Example 16:

Enterprise L engaged in manufacture and assembly of four-seater cars with brands N and S:

- All Brand N cars are delivered and sold to independent parties.

- All Brand S cars are delivered and sold to Enterprise L1 which is a company with one hundred (100) per cent capital funded by Enterprise L.

- All transactions for procurement for manufacture and assembly of the above two types of cars are independent transactions.

In year 200x, the accounting data of Enterprise L is as follows:

- Net turnover from sales of Brand N cars: USD18,000 (as independent transactions)
- Before-tax profit earned from sales of Brand N cars: USD2,000
- Net turnover from sales of Brand S cars: USD25,000 (as related transactions)
- Before-tax profit earned from sales of Brand S cars: USD1,800
- Enterprise L1 provides a loan to Enterprise L and loan interest at the market rate of interest is USD100.

The ratio of before-tax profit to the net turnover from sales of Brand N cars:

3 Allens Arthur Robinson footnote: The literal translation throughout this document is "net profit before payment of corporate income tax".

4 Allens Arthur Robinson footnote: The literal translation throughout this document is "net income before payment of corporate income tax".

2,000 divided (:) by 18,000 multiplied (x) by 100% = 11.1%

The ratio of before-tax profit to the net turnover from sales of Brand S cars:

1,800 divided (:) by 25,000 multiplied (x) by 100% = 7.2%

Suppose that differences with significant effects between two transactions of sales of Brand N and Brand S cars have been adjusted to enable the results of transactions with Enterprise L1 to reach a ratio of net profit before payment of taxes and loan interest to the turnover being 11.1%. In this case, the data on sales of Brand S cars shall be re-calculated as follows:

Total cost: 25,000 minus (-) 1.800 minus (-) 100 = USD23,100

Net turnover: 23,100 divided by (1 minus 0.111) = USD25,984

Net profit before payment of taxes and loan interest:

25,984 minus (-) 23,100 = USD2,884

Before-tax net profit: 2,884 minus (-) 100 = USD2,784

Company L must declare its before-tax net profit earned from sales of Brand S cars being USD2,784 in place of the previous data in the books of account being USD1,800.

2.4.2.2 Ratio of before-tax income to the total costs for production or business activities.

It shall not use the ratio of before-tax income to the total costs for the case where there are costs incurred from a related transaction because the data on costs from the related transaction is subject to the governing scope of the calculation of market prices.

Example 17:

Enterprise A is a subsidiary company of Company B and acts as a forwarding service agent for B. Enterprise C is an independent enterprise specializing in provision of forwarding services (to numerous independent clients). The data on turnover and costs of A and C are as follows:

Unit: USD1,000

	AVN	B
Total costs	1,500	2,000
Total turnover	1,650	2,500

Suppose that Enterprise C satisfies all of the conditions for it being selected for comparison with A in terms of the ratio of before-tax income to the total costs.

- The ratio of before-tax income to the total costs of A:

  (1,650 minus (-) 1,500) divided by 1,500 = 10%

- The ratio of before-tax income to the total costs of C:

  (2,500 minus (-) 2,000) divided by 2,000 = 25%

Enterprise A must declare before-tax income earned from related transactions in accordance with the ratio of before-tax income to the total costs corresponding to the rate of Enterprise C being 25%.

2.4.2.3 Ratio of before-tax income to assets for production or business activities.

This ratio shall be used only in the case where fixed assets of an enterprise account for a significant percentage of its total investment capital (for example, enterprises in manufacturing industries or the mining industry).

The value of assets shall be the arithmetical mean of the beginning balance of assets and ending balance of assets, including fixed assets and current assets, but excluding assets used for investment in or capital contribution to joint ventures or business co-operation (for example, purchase of State bonds or shares).

Example 18:

- N is a subsidiary in Vietnam of Group P which is specialized in production of alcohol from rice. Its parent company provides most input for production and assumes the off-take of all of its output products. In year 200x, the ratio of net before-tax income to assets of Enterprise N was 3%.

