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POLICY BRIEF

Double Taxation Treaties in Vietnam: Red carpet for whom?

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List of Abbreviations

AAV	ActionAid Vietnam
AFV	Aid for Social Protection Program Foundation Vietnam
DTT	Double Tax Treaty
FDI	Foreign Direct Investment
G20	Group of Twenty
GDT	General Department of Taxation
GSO	General Statistics Office of Vietnam
UK	United Kingdom
US	United States of America
VAT	Value Added Tax

Key messages

- Around the world, double taxation treaties (DTTs) are resulting in forgone revenue for developing countries.[1]
- Treaties can restrict developing countries' ability to tax multinational companies.
- Multinational companies can flexibly use tax treaties to avoid tax or to shift profits to countries with lower tax rates.
- Vietnam has entered into 77 DTTs – more than Laos, Myanmar, Cambodia and the Philippines combined.[2]
- 84% of registered capital of major FDI projects in Vietnam comes from tax treaty partners. However, it is difficult to quantify the extent to which DTTs have caused this investment as other factors (like overall tax rates, regulatory environment, infrastructure and skills) can influence investment decisions.[3]
- Some early treaties restrict Vietnam's ability to tax foreign businesses. Tax treaties concluded more recently have better protections of Vietnam's right to tax foreign companies.
- The top four direct providers of FDI to Vietnam (Republic of Korea, Japan, Singapore and Taiwan) enacted among the most restrictive original DTTs, based on ActionAid International Tax Treaties Dataset.[4]
- Tax revenues, including from FDI, are essential to funding public services like health and education.[5] These services enable women and girls to participate in Vietnam's development and to enjoy their fundamental human rights.[6]

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1 ActionAid International, 2016, Mistreated: The tax treaties that are depriving the world's poorest countries of vital revenue available at: http://www.actionaid.org/sites/files/actionaid/actionaid_-_mistreated_tax_treaties_report_-_feb_2016.pdf

2 General Department of Taxation, as at October 2016.

3 General statistics office, 31 December 2016.

4 Vietnam and Singapore have since negotiated a protocol to their DTT which came into effect in 2014 and amended some restrictive terms.

5 See ActionAid Vietnam (2015) Cost of Tax Incentives and Tax Avoidance by FDIs to Vietnam, http://www.actionaid.org/sites/files/actionaid/bao_cao_tax_ta_sua_21.4.pdf; pages 11-13;.

6 See ActionAid Vietnam (2015) Gender Responsive Public Services: Where is the Answer for Viet Nam?, http://www.actionaid.org/sites/files/actionaid/ruot_bao_cao_grps_-_ta_0.pdf; page 6

Introduction

Double Taxation Treaties (DTTs)[7] are agreements made between countries that divide up rights to tax. DTTs decide how much countries can tax multinational companies and other cross-border activities. DTTs provide certainty to international business by indicating which taxes will be limited when making money overseas. DTTs also aim to prevent a company or individual being taxed twice when they are based in one country but earning income in another.

While DTTs can help to provide certainty, they can also restrict the rights of lower-income countries to tax multinational companies, resulting in losses of revenue which could otherwise be used for vital public services. For example, ActionAid International estimates Bangladesh is losing approximately US$85 million every year from just one clause in its tax treaties that severely restricts its right to tax dividends.[8] In some cases, DTTs can also result in double non-taxation, where companies engage in 'treaty shopping' to route their funds through favourable treaty countries.[9]

This policy brief looks at the implications of Vietnam's DTTs and makes recommendations to minimize impacts of DTTs on Vietnam's ability to derive the greatest benefit for its citizens from its increasing flows of foreign investment. It draws on research conducted for ActionAid in 2016.

Objectives of This Policy Brief

This policy brief aims to:

1. Outline the current status and potential impacts of DTTs in Vietnam; and
2. Evidence the need to fundamentally improve the approach to existing and potential DTTs in the future.

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7 Also known as Agreements for the Avoidance of Double Taxation, or Double Taxation Agreements.

8 ActionAid International, 2016, Mistreated: The tax treaties that are depriving the world's poorest countries of vital revenue available at: http://www.actionaid.org/sites/files/actionaid/actionaid_-_mistreated_tax_treaties_report_-_feb_2016.pdf at p 3.

