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International Tax Planning for Structuring Investments in Vietnam

by Jack Sheehan

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In this article, Sheehan examines the international tax aspects of structuring investments in Vietnam and discusses recent international tax developments regarding the OECD base erosion and profit-shifting project and pillar 2 global anti-base-erosion rules in Vietnam.

This article examines the international tax planning aspects of structuring investments in Vietnam, including the Vietnamese tax rules applicable to cross-border dividends, interest, royalties, and service fees; Vietnamese antiabuse rules; Vietnam's tax treaty network; the taxation of capital gains on direct and indirect transfers of shares in Vietnamese companies; and popular holding jurisdictions for structuring investments in Vietnam. This article concludes by discussing recent international tax developments regarding the OECD base erosion and profit-shifting project and pillar 2 global anti-base-erosion (GLOBE) model rules in Vietnam.

Competitive Tax Rules

When compared with other countries in Asia, Vietnam has a competitive tax system in which dividends are exempt from withholding tax if paid to either domestic or foreign corporate shareholders. Moreover, withholding tax on interest payments is 5 percent and royalties 10 percent, making it one of the lowest in Asia. (See Table 1.)

Service and management fees paid to a nonresident company are subject to a withholding tax of 5 percent. However, this can be exempt under the business profits articles of Vietnamese tax treaties. In addition to the withholding tax, there is a VAT of 5 percent on the payment of service or management fees to nonresidents. The Vietnamese tax authorities regularly challenge management fees. For management fees to be deductible, a taxpayer must prove that *specific and direct economic benefits* have resulted from the management services, which is often challenging to prove in practice.

Tax Treaties

Vietnam has 80 tax treaties with other countries,[1] which include many major economies and trading partners, like Australia, Canada, China, France, Germany, Hong Kong, India, Ireland, Japan, the Netherlands, Singapore, and the United Kingdom. The United States and Vietnam signed a tax treaty in July 2015.[2] As of this writing, even though Vietnam ratified the treaty in February 2017, the U.S.-Vietnam tax treaty has not entered into effect because that ratification is still pending with the U.S. Senate.

[1] A list of tax treaties is available online at the Vietnamese Ministry of Finance's website.

[2] *See* Jack Sheehan and Bernard Cobarrubias, "Features of the US Vietnam Double Tax Treaty and Tax Planning Case Studies," American Chamber of Commerce in Vietnam (Sept. 9, 2015).

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Table 1. Comparison With Other Countries and Jurisdictions in Asia

	Dividends	Interest	Royalties
Vietnam	0%	5%	10%
China	10%	10%	10%
Japan[a]	20%	20%	20%
Indonesia	20%	20%	20%
Korea	20%	20%	20%
Thailand	10%	15%	15%
India[b]	10%/20%	10%/20%	5%/20%/40%
Philippines	15%/25%	20%	25%
Singapore	0%	15%	10%

Note: Withholding tax rates may be reduced under a tax treaty.

[a]Dividends, interest, and royalties paid to nonresident companies are generally subject to a withholding tax of 20 percent. However, in specific cases, lower rates may apply — for example, certain long-term bonds may be exempt from withholding tax.

[b]The withholding tax rate can vary and is subject to a surcharge and an educational cess.

Tax treaty relief is not automatic in Vietnam. Therefore, a taxpayer must apply in advance and receive approval for relief from tax authorities before making a cross-border payment. Failure to obtain approval from the tax authorities within the regulatory timelines will result in an upfront payment of the tax and require the taxpayer to claim a tax refund, which is time-consuming and usually difficult in practice.

Antiabuse Rules

The General Department of Tax in Vietnam issued rules against abusive arrangements to obtain tax treaty relief.[3] Agreements or contracts may be considered abusive if their purpose is solely or mainly to obtain treaty benefits. The tax authorities can deny treaty benefits if the recipient of the income is not a resident of the treaty partner jurisdiction or not the *beneficial owner* of the income.[4]

There has been some debate, at least academically, whether Vietnam is correct to apply a domestic law definition of *beneficial owner* under the dividends, interest, and royalty articles of tax treaties. Some argue that the term "beneficial owner" should take on an international fiscal meaning and be more aligned with OECD guidance on beneficial ownership and not used in a narrow technical sense. Vietnam is not the first country in Asia to introduce a domestic law definition for determining beneficial ownership in a tax treaty context.[5] In practice, the Vietnamese tax authorities seldom apply the antiabuse and beneficial ownership rules, because the domestic withholding tax rates are already lower than (or equal to) the tax treaty rates.

Vietnam has not implemented thin capitalization rules concerning the permitted amounts of debt-to-equity for tax purposes. However, depending on the type of business activity or project in Vietnam, authorities can determine an appropriate ratio specific to the project. Vietnamese transfer pricing rules limit the tax deductibility of interest to 30 percent of earnings before interest, taxes, depreciation, and amortization on net interest expense (that is, after offsetting against interest income from loans and deposits).

Vietnam has no controlled foreign company rules.

Vietnam has transfer pricing rules that broadly follow the OECD guidelines. Consistent with these guidelines, the Vietnamese tax authorities assert that transactions between related parties should be conducted in line with the arm's-length principle. Vietnamese transfer pricing rules apply to controlled transactions between related parties, including goods and services transfers, intangible property, loans, and intragroup transactions. Also, under domestic regulations, taxpayers can enter unilateral,

[3]Vietnamese MOF, "Guiding the Implementation of the Agreements on Double Tax Avoidance and Evasion Between Vietnam and Other Countries," Circular 205 (2013).

[4]*See* Sheehan et al., "Anti-Avoidance Rules, Transfer Pricing and Advanced Pricing Agreements," presentation to the American Chamber of Commerce in Vietnam (May 14, 2014).

