AUTOMOTIVE POSITION PAPER

Prepared by
Automotive Working Group
Vietnam Business Forum

The Automotive Working Group – Vietnam Business Forum, comprises interests of the following sub sections of the industry:

a) Passenger Cars and Commercial Vehicles
   i. CKD (Local Assembly/Manufacturers)
   ii. CBU (Imports)

b) Two Wheelers (Scooters/Motorbikes)

We would like to thank the Government for, including the manufacture of automobiles and automotive parts/components into the incentive investment sector list of the revised Law on Investment, removing controlled expenses in Law No.32/2013 to amend the law on enterprise income tax , allowing enterprises to conduct any business lines that the law, ordinary and decree, does not prohibit, and for some other changes in the laws recently adopted by the National Assembly to improve investment and the business environment in Vietnam.

I. PASSENGER CARS & COMMERCIAL VEHICLE INDUSTRY (CKD/CBU)

We would like to give special thanks to the office of the Government for obtaining the Prime Minister's approval on the Automotive Master Plan for Vietnam's automobile industry development to 2020 with a vision to 2030 at the decision No: 1211/QD-TTG dated July 24th, 2014. This reinforces the interest of the Government to develop Vietnam's automobile industry by enabling healthy competition and promoting a level playing field for all players.

However despite having more than 20 players and 40 brands in the automotive industry in Vietnam, the growth in the overall automotive sector has not been as per expectations of both- the investors and the Government. Although the industry is witnessing good growth in 2014 and based on Vietnam Automobile Manufacturers Association's forecast it is expected to be in the range of 150,000 units in CY 2014, this is still lower than the industry in 2009 and this growth comes with the backdrop of a 40% drop in 2012. The total Industry in 2014 of around 150,000 units is split across CKD and CBU with CKD being approximately 80% of the industry. The overall capacity utilization of the industry is a mere ~30% since the total available capacity is in the range of ~500,000 units. Lack of growth and sub optimal capacity utilization has hurt the investor confidence and also questioned the future returns for new investments.

The growth and development of the automotive industry of Vietnam has been affected by:

a) Frequent changes in the policies and erratic proposals during the last few years;
b) Delay and lack of consistent /transparent policy aimed at the development of the industry;
c) Lack of clarity of business impact to CKD/CBU after full integration with ASEAN in 2018;
d) Continued high and multiple taxation; and
e) Inadequate implementation of programs to address the under developed infrastructure.

A key factor to attract investment in a country is to grow the overall size and competitiveness of the CKD and Component industry. Investors plan their strategy based on the overall size of the industry and the cost competitiveness of the CKD.

The Government of Vietnam should consider steps to accelerate growth of the overall industry and to drive cost competitiveness of CKD to maintain a sustainable automotive industry in Vietnam. These factors will lead to suppliers and investors coming to Vietnam, which in turn, would aid the growth and development of the industry.

With the recent approval of the automotive master plan we are hopeful of stability and transparency in policy going forward.

Based on the above and the working of the group and interactions with different bodies, we present below a set of recommendations corresponding to the issues raised by the CKD manufacturers that could possibly help in the growth and development of the automotive industry in Vietnam.

1. Cost gaps and weak cost competitiveness of local CKD operations

A key guiding principle to promote a level playing field and drive sustainable cost competitiveness of CKD should be to eliminate the cost gap of CKD and CBU. The policy should aim at recognizing the investments of CKD players in Vietnam and ensuring safe guarding of interest of CKD during the transition to the AFTA regime from 2018 onwards. It is estimated that CKD production is approximately 20% higher in Vietnam than in neighboring countries.

Recommendations: Some of the actions that may be considered to retain cost- competitiveness of the CKD industry are:

- Providing adequate production linked incentives for CKD
- Review the methodology of taxation across the industry – for example SCT.
- Impose stricter control and enforce transparency on the import of vehicles
  - Verify declared value of imported cars
  - Tighten the control of "Used Car" imports

2. Need for transparency and speed on duty road map within ASEAN & Other FTAs

Investors and industry players look towards a minimum of a 5 year window on tax policy. Currently, in the auto sector the import duty rates are declared 1 month prior to each year. For example: November 2014 for the rate starting Jan 2015. This has put an immense strain on the ability of the players to plan for an extended term regarding their operations in Vietnam. There are different versions of import duty road maps between 2015 and 2018 - some at 50-50-30-0, others at 50-40-30-0. A lack of clarity prevents companies from planning for the medium-long term in Vietnam.

