POSITION PAPER OF TAX & CUSTOMS WORKING GROUP

Shortfalls in the implementation of tax & customs policy and the influence on the investment environment

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In recent years, the Government has really paid attention to renovate the business and investment environment, support enterprises, reform administrative procedures, attract investment and promote the socio-economic development. To further implement effectively those resolutions and directives including Directive No. 20/CT-TTg and Directive No. 07/CT-TTg, the Prime Minister has requested Ministries, local authorities of provinces focus on implementing consistently and quickly those targets and missions established: draft Law on amending, supplementing the Laws on Taxes to clarify/address current tax issues of taxpayers; simple tax and accounting systems for small and medium enterprises, especially those converted from business households; draft Law on Securities to improve the foreign indirect investment environment for investors. However, based on our actual observation, there still exists issues during the implementation of these tax and customs policies which could impact investors when making investment or investment expansion decisions in Vietnam. These issues have been brought up for discussion several times but are still pending for quite a while and have yet been settled.

1. Investment protection

Issue

For investors, licenses issued by the competent authority are regarded as strong commitment between the Government of Vietnam and the investors. These documents are very important in securing their investment activities in Vietnam. The Investment Law has always affirmed the principle of investment protection; accordingly, in case under the new regulations, investment incentives are lower than those stipulated in the licenses, the investors are entitled to continue enjoying investment incentives provided in such licenses.

However, in practice, enterprises have initially been licensed with specific incentives and have implemented in accordance with such incentives. However, when the tax authorities conducted tax audit and inspection, they denied and refused to apply incentives that the enterprise being granted. In some cases, the tax authorities claimed that the licensing agencies have made mistakes when issuing such incentives to investors, accordingly required enterprises to pay additional tax, late payment interest and even pay penalties due to incorrect tax declaration.

From the perspective of investors, they argue that the Government has failed to comply with the commitments, disrespect the principle of investment protection, and that the tax authorities are forcing enterprises to take responsibility and suffer the damages for the mistakes made by the governmental authorities themselves. Such situations often cause great distress and loss of confidence among investors. As a result, they will express their resentment on different investor forums and communities, which in turn seriously affects the investment environment and the ability of Vietnam to attract new investors. In fact, there were cases in which enterprises have been facing prolonged prosecution.

Recommendation

In case the licensing authority of Vietnam incorrectly states the tax incentive criteria on the Investment Certificate (IC), the responsibility of which should accordingly be borne by the

licensing authority, not the Enterprises. Therefore, tax incentives for the Enterprises for which ICs are issued should be implemented as stated in the issued IC if all conditions for enjoying the tax incentive are qualified. Upon discovering inaccuracy in the IC, the licensing authority should explain to the Investors to amend the incorrect terms, then enterprises shall implement calculation of tax in accordance with the amended ICs from the date amended in the ICs.

2. Respect Vietnam's World Trade Organization (WTO) commitments

Issue

In practice, investment incentives of investors which have been granted by competent authorities in Vietnam in accordance with prevailing regulations in Vietnam are rejected, though such investment incentives (including Corporate Income Tax (CIT) incentives) are stated clearly under relevant ICs. These CIT incentives are in line with the Vietnam's WTO commitments as stated under Section 279 Page 104 of the Report of the Vietnam's Accession to WTO Adhoc Committee commitments that "Investment incentives and the period for entitlement of such investment incentives are stipulated clearly under ICs". This is really an issue for investors because investors believe that ICs are the highest legal document concerning the establishment and operation of their investment projects in Vietnam, showing the commitments of Vietnamese Government for an attractive and transperant investment environment. Investors also rely on such ICs and stated investment incentives to make investment and investment expansion decisions in Vietnam.

In additions, we understand that this issue is actually encourtered by several investors, but local tax authorities only seem to consider this case for certain investors from certain countries, but not for all. This seems to go against the Most Favoured Nation rule which is stated clearly under the Law on Investment 2005 and again under the current Law on Investment 2014, particularly under Item 4, Article 5 of the Law on Investment 2014 which stipulates that "the Government shall treat investors equitably; introduce policies to encourage and enable investors to make business investment and to ensure sustainable development of economic sectors."

Recommendation

The local tax authorities should respect Vietnam's WTO commitments and apply correctly and consistely the Most Favoured Nations among investors.

