

TAX REFORM IN VIETNAM ISSUES FOR 2011-2015



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Overview of Revenue Issues



Tax Reform Strategy 2011-2020

Create a tax system that:

- Is comprehensive, fair, efficient and consistent with a socialist market economy
- Is simple and transparent
- Promotes competitiveness and exports
- Encourages investment, especially in high technology
- Creates employment and growth

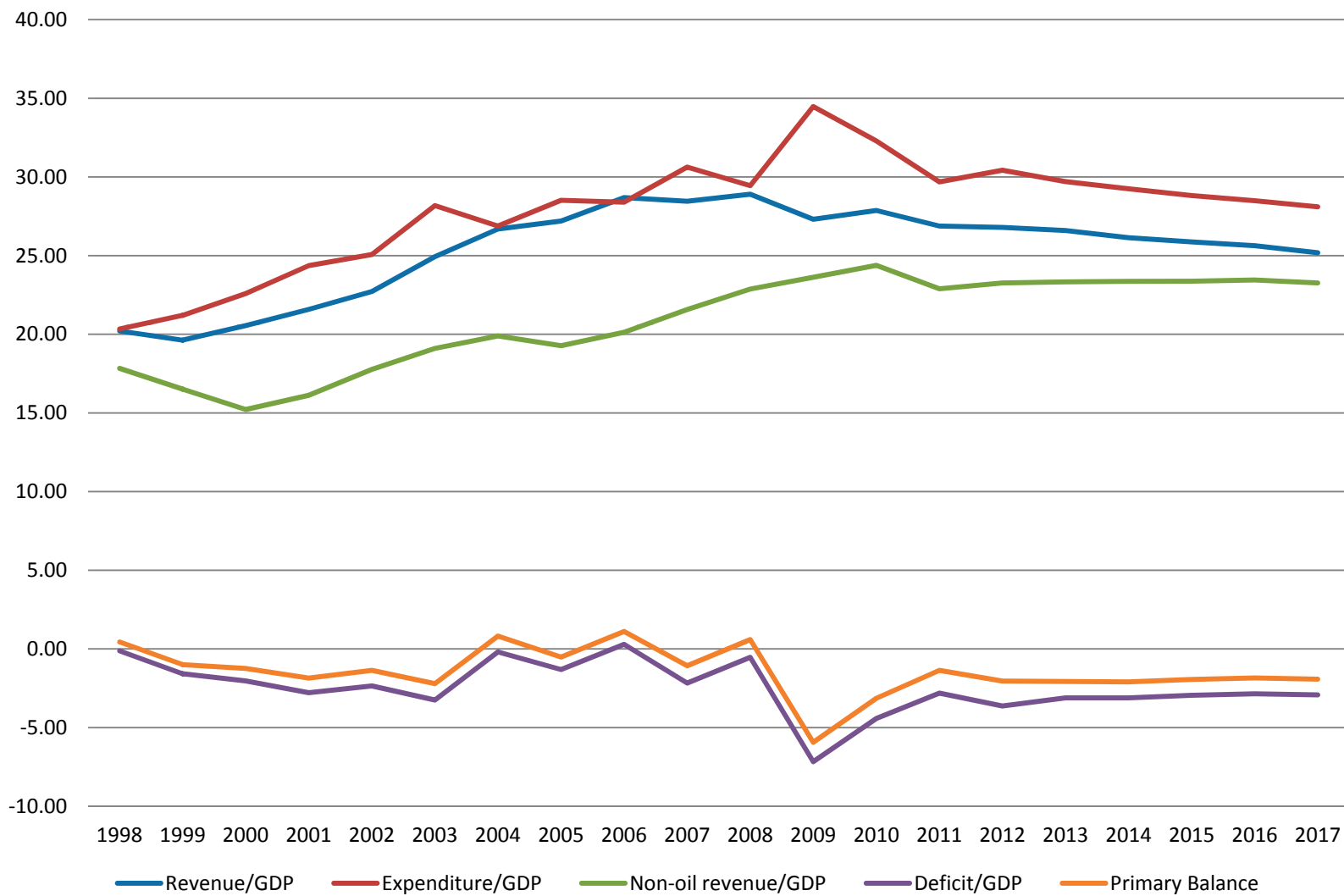


Revenue Outlook

- Vietnam's revenue peaked at almost 29% of GDP in 2008.
 - Slight decline to approximately 27% in 2011 due to lower oil prices
- Non-oil revenues continued to rise from 18.4% of GDP in 2008 to 20.6% of GDP in 2010
- Target revenues of 23-24% in Reform Strategy appear achievable, despite projected decline in oil and trade revenue and foreign grants



Vietnam: Budget Balance, 1998-2017



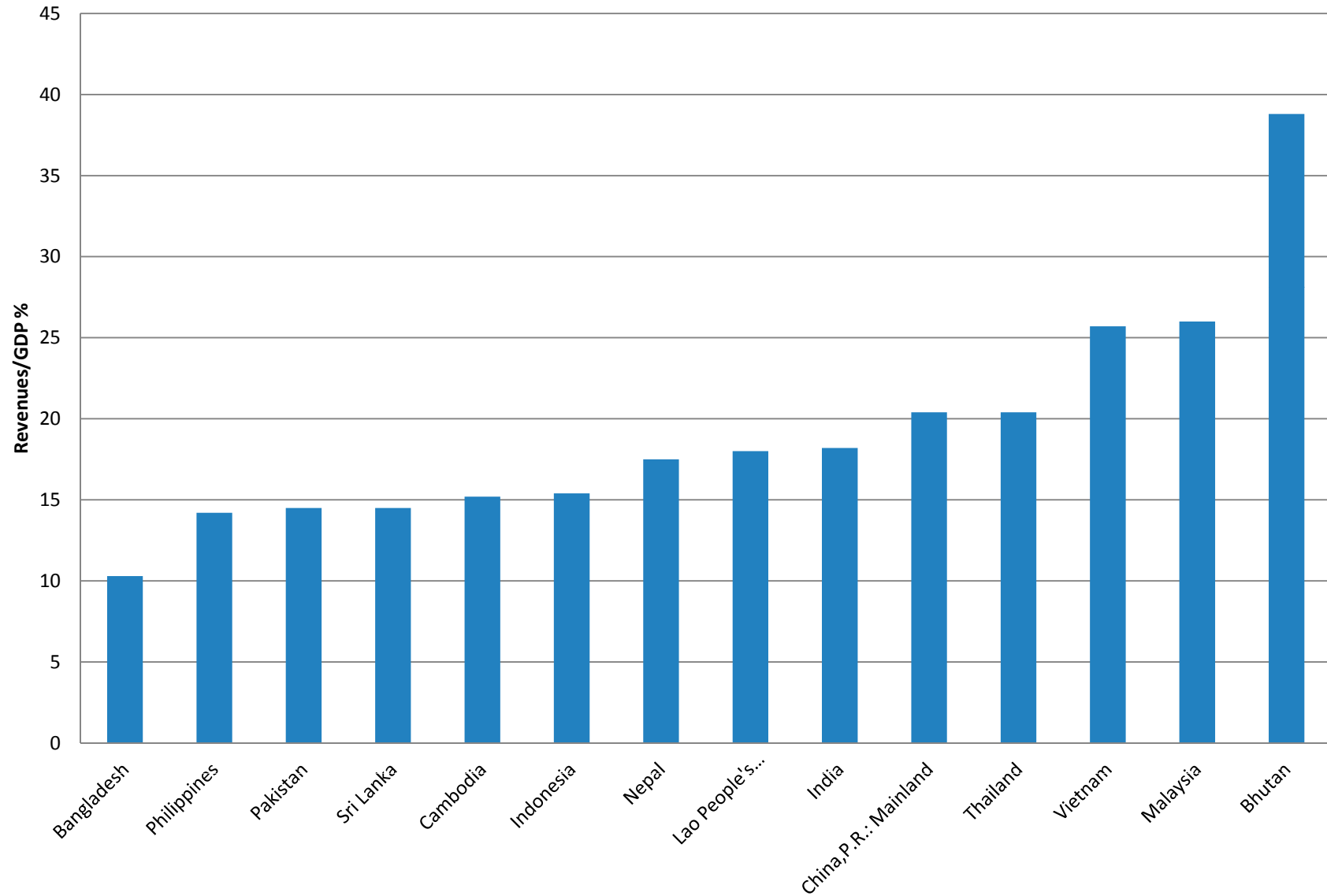


Revenue Performance: Regional Comparison

- Vietnam has one of highest ratios of revenue to GDP in the region
 - Only Malaysia and Bhutan are higher
 - Relative to GDP per capita, Vietnam's revenue ratio is the highest