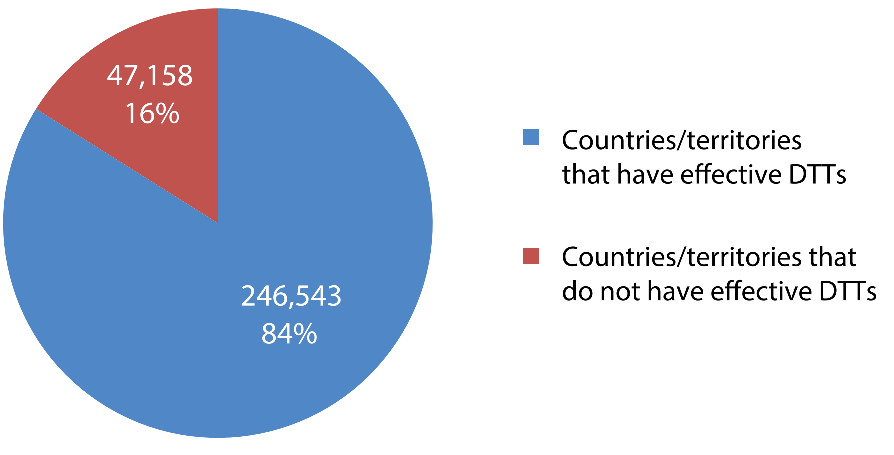
9 ActionAid and SEATINI (2014) Double Taxation Treaties in Uganda: Impact and Policy Implications, highlights an example from Zambia of a Zambian subsidiary of British company, Associated British Foods, routing a loan from the UK through Ireland to avoid paying withholding tax. See: http://www.seatiniuganda.org/publications/research/72-double-taxation-treaties-in-uganda-1/file.html at p 10.

Vietnam's Double Taxation Treaties

Since 1992, Vietnam has signed DTTs with 77 countries - more than Laos, Myanmar, Cambodia and the Philippines combined.[10] Among other things, these treaties reduce or eliminate the tax payable in Vietnam for residents of the other country; and allow Vietnamese residents to deduct taxes they have paid in the other country from their tax in Vietnam.

Vietnam receives most of its foreign direct investment from DTT partners. 26 of the 32 top providers of FDI to Vietnam have a DTT with Vietnam, and DTT partners account for 91% in terms of project number and 84% in terms of registered capital of major FDI providers 'projects in Vietnam.[11] Many of the top 10 providers of FDI to Vietnam have had DTTs since the 1990s.

Figure 1: Registered capital of Vietnam's major FDI providers accumulated valid projects to Dec 2016 ($ Billion USD)



Source: Compiled from data of GDT and GSO.

While this suggests that DTTs are influential in attracting FDI, they constitute only one of the many determinants of foreign investment - which also includes overall tax rates, regulatory environment, infrastructure and skills.[12] The existence of a DTT can also provide more flexibility for foreign investors to choose the jurisdiction through which to enter Vietnam, potentially leading to more FDI flowing through treaty partner countries, even where they are not the source of the investment.

Compared with other developing nations, Vietnam's treaties are generally more protective of its own right to tax - with some significant exceptions. DTTs set out when a country is allowed to tax income earned by a foreign individual or company within its borders (source taxation) or when it is allowed to tax income earned by its residents when they operate overseas (residence taxation). Restrictions on source taxation apply to both parties to the treaty. However, when investment flows

[10] General Department of Taxation; Data as at 16 October 2016.

