

**T**he foreign invested enterprises' operations not only contributes to economic growth and development but also creates significant revenues to the State budget. In the trend of integration into the global economic development and trade, each nation's economy has to be increasingly open and recognizes more competition, the support for export thus rises and the contribution from export duty to the revenues of the budget is on the fall. When the economy develops, conditions of the agreements on export duty reduction are more and more important. This will result in the revenues mainly based on taxes on special consumption and on profits.

The foreign investors, on the whole, are only concerned about turnover tax or special consumption tax in terms of competition in the market, because in any conditions their products are mainly sold in the country and that tax is also paid by consumers eventually. The investor pays the most attention to the profits tax, part of profits taken away by tax, this tax is most important in developed countries. Just because of this, countries' investment laws have to compete with each other in the reduction of profits tax and taxes concerning the investor's profits and the tax reduction is used as lever to attract and orientate foreign investment. Therefore this leads to the difference in tax rates as compared with the domestic investment law. Although the foreign invested enterprises' products and services currently represent a big share but the profits tax is not considerable due to regulations on reduction of profits tax in the first years in order to attract foreign investment.

The special consumption tax is levied on some special goods, commonly luxurious ones or goods used according to the increase in incomes, other prices are not affected by this tax and the people accept it since it will reduce the social inequality and limit consumption of luxury or harmful ones. The commodities subject to special consumption tax commonly have very high profit ratio, consequently, when the supply is not enough, the production of fake goods and smuggling take shape, causing losses to the Treasury and producers' operations. The number of

categories liable to special consumption tax is small, the tax objects are easily controlled, but due to very high tax rates and the volume of taxable goods is great so the revenues are enormous. The special consumption tax is a significant revenue to the State budget. However, in the open economy, there are also certain deficiencies in the application of high rates due to competition with goods imported legally or illegally.

## I. PROFITS TAX

### 1. Overview:

As for foreign investors, their concerns aim at profits tax, tax on profits transferred overseas. The profits tax for foreign invested enterprises are stipulated basically and sufficiently in the Foreign Investment Law. In addition, the following documents give detailed regulations on profits tax and how to identify it: Decree 18-CP dated April 16, 1993, Circular 31-TC/TCBN dated July 18, 1992, Circular 51-TC/TCT dated July 3, 1993 and official letters on guidelines for implementation of the General Department of Taxation.

BOT projects have their own regulations due to later appearance, foreign sub-contractors, foreign economic organizations and individuals doing business in Vietnam but not affected by the Foreign Investment Law are not subject to profits tax.

The outstanding feature of profits tax in the foreign invested sector is low tax rates due to tax reduction and exemption with the aim to attract investment and reinvestment capital in the condition of competing against other countries and poor infrastructures. This causes many home investors' complaints about the difference in tax rates and tax reduction and exemption.

Tax rates are regulated from 15% to 25%, possibly reduced to 10% for sectors that need investment promotion (Article 28). Regarding oil, gas and precious and rare resources, international practice is applied (Article 26), so the tax rate is higher.

The profits tax is exempted for a maximum period of two years (Article 27) commencing from the first profits making year and further is reduced by 50% in the two

# MAIN TAXES FOR FOREIGN INVESTED ENTERPRISES: PROFITS TAX AND SPECIAL CONSUMPTION TAX

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successive years according to investment field, scale, location, and nature of the project. The tax rate can be lowered to 10% in case of investment encouragement (Article 28).

Operating losses incurred in any year may be carried forward to the following and set off against the profits of that year for up to five successive years (Article 27). After payment of its profits tax, a foreign invested enterprise shall appropriate 5% of the remaining profits to establish a reserve fund, this fund is limited to 25% of the legal capital. Other funds are determined in agreement and regulated in the enterprise's charter (Article 30).

When any foreign organization or individual reinvests part of their share of the profits, they shall receive a refund from the tax authorities of the amount of profits tax already paid on that part of those profits (Article 32). Upon transfer of the investor's profits abroad, the tax rate is between 5% and 10% of the transferred profits. In case of investment encouragement, tax reduction and exemption may be granted (Article 33).

## 2. Determination of taxable profits

Each business cooperation contract is a tax object, so its profits are separately determined for tax payment in case the foreign party has many contracts. The enterprise's taxable profits certainly include affiliated branches and establishments' profits.

The taxable profits are the difference between the total revenues and the total expenditures plus auxiliary earnings such as the rent of fixed assets, sales of assets, transfer of shares, profits from joint venturing, the difference between deposit and lending interests.

Legal revenues and expenditures are stipulated for taxable profits as follows:

### a. Revenues:

- Earnings from selling products, services.
- Earnings from other activities.