Emerging Asia: Revenue to GDP Ratios, 2010



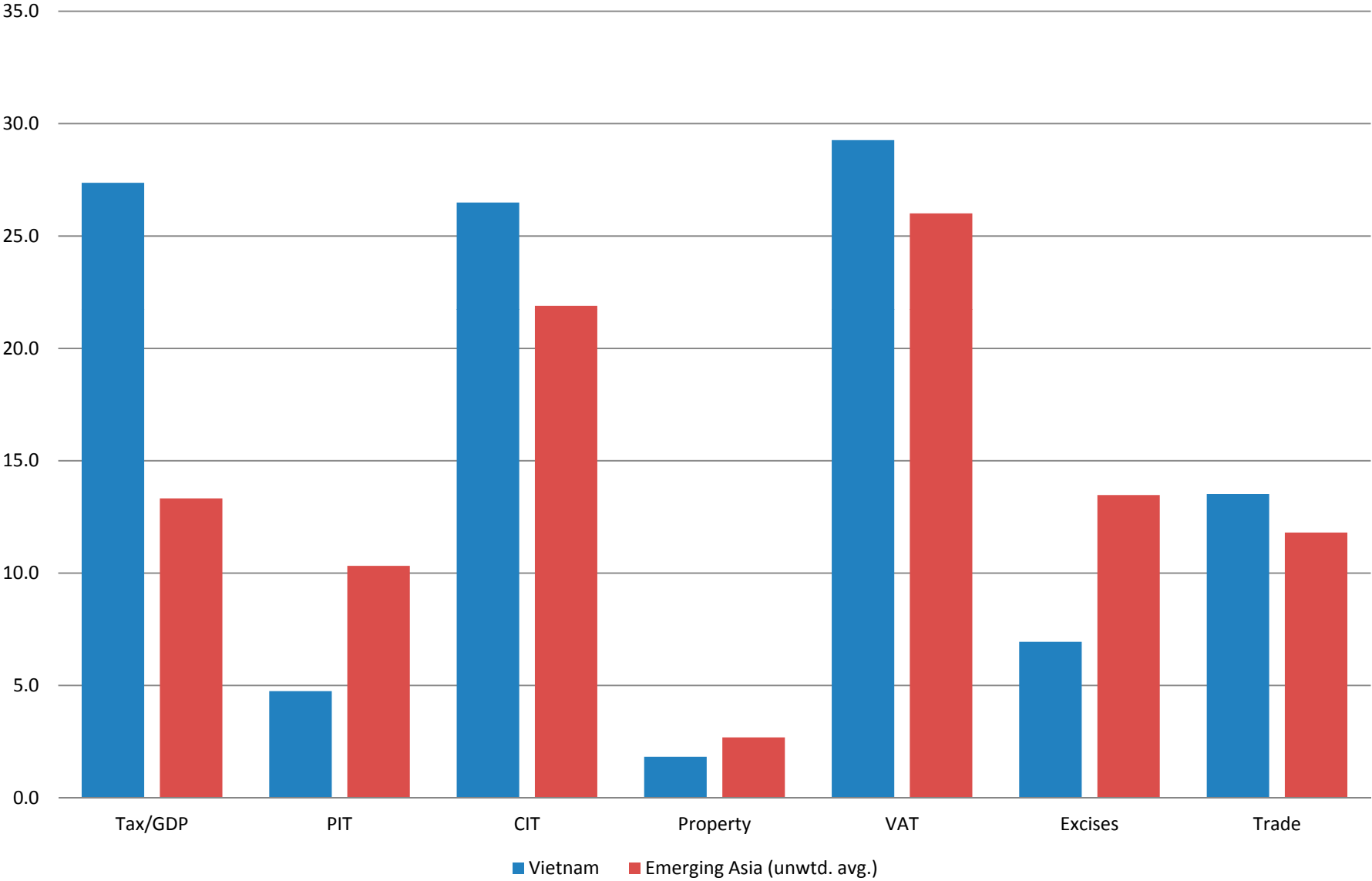


Revenue Shares: Regional Comparison

- Relative to other emerging Asian countries, Vietnam relies more heavily on
 - CIT
 - VAT
 - Trade (including import excises)
- And less heavily on
 - PIT
 - Property
 - Excises
- This is not prescriptive, but shows possible areas for revenue development.