Recommendations: Since the year 2018 is very significant for integration with ASEAN for Vietnam and is only 3 years away, we sincerely request the Government to finalize this import duty road map. It will also be helpful to share the ongoing discussions with regards to different Free Trade Agreements (biateral or otherwise) and the possible impacts on the auto sector.

By doing the above, the industry players will be able to plan and serve the customers better.

3. Continued high taxes/Special Consumption Tax ("SCT")_

Vietnam is going to fully integrate into ASEAN by 2018 and the future (survival and growth) of Vietnam's automobile manufacturing industry largely depends on the Government's policies on taxes and fees in which the SCT is of importance. Due to disadvantages of small production and economic scales, automotive production costs in Vietnam are 20% higher than those of automobiles imported from Thailand. Key issues affecting the industry are:

(i) SCT – rate etc;
(ii) Import duties on auto parts and components for CKD-produced operations are still at high rates, in the meanwhile Thailand CKD-produced operations are in the industrial cluster or exporting processing zones, which are duty free for auto parts and components imported from all over the world;
(iii) Automobile production costs in Vietnam are very high due to output being too small.

Recommendations: However, to let the Vietnam's industry of automobile manufacturing live up to its full potential, automobile manufacturers in Vietnam would respectfully request the Government consider revising SCT tax rate applied to the industry as follows:

(i) Apply the ex-factory price for CKD-produced automobile SCT calculation as is the case in Thailand and Indonesia.
(ii) Have necessary incentive policies for the local production to compensate for higher production costs, especially in the context of transition periods when the market size is not big enough. We would like to propose production incentives that are compliant with WTO norms, i.e. amount equivalent to 10% of SCT taxable price.
(iii) The reduction in SCT will help to expand the market and support the manufacturers to improve the economies of scale for small passenger cars. A potential roadmap, if shared, will help the industry and customers to plan.
(iv) Reduction of SCT for the low fuel consumption and environmentally friendly vehicles in accordance with the approved Master Plan for Automobile Industry development toward 2020, with a vision to 2030. VBF proposes a joint workshop between the industry and Government to align for definition for environmentally friendly vehicles.
(v) Eliminate the SCT rate for (16-24)-seat-buses and pick-ups, as they are commercial vehicles that are supporting a lot of Vietnamese people in travelling or in the carrying of goods, especially in suburban and/or countryside areas.

Furthermore, the reduction on SCT will support the automotive supporting industry and also promote economic development. An example of resultant economic development is that tax reduction leads to lower vehicle prices, thus increasing market size, in turn, increasing the state budget.

IMPORTANT IMPACT BY ENABLING MOTORISATION
By enabling increased vehicle ownership, people can have the option of living in suburban areas and commuting into the city for work. This will indirectly help in the development of suburban areas, reduce pressure on city infrastructure and also promote overall growth of the real estate sector.

II. TWO WHEELER INDUSTRY (Scooters and Motorcycles)

1. Number plate fee
Effective as of January 1st 2012 in Hanoi, and based on the decision from the Government to resolve the traffic issues in big cities. A regulation was issued by the People's Committee of Hanoi, which implemented the increase of number plate fees in three categories of motorcycle (of value above VND 40million; of value from VND 15million to VND 40 million; of value below VND 15million). Accordingly, the highest rate of VND 4 million/per motorcycles is imposed upon motorcycles with a value of VND 40 million or more.

We believe that limiting the number of motorcycles circulating on the roads by imposing a significantly higher number plate fee, upon only motorcycles with the value of over VND 40 million, is not an effective resolution to the traffic problems. Actually, the traffic situation in Hanoi, since this policy was applied, has improved little. This is because the majority of motorcycles circulating in Hanoi do not belong to the above VND 40million bracket.