- Earnings from product sharing contracts = the quantity x average price of a unit calculated by tax authorities

### b. Expenditures:

Every expenditure must have legal voucher. Only expenditures directly for business performance can be calculated.

#### b1. Legal expenditures include:

- Costs of raw material, power for production.
- Salaries, wages and allowances.
- Depreciation of fixed assets.

- Expenses on buying or paying for using technical documents, patents, technology and technical services.

- Administrative expenses comprising expenses on recruiting and training, maintaining warehouses, buildings and laboratories, labor protection, environmental protection, fire prevention, security operations, awards for new invention.

- Taxes and fees (excluding profits tax)
- Borrowing interests with reasonable interest rates.
- Costs of selling products and services such as: costs of packaging, maintaining, loading and unloading, advertising.

- Payments of social welfare to laborers.
- Payment for insurance of the enterprise's assets.
- Losses in the previous years (not exceeding 5 years).
- Other expenses but not surpassing 5% of the total above expenses.

b2. Expenditures cannot be mentioned for taxable profits including:

- Damages exceeding limits clearly defined in the circular.
- Costs of materials, power used for other purposes not concerning profits such as: lending, selling, offering, exchanging.

- Amortization exceeding the limit or depreciation of the asset whose amortization has been completed.

- Damages of assets in case they were robbed, suffered calamity, fire and who must compensate for these damages cannot be identified.

- Damages already settled by the insurance fund.

- Damages due to production halt in any condition.

- Fines paid by the enterprise due to violations of economic contracts, law, delayed payment of debts.

- Interests paid for loaning capital.

- Interests exceeding 234% of legal capital, not to mention the fact that the former State Committee for Cooperation and Investment (SCCI) and now the Ministry of Planning and Investment agreed that the legal capital is 30% smaller than the total investment capital.

- Losses due to transferring shares.

## 3. Rates of profits tax:

The tax rates are totally progressive. The rate of profits tax is generally 25%, excluding the case of investment encouragement. The oil industry applies international practice with a rate of over 25%. The preferential tax rate is stated clearly on the investment licence and the duration of applying that tax rate.

By comparing the tax rates applied in:

Foreign invested enterprises: 10% 15% 20% 25%

Domestic enterprises: 25% 35% 45% 50%

we will see foreign invested enterprises enjoy great privileges.

In the process of carrying out the project, if the enterprise did not meet the conditions for preferential treatment, then the Ministry of Planning and Investment will adjust the preferential tax rate stated in the licence. The real after-tax profits are not liable to income tax.

The tax rates are defined at Articles 66, 67, 68 of the Decree 18 CP dated April 16, 1993. The duration of application is as follows:

- Tax rates of 15% and 20% applied for a period between 5 and 7 years after the investment licence was granted.

- Tax rate of 10% applied for a period between 8 and 10 years after the investment licence was granted, in special cases there will be extension but not exceeding 15 years.

### a. The 10% tax rate is applied to the following areas:

- Building infrastructure including projects of transportation, production and power supply.
- Building infrastructure of export processing zones, concentrated industrial estate.
- Building infrastructure for projects of information, communication, telecommunication in mountainous areas and challenging areas.(Appendix 1)
- Afforesting for exploitation.
- Important projects put forward by the Ministry of Planning and Investment in each period.

### b. The 15% tax rate is applied to the following areas:

- Building infrastructure in provinces and areas not mentioned in Appendix 1.
- Exploiting natural resources (excluding oil, gas and valuable and rare resources)
- Projects in the heavy industry (including metallurgy, mechanical engineering, basic chemicals, cement, production of electric and electronic materials, fertilizer, insecticides and veterinary medicine).

- Growing perennials.
- Investing in mountainous areas and challenging areas (Appendix 1) including projects of hotels.
- Projects which will be transferred to Vietnam party without refunding assets when the operational duration comes to an end including projects of hotels.

### c. The 20% tax rate is applied to the project meeting



two of the following conditions:

- Employing over 500 workers.
- Applying advanced technology satisfying Article 4 of the Decree on Technology Transfer dated Dec 5, 1988 and accepted by the Ministry of Science, Technology and Environment.

- Exporting 80% of the products at least.
- Having legal capital of US\$10 million a minimum.

d. The 25% tax rate is applied to:

- Areas of finance, insurance, services of consultancy, accounting and auditing, banking, trade, hotel.
- Projects not encouraged in Part 1,2,3.

e. The tax rate of above 25% is applied to:

- Exploring, exploiting, processing oil, precious and rare resources.

- Profits tax rate of over 25% determined by the Ministry of Planning and Investment for each project when granting an investment licence according to international practice.