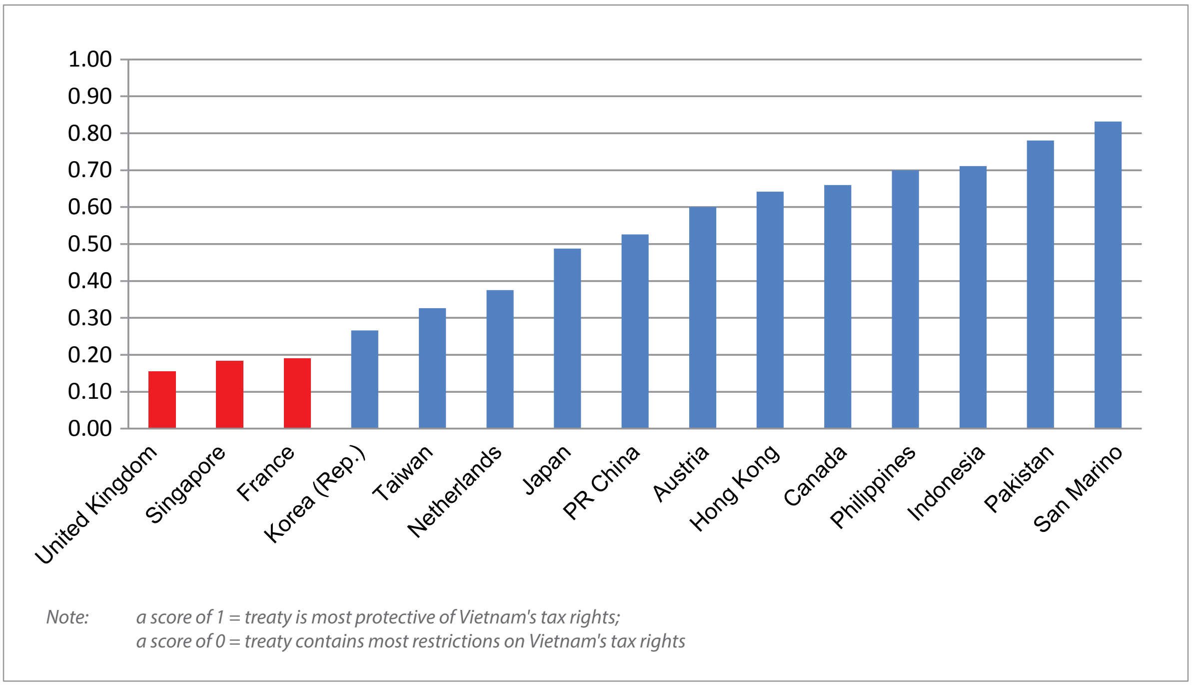
[11] Compiled from data of GDT and GSO, Foreign direct investment projects licensed by main counterparts, as at 31 December 2016; available at: https://www.gso.gov.vn/default_en.aspx?tabid=776. Only treaties in force included in the calculation.

[12] For example, in a 2013 survey, foreign companies investing in Africa ranked the existence of a DTT 10th out of 12 factors determining where they invest, behind economic and political stability, transparency, labour skills and cost of labour. IMF has also argued that the empirical evidence for the investment attraction effects of DTTs is mixed, and that countries need to be cautious that the losses from DTTs do not outweigh the benefits from any FDI generated - see IMF (2014) Spillovers in International Corporate Taxation, available: http://www.imf.org/external/np/pp/eng/2014/050914.pdf and UNIDO (2011) Africa Investor Report, at: https://www.unido.org/fileadmin/user_media/Publications/Pub_free/AIS_Report_A4.pdf

are mostly one-way (eg: from a developed country to a developing country), these restrictions hurt the developing country partner hardest. The ActionAid Tax Treaties Dataset (which compares key features of 519 DTTs) provides each treaty with a 'Source Index' score between 0 and 1, where a higher number means the developing country has kept more source taxation rights under the treaty.[13] Vietnam's DTTs with G20 members have a higher average source index (that is, are more protective of Vietnam's right to tax) than many other developing nations.[14] Vietnam's DTTs have also become more protective over time, with the Source Index value of its treaties gradually increasing as a trend.

Despite this general trend, some original treaties signed in the 1990s are comparatively very restrictive on Vietnam's right to tax foreign investment. Considering Vietnam's treaties with higher-income countries, the treaty with the UK is most restrictive, with 0.16 points, followed by the treaty with Singapore with 0.18 points and France with 0.19 points - although Vietnam and Singapore have since negotiated a protocol to their DTT which took effect in 2014 and amended some restrictive terms. Also significantly, the DTTs with the top four direct providers of FDI to Vietnam (Republic of Korea, Japan, Singapore and Taiwan) are in the most restrictive 25% of Vietnam's treaties; each with a Source Index lower than 0.5.[15]

Figure 2: How much do various treaties protect Vietnam's right to tax foreign companies?



Source: ActionAid International Treaties Dataset, data as at 2014.
Chart shows a selection of the 64 treaties analysed in the ActionAid dataset

13 ActionAid Tax Treaties Dataset: http://www.actionaid.org/sites/files/actionaid/aa_treaties_dataset_feb_2016.xlsx - dataset analyses treaties from 1970 to 2014. It includes renegotiated treaties, but excludes protocols other than those signed at the time of the original treaty. For further discussion, see: Hearson, M. 2016. Measuring tax treaty negotiation outcomes: the ActionAid tax treaties dataset. International Centre for Tax and Development Working Paper No 47. Brighton: Institute of Development Studies. Available at: http://www.ictd.ac/datasets/action-aid-tax-treaties-datasets