- V is an independent company specialized in production of drinks of all types and has plants for production of alcohol from rice, beer and other carbonated soft drinks. In year 200x, the ratio of before-tax income to the total assets of the company was 7%, including the ratio of before-tax income to the assets of the plant for production of alcohol from rice being 7.5%.

Suppose that V satisfies all the conditions for it being selected for comparison with N in terms of the ratio of before-tax income to assets, therefore N must adjust its taxable income in accordance with the ratio of before-tax income to assets being 7.5%.

2.4.3 Enterprises shall select one of the above profitability ratios for comparison of profitability ratios of related transactions and of independent transactions and may use one or more of other profitability ratios set out in the regulations on financial reporting in order to support examination of the accuracy of the selected profitability ratio. The selection of a profitability ratio on net turnover, costs or assets shall be subject to the economic nature of the transaction (*see Part B.3 of Appendix 2-GCN/CC on formulas of calculation of a profitability ratio in order to apply the method of comparison of profits*).

Example 19:

- Suppose that an enterprise conducts related transactions in the phase of sales of products, it shall not use the ratio of before-tax income to turnover because the data on turnover from the related transactions is subject to the governing scope of the calculation of market prices.

- Suppose that an enterprise provides services, it shall not use the ratio of before-tax income to assets.

2.4.4 The profitability ratio of related transactions shall be compared with the most appropriate profitability ratio which falls within the standard market price margin in order to make an appropriate adjustment in compliance with the principles set out in sub-clause 1.2 of clause 1 of article 5 of Part B of this Circular.

2.4.5 With respect to this method, upon comparative analysis of four influential criteria in accordance with the guidelines provided in article 4 of Part B of this Circular, the priority criterion shall be the operational functions of the enterprise and the subordinate criteria shall be contractual conditions, properties of products and economic conditions.

2.4.6 The method of profit comparison shall be applicable on one of the following conditions:

(a) There is no difference which causes a significant effect on the profitability ratio in transaction conditions upon comparison between independent transactions and related transactions;

(b) There are differences causing a significant effect on the profitability ratio but such differences are excluded in accordance with the guidelines provided in article 4 of Part B of this Circular.

2.4.7 Elements significantly affecting profitability ratios such as:

(a) Elements in relation to assets, capital and costs for performance of main functions of an enterprise (for example, production or processing using machinery invested by the enterprise will earn higher profit than production or processing using machinery leased from another establishment for processing);

(b) The nature of business lines, category of products and phases of production or sale (for example, finished products are made from raw materials or semi-finished products);

(c) The method of cost accounting and structure of costs for products (for example, products are in the period of depreciation in accordance with the fast depreciation method but not in accordance with usual depreciation methods).

2.4.8 The method of profit comparison shall be considered as a method developed from the method of reselling prices and the method of prime cost plus profit. Therefore, the method of profit comparison is applied widely in the cases referred to in paragraph 2.2.7 of sub-clause 2.2 and paragraph 2.3.7 of sub-clause 2.3 of clause 2 of article 5 of Part B of this Circular.

2.5 Method of profit division

2.5.1 The method of profit division shall use profit earned from one related general transaction conducted by several affiliated enterprises as the basis for calculation of an appropriate [*share*] of profit for each of such affiliated enterprises in the [same] manner as independent parties would distribute profit in equivalent independent transactions.

A related general transaction in which several affiliated enterprises take part means the transaction of the sole and special nature comprising several related transactions which have a close relationship with each other in terms of exclusive products, or closed related transactions between relevant affiliated parties.

2.5.2 The method of profit division shall comprise two methods of calculation:

2.5.2.1 First method of calculation: the profit shall be allocated to each affiliated party on the basis of its ratio of costs incurred; whereby the share of profit of each affiliated enterprise to the transaction shall be calculated on the basis of allocation of the total profit earned from the related general transaction in accordance with the ratio of actual costs incurred by such enterprise in the related transaction to the total actual costs for production of final products (*see Part B.4 of Appendix 2-GCN/CC on the formula of allocation of profit in accordance with ratios of capital contribution*).

Example 20:

The following is the relevant information regarding Enterprise A in Vietnam and Enterprise B overseas:

- Both companies are member companies of Group T engaged in production of electronic products.