#### 4. Tax exemption and reduction according to territory:

- The projects mentioned at point d with 25% tax rate will be exempt from profits tax for one year since the first profit making year and enjoy a 50% reduction for the two successive years if they are realized in the challenging areas stated in Appendix 1.

- The projects mentioned at point c with 20% tax rate which are realized in the challenging areas stated in Appendix 2 will be free from profits tax for a maximum period of 2 years since the first profits making year and enjoy a 50% reduction for the three successive years. If they are carried out in localities not included in Appendix 1 and 2, they are exempt from profits tax for a maximum period of 1 year since the first profits making year and enjoy a 50% reduction for the two successive years.

- The projects mentioned at point b with 10% tax rate will be exempt from profits tax for 4 years at most since the first profits making year and enjoy a 50% reduction for the four successive years.

If they do not enjoy privileges by territory, the following projects will not enjoy privileges in profits tax:

- Hotel.
- Banking, finance, insurance, services of accounting, auditing, trade.

#### 5. Profits tax and other exemption and reduction

Profits produced by transferring partly or wholly capital stock in a company will be liable to a tax on transferring with a rate of 25%. The transferring of the right to contribute capital which produces profits will be subject to tax like capital transferring.

Profits used for reinvestment: increasing legal capital or realizing a new investment project, for three years up will be refunded profits tax already paid. The legal capital that has not been pooled completely yet does not meet conditions to consider as reinvestment. In principle, profits in Vietnamese currency deriving from previous investment can be used for reinvestment but the investor must be permitted by the Ministry of Planning and Investment. The additional dossiers are submitted to the local tax authorities.

Profits transferred abroad including profits tax refunded due to reinvestment will be subject to tax rates as follows:

- 5% for individuals and organizations having legal capital of US\$10 million up.
- 7% for individuals and organizations having legal capital of US\$5 million up.
- 10% for other cases.

#### 6. Remark:

For foreign investors, the profits tax plays an impor-

tant role. The problem has been more difficult before due to double taxation in the investing country and when the profits are transferred overseas. Currently, when they have investment relations, most of countries try to sign the agreement on avoiding double taxation and if they did not face troubles in relations, they still applied the common practice of avoiding double taxation. Vietnam has signed agreements on avoiding double taxation with major investing countries.

The foreign direct investment is on the rise but the increase in profits tax concerning this sector is not considerable due to low tax rate, exemption and reduction and much investment encouragement. In the favorable condition of business, reinvestment to raise competitiveness and gain more market shares is important and inevitable, and this is free from profits tax, therefore, the investment capital will soar but profits tax will not be on the same rise, the revenues of the State budget will depend upon other sources and taxes arising from economic growth.

The above-mentioned profits tax rates are low because according to the Ministry of Finance, our country is badly in need of investment capital and in the stage of encouraging foreign investment, and according to the Ministry of Planning and Investment, profits tax for domestic investors is high due to subsidization of land, transportation fee, electricity, water.

Domestic enterprises commonly have outdated equipment, small capital and also bear high tax rates. This makes reinvestment, modernization, and improvement of competitiveness with foreign invested enterprises more difficult, as a result, many domestic enterprises consider the competition environment unequal, not proportionate. In addition, the level liable to domestic income tax is very low including additional tax rates, so the investment possibility can be lost. Therefore, some opinions said that Laws on Foreign Investment and Domestic Investment should be uniform. However, the Committee for drafting amendments of the Law on Foreign Investment has suggested the Prime Minister should not unify these two laws as developed countries for 5-10 years initially.

## II. TAX ON SPECIAL CONSUMPTION

### 1. Overview:

Based on Law on Special Consumption Tax, amended and supplemented, dated July 7, 1993, Decree 97/CP dated Dec 27, 1995, Circular 98-CT/TCT on guidelines for implementation dated Dec 30, 1995, our country's tax on special consumption for foreign invested sector has the following characteristics:

The special consumption tax is a kind of indirect tax imposed on luxurious goods which need limits on consumption or are not really necessary for the people's common living. Which goods subject to tax are defined clearly. The goods liable to special consumption tax are taxed one time at the place of production. They will be deducted special consumption tax paid in earlier stages if there are enough vouchers. If they are for export, they are free from special consumption tax (Article 2). Commodities processed for export, materials used for making exports and goods temporarily imported and re-exported in the valid time are also free from special consumption tax.

The special consumption tax is collected right at the producer or importer, in case of import consignment, the consignor will pay tax. If the business has subsidiary establishments or shops, these units have to pay turnover tax to the local tax authorities, but the special consumption tax is declared and paid at the place of production.