Comparison of Tax Revenue Shares, Vietnam and Emerging Asia, 2010



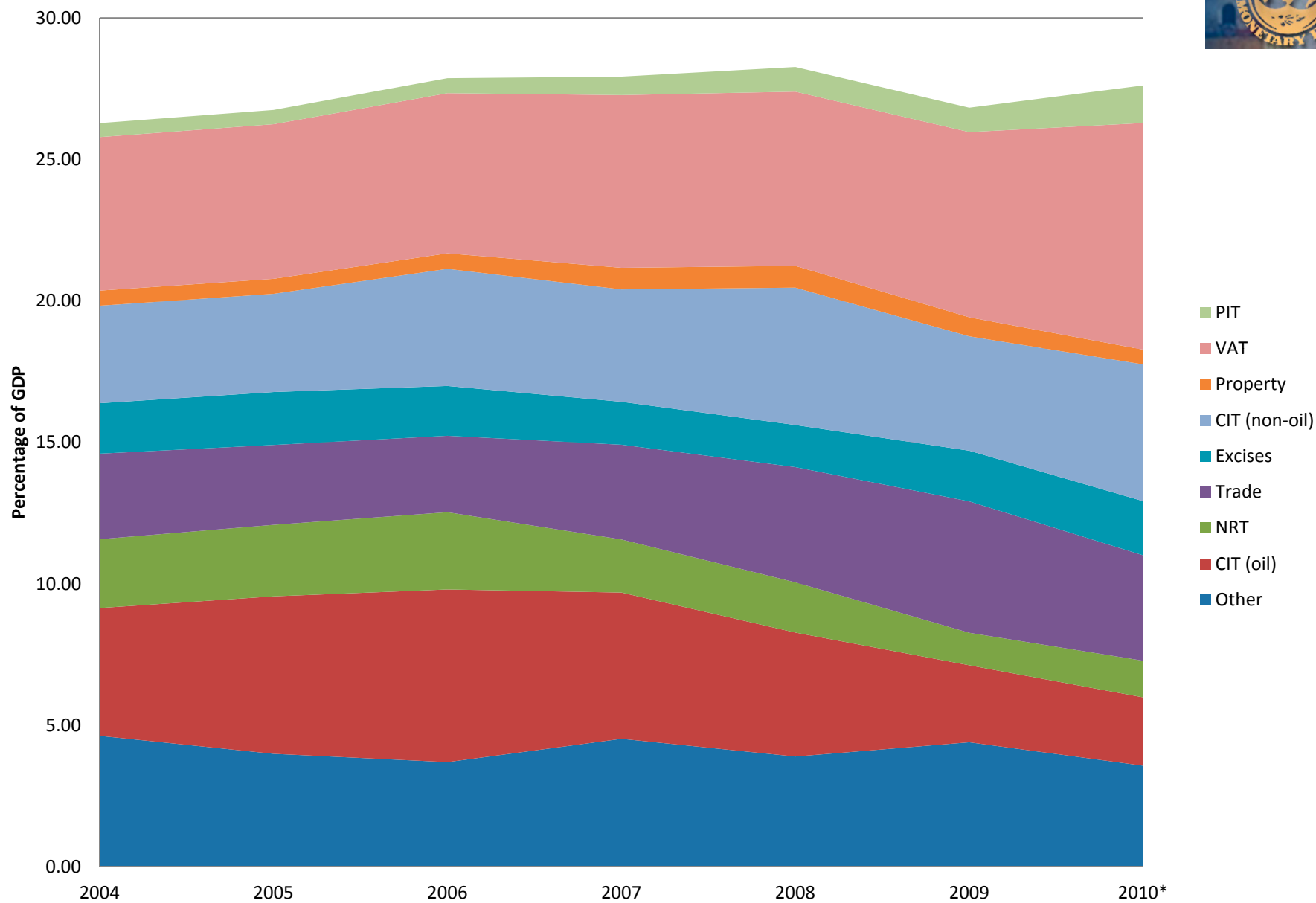


Vietnam: Revenue Shares

- Declining revenues from oil
- Trade revenues also expected to decline somewhat due to WTO tariff reductions
- Steady contribution of non-oil CIT, excises
- Very small contribution of *recurrent* property taxes
- Growing importance of VAT revenue
- PIT also growing (from a low level)



Vietnam: Composition of Revenues, 2004-2010





VAT



Present VAT – key design features

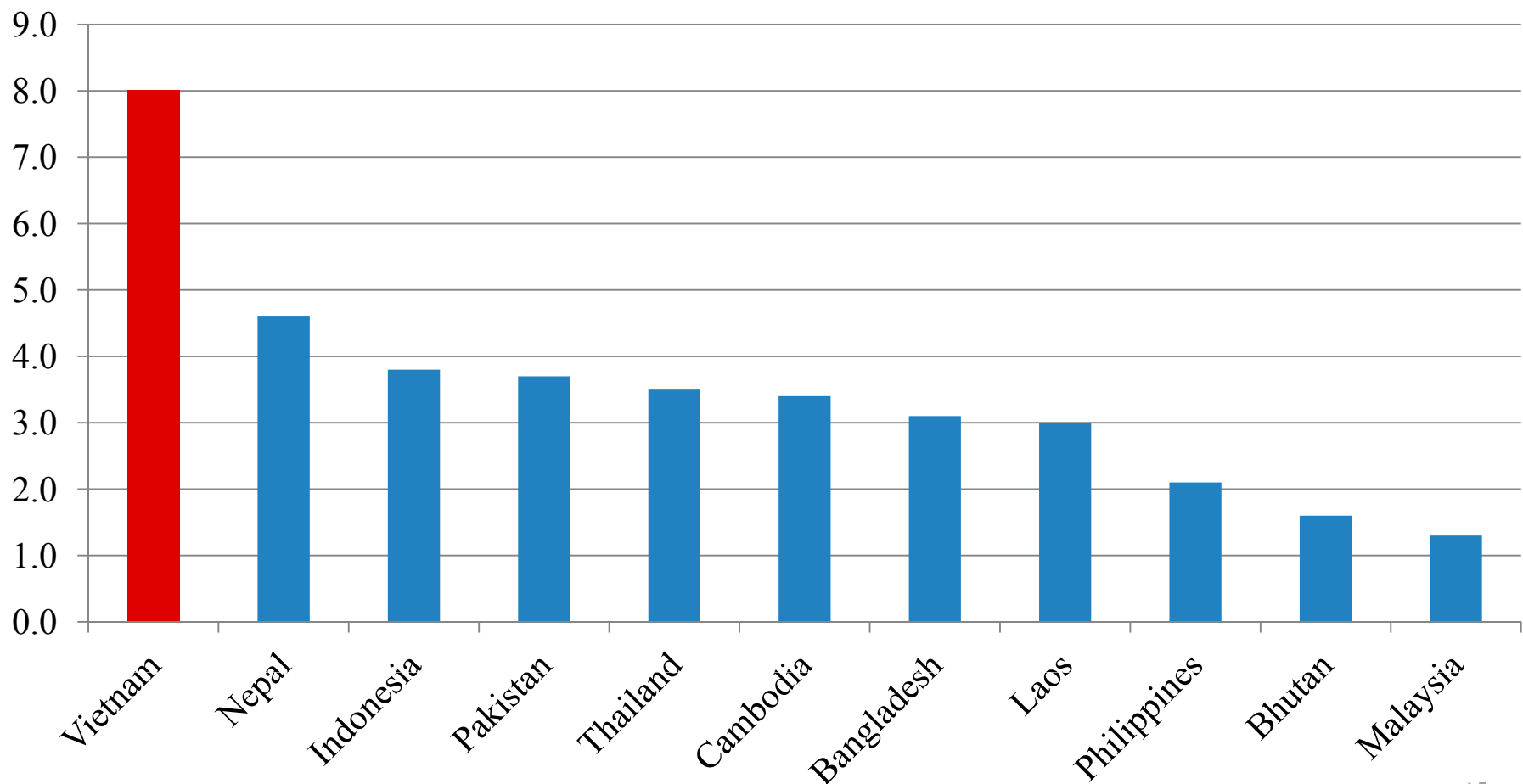
- Modern destination-based VAT using (mostly) invoice-credit method
- Standard rate of 10% plus lower rate of 5% on list of goods (clean water, fertilizers, fresh food, sugar.....)
- Number (about 25) of exempt (*non-taxable*) goods and services
- No standard threshold
- Refunds only above threshold
- Revenue in part collected by local governments



How much revenue do they raise?

VAT Revenues, 2010

(In percent of GDP)