- Both companies take part in production of new products being TV sets with a liquid crystal picture tube.

- A is responsible for designing and manufacturing television cabinets and picture tubes and delivers them to B for assembly together with other parts (such as loops, chips and so forth) invented and manufactured by B, and after that finished TV sets with a liquid crystal picture tube are sold to C as an independent distributor at the price of USD550.

- The total cost of a product delivered by A to B is USD300. B expends USD150 for further production.

Profit allocated to A will be calculated as follows:

[(550 - (300 + 150)) divided (:) by 450] multiplied (x) by 300 = USD66.66

2.5.2.2 Second method of calculation: Profit will be distributed in two steps as follows:

2.5.2.2.1 First step:

Distribution of basic profit: each enterprise to a related transaction may receive a share of basic profit corresponding to its operational functions. Such share of basic profit shall show the value of profit earned by the enterprise from the related general transaction because of the performance of its operational functions and shall not take account of the sole and special elements (such as exclusive ownership rights or right to use intangible property or intellectual property).

The share of basic profit shall be calculated in accordance with the gross profit ratio or profitability ratio corresponding to the most appropriate value which falls within the standard market price margin for the gross profit ratio or profitability ratio in accordance with the guidelines provided in sub-clauses 2.2, 2.3 and 2.4 of clause 2 of article 5 of Part B of this Circular.

2.5.2.2.2 Second step:

Distribution of extra profit: each enterprise to the related transaction may further receive a share of extra profit corresponding to its ratio of contribution to create the total extra profit (i.e. total profit earned minus (-) the total basic profit which has been distributed in the first step) of the related general transaction. Such share of extra profit shall show profit, in addition to its share of basic profit, earned by the enterprise from the related general transaction due to the sole and special elements.

The share of extra profit received by each enterprise shall be calculated by way of multiplying the total extra profit earned from the related general transaction and the ratio of contribution of each enterprise to the following costs or assets:

(a) costs for research and development of products; or

(b) value (after deducting depreciation) of intangible property or of intellectual property used for production or business of products.

Costs for research and development, value of intangible property or of intellectual property must be calculated on the basis of market prices (in accordance with the methods set out in this Circular) or costs actually incurred by each party in compliance with the principles of cost accounting in respect of costs or property.

Example 21:

Company H and Company M are two companies of the same group engaged in manufacture of mobile phones. Company H manufactures modules and Company M assembles and installs software in complete products for sale to independent distributors. Accounting data of Company H and M related to the related transaction of manufacture of mobile phones is as follows:

Unit: USD1,000

Item	H	M
Net turnover	200	500
Prime cost of goods sold including:		
Costs for purchase of input raw materials	100	200
Production costs	50	150
Research and development costs (R&D)	30	50
Selling expenses and overhead costs	10	50
Profit	10	50

Calculation of profit earned by H and M in accordance with the method of profit division:

Step 1: Distribution of basic profit

- Re-calculation of data in general statements on business results:

Unit: USD1,000

Item	Amount
Net turnover	500
Prime cost of goods sold	300
Research and development costs (R&D)	80
Selling expenses and overhead costs	60
Profit	60

- Suppose that the ratios of gross profit to prime cost at the market value of H and M, which are calculated in accordance with the guidelines provided in clause 2.3 of article 5 of Part B of this Circular, are 10% and 8%, respectively.

- Calculation of profit of H and M in accordance with the following formula:

  Profits = gross profit ratio multiplied (x) by cost

  Total cost = prime cost of goods sold plus (+) R&D costs plus (+) selling expenses and overhead costs

  + Profit of H: 10% multiplied (x) by (100 plus (+) 50 plus (+) 30 plus (+) 10) = USD19,000
  + Profit of M: 8% multiplied (x) by (300 plus (+) 80 plus (+) 60 minus (-) 190) = USD20,000

  Extra profit after distribution of basic profit:

  60 minus (-) 19 minus (-) 20 = USD21,000

Step 2: Distribution of extra profit in accordance with their respective ratios of contribution to R&D costs

- Calculation of a ratio of contribution of each party to R&D costs:

  + H: 30/80 multiplied (x) by 100% = 37.5%;
  + M = 100% - 37.5% = 62.5%

- Calculation of the share of extra profit of H and M:

  + H: 21 multiplied (x) by 37.5% = USD8.87 thousand
  + M: 21minus (-) 8.87 = USD12.13 thousand

Conclusion:

- H will declare its profit earned from the related transaction being: 19 plus (+) 8.87 = USD27.87 thousand in place of the previous data being USD10 thousand; and

- M will declare its profit earned from the related transaction being: 20 plus (+) 12.13 = USD32.13 thousand in place of the previous data being USD50 thousand.

