



RESEARCH REPORT

# **ASSESSING VIETNAM'S TAX INCENTIVE POLICIES**

Hanoi, September 2016





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# ABBREVIATIONS

ASEAN	Association of Southeast Asian Nations
ADB	Asian Development Bank
CIT	Corporate Income Tax (Enterprise Income Tax)
EIT	Export and Import Tax
EU	European Union
FDI	Foreign Direct Investment
FTA	Free Trade Agreement
FTZ	Free Trade Zone
GDP	Gross Domestic Product
GSO	General Statistics Office
IMF	International Monetary Fund
MNC	Multinational Corporation
MOF	Ministry of Finance
MOLISA	Ministry of Labour, Invalids and Social Affairs
MPI	Ministry of Planning and Investment
NA	National Assembly
NGOs	Non-Governmental Organizations
OECD	Organisation for Economic Co-operation & Development
PIT	Personal Income Tax
R&D	Research and Development
SCT	Special Consumption Tax
SEZ	Special Economic Zone
SMEs	Small and Medium Enterprises
SOE	State-Owned Enterprise
TPP	Trans Pacific Partnership Agreement
UNCTAD	United Nations Conference on Trade and Development
UNIDO	United Nations Industrial Development Organization
UK	United Kingdom
US	United States
USD	US Dollar
VND	Vietnamese Dong
VAT	Value Added Tax
WTO	World Trade Organization



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# EXECUTIVE SUMMARY



[1] Tax incentives have been widely used as a means for promoting investment in both developed and developing countries. However, arguments on the effectiveness of the use of tax incentives in promoting investment are divergent. Tax incentives may be effective in some circumstances, but to some extent they also pose a number of issues, which include tax revenue losses, distortion of the allocation of resources in the economy and additional complexity to the tax system. Tax incentives may have many forms such as: (i) reduced tax rates; (ii) tax holidays; (iii) investment allowances; (iv) tax credits; (v) partial or full exemption of import tax or indirect taxes; (vi) accelerated depreciation; (vii) incentives provided under special zones, such as economic zones and export processing zones. Among different types of tax incentives, tax holidays are the most popular, especially in developing countries. There are some circumstances under which the use of tax incentives could be economically justified. These include incentives granted to projects which are expected to confer significant positive externalities to the rest of the economy, such as investment in high-tech industry, research and development (R&D). However, potential costs from the use of such incentives also need to be taken into account when accessing these benefits. These costs include the losses of revenue collection, distortions of the allocation of resources and additional complexity into the tax system.

[2] Since 1986, Vietnam has taken a number of specific steps to shift its economy toward greater market orientation, such as gradual liberalizing of investment and trade, restructuring state-owned enterprises (SOEs) and reforming the banking and finance systems. Following Doi Moi, there have been many important changes in Vietnam's tax system. The focal points of tax reforms in Vietnam have concentrated on broadening the tax base, reducing tax rates and simplifying methods of tax calculation and declaration and payments. Together with the process of tax reform, Vietnam's tax incentives have evolved and changed significantly. Before 2000s, tax incentives adopted by Vietnam reflected discriminatory treatment between domestic and foreign investment. Tax incentives granted to

foreign investment were higher than these applied to domestic investments. In early 2000s, a number of steps were implemented to establish a non-discriminatory tax incentive system. The discrimination in the tax incentives between domestic enterprises and foreign-invested enterprises was gradually removed. Currently, domestic enterprises and foreign invested enterprises are treated equally under the existing tax legislation in terms of both conditions and level of incentives.

[3] Tax incentives have been used extensively in Vietnam over the past three decades. Incentives have contributed significantly to the increase in investment and in achieving other goals of the Government, such as in promoting investment in poor regions of the country and in prioritized sectors. However, their impacts and effectiveness still do not receive adequate analysis from either academic researchers or policy makers. Currently, due to lack of information and data, there is very limited research that is able to provide an in-depth analysis on the costs and effectiveness of tax incentives in Vietnam.

Reviewing the implementation of tax incentives shows that Vietnam has offered generous incentives to projects located in less developed regions, but these regions still fail to attract more investment from outside. Vietnam also offers very generous incentives for projects in some sectors, such as agriculture development and processing of agricultural and aquatic products. However, currently, the level of investment in the agricultural sector is still relatively low.

Vietnam's tax incentive regime is relatively complex. The coverage of incentives is based on a lengthy and scattered list of incentive eligibility (business areas and locations) provided in the 2005 Law on Investment. Accordingly, tax incentives are granted to 30 encouraged business sectors and 27 especially encouraged business sectors. In terms of geographical location, tax incentives are granted in "encouraged areas", including districts and towns in 53 out of 63 provinces in the country. In addition, high-tech zones, economic zones, industrial parks and export processing zones established under decision of Prime Minister are also entitled to corporate income tax incentives.

Another feature of existing tax incentives in Vietnam is the integration of social policy objectives into tax incentive policy, including gender equity-related issues. However, the question of how these tax incentives have achieved desired social objectives, including gender objectives, has not received attention so far from relevant stakeholders, such as academic institutions, development actors and government agencies.

[4] Economic theory and empirical experiences have showed that in certain stages of economic development and circumstances, tax incentives could contribute to economic growth through stimulating investment and strengthening competitiveness of the targeted industries. Thus, this report does not argue that tax incentives should never be used to promote investment in Vietnam, rather they must be reviewed and rationalized in order to be more effective in achieving the desired goals while minimizing their costs. The report recommends that:

- Vietnam should continue to ensure macroeconomic stability and to enhance competitiveness through appropriate macro and structural reforms. Much research shows that the decision to invest in an enterprise depends on many factors, among which the most important factors are macroeconomic stability, political stability and a strong institutional framework. The availability of tax incentives is only one of many factors.
- Vietnam also should review and rationalize all types of tax incentives. Currently, tax incentives for business sectors and geographical locations are very scattered. Instead, incentives should be limited to the sectors that are expected to generate positive externalities for the whole economy, such as to promote R&D activities, information technology or use of high technology. More importantly, tax incentives should be linked to the national development priorities or specific targeted industries in which Vietnam can generate comparative advantages. In addition, Vietnam should rationalize tax policy in general and tax incentives in particular to deal with social issues, including gender equity.
- Vietnam should reduce the reliance on tax holidays. Among the different types of tax incentives, tax holidays have the highest cost in terms of revenue forgone. This incentive tends to favour short term investment. Therefore, Vietnam should consider introducing new incentives that have been used effectively in other countries, such as investment allowances or multiple deductions of expenses in encouraged activities, e.g. expenses for R&D.
- Administrative procedures for assessing and granting tax incentives should be simpler and more transparent. All tax incentives should be reviewed and incorporated into the relevant tax laws so that tax authorities can administer them. This will make the formulation, implementation and administration of these incentives easier and cheaper. In addition, criteria to qualify for tax incentives need to be defined clearly in tax legislations;

there should not be any room for subjective interpretation by tax administrators.

- Vietnam should conduct a careful and long-term cost-benefit analysis before and after implementing any tax incentive measure, including from social and gender equality perspectives. In a cost-benefit analysis, positive contributions of tax incentives should be weighted again the opportunity costs of such incentives. This will assist the government in gaining an informed view about how much these incentives cost in terms of revenue foregone before any adjustment is made. In short, cost-benefit analysis both in the short and long term should be used to rationalize tax incentives.
- Vietnam needs to establish a reporting mechanism in order for the tax authorities to collect information and data relating to tax incentives, such as the number of projects actually eligible for tax incentives, the actual amount of revenue forgone due to such incentives, and the contributions of projects granted incentives in terms of employment creation, export volume, and other factors. This will allow government and other stakeholders to better assess whether incentives are indeed the fairest and most efficient use of public resources. This also helps to increase transparency and enforcement. All of the acquired information should be made available and accessible by the public and NGOs for supervision. Vietnam should also adopt tax expenditure practices as implemented in many countries.
- Vietnam should put greater efforts on the reform of its overall tax system and adopt international best practices. For prospective investors, the overall features of the tax system are more important than the tax incentives. Experiences of many countries have shown that tax incentives can only function effectively if the tax system underlying these types of incentives is properly designed. The reform of the tax incentive regime should also be placed in line with the reform of the overall tax system. Tax reform needs to be carried out in accordance with a growth-friendly approach, focusing on expansion of the tax base while continuing to maintain tax rates at an adequate and competitive level. Tax reform is a difficult and multi-faceted issue, which needs to be carried out in a relevant sequence. Given that the country is still in a transition process and delivering tax reform is not an easy task, technical support from international organizations such as the IMF or World Bank, may be helpful for Vietnam in future growth-friendly tax reforms.
- Vietnam should review and revise the taxation data system from a gender perspective. Currently, Vietnam's tax policies, including tax incentives are formulated following a process governed by law with participation of different stakeholders. However, due to the lack of gender-disaggregated data, gender impact analysis of tax incentives in Vietnam is difficult and cannot show convincing evidence. Therefore, it is recommended to take gender impact studies, especially gender equity as a social concern in tax policy formulation.



01

**INTRODUCTION  
AND  
OBJECTIVES OF  
THE RESEARCH**

Tax incentives have been widely used as a means for promoting investment in both developed and developing countries (Zee, Stotsky & Ley, 2005). Many countries have offered tax incentives to stimulate domestic investment as well as to encourage the inflows of foreign capital. The popularity of tax incentives has also been fuelled by economic successes of newly industrialized countries, such as South Korea, Taiwan and Singapore where tax incentives at some stages of their economic development were a prominent feature of their investment promotion policies (James, 2013). However, there have been recently many major debates on the effectiveness of using tax incentives. Tax incentives may be effective in some circumstances, but to some extent they also pose a number of issues, which include tax revenue losses, distortion of the allocation of resources in the economy and additional complexity to the tax system (Fletcher, 2002). Arguments on the effectiveness of the use of tax incentives in promoting investment are divergent, still ongoing and unsettled (Tanzi and Zee, 2000). Some researchers support the view that tax incentives are effective in promoting investment while others claim that tax incentives are costly and having a marginal impact in promoting investment. In addition, in recent years, there have been some arguments on the use of tax incentives in achieving certain social objectives, such as in promoting gender equality. Some studies have revealed that having differential impacts on men and women, tax systems are not gender neutral and in some extent, tax incentives can be used as an instrument to improve gender equality.

Over the last three decades, like many other developing countries, as part of its economic reform, Vietnam has introduced various forms of tax incentives, including reduced tax rates, tax holidays and exemption from import tax, to stimulate investment as well as other objectives such as export promotion or employment creation. However, the extent to which these incentive measures contributes to the achievement of these objectives in Vietnam still do not receive adequate attention from both tax researchers and tax policy makers. Currently, Vietnam has not yet developed an adequate mechanism to assess the costs and benefits of tax incentives. There is not much information and data available in order to conduct a careful analysis on the effectiveness of tax incentives in Vietnam.

The purpose of this research is to provide an in-depth-discussion on the development of Vietnam's tax incentive regime and its effectiveness. In particular, the research is designed to achieve the following objectives:

- i. To review the theoretical and empirical literature on the costs and benefits of tax incentives with special reference to Vietnam, including, who are the recipients of tax incentives, what are the likely effects of tax incentives; and to provide an analysis on international experiences on tax incentives and lessons learned for Vietnam;
- ii. To provide an examination of tax incentives in Vietnam, including, what are the major features of Vietnam's tax incentive regime; who are engaging in the tax policy

formulation in general and tax incentive measures in particular; what are the costs and benefits of tax incentives in Vietnam, including gender implications of Vietnam's tax incentive policies.

- iii. To discuss relevant issues that require further and deeper investigations, and to propose recommendations for potential changes in tax policy in Vietnam in general and tax incentives in particular, including gender related issues,

The report of this research is divided into four sections. Following the introduction, section 2 focuses on conceptual issues relating to tax incentives, including definition and classification of tax incentives and cost and benefits of tax incentives from both theoretical and empirical perspectives, and provides a brief review of international experiences on tax incentives. Section 3 discusses the current tax incentive regime in Vietnam and associated issues, including an overview discussion on Vietnam's tax system and tax reform in Vietnam. Section 4 proposes policy recommendations for Vietnam and a summary conclusion.





02

**TAX INCENTIVES  
AND THEIR  
EFFECTIVENESS**

Theoretical and  
empirical evidence

## 2.1. WHAT ARE TAX INCENTIVES?

Tax incentives can be defined in a number of ways. A tax incentive can be defined tax provisions designed to reduce the tax burden for the investors in order to encourage them to behave in certain manners (UNCTAD, 2000). More generally, Keen (2015) defined tax incentive as a departure from a general tax rule that is favourable to the taxpayer. By definition, any tax provision that is applicable to projects in general does not constitute a tax incentive. In this Report, a "tax incentive" means a special and favourable tax provision in Vietnam's tax legislation granted to "qualified" taxpayers".

## 2.2. FORMS OF TAX INCENTIVES

Tax incentives may have many forms and can be divided into the following major forms:

- (i) reduced tax rates;
- (ii) tax holidays;
- (iii) investment allowances;
- (iv) tax credits;
- (v) partial or full exemption of import tax or indirect taxes;
- (vi) accelerated depreciation;
- (vii) incentives provided under special zones, such as economic zones and export processing zones<sup>1</sup>.

These tax incentives can be also grouped into two broad categories: profit-based incentives such as reduced tax rates or tax holiday, and cost-based incentives, such as accelerated depreciation or import duty exemption (Keen, 2015).

Under a reduced tax rate incentive, the government sets lower tax rates as an exception to the standard tax rate to attract capital into specific sectors or regions of the country. Under a tax holiday incentive, qualified investors are exempted partly or fully from paying income taxes for a certain period. Investment allowances are linked to deductions in tax liabilities that are based on the value of expenditures of qualifying investment. Under investment allowances and tax credits, investors are allowed to recover partly or fully the costs of their investment. Indirect tax exemptions are the exemptions given to qualified investors when they import or purchase certain categories of goods or services. Exempting capital goods from import tax is an example of this type of tax incentive. Under special zones, eligible enterprises are located and invested in the zones are eligible to various types of tax exemptions or reductions, such as completely exemption of indirect taxes.

Among these types of tax incentives, tax holiday and reduced tax rate are the most popular forms, which then are followed by tax credit and exemptions from import tariffs (Boonnyarat, 2014 and UNCTAD, 2000). Tax holidays and reduced tax rates are usually applied to income tax, especially corporate income tax (CIT). Comparative merits of these different types of tax incentive are not the same. Investment allowances and tax credits are better targeting instruments for promoting investment in certain sectors and the revenue costs of such incentives are known in advance. However, when the investors are eligible for investment allowances and tax credits upon the replacement of assets, they tend to distort the choice of capital assets in favour of the short-lived assets (James, 2013).



Tax holidays are easier to administer, but the revenue cost are not transparent as they cannot be determined in advance (Fletcher, 2003). In addition, as noted by Boonnyarat (2014), tax holidays are inefficient as the investors may sell or close their businesses at the end of tax holidays and reopen a new business in order to enjoy new round of tax holidays. Tax holidays also create incentives for the investors to using different techniques (e.g. transfer pricing) to shifting profits from not eligible to tax holidays to projects receiving tax holidays (World Bank, 2014). Pros and cons of different types of tax incentives are summarized in Table 1.

<sup>1</sup> These zones are geographically limited areas in which eligible enterprises are located and invested, and then eligible to various types of tax exemptions or reductions.

**TABLE 1. PROS AND CONS OF DIFFERENT TYPES OF TAX INCENTIVES**

PROS	CONS
<b>1. TAX HOLIDAY</b>	
- Simple to administer	- Attract short-run projects - Risk of indefinite extension of holiday - Revenue costs are not transparent unless tax filling is required
<b>2. LOWER CIT RATE</b>	
- Simple to administer - Revenue costs are more transparent	- Invites tax avoidance through high-tax enterprises shifting profits to low-tax ones via transfer pricing
<b>3. INVESTMENT ALLOWANCES AND TAX CREDITS</b>	
- Can be targeted to certain types of investment with highest positive spillovers - Revenue costs are more transparent	- Distorts choice of capital assets in favour of short-lived ones, since a further allowance is available each time an asset is replaced - Administrative burden
<b>4. ACCELERATED DEPRECIATION</b>	
- Can be targeted to certain types of investment with highest positive spillovers - Revenue costs are more transparent - Does not discriminate against long-lived assets	- Administrative burden
<b>5. EXEMPTIONS FROM INDIRECT TAXES (VAT, IMPORT TARIFFS, ECT.)</b>	
- Allows taxpayers to avoid contact with tax administration (which may be important if its is complex or corrupt)	- VAT exemptions may be of little benefit – under regular VAT, tax on inputs is already creditable - Administrative burden
<b>6. EXPORT PROCESSING ZONE</b>	
- Allows taxpayers to avoid contact with tax administration (which may be important if its is complex or corrupt)	- Distort locational decision - Typically results in substantial leakage of untaxed goods into domestic market, eroding the tax base

Sources: Adopted from Boonnyarat (2014).

## 2.3. TAX INCENTIVES IN SELECTED ASIA'S COUNTRIES

The world economy has been increasingly globalized. Cross-border transactions in trade and investment have expanded substantially over the last more than three decades (IMF, 2016). In the same period, the level of world direct investment flows also increased substantially. While

government policy along with technological change have been a driving factor for the growing market integration, globalization in turn has posed a number of impacts on government's policy toward the promotion of investment. There has been a decline in the importance of market size as a determinant of investment location (Blomström & Kokko, 2003)<sup>2</sup>. The scope for using traditional instruments, such as exchange rate policy or trade policy, to stimulate foreign capital inflows has diminished as the result of the global trade

<sup>2</sup> The removals of trade impediments through cutting tariffs and abolishing non-tariff barriers have increasingly facilitated for movement of goods internationally. The reductions in communication and transportation costs have also made it easier for multinational corporations to set up their international production network. Goods can be shipped cheaply to international customers.

liberalization and the internationalization of the capital markets. Higher degree of mobility of capital and labour had made the investment and allocation decisions of the investors become more responsive to tax differentials (Edwards and de Rugy, 2002).

To promote the inflows of foreign capital, countries throughout the world have shifted the focus to other policy instruments,

including tax incentives. Consequently, the use of tax incentives as a measure to promote the inflows of foreign investment has expanded extensively. For many countries, tax incentives are considered a visible and flexible instrument for investment promotion (Zee, Stotsky and Ley, 2005). The prevalence of tax incentive around the world is summarized in Table 2.