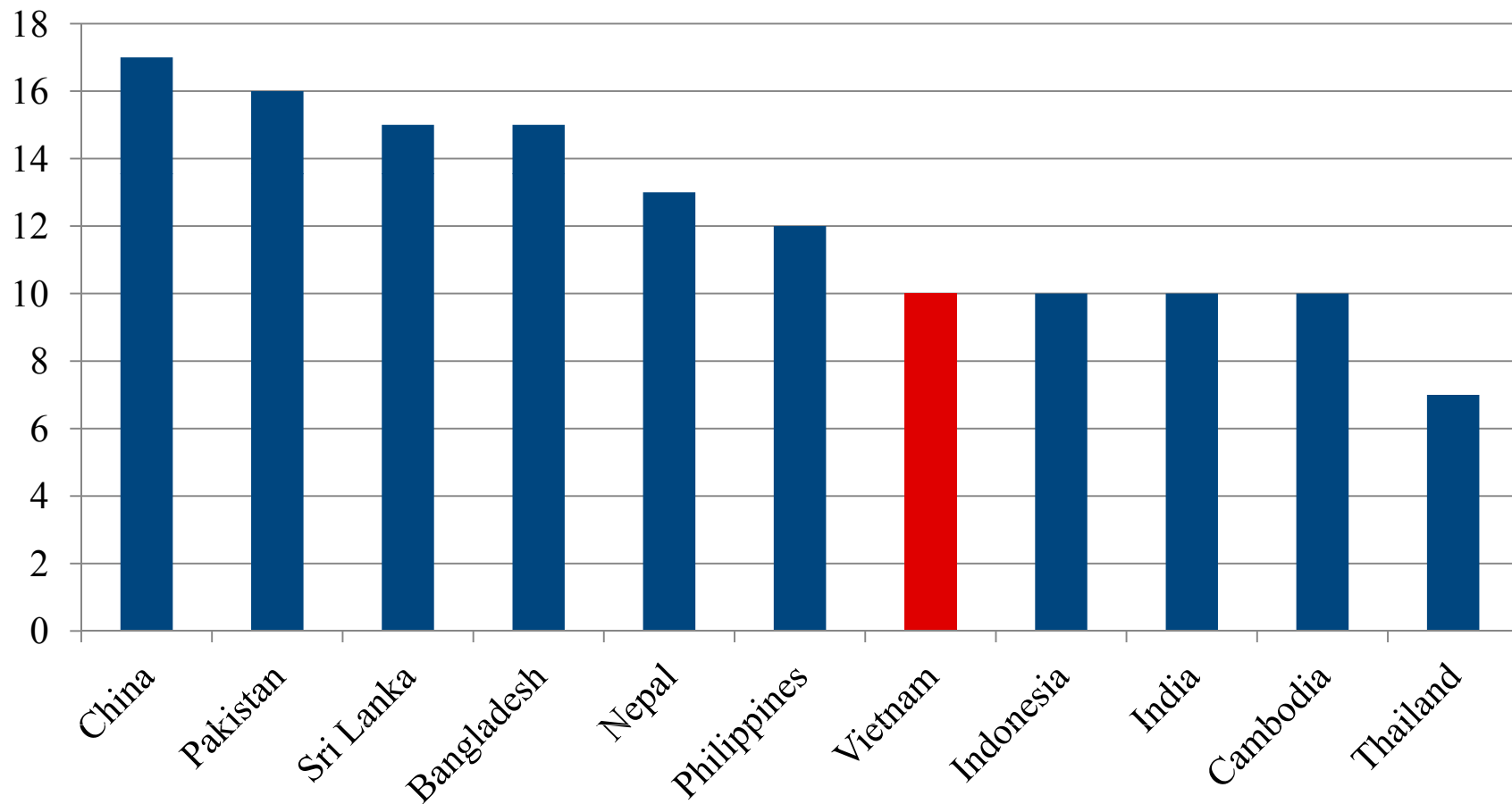




ARE RATES DIFFERENT?

VAT Standard Rate, 2010

(In percent)

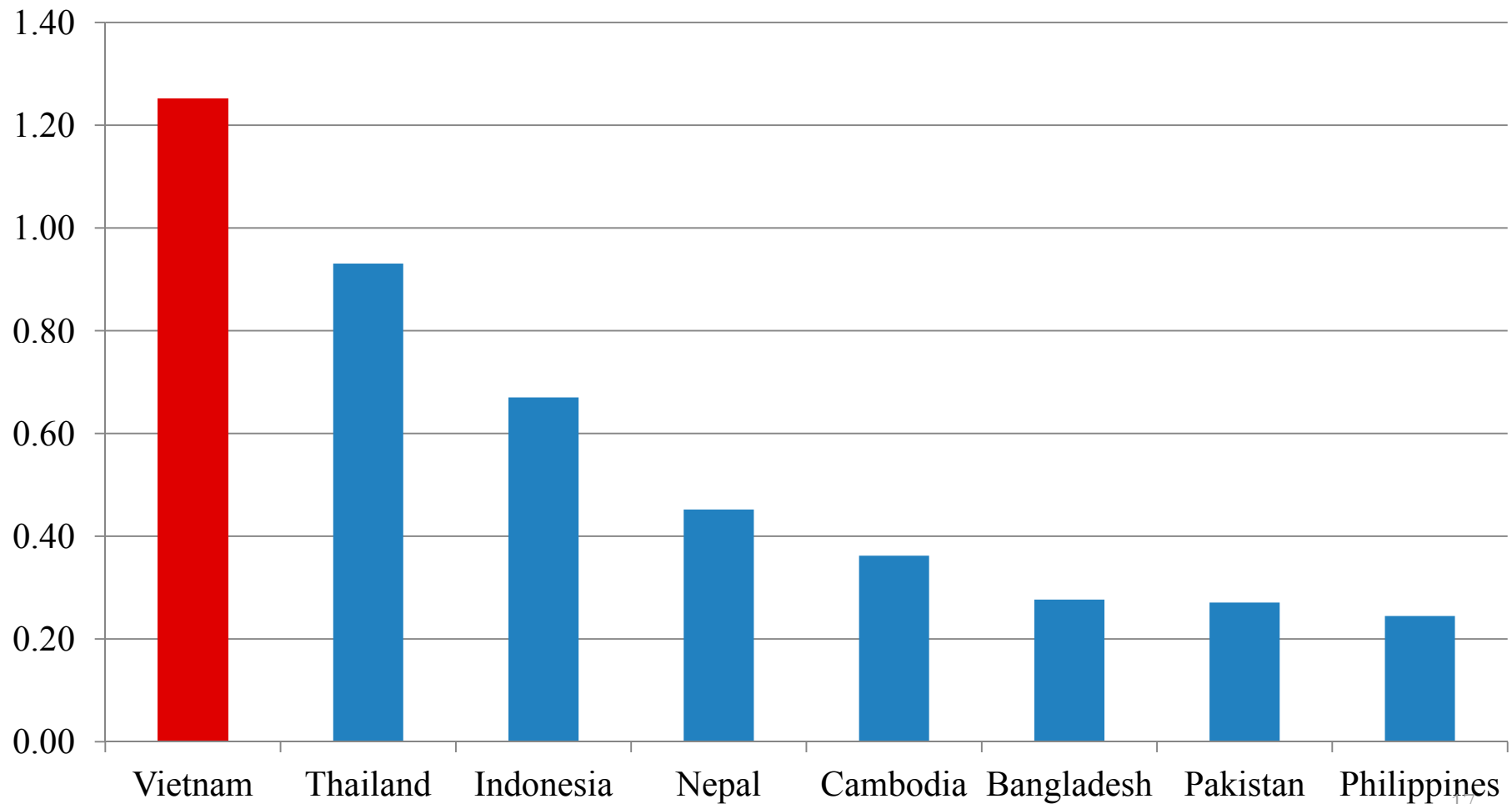




Do “C-efficiencies” differ?

VAT Efficiency, 2010

(Consumption based)





VAT measures in 2011-2015 plan

- Reduction in exempt goods and services
- Reduce number of goods and services subject to 5% rate
- Study the feasibility of one uniform rate by 2020
- Move towards credit-invoice (deduction) method for all taxpayers (except those below threshold)
- Introduce VAT threshold applied to turnover in line with international practice



Recommendations:

- Streamline substantially the list of exempt goods (with specific proposals)
- Eliminate the lower 5% rate and classify goods to which lower rate applies either as exempt or subject to the standard rate
- Introduce an exemption threshold for small businesses in terms of turnover (with turnover tax in lieu of VAT below threshold)
- Eliminate refund threshold for exporters
- Centralize payment of VAT (with transfers to local governments)



Excises



IMF 2009 Report: Issues

Wide array of goods/services subject to tax:

- tobacco
 - alcoholic beverages
 - oil products
 - autos
 - aircrafts
 - yachts
 - ... and different rates
- air conditioning devices
 - playing cards
 - votive paper
 - gambling
 - amusement services



Issues

- A number of these taxes may not be efficient
- all rates ad valorem
- low rate on petrol products (10%)
- contraband/ low rates in Cambodia