2.5.3 With respect to this method, the comparative analysis of four influential criteria shall be carried out in accordance with the guidelines provided in article 4 of Part B of this Circular and conditions for application [*of this method*] shall be subject to the provisions in respect of the method of reselling prices, method of prime cost plus profits or method of profit comparison, as the case may be, in compliance with the guidelines provided in paragraph 2.5.2.2.1 of sub-clause 2.5 of clause 2 of article 5 of Part B.

2.5.4 The method of profit division is usually applied in the case where affiliated parties jointly take part in research and development of new products or development of products being exclusive intangible assets or where transactions during the process of production or business are continued between such affiliated parties from raw materials to final finished products for distribution of products attached to the ownership or sole use of intellectual property rights.

Article 6 *Provisions on calculation of market prices in a number of special cases*

Where, due to the special or exclusive nature of a related transaction, an enterprise is unable to select any independent transaction for comparison in accordance with the guidelines provided in sub-clauses 1.1 to 1.6 of clause 1 of article 4 of Party B of this Circular and the methods of calculation of market prices referred to in article 5 of Part B of this Circular, it must specify reasons therefor (including information on its business operation) and take one of the following measures:

1. General measure:

1.1 Expanding the scope of selection of independent transactions (or enterprises) into sub-branches of the national economy (in accordance with the list of branches of the national economy published by the authorized State body) other than the sub-branch in which the enterprise currently operates for the purpose of comparison with conditions in which enterprises with the operational functions equivalent to the former conduct independent transactions; analysing four influential criteria and excluding significant differences on the basis of economic criteria used in sub-branches in order to show objectively, results of investment in business, economic growth or added value of products. The number of independent transactions or independent enterprises selected for comparison shall be at least 5 (five).

1.2 Calculating a market price margin in accordance with the most appropriate method of calculation of a price specified in article 5 of Part B of this Circular; using the quartile statistical function or percentile statistical functions to calculate a standard market price margin and appropriate average value resulting from the standard market price margin (*See Section C.2 of Appendix 2-GCN/CC on methods of calculating quartiles and percentiles to calculate standard market price margin*).

1.3 Where the price of products, ratio of gross profit or profitability ratio of products in a related transaction is equal to or higher than such average value within standard market price margin or the purchase price of products in a related transaction is not higher than such average value, the enterprise shall not be required to make any adjustment to its related transaction. Where the selling price of products, ratio of gross profit or profitability ratio of products in the related transaction is lower than such average value or the purchase price of products in the related transaction is higher than such average value, the enterprise shall be required to make an adjustment in accordance with the most appropriate value which falls within the standard market price margin but is not lower than the average value showing the relevant selling price, ratio of gross profit or profitability ratio or is not higher than the average value showing the relevant purchase price.

1.4 Subject to each specific case, an enterprise may use a combination of the methods of calculation of a price specified in article 5 of Part B of this Circular (*see Example 15*) or concurrently use two methods of calculation of a price to support the examination of the accuracy and objectiveness of the price, ratio of gross profit or profitability ratio of products in a related transaction.

1.5 With respect to the method of profit division, the second method of calculation and the guidelines provided in sub-clauses 1.1 to 1.3 of clause 1 of article 6 of Part B shall be used as the basis for adjustment of basic profit; enterprises shall carry out the distribution of extra profit in accordance with the guidelines provided in paragraph 2.5.2.2.2 of sub-clause 2.5 of clause 2 of article 5 of Part B of this Circular.

