SEVERALTAX ISSUES

Prepared by
Ms. Huong Vu
Head of Tax Sub-group

On behalf of Vietnamese Business Forum, we would like to express our gratitude about the recent reform and amendment of the tax policy by the Government. This represents for the comprehension and responsiveness of the Government tolegimate proposals of enterprise community which are raised via dialogues hosted by Vietnam Business Forum, aligning the Vietnam tax policy with international practice.

Among the issues raised by the Vietnam Business Forum and approved by Government, Vietnamese enterprise communityhighly appreciated and applauded the changes on the followings:

(1) Foreign contractor tax policy applied for supply transaction in Vietnam accompanied with warranty term
(2) Thephasing out of the cap onadvertisement and promotion (A&P) expense.
(3) The reform and simplification of tax administration procedures which are presented by the elimination of CIT quarterly declaration and the broadening of companies subject to quarterly VAT filling instead of monthly filling.

In this document, through the dialogue channel of Vietnam Business Forum, we would like to raise some tax issuesfrom the perspective of international practice in commercial transactions and incentives for expansion investment which are much concerned by Vietnamese enterprise community in general and by foreign investment enterprises in particular:

I. ISSUES ON REFORM OF ADMINISTRATION PROCEDURES IN THE FIELD OF TAX AND CUSTOMS

1. Declaring norm of material used for export processing and export production

Issue: Pursuant to current regulation on customs, enterprises have to set up actual production norm of exported products and notify the norm to customs authority before or at the time of filling customs declaration of the first product lot of the HS code declared in the notification.

Shortcomings: The norm is set up, monitored by enterprise, even in the case the norm changes, enterprises are eligible to notify the change of the registered norm. As such, the notification of the norm to customs authority before or at the time of filling customs clearance is not necessary. To ensure the control of the customs authority toward the production norm, it is necessary for enterprise to keep the norm at their premise and present to authority when requested.

Proposal: We would propose to the Ministry of Finance to remove the requirement of enterprises to register the production norm to custom authority. Enterprises shall set up and monitor the norm by themselves and present to authority when requested.

2. Tax payment deadline for imported material used for export production

Issue: Pursuant to the current regulations, imported material used for export production are entitled for grace period of 275 days if satisfying specific conditions. If the products are exported after 275 days, enterprises have to pay VAT and import duty for the imported material plus penalty.

Shortcomings: The above regulation has caused difficulties for many enterprises who produce high value exported products (such as ship) since after 275 days the products cannot be finished and exported, meanwhile enterprises have to pay a large amount of VAT and customs duty for the imported material. This could affect cash flow of the enterprises significantly and also

increase the administration procedure as when the products are exported, the paid VAT and customs duty are refunded.

On the other hand, some enterprises having in stock redundant material which are not sold domestically and over 275 days. When carrying on inspection, customs authority imposes tax duty on the materials, forces enterprises to pay imposed VAT and customs duty on this redundant material and late payment interest. This is illogical as the redundant material is still used for the purpose of producing exported products.

Proposal: To simplify administration procedures, we would propose to the Ministry of Finance to eliminate the regulations of 275 days deadline applied for imported material used for producing exported products. This kind of material only should be taxed when material or products are sold inland.

3. VAT declaration for the activity of peripheral provincial construction

Issue: Circular 156/2013/TT-BTC dated 6 November 2013 provides that: Where the taxpayer engages in peripheral provincial construction, installation, or sale, or real estate transfer without establishing an affiliate in that province (hereinafter referred to as peripheral provincial business), the taxpayer must submit a tax declaration to the tax authority of the locality where the peripheral provincial business takes place.

Shortcomings: The provision needs being reconsidered because of the following reasons:

- In many cases, enterprises having construction or installation with small value in the province, but under this provision, they have to file and pay tax at that province. The payable tax amount is very small but enterprises have to carry out procedures to register tax code at that province, suffering unnecessary administration procedures.

- For the peripheral provincial sale, there are no clear regulations to identify which case taxpayer has to pay tax in local province and which case company has to pay tax for the whole revenue of the company. In practice, it is hard for the tax authority to manage those activities; as such the feasibility of the tax management is low.

- In many case, due to the lack of knowledge, taxpayers does pay all tax at headquarter, but the tax authority still request them to pay tax at local province regardless of the payment status. This cause the double tax payments and burdensome to taxpayers

- In nature, this is the allocation of revenue amongst local budgets and is derived from the principle that VAT must be declared and paid at location where business takes place. However, this provision has been causing burden of administration procedure to taxpayers.