Recommendations

- Review cost effectiveness of excises on minor consumption goods; eliminate those with scarce revenues/high collection cost and easily eluded;
- Consider possibility of increasing gasoline tax;
- Introduce specific excises to replace ad valorem;
- Streamline rates (e.g: lotteries and gambling);
- Regional coordination to prevent smuggling



Natural Resources

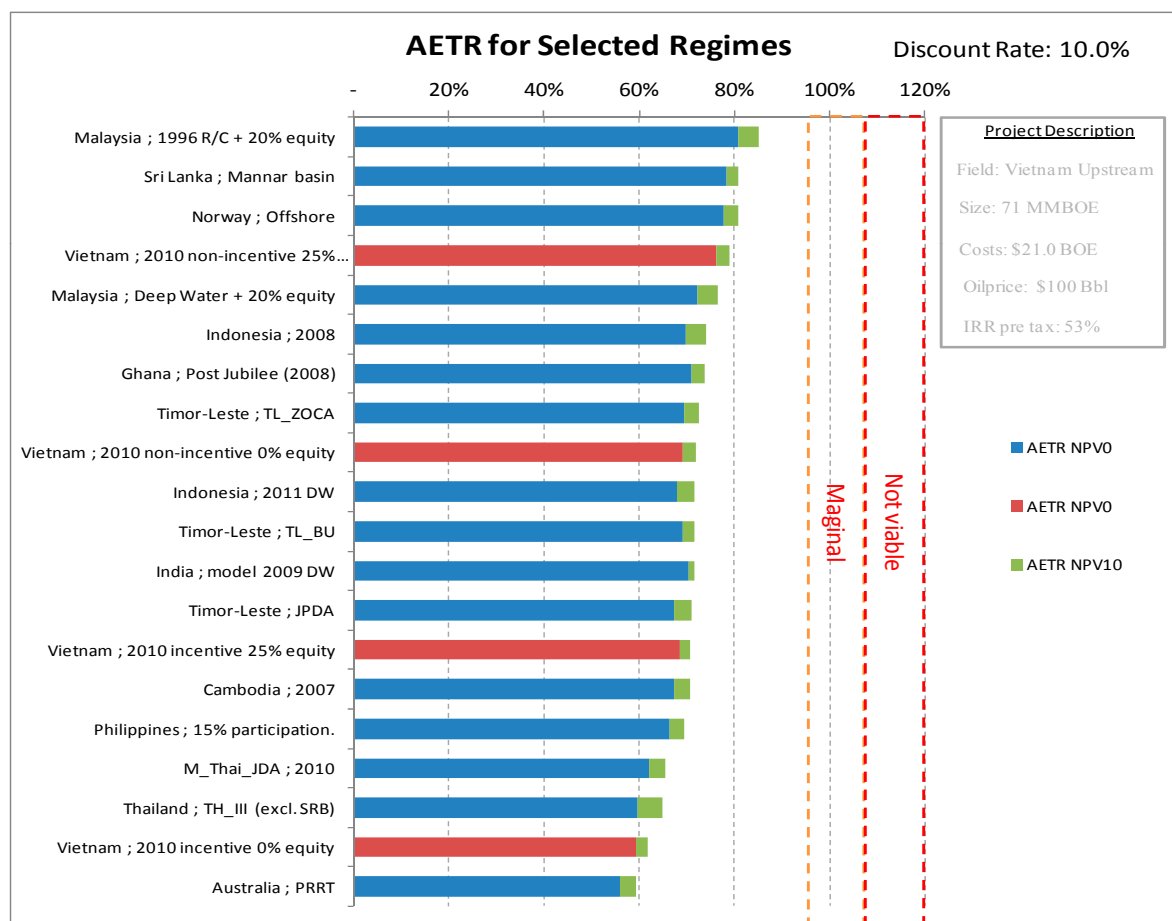
Current Fiscal Regime: Natural Resources



- CIT rate 50%
 - Promoted projects: 32-40%
- Royalties
 - Oil: 7-29%
 - Metals: 10-15%
- Mining rights fee an additional 2.5-3%
- Export duties
 - 40% iron ore, 10% gold, 10% oil
 - Natural gas export forbidden
- No VAT refund for unprocessed exports