The special consumption tax is different from other taxes because the tax arises as soon as the goods are



transported. The goods liable to special consumption tax when transported must have legal vouchers including (Article 17): Receipt or voucher of tax payment issued by the tax agency, transportation permit issued by the tax agency, sales receipt (registered at the tax agency) or declaration form of imported goods accepted by the tax agency or the permit for changing warehouses which is applied for goods that have not paid special consumption tax yet and issued by the tax agency. Shops or warehouses that store goods liable to special consumption tax must have receipts of tax payment, receipts of sales.

The price for tax calculation is the selling price at the place of production before special consumption tax (amended Article 7), as for imports, it is the price for calculating import duty plus import duty (including the case of exemption from import duty).

## 2. Special consumption tax rates:

|   | Tax rates<br>1990 | Amended<br>rates 1995 |
|---|-------------------|-----------------------|
| 1. a. Tobacco   | 20%               |                       |
| b. Cigarettes   | 50%               |                       |
| Imported raw materials  |                   | 70%                   |
| Domestic materials  |                   | 52%                   |
| Without filter, cigar   | 40%               | 32%                   |
| With filter   |                   | 70%                   |
| 2. Liquor   |                   | 15%                   |
| - Medicine liquor   |                   | 90%                   |
| - Over 40o  | 65%               | 75%                   |
| - From 30 to 40 <sup>o</sup>                                      | 60%               | 25%                   |
| - Below 30o   | 55%               |                       |
| 3. Beer   | 50%               | 90%                   |
| Various kinds   |                   | 75%                   |
| Canned beer   |                   |                       |
| 4. Fireworks  |                   | 100%                  |
| 5. Imported cars including SDK form:                              |                   |                       |
| - below 5 seats   |                   | 100%                  |
| - 6-15 seats  |                   | 60%                   |
| - 16-24 seats   |                   | 30%                   |
| 6. Various kinds of petrol, naptha, substantial to produce petrol |                   | 15%                   |

## 3. Tax exemption and reduction:

The exemption from and reduction of special consumption tax are stipulated as follows (according to Article 19 of the Law on Special Consumption Tax amended on July 5, 1993):

- The establishment faces difficulty due to natural calamities, sudden accident, the rate of tax reduction is based on the amount of loss but not exceeds 30% of loss and 50% of tax paid. The tax holiday does not surpass 180 days since the establishment suffered losses.

- The establishment which is newly founded, expands production with new technology and suffers losses if it pays special consumption tax will be considered to enjoy tax reduction by maximum 30% of the tax paid in the duration not exceeding two years (defined in each specific

case).

- Regarding small-size production units which is not able to pay tax according to regulations, the Ministry of Finance depends on the business performance, prices and markets to determine reduction for each specific case.

- In other cases of reduction, the Ministry of Finance submits to the Government for approval.

## 4. Remark:

The domestic companies producing cigarettes, beer and liquor have made great contribution to the State budget for a long time. At present the special consumption tax is paid by enterprises importing cars and producing beer and liquor in joint venture with foreign partners. JVs producing cigarettes still depend on the anti-smuggling forces. That shows there are deficiencies in special consumption tax, especially for imported raw materials and the quality of domestically-planted tobacco is poor.

The foreign investment, on the whole, is booming in the tourism industry, and in the manufacturing industry, there is fierce competition in sectors that have very high profit rate such as food processing: MSG seasoning, milk, beer and liquor, soft drink; production of cigarettes, cosmetics and detergents; car and motorbike assembly. Most of these sectors are liable to special consumption tax. Domestic producers in these areas must jointventure with famous foreign partners to survive, sometimes not because of capital or technology but trademark, marketing and advertising. Furthermore, there are shortcomings and negative acts in the investment direction. Once all industries earning high profit rate belong to foreign capitalists, the accumulation for reinvestment and profits regulation, saving encouragement will depend on special consumption tax and wages.

In industries earning high profit rate, even though feasible projects put forward how many products are for export, eventually these products are mainly sold in the home markets. In this area, the most important is the consumer market. The trend of spending on luxurious goods in developing countries is very strong and cannot be limited by high special consumption tax. Many combined measures should be used to encourage high income earners to use their incomes to invest instead of spending with the aim to secure the economic growth rate high and stable.

As a result, we should see in addition to attracting vigorously foreign direct investment, domestic investment always plays a major and significant role in economic development and creates jobs for the people. The diversification of foreign investment in our country must include numerous overseas Vietnamese which have great capability to invest in the motherland and special relations of Chinese in the Southeast Asian region. This has also caused complicated issues in business, investment and economic management with too many forms and authorized units. Therefore if the unification of Laws on Foreign Investment and Domestic Investment is performed soon, it will reduce many negative acts and better the activities of investment, business and State economic management