Proposal: From above situation, we would like to propose to the Ministry of Finance to reconsider the regulations toward a more realistic approach, specifically:

- To eliminate the regulations of local tax declaration for the peripheral provincial construction, installation, or sale

- To keep the regulation of requiring the tax payer to temporary declare and pay VAT at the local tax authority for local infrastructure construction works but limit to contracts, transactions with the value over one billion Vietnam Dong.

II. ISSUES ON TAX POLICY

1. Foreign contractor tax policy applied to sale of goods into Vietnam

Issues: Circular No. 103/2014/TT-BTC dated 6 August, 2014 (Circular 103) regarding FCT has expanded the subjects bearing tax which include cases of foreign company distributing goods in

Vietnam. Specifically, Circular 103 set out the applicable subjects of this Circular include: "Any foreign entity that performs the whole or part of goods distribution or service provision in Vietnam, who is still the owner of goods that are delivered to Vietnamese organizations or take responsibility for the cost of distribution, advertising, marketing, quality of goods/services delivered to Vietnamese organizations, or impose prices including the cases in which the foreign entity authorities or hires some Vietnamese organization to perform part of the distribution or service provision pertaining to goods sale in Vietnam."

Shortcomings: This provision should be reconsidered due to the following drawbacks:

- It is clearly that the scope of above provision is quite enormous, and applicable to many cases selling goods from overseas into Vietnam including transactions with purely commercial nature which, up to now, falling under the governed subjects of Law on import and export tax, leading to more cost burdento Vietnams enterprises since consequently foreign contractor tax will be added to prices borne by Vietnamese buyers.

- In particular, with the current regulations, local tax authorities have full competence to impose tax regarding goods distribution contracts when:

- **Company A (seller) bears responsibility for quality of goods provided to Company B (buyer):** The seller bearing responsibility for quality of goods provided to Vietnamese buyers is a certain commercial condition. This transaction of goods trading cannot be carried out when the seller does not undertake the responsibility for quality of goods. The Circular 103 recorded one improvement in comparison with the previous regulations when confirming that the agreement for purchase and sale of goods with delivery at Vietnamese border gate accompanying with the warranty condition of the supplier will not bear the foreign contractor tax. However, the provisions lead to confusion, misunderstanding and detriment to tax payers. In practice, the local tax authorities are applying the provision in this Circular to impose tax on goods supplement contract in which the supplier bearing the responsibility for quality of goods via warranty's term.

- **Company A imposes selling price:** The price is a fundamental component of the value proposition of one enterprise in the market. At the present time, when the borders are blurred, the markets are connected and integrated, the multi-national companies have to calculate a global pricing strategy in order to maintain the competitiveness while still retaining the product's image to the consumers. For this purpose, the foreign supplier shall have a certain control on pricing policy in every market where they sell goods and prevent the unhealthy speculation among markets and undermine the official distribution system. The implementation of pricing strategy – an integral part of business strategy – cannot and should not turn the foreign suppliers into the entities bearing foreign contractor tax.

- **Company A authorizes or hires a Vietnamese organization to conduct part of a distribution service, other services related to the sale of goods in Vietnam:** The current regulation is too general about what is authorizing or hiring a Vietnamese organization to conduct part of service relating to the distribution and sale in Vietnam. With the current wording, the seller offers free warranty through bartering, replacing goods or supplying parts for buyers in Vietnam to provide warranty service to final consumer or implement the warranty obligation in accordance with commitment could also be considered as conducting "services relating to the sale of goods in Vietnam" and thus subject to the foreign contract withholding tax.

Proposal: Under the international practices, which are typically Agreements on avoiding double taxation signed between Vietnam and regions, the distribution activity of foreign sellers, depending on the model and level of participation in Vietnamese market, might create a permanent establishment in Vietnam and might be taxed on the income allocated to such permanent establishment. The Agreements are based on the principle if the business (sales) in

Vietnam is conducted through a broker, a commission agent or any other agent with **independent status** provided that they shall only operate within **the framework of their ordinary business activities**, then foreign contractor shall not be subject to tax.

Based on the above analysis, we propose to the Ministry of Finance to consider and clarify which distribution activities shall be subject to foreign contractor withholding tax. In particular, we would like to propose to Ministry of Finance to study and provide guidance base on the description and regulation about permanent establishment under international practice and standard as the UN and the OECD to identify whether the foreign contractor has permanent establishment, thereby determining the tax liability of foreign contractors. With that opinion, Circular 103 should be amended to exclude the condition when the seller bears responsibility for quality of goods/services and/or imposes selling price from the conditions triggering FCT to seller.