TABLE 2. AVAILABILITY OF TAX INCENTIVES BY REGIONS

	Countries Surveyed	Tax holiday/ exemption	Reduced Tax rate	Investment allowance/	R&D Tax Incentive	Super- deductions
East Asia and Pacific	12	92	75	67	83	33
Eastern Europe and Central Asia	16	88	38	25	31	0
Latin America and the Caribbean	25	88	32	52	12	4
Middle East and North Africa	15	80	40	13	0	0
OECD	33	21	36	64	76	21
South Asia	7	100	43	71	29	71
Sub-Saharan Africa	45	78	62	78	11	18

Number of countries in percent of total in the group

Source: Adopted from James (2013).

Currently, tax incentives have been used nearly all countries throughout the world (James, 2013). Among different types of tax incentives, tax holidays are the most popular, especially in the developing countries. In the 1980s, there were less than 40 percent of low income countries in sub-Saharan Africa offering tax holidays, however, in 2005, over 80 percent of the countries in the region offered tax holiday (Keen, 2015). According to James (2013), out of 12 countries in East Asia& Pacific, 92 percent of the countries adopted tax holiday or exemption; 72 percent of the countries adopted reduced CIT rates and 67 percent of countries adopted investment allowance. The corresponding ratios for 25 countries in Latin America and the Caribbean were 88, 32 and 52 percent respectively. Recently, developed countries have moved away the use of tax holidays over time due to their ineffectiveness in attracting investment (World Bank, 2014a). Developed countries now tend to rely more on investment allowances and tax credits (James, 2013).

As with many other regions around the world, East Asia and Pacific countries have a long history in the adoption of tax incentives. Various forms of tax incentive were introduced to promote exports, private saving and investment, technological development in these countries. Forms of incentives applied in

these countries include investment allowances, tax holidays, reduced tax rates, accelerated depreciation or import tax exemption. Among these forms of tax incentives, tax holidays are found very popular in Asian countries, such as in Singapore, Philippines, Thailand or Indonesia. Similarly, partial or full import tax exemptions are also prevalent in ASEAN. Key feature of tax incentives in selected Asian countries are summarized in Table 3.

Recently, focus of tax incentives in many developed countries and East Asia Pacific countries has shifted to the promotion of technological innovation. According to James (2013), 76 percent of total 33 OECD countries under Survey offered tax incentives for research and development (R&D) and this ratio for 12 countries surveyed in East Asia and Pacific is even more higher (83 percent). Granting tax incentives for promotion of technological innovation is justifiable as it is expected to generate positive externality and spill-over effects for the whole economy and help to strengthen the global competitiveness.

Another issue that is worth noting is the fact that, in recent

**TABLE 3. SUMMARY OF TAX INCENTIVES IN SELECTED ASIAN COUNTRIES**

	Singapore	Philippines	Thailand	Indonesia
<b>Tax holidays</b>	5–10 years exemption or reduction in corporate tax on profits for pioneer industries, tax reductions for plant expansion	6–8 years tax holidays for pioneer activities and projects in less developed areas, 4–7 years tax exemptions for non-pioneer activities	3–8 years income tax holidays depending on location (Zone 1,2 or 3)	3–8 years for new enterprise
<b>Reduced CIT rates</b>	Partial exemption on chargeable income of up to \$300,000 (18% CIT standard)	Exemption for 4–8 years for companies located in the export processing zones (35% CIT standards)	50% reduction for 5 years for enterprises in investment promotion zones (20% CIT standard)	CIT can be reduced by 30% of realized investment spread over a six-year period (i.e., 5% per year) (25% CIT standard)
<b>Import duty &amp; VAT exemptions</b>	Customs duty exemption on machinery, raw materials and heavy oil for pioneer industries	Tax & duty-free importation of capital equipment & raw materials for zone enterprises; tax credit on raw materials & supplies for registered firms	Exemptions & reduced import duty & VAT rates on inputs in certain sectors especially exporters	Exemptions & reduced import duty & VAT rates on inputs in certain sectors especially exporters
<b>Investment allowances &amp; credits</b>	Exemption of taxable income equal to a specified proportion of new fixed investment in certain industries	Tax credits for purchases of domestic breeding stocks & genetic materials	Allowance of 25% for investment in infrastructure	Reduction of taxable income by up to 30% of investment in priority
<b>Accelerated depreciation</b>	Accelerated depreciation for certain plants, machinery and equipment	Immediate expensing of major infrastructure investments by export enterprises in less developed areas		Doubling of depreciation rates in favoured zones and sectors
<b>Promoted activities</b>	Pioneer industries (new manufacturing and service investments) declared by the Ministry of Finance	Pioneer activities (new manufacturing industries; agricultural, forestry, and mining industries of national interest; industries using new technologies); projects in less developed areas; project expansion or modernization; export industries	Automotive and electronics industries; export industries; activities located in remote area, industrial zones; processing of local agricultural raw materials	Pioneer industries: 1) basic metal industry; 2) oil refinery; 3) machinery industry; 4) renewable energy industry; and 5) telecommunication equipment industry)

Source: Adapted from Boonnyarat (2014).

years, several countries have gradually phased out tax incentives as the focus of tax policy shifting to the achievement of tax equity and neutrality, such as Jamaica and Egypt (Keen, 2015). Another example is China. In the late of the 2000s, China made some important moves in simplifying its tax incentive regime. In 2008, China government harmonized the CIT rates between domestic enterprises and foreign enterprises<sup>3</sup>. In the past, China provided very high level of tax incentives for foreign investment enterprises, such as tax holidays of between 3 to 10 years and reduced CIT rates of 24, 15 or 10 percent<sup>4</sup>. As from 1 January 2008, most of the tax incentives for foreign investment enterprises were abolished, including tax holidays. China also removed the 24 and 10 percent reduced rates.

## 2.4. BENEFITS AND COSTS OF TAX INCENTIVES

As noted earlier, the increase in international capital mobility resulting from the rise of globalization has made investment and location decisions become more sensitive to taxation. There are some circumstances under which the use of tax incentives could be economically justified. These include incentives granted to projects which are expected to confer significant positive externalities to the rest of the economy, such as investment in high-tech industry or in R&D. However, potential costs from the use of such incentives also need to be taken into account when accessing these benefits. These costs include the losses of revenue collection, distortions of the allocation of resources and additional complexity into the tax system. It is easier to measure the costs of tax incentives than the benefits. Benefits of tax incentives may include additional job created, a more diversified economy, technological and skills spill over, which are usually hard to quantify (James, 2013).

The following section will briefly discuss the benefits and costs of granting tax incentives:

- Granting tax incentives helps to stimulate investment inflows, which in turn promote economic growth and reduce unemployment. There are some empirical evidence supports for this view. After investigating the impact of taxes on the inflows and outflows of foreign direct investment (FDI) in the European Union (EU), Groppe and Kostial (2000) concluded that tax rate is significant negatively related to FDI inflows and positively related to FDI outflows. Tax incentives could be used use to increase the competitiveness of the domestic investment and therefore, helps to induce investment inflows, including both direct investment and portfolio investment;
- A country may use tax incentives to channel investment to particular regions or sectors that are considered more desirable for social and economic development. These are

regions or sectors which are expect to generate positive externalities for the economy as a whole (D'Amuri and Marenzi, 2005). Tax incentives granted to projects located in less-developed regions are likely to confer significant positive externalities through reducing in disparity in income distribution. Another example is tax incentives granted for R&D and investment in high-tech industries discussed in Section 2.2 above. Granting tax incentives in this case is justifiable in the sense that technology and knowledge have some characteristics of public goods; hence, there is a prospect for knowledge spill-over throughout the country resulting from the increase in R&D activities.

- It is also commonly argued that tax incentives are needed to compensate for negative factors in the country's investment climate, such as lack of infrastructure, inadequate legal and regulatory systems (Holland and Vann, 1998). This is the reason to explain why tax incentives are found to be more popular in the developing countries than the developed countries. Generous tax incentives available to investment projects locating in economic zones and less developed regions will help to compensate for poor location or inadequate facilities and then to improve their overall zone performance.

However, as noted above, tax incentives also have a number of costs. These costs can be grouped into the following categories:

- Tax incentives are costly for the government, including both direct and indirect costs. The most direct costs are these associated with potential revenue losses for the government<sup>5</sup>. This direct revenue cost can be in two forms. The first one is the revenue forgone from projects that would have been undertaken even if the investor did not receive any tax incentives. The second is the loss of revenue from erosion of the revenue base due to taxpayers abusing the tax incentive regimes activities, such as shift income from related taxable firms to those firms qualifying for favourable tax treatment (Zolt, 2015). A question to answer in granting tax incentives is whether the benefits created by the increase in investment created by tax incentives are worth the revenue forgone that would have been carried out without such incentives.
- Using tax incentives to stimulate FDI would be simply a gift from the host country to the treasury of the investor's home country if there is the case that the investor's home country adopting worldwide income taxation. Most of FDI to developing countries are from the developed countries, such as Japan, the US or UK. However, in these countries CIT is normally imposed on based resident worldwide income. They also adopt a mechanism to avoid double taxation by providing tax credit for foreign taxes paid. Therefore, tax incentives, which reduce the tax liabilities for the investors coming from these countries, also reduce the tax credits that they are entitled to deduct in their home countries if there is no tax-sparing clause in the bilateral double tax treaties between

<sup>3</sup> Currently, in China, CIT rate of 25 percent is applied to both types of enterprises.

<sup>4</sup> The normal CIT rate was 33 percent that consists of 30 percent national tax and 3 percent local tax.

<sup>5</sup> According to Botman (2008), revenue loss from redundant incentives in the case of the Philippines could be as large as 1 percent of GDP.

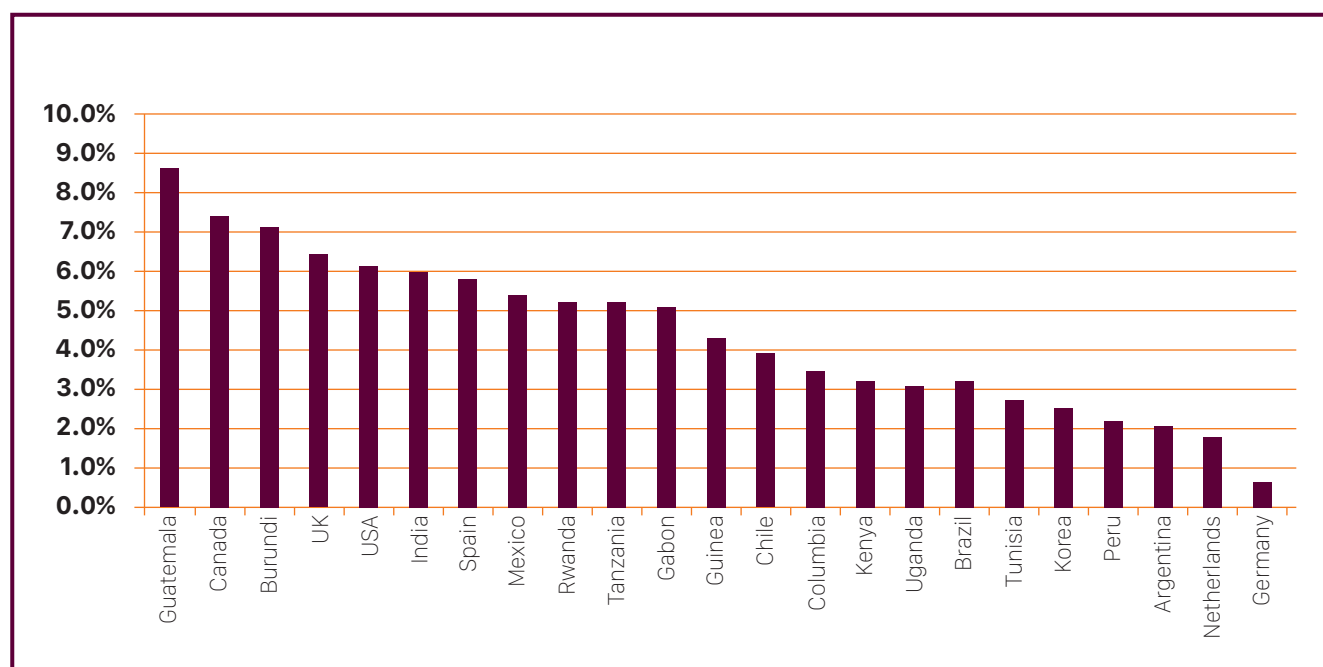
the host country and their home countries<sup>6</sup>. As a result, there may be an increase in tax revenue of their home countries as an expense of the host country, but the total tax burden for the investors in these cases is unchanged if there is no tax sparing provision in place.

- One of the most popular measurements of direct costs of tax incentives is through what is known as "tax expenditure". Tax expenditure can be defined as "government revenues foregone as a result of differential or preferential treatment of specific sectors, activities, regions, or agents" (Tyson, 2014). By definition, the scope of tax expenditure is not only cover tax incentives, but also other items, like deductions under the PIT. However, tax expenditure can be employed to assess the effectiveness of tax incentives in term of weighting the benefits obtained with the costs of revenue forgone. In many developed countries, governments prepare tax expenditure reports as part of the overall budget reports, such as in Australia, UK and the US<sup>7</sup>. These tax expenditure reports could cover all the types of tax incentives discussed above. Figure 1 below illustrated the cost of tax expenditure in selected countries, which may be high in some countries, such as Guatemala, Canada or UK. Recently, several countries in the region have also started to publish the data on tax

expenditures, such as Malaysia and Philippines (Keen, 2015)<sup>8</sup>.

- In addition to direct costs to the government budget, there are also are other indirect costs. These are the costs of enforcement and administration of tax incentives system. Tax incentives make the tax system become more complicated. This is because all tax incentives are the exceptions of the general tax provisions. In many cases, tax incentives could be difficult to administer as tax authorities are often required to determine which investments meet the specified conditions and criteria. Where tax incentives are granted based on ad hoc basis, it may also create rooms and opportunities for corruption.
- Tax incentives distort the allocation of resources. Tax incentives violate the basic principles of taxation (neutrality and equity). Investment may take place just because the investors want to exploit the benefits of available tax incentives and can lead to investments that yield a lower pre-tax return (Keen, 2015). Tax incentives distort the allocation of resources. The inflows of FDI may take place just because the investors want to exploit the benefits of available tax incentives (Zee, Stotsky and Ley, 2005).
- Tax incentives may lead to tax competition. The introduction of

**FIGURE 1. TAX EXPENDITURES IN SELECTED COUNTRIES (% OF GDP)**



Source: Adapted from James (2013).

<sup>6</sup> Tax sparing is "agreements with many countries that allow businesses to retain the benefits of tax incentives offered in other countries" (Fletcher, 2003, p.2). In other words, tax sparing is a provision where a country allows the investors to apply a tax credit against taxes owed on foreign-income that is equivalent to the tax exemption provided by the foreign country. For example, Company A from country X (resident of country X) invested in a project in the country Y through a subsidiary B and the project is eligible to a 2-year CIT exemption. Assuming that in the second year, the subsidiary make a net profit of 100 USD and all profit is distributed to company A in country X. The CIT rate in country X is 25 percent and in the country Y is 30 percent. The subsidiary does not pay CIT for the first two years and hence the amount of CIT that the subsidiary B spared in country Y is 25 USD. Country X also taxes the dividend at the rate of 30 percent but give the company a credit for tax pay in country Y. However, as no tax is paid in country Y, company A has to pay a tax of 30 USD on the dividend received (30 percent of 100 USD). If there is a tax sparing provision between country X and country Y, country X will provide for the company A with a tax credit equivalent to the tax that could have been paid by company B in country Y, which is equivalent to 25 USD (25 percent of 100 USD). Hence, with the tax sparing provision, company A will only have to pay 5 USD for the dividend they receive from the subsidiary B.

<sup>7</sup> See Department of Finance, Ireland (2015). "Report on Tax Expenditures", from [http://www.budget.gov.ie/Budgets/2015/Documents/Tax\\_Expenditures\\_Oct14.pdf](http://www.budget.gov.ie/Budgets/2015/Documents/Tax_Expenditures_Oct14.pdf).

<sup>8</sup> Vietnam currently does not publish any information regarding tax expenditures or information regards annual revenue costs of tax incentives.

tax incentives in one country may induce other country competing for capital to adopt the same measure (Holland and Vann, 1998). If this is the case, the relative incentive to invest between among countries do not change and but the consequence is the loss of revenue in both countries.

- Tax incentives also have gender and social implications. The tax system brings in resources for the government to fund for social expenditures, such as spending programs in health, education and social welfare. Tax incentives cause revenue losses which in turn undermine government expenditure on social services. If such programs are reduced due to less tax revenue being collected, the lives of women will be disproportionately negatively impacted since consumption of social spending is gendered related (Africa Tax Spotlight, 2011). Therefore, tax incentives may have negatively impacts on gender equality.