Recommendations: This issue has been raised since 2013; however, it has not yet been resolved. Therefore, we would like to reiterate this issue with a recommendation that the highest fees should not be imposed on motorcycles with a value of VND40 million. In addition, we strongly recommend that the Government work on more sustainable solutions, such as the development of public transportation means, road infrastructure in big cities, as well as education on good traffic practices for traffic users that will effectively resolve the traffic problems in the long-term.

2. Special Consumption Tax (SCT): Remove 125cc motorcycles from the list of which SCT is applied

In accordance with the Draft Law, SCT, at a rate of 20%, is still applied to motorcycles with capacities over 125cc. In fact, this provision is no longer practical, therefore, we strongly recommend the National Assembly and the Government, during its legislation making, to amend the Law amending and revising a number of Articles of the Law on Special Consumption Tax, to consider NOT applying SCT to motorcycles with capacities under 150cc or at least having a roadmap reducing the SCT tax rate for scooters over 125cc.

Our above proposal has been based on the following grounds:

- The motorcycles with capacities under 150cc are in fact a suitable means of transportation for Asian and Vietnamese terrain. These vehicles are considered as a transportation means with advanced technology, comfort, environmentally friendly, and have the potential for an exporting market in the regional area.
- Specification, composition and design of a 150cc motorcycle is no different to that of a 125 cc motorcycle, except for its capacity.
- In reality, driving/using a 150cc motorcycle is similar to driving one with a capacity of 125cc (Government provisions on issuance of driving licenses for two-wheelers with a capacity below 175cc is the same and not limited); therefore, they should not be considered as luxury goods. The definition/classification of these motorcycles as luxury was relevant a few years ago; but now the overall market has graduated.
- A SCT of 20% puts pressure on locally produced vehicles and domestic manufacturers. Vietnamese manufacturers will not be encouraged accordingly to invest in and develop this business segment.
- Regulations and provisions of competent authorities on import duties of two-wheelers with a capacity from 50cc to 200cc are the same, and there is no discrimination between a 125cc and a 150cc motorcycle.
- The application of SCT to 135cc and 150cc motorcycles has not contributed much more to the State budget, in fact, it has caused the contribution of Value Added Tax (VAT) to decrease due to the fall in sales volume of these types of vehicles (since the customer has to pay more tax when purchasing them).

3. Limitation on the number of two wheel vehicles up to 2020

Further to Decision No.356/QĐ-TTg dated 25th February 2013 (Road Transportation Plan) providing a limitation of the number of motorcycles circulating on the roads (also referred to as 'Units in Operation' (UIO's) motorcycles) to 36 million units by 2020, on 27th January 2014, the Prime Minister sent Letter No.148 to five big cities (Hanoi, Hai Phong, Da Nang, Can Tho and Ho Chi Minh city) requiring them to submit goals to limit the number of vehicles and plans to develop public transportation in accordance with Decision No. 356 and the Scheme of development of suitable transportation means in big cities in Vietnam. We know that the authorities of the five big cities are working on setting goals/implementing a schedule to limit personal vehicles as requested.

As a result of the above, the motorcycle industry is facing difficulties in developing its strategy for the future. The limitation of vehicles circulating on the roads, under Decision 356, does not seem to encourage nor support the development of the motorcycle industry.

Recommendations: We would like the competent authorities to consider the following factors when working on their goals/schedules, such as the referencing and harmonization of some factors such as:

- Big immigration numbers in the big cities;

- People's travel demands;
- A mechanism to manage the exact number of motorcycles circulating on the roads;
- The effects on the local economy

These elements could be taken into account to build effective objectives and implement the relevant roadmaps on "Decision No. 356"and on the "Development Scheme of suitable transportation means in big cities in Vietnam", in order to minimize the negative impacts of such limitation on society and the motorcycle industry.