3. Refund of Value Added Tax (VAT)

Issue

The tax regulations need to be constantly amended in order to be in line with the economic development in general and with business activities of enterprises in particular. However, tax policy can not be clear in all situations and may have different interpretations. Hence, the implementation of tax policies should be based on reasonableness and the tax philsophy. Based on tax philosophy and principle, VAT should not become a cost/revenue of either party. In relevant tax regulations, the Government has provided guidance on different cases which are entitled to input VAT refund. However, in practice, local tax officers seem to try best to detect mistake(s) made by taxpayers even though such mistake is simply an administrative mistake, and reject the refund eligibility and accordingly increase tax collection rather than looking at the nature of transaction.

Local tax and customs authorities insist to detect administrative mistake(s) made by taxpayers and even go against the economic nature of transactions and reject the refund eligibility of taxpayers. For example, taxpayer has been rejected for a refund because the refund dossier was submitted late or wrong statutory form was used for refund purpose, even though taxpayer has corrected such

mistake in accordance with prevailing regulations and/or as requested by local tax and customs officer(s).

For input VAT refund during construction period: under VAT regulations from the beginning, input VAT incurred during construction period would be refunded if the amount is VND300 million and above. This policy has helped to improve the cash position/movement of investors especially when investors have to spend a significant amount of cash and accordingly incur a signficiant amount of input VAT during this period. However, there seems to be a different treatment in terms of input VAT refund for new investment project and expansion project because for expansion project, investor has to first offset the input VAT incurred during construction period for expansion project with output VAT from its current business activities and if the amount of input VAT after offset is still greater than VND300 million, then a refund is available.

In additions, from 1 July 2016, the refund for input VAT incurred from imported goods for subsequent export was not allowed as Decree 100/2016/NĐ-CP came into force. This had since then become a matter of concern for many enterprises having significant VAT input not fully credited. Taking into account this matter, Decree 146/2017/NĐ-CP effective on 1 February 2018 has supplemented the provision of refund for the same under certain conditions.

That is to say, from the effective date of Decree 146 (1 February 2018), an enterprise can apply VAT refund for the activity of import for export. However, it is not clear under the new Decree whether enterprises could get refunded for all input VAT accumulated up to time of refund application (including input VAT incurred from 1 July 2016 to 1 February 2018).

Due to the lack of guidance, during the period from 1 July 2016 to 1 February 2018, input VAT incurred from imported goods for export to EPE or to overseas which has not been credited are also likely treated by tax authorities as not subject to VAT refund.

Recommendation

i. The input VAT refund should be applied consistently between new investment projects and expansion projects, as long as taxpayers statisfy the condition of having the input VAT amount of more than VND300 million. There should not be any different treatment because in both cases, investors have to spend a great deal of cash for investment and therefore incur a signficiant amount of input VAT during construction period. A refund of such input VAT would help to improve the cash position for investors, and accordingly encourage investors to make further investment and expand its business activities in Vietnam.

ii. Considering the nature of the business and tax philosophy, enterprises carrying import for subsequent export should be treated as subject to VAT refund considering that these goods are not consumed in Vietnam. The relevant clause as specified in Decree 100 has appeared to be a mistake during drafting process and caused unclear and confusing guidance which is against tax philosophy.

Therefore, the amendment of this clause in the Decree 146 is necessary and reasonable. As such, the Government and Ministry of Finance should provide a detailed guidance which allows entities to enjoy refund for all input VAT incurred but has not been credited during the period from 1 July 2016 and 1 February 2018.

4. VAT for exported goods which are extracted natural resources and have not been processed into other products

Issue

As per item 1, Article 1, Decree 146/2017/ND-CP, exports which are extracted natural resources and have not been processed into other products are not subject to VAT. Exports that are products mainly derived from natural resources and/or minerals whose total value plus energy cost makes up at least 51% of the prime cost excepted for cases provided under Item 1, Article 1 (for example exports which are produced from materials (other than natural resources and minerals that have been processed into other products) bought for processing by traders or other facilities hired by the traders will be entitled to 0% VAT if the conditions prescribed in Point c Clause 2 Article 12 of Law on VAT are satisfied). However, there is no exact definition of "other products" processed from extracted natural resources and detailed guidance on the calculation of 51% of the prime cost.