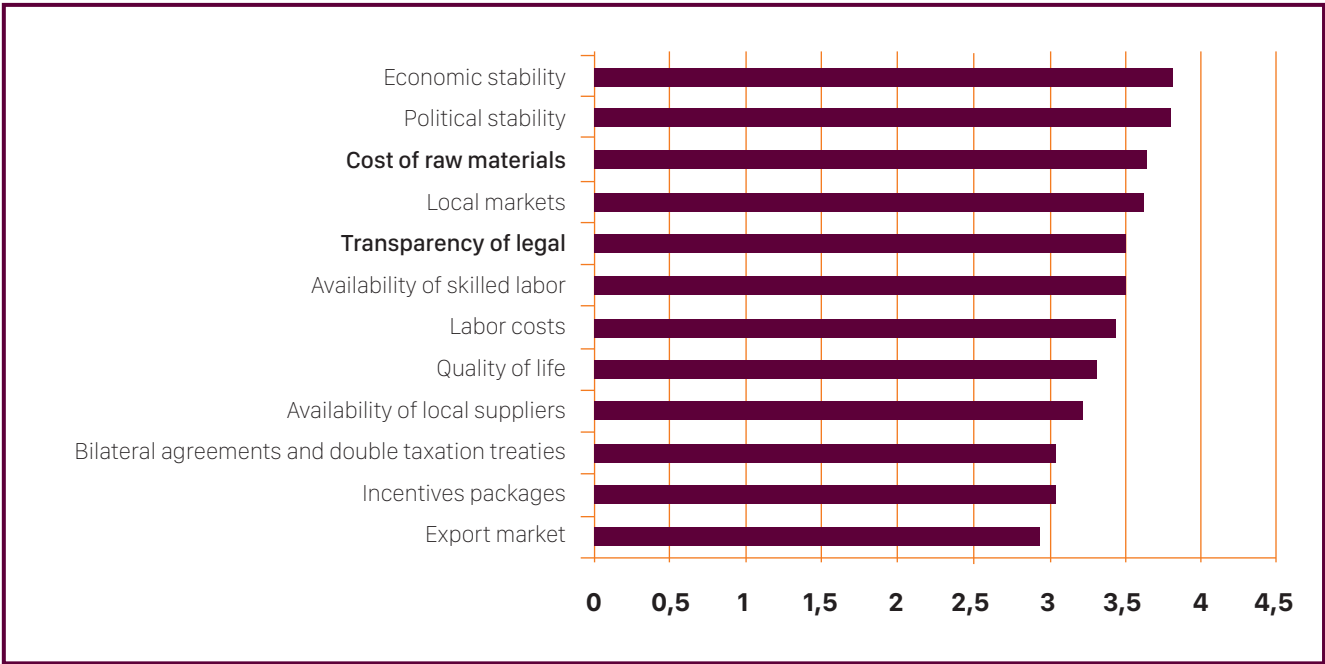
## 2.5. EMPIRICAL EVIDENCE ON THE EFFECTIVENESS OF TAX INCENTIVES

There is a variety of empirical work investigating the effectiveness of tax incentives in FDI promotion. However, there is no clear consensus about their effectiveness. There are a number of studies that find support for the view that tax

incentives are effective in promoting FDI, while others claim that the impact of tax incentives in promoting FDI is marginal relative to their high costs. The following will briefly summarise the findings of a number of empirical studies on the effectiveness of tax incentives:

- Gropp and Kostial (2000) examined the impact of taxes on the inflows and outflows of FDI in the EU. They concluded that tax rate is significant negatively related to FDI inflows and positively related to FDI outflows. The study found that a 10 percentage point increase in statutory tax rates reduces FDI inflows by 0.3 percent of GDP and increases FDI outflows of 0.2 percent.
- Benassy-Quere, Fontagne & Labreche-Revil (2003) analysed the sensitiveness of FDI to the differences in tax rates across 11 OECD over the period from 1984 to 2000. They found that tax rate differentials affecting the flows of FDI and the elasticity of statutory tax rates of FDI is 4.22 percent. In other words, an increase in the statutory tax rate of one percent in the host country relative to the tax rate in country of the home country reduces FDI inflows by 4.22 percent.
- In a single country context, Altshuler, Grubert and Newlon (1998) investigated the sensitiveness of investment location decisions of the US multinational corporations (MNCs) to the tax rates in 1984 and 1992. They found that real capital elasticity to after-tax-rate of return was 1.7 percent in 1984 and 3.2 percent in 1992. The increase in the level of real capital elasticity from 1.7 to 3.2 percent shows that the allocation of real capital abroad of the US MNCs has become more sensitive to tax differentials among host countries.

FIGURE 2. DETERMINANTS OF INVESTMENT DECISION BY THE FIRMS<sup>9</sup>



Source: UNIDO (2011a).

<sup>9</sup> The findings are based on Investment surveys conducted by the United Nations Industrial Development Organization (UNIDO) of 7,000 companies in 19 sub-Saharan African countries.

- There are also a number of studies which argue that tax incentives play a minor role in FDI promotion. After examining the tax systems of the developing countries, where the tax incentives were very popular, Tanzi and Zee (2000) concluded that the effectiveness of tax incentives in investment promotion is generally doubtful, as the decision to invest in a particular country depends on many factors, among which the availability of tax incentives is only one. In addition, there has been also argument that granting tax incentive only becomes an issue if other factors are positive for the investors to expect their investment to be profitable (Heady, 2002). These factors include access to materials and quality of labour forces at competitive prices.
- The results of a survey by UNIDO (2011a) on the effects of different factors on investment have also shown that economic stability, political stability, costs of raw materials, local market, labour costs, transparency of legal framework in the host countries are more important than the availability of tax incentives. In particular, findings of UNIDO (2011a) suggested that tax incentives ranked 11th out of 12 in

importance while transparency of the legal framework ranked 5th in investors' concerns and grew in importance over time. Tax incentives can promote investment, but they are not the "first best" solution as overall economic and institutional environment may be more important for a success of projects (Tanzi and Zee, 2000).

- There has been evidence showing that there are cases incentives are given to investors who would have made their investment decision anyway. According to James (2013), the redundancy ratio, which measured the percentage of investors who claimed that they would have invested even without the present of tax incentives<sup>10</sup>, may be very high in some cases. Survey's results from Table 4 illustrated that redundancy rates of more than 50 percent are found in many developing countries and especially, in some countries, redundancy rates are more than 80 percent, such as in Guinea, Malaysia, Rwanda or Tanzania. In this sense, it can be seen that many investments are carried out not because of tax incentives.

TABLE 4. REDUNDANCY RATIO OF TAX INCENTIVES BASED ON INVESTOR SURVEYS

<b>Burundi, 2011</b>	77%	<b>Serbia, 2009</b>	71%	<b>Guinea, 2012</b>	92%
<b>Tanzania, 2011</b>	91%	<b>Jordani, 2009</b>	70%	<b>Tunisia, 2012</b>	58%
<b>Kenya, 2012</b>	61%	<b>Uganda, 2011</b>	93%	<b>Nicaragua, 2009</b>	15%
<b>Thailand, 1999</b>	81%	<b>Rwanda, 2011</b>	98%	<b>Mozambique, 2009</b>	87%

Source: Adopted from James (2013).

- Effectiveness of tax incentives from social aspects is of a question whether tax incentives could bring equal benefits to different social groups, such as the low-income groups, women and men. While increased flows of FDI that may create more employment, it is not necessary that both men and women are equally beneficial. In addition, the immediate consequence of lower rates of CIT is a loss of revenue available for public expenditure that is likely to affect women and their children the most. If women are not able to access to healthcare, education or employment opportunities due to a cut in public services, then their life would be impacted (Christian Aid, 2014). Eliminating tax exemptions in the corporate and personal income tax may also encourage gender equality in terms of the tax burden because men tend to benefit disproportionately from such exemptions. This is mainly due to the fact that they are more likely to run a business, be a shareholder or be a house-owner who can claim these deductions (GIZ, 2011).



<sup>10</sup> This ratio is usually obtained through investor surveys (James, 2013).



03

**TAX INCENTIVES  
IN VIETNAM**

### 3.1. BRIEF OVERVIEW OF VIETNAM'S TAX SYSTEM

In 1986, the Government of Vietnam adopted Doi Moi, which was the beginning of a more market-oriented approach to the management of the economy. Since then, a number of specific steps have been taken by the Government of Vietnam to shift its economy toward greater market orientation, such as gradual liberalizing of investment and trade, restructuring state owned enterprises (SOEs) and reforming banking and finance system. In the last three decades of reform, Vietnam has acquired important achievements in terms of economic growth and in the improvement of the living standard of its people. Vietnam has become one of the fastest growing countries in Asia. In 2011-2015, average GDP growth rate in Vietnam was 5.9%, which was much higher in the average growth rate of 4.77% of emerging and developing countries in Asia and ASEAN-5 countries respectively (IMF, 2016)<sup>11</sup>. Rapid economic growth has created favourable conditions for Vietnam to improve living standards of its people. GDP per capita has increased from 402 USD in 2000 to 2,300 USD in 2015. Poverty rate has fallen dramatically, from 14.2% in 2010 to less than 4.5% in 2015 (GSO, 2016)<sup>12</sup>. However, the benefits from economic growth among different groups (e.g. the ethnic minority, the poor, the migrants, etc.) are not equally shared. While economic achievement and social progress has been reflected in diverse area, efforts towards gender equality and the advancement of women continue to face challenges. A summary of recent development of Vietnam's economy is discussed in Annex 1.

Following Doi Moi, there have been many important changes in the Vietnam's tax system over the last three decades. The scope and sequence of these reforms have been driven by the nature of the transition process. Focal points of tax reforms in Vietnam have been concentrated on broadening the tax bases, reducing tax rates and simplifying methods of tax calculation and declaration and payments. The sequence of tax reform in Vietnam over the past three decades can be summarised as follows:

- The first phase of tax reform took place during early 1990s, which focused on the establishment of the foundation for a tax system that could facilitate for the functioning of a market-oriented economy. Various tax legislation was enacted to replace the administrative decrees of the centrally planned economy, such as the Law on Turnover Tax (1990); the Law on Special Consumption Tax (SCT) (1990); the Law on Profit Tax (1990); Law on Export and Import Taxes (EIT) (1991); the Ordinance on Taxation on High-income Earners; and the Law on Agricultural Land Use Tax (1993).
- The second phase of reform took place in the late of the 1990s and early 2000s. This phase of tax reforms was marked with the introduction of various modern tax laws. The tax laws included the Law on Value Added Tax (VAT) (1997), the Law on Corporate Income Tax (CIT) (1997)<sup>13</sup>. In this phase, the Law on SCT and the Law on EIT (1998) were also subjected to various amendments
- The third phase of tax reform was carried out in the mid of the 2000s. In this phase, changes have been made in all of Vietnam's major tax legislation. In particular, Vietnam has undertaken a tax overhaul to meet the requirements of acceding to the World Trade Organization (WTO), especially in fulfilling the requirements of the principles of Most Favour Nation and National Treatments. In general, these changes are linked with the overall directions set out in the Tax Reform Plan toward 2010, which was approved by the Decision No. 201/QĐ-TTg dated December 6, 2004 of the Prime Minister. In addition, several new tax laws were also introduced in this phase of reform, including the Law on Personal income tax (PIT) (2007) ; the Law on Natural Resource Tax (2009), the Law on Non-agricultural Land Tax (2010) and the Law on Environmental Protection Tax (2010).

In the last five years, Vietnam has also embarked in another round of tax reform in line with the directions set in the Tax Reform Strategy 2011-2020, which was approved by the Prime Minister in the Decision 732/QĐ-TTg dated May 17, 2011. The objective of this strategy is to create a tax system that (i) is comprehensive, fair, efficient and consistent with a socialist market economy; (ii) is simple and transparent; (ii) promotes competitiveness and exports; (iii) to encourage investment, especially in high technology; and (iv) creates employment and growth. In line with these directions, all of Vietnam's major taxes has been amended and supplemented over the last five years, including the Law on VAT, Law on CIT; Law on PIT, the Law on SCT and the Law on EIT. Accordingly, Vietnam has reduced its CIT rate from 25 to 22 percent and further to 20 percent since January 1, 2016. PIT deduction threshold for the taxpayer was increased by 2.25 times in 2012, from 4 million VND per month to 9 million VND per month. This increase has contributed to a substantial reduction of the income tax burden for individuals in recent years. Vietnam has also set a three-year roadmap to increase the excise rates on cigarettes, beers and alcohol products, beginning from January 1, 2016. A new Law on fees and charges was also approved by the National Assembly in November 2015, which from January 1, 2017 will replace the Ordinance on Fees and Charges. By the end of the 2015, most of the major types of taxes, which are considered as necessary for

<sup>11</sup> International Monetary Fund, World Economic Outlook Database, April 2016

<sup>12</sup> Based on the official Ministry of Labour – Invalids and Social Affairs poverty lines (revised every 5 years).

<sup>13</sup> The Law on VAT and the Law on CIT took effective from January 1, 1999 and replaced the Law on Turnover Tax and the Law on Profit tax respectively.

## TYPES OF TAXES IN VIETNAM (AS OF MAY 2016)

1. Value-added tax
2. Special consumption tax
3. Export - import taxes
4. Corporate income tax
5. Personal income tax
6. Natural resource tax
7. Agricultural land use tax
8. Non-agricultural land use tax (effective from January 1, 2012)
9. Environmental protection tax (effective from January 1, 2012)
10. License tax
11. Various types of fees and charges (a new Law on fees and charges will be effective from January 1, 2017)

the functioning of a market-oriented economy, are present in the Vietnam's tax system.

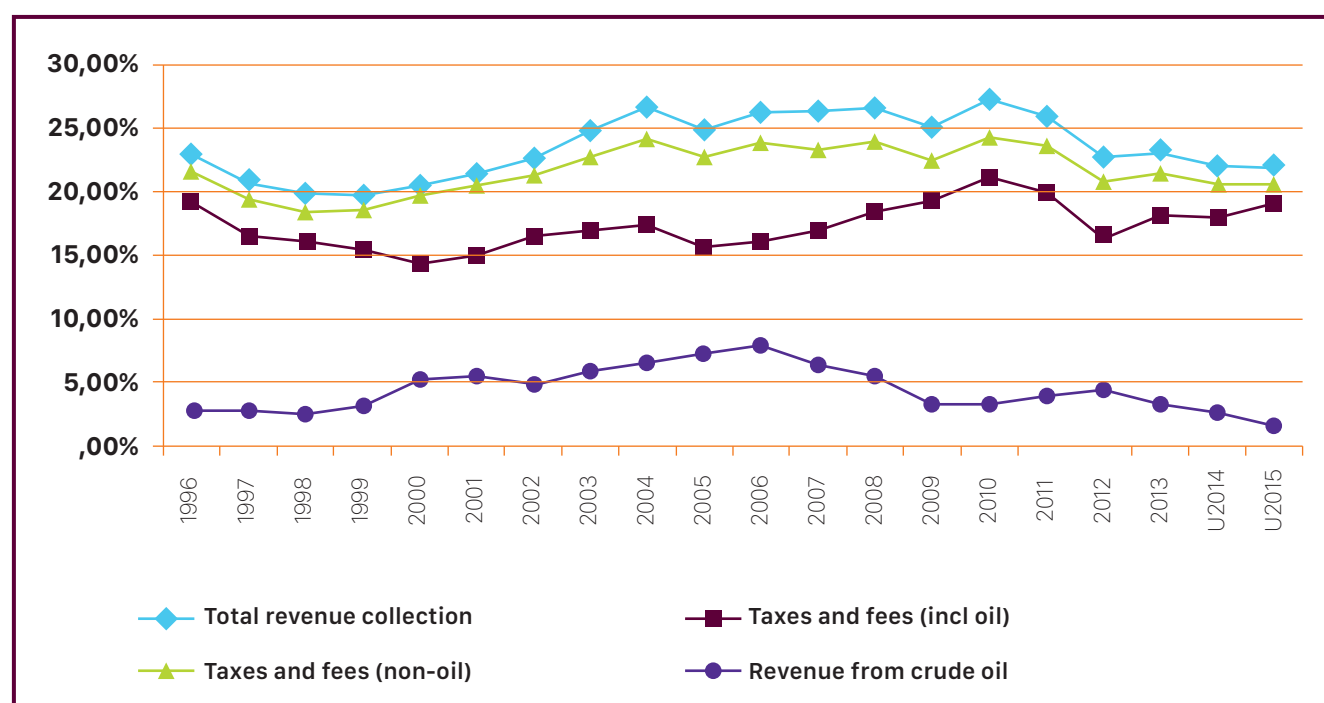
In general, Vietnam's achievements in tax reform have been quite impressive and the country has recorded itself as one of strong performers in tax reform (IMF, 2011). Tax reform in Vietnam has yielded remarkable successes in term of revenue mobilization, especially up to the late 2010s (Pham, Le & Shukla, 2012). Changes in Vietnam's State revenue as a percentage of nominal GDP are illustrated in Figure 3. Ratio of total State revenue to nominal GDP increased from 21.6 percent in 2001 to 28.2 percent in 2010. Of which, revenue from taxes and fees (exclusive of crude oil) increased from 15.1 percent to 22.3 percent of nominal GDP. On average, ratio of total revenue to nominal GDP over the 2001-2010 was 26.7

percent. This compares quite favourably with other developing countries, many of which have much higher income per capita than Vietnam (Pham, Le & Shukla, 2012).

However, over the past five years, the size of State budget revenue relative to GDP reduced significantly. Average State budget revenue in 2011-2015 was estimated at 22.7 percent of GDP, down from 26.3 percent of GDP in 2006-2010 (Figure 3). The decrease size of in State budget revenue as percentage of GDP in recent years has been due to many reasons, including (i) decreasing in tax rates to stimulate growth; (ii) lower crude oil prices<sup>14</sup>; iii) reducing in import taxes and (iv) reducing in the role of revenue from land<sup>15</sup>.

IMF (2014) also argued that the reduction in relative revenue collection in recent years has also been due to the expansion

**FIGURE 3. STATE BUDGET REVENUE COLLECTION IN VIETNAM  
(% OF NOMINAL GDP OF THE CORRESPONDING YEAR)**



Source: Calculated by authors from the GSO's data (2016).

<sup>14</sup> On average, revenue from crude oil as percentage of nominal GDP decreased from 5.26 percent in 2006-2010 to 3.10 percent in 2011 -2015.

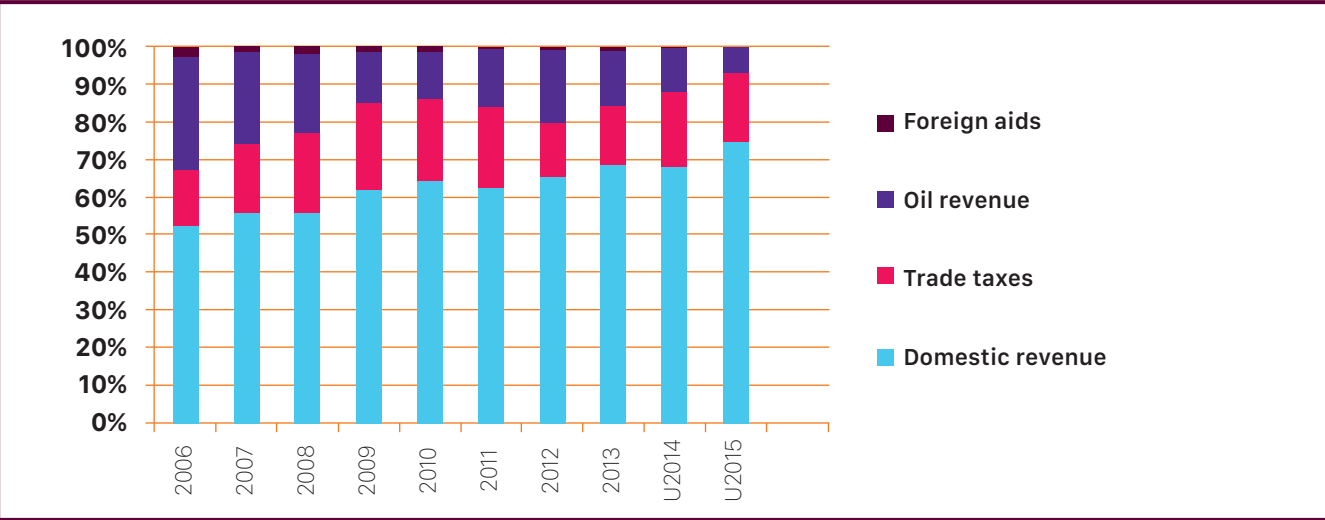
<sup>15</sup> Size of revenue from land (selling of land use right) decreased from 2.39 percent of GDP in 2010 to around 1.29 percent of GDP in 2015.

of tax incentives by the Government of Vietnam in an effort to increase the attractiveness of its domestic investment environment. In the coming years, there may be further substantial fall revenue from trade taxes when Vietnam fulfils its commitments in cutting the tariffs under different free trade agreements (FTAs). Revenue from crude oils also has an unstable outlook as oil price would not likely to be restored in the next several years.