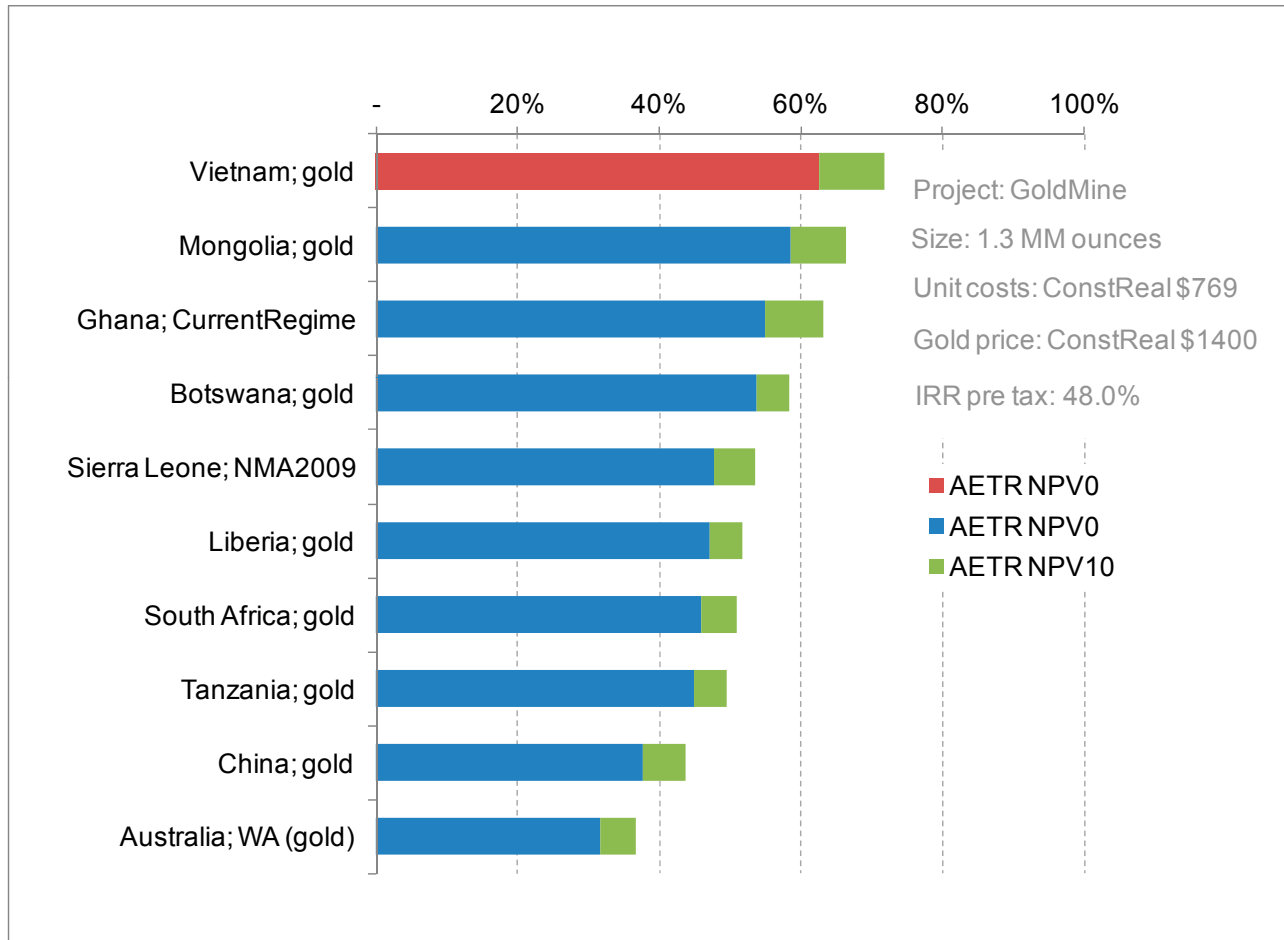


International Comparison: Oil





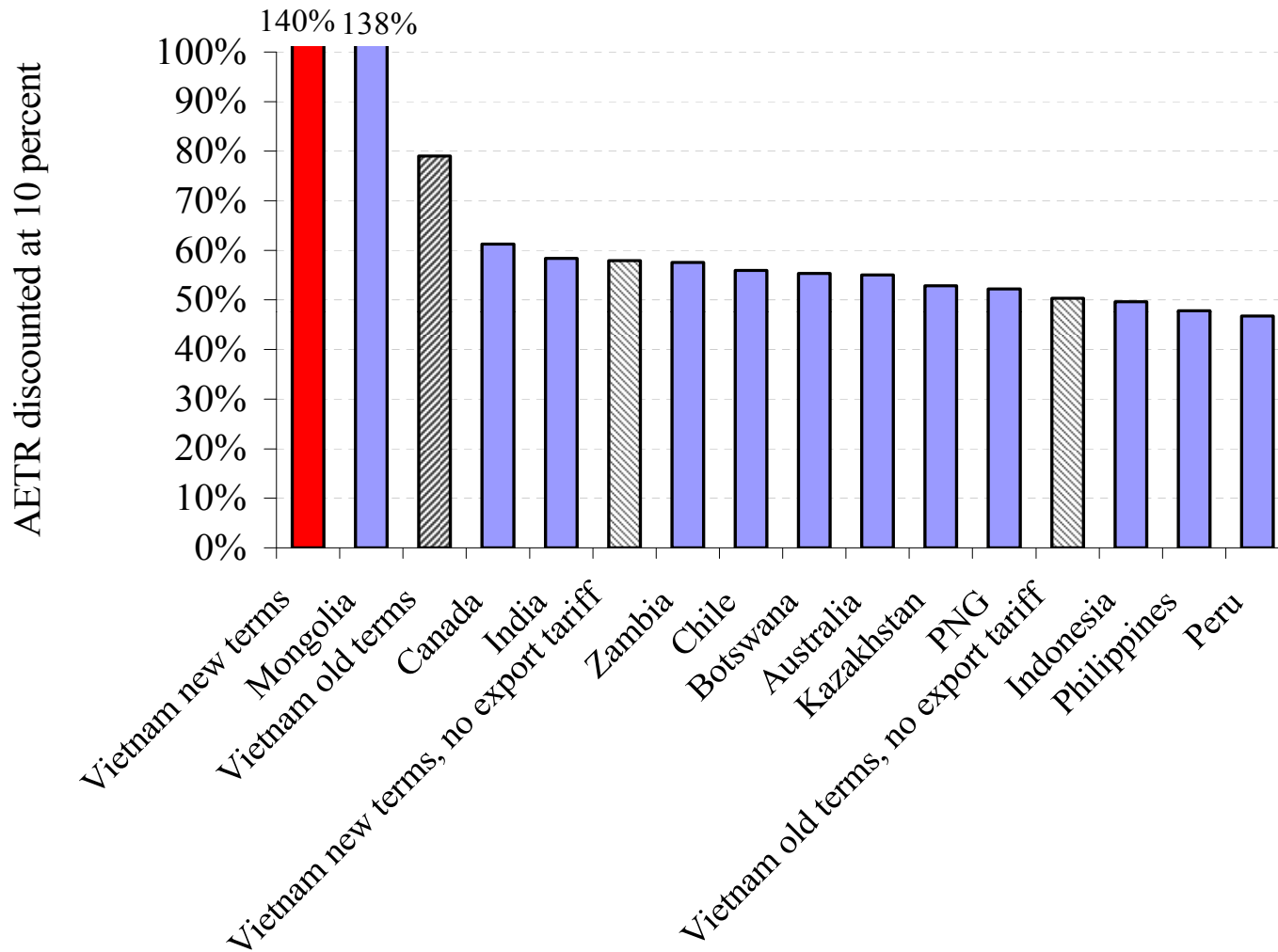
International comparison: Gold



The Average Effective Tax Rate (AETR), or the government take, is the ratio of the net present value (NPV) of tax collections to the NPV of the project pre-tax net cash flows.



International Comparison: Copper





Issues

- Combination of high royalty rates, high CIT rates and export taxes may render investment in Vietnam's energy and mining sectors unattractive relative to other countries.
- Export taxes are an inefficient way to stimulate domestic refining.
- Need to enhance fiscal transparency



Recommendations

- Carefully review overall taxation of energy and minerals to ensure international competitiveness
 - Consider shifting the balance between taxes on production (royalties) and taxes on rent, particularly for marginal and maturing projects.
 - Since natural resource taxation is highly technical, expert assistance is advised.
- Phase out export taxes and VAT penalties for exporters
- Implement EITI accounting standards to ensure transparency



Corporate Income Tax



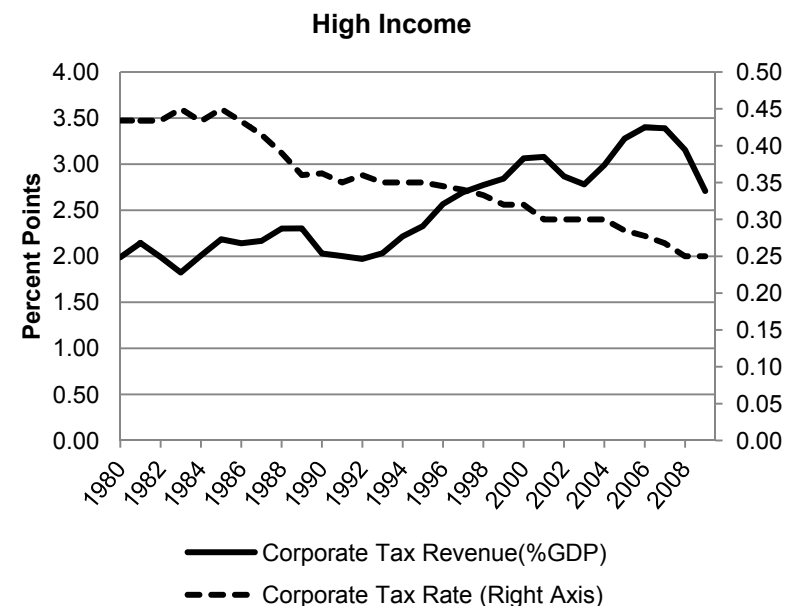
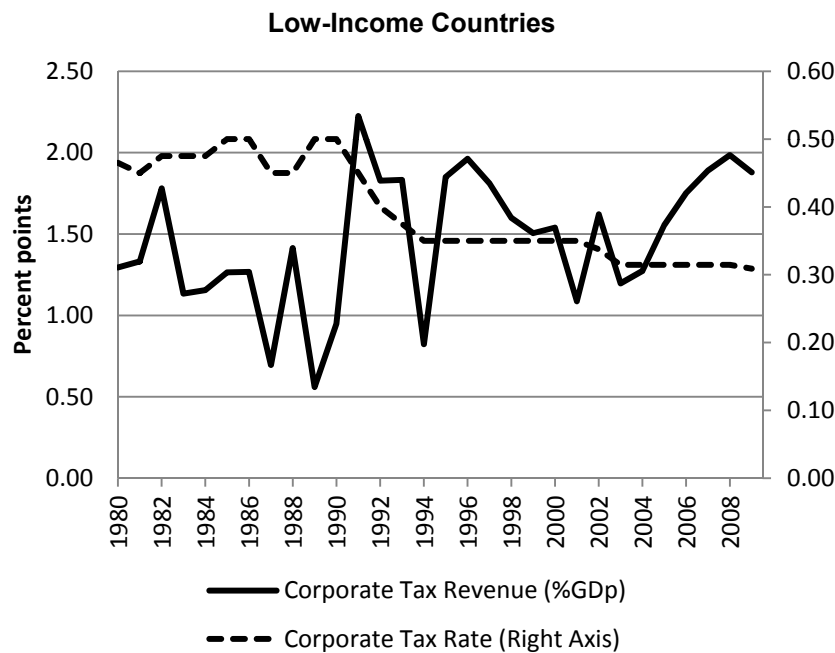
CIT – Key Features

