MEASURES TO REDUCE LOSSES OF REVENUE FROM FOREIGN SECTOR

by MEcon. NGUYỄN THỊ NGỌC TRANG

In recent years, state revenue from the foreign sector has increased remarkably. However, number of foreign-invested companies that announce losses is also on the increase: from 390 in 1995 to 481 in 1996, 576 in 1997, and 702 in 1998. As everybody knows, announcing losses is a way to avoid paying taxes. In addition, foreign-invested companies falling into arrears with tax payment are found everywhere. That is why the foreign sector represents only 6% - 7% of the budget income while it accounts for 23% of the gross investment. Main causes of this situation originate from the following facts:

- The law system contains many loopholes that are exploited by foreign investors.
- Tax officials in charge of the foreign sector lack necessary expertise.
- Related governmental bodies fail to cooperate effectively and closely in dealing with violations of tax laws.
- Transfer pricing practices adopted by multinationals with the aim of evading taxes cause losses to the state revenue.

In my opinions, necessary measures should be taken to deal with these problems in order to increase the budget income from the foreign sector. The following are our suggested measures.

1. Applying measures against transfer pricing practice

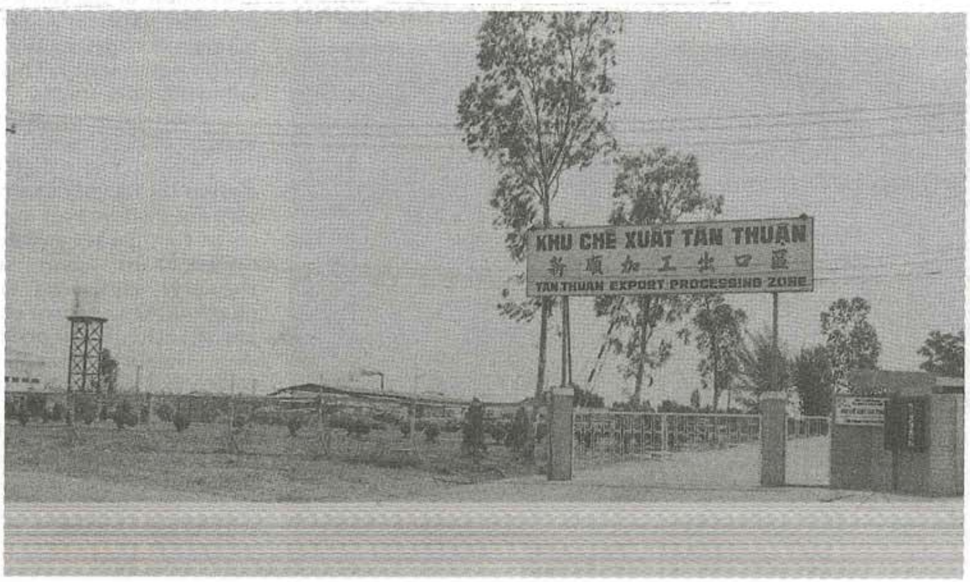
To prevent these practices, the Ministry of Finance and General Tax Department have issued Circular 74/TC/TCT and Circular 89/1999/TT-BTC dealing with these practices and more recently, Circular 13/2001/TT-BTC that was effective from Jan. 23,2001 prevents foreign-invested companies from paying (part of) overheads of parent companies.

However, there are some difficulties in implementing measures against transfer pricing introduced by the Circular 89/1999/TT-BTC.

To apply these measures, tax agencies should gather enough information about quality of goods, payment terms, time of delivery, etc. (needed for comparing market prices); average gross profit rate of the like industry (needed for working out the buying price from the selling price); and average net profit rate of the like industry (for assessing taxable income out of production cost). This task is usually complicated and time-consuming, and requires help from other governmental agencies, otherwise it will lead to losses to either companies or the budget revenue.

Foreign experience shows that the struggle against transfer pricing practices requires a lot of time and energy and depends on many laws and regulations (antitrust law, anti-dumping law, accounting and auditing norms, etc.). For the time being, the short-term solution is to create necessary conditions for carrying out measures introduced by the said circulars.

a. The General Tax Department cooperates with other governmental bodies (Technical Appreciation Agency, auditing authority, Pricing Agency, State Bank of Vietnam, insurance companies, etc.) to build general criteria of goods quality, pay-



ment term, time of delivery, etc. in order to provide local tax agencies with instruments for checking information gathered from foreign-invested companies.

b. The General Tax Department determines the average gross and net profit rate of each industry by using statistics collected in the previous five or 10 years or allows tax assessors to consult data in statistics agencies. The General Tax Department can gather information about profit rates from Vietnamese embassies in foreign countries that have trading and investment relations with Vietnam or enter agreements on double taxation with Vietnam.

c. The General Tax Department can exchange information with foreign counterparts to determine the average net profit rate of various industries and prevent commercial frauds.