III. COMMON ISSUES ACROSS TWO WHEELER / PASSENGER & COMMERCIAL VEHICLES

1. Corporate Income Tax (CIT) incentives for supporting industries

Currently, the Ministry of Industry and Trade is working on a draft Decree on the development of supporting industries in Vietnam. Accordingly, CIT incentives shall be given to projects investing in supporting industry that meets conditions as stated in the draft decree. Supporting industries are industries involved in the manufacture of spare parts, parts, components and materials to supply for the manufacturing industries and assembling completed products which are materials for manufactures of consuming products. We expect this definition to also cover supporting industries for motorcycle manufacturing.

It is drafted that such decree will be issued and come into force in 2014 (it remains to be seen whether it will come into force by the end of 2014). However, it is not clear in the draft whether the incentives will be retroactively applicable to projects which were granted investment certificates or operated before the effective date of the new decree.

The incentives given to supporting industry gives very good encouragement from the Government to the development of this industry. However, given that the new decree and its implementing regulations do not allow investors to enjoy tax incentives for projects invested and operated before the effective date of the decree, investors might deem the business environment as unfair and inconsistent. Since those investors have invested a lot of money and efforts into their projects, they should enjoy the same treatment as other investors investing in the same sector in a different period of time.

Recommendations: The decree should also be applied to projects meeting conditions to enjoy incentives but operated before the effective date of the decree (provided that those projects are still running in the period for enjoying tax incentives).

2. CIT incentives for expansion projects prior to 1st January 2014

On 19th June 2013, the National Assembly passed Law No. 32/2013/QH13 on Amendment and Supplementation of a number of Articles of the Law on Corporate Income Tax (Law on CIT no.32), to be effective from 1st January 2014. Decree No. 218/2013/NĐ-CP and Circular 78/2014/TT-BTC providing detailed guidance to the new Law were also adopted by the Government and the Ministry of Finance on 26th December 2013 and on 18th June 2014. Accordingly, any enterprise with a project for investment and development, currently operating in a sector or geographical area entitled to CIT incentives (tax exemption and reductions applicable to increased income from investment expansion) as prescribed in these regulations, subject to certain conditions prescribed in the regulations.

However, such treatment under these regulations is only applied for (i) expansion projects implemented before 31st December 2008 with operations starting before 2009; (ii) projects invested after 1st January 2014 and (iii) projects before 1st January 2014, but starting operations and generating revenue from 1st January 2014. We would like to particularly ascertain old investment expansion projects during the period from 1st January 2009 to 31st December 2013, which meet the criteria for tax incentives entitlement and have been contributing to the development of the economy of Vietnam, but are not entitled to incentives, while the new investments from 1st January 2014 are entitled to CIT incentives.

Given that the new Law and its implementing regulations do not allow investors to enjoy tax incentives for project expansions which have been implemented during the period from 1st January 2009 to 31st December 2013, investors might find the business environment to be confusing. Investors may see the inconsistencies in treatment from the Vietnamese Government and they will feel unprotected and unfairly treated. This will seriously impact the confidence of investors when they plan to invest in Vietnam.

We respectfully request the Government and the MOF to allow the tax incentive entitlement for investment expansion which has been implemented during the period from 1st January 2009 to 31st December 2013, if all criteria for tax incentives are met, to investments implemented in other periods.

3. Importation of Remanufactured Parts

Currently, there is no regulation providing a definition for so-called "re-manufactured" parts as was explained in last year's forum. Therefore, Vietnam Customs interprets any part which is not 'brand new' to be a 'used part' and hence, makes the importation of re-manufactured parts impossible.

Re-manufacturing saves energy, cuts CO^2 emissions, conserves resources and benefits customers and consumers in Vietnam. Furthermore, re-manufacturing saves thousands of tons of precious raw materials and many tens of thousands of megawatt hours of electricity. In brief, re-manufacturing reduces the burden on the environment. Every European country and most Asian countries have understood the importance and environmental significance of re-manufactured parts and therefore allow the importation and trading of such parts. This has also been demonstrated by various life cycle assessment studies certified by independent testing organisations such as 'TÜV SÜD' in accordance with international standards.

