SOME MEASURES TO REFORM THE INCOME TAX ON HIGH-INCOME EARNERS

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The personal income tax has become more and more important to the tax system as a source of budget income. In OECD countries, the personal income tax accounted for some 30% of the tax take in 1989 while the corporation tax accounted for only 7.8%. This figure was about 50% in the U.S. and Canada, and 25.7% in China.

In Vietnam, after 1986 when the economic reform was launched, the tax system changed basically, and the introduction of the income tax on high-income earners (referred to as the high income tax hereafter) in 1991 was one of important reforms. The high income tax law has been adjusted and improved many times to be more suitable to economic development. This tax has helped bridge the gap between the rich and the poor and provided the budget with an increasing income: VND62 billion in 1992, 520 billion in 1995, 1,782 billion in 1998, 1,831 billion in 2000 and over 2,000 billion in 2002. In Đồng Nai Province where the growth rate of industrial output is of the highest in Vietnam, the figure was VND1.1 billion in 1991, 14.3 billion in 1995, 106.5 billion in 1998, 132 billion in 2000 and 155.5 billion in 2002.

However, this tax has revealed many shortcomings and defects to deal with.

- Kinds of taxable income are limited. They include mainly earned incomes (wages and salaries) and pay no attention to unearned incomes, such as the gain from the sale of real estate, dividend or interest on bank accounts, etc.

- The tax law keeps giving different treatment to nationals and foreigners. For example, the taxable income set for a Vietnamese is VND3 million compared with VND8 million for a foreigner. The difference between two successive tax brackets imposed on those two taxpayers could be a tenfold one. In addition, a Vietnamese taxpayer must pay an extra income tax when his monthly income is VND15 million higher than the taxable income. This discrimination discourages local workers from striving for higher positions in foreign-invested companies. As for these companies, they tend to give such positions to foreigners in order to avoid responsibility to pay this tax. For example, a foreign-invested company offers an after-tax income of US$2,500 to a foreign manager, it need only ensure a net income of US$2,900, while it has to pay US$5,730 to a Vietnamese manager if it wants to ensure the same after-tax income. This difference is unacceptable, not to mention other expenses on social and medical security. Moreover, the taxable income applies to all groups of taxpayers without paying attention to their family status. This practice is unreasonable and unjust.

- The income tax rate is still high although the maximum rate has been reduced many times (it is 50% now). In addition, the difference in incomes paying the same tax rate, and difference between the lowest and the highest levels are small (this means that tax payment rises fast over income –levels): five times in case of Vietnamese taxpayer and 15 times in cases of foreign one, while all neighboring countries accept lower maximum rates (28% in Singapore, 37% in Thailand, 30% in Indonesia and Malaysia, etc.) and wide differentials between the highest and the lowest income-levels (60 times in Malaysia, 53 times in Singapore, 40 times in Thailand and 200 times in the Philippines).

Thus, the high income tax payment make the overheads of foreign-invested companies higher than that of local companies and foreign counterparts.

To deal with these shortcomings, thereby improving the tax system and encouraging the FDI flow, we suggest the following measures:

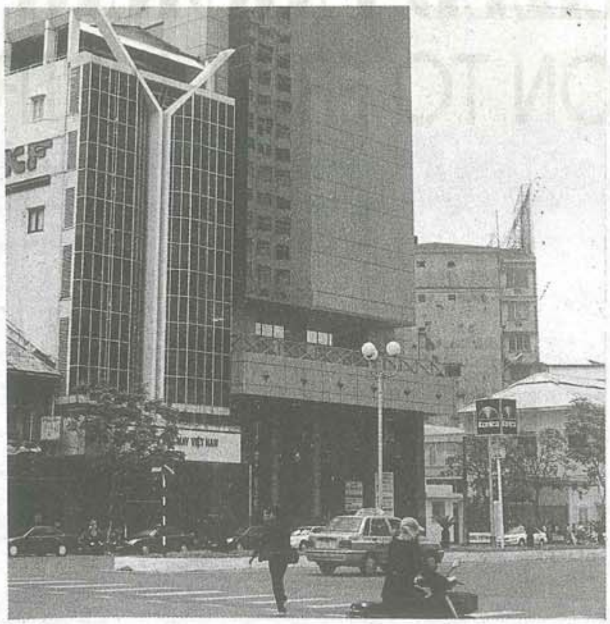
1. On the name and objectives of this tax:

The Ordinance on the High Income Tax could be develop into the Personal Income Law in order to put this tax on the same legal basis as other taxes, thereby regulating personal income in a more reasonable manner and helping this tax account for 5% of the budget income by 2005 and 7.1% by 2010 as planned by the General Department of Taxation.