Example 22:

Company X manufactures integrated circuits and exports all products to its parent company overseas at the selling price (turnover) equal to 1.1 times the total cost.

Suppose that:

- There is no independent transaction or enterprise in this integrated circuit production sector for comparison.

- Company X selects ten (10) enterprises in the electronic production sub-branch to calculate the standard market price margin and its relevant average value (in accordance with article 5 of Part B of this Circular). The result [of calculation] shows that the average of the standard market price margin of the ratio of before-tax income to net turnover of ten selected enterprises is 30%.

- Upon analyses of economic criteria reflecting the result of investment in the electronic production sub-branch, Company X calculates the ratio of before-tax income to turnover being 30% which is consistent with the actual operation of Company X (i.e. no significant difference is required to be adjusted).

Thus:

- Company X may examine its price calculation in order to ensure that its ratio of before-tax income to net turnover reaches 30% or may calculate a ratio of before-tax income to the total cost on the basis of the ratio of before-tax income to net turnover for the purpose of comparison and make an adjustment accordingly.

- The re-calculation may be conducted as follows:

    + Ratio of before-tax income to net turnover = (net turnover minus (-) costs) divided by net turnover = 0.3
    + Net turnover = 1.429 times costs.

2. Method of using figures between periods

An enterprise may use equivalent related transactions, for which a market price is calculated in accordance with the guidelines provided in this Circular, between periods (not exceeding five years from the time when the related transaction arises), prepare a file of competitive analysis of four influential criteria between transactions, adjust significant differences and use objective grounds to adjust economic values on a time basis (for example: average rate of increase in prices, rate of interest, rate of inflation and economic growth) in order to calculate an appropriate price for products, ratio of gross profit or profitability ratio of the related transaction conducted in the tax period of the enterprise.

Example 23:

The following is the relevant information regarding Enterprise A which is an enterprise with one hundred (100) per cent foreign owned capital and also is the sole enterprise exploring and processing Metal X ore in Vietnam for export:

- In year 2xx1, Enterprise A conducted both related transactions and independent transactions. With respect to related transactions, Enterprise A has used the method of comparison of prices in independent transactions and calculated the unit price of products as USD800 per ton of ore with Metal X content of 35%.

- In year 2xx2, Enterprise A exported one hundred (100) per cent products to its parent company (there is no independent transaction for comparison; the price of Metal X ore on the international market in year 2xx2 increased by 20% compared with 2xx1; other elements affecting the price of products (namely metal content, terms of delivery and payment and so forth) remain unchanged.

Thus, Enterprise A will make a declaration for tax calculation for year 2xx2 on the basis of the turnover from sales of Metal X ore at the unit price of USD960 or more per ton (= USD800 per ton multiplied (X) by 120%).

Article 7 *Keeping and providing data and source documents in relation to methods of calculation of a market price*

1. Selection of data and source documents

1.1 Data, source documents and documents which are used as the basis for comparative analysis must specify their origin to enable the tax office to carry out an examination and verification. Enterprises may use information and data from the following sources:

(a) Information and data which State bodies and branches, institutes, associations and specialized organizations which are recognized by the State are responsible for publishing or providing upon the request;

(b) Information and data certified or published by organizations and individuals licensed to operate in an independent professional service sector (for example, independent auditing body, registry, quality registration agency, credit rating agency);

(c) Annual or periodical financial statements and reports on investments of companies listed on the securities market, which are announced publicly in accordance with the regulations and charter for operation of the stock market;

(d) Data, source documents and documents on business transactions used for declaration and tax payment which enterprises provide and are responsible for.

Any data, source documents and documents originating from unofficial or unclear sources shall only be used as references.

1.2 Upon selection of transactions for analysis, comparison and calculation of ratios of gross profit or profitability ratios, enterprises must produce data in a form which is comparable in a period of at least three consecutive fiscal years. Where an enterprise only exists for a period of less than three consecutive fiscal years or carries out seasonal operations in part of the year, the period of time shall be determined on a monthly, quarterly or seasonal basis, accordingly.