- Internationally competitive **CIT rate** of 25%
- Range of **CIT incentives** – some rationalization in recent years, but continue to be very generous and unnecessarily complex
- **CIT Income/Deductions** – broadly consistent with international practice, but scope remains for removing deduction limitations and simplifying depreciation allowances
- Gradually introducing **rules to deal with abusive tax planning**: transfer pricing rules; new thin capitalization rules



CIT – International Trends

Rates falling, but revenue has held up—though less raised in LICs (pre-crisis) than elsewhere



May reflect broadening of tax bases including reducing CIT incentives

CIT – International Trends



Challenges:

- Incentives
 - Threaten revenue, including from profit-shifting
 - Only attract FDI if governance good
 - Adversely affect governance, especially if discretionary
- Profit-shifting
 - How much can one reasonably expect to control this?
- Case for regional/wider cooperation, including on policy, becoming stronger?



CIT – Possible Reforms

- Further base broadening by ***rationalizing incentives*** ... allowing for a ***reduction in the CIT rate*** in the medium to long term
 - Average CIT rate for Asia region in 2011 was 22.78%
- ***Align CIT deductions with international practice*** by:
 - Removing deduction limitations, but may limit for business entertainment and sponsorship for sporting and artistic events
 - Simplifying depreciation deductions using a pooled basis with 3 or 4 depreciation pools
- Ensure ***effective implementation of rules to address abusive tax planning***



Personal Income Tax



Present system: issues

Very progressive tax schedule, but ...

Poor tax revenues (0.8% of GDP - 2008) due to:

- High basic personal allowance
- High dependent allowance
- Interest income exempt
- Business income/self employed professionals shelter under lower CIT rate
- Pensions exempt



Present system: Issues

Also complex rate structure:

- Capital gains securities: 20% on nominal gain or 0.1% on selling price;
- Capital gains property: 25% on nominal gain or 2% on selling price;
- Interest income/dividends: 5%
- Other irregular income, such as prizes and inheritance: 10%



IMF 2009 Report: Recommendations

- lower basic and dependant allowances
- tax pensions
- lower PIT top marginal/ align with CIT rate
- unify capital gains tax rates/consider a dual tax system
- broaden the base of capital gains tax



Property Taxes

Land & Housing Tax – Key Features



- New design for non-agricultural land from 1 January 2012
- Applies to land only (previous plan to include buildings not accepted)
- Tax base continues to be: *land size x price per square meter* ... but the price will be based on market value (rather than multiple of the agricultural land tax as previously)
- Tax rate:
 - Progressive rates depending on whether allocated land quota is exceeded: 0.03% standard; 0.07% for land up to 3 times in excess of quota; 0.15% for excess greater than 3 times.
 - Same rate for residential and commercial land
- Exemptions/reductions - similar to previous law including for investment projects and special locations
- Administration – continues as a central tax collected at the local level with revenues staying with the local government

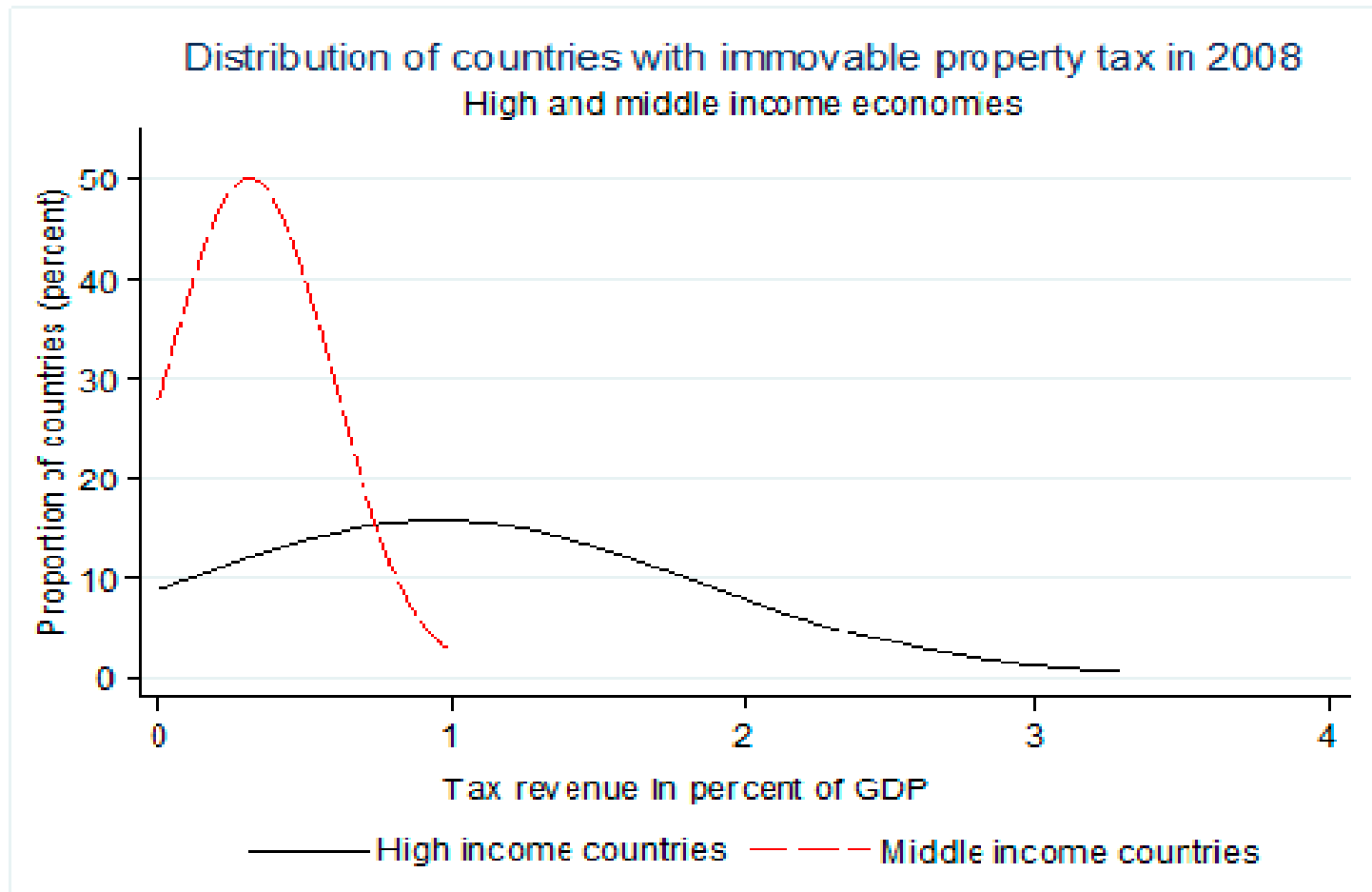
Property Taxes - International Experience



