

The value-added tax (VAT) is an indirect tax charged on the added value of goods and services in the process of production and distribution. This tax targets at the consumption of commodities and services, so the taxable persons are just consumers, businesses only pay tax for them. In Vietnam, the VAT Law was adopted by the National Assembly, Term IX, 11<sup>th</sup> session, on May 10, 1997. It is effective as of Jan 1, 1999. The sales tax is replaced with VAT to overcome its shortcomings and stimulate production and at the same time step by step perfect the country's tax system with a view to developing the market economy; integrating into the regional and global economies; attracting local

competitiveness of domestic enterprises; secure their local market shares, develop local production; create favorable conditions for the integration into the regional and global economies when Vietnam is bound to cut its tariff and finally generate a better investment climate for overseas and local enterprises.

- Forcing enterprises to improve their accounting.

However, in addition to the above advantages, the VAT has also negative effects on the country's economy as follows;

- When applying VAT, the prices of goods and services tend to rise. This results from the unawareness or misunderstanding of VAT because the sales tax has been executed for a very long time and rooted

in the consumers' mind. Although the sales tax is an indirect tax, but it is included in the selling price of goods and services, the consumers therefore can hardly know they are really taxpayers and firms only pay tax for them. They always think the firms must be subject to the sales tax. As a result, when applying VAT in replacement of sales tax, although it is also an indirect tax upon the consumers, but the accounting mechanism changes, that means the tax is separated from the selling prices of goods and services and this makes users know distinctly their payable tax, so they feel as if they had to bear a new tax which they did not pay before. Just because of this, businesses raise the selling prices of goods and services for higher profits. Their negative behaviors could increase the inflation rate, contract consumer markets and reduce investment capital from local and overseas firms. The drop in investment capital will lessen the firms' competitiveness and production, distort the economic structure, and restrict the economic growth.

- The amount of VAT collection tends to decrease as compared with the sales tax receipts. This will widen the deficit of the State budget.

- The tax avoidance will be more prevailing, serious and sophisticated. It is not surprising that not a few firms set up two accounting systems including books, invoices, economic contracts: one for tax declaration and other for internal use. Illegal businesses are rising. Recently the tax authorities gave the alarm of false and dishonest

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and foreign investment; strengthening the firms' accounting and tax collection; reducing tax losses; solidifying and increasing the State budget revenues.

Since the start of VAT execution till now, there are positive effects on our country's economy as follows:

- Encouraging export activities; expanding consumer markets; beefing up production of goods for export and creating more jobs for workers.

- Boosting investment; scaling up business and production; and innovating technologies because the VAT is exempted in case of investment in fixed assets, the whole VAT paid in buying fixed assets will be deducted or refunded.

- The VAT helps protect local production since it is levied on imports. This will heighten the





invoices and the fact that when buying goods without invoices, firms buy outside invoices, fill out the quantity and prices on their own to avoid input tax and enjoy tax deduction or return. Moreover, the firms take the advantage of tax officials' loose control, apply for a business halt or disbandment, sell the invoices to other firms for tax evasion with tax collectors' help.

These negative effects happen because VAT is a new tax and remains strange to the public and so complicated in tax payment and collection. Besides it is due to our countries' VAT defects. To surpass these effects, the VAT policy should be corrected.

The country's VAT perfection need be based on the principles of a good tax system, that is:

- Firstly, efficiency principle: This principle requires VAT to secure not only the significant revenues for the Treasury but also social stability and to stimulate production and business and economic growth. In the situation of our country's limited budget, the VAT application to obtain firm revenues for the State budget is a must, but the factors of economic development and equity should be taken into account. The economy can grow only when there is equity and in turn, it will generate revenues to the Treasury.

- Secondly, the principle of equitableness: The tax policy must secure fair execution for taxable persons and taxpayers. In the multisectoral economy, the VAT policy should ensure the impartiality between taxpayers to create a healthy competition environment for all firms and thus spur the economic development.