1.3 Upon calculation of relative figures (for example, data regarding ratios expressed as a percentage) on the basis of the absolute figures, enterprises must round figures up to the third place after the decimal point. Where a relative figure results from published data without any absolute figure attached and the above principle of rounding is not used, the published data shall be used.

Example 24:

- Where the absolute figure used for calculation of a ratio of gross profit has the value of 5.2856, the relative figure will be rounded up to 5.286%.

- Where the published economic growth rate is 7.8%, such figure will not be rounded up.

- Where the published rate of interest is 4.9854%, such figure will be rounded up to 4.985%.

2. Requirements of keeping and providing information, documents and source documents

2.1 Enterprises conducting related transactions shall be obliged to and responsible to keep information, documents and source documents which are used as the basis for application of their method of calculation of a market price of products in related transactions and produce them upon the request of the tax office for examination and inspection. Information, documents and sources documents related to production and business activities and method of calculation of a market price in respect of related transactions must be prepared at the time of the related transaction and shall be updated during the performance of the transaction and kept in accordance with the regulations on keeping of sources documents and books of account set out in the laws on accounting, statistics and taxation.

2.2 Upon carrying out corporate income tax finalization, enterprises shall be responsible for preparing a declaration of related transactions in Form GCN-01/QLT set out in Appendix 1-GCN/CC issued with this Circular. The deadline for submission of Appendix 1-GCN/CC shall also be the deadline for submission of the declaration for corporate income tax finalization.

2.3 Enterprises shall be obliged to prepare and keep a file including the following information, documents and source documents relating to a related transaction:

2.3.1 General information on the enterprise and affiliated parties:

(a) Information on relationships between affiliated parties and the enterprise;

(b) Information and updated reports on strategy for development, administration and control between affiliated parties; pricing policy for transactions in relation to each group of products in accordance with the general guidance of affiliated parties and the enterprise;

(c) Documents and reports on the process of development, business strategy, projects, production, business or investment plans; regulations and procedures for financial statements and internal control reports of the enterprise;

(d) Documents describing the organizational structure and operational functions of the enterprise.

2.3.2 Information on transactions of the enterprise:

(a) A diagram of transactions and documents describing transactions including information on parties to transactions, order and procedures for payment, delivery of products and so forth;

(b) Documents specifying properties and technical specifications of products; breakdown of costs (or cost) of one product, selling price of products, total amount of products produced or traded and sold in the period (specifying such items on the basis of the related transaction and an independent transaction (if any)); the quantity of products;

(c) Information, documents and source documents concerning the process of negotiation, signing, performance and liquidation of economic contracts/agreements related to transactions;

(d) Information, documents and source documents related to economic conditions of the market at the time of related transactions affecting the method of calculation of a price for transactions.

2.3.3 Information on methods of calculation of a market price:

(a) Pricing policy for purchase or selling price or exchange of products of the enterprise, procedures for control and approval of prices, list of selling prices of products on sale markets;

(b) Information, documents and source documents which are used as the basis for substantiation for the selection and application of the method of calculation of a most appropriate price in related transactions of the enterprise including information, data and source documents used for comparative analysis and adjustment of significant differences, pricing note for transactions in accordance with the method of calculation of a price applied by the enterprise and for explanation of reasons for selection of such method;

(c) Other information, documents and source documents as references related to the selection and application of the method of calculation of a price in related transactions (if any).

2.4 When the tax office so requests, an enterprise shall be obliged to provide information, documents and source documents within thirty (30) working days from the date of receipt of the request in writing from the tax office. Where the enterprise has a legitimate reason, this period may be extended once for thirty (30) days or less from the expiry date.

2.5 Information, documents and source documents provided by enterprises to the tax office must be the original copies or photocopies as stipulated in the law. Where an enterprise uses electronic documents, the provision of such documents shall be subject to the *Law on Accounting* and applicable legal instruments providing guidelines on electronic documents.

Documents and source documents in a foreign language must be translated into Vietnamese as stipulated by the laws on accounting and accounting regime. The enterprises shall be responsible for the content of the translation.