- Real estate taxes can be efficient and equitable, and particularly suitable for local governments:
 - relatively benign for growth;
 - raise few issues of international coordination; and
 - while their incidence is not fully understood, they seem to be borne mainly by the well-off.
- Revenue potential modest in absolute terms, but:
 - Could be transformative for local governments;
 - A relatively easy source of some progressivity?
- Challenges are mainly administrative: developing cadastres and valuation methods



Distribution of Yields from Property Taxes, 2008



Land & Housing Tax – Potential Reforms



- New regime is a positive reform – especially the move to market valuation
- In short term, allow time for the new regime to be implemented ... implementation and valuation would be helped by developing a modern computerized cadastre
- In the medium to long term consider:
 - Increasing the tax rate as the current rates are very low
 - Expanding the base by including buildings
 - Giving local governments some flexibility to set tax rates within a range set by the central government



Environmental Taxes



Current tax system 1

- Environmental Protection Charges
 - Extraction charges (minerals, fuels)
 - Base: Volumes/Weights of fuel
 - Rates: specific rates, relation to damages unclear
 - Waste water charges
 - Base: Pollutants (Hg, Pb, As, Cd, suspended solids)
 - Exemptions: Some user types, use forms, and regions
 - Rates: Ranges (floors and ceilings)
 - Solid waste charges
- Revenue use: local restoration



Current tax system 2

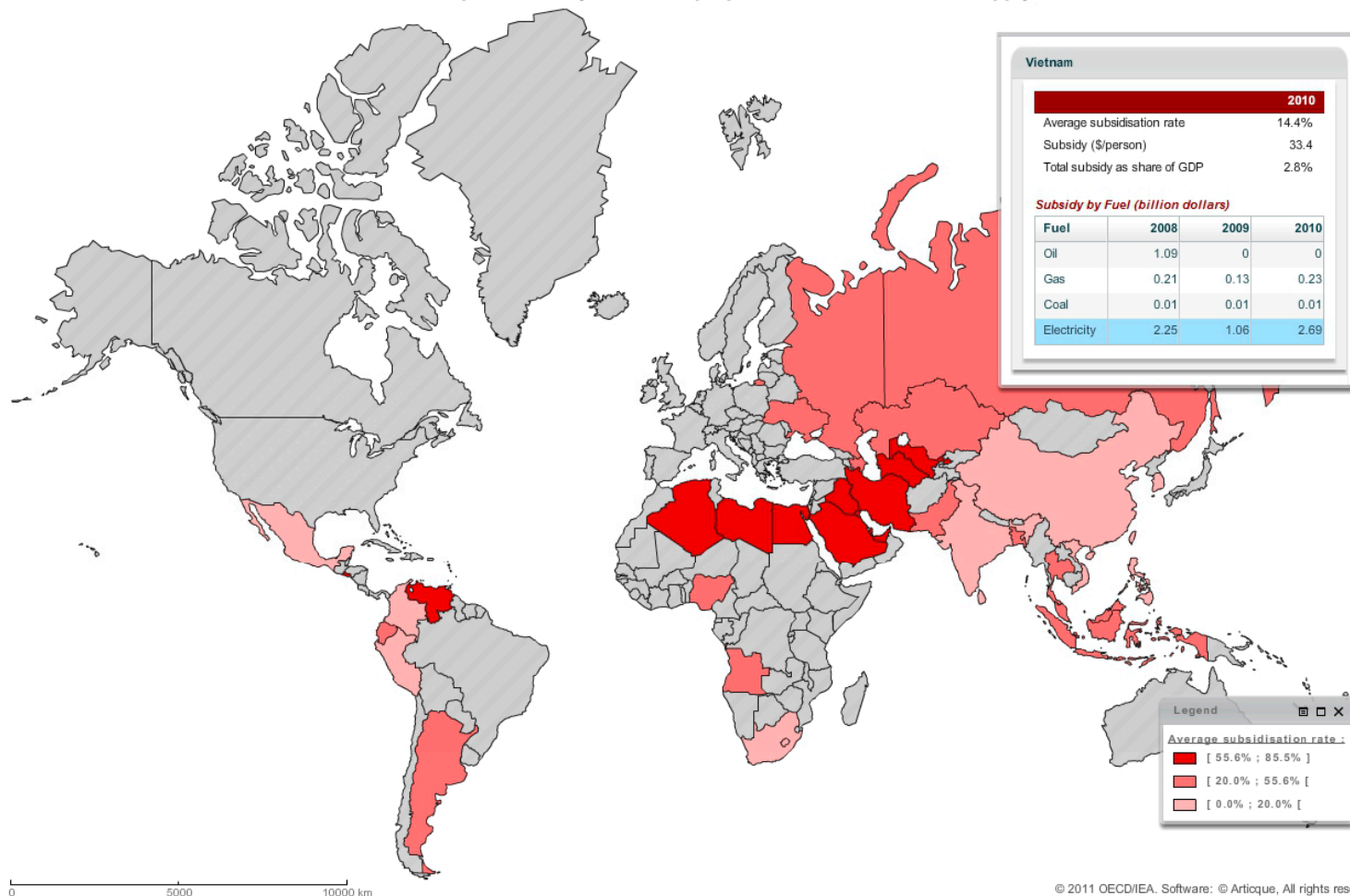
- 2012 Environmental Tax Reform
 - Tax on various fuels, certain classes of chemicals
 - Exemptions: natural gas, biofuels (all biofuel types)
 - Very low (specific) rates without indexation

Current subsidy system

- Part of top 34 fuel consumption subsidies providers

IEA - World Energy Outlook 2011

Fossil-fuel consumption subsidy rates as a proportion of the full cost of supply, 2010





2009 Recommendations

- Increase fuel taxes, do poverty alleviation via targeted transfers, not distortive subsidies
 - Started small Environmental Tax Reform (2012)
- Replace ad valorem taxes with specific rates and index
 - Specific rates for new taxes, not indexed
- Set tax rates equal to marginal damage estimate

The Way Forward: The Government's Objectives



- Government 5-Year-Plan for environmental taxes
 - “encourage enterprises and people to change their acts to use and consume product which help protect the environment”
 - “increase the revenue of the state budget”
 - “continue to study and supplement taxable subjects”
 - “revise the regulating level to help limit the use of products which have negative impacts on environment and ecosystem”



The way forward: Tools

- Set tax rates at least equal to marginal damages
 - International agencies can provide damages
 - Charge fuels / cars according to their damage
- Do not provide exemptions
 - If competitiveness concern, one can resolve this problem by handing environmental tax revenue back to industry as an output subsidy, but still tax pollution equally for all sectors of the economy.
- Efficiency requires that equal damage must be equally priced
 - Do not allow deductibility of environmental tax payments.
- Indexation of specific rates



The way forward: Tools

- Tax upstream according to the pollutant content of fuels
 - Apply oil tax at refinery level, coal tax at the mine, or at ports → fewer collection points, less administration cost than charging consumers
 - This would address electricity subsidy without excise
- Use targeted transfers –not fuel subsidies – for poverty alleviation
 - Avoid leakages of fuel subsidies
 - Achieve much bigger poverty reduction for same cost



Conclusion



Concluding Comments

- On tax, Vietnam compares favorably in the region
-and much has been done already!
- Reform agenda for 2011-15 is quite ambitious...
- ...and needs to be carefully prepared and sequenced (probably beyond 2015?)
- Significant scope for further simplification and base-broadening – but 23-24% target definitely feasible!
- More work is, however, needed (on resource tax, environmental tax, property tax, and revenue estimation)