2. Applying the Foreign Contractor Tax policies for EPC contracts

Issues: Circular 103/2014/TT-BTC guiding on withholding tax prescribes the applicable tax rate to calculate VAT, CIT on revenue for construction, installation work involving the supply of raw materials or machinery and equipment associated with construction works under two circumstances:

- In the contract, if the value of each business activities could be separated, the foreign contractor is not required to pay VAT on the value of raw materials or machinery and equipment, which has been paid at importation stage or is VAT exempted, for each part of work under the contract, the ratio % shall be applicable for VAT and CIT calculation on corresponding revenue for that business activity.

- If the value of each business activities could not be separated in the contract, the VAT rate of 3% and CIT rate of 2% shall be applied on the whole contract value.

Meanwhile, Circular 60/2012/TT-BTC prescribes that regardless each business activities could be separated in the contract, 3% VAT and 2% CIT shall be applied on the whole contract value.
The change is an important progress on contractor withholding tax policies, reflecting the principles of taxing on each activity implemented by contractors. This improvement will help to reduce significantly the cost to Project Owner as the proportion value of M&E in EPC contracts is normally very high, often accounting up to about 70%-80% of the whole contract value. However, the current provisions of Circular 103 only apply to contracts signed from the date 1st October 2014.

Shortcomings: In principle, withholding tax is declared and paid on each payment. For a number of contracts, particularly EPC contracts, several payments could be made during contract implementation period.

So if the above guidance of Circular 103 applies only to contracts entered into after the date of 1st October 2014, it shall be unfair for those contracts entered into prior to 1st October 2014 but the payment made after 1st October 2014.

Proposal: We understand that Vietnam Government has encouragement and protection policy toward investment of local and foreign enterprises in Vietnam. In particular, investors are entitled for applying more favorable condition if the policy changes. As such, in order to create favorable conditions for foreign contractors as well as to generate the equality among contractors performing EPC contract in respect of the tax payment obligation in Vietnam, we kindly propose Ministry of Finance to consider allowing the EPC contract which signed before the date of 01/10/014 but the payment done after the dated of 01/10/2014 have choice to apply tax policies prescribed in Circular 103 for payment after 10/01/2014.

The principle of applying FCT policy base on date of contract is unchanged, however if the tax policy changes in the way to offer more favor to taxpayers, taxpayers can apply the new policy at the time of payment to declare and pay tax. We understand that this grandfather clause was stated clearly in the previous change in FCT policy (Circular 60/2012) and was very welcomed by enterprises.

3. Identifying expanded investment and regular investment

Issues: Pursuant to regulations on Corporate Income Tax and Investment Law, expanded investment project is project developing on-going project in order to expand and improve the production and capability of business, innovate technology, improve product quality, reduce environmental pollution.

In practice, during the process of production and business activities, the enterprise must constantly invest in fixed assets to replace, suplement assets to maintain productive activities using internal cash flow generated from depreciation fund or retain earnings, without any injection of capital from external sourced, i.e. loan or increase in contributed capital. However the lack of clear guidance in determining point of time starting expanded investment has led to arbitrategeous interpretations in practice. In particular:

Firstly, the tax authorities do not consider whether enterprises contribute more capital into exiting project. FDI companies when submitting dosierfor establishment must register total investment capital. This is considered as a measure of project scale. Total investment capital includes chatter capital and mid-long term loan used for purchasing fixed assets and exclude working capital. As such the figure in the Balance Sheet closely reflecting the capital implementation of the enterprise is the value of fixed asset after accumulated depreciation as opposed to registered capital. If this figure is less than the registered capital, it can not be said the enterprise has expanded investment. However many tax authorities deem all assets newly purchased from 2009 as expanded investment, or deem the excess of total historical value of assets over the registered capital as expanded capital.

Secondly, tax authorities do not consider the cause and purpose of the increase in asset value and treat the regular investment in fixed assets to replace, suplement assets to maintain current productive activities as the same category as expanding investment, accordingly they deem thatwhen the enterprise has increasedin asset value, it means enterprise carry on expanded investment.

Shortcomings: The regular investment in fixed assets to replace, supplement assets to maintain productive activities is inevitable activity of any enterprise. Capital to invest regularly (replacement of property or buying office property for management activities, improving working condition for employees) can be financed from the source of asset depreciation or retain earnings without the need to increase capital investment. Thus it can not be considered the regular investment in fixed assets to replace, supplement assets to maintain productive activities as expanding investment, also expanded investment cannot be identified only based on indicator of increase in fixed assets.