In term of revenue structure, Vietnam's tax reform has made

positive steps towards building a tax system conducive to economic development (IMF, 2011). The growth rate of the revenue from stable sources, such as from CIT, PIT, VAT and SCT has been higher than the average growth rate of total revenue. Consequently, there has been a decrease in the reliance on non-tax revenue and revenue from crude oil (Figure 4). In 2001, non-oil tax revenue accounted for just over 63 percent of Vietnam's total revenue. In 2015, this ratio increased to around 75 percent (MOF, 2016).

FIGURE 4. STATE BUDGET REVENUE STRUCTURE OF VIETNAM (% OF TOTAL REVENUE)

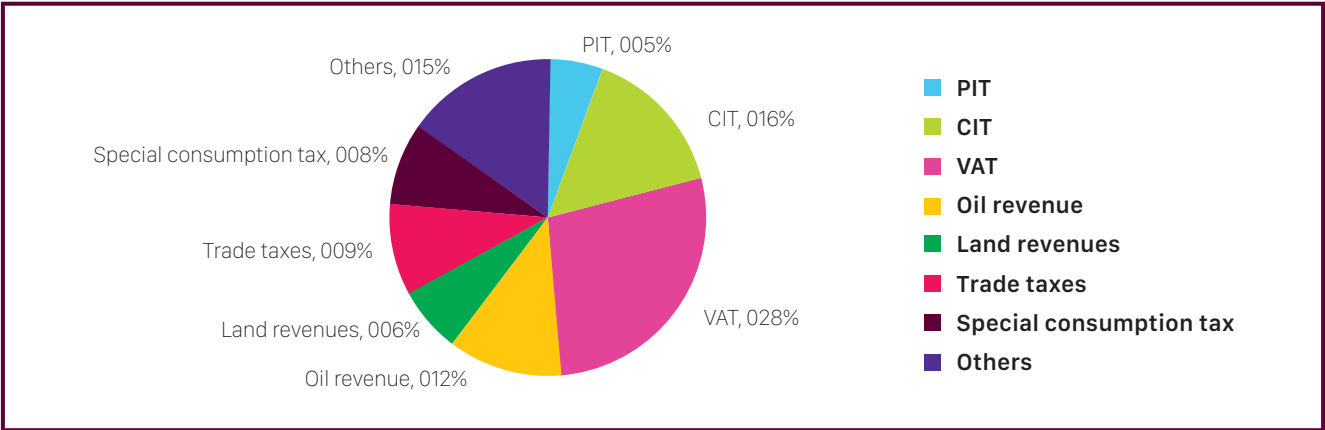


Source: Calculated by authors from the GSO's data (2016).

Currently, Vietnam relies more on VAT and CIT in term of revenue generation. In the 2014, share of revenue from VAT in total revenue was 27.9 percent. Similarly, revenue from CIT (excluding CIT from oil and gas) took the second largest share, accounted for 16.26 percent of total revenue (Figure 5). Share of PIT and property tax in Vietnam's government revenue has been relatively low. In 2014, share of revenue collected from CIT in total revenue was 5.4 percent. Revenue from land has

mainly relied on selling of land use rights, which is unsustainable as the supply of land is limited. The role of property tax (e.g. agricultural land use tax and non-agricultural land tax) has remained very modest. In 2015, revenue collected from non-agricultural land tax in Vietnam is just accounted for 0.15 percent of total revenue from fees and taxes (0.03 percent of GDP), well below the average of other transition countries<sup>16</sup>.

FIGURE 5. STATE BUDGET REVENUE STRUCTURE BY TAX CATEGORIES (% OF TOTAL REVENUE, 2014)



Source: Calculated by authors from the GSO's data (2016).

<sup>16</sup> In 2008, revenue from property tax in Indonesia accounted for 3.85 percent of its tax revenue or equivalent to 0.51 percent of GDP and for China was 1.51 percent and 0.26 percent respectively (IMF, 2010).

## 3.2. HISTORICAL DEVELOPMENTS OF VIETNAM'S TAX INCENTIVES

Together with the process of tax reform, Vietnam's tax incentives have evolved and changed significantly over the past three decades. Since the adoption of Doi Moi, to promote investment, following examples of many other developing countries, Vietnam has introduced various forms of tax incentives. Tax incentives in Vietnam take the forms of reduced CIT, tax holidays and exemptions of indirect taxes, in particular import tax and accelerated depreciation.

Prior to 2004, tax incentives adopted by Vietnam reflected discriminatory treatment between domestic and foreign investment. The discrimination was particularly found in CIT and import taxes. In particular, tax incentives granted to foreign investment were higher than those applied to domestic investments. In addition to tax laws, tax incentives were also contained in various non-tax laws, such as the Law on FDI (1987)<sup>17</sup> and the Law on Promotion of Domestic Investment (1998) and their subsidiary documents.

The standard CIT rate for foreign-invested enterprises was 25 percent while that for domestic enterprises was 32 percent. Preferential tax rates available to foreign-invested enterprises consisted of 20, 15 and 10 percent, which were lower than the respective preferential rates of 25, 20 and 15 percent applied to domestic investors. Foreign-invested enterprises were entitled to benefit longer tax holidays, including maximum four-year CIT exemption and a 50 percent CIT reduction in the next four years (8 years for especially encouraged projects). In addition, foreign investors using allocated income for reinvestment were entitled to a refund of the CIT amount paid for the portion of reinvested income.

In this period, both domestic and foreign-invested enterprises were also eligible to several forms of import tax exemptions, such as machinery and equipment imported for the formation of fixed assets. However, to some extent, import tax incentives granted to foreign-invested enterprises were larger than those applied to domestic enterprises. Exemption of import tax on raw materials and parts for projects in the especially encouraged locations was available only to foreign-invested enterprises. Another type of indirect tax incentive for both domestic and foreign-invested enterprises was SCT reduction adopted in the late 1990s by the Government of Vietnam to support for the development of local automobile industry. There was a 50 percent reduction of SCT rates for locally assembled automobiles.

In early 2000s, a number of steps were implemented to establish a non-discriminatory tax incentive system. The discrimination in the tax incentives between domestic

enterprises and foreign-invested enterprises was gradually removed. The first step in the removal of the discrimination in tax incentives was the introduction of a new Law on CIT in 2003. According to the Law on CIT (2003), CIT incentives would apply equally to both domestic enterprises and foreign-invested enterprises. In fact, the Law on CIT (2003) incorporated the highest-level incentives stipulated in the previous Law on CIT (1997) as well as in the Law on Promotion of Domestic Investment (1998) and Law on FDI (1996). This law also abolished the profit remittance tax, which was previously applied to the foreign-invested enterprises when they remit their profit abroad. Another step in phasing out discrimination in tax incentives was the approval of a new Law on EIT and the Law on amendments and supplements of the Law on SCT and the Law on VAT by the National Assembly in 2005. With these developments, discriminations in tax incentives were fully removed in 2006. Currently, domestic enterprises and foreign-invested enterprises are treated equally under the existing tax legislation in terms of both conditions and level of incentives.

## 3.3. POLICY OBJECTIVES AND LEGAL BASIS OF VIETNAM'S TAX INCENTIVES

Tax incentives have become a prominent feature of Vietnamese tax system. Incentives are found in almost every tax in the country's tax system, including both direct taxes (CIT, PIT) and indirect taxes (EIT, VAT and SCT). The objectives of granting tax incentives are to promote the investment in the areas or sectors that are in line with the government's development orientations. As Vietnam is still in a transition process to a market-oriented economy, there are a number of negative factors still inherent in the country's investment climate, such as lack of adequate infrastructure and a well-functioning legal system. Despite recent improvements, in 2015, Vietnam still ranked 56th position in the Global Competitiveness List published by the World Economic Forum (WEF). The quality of higher education and training, technological readiness or financial market development were all ranked below other countries in the region such as Thailand, Indonesia and the Philippines (WEF, 2016). In this regard, a well-designed incentive system is considered necessary to compensate for these factors to stimulate investment, especially for the inflows of FDI in Vietnam.

In Vietnam, tax incentives are granted based on regulated encouraged business sectors, encouraged locations, and size of the projects. The sectors that are encouraged by the

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<sup>17</sup> Including amended Law on foreign investment (1990); the Law on foreign investment (1992); Law on foreign investment (1996); and Decree 12/CP dated February 18th, 1997 of the Government.



Vietnamese government include education, health care, sport & culture, high technology, environmental protection, research and development, infrastructural development, and information technology. Historically, generous tax incentives were also granted to promoted exports and increased local contents in the products. However, these policies were eliminated in the mid-2000s as parts of Vietnam's commitment when joining the WTO. The areas or sectors which are eligible for investment incentives are specified in the investment legislation. Especially, the Law on Investment (2014) identified 13 broad types of business areas and 3 types of geographical locations<sup>18</sup> that are eligible for investment incentives and gives the Government the power in deciding what particular sectors or geographical regions will be eligible for tax incentives (Article 16)<sup>19</sup>. In addition, according to the Law on Investment (2014), the level of each type of incentives shall be specified by tax legislations. In Vietnam, the draft of the Law on investments and its subsidiary documents is vested within the function of the Ministry of Planning and Investment, while all tax legislation is prepared by the Ministry of Finance. Details of process for preparing tax legislation are summarised in Annex 3.

Over the past more than fifteen years, various efforts have been adopted by the Government of Vietnam to incorporate all tax incentives into relevant tax legislation. In 2001, the Prime

Minister issued Directive No.07/CT-TTg dated April 24, 2001 requesting all line ministries not to put any specific tax incentive provisions when drafting their own legal documents to reduce overlaps in incentive grants and facilitate enterprises in monitoring and application. Currently, all most provisions relating to tax incentives are already incorporated into relevant tax legislations.

## 3.4. FORMS OF VIETNAM'S TAX INCENTIVES AND ELIGIBILITY CONDITIONS

### 3.4.1. FORMS OF TAX INCENTIVES IN VIETNAM

Vietnam's tax incentives comprise different forms, including reduced CIT, tax holidays and exemptions of indirect taxes, such as VAT and EIT. In general, Vietnam's tax incentives are similar to these offered by other countries in ASEAN (Thomsen, 2004). Among these forms, reduced CIT rates and tax holidays are found to be more popular in Vietnam. The following section describes the development and current feature of tax incentives in Vietnam's major tax legislation.

<sup>18</sup> Includes: the disadvantaged areas or extremely disadvantaged areas; or industrial parks, export-processing zones, hi-tech zones, economic zones.

<sup>19</sup> Article 15 of the Law on investment (2014) specified 3 forms of tax incentives will be applied in Vietnam, which include: i) application of a lower rate of CIT for a certain period of time or throughout the project execution; ii) exemption, reduction of CIT and; iii) exemption or reduction of import tax on goods imported as fixed assets; raw materials, supplies, and parts used for the projects. However, tax incentives in Vietnam also include other forms, such as accelerated depreciation.

**TABLE 5. SUMMARY OF CURRENT TAX INCENTIVES IN VIETNAM**

		TAXES	TYPES OF INCENTIVES
DIRECT TAXES	1	Corporate income tax (CIT)	<b>Tax exemption:</b> for income from farming, husbandry, processing agriculture and aquaculture products and salt production of cooperatives, income from License transfer for waste reduction,....
			<b>Reduced CIT rate:</b> 10% and 20% and these rates are available for 15 years and 10 years respectively (compared to the standard tax rate of 20% from 01/01/2016)
			<b>Tax holiday:</b> Maximum CIT exemption of 4 years and 50% CIT reduction of 9 years (depend on projects)
			<b>Carrying loss:</b> Corporates can carry their loss up to 5 years
			<b>Accelerated depreciation:</b> Maximum rate cannot exceed twice the ordinary rate of depreciation
			<b>Other situations:</b> Corporates with high percentage of women workers, corporates with percentage of ethnic minority workers
	2	Personal income tax (PIT)	<b>PIT reduction:</b> 50% PIT reduction of 50% for individual working in the economic zones; reduce 9 million VND/month for taxpayer and 3.6 million/month for dependents and other situations in which the individual face difficulties due to natural disasters,....
			<b>PIT exemptions:</b> Certain types of income include: Interest earned on deposits; Compensation paid under life/non-life insurance policies; Income from transfer of properties between various direct family members; Income of Vietnamese vessel crew members working for foreign shipping companies or Vietnamese international transportation companies.
INDIRECT TAXES	3	Import and export taxes (EIT)	<b>Import duty exemptions:</b> i) goods imported for projects which are listed as encouraged sectors; machinery & equipment, specialized means of transportation and construction materials to form fixed assets of certain projects if such goods could not be locally produced; (ii) import duty exemption for raw materials, spare parts, accessories, other supplies, samples, machinery and equipment imported for the processing of goods for export and iii) import duty exemption of raw materials, equipment and components for five years following the commencement of operation if the investment projects are carried out in the regions where investment was especially encouraged.
			<b>VAT exemption:</b> There are 25 types of goods and services which are exempted from VAT (certain agricultural products; financial derivatives and credit services; certain insurance services; medical services; teaching and training; printing and publishing of newspapers, magazines, and certain types of books...).
	4	Value added tax (VAT)	<b>Reduced VAT rate:</b> 5 percent VAT rate applied for essential goods and services (such as water, fertilizer, medicine, educational equipment, etc)

## a) Direct taxes (CIT and PIT)

**CIT:** CIT was introduced in Vietnam in 1997. Since its adoption, the Law on CIT has been amended six times (2003, 2005, 2008, 2012, 2014 and 2016). Changes in the Law on CIT have focused mainly on (i) unifying and reducing the CIT rates; (ii) reforming the CIT base (e.g. deductions for reasonable expenses); (iii) "rationalizing" tax incentives and (iv) simplifying CIT administration. Currently, CIT is one of the most important taxes in Vietnam's tax system in terms of revenue creation. In 2014, revenue collected from CIT (exclude from oil and gas) accounted for 15.6 percent of total Government revenue or equivalent to 3.39 percent of GDP (MOF, 2016).

As noted in Section 3.2, prior to December 31, 2003, domestic enterprises and foreign – invested enterprises were subject to two different sets of CIT. Since January 1, 2004, a harmonized CIT regime has been applied to both types of enterprises. The standard CIT rate was uniformly set at 28 percent instead of 32 percent applied to domestic enterprises and 25% rate applied to foreign invested enterprises<sup>20</sup>. CIT incentives which were incomparable with non-discrimination principles of the WTO, such as these granted based on local content requirements and on the level of export performance, were also completely removed. In 2008, standard CIT rate was reduced from 28 percent to 25 percent<sup>21</sup>. In 2013, the standard CIT rate was further reduced to 22 percent from January 1, 2014 and to 20 percent from January 1, 2016. The objective of the Government of Vietnam in reducing its standard CIT rate is to increase the competitiveness of the domestic environment<sup>22</sup>.

In 2014, with the approval of the Law on the Amendments and Supplements to a number of Tax Laws<sup>23</sup> by the National Assembly, there were other several significant changes in CIT incentives. Changes are made on both aspects: incentive eligibility and degree incentives granted. A number of new sectors have been added to the eligibility list, such as "supporting industries". In which, the preferential CIT rate applied for large manufacturing projects can be extended for a maximum of 15 years if the project manufactures goods having "international competitiveness" and revenue exceeds 20,000 billion VND per year (around 950 million USD) within 5 years from the first year of revenue generation. In addition, new investment projects engaging in manufacturing industrial products prioritized for development will be also entitled to very generous CIT incentives<sup>24</sup>. According to the government of Vietnam, its objective in providing such incentives is to promote the development of supporting industries in Vietnam

in effort to accelerate the process of industrialization and modernization<sup>25</sup>.

Currently, CIT incentives in Vietnam take following forms:

- **Preferential CIT rate:** Projects qualified for tax incentives are entitled to preferential CIT rates of 20 percent (from 2016 this rate will be 17 percent) 15 percent or 10 percent, depending on eligibility criteria, such as contribution to employment, locations of investment and areas of investment. Preferential CIT rates are applied for a period of ten years and fifteen years respectively, starting from the commencement of operating activities and can be extended in certain cases. There are certain projects which can be eligible to enjoy preferential CIT rate for the whole life of the projects, such as socialized sectors (e.g. education, health) could enjoy the 10 percent rate for the life of the project.
- **Tax holiday:** Tax holidays take the form of a complete exemption, beginning immediately after the enterprise first makes profits or 50 percent reduction of CIT of the applicable rate. However, where the enterprise has not derived profits within three years of the commencement of operations, the tax holiday will start from the fourth year of operation. Tax holidays are granted based on the ability of the enterprises in meeting with incentive eligibility criteria, which may be up to four-year CIT exemption or 50 percent reduction for the next nine years.
- **Accelerated depreciation:** Highly efficient business establishments are allowed to implement accelerated depreciation of the fixed assets. However, the maximum rate cannot exceed twice the ordinary rate of depreciation. The business establishment must ensure to be profitable when applying accelerated depreciation.
- **Other cases of tax reduction included:** i) Enterprises engaged in production, construction or transportation which employ many female employees<sup>26</sup> shall be entitled to a reduction of CIT tax equal to the additional amount of expenses incurred for female employees<sup>27</sup>; ii) Enterprises employing many ethnic minority people shall be entitled to a reduction of CIT equal to the additional amount of expenses incurred for employees being ethnic minority people; iii) income generated from R&D contracts, from sales of products manufactured by new technology, from technical service contracts for agriculture and from vocational training reserved exclusively for the disabled people shall be exempted from CIT.

<sup>20</sup> For foreign-invested enterprises, there was an increase in the standard CIT rate from 25 percent to 28 percent. However, this increase was compensated by the removal of profit remittance tax, which was previously imposed at the rates of 3, 5 and 7 percent. For the domestic enterprises, there was a reduction in the standard CIT rate from 32 percent to 28 percent. Supplementary CIT on certain domestic enterprises was also abolished. Other change included the incorporation of capital gains from the transfer of real estate in to the tax base of CIT to replace for the land use right transfer tax.

<sup>21</sup> Companies operating in the oil and gas industry are subject to CIT rates ranging from 32 percent to 50 percent depending on the location and specific project conditions. Companies engaging in exploration and exploitation of mineral resources (e.g. silver, gold, and gemstones) are subject to CIT rates of 40 percent or 50 percent, depending on the project's location.