Recommendation

Since this has a significant impact on taxpayers and in practice, due to lack of a detailed guidance, local tax officers have reject the input VAT refund of several taxpayers, the Ministry of Finance should soon issue a detailed guidance at Circular level on how to calculate the 51% of the prime cost and a detailed definition of "other products" processed from extracted natural resources. This is to avoid cases in practice where local tax officers forcefully interpret tax policies in a beneficial way to tax collectors, not to taxpayers.

5. Cap on interest expenses

Issue

Decree 20/2017/NĐ-CP and Circular 41/2017/TT-BTC became effective from 1 May 2017 is applied to the entities paying corporate income tax according to the declaration method and having transactions with related parties. Pursuant to Clause 3 Article 8 Decree 20, taxpayer's total loan interest expense arising within a specified tax period qualified as a deduction from income subject to corporate income tax shall not exceed 20% of total net profit generated from business activities plus loan interest expense and depreciation and amortization expense arising within that period. This regulation is currently applied by the local tax authority to enterprises having transactions with related parties, including Vietnamese enterprises and FDI enterprises. In Vietnam, many enterprises operating under parent-subsidiary model often incurr lending transaction, in which the parent companies borrow loans from third parties and lend to their subsidiaries. Therefore, these enterprises are significantly impacted by Decree 20.

It should be noted that the threshold imposed on interest expense in Vietnam has been referred to the guidelines of OECD and Action 4 of Forum on Implementation of Measures to counter Base Erosion Profit Shifting ("BEPS"). In June 2017, Vietnam officially announced its participation and became the 100th member of the Forum on Implementation of Measures to counter BEPS, thus, it is necessary to adjust the regulations under domestic law to be in line with these international best practices.

Decree 20 was issued with the purpose of bringing regulations on transfer pricing in Vietnam closer to international standards. However, we would like to emphasize that the OECD regulations only provide general guidelines for countries to apply, subject to specific conditions and context. For regulations that allow a net interest-rate adjustment instead of net interest, in accordance with the BEPS guidelines, the use of net borrowing can reduce the risk of double taxation (net interest income will offset with interest expenses before the limit is applied). However, according to OECD, an enterprise incurring low net interest expenses does not mean that it is risk-free of base erosion and profit shifting. For example, an enterprise may take advantage of offseting interest expense against interest income, or converting/classifying other income into interest income to offset against interest expense so as to adjust the net interest expense. Therefore, OECD guidelines

recommend that countries should still maintain regulations on the threshold of gross interest expenses under certain circumstances

Recommendation
The regulation on interest expense under Decree 20 currently has some shortcomings and may cause difficulties for domestic enterprises and FDI entities. This regulation should be adjusted in a more flexible way similar to some OECD guidelines to be appropriate in different situations:

i. Interest expense exceeding the regulated threshold is allowed to be carried forward to the next period. Action 4 of BEPS mentions that it is in the best practice that interest expense exceeding the threshold is not required to be carried forward to the next year. Thus, this approach should be considered for application depending on each country's conditions.

ii. For Groups of companies operating under the parent-subsidiary model, the ratio of interest expense associated with third party loan / EBITDA can be calculated at the consolidated level and applied to each entity within the Group (Group ratio rule). The purpose of this guideline, according to OECD, is to ensure that the total deductible interest expense does not exceed the actual interest expense paid to third parties. Following this guideline, after the calculation of the ratio of interest expense associated with third parties/EBITDA, this ratio shall also have to be reviewed and assessed for each entity of the Group before being used for tax adjustment.

iii. Special treatment is applied for entities newly established or starting to generate revenue.

6. Exemption for imported materials under contract-manufacturing scheme

Issue
Under the prevailing regulations, materials and supplies imported for the purpose of contract manufacturing for exports are exempted from import duty and value added tax at the entry. Nonetheless, by guidance at recent ruling (i.e. Official Letter 5826/TCHQ-TXNK dated October 05, 2018), such duty exemption scheme does not apply to imported materials for contract manufacturing purpose with the finished products sold to an overseas entity but delivered to another Vietnamese entity under the assignment of the oversea entity by implementation of on-the-spot (OTS) import/export procedure.