Proposal: Foreign investors when being awarded investment certificate alreadyregistered investment capital. We understand that this is very important indicator for Government to consider the incentive mechanism for investment projects. As such for the consistency between Investment Law and Tax Law, we would propose to Government and Ministry of Finance to provide more specific guidance to identify investment expansion for the period prior 2014 in the way that would base on invested capital which includes charter capital and loan capital and is measured by the value of fixed asset after accumulated depreciation on the Balance Sheet. In case enterprises use internal cash flow generated from depreciation source to purchase assets, it cannot be considered as expanding investment. In case enterprise used up all registered

capital but invest using retain earnings to purchase asset to maintain the manufacturing activities without any increase in capital, capacity, scale of business, then the investment should not be deemed as expanded investment and shall be able to applied corresponding tax policy in each period.

4. Tax incentive for regular investment in acquisition of fixed asset

Issues: Resolution 63 newly issued by the Government has brought much positive signal to Vietnamese business community, solving lots of difficulties for businesses as well as for tax authorities. Steering spirit of Resolution 63 is said that it is very common sense. However when Resolution 63 is guided by Circular, it seems that common sense was undermined. Specially, provisions on incentives for regular investment in purchasing property are as follows:

- Point 4, Section I, Resolution 63 specifies: "For businesses entitled to the preferential business income tax of period 2009-2013 with their regular investment in machinery and equipment during production and business, then they will be entitled to the preferential business income tax for the additionally increased income (no re-settlement to cases which have been implemented)"

  According to the above we understand that the only exception of those cases have been tax audited for the 2009-2013 period, the business which has investment of acquisition of fixed asset during the 2009-2013 period, will be applied the current tax incentive of project.

- However, the circular 151/2014/TT-BTC provides that: "Investment projects of enterprises applied tax incentive and if in the 2009 – 2013 period, the enterprises had invested in machinery and equipment regularly during production which not belongs to the new investment project and new projects expansion, the part of the additional income by investing in additional machinery and equipment, is also applied tax incentives under the project for the remaining time from the tax period 2014 "

  Thus Circular limits the period of application for preferential tax period only from 2014. Moreover, the guidance of this Circular seems to be illogical due to if the investment is not the new investment project and new project expansion, such investment does not belong to the current project which enjoy tax incentive or has tax obligation as current projects.

Shortcomings: We understand that the guidance in Circular seems to be illogical because if the investment does not belong to *"new investment project and expansion project"*, such project must belong to existing project, accordingly it is entitled for tax incentive or tax obligation as current project. Therefore, if enterprise makes regular investment in the period of 2009-2013 which is not new investment project and/or expanding investment project, such project will be applied tax incentive of current project obviously. However, because of the inconsistent perception of the tax authorities and the guidance in Circular as analyzed above, the regular investments are regarded as expanding investment, and are not be applied tax incentive for the 2009-2013 period.

Proposal: We kindly propose that the Ministry of Finance should consider adopting guidelines on tax incentives applied for the regular investment in the consistent spirit of both Resolution and Decree in the way that: If the investment project of enterprise is currently enjoying tax incentives and if in the 2009-2013 period, there is an investment in machinery and equipment during operation which is not a new investment project and the expansion investment project, the additional income from the investment in machinery and equipment is entitled for tax incentives same as the current project for the remaining time.

5. Applying DTA to determining Permanent Establishment for tax reduction and tax exemption

Issue: According to the guidance in Circular 205/2014/TT-BTC and some guidance petitions, tax authorities tend to interpret broadly the Permanent Establishment (PE) definitions in tax treaties to conclude that foreign companies have a PE in Vietnam, specifically for purely commercial activities of foreign contractors such as on the spot imported/exported activity, commodity distribution activity, sales activities delivered at the bonded warehouse and so on.

Shortcomings: The interpretation of tax authority sometimes does not take into account the commercial nature of the transaction as well as international trading practices. Some cases are as following:

- For on the spot import/export activity: tax authorities consider that a Vietnamese enterprise deliver goods to another Vietnamese enterprise according to instruction of the foreign buyer, they will be treated as representative of the foreign enterprise so the foreign enterprise is deemed to perform business in Vietnam via a permanent establishment, whereas in the activity of on the spot importing and exporting, such transaction is only a commercial agreement in order to optimize delivery/stock circulation of commercial trading activities.

- For goods distribution activities in which foreign enterprises have control of the sale price in Vietnamese market: the tax authority said that foreign enterprises having control of the sale price means they have control of sale activities of Vietnamese enterprises such that Vietnamese enterprises will become dependent establishment of foreign enterprises leading to constitution of permanent establishments. Meanwhile the implementation of pricing strategy is an integral part of business strategy, especially in an integrated global economy.

The interpretations mentioned above made the application of DTA of foreign enterprisesimpossible, effectively it obliterate the legitimate benefit of enterprises.

Proposal: We would propose the Ministry of Finance to consider and have guidance to local Tax authorities to take into account the true nature of transactions as well as the perspective of international practices when interpreting DTA.