<sup>22</sup> Proposal No. 160/TTg-CP dated April 23, 2013 of the Government on the Draft of the Law on Amendment and Supplements of Law on CIT

<sup>23</sup> This Law changed the provisions of five different tax laws, including the Law on CIT, the Law on PIT, the Law on VAT, the Law on Natural Resource Tax and the Law on Tax Administration..

<sup>24</sup> Include: i) products support the high technology sector, or ii) products support the garment, textile, and footwear; information technology; automobiles assembly; or mechanical sector and are not produced domestically as of 1 January 2015, or if produced domestically, they meet the quality standards of the EU or equivalent.

<sup>25</sup> Source: The Proposal submitted to the National Assembly by the Government on the Law on the Amendments and Supplements to A Number of Tax Laws in 2014.

<sup>26</sup> More details are regulated in the Decree 85/2015-ND-CP dated 01 October 2015 of the Government on on detailed instruction on implementation on regulation for female employees

<sup>27</sup> The additional expenses for female laborers to be included in deductible expenses are: Expenses for re-training for women workers in the case of jobs are no longer suitable and need to be converted to other jobs under plan of enterprises. These expenses include tuition fees (if applicable) and salary (ensure 100% of salary for trainees); Cost of salaries and allowances (if any) for teachers of pre-schools organized and managed by the enterprises; Costs of additional health check for female employees; Costs of additional health check for female employees; and Overtime allowance for female workers in the case female employees do not take maternity leave due to certain reasons.

In addition, business establishments are also entitled to deduct a maximum of 10 percent of their annual taxable income to establish their Science and Technology Development Fund. This provision is adopted by the Government of Vietnam with an objective to promote R&D activities of the business sector.

**PIT:** PIT in Vietnam dated back to 1990 when the Ordinance on Income Tax on High Income Earners was passed by the National Assembly<sup>28</sup>. In 2007, the Law on PIT (amended in 2012, 2014) was passed by the National Assembly. This Law has made a number of important changes on taxing personal income in Vietnam. These changes include: lowering top bracket rate from 40 percent to 35 percent while that for the lowest bracket was reduced from 10 percent to 5 percent, broadening the tax base to cover investment income, capital gains and allowing deduction for the individual taxpayer herself and deductions for dependants<sup>29</sup>. PIT discriminations between the Vietnamese individuals and foreigners working in Vietnam were also completely removed<sup>30</sup>. Share of PIT revenue in total revenue is on an increasing trend, but remains still very small. In 2014, PIT revenue is estimated to account for 5.44 percent of total Government revenue or 1.18 percent of GDP (MOF, 2016).

Under the Law on PIT, certain types of income are tax-exempted. These income include: i) Interests earned on deposits with credit institutions/banks and on life insurance policies; ii) Compensation paid under life/non-life insurance policies; iii) Retirement pensions paid under the Social Insurance law (or the foreign equivalent); vi) Income from transfer of properties between various direct family members; v) Inheritances/gifts between various direct family members; Monthly retirement pensions paid under voluntary insurance schemes; vi) Income of Vietnamese vessel crew members working for foreign shipping companies or Vietnamese international transportation companies<sup>31</sup>. There is also a provision on PIT reduction of 50 percent for individual working in the economic zones. This incentive measure was adopted by the Government of Vietnam in an effort to promote the development of economic zones.

## **b) Indirect taxes (VAT and SCT and import and export taxes)**

**VAT:** VAT was introduced in January 1999. As noted in Section 4.1, VAT is currently the largest tax in Vietnam's tax system in term of revenue generation. In 2014, revenue from VAT accounted for about 27.9 percent of total Government revenue or equivalent to 6.07% of GDP. Originally, the Vietnam's VAT system has four tax rates: 0 percent for exports, 5 percent for essential goods and services (such as water, fertilizer, medicine, educational equipment); 20 percent for some specific goods and services (e.g. luxury goods); and 10 percent for all other goods and services. However, the 20 percent rate was abolished on 1 January 2004. Under the current VAT regime, imported goods are subject to VAT at the same rates as domestically produced goods under each tax bracket. According to the Law on VAT, an input tax credit is available for VAT paid on business supplies in the production process when goods or services are exported, which is the same as in many other countries applying VAT<sup>32</sup>.

There are 25 types of goods and services which are exempted from VAT. Examples of these goods and services include: certain agricultural products; financial derivatives and credit services; certain insurance services; medical services; teaching and training; printing and publishing of newspapers, magazines, and certain types of books; a number of cultural, artistic, sport services; public transportation services; transfer of technology and software services and export mineral products which are not yet processed, such as crude oil, rock, sand, rare stones<sup>33</sup>. In 2009, a policy of reducing 50 percent of the VAT rates on certain categories of goods and services for one-year was introduced by the Government of Vietnam in an effort to deal with the impacts of the global economic crisis.

**SCT:** In Vietnam, SCT is applied to both goods and services in accordance with the provision of the Law on SCT introduced in 1990<sup>34</sup>. Currently, there are currently 10 types of goods and six categories of services which are subject to SCT, including cigarettes, liquors, beers, automobiles having less than 24 seats, motorcycles, airplanes and boats<sup>35</sup>, gasoline, air-conditioners with capacity of less than 90,000 BTU, discotheque, massage, karaoke, casino. There are 16 SCT rates, ranging from 7 to 70 percent. The highest SCT rate of 70 percent is applied to cigarettes<sup>36</sup>. The lowest 7 percent

<sup>28</sup> This Ordinance was subject to continuous revised (in 1992, 1993, 1994, 1997, 1999, 2001 and 2004). In the 1990s, PIT rate was set at very high level, which at some point reached 60 percent. In 2001, the highest PIT rate was reduced to 50 percent and further to 40 percent in 2004.

<sup>29</sup> Personal allowance is 9 million VND per month and dependent allowance is 3.6 million VND per month for each dependent. The dependent allowance is not automatically granted and the taxpayer needs to register qualifying dependents and provide supporting documents to the tax authority.

<sup>30</sup> Previously, Vietnamese and foreigners working in Vietnam were subject to two separate rate schedules and the tax brackets for the foreigners were wider.

<sup>31</sup> According to the proposal of the Government of Vietnam submitted to the National Assembly in 2014, the purpose of exempting PIT for Vietnamese vessel crew members working for foreign shipping companies or Vietnamese international transportation companies is to support for the development of the shipping industry and as the same time reduce the administration burden because these individuals are mainly working outside the territory of Vietnam and in most cases they are regarded as "non-resident" taxpayers under the provisions of the Law on PIT (2007).

<sup>32</sup> Under the deduction method of VAT calculation, VAT payable = Output VAT - Input VAT. In which: i) the output VAT to be charged is calculated by multiplying the taxable price by the applicable VAT rate and for imported goods, VAT is calculated on the import dutiable price plus import tax plus SCT (if applicable) plus environment protection tax (if applicable); ii) Input VAT is based on VAT invoices. If a business sells exempt goods or services it cannot recover any input VAT paid on its purchases. This contrasts with supplies entitled to 0 percent VAT where the input VAT can be recovered. Where a business generates both VAT and VAT exempt sales, it can only claim an input VAT credit for the portion of inputs used in the VAT activity.

<sup>33</sup> For more information on the VAT rates and List of VAT exemptions refers to the Law on Value Added Tax No.13/2008/QH12.

<sup>34</sup> Since that time, SCT regime has been reformed six times (1995, 1998, 2003, 2005, 2008 and 2015).

<sup>35</sup> Motorcycles with engine capacity of more than 125 cc, airplanes and boats have been subject to SCT since April 1, 2009.

<sup>36</sup> From January 1, 2019, this rate will increase to 75 percent.

rate is applied to E10 gasoline. In 2014, revenue collected from SCT was accounted for 8.3 percent of total Government revenue or equivalent to 1.8 percent of GDP (MOF, 2016).

In the past, SCT incentives were found in the provisions allowing certain locally produced products, including automobiles and cigarettes to enjoy certain tax reduction. This policy was in favour of domestic produced goods over imported goods. Prior 2003, local automobile manufacturers were eligible for a 50 percent of SCT rates on their products. This measure was adopted with the purpose to support the local automobile industry in its initial stage of development and the encourage localization (local content). Cigarettes with imported filter used to be subject to the SCT rate of 65 percent, but the SCT rate applied to cigarettes with domestic filter was only 45 percent. All treatments which are in favour of domestic produced goods over imported goods were completely removed in 2005. SCT is now imposed equally on both domestic and imported goods. This removal was part of the commitment that Vietnam made in the process of negotiating to join the WTO.

**Import and export taxes:** The import and export taxes were among the first type of taxes introduced in Vietnam. The Law on EIT of Commercial Goods was introduced in 1988 when the country was in its very early stage of economic transformation. In 1991, the Law on EIT was approved by the National Assembly to replace for the Law on EIT of Commercial Goods (1988), which was later amended in 1993 and in 2005. On March, 2016, a new Law on EIT was passed by the National Assembly to replace its predecessor<sup>37</sup>. In the Law on EIT (2016), there is a relatively long list of incentives in terms of import tax exemption, such as (i) goods imported for projects which are listed as encouraged sectors; ii) machinery & equipment, specialized means of transportation and construction materials to form fixed assets of certain projects if such goods could not be locally produced; (iii) raw materials, spare parts, accessories, other supplies, samples, machinery and equipment imported for the processing of goods for export<sup>38</sup>. If the investment projects carried out in the regions where investment was especially encouraged, enterprises are also eligible for import duty exemption of raw materials, equipment and components for five years following the commencement of operation.

Prior to 2012, a duty rebate scheme was also adopted by the Government of Vietnam as a form of incentive used to promote exports. In accordance with this scheme, import tax paid on inputs imported for the production of export goods shall be refunded when the goods are exported. A duty suspension

scheme was also introduced in 1993 to facilitate export activities. Initially, this system enabled export-oriented firms to suspend duty payments up to 90 days and then the suspension period was extended to 275 days. However, this mechanism was also abolished in 2012 under the provisions of the Law on the Amendment and Supplement of a number of Articles of the Law on Tax Administration. Currently raw materials, spare parts, accessories imported for producing goods for exporting are exempted from import tax

### 3.4.2. COVERAGE AND ELIGIBILITY OF TAX INCENTIVES IN VIETNAM

The current tax incentive regime is explicitly targeted by geographical areas and business sectors. Incentive eligibility criteria are set out in the Law on Investment (2014) and related legal documents by the Government. Currently, investment projects meeting one of the following eligibility conditions are entitled to tax incentives<sup>39</sup>:

- Investment in business sectors and industries, which are eligible for investment incentives or special investment incentives (known as Incentive List and Special Incentive List). Sectors covered in these two lists include: high-tech activities; R&D; production of new materials, new energy, clean energy, renewable energy; productions of products with at least 30 percent value added; energy-saving products; production of key electronic, mechanical products, agricultural machinery, cars, car parts; ship building; production of ancillary products; cultivation, processing of agriculture products, etc....;
- Investment in locations under the List of Encouraged Areas, including disadvantaged areas or extremely disadvantaged areas; industrial parks, export-processing zones, hi-tech zones, economic zones;
- Investment in large manufacturing projects with investment capital of more than 6 trillion VND and satisfying the following conditions: (i) minimum turnover is 10 trillion VND per annum for at least three years after the first year of operations, and (ii) minimum headcount is 3,000 for at least three years after the first year of operations<sup>40</sup>.
- Investment in projects in rural areas utilizing more than 500 workers (not including part-time workers and workers whose employment contracts are shorter than 12 months);
- High technology enterprises, science and technology enterprises, science and technology organizations defined by regulations of law on high technology, science and technology.

<sup>37</sup> Export and import taxes used to play a very important role in terms of revenue generation for the State budget, especially prior to the mid of the 2000s. In 2001, revenue collected from export and import taxes accounted up to 15.47 percent of total revenue. However, there has been a steady decline in the share of revenue contributed from export and import taxes. In 2015, share of export and import tax revenue in total government revenue was less than 8 percent.

<sup>38</sup> The administration of these incentives is carried out in accordance of the provisions of the Law on tax administration 2007 and its amendments and the Law on Customs 2014.

<sup>39</sup> Detail eligible conditions for investment incentives are stipulated in the Decree 118/ND-CP dated November 12, 2015 of the Government.

<sup>40</sup> From 2015, large manufacturing projects are defined to include projects with investment capital of 12 trillion VND or more, disbursed within five years of being licensed. If the company does not respect the conditions, they have to pay back the taxes to the Government.

The actual level of tax incentive is determined based on the extent to which these eligibility criteria are met. Investment projects located in regions which is under the List of disadvantaged areas and investment is made in the sector which is included in the Special Incentive List shall be eligible to the highest level of tax incentives. Large projects are eligible for the same investment incentives as investment projects in extremely disadvantaged areas. Investment projects in sector eligible for investment incentives and take place in disadvantaged areas are eligible for the same investment incentives as investment projects in extremely disadvantaged areas. In addition, an investment project that is eligible for various levels of investment incentive may apply the highest level.

In accordance with the Law on Investment (2014) if the project has been granted a Certificate of investment registration, the registry office shall write the investment incentives on the Certificate of investment registration. In other case if a Certificate of investment registration is not required, the investor shall be given investment incentives if the conditions for investment incentives are satisfied without having to apply for a certificate of investment. In this case, the investor shall determine the investment incentives and follow procedures for investment incentives at the tax authority, finance authority, or customs authority according to the conditions for investment incentives.

In addition, CIT incentives prescribed above apply only to enterprises which comply with the cost accounting regime, maintain invoices and source vouchers, and pay tax in accordance with declarations. Enterprises must account separately for income from activities entitled to preferential the tax rates and activities not entitled to tax incentive rates, failing which it shall be determined as a ratio of turnover from

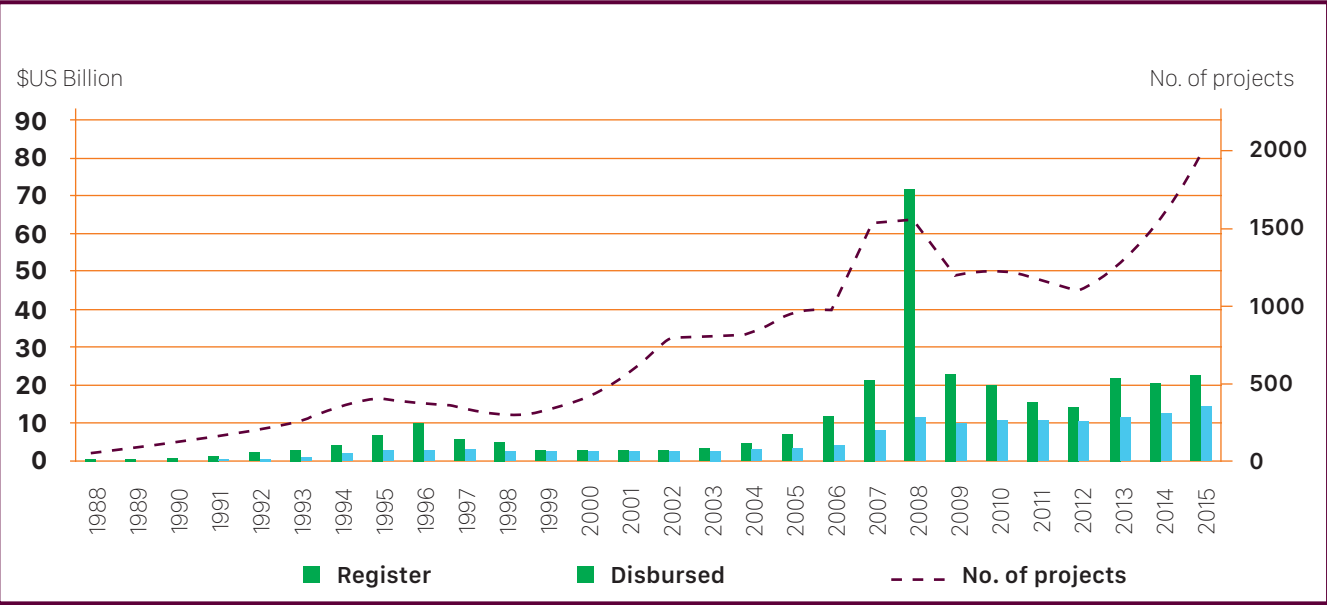
activities entitled to tax incentive rates over total turnover of the enterprise. In addition, CIT incentives do not apply to income from activities of prospecting, exploration and mining of petroleum and gas and other rare and precious natural resources; income from casino and gambling businesses.

### 3.5. BENEFITS AND COSTS OF VIETNAM'S CURRENT TAX INCENTIVES

As noted in Section 3.3, tax incentives have been applied consistently to stimulate investment, especially for the inflows of FDI in Vietnam. It can be seen that reductions in tax obligations while increasing tax incentives in some investment sectors and locations have created favourable conditions for the enterprises to increase capital accumulation, expand manufacturing and speed up the economic growth in Vietnam in the past more than two decades of economic reform. Benefits of tax incentives can be seen from the specific figures:

- Since the introduction of economic reform in the late 1980s, achieving high rate of investment has been viewed by the Government of Vietnam as a key to its economic growth ambition. Therefore, like other countries, Vietnam has been adopted a wide range of tax incentives to promote investment. Over the past three decades, together with many other economic measures, tax incentives have made a certain contribution in attracting external and internal

FIGURE 6. FDI IN VIETNAM 1988-2015



Source: Adopted from Pham (2015).

resources, fostering export and stably rapid economic growth<sup>41</sup>. Total investment capital of the whole society was kept at the average level of more than 30 percent of GDP in 2011-2015. Among all economic sectors, investment from non-state sector has increased significantly. Share of non-state investment out of total investment of the whole society increased from 23 percent in 2000 to more than 43 percent in 2015.