In Official Letter 5826/TCHQ-TXNK, the General Department of Customs (GDC) takes the position that the OTS export is not export activities based on the definition of export/import as set forth under Article 28, Commercial Law No. 36/2005/QH11, saying that export activities are exporting goods overseas, or to special zones which are classified as special customs-control zones as legally regulated. To that end, OTS export is not entitled to exemption of import duty and import VAT applicable to importation of materials to produce goods for export as set forth under Article 12 Decree 134/2016/ND-CP.

We take the view that GDC is establishing a paradox that completely ignores logical and legal principles as follows:

6.1. If OTS export is not recognized as export activities, OTS import should not also be recognized as import activities or vice versa

As regulated under current regulations, OTS export is mandatory accompanied by OTS import to establish the OTS export/import structure. If there is no OTS export, OTS import would not exist. Here exists the paradox when companies conduct the OTS import in parallel with the OTS export in discussion. Particularly, on the one hand, customs authority reject to treat the OTS export as export activities to revoke the exemption of import duty for imported materials. On the other hand, customs authority still imposes import duty on the OTS import, which should only be applicable if OTS import is recognized as import activities.

In other words, adopting the same rationale of GDC, once customs authority rejects to recognize OTS export as export activities, customs authority should also stop imposing import duty on OTS import.

Otherwise, if customs authority recognizes OTS import as import activities to impose import duties, there is no reason or legal basis for customs authority to deny the export status of OTS export.

6.2.Double taxation on imported materials and tax on tax

As aforementioned, the materials imported by for contract manufacturing purpose but the finished products are later delivered to a domestic Vienamnese entity (under the assginment of the overseas buyer) is refused exemption from import duty at import stage. Furthermore, the Vietnamese entity must also pay import duty when importing the finished products. Obviously, the imported materials are actually imported into Vietnam once but are subject to import duty twice, which is completely unreasonable.

6.3.Inconsistency between legislations

Pursuant to Article 12, Decree 134/2016/ND-CP regulating the import duty exemption, one of the conditions to be eligible for import duty exemption when importing goods to produce goods for exportation is that the goods are actually exported. To that end, Article 12 Decree 134/2016/ND-CP does not itself make any discrimination between OTS export and other export activities. Instead, the guidance in the Official Letter 5826/TCHQ-TXNK is just interpretation made by GDC based on the general definition on exportation of the Law on Commerce.

Apparently, such interpretion is in conflict with current legislations in both tax and customs aspects. Particularly, Article 8 Law on Value Added Tax only allows application of 0% VAT rate to exported goods and Decree 209/2013/ND-CP (Article 6.1) and Circular 219/2013/TT-BTC (Article 9.1) clearly recognize OTS export is a form of export.

Further, pursuant to Circular 38/2015/TT-BTC and Circular 39/2018/TT-BTC, OTS export is still subject to the same export procedure as that imposed to other export activities.

Recommendation

The GDC should recognize OTS export as other export activities, and grant exemption of import duty and import VAT to the materials imported for the production of goods to be exported under OTS exportation model

7. On-the-spot export rights of Foreign Direct Invested (FDI) enterprises

Issue

By prevailing regulations on sales of goods of FDI enterprises in Vietnam, a FDI enterprise entitled to export can export goods purchased in Vietnam; goods processed in Vietnam and goods

legitimately imported in Vietnam to a foreign country or a separate customs-control zone if certain conditions are satisfied.

Pursuant to the regulations at Circular 04/2007/TT-BTM of the Ministry of Trade, currently known as the Ministry of Industry and Trade, a FDI enterprises may conduct on-the-spot export of their goods produced in Vietnam given certain condition are met.

However, Circular 04/2007/TT-BTM have already expired and there is yet any replacement. At the same time, prevailing regulations do not clearly specify whether a FDI enterprise entitled to export goods purchased in Vietnam may conduct on-the-spot export.

Such gap in prevailing regulations creates difficulties for enterprises and the local customs authorities alike when carry out customs procedures.

Recommendation
The Ministry of Industry and Trade and the GDC should discuss and conclude a unified guidance on the specific issue for clear implementation.

8. Penalty and late payment collection in case higher tariff applicable to on-the-spot import/export

Issue
Recently with the enterprises conducted on-the-spot import/export activities, there is a controversial debate on what import duty rate (i.e. FTA, MFN, ordinary) should be applied if they have legitimate C/O.