- Thirdly, the principle of succession: Because VAT is a new kind of tax and very strange to the population, therefore, to set up an effective VAT policy, we should study and learn lessons from other countries in the region and the world in the VAT application to suit the tax to our country's reality and steadily integrate into other countries.

- Fourthly, the principle of feasibility: This principle suggests that the establishment of the VAT policy must depend on scientific theories and current socio-economic evidence. The Government's rules should be compatible with the tax officials' managerial skills and taxpayers' capability of tax payment. In Vietnam, the public incomes remain low, tax officials' skills and the

public understanding is not high, so the tax collection and rates shall be simple and appropriate.

- Fifthly, the principle of uniformity: When building a tax policy, the Government should review the whole tax system to prevent the backwardness and conflicts between tax policies, thereby securing the uniformity and mutual supplementation with the aim to make the best use of each policy as well as the whole system at most. As a result, when building VAT policies, the Government should pay attention to the perfection of relevant tax policies such as import, export taxes, special consumption tax, resource tax, corporate income tax

Based on these basic principles to build good tax policies in combination with the experience of other countries and initial VAT execution in the past months, we would like to present our following suggestions for the VAT perfection in future:

### 1. VAT rates:

Tax rate is soul of a tax and the most important factor of a tax policy because it characterizes the government's policies and mirrors the relations between the State and other entities in the economy. The setting of proper tax rates will boost the production, increase revenues for State budget and spur the economic development. The determination of the number and value of tax rates will lead to a success or failure of a tax policy. Numerous tax rates will complicate the tax policy and make it hard to control and easy to misapply for tax evasion and avoidance, thus causing losses to the State budget. However, this practice makes easy adjustments in specific cases in accordance with the socio-economic situation and characteristics of each tax. In contrast, if the number of tax rates is too small, the Government can hardly carry out its social policies and easily face with oppositions. But it is simple, easily applied and abridges tax losses. To tackle VAT bad effects on the economy, we suggest the Government should set only tax rate of 10% for all goods and services except exported goods and services.

### 2. Methods of VAT calculation:

According to provisions, there are two methods of VAT calculation: tax deduction and direct charge on added value. The deduction method is used for large and medium enterprises which have enough con-

ditions for book-keeping. The rest is used for individuals, households and foreign individuals and organizations which are not affected by the Foreign Investment Law and do not meet enough requirements for accounting as tax base for tax deduction and jewelry traders. In our country, there are so many medium and small business units which can not yet fulfill the accounting and they cannot use the deduction method, so the application of these two methods is a must. However, the evidence of VAT execution indicates the concurrent existence of these two calculations is unreasonable, because:

- They will cause an unfair playground for economic entities.

- Due to the occurrence of false and dishonest invoices and receipts, in case of direct charge method, most of businesses pay tax based on their sales. In fact, the tax collectors usually depend on the sales tax paid earlier to induce the taxable sales and the payable VAT (after multiplying by the ratio of value added as stipulated by the tax authorities). This is not different from the former sales tax, in other words, "new bottle, old wine".

- Making favorable conditions for taxpayers in deduction method and direct charge method to transfer products, goods and services through the legalization of false and dishonest invoices and receipts.

As a result of these defects, we propose the tax authorities to apply only method of tax deduction.

### 3. VAT execution

To make VAT useful for the economy, the tax collection should be implemented uniformly with following measures:

- Improving qualifications of tax officials and providing them with modern equipment meeting the requirements for tax control and collection. This is an important stage deciding the effectiveness of the tax policies.

- Intensifying the dissemination of VAT policies so that the population know VAT advantages well and avoid misunderstanding which may be misused to cause the social unrest; and assuring every investor to pour their money in production and business.

- Reinforcing the tax surveillance and inspection; carrying out uniformly economic measures in tax collection with the aim to prevent false and dishonest invoices and receipts used for tax evasion.