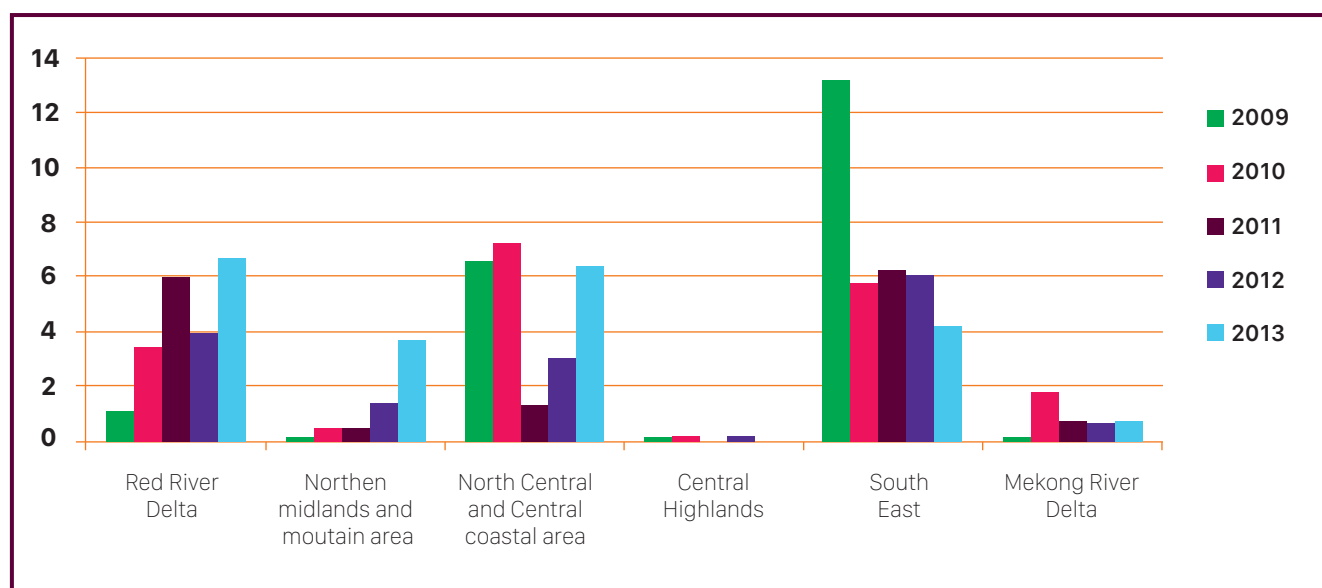
- Vietnam has also become an attractive destination for FDI. The reduction in the overall tax burden and the introduction of various forms of tax incentives has contributed to creating a more favourable environment to attract foreign investment. Total FDI disbursement in Vietnam has exceeded 10 billion USD per year over the past five years. Although, within the scope of this research, it is very hard to measure the extent to which the reduction in CIT in recent years has led to the increase in FDI inflows, the recent surge in FDI inflow in Vietnam has indicated significant improvement in Vietnam's investment environment. As of December 2014, Vietnam has attracted 17,250 FDI projects with a total registered capital of 254 billion USD (Nguyen, 2015). In 2015, Vietnam attracted more than 22.75 billion USD of FDI, marking an increase of more than 10 percent in compared with that of 2014 (GSO, 2015).
- Over the past two decades, the FDI sector has been played an increasing role in the Vietnam's economy. The FDI sector accounted for 23 percent of the country's investment capital in 2015. Share of output from FDI sector in total nominal GDP increased from 7.4 percent in 1996 to 18 percent in 2015 (GSO, 2016). Tax exemption and reduction for export activities have helps to push up export turnover through years, especially from the FDI sector. Vietnam's total export

turnover in 2015 reached 162 billion USD, which was more than 11 times higher than that of 2000. In 2015, exports of the FDI sector accounted for more than 63 percent of the Vietnam's total exports, up from 47 percent in 2000.

In particular, certain large FDI projects, which are usually granted with high level of tax incentives by the Government, such as Samsung's projects in Bac Ninh and Thai Nguyen, have made strong contribution to Vietnam' exports in recent years. In 2015, total exports by Samsung projects in Vietnam reached more than 30 billion USD, representing a share of 20 percent of Vietnam's total exports (GSO, 2016). In addition, with strong participation of FDI sector in export activities, exports from the higher value-added products has expanded faster compared to the traditional group's export expansion.

- The increase in the size of FDI sector in GDP has helped to shift the structure of the economy toward a greater industrial orientation. In 2011-2015, the industrial sector and service sector grew at average rates of 6.9 percent and 6.3 percent respectively. The share of agriculture sector decreased from 24.53 percent in 2000 to 16.08 percent in 2005. The proportion of the industrial sector in GDP increased from 36.73 percent to 39.82 percent (GSO, 2016).
- The regional structure of investment has also experienced changes in recent years. Proportion of FDI in Northern mountainous region and Northern central region and Coastal central region also increased substantially in recent years, which are among the poorest region of the country (Figure 8). In recent years, provinces in less developed regions have begun to attract a number of very large projects, such as in 2014, Samsung decided to invest in a 3.2 billion USD project in Thai Nguyen. According to the Ministry

**FIGURE 7. FDI BY REGION 2009-2013 (BILLIONS OF USD, REGISTERED CAPITAL)**



Source: Adopted from Pham (2015).

<sup>41</sup> The Proposal submitted to the National Assembly by the Government on the Law on the Amendments and Supplements to A Number of Tax Laws in 2014.

of Investment and Planning, since 2006, the structure of FDI by region has shifted in a more positive direction. Poor provinces in the Central Coastal and Mekong Delta Rivers, such as Thanh Hoa, Ha Tinh, Phu Yen and Kien Giang have begun to attract a greater share of FDI (Pham, 2015).

However, as in other countries, tax incentives have also posed a number of issues for Vietnam, which include the losses of revenue collection and additional complexity into the tax system. The followings will provide a brief discussion on these issues:

- As discussed above, tax incentives in Vietnam are very generous (Pham, Le & Shukla, 2012)<sup>42</sup>. Generous tax incentives also mean that they generate a very high opportunity cost in term of revenue forgone<sup>43</sup>. Currently, due to absence of statistics on tax expenditure and the information on the effects of tax incentives, it is impossible to accurately and objectively assess impacts of the tax incentives applied. However, through some statistics published by the Government recently, it can be noticed that costs of tax incentives in term of revenue foregone is relatively substantial. According to the IMF (2014), the expansion of tax incentives in recent years has been among the factors leading to the decrease in the level of revenue mobilization in Vietnam.

Recently, as part of a required procedure in drafting tax legislation, the government of Vietnam has published some documents estimating the revenue consequent of new tax measures, including tax incentives. In 2013, the Government of Vietnam estimated that revenue cost of applying CIT incentives to business expansion projects measures proposed under the Law on Amendment and Supplements of Article of the Law on CIT (2003) was around VND 2,080 billion or about 1.6 percent of CIT revenue (non-oil) at that time<sup>44</sup>. Similarly, in 2014, revenue cost of introducing new CIT and PIT incentives under the Law on the Amendments and Supplements to a number of Tax Laws was around VND 2,500 billion or equivalent to 1.85 percent of CIT (non-oil) revenue in 2014<sup>45</sup>.

As noted earlier, it is extremely difficult in obtaining relevant data for analysing the costs of tax incentives in Vietnam. Vietnam's tax authorities in recent years has conducted some analysis on the revenue cost of tax incentives but not yet published the results of their study. In an effort to provide some information an assessment on the revenue cost of tax incentives in Vietnam, this Research used the data on taxable income and amount of CIT actually paid by 394 profit-making companies listed in Hanoi Stock Exchanges in 2014. The data is collected from the financial statements of these listed companies, which by the requirements of the Law on Securities have to be made available. In order to provide some information on the revenue cost of tax incentives, this research compared ratio between total

amount of CIT actual paid by the listed companies and total profits before CIT. In some extents, this ratio could be use as proxy for estimating revenue costs of tax incentives in Vietnam. Following this approach, the ratio estimated for 2014 was 20.5 percent, which was below the standard CIT rate of 22 percent applied in 2014. There are some other factors that need to be taken into account to come up with the exact conclusion on revenue impacts of tax incentives, such as the impacts of loss-carry forward, this finding has provided the extent on the revenue cost of granting tax incentives in Vietnam.

- As noted in Section 3.4 above, Vietnam's tax incentive regime is relatively complicated. The coverage of the incentives is based on a lengthy and scattered list of incentive eligibility (business areas and locations) provided in the Law on Investment (2014). Many enterprises recently have showed their concern about the enforcement of certain tax incentive provisions. For example, it is extremely difficult for the enterprises to know whether their products meet "the quality standards of the European Union or equivalent" in order to be eligible for new tax incentives provided in the Law on Amendments and Supplements a number of Tax Laws 2014. In addition, continuous changes in tax incentives in recent years have made it more costly for enterprises in complying with these changes. Currently, due to lack of information and data available, there is very limited research that is able to provide in-depth analyses on the administrative costs of tax incentives in Vietnam. Furthermore, due to time constraints and limited resources, conducting such research is also well beyond the scope of this research. There are nevertheless some evidences which can be used to highlight for the complexity of Vietnam's tax system. According to the World Bank (2016), the total time an enterprise must spend to prepare, file, and pay three major types of taxes (including CIT, VAT, PIT) and other social security contributions in Vietnam in 2015 is much higher than other countries in the region. Reforming tax administration, therefore, should continue to be a priority for Vietnam in its tax reform's efforts in the coming years.
- In 2011, UNIDO conducted an Industry Investor Survey from 1,426 manufacturing firms located in four key provinces in Vietnam, namely Ho Chi Minh City (390 firms), Binh Duong (375 firms), Dong Nai (233 firms), Hanoi (290 firms) and in four other provinces: Vinh Phuc (23 firms), Bac Ninh (31 firms), Da Nang (31 firms), and Ba Ria - Vung Tau (33 firms), of which, 58.6 percent (836 firms) are foreign-owned firms, 32.4 percent (462 firms) are private domestic firms and 9.0 (128 firms) percent are state-owned enterprises. The findings of the survey suggest that the most important factors investors refer to are political and economic stability, labour costs, taxation, the country's legal framework and the quality of infrastructure (UNIDO, 2011b).

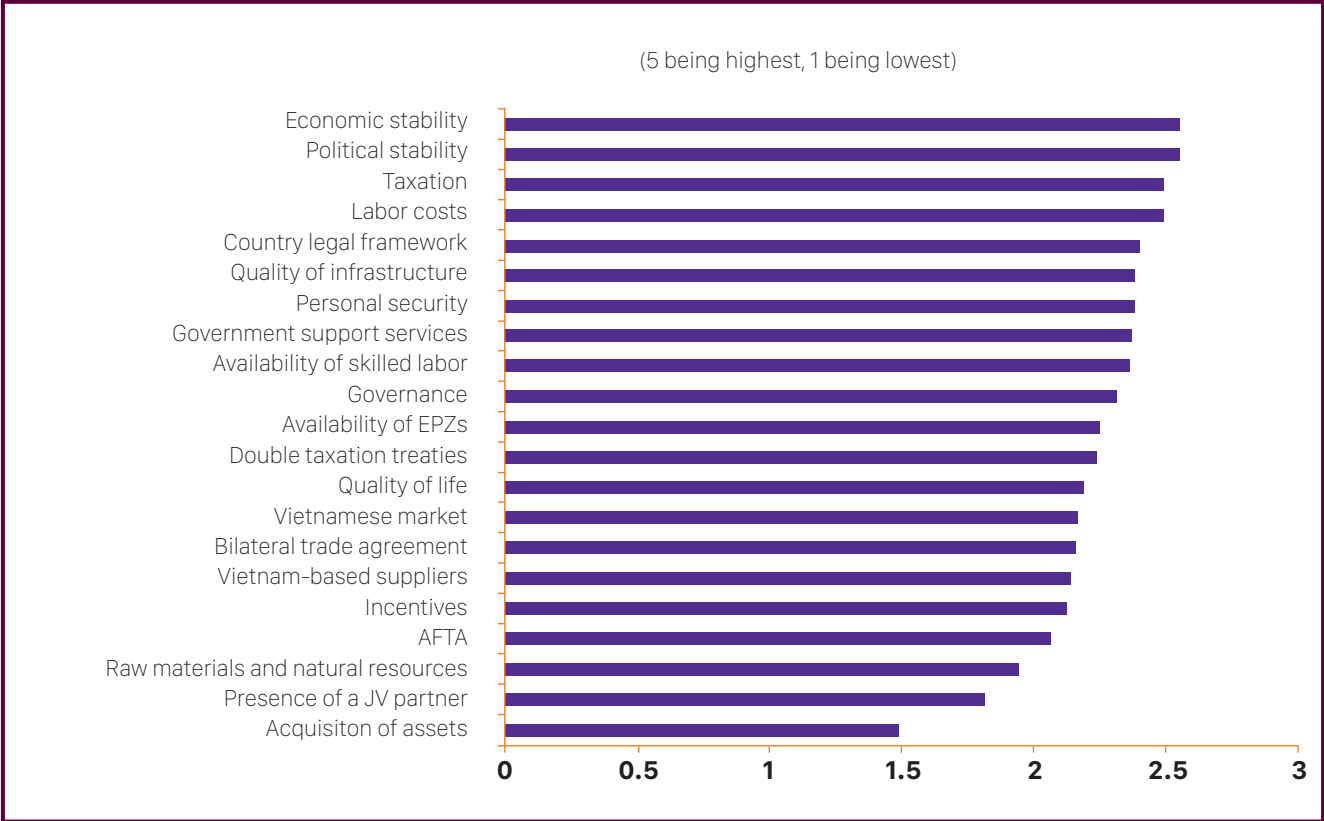
<sup>42</sup> Existing CIT incentives in Vietnam consist of both preferential tax rates and tax holidays, in which the highest applicable CIT incentive package for a project may include: the rate of 10 percent for 15 years, tax exemption for four years and 50 percent reduction on CIT amount due for 9 subsequent years, which is much higher than that in Thai Land or Malaysia and Indonesia.

<sup>43</sup> Assuming there is a case that an enterprise invests a new project in an economic zone in 2015. Income generated from this project will be taxed at 10 percent (instead of 20 percent) for 15 years, exempted for four years and reduced 50 percent for 9 years. Total duration eligible for CIT incentives of this project is 28 years. If the enterprise makes 1 billion VND taxable incomes per year since 2016 and if CIT policies keep unchanged for 28 years, the averaged tax liability is around 85.7 million per year instead of 200 million per year, representing an effective rate of 8.57 percent.

<sup>44</sup> The Proposal submitted to the National Assembly by the Government on the Draft of the Law on Amendment and Supplements of the Law on CIT in 2013.

<sup>45</sup> The Proposal submitted to the National Assembly by the Government on the Draft of the Law on Amendments and Supplements a Number of Tax Laws.

FIGURE 8. RANKING OF IMPORTANCE OF LOCAL FACTORS BY FOREIGN INVESTORS



Source: UNIDO (2011b)

### 3.6. OVERALL EVALUATION ON TAX INCENTIVES IN VIETNAM

As discussed earlier, tax incentives have been used widely in both developed and developing countries to promote investment and they may be effective in some circumstances. However, tax incentives have also posed a number of issues. For Vietnam, these issues are more critical given the following issues of its tax incentive regime:

[1] Tax incentives have been used extensively in Vietnam over the past three decades but the extent to which these incentive measures contribute to the increase in investment and in achieving other Vietnam's Government goals, such as in promoting the investment in poor regions of the country and in prioritized sector<sup>46</sup> still do not receive adequate analysis from both academic researchers and policy makers<sup>47</sup>. Currently, due to lack of information and data available, there are very limited researches which are able to provide an in-depth analysis on the costs and

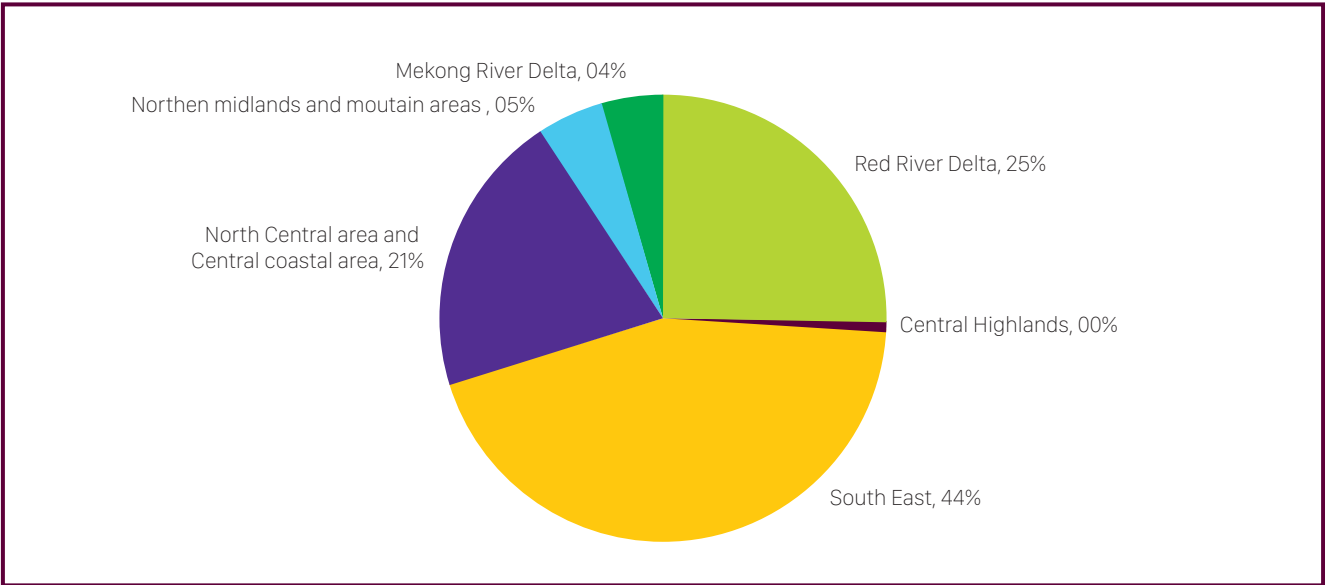
effectiveness of tax incentives in Vietnam. Not much data relating the revenue costs of tax incentives are available. In addition, concept of tax expenditure is currently not adopted in Vietnam. For Vietnam, these issues are very important to look at given the prevalence of its tax incentives (Pham, Le & Shukla, 2012).

[2] In Vietnam, to promote investment, generous tax incentives are available to enterprises locating in economic zones as well as in less developed regions. However, there is little evidence that location-based tax incentives are effective in attracting more investment into these regions. Vietnam has offered generous incentives to project located in the less developed regions, but these regions still fail to attract more investment from outside due to inconvenient location or inadequate facilities. Good actors in attracting investment in Vietnam are still the areas where there is high quality infrastructure and convenient location close to ports, highways and major cities with skilled workforce, such as the areas surrounding Hanoi and Ho Chi Minh City. On the other

<sup>46</sup> These sectors are stipulated in the Law on investment 2015, included: high-tech activities; R&D; production of new materials, new energy, clean energy, renewable energy; productions of products with at least 30 percent value added; energy-saving products; production of key electronic, mechanical products, agricultural machinery, cars, car parts; shipbuilding; production of ancillary products; cultivation and processing of agriculture products.

<sup>47</sup> Tax incentive eligibility is determined based on the geographical location of the project, the sector at which the project is invested in, and the size of the project.