Many enterprises applied special preferential tax rates under FTAs for on-the-spot consignments of imported goods with respective C/O submitted on time, customs declarations inspected and stamped by customs authority during clearance. That's implemented previously. However, Since the end of 2017, local customs authorities started to conclude that on-spot imports must apply preferential duty rates (MFN tariff) from September 1, 2016 onwards according to Decree 129/2016/ND-CP instead of special preferential duty rates (FTA tariff). Accordingly, enterprises were imposed additional import duty and VAT on the on-spot import consignments by decisions of local customs authorities.

Even though recognizing the inconsistency in policies and guidance, in order to show a high level of cooperation and compliance, companies complied and paid the additional import duties at MFN rates instead of special preferential rates under FTAs. However the goodwill action led to the consequency that the local customs authorities request to pay penalties on late payment. More seriously all import and export activities are delayed because enterprise is enforced by customs authorities and managers of enterprises are not allowed to exit.

In addition, instead of importing goods on-the-spot locally from Vietnam and applying the non-preferential duty rate as currently guided, the enterprises can easily import the same goods from countries with Free Trade Agreements and enjoys special preferential duty rates. Thus, the current application of duty rate regime may bring short-term benefits to the customs authority in terms of budget collection, but in the long run it shall restrict domestic goods consumption as a whole which goes against the economic development guidelines of the Government.

Recommendation
Urgently ask the Government, Ministry of Finance, General Customs for consideration and guidance to write off the pending penalties and late payment interests to prevent customs enforcement and further serious impacts on the enterprises' business activities in Vietnam, at the same time resolve the issue of duty rate applicable for on-spot import, which is still a pressing concern for many.

9. Administrative penalty for incorrect declaration which leads to under-paid tax amount or under-claimed refunded amount

Issue
According to Article 107 of the amended Law on Tax Administration and Article 12 Circular 166/2013/TT-BTC providing guidance on administrative penalty for violations in the tax domain, in case taxpayer makes an incorrect tax declaration which leads to under-paid tax amount or under-claimed refunded amount, it would be subject to 20% administrative penalty on the under-declared and under-paid amount. Accordingly, the incorrect declaration act is not subject to 20% administrative penalty if such act does not lead to any under-paid tax amount. This is reasonable with tax principle. However, we observe in pactice that the Hanoi Tax Department still insists to impose the 20% administrative penalty on the under-declared and under-paid amount even though taxpayer has provisionally declared and over-paid its total tax liabilities but this specific tax amount is under-declared and under-paid. This is rather unfair and impact the trust of taxpayer in the enforcement of tax policies.

Recommendation
To avoid losing trust of taxpayer, we request the Ministry of Finance to further guide the General Department of Taxation and local tax authorities to follow the principle of tax policies. Apart from that, to avoid any misunderstanding, the Ministry of Finance should make clear about this under the upcoming draft Law on Tax Administration.

10. Transfer Pricing

The Decree 20 and the Circular 41 for guidance being effective since 2017 are based on transfer pricing principles of OECD. However Vietnam's regulations differ from OECD law and practice in a significant aspect, the lack of a rubust advanced pricing agreement mechanism. Instead the Vietnamese Tax authoritises apply their own pricing based on their own data base. This has been causing substantial uncertainty and risk for enterprises because they have no idea in advance what Vietnamese tax authorities consider the "proper" price and are thus exposed to unexpected payments with penalty and interest. Additionally, when enterprises are informed by the Tax authorities with interpretation of the proper pricing, they are often completely unclear of the basis for that interpretation because the data for the tax authorities to make conclusion is not disclosed to the enterprise.

Recommendation: A robust widely available mechanism for quickly concluding Advanced Pricing Agreements is essential and urgent and should not require approval by the Prime Minister. If tax authorities are able to quickly determine the interpretation of a proper price at the time of the audit, why can't they come up with a price prior to original transaction? Tax authorities can make this certainty, but they seem reluctant to do so for unclear reasons. Also, the source of the pricing from GDT or GDC should be informed with the enterprises so when APA's is reached both parties well understand the calculation of each other if those could be different from each other.