14 Vietnam's average Source Index is 0.56 while the average across all developing countries is 0.45.

15 ActionAid Tax Treaties Dataset: http://www.actionaid.org/sites/files/actionaid/aa_treaties_dataset_feb_2016.xlsx.

Figure 3: Top 10 providers of FDI by tax treaty date

No	Country/ Territory	Year original DTT signed	Source Index	Registered capital (million USD) as at 31 December 2016
1	South Korea	1994	0.27	50,554
2	Japan	1995	0.49	42,434
3	Singapore	1994	0.18	38,255
4	Taiwan	1998	0.33	31,886
5	Virgin Islands	No treaty	No treaty	20,482
6	Hong Kong	2008	0.64	17,003
7	Malaysia	1995	0.4	11,967
8	China	1995	0.53	10,528
9	USA	2015	N/A[16]	10,142
10	Netherlands	1992	0.33	7,800

Source: GSO, as at 31 December 2016; ActionAid Tax Treaties Dataset;
Note Vietnam's average source index is 0.56.

As example of restrictive provisions, the 1994 DTT with Singapore prevents Vietnam from taxing dividends of companies from Singapore even if the companies derive income or profits from Vietnam.[17] As another example, under the DTT with the UK, a UK company operating in Vietnam only has to pay tax in Vietnam if it has a 'permanent establishment' in Vietnam (and vice versa) - however, the definition of 'permanent establishment' does not include businesses engaged in provision of services, and also excludes facilities for delivery and storage of goods (like warehouses).[18]

16 No data for US as treaty signed after AAI tax treaties dataset

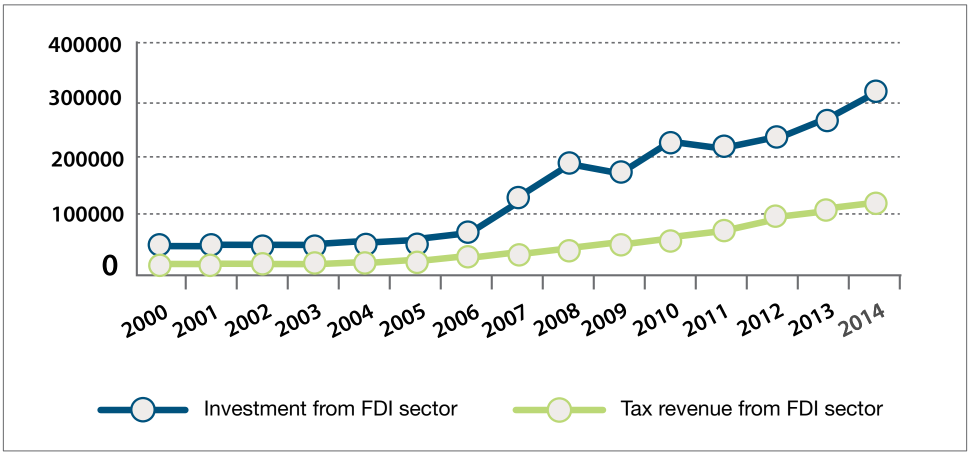
17 The exception is if a Vietnamese resident is receiving the dividends. Vietnam- Singapore Tax Treaty; 2 March 1994; available at: https://www.iras.gov.sg/IRASHome/uploadedFiles/IRASHome/Quick_Links/Second%20Protocol%20amending%20Singapore-Vietnam%20DTA%20(Ratified)(11%20Jan%202013).pdf

18 Vietnam–UK Tax Treaty: https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/507435/1994-vietnam_-_in_force.pdf

Slow Growth of Tax Revenue from FDI

FDI inflows have increased significantly in Vietnam since 2007 as a result of many factors, including tax system reforms, land and infrastructure incentives, incentives provided under Free Trade Agreements and potentially the existence of DTTs. However, tax revenues contributed by FDI enterprises have grown at much slower pace.

Figure 4: Investment versus tax revenues from FDI sector



Source: CIEM

The diminishing tax returns from FDI put more pressure on domestic resources to meet the needs of the population and provide the public services required to fulfil the rights of women and girls. At the same time, revenues from corporate income tax are falling as a proportion of the overall budget, with VAT (a tax that impacts the poor proportionally more than other taxes) making up much of the difference.[19]

Box 1: Tax and Gender-Responsive Public Services

Public services such as education, health care, clean water, housing, employment, social security and environmental hygiene have an essential role in every citizen's life, and play a key role in ensuring human rights, especially the rights of women and girls. Tax revenues are an important source of funding for these services.[20] Research by ActionAid and partners in 2015 found gaps in the availability, accessibility and gender-responsiveness of public services to women and girls, despite good progress. For example, while basic education facilities are available, most respondents did not have access to universities, vocational training centers, educational institutions for children with disabilities, vocational training centers for women, language or soft skills training.[21] Strong gender-responsive public services will help to ensure that women and girls are not left out of the development process in Vietnam.