2. Groups of taxpayers:

The number of groups of taxpayer could be increased. Farmers, peasants and family businesses could pay this tax instead of the corporation tax from 2006 on. The taxable income level and regulations on tax exemption must be adjusted in order to force all income earners to pay income tax. All unearned incomes must pay income taxes in the same way in which companies pay corporation tax.

In determining the taxable income, all expenses relating to the earning of income will be taken away (overheads of family businesses, value of the land use rights for those who transfer their rights, level of tax-free income for wage-earners, etc.). From this viewpoint, we can see that it's unreasonable to impose the same tax rate on the incomes earned in the same manner. A single person and a married one who has to support two children shouldn't pay the same amount of money in tax. It's also unjust to force a foreigner and a Vietnamese citizen to pay the same tax for the same income they earn, because a foreigner in Vietnam has to not only pay higher prices for many goods and services he needs but also support their dependants in his home country where the cost of living is much higher than that in Vietnam.



3. On tax schedule and rates:

We support the policy to impose the same income tax on foreigners and nationals. So we think that the new income tax law can allow tax exemption or set the tax base with a view to expanding groups of taxpayers, lower the highest and the lowest tax rates, and widen the difference between taxable incomes in the same class with a view to making the income tax law appropriate to local conditions and foreign practices. The following is the suggested tax schedule.

Class	Average annual income (VND)	Tax rate (%)
1	Up to 60 million	5
2	From 60 to 200 million	10
3	From 200 million to 600 million	20
4	From 600 to 1,200 million	30
5	Over 1,200 million	40

This schedule will be free from shortcomings in the current one.

- The lowest tax rate reduces from 10% to 5%, which makes the tax payment rather small compared with the income. A Vietnamese who earns VND3 million a month, after taking away allowances and tax base for a married person (about VND2.5 million) has to pay some VND25,000 in tax, or 0.83% of the income. This schedule is easy to accept because most Vietnamese wage-earners today will pay tax rates 5% or 10%. The maximum tax rate also reduces from 50% to 40% in order to be suitable to foreign practices and the corporation tax that was reduced to 25%. Thus, a person who invests in bonds or stocks will pay 25% in the corporation tax and 10% in the tax on unearned income.

- In this schedule, the difference between incomes within a class is wider (from 1.25 – 2.5 times to 2.0 – 3.33 times) and the difference between the taxable incomes of the highest and the lowest classes is much wider, which is appropriate to the tax schedules adopted by neighboring countries. This measure also encourages taxpayers to make rich and increase the tax revenue.

- The tax system of most countries usually offers a tax allowance that includes a personal allowance and allowances for his/her dependants. In present conditions in Vietnam, we suggest a tax allowance of VND2.5 million a month, or VND30 million a year (a personal allowance of 1.5 million a month plus an allowance for two dependants equal to VND1 million) for Vietnamese citizens and VND72 million for foreigners. The calculation of allowance will ensure tax equity. To save energy and money needed for controlling and collecting income tax for the time being when the tax machinery isn't perfect, the Government can adopt a tax base, or taxable income level, that is VND2.5 million a month for nationals and VND6 million for foreigners.

This level that is lower than the level set by the current tax schedule (from VND3 million to 2.5 million for nationals and from 8 to 6 million for foreigners) helps expand the number of groups of taxpayers and increase the tax revenue.

When the management ability of the tax machinery and sense of responsibility of taxpayers are improved, the application of allowances could replace the use of taxable income level.

Finally, we suggest removing the higher rate of 30% on the part of income above VND15 million per month earned by Vietnamese nationals in order to encourage taxpayers to increase their income.■