2. Supporting actions for measures against transfer pricing practices

To facilitate the implementation of these measures, the following actions could be taken:

- The tax authority should examine features of each transfer activity and market conditions in which the transfer takes place (transfer between affiliated companies of the same parent company or between affiliated company with a third party). Results of this examination can help tax authority classify companies according to their main operations, thereby picking out companies of the same kind to compare.

- Tax authorities could interview businesspersons to gather necessary information about appropriate market prices that should be used for transferring goods between affiliated companies.

- Foreign-invested companies could be required to store and produce necessary documents if need be. Tax authority could ask companies in question to produce documents to justify prices they apply to imports or exports. This could be seen as both a right and duty of the company because the tax authority accepts its pricing policy when prices they used are justified.

3. Better policies and control of foreign-invested companies

The Foreign Investment Law still contains loopholes that are exploited by foreign investors. They usually take advantage of the lack of information and expertise of Vietnamese parties to sell machines or materials with high mark- up to joint ventures; overprice imports from the parent company or underprice exports for the purpose of transferring profits out of Vietnam; or underprice imports from the parent company in order to compete more effectively in the domestic market. Tax authorities should inspect regularly their tax declaration and profit and loss statement for tax evasion, especially evasion of company income tax and profit transfer tax.

The Government had better establish asset valuation agencies with officials trained abroad who have enough expertise and work ethic to protect interests of local companies and the country as well.

4. Enhancing expertise and performance of tax officials

To enhance expertise and performance of tax officials, full attention should be paid to the following issues:

- Training courses in foreign languages, computing and tax laws and procedures.

- Better mechanism for organizing and controlling tax officials.

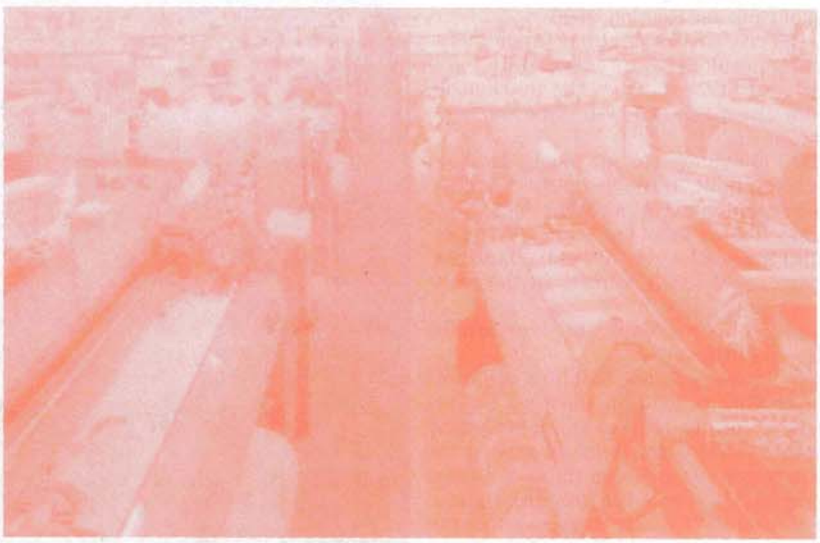
- Better facilities for performance of tax officials.

5. Enhancing abilities of officials working in joint ventures with foreign parties

Officials working in foreign-invested joint ventures should have managerial skills and knowledge to master operations of joint ventures, thereby discovering and preventing tax evasion by foreign parties.

6. An agency for inspecting company finance

Tax authorities should cooperate with other governmental bodies (finance, market control, police, etc.) to



establish agencies for inspecting company finance. This task is also suitable to the finance strategy set by the Government for the years 2001-2010 aiming at enhancing performance of foreign investment.

In the globalization trend, and the industrialization and modernization process, the foreign investment is very important to the economic development. The problem is how to make the most of this source of finance. Therefore the Government should take measures to upgrade the ability to control and supervise operations of foreign-invested companies with a view to protecting national interests and avoiding risks when doing business with foreign companies ■