**FIGURE 9. REGISTERED FDI BY REGIONS (% OF TOTAL, AS OF DECEMBER 31, 2014)**



Source: Calculated by authors from the GSO's data (2016).

hand, economic and industrial zones located in less disadvantaged locations remain under-invested despite the availability of considerable tax benefits (MPI, 2015).

The regions with the most developed infrastructure and highest availability of relatively skilled labour attract most of the share of total FDI in Vietnam. About 25.36 percent of registered FDI in 2014 were located in the Red River Delta, especially regions around Hanoi and Hai Phong. The South East attracted 44.24 percent of total registered FDI, with Ho Chi Minh City alone accounting for one quarter (GSO, 2016). Recently, various tax incentives have been introduced to attract FDI in remote regions outside the metropolitan areas. However, the attempts to attract FDI outside the main urban areas have not proved success yet (Tran and Dinh, 2014). As of 2014, there were only 4.70 percent of registered FDI locating in the Northern Midland and Mountain Area (GSO, 2016). FDI in the Central Highlands accounted for less than 0.33 percent of the total registered FDI.

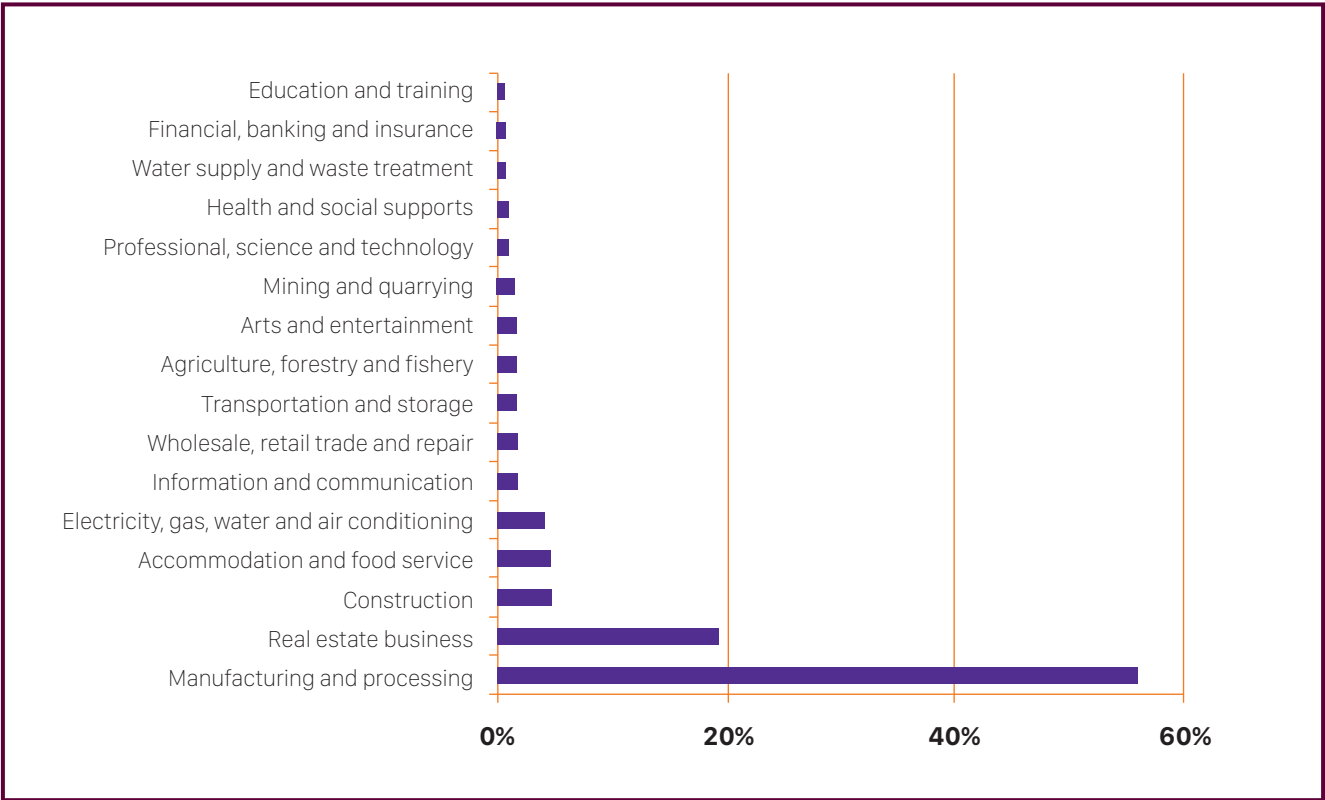
[3] Vietnam offers very generous incentives for projects in some sectors, such as agriculture development and processing of agricultural and aquatic products, software production and renewable energy. However, currently, the level of investment in the agricultural sector is still relatively low. Agriculture accounted for around 18 percent of GDP, but in 2015, the share of total investment in the agriculture sector was less than 7 percent (GSO, 2016). Most of FDI in Vietnam are in the manufacturing sector and real estate sectors. In 2015, these two sectors accounted for more than 78 percent of registered FDI in Vietnam. In 2015, only 1 percent of registered FDI went to agricultural sector.

[4] One of the main features of Vietnam CIT incentive regime is that most the incentives granted are mainly profit-based, in

which tax holidays are the most popular. Other forms of incentives such as tax credit or investment allowance are currently not presented in Vietnam. As noted in Section 2.1, tax holidays tend to attract investments with short term horizon and do not benefit longer term projects that generate profits beyond the tax holiday period. Under tax holidays, profits are exempted regardless of their amount and hence the most profitable investments, which would have taken place anyway tends to be benefit the most. According to the World Bank (2014), tax holidays have created a motivation for tax avoidance through the indefinite extension of holidays such as creative restructuring of existing investments as new investments.

[5] As noted in Section 4.3, Vietnam's tax incentive regime is relatively complex. This is due to the coverage of the incentives are based on a lengthy and scattered list of incentive eligibility (business areas and locations) provided in the Law on Investment 2014. Recently, the Government issued Decree 118/ND-CP dated November 18, 2015 providing guidelines for Investment Law has provided the conditions for tax incentives based on the business sectors, industries and locations. According to this Decree, 30 encouraged business sectors and 27 especially encouraged business sectors are eligible to investment incentives, including tax incentives. In terms of geographical location, tax incentives are granted in "encouraged areas", including districts and towns in 53 out of 63 total provinces in the country. In addition, high-tech zones, economic zones, industrial parks and export processing zones established under decision of Prime Minister are also entitled to CIT incentives. Currently, there are more than 300 such zones established in Vietnam, and all of them are eligible for tax incentives of various forms.

FIGURE 10. SHARE OF REGISTERED FDI BY BUSINESS SECTOR (% OF TOTAL, AS OF DECEMBER 31, 2014)



Source: Calculated by authors from the GSO's data (2016).

In addition, there is a long list of indirect tax incentives, especially in the EIT in Vietnam. In the recently approved Law on EIT (2016), there are 23 cases which are eligible for EIT exemptions, which is broader than what stipulated in the Law on EIT (2005)<sup>48</sup>. Within these 23 cases eligible for EIT exemption, there are still cases, in which the exemptions are subject to the decisions of the Prime Minister. In the VAT legislation, there are also extensive of goods and services which are VAT exempted or eligible to reduced rate of 5 percent. Furthermore, exemption of intermediary inputs from VAT may also increase the cost of final goods as buyers are not allowed to claim input tax on purchases of exempt items, so that part of the value added in a final product is taxed more than once<sup>49</sup>. Extensive VAT exemptions also increase tax compliance and administration cost, particularly for the enterprises producing both VAT exempt and non-exempt products and services.

[6] Decisions granting tax incentives in Vietnam are fragmented to some extent, requiring the involvement of different line ministries. For example, to implement the tax incentive regulations provided in the recent Law of EIT 2016, in addition to the Ministry of Finance, 11 other ministries and government agencies also have to issue guiding documents. In the Law on CIT, income from new investment projects engaging in manufacturing products in the List prioritized for development will be entitled to very high CIT incentives if their products support the certain industries<sup>50</sup> and are not produced domestically as at 1 January 2015, or if produced domestically, they meet the quality standards of the EU or equivalent. Implementing such regulation will require substantial involvement of the line ministries. Therefore, improving policy coordination is very important as when tax incentives are granted, later on it is also very difficult to remove such the incentives despite the

<sup>48</sup> This is because in the process of drafting the Law on EIT (2016), the Government of Vietnam incorporated all EIT incentives which previously stipulated in other non-tax legislation, such as the Law on Education, the Law on Science and Technology and the Law on Environmental Protections.

<sup>49</sup> For example, in 2014, the Law on Amendments and Supplement a number of Tax Laws moved certain goods used for agricultural production, such as fertilizer, from paying VAT at the rate of 5 percent to the category of VAT exemption with a purpose to reduce tax burden for agriculture sector, such as fertilizers. Fertilizer production companies have argued that previously they were able to claim part of 10 percent of VAT paid on input materials. However, with the new VAT exemption policy, they have to pay a full 10 percent in input taxes, and this pushed up the production costs (Source: Vietnam New, March 6, 2015: "Fertiliser firms seek VAT waiver on inputs", from <http://vietnamnews.vn/economy/268275/fertiliser-firms-seek-vat-waiver-on-inputs.html>).

<sup>50</sup> Such as garment, textile and footwear; information technology or automobiles assemble.

recognition that tax incentives may come at significant fiscal cost and ineffectiveness in promoting investment.

[7] Another feature of existing tax incentives in Vietnam is the integration of social policy objectives into tax incentive policy, especially in the CIT legislation. While Vietnam has generous tax incentive policies to achieve certain social objectives, it is unclear how they could contribute to social objectives in reality due to the lack of relevant data, including sex-disaggregated data and information. For example, CIT exemption is currently granted to income generated from production and trading of goods and services by business establishments specially reserved for employees being disabled people and from vocational training for the ethnic minorities, specially disadvantaged children. Female labourer intensive establishments doing business in manufacturing, construction and transportation are also eligible to special CIT incentives. However, there has been not much evidence on the effectiveness of such incentives.

In addition, there have not been impact analyses of tax incentives on gender equality perspective given the fact that the same tax policy may have different implications on men and woman. The question of how tax incentives have helped to achieve the desired social objectives, including gender objectives, has not yet received enough attention from relevant stakeholders, such as academic institutions, development actors and government agencies. The policy on tax reduction for enterprises employing many female employees is considered necessary to promote the utilization of female employees, however, in fact there have been many arguments on the effectiveness of these tax incentives. The effectiveness of this tax incentive is unclear while it is a burden for businesses when employ many female workers<sup>51</sup>. According to the report of the Ministry of Labour, Invalids and Social Affairs (MOLISA) on the implementation of tax cuts for businesses to use more female workers, out of 48 provinces and cities and four ministries, three industrial parks and a corporation surveyed, only Nghe An and Binh Dinh provinces have businesses using many female employees that are considered exempt from CIT reduction<sup>52</sup>. In addition, the definition of "enterprises using many female employees" under the CIT legislation excludes micro-enterprises with less than 10 employees, which are owned primarily by women. This kind of micro-enterprise does not get benefit from this policy even if all their workers are female. In the VAT legislation, there are 25 categories of goods and services exempted from VAT and certain goods and



services are subject to reduced VAT rate of 5 percent. Among the list of goods and services which are VAT-exempt, there are items reflect social objectives, such as health care or training service. However, there is lack of analysis to examine how those tax provisions can promote gender equality. These policies may have different impacts on women and men due to their traditional roles. The application of VAT at lower rate for basic commodities such as food and clean water, from a gender perspective, would bring more benefits to women as they are likely to spend more on these items than their male counterparts.

[8] Tax incentives in Vietnam tend to favour large investment projects. Larger investment projects are eligible to receive more preferential tax treatments. Currently, projects of value of investment of more than 6,000 billion VND (about 280 million USD) could be able to enjoy the highest tax incentives<sup>53</sup>. This policy will benefit more foreign companies, well established domestic investors and capital-intensive firms. It is difficult to judge whether new investments below a certain threshold are less beneficial to the economy than investment above such a threshold. Over the past five years, large investment project in Vietnam frequent seeks a very high level of tax incentives, which may also fall outside the scope of the current legislation. In fact, there has been several tailored investment incentive packages for individual large investors, including tax incentives and other incentives such as land rental. In the case of Samsung Project in Thai Nguyen province, in accordance with the Resolution No. 63/NQ-HĐND dated December 12, 2014 of the People Council of Thai Nguyen province, in addition to the incentives stipulated in CIT legislation, this project will also enjoy additional three years of 50 percent CIT reduction.

<sup>51</sup> Source: <http://hawee.vn/content/tham-vấn-lấy-ý-kiến-xây-dựng-chính-sách-ưu-đãi-cho-nữ-chủ-doanh-nghiệp-và-doanh-nhiều-lao-động-nữ>.

<sup>52</sup> Source: [http://nguoiibaovequyenloi.com/User/ThôngTin\\_ChiTiet.aspx?MaTT=83201642956607951&MaMT=23&MaNT=2](http://nguoiibaovequyenloi.com/User/ThôngTin_ChiTiet.aspx?MaTT=83201642956607951&MaMT=23&MaNT=2)

Source: <http://business.gov.vn/tabid/128/catid/432/item/13076/tỷ-lệ-nữ-lãnh-đạo-trong-doanh-nghiệp-việt-cao-thứ-2-đông-nam-á>.

<sup>53</sup> A CIT holiday of a total of 13 years (4 year exemption and 9 year reduction of 50 percent) and reduced CIT rate of 10 percent for 15 years.

A large flock of ducks is gathered in a body of water. In the center-left, a person wearing a hat and dark clothing is wading through the water, holding a white bag. The water is a murky green-brown color. The ducks are of various breeds, including mallards and Muscovy ducks, and are densely packed in some areas.

04

**POLICY  
RECOMMENDATIONS  
AND SUMMARY  
CONCLUSION**

## 4.1. POLICY RECOMMENDATIONS

Theoretical and empirical experiences have highlighted the fact that in certain stages of economic development and circumstances tax incentives could contribute to economic growth through stimulating investment and strengthening competitiveness of the targeted industries. Thus, in view of the problems discussed in Section 3.6, we do not argue that tax incentives should never be used to promote investment in Vietnam, rather they must be reviewed and rationalized in order to be more effective in achieving the desired goals while minimizing the cost of using them. The following will highlight some policy options and recommendations with respect to the reform of the Vietnamese tax system in general and its tax incentive regime in particular.

[1] Vietnam should continue to ensure macroeconomic stability and to enhance level of competitiveness through appropriate macro and structural reforms. Tax incentives can promote investment, but they are not the “first best” solution as overall economic and institutional environment may be more important for a success of a project. The decision to invest of an enterprise depends on many factors, among which the availability of tax incentive is only one. Strong and stable economic fundamentals are equally if not more important than the availability of tax incentives.

In reality, CIT incentives are useful for the investors if they are having profits. Tax incentives offer no benefit if the investor suffering losses. However, the question whether the investors having profit or not depend on non-tax factors, such as low labour costs, absence of undue administrative impediments, adequate infrastructure and ability to access to materials. Vietnam should therefore focus on reforming its legal and administrative system and developing adequate supporting institutions such as banks, transportation, communications and infrastructure facilities, such as roads and railway network.

[2] Vietnam also should review and rationalize all types of tax incentives. In particular, all current tax incentives need to be reviewed carefully to reduce the redundancy, to avoid wasteful grants of incentives and to keep the incentives simple and transparent and all tax incentives need to be in line with the government development priorities identified in its medium and long-term development plans, such as Five Year Socio-Economic Development Plan. As for the CIT, incentive eligibility conditions for tax incentives need to be targeted and selective, focusing on certain key sectors or areas. As discussed above, under the existing regime, business sectors and geographical locations eligible for tax incentives are very scattered. As a general rule, tax incentives should be limited to the sectors or locations that are expected to generate positive externalities for the whole economy, such as to promote R&D activities, information technology or use of high technology. More importantly, tax incentives should be linked to the national

development priorities or specific targeted industries in which Vietnam can generate comparative advantages. In addition, the incorporation of social policy objectives into the tax incentives should be eliminated or limited to the extent, which is easily to manage or monitor. The current list of VAT exempt items also needs to be scrutinized and only a few of the 25 items should remain exempt. Furthermore, Vietnam should strengthen the transparency and ensure the simplicity in implementing import tax incentives, especially in identifying the list of goods eligible to import tax exemption by the line-ministries.

In addition, the incorporation of social policy objectives into the tax incentives should be eliminated or limited to the extent, which is easily to manage or monitor. The implementation of social policy should be funded directly from the government budget via relevant spending programs rather than indirectly through tax incentives. This will ensure greater equity, transparency and easier management. For example, if the government would like to support the handicapped or ethnic minorities, it would be better to increase subsidies allocated to them through social spending program of the government, rather than through tax incentives granted to businesses which employ these targeted people. In fact, it will be difficult or more costly in monitoring to ensure that the benefits of such incentives reach the targeted beneficiaries. When beneficiaries are supported by directly through State budget spending, there will be more transparency and it will also be easier for the government to control and manage.

[3] Vietnam should reduce the reliance on tax holidays. Among different types of tax incentives, tax holidays have the highest cost in terms of revenue forgone. Therefore, given the fact that preferential CIT rates and tax holiday are widespread used in Vietnam, cost factor is very important consideration for Vietnam when reviewing its tax incentive policy. Vietnam should consider reducing the reliance on tax holidays and introducing new forms of tax incentives, which has been approved effectively in other countries, such as investment allowances or multiple deductions of expenses in encouraged activities, e.g. expenses for R&D. Tax holidays have completely disappeared from developed countries and currently OECD countries only use investment tax credit or accelerated depreciation both of which are quite well targeted to investment (World Bank, 2014).

[4] Administrative procedures for assessing and granting tax incentives should be simpler and more transparent. All tax incentives should be incorporated into the relevant tax laws so that tax authorities can administer them. This will make the formulation, implementation and administration of these incentives easier and cheaper. In addition, criteria to qualify for tax incentives need to be defined clearly in tax

legislation and there should not be any room for subjective interpretation by tax administrators.

[5] Vietnam should conduct a careful cost-benefit analysis before and after implementing any tax incentive measure including from social and gender equality perspectives. In a cost benefit analysis, positive contributions of tax incentives should be weighted again the opportunity costs of such incentives. This will assist the government in gaining an informed view about how much these incentives cost in terms of revenue foregone before any adjustment is

made. In other words, cost and benefit analysis from short-term and long-term perspective should be used to rationalize tax incentives. Designing tax incentives should take into account the revenue aspect to guarantee a certain level of revenues to the State, especially in the context of decreasing the level of State budget revenue in recent years. A framework illustrated in Table 6 can be used to evaluate tax incentives.