Recommendations: We, once again, recommend the Government of Vietnam to allow the import of re-manufactured parts subject to clear definitions. Genuine re-manufactured parts meet the same quality standards as brand new parts. They are produced according to strict quality requirements and undergo final quality examination that has exactly the same standards as brand new parts. Furthermore, genuine re-manufactured parts are supplied by car makers with the same warranty given as for new parts, and are more cost effective for customers and they align with environmental protection trends.

4. End of life treatment for products

According to Prime Minister's Decision No. 50/2013/QD-TTg dated 9th August 2013 on collecting and treating discarded products and a road map for collecting and treating discarded products: batteries and oils from 1st January 2015, tires from 1st January 2016 and motor vehicles from 1st January 2018, etc.

The Ministry of Natural Resources and Environment (MONRE) has drafted a circular detailing and guiding the implementation of Decision No. 50/2013/QD-TTg dated 9th August 2013. Based on discussions between VAMA and Vietnam Environment Administration (VEA), MONRE will draft some legal documents, including an update of relevant decrees and issuance of circulars instead of only one circular for detailing and guiding the implementation of Decision No. 50/2013/QD-TTg.

However, those legal documents for detailing and guiding the implementation of Decision No. 50/2013/QD-TTg dated 9th August 2013 have not yet been further drafted and issued.

5. Law making process

There is a concern about the time period between announcements regarding changes in duty and implementation dates. For example: For the registration fee reduction, it takes 3 months to implement the new fee structure since Government Resolution 02 on January 7th until Decree 23/2013/NĐ-CP dated 25/3/2013 with the effective date of 1st April 2013. As a result, purchases were delayed and the overall industry suffered during this period.

Recommendations: We recommend improved time planning between the date of decision making, announcement and the effective date. We also urge the Government to discuss proposals and changes with industry bodies to assess the implication of changes prior to announcing the proposals in the media and also look at ways to reduce the time gap between announcement and implementation, especially when reducing duties.

6. Greater incentive for Eco-Green Vehicles

With the current plans for motorization, the Government should also start to consider factors that can impact automotive solutions for Vietnam in the medium to long term. Some of these are:

a) Environmentally Friendly solutions:

Currently the availability of eco/environmentally friendly cars is limited primarily due to costs and infrastructure. The Government should consider promoting increased availability of eco/environmentally friendly technologies in the auto sector. The Government should consider abolishing duties and taxes for eco/environmentally friendly cars with a defined road map. The current duty advantage is not adequate to promote these vehicles.

b) Fuel Efficiency/Emissions Guidelines

The Government should consider investment to enhance infrastructure as road conditions and traffic management play a key role in improving fuel efficiency. Additionally the Government should commence work on guidelines for establishing benchmarks for fuel efficiency – for example: CAFE (Corporate Average Fuel Efficiency) norms in developed countries.

7. Improved road safety needs

Although 4 wheelers are safer than 2-wheelers, the era of motorization will also bring its own potential challenges –a key challenge being "safety requirements" (e.g. driving skills and traffic rule compliance, vehicle safety features, upgraded infrastructure, etc.)

Therefore, the Government should approach safety from the aspects of:

- People (compliance, attitudes and skills of drivers, passengers and other traffic attendants),
- Vehicles (step-by-step enhancement of vehicle safety features in line with the regional level)
- Infrastructure (including roads, parking and traffic control systems, etc.).

Since the issues above need longer gestation time frames, we recommend that the Government should start to develop a joint forum inviting a comprehensive dialogue from different ministries – MOST/MOF/MOT (VR) etc. to discuss and develop a policy framework with key parameters and milestones for the automotive industry of Vietnam.

IV. OVERALL CONCLUSION

Joint working and cooperation with industry bodies like VBF to address the situation in the automotive sector will help in having inclusive growth policies that will develop the overall industry and serve to increase tax revenue for the Government.

The players in the automotive industry are committed to develop the industry in Vietnam and we request the Government to consider the above mentioned key factors for both -Two wheeler and Passenger/Commercial vehicles (CBU-CKD).