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19 Vietnam –UK Tax Treaty: https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/507435/1994-vietnam_-_in_force.pdf

20 CIEM calculation based on CEIC database (2011), Ministry of Finance (2013b, 2014a, 2014b, 2015a, 2015b).

21 See ActionAid Vietnam (2015) Cost of Tax Incentives and Tax Avoidance by FDIs to Vietnam, http://www.actionaid.org/sites/files/actionaid/bao_cao_tax_ta_sua_21.4.pdf; pages 11-13;

The combined pressures on the budget from the above factors make it increasingly important to derive tax revenue from the growing pool of foreign investment. This highlights the need to carefully consider any agreements which have the potential to reduce Vietnam's ability to raise taxes from foreign companies.

Box 2: Efforts to reduce transfer mispricing

In recent years, the Government of Vietnam has taken significant steps to combat tax evasion and avoidance, including through transfer mispricing. As one example, transfer mispricing occurs where two related companies that are part of the same multinational group trade with each other but artificially distort the price at which the trade is recorded, in order to minimize tax. This typically involves recording a loss in a country with higher taxes, and recording a profit in a country with lower taxes.

According to the GSO (2016), the number and proportion of FDI enterprises making losses in Vietnam is increasing, with 47.3 per cent of foreign enterprises recording losses in 2014.[22] The incidence of losses is higher among wholly-foreign-owned enterprises, than among joint ventures. While these losses cannot be directly associated with base erosion or transfer mispricing, it is relevant that some enterprises have attempted to increase investment even with frequent losses. In recent years, the Government of Vietnam has paid increasing attention to strengthen transfer pricing management. As well as a comprehensive legal framework, the number of transfer pricing audits of companies has been on the rise since 2010 with significant results.[23] The Government also issued a new Decree in February 2017 to further improve transparency and combat tax avoidance in related party transactions.[24]

22 General Statistics Office (2016), Business Results of Vietnamese Enterprises in the Period 2010-2014. Statistical Publishing House.

23 For example, in the period 2013 to 2015, 29 cases were completed with total adjustments of around VND 8,700 billion (approximately USD 415 million), or an average of VND 300 billion (USD14 million) per case. Information provided by General Department of Taxation after three years of pilot program on transfer pricing. Source: https://www.tienphong.vn/kinh-te/dieu-tra-29-vu-chuyen-gia-giam-lo-gan-chuc-ngan-tydong-926217.tpo.

24 Decree No 20/2017/ND-CP.

Conclusion

Vietnam has signed a relatively large number of DTTs, which may have been helpful in attracting foreign investment, and have generally improved over time in the level of protection they offer for Vietnam. However, while Vietnam rolls out a red carpet for foreign investors in the form of tax treaties and other tax incentives, this approach risks increasing inequalities between domestic and foreign businesses and reduces the taxes that Vietnam can obtain from foreign investment. This in turn impacts on the ability to provide public services to poor and vulnerable people, particularly women and girls. As an implication, Vietnam should carefully review the impacts of existing and new DTTs. While Vietnam has derived benefits from its effective integration into the world economy, including measures to attract and facilitate foreign investment, it has reached a stage where a focus on "optimal integration", rather than "maximal integration", may be appropriate to ensure that economic integration will continue to benefit those who need it most.

Key Recomendations

1. **Vietnam should avoid promising or extending new DTTs to foreign countries until a further review has been done of the impacts of existing DTTs.** Any decision to enter into new DTTs should be based on evidence of past impacts of existing DTTs, potential future impacts, and public consultation. This principle should also apply to decisions to ratify DTTs that have been signed but are not yet in force.
2. **Vietnam should also review DTT rules and make necessary adjustments, including renegotiating DTTs where they are too restrictive.** In particular, restrictive provisions in treaties with major FDI providers should be renegotiated.
3. **Future decision-making on DTTs should consider the important role that tax plays in funding gender-responsive public services for women and girls**, and the need for sufficient taxation revenue to provide these services.

ActionAid's Research Signature

People-centred evidence with women and girls at the core, combined with knowledge from in and outside the organization, enables power shifts. This brings about changes at local, national and international levels.

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