11. PE Treatment and Honoring Treaty Obligations

Vietnam allows enterprises to self assess the benefits they are entitled to under relevant tax treaties with relevant countries. However, at the time of the audit, the enterprises self-assessment is often not accepted by the tax authority without providing adequate explanation. Also, definitioins of Permanent Establsihment continue to be ambiguous, including for example "control" on pricing. As we previously informed, many international brands with only an arm's length presence in Vietnam require their distributors in Vietnam and elsewhere to price products within a proscribed range in order to have global consistency of pricing and/or to ensure their distributors are pricing their products competitively.

Recommendation: Improve implementing decrees relevant to DTA's and improve education among local tax authorities. Also, definitions of Permanent Establishment should be clearer and more practical and exclude definitions that are outside of international norms.

12. Treatment of FCT for royalties is inconsistent between deemed CIT and deemed VAT

For the purposes of Deemed CIT, royalties are treated as a deemed withhold is 10%. However in the case of Deemed VAT, the same royalty item is treated as a service and assessed a deemed VAT of 5%. This defies logic. Under Vietnam's Substance over form treatment, the substance of an expense does not change based on whether it is being evaluated for assessment of VAT or CIT. Royalties are not in substance services.

Recommendation: Royalties are treated as such in assessing deemed CIT and that treatment should apply consistently to assessment of deemed VAT.

13. Retroactive Application of Laws undermines business confidence

Businesses make decisions on transactions and investmens on conditions in place or reasonably predictable in the futre, including tax conditions. Business operating in good faith, who have been relying on previous laws and established practices should not be subject to the risk and uncertainty of having new tax laws apply to previous transations and then applying penalty and interest.

Recommendation: New tax regulatins should not apply retroactively and should only be effective after a period of sufficient stakeholder education.

14. Reduce PIT for companies in economic zones:

PIT for companies located in economic zones enjoyed a 50% reduction. Howeveer Decree 82/2018/ND-CP issued in may of this eliminated this 50% reduction. The new decree became effective in July. This change brings unexpected tax expense for investors.

Recommendation: We strongly request the Vietnamese government to compler with Article 13.2 of the investment law and confirm that companies established before the effective date of rhis Decree are able to continue enjoying this incentive.

15. Applying different FCT method to different contracts.

Cirular 156/2013/TT-BTC requires foreign contractors to apply the same FCT method to subsequent contracts as present contracts until that first contract completes. This is impractical for a variety of reasons. If contractors have contininous string of contracts, the method selected for

one contract may need to apply for years in the future, even if that method is not appropriate based on conditions of future contracts.

Recommendation: The government should allow contractors to apply FCT method to each individual contract.

16. Impose Tax on sugar beverages

Issue:
In recent years, the Government has considered taxing sugary drinks for health reasons and to increase tax revenue. A considerable excise tax will be proposed by the Government to impose on sugar beverage. The target to increase tax revenue may not be fully achieved but led to many negative consequences.

- International practice shows that taxation is not a universal and global countermeasures to deal with obesity.
- 86% ASEAN countries does not impose tax on sugar beverage and 97.8% Asian countries in general has no taxation on sugar beverage.
- Some countries that have applied the tax on sugar beverage have subsequently revoked this policy due to ineffective use.
- As far as taxes are concerned, many small producers and suppliers will have difficulty because they will be less able to compete with large producers and suppliers
- The proposed tax is regressive. That is, consumers with the lowest income will pay a higher share of their income for higher taxes than those with high incomes. This issue needs attention from the Government.

Recommendation
The Government should encourage community health education as a concrete guide to improving health. Other studies should be considered to determine the extent of obesity in Vietnam and its main causes. Vietnam can learn from other countries. We recommend that, in order to achieve the goal of good health, the Government considers nutrition education and labeling.

GENERAL RECOMMENDATIONS FOR CUSTOMS

1. Prioritize implementation Customs Bond System in accordance with TFA Aricle 7.3
2. Fully implement at an early date the TFA commitments on Advanced Rulings for valuation as well as classification.
3. Fully implement TFA commitments on Authorized Economic Operators and to do so on as broad a basis as possible, bringing advantages to many rather than few economic operators.
4. Concluding a Customs Mutual Assistance Agreement between the U.S. CBP and GDVC, a commitment in TFA, Sec. I, Article 12.[1]This would provide a framework for substantial U.S. trade facilitation technical assistance direct from CBP to GDVC