[6] Vietnam also needs to establish a reporting mechanism in order for the tax authorities to collect the information and

TABLE 6. KEY CRITERIA FOR TAX INCENTIVE EVALUATION

EX ANTE EVALUATIONS	EX POST EVALUATION
What objective does the tax expenditure aim to achieve?	Is the tax expenditure still relevant?
What market failure is being addressed?	How much did the tax expenditure cost?
Is a tax expenditure the best approach to address the market failure?	What was the impact of the tax expenditure?
What economic impact is the tax expenditure likely to have?	Was it efficient?
How much is it expected to cost?	

Source: Department of Finance, Ireland (2015).

data relating to tax incentives, such as number of projects actually eligible to tax incentives, what are the actual amount of revenue forgone due to such incentives and what are the contributions of the projects for the economy in terms of employment creations, exports volume. In particular, firms receiving tax incentives should also be required to file tax returns, even if no taxes are due. These returns would show how much the taxpayers would have needed to pay in the absence of the incentives provided. This also helps to increase transparency and enforcement. All of the acquired information should be made available and accessible by the public and the NGOs .

[7] Vietnam should also adopt tax expenditure practices as implemented in many countries. Tax expenditures are revenue losses attributable to tax incentives and other tax concessions. Tax expenditures are also considered "off-budget" spending. According to Tyson (2014), tax expenditure is "revenue a government foregoes through the provisions of tax laws that allow (1) deductions, exclusions, or exemptions from the taxpayers' taxable expenditure, income, or investment, (2) deferral of tax liability or (3) preferential tax rates should be adequately recorded and monitored". Tax expenditure data then can be used to justify for the costs and benefits of any particular tax incentive.

[8] Vietnam should also continue to put greater efforts on the reform of its overall tax system and adopts "international best practices". For prospective investors, the overall features of the tax system are more important than the tax incentives (Holland, 1998). Experiences of many countries have also shown that tax incentives can only function effectively if the tax system underlying these types of incentives is properly designed. The reform of tax incentive regime should also be placed in line with the reform of the overall tax system. As the country has been in a transition process, a number of provisions of the existing tax legislation, such as the Law on CIT, the Law on PIT and the Law on SCT, also need to be adjusted to reflect the new changes in socio-economic environment and to develop a tax system that is efficient, equitable and consistent with the operation of a market economy in the context of increasing globalization.

Tax reform also needs to be carried out in accordance with a growth-friendly approach, focusing on the expansion the tax base while continue to maintain the tax rates at adequate and competitive level. Vietnam should also refrain from further reduction in the standard CIT rate to avoid further decrease in Government revenue. As discussed in Section 3.2, over the past ten years, together with introducing new incentives, Vietnam has also

consistently decreased its standard CIT rate as part of the overall tax reform, from 28 percent to 25 percent, then to 22 percent and from 2016 the rate was set at 20 percent. The CIT rate in the Vietnam currently is lower than the average rate in neighbouring countries. CIT rate reduction in various ways has helped to improve the attractiveness of domestic investment. However, it has also created revenue cost for the Government. According to the calculation of the Government of Vietnam in its proposal to the National Assembly to reduce the CIT rate in 2013, a 1 percent reduction in CIT rate would cause the CIT revenue to reduce around 6.000 billion VND.

Vietnam should establish an appropriate a more balanced tax structure (income taxes, consumption taxes and property taxes). Real estate tax should also be constructed to replace current land-related taxes. This tax shows great potential for increasing tax revenue for Vietnam given rapid urbanization in recent years<sup>54</sup>. However, it is still worth noting that tax reform is difficult and a multi-facet issue, which needs to be carried out in a relevant sequence. Given the country is still in transition process and delivering tax reform is not an easy task, technical supports from international organizations, such as IMF or the World Bank, may be very helpful for Vietnam in developing a growth-friendly tax reform in the next five years.

- [9] Regarding gender aspects, there should be some measures in place to ensure that the tax system in general and tax incentives in particular take gender equality into account, as tax policies and incentives may have different impacts on men and women. To facilitate this, it is suggested to review and revise the taxation data system from gender perspective. Currently, Vietnam's tax policies,

including tax incentives are formulated following a process governed by law with participation of different stakeholders. However, due to lack of gender disaggregated data, gender impact analysis of tax incentives in Vietnam is difficult. In addition, given the importance of gender equality, it would be very essential to enhance capacity building and awareness raising for tax officials and respective organizations (e.g. tax policy department, tax administration department, and women's organizations) to increase knowledge on gender issues and make sure that all requirements related to gender equality are incorporated in the process of designing tax policy in general and tax incentives in particular.

## 4.2. SUMMARY CONCLUSION

Tax incentives have been widely used as a means to promote investment by countries around the world. Vietnam is not an exception. There are costs and benefits associated with the use of tax incentives and empirical evidence on the effectiveness of the use of tax incentives in promoting investment is still divergent. Different types of tax incentives have different impacts on the behaviour of the investors. Adopting right types of tax incentives for right economic objectives is very crucial in ensuring the effectiveness of tax incentive policy.

In Vietnam, over the past three decades, there have been substantial changes in the use of tax incentives as a means of investment promotion. To various extents, tax incentives have made significant to the country's recent economic achievement, especially in terms of attracting FDI. However, as



<sup>54</sup> Over the past few decades, substantial infrastructure investments have been made by the Government leading to substantial increases in land and housing prices but an adequate mechanism to recapture part of the increase in the added value of the real estate is still not presented.

with other countries, there are also costs associated with the use of tax incentives, in which revenue cost is a very important factor that need to be taken into account when assessing the effectiveness of tax incentives in Vietnam. In addition, the implementation of tax incentives in Vietnam has also revealed a number of issues relating to their complexity and effectiveness.

For tax incentives to be effective in stimulating investment, it is critical for Vietnam to pay attention to both macro and structural reforms and the reform of tax incentive regime itself. In term of macro and structural reforms, it is very important to ensure macroeconomic and political stability, and the overall tax system underlying the incentives is well designed and formulated. In terms of tax incentives themselves, tax incentive regime should be simple, clear, transparent and compatible to international common practices. Eligibility criteria should be more targeted and based on well-defined objectives, avoiding widespread and wasteful grants of incentives. In addition, cost-benefit analysis should be carried out before and after implementing any major tax incentive measure.

### 4.3. POSSIBLE DIRECTIONS FOR FUTURE RESEARCH

Studying tax incentives and their effectiveness is not an easy task. Given the time and resource constraints, this research has been subject to a number of limitations. More careful analysis on the costs and benefits of tax incentives in Vietnam could be made if there is scope for incorporating some field surveys, including the interviews with Government's officials who are directly involved in the process of tax policy formulation as well as the tax officials at local tax offices, especially in the regions where the present of FDI is substantial. These interviews may provide better information on tax incentives from the formulation of such incentives to their implementation in practice. In addition, given the fact that consolidated data on tax incentives in Vietnam is not available, it will also be very helpful in analysing the costs and benefits of tax incentives in Vietnam if researchers can get access to the CIT returns from the database of the tax authority. In addition, as noted above, analysis of the impact of Vietnam's tax incentives from gender perspective is challenged by lack of sex-disaggregated data on taxpayers, information on gender and taxation, expertise or good understanding of both gender and tax issues. Tax policy in general and tax incentives in particular may have different impacts on men and women. Therefore, it is recommended to take gender impacts studies, such as evaluation on effectiveness of tax incentives applied to the enterprises using many female employees or gender impacts of VAT on households and small and medium enterprises.



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# ANNEX 1

## Overview of the development of the Vietnamese economy

In 1986, the Government of Vietnam adopted Doi Moi which was the beginning of a more market-oriented approach to the management of the economy. Compared with other countries in Eastern Europe and former Soviet Union, Vietnam emphasizes gradualism over radical changes in its reform process. In the past three decades of reform, Vietnam has acquired important achievements in terms of economic growth and in the improvement of the living standard of its people.

Vietnam has become one of the fastest growing countries in Asia. In 2011–2015, average annual GDP growth rate in Vietnam was 5.9 percent, which was much higher in the average growth rate of 4.77 percent of emerging and developing countries in Asia and ASEAN-5 countries respectively (IMF, 2016). Economic growth in Vietnam has been driven mainly by the rapid expansion of industrial and service sectors. In 2011–2015, the industrial sector and service sector grew at the average rate of 6.9 percent and 6.3 percent respectively. Share of industrial sector in GDP (nominal price) increased from 35.98 percent in 2011 to 39.82 percent in 2015 and in the same time, share of agricultural sector increased from 22.02 percent to 16.08 percent (GSO, 2016).

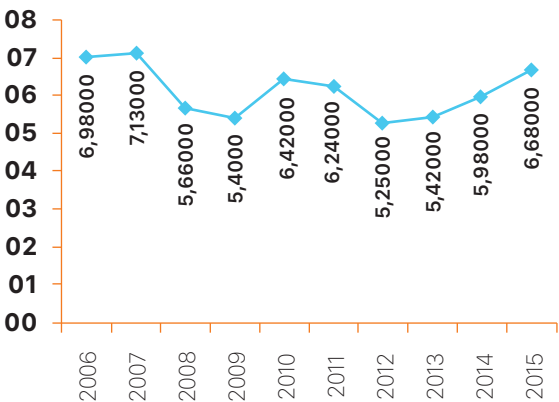
Rapid economic growth has created favourable conditions for Vietnam to improve living standards of its people. GDP per capita has increased from 402 USD in 2000 to 2,300 USD in 2015. Poverty rate has fallen dramatically, from 14.2 percent in 2010 to less than 4.5 percent in 2015 (GSO, 2015)<sup>55</sup>. Vietnam has also made various important moves towards achieving the goal of universal primary education. In 2013, the net enrolment rate in primary school was 98.1 percent; the primary school completion rate was 98.1 percent (ADB, 2015). The provision of health care has also improved significantly. Number hospital beds per 10,000 inhabitants increased from 21 in 2011 to 24 in 2015 (GSO). The life - expectancy at birth in Vietnam in 2014 was 74 years, which is relatively high compare with other developing countries in the region. Under-five mortality rate per 1,000 live birth also decreased from 34 in 2000 to 22 in 2015 (ADB, 2015).

Viet Nam has made significant progress in gender equality during the past few decades, including improvements to policies, legal frameworks and the national institutional mechanism on gender equality and the advancement of women. This progress has been reflected in diverse areas of society, including education and training, employment, health care and labour.

However, in its process of transition and development, Vietnam still faces with many problems and challenges. As the country starts from a very low level of development, Vietnam is still among the poorest countries in South East Asia with a very low GDP per capita. Vietnam's population remains predominantly rural. In 2014, around 66.9 percent of Vietnam's population is located in the rural areas (ADB, 2015). While the country's successes in poverty reduction are significant, high poverty incidence still exists in rural and areas. In 2014, the nation-wide poverty rate was 8.4 percent, while the poverty rate in the rural area was still around 10.8 percent (GSO, 2015). Access to health care and education in remote and mountainous areas is still difficult. Infant mortality rate and child malnutrition, remain high in mountainous and remote areas. Malnutrition rates among ethnic minority children are two times higher than those of the majority (World Bank, 2014). Social and economic inequality has also increased. In 2012, the income of 20 percent of Vietnamese richest households was 9.4 times higher than that of 20 percent of the poorest households, increased from 8.31 times in 2002 (Pham and Nguyen, 2015). Although the Government at all levels has made great efforts to follow and act in the spirit of the Gender Equality Law 2006 and the National Strategy on Gender Equality 2011–2020, efforts towards gender equality and the advancement of women continue to face challenges. Challenges in informal sector employment, climate change impacts and social security system access limitations have affected the lives of a large proportion of the country's population, the majority of whom are women and the poor<sup>56</sup>.

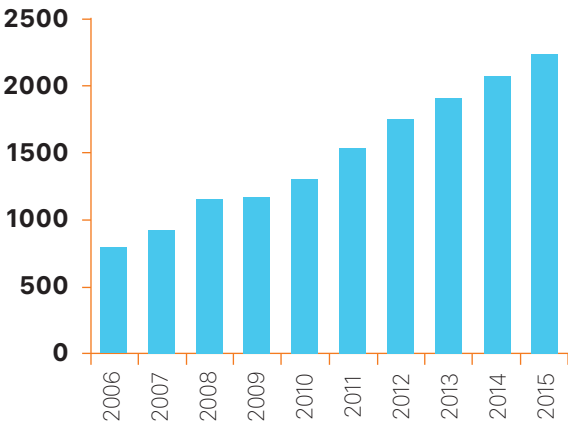
The Government's development vision for the next decade is

REAL GDP GROWTH IN VIETNAM (%)



Source: GSO (2016).

NOMINAL GDP PER CAPITA IN VIETNAM (USD)



Source: GSO (2016).

<sup>55</sup> Based on the official Ministry of Labour – Invalids and Social Affairs poverty lines (revised every 5 years)

laid out in its Socio-Economic Development Strategy (SEDS) 2011-2020. The SEDS gives attention to structural reforms, environmental sustainability, social equity, and emerging issues of macroeconomic stability. It defines three "breakthrough areas": (i) promoting human resource development; (ii) improving market institutions; and (iii) infrastructure development. In addition, the Government of Vietnam has reaffirmed that the transition and development of the Vietnamese economy should be pro-poor and more investment in rural and lagging regions will be made. Especially, in recently adopted Socio-economic Development

Plan (SEDP) 2016-2020, Vietnam has set the target to achieve an average GDP growth rate of between 6.5 to 7.0 percent and reduces the share of agricultural sector in GDP to 15 percent in 2020. Vietnam has also aimed to achieve GDP per capita in Vietnam of around 3,200 to 3,500 USD by the year 2020. Strong emphasis has continued to be given to the restructuring of the economy in association with a new growth model towards improving quality, efficiency and competitiveness of the economy. Efforts will also be made to secure social welfare and address pressing social problems.

## ANNEX 2

### Tax policy formulation and tax legislation drafting process in Vietnam

In Vietnam, legislative powers are constitutionally attributed to the National Assembly. As a legislative authority, the National Assembly adopts a resolution on annual plan of laws making. However, a law initiative is usually proposed by executive authority following a strict process, provided by the Law on Promulgation of legislative documents, in order to ensure participation of all stakeholders<sup>57</sup>. Based on the National Assembly resolution, the Government assigns a ministry in charge of preparation with participation and coordination of other line ministries.

Tax policy formulation follows the same process. Following the National Assembly Resolution on plan of law making, the Government assigns the Ministry of Finance to prepare a draft tax law. Then, the Minister of Finance establishes a Committee for preparation of the tax law proposal. The Committee is usually led by a Vice - Minister of Finance and representative from Tax Policy Department, National Institute for Finance, Legal Affairs Department, General Department of Taxation, General Department of Customs, related departments of the Ministry of Finance and related ministries.

The Committee details agenda for tax law formulation and identifies problems to be considered in the tax law and then submits identified problems to the Minister of Finance for determining objectives and principles of tax policy formulation. It also collects documents, theoretical and empirical evidence/arguments and international experiences, and prepare a first draft and related documents (tax law proposal, report on current tax law implementation (if any), tax law explanation, report on international experiences, report on tax law impacts assessment).

After first draft has been completed, the Ministry of Finance sends the draft to various ministries and local governments for comments and advice. The Ministry also gathers comments and suggestions from experts, institutes, universities, businesses, and the public through workshops, Government website and Ministry of Finance's website. Ministry of Finance completes the draft before submitting the draft to Ministry of Justice for appraisal.

The Ministry of Justice shall take charge and cooperates with the Ministry of Finance, the Ministry of Home Affairs, the Ministry of Foreign Affairs, relevant organizations in appraising the request for law formulation before submitting it to the government within 20 days from the receipt of the satisfactory applications from the Ministry of Finance<sup>58</sup>. The appraisal report must contain opinions of the Ministry of Justice about the appraised contents and whether or not the request for law formulation is satisfactory enough to be submitted to the Prime Minister. The appraisal report must be sent to the Ministry of Finance within 10 days from the end of the appraisal. The Ministry of Finance shall submit the tax law proposal and related documents to the government at least 20 days before the date of meeting of the Government. The Government shall hold a meeting to consider the tax law proposal and vote for the policies proposed and submit the tax law proposal to the Standing Committee of the National Assembly and to the National Assembly for consideration and discussion.

Before submitting the tax law proposal to the National Assembly or Standing Committee of the National Assembly for consideration and discussion, it must be inspected by the Finance and Budget Committee of the National Assembly. The

<sup>57</sup> According to the Law on Promulgation of legislative documents, the Vietnamese Fatherland Front, Vietnam Chamber of Commerce and Industry, other associate organizations of Vietnamese Fatherland Front, other agencies, organizations, and individuals are entitled and will be enabled to provide opinions about formulation of legislative documents and draft legislative documents. During the formulation of legislative documents, the drafting agencies and relevant organizations must enable other organizations and individuals to provide opinions about formulation of legislative documents and draft legislative documents; seek opinions from entities regulated by legislative documents. Opinions about formulation of legislative documents and draft legislative documents must be considered during the process of adjusting draft documents.

<sup>58</sup> The appraisal shall focus on: (i) the necessity of the law; entities regulated by the law; (ii) the conformity of the proposed policies with other policies; (iii) the constitutionality, legitimacy, and consistency of policies with the legal system; feasibility of the proposed policies; solutions and conditions for ensuring implementation of the proposed policies; (iv) the compatibility of the proposed policies with relevant international agreements to which Socialist Republic of Vietnam is a signatory; (v) the necessity, reasonability, cost of administrative procedures of proposed policies (if they are related to administrative procedures); integration of gender equality in the request for law/ordinance formulation (if they are related to gender equality); (vi) the adherence to procedures for requesting law formulation.

Finance and Budget Committee of the National Assembly shall invite the Standing Legal Committee, Standing Social Affairs Committee, and other agencies to attend the inspection meeting and provide opinions about the tax law proposal. This Committee may also invite representatives of relevant organizations, experts, scholars, and representatives of entities being impacted by the tax law to attend the meeting.

At least seven days before the opening date of meeting of Standing Committee of the National Assembly, the Ministry of Finance must send the tax law proposal to Standing Committee of the National Assembly for comments. The draft document, description, and report on inspection of the tax law

proposal shall be posted on the portal of the National Assembly. Ministry of Finance shall consider opinions offered by Standing Committee of the National Assembly to revise the tax law proposal.

At least 20 days before the first meeting date of the National Assembly, the tax law proposal submitted to the National Assembly must be sent to all members of the National Assembly. The National Assembly shall consider approving the tax law proposal after one or two meetings of the National Assembly; if the law has complicated clauses, the National Assembly may consider approving it after three meetings.

SEQUENCING OF TAX POLICY FORMULATION PROCESS IN VIETNAM









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