PART C

Rights and Obligations of Enterprises; Responsibilities and Duties of Tax Offices

Article 8 *Rights and obligations of enterprises*

In addition to the performance of the rights and obligations in accordance with the laws on taxation as stipulated in legal instruments in relation to taxation and in this Circular, enterprises shall have the following rights and obligations:

1. To request the tax office to keep confidentiality of information provided for calculation of market prices in business transactions between affiliated parties for tax calculation purposes.

2. To be obliged to present fully necessary data, documents and sources documents to substantiate the selection and application of the most appropriate method of calculation of a price for related transactions.

Article 9 *Responsibilities and powers of tax offices*

In addition to the performance of the responsibilities and powers in accordance with the laws on taxation as stipulated in legal instruments in relation to taxation and in this Circular, tax enterprises shall have the following responsibilities and powers:

1. To keep confidentiality of information provided by enterprises in relation to the calculation of market prices in business transactions between affiliated parties for the purpose of tax calculation in accordance with this Circular when such information does not originate from publicly announced sources. The provision of confidential information by taxpayers to relevant State bodies shall be subject to the laws.

2. To fix prices used to make a declaration for tax calculation and to fix taxable income or amount of corporate income tax payable by a enterprise conducting related transactions in the following cases:

   (a) An enterprise calculates prices, ratio of gross profit or profitability ratio applicable to its related transactions on the basis of documents, data and source documents which are illegal or improper or originate from an unclear source.

   (b) An enterprise creates a false independent transaction or changes a related transaction into an independent transaction and uses such transaction as a selected independent transaction for comparison.

   (c) An enterprise fails to declare or declares incompletely Form 1-GCN-CC in respect of related transactions conducted in the year for which corporate income tax finalization is made; fails to perform strictly requirements in terms of the time-limit for provision of information, data and documents to prove the declaration and accounting of market prices with respect to related transactions.

   (d) The tax office suspects that an enterprise failed to apply or intentionally applied improperly the provisions of this Circular and the enterprise fails to produce substantiation within a maximum period of ninety (90) days from the date of receipt of a notice from the tax office.

3. The General Department of Taxation shall, on the basis of information obtained from the declaration of tax obligations by respective enterprises engaged in related transactions and the tax office's database, provide guidelines for implementation of tax nomination on the following principles:

   (a) Where an enterprise performs fully the accounting regime, invoices and source documents; its turnover, costs or taxable income for calculation of tax obligations shall be fixed in accordance with the methods of calculation of market prices specified in clause 2 of article 5 and article 6 of Part B of this Circular on the basis of prices, appropriate gross profit ratio or profitability ratio determined by the tax office in compliance with each case or each business line.

   (b) In other cases, tax nomination shall be carried out on the basis of the tax office's database in compliance with the regulations on tax nomination applicable to an enterprise which fails to implement fully the accounting regime, invoices and source documents; or in compliance with the regulations on dealing with breaches in relation to taxation.

   (c) Upon performance of tax nomination related to the standard market price margin, the most appropriate value for calculation of selling prices, gross profit ratio or profitability ratios applicable to an enterprise engaged in a related transaction subject to tax nomination shall not be lower than the average value of the standard market price margin determined by the tax office; the most appropriate value for calculation of a purchase price applicable to an enterprise engaged in a related transaction subject to tax nomination shall not be higher than the average value of the standard market price margin determined by the tax office.

4. The General Department of Taxation shall provide guidelines on examination and inspection of the implementation of this Circular by enterprises.

PART D

Organization of Implementation

Article 10 *Effectiveness*

This Circular shall be of full force and effect after forty five (45) days from the date of signing for promulgation. Circular 117-2005-TT-BTC of the Ministry of Finance dated 19 December 2005 providing guidelines on calculation of market prices in business transactions between affiliated parties and Decision 37-2006-QD-BTC of the Ministry of Finance dated 4 January 2006 on correction of Circular 117-2005-TT-BTC of the Ministry of Finance dated 19 December 2005 providing guidelines on calculation of market prices in business transactions between affiliated parties are hereby repealed.

If any difficulties or problems arise during implementation of this Circular, entities and enterprises are requested to report them in a timely manner to the Ministry of Finance for consideration and timely resolution.

For the Minister
Deputy Minister
DO HOANG ANH TUAN