[5]Tax authorities in China, India, Indonesia, Japan, and Korea all have rules for denying treaty benefits if a structure lacks substance or if the recipient is not the beneficial owner of the income.

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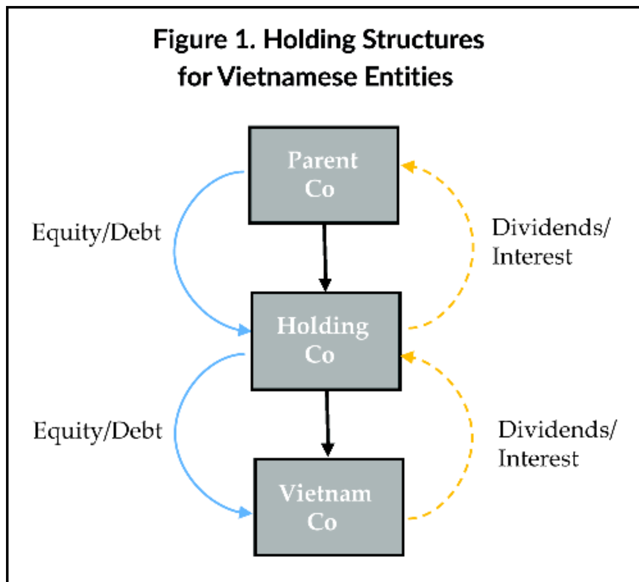
Figure 1. Holding Structures for Vietnamese Entities



bilateral, or multilateral advanced pricing agreements with the tax authorities.

Consistent with BEPS action 13, Vietnam has adopted country-by-country reporting. CbC reports must be prepared when a business group (that the Vietnam entity is part of) has global consolidated gross revenue of over VND 18 trillion and the Vietnamese entity is either the ultimate parent entity or it is required to prepare or submit CbC reports.

Popular Holding Company Jurisdictions

While Singapore and Hong Kong are popular holding company jurisdictions in Asia, other popular intermediary holding jurisdictions include the Netherlands and some low-tax jurisdictions like the Cayman Islands and British Virgin Islands. (See Figure 1.)

Taxation of Capital Gains on Share Transfers

Transfers of shares by corporate shareholders in either a limited liability company or a nonpublic joint stock company incorporated in Vietnam are considered capital transfers and are subject to corporate income tax of 20 percent.

Transfers of securities (including bonds and shares issued by public joint stock companies) by nonresident corporate shareholders are subject to deemed withholding tax of 0.1 percent on the sales proceeds.

Under Vietnamese corporate income tax regulations, Vietnamese-source income is broadly defined to include income from capital assignments, irrespective of whether a transaction is conducted in Vietnam or elsewhere.[6] The tax authorities have also issued several private tax rulings known as official letters on the indirect transfer of shares in Vietnamese companies. The official letters provide that the sale or transfer of shares in an offshore company that holds an interest in a Vietnamese company is Vietnamese-source income and subject to income tax in Vietnam.[7]

There is no specific guidance in Vietnam on calculating the capital gains from transferring shares of an offshore holding company. The official letters provide that the tax authorities will use the general provisions of the tax regulations applicable to direct transfers of shares in Vietnamese companies for indirect transfers. However, there is no clear guidance for determining capital gains from an indirect transfer of shares if the shares in an offshore entity include other assets (other than the Vietnamese company) or if there are multiple layers of holding companies. Tax treaties can offer foreign investors protection from the tax on capital gains from the sale of shares in Vietnam.

Further, the Vietnamese tax authorities will often become aware that an indirect transfer of shares has occurred from changes in the licenses of Vietnamese companies, from conducting tax audits, or from news media reports (in the case of large transactions).

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[6] Vietnamese government, article 1.1 of Decree 12/2015/ND-CP (Feb. 12, 2015).

[7] Vietnamese General Department of Taxation (GDT), Official Letter 2747/TCT-CS (July 12, 2018); Hanoi Tax Department, Official Letter 44290/CT-TTHT (June 10, 2019); and GDT, Official Letter 766/TCT-DNL (Feb. 29, 2016).

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Table 2. Tax Treaty Rates

Payment of:	Tax Treaty Rates			
	U.S. and Non-Treaty Countries	Singapore	Hong Kong	The Netherlands
Dividends	0%	5%/7%/12.5%[a]	10%[b]	5%/10%/15%[c]
Interest	5%	10%[d]	10%[e]	10%[f]
Royalties	10%	5%/10%[g]	7%/10%[h]	5%/10%/15%[i]
Business profits (service fees and management fees)	Various rates depending on the nature of the service (that is, 5% applies for general services)	Exempt if there is no permanent establishment in Vietnam through which the income is derived	Exempt if there is no PE in Vietnam through which the income is derived	Exempt if there is no PE in Vietnam through which the income is derived
Capital gains on the sale of shares in a Vietnamese company	20%	Exempt[j]	Exempt[k]	Exempt[l]

[a]Vietnam exempts dividends paid to corporate shareholders. Therefore, the Vietnamese domestic rate of zero applies to dividends.

[b]*Id.*

[c]*Id.*

[d]The Vietnamese domestic rate of 5 percent applies to interest.

[e]*Id.*

[f]*Id.*

[g]Second protocol of the Singapore-Vietnam tax treaty, art. 12(2) (1994): "5 percent of the gross amount of the royalties in respect of payments of any kind received as a consideration for the use of, or the right to use, any patent, design or model, plan, secret formula or process, or for the use of, or the right to use, industrial, commercial or scientific equipment, or for information concerning industrial, commercial, or scientific experience; and 10 percent of the gross amount of royalties in all other cases."

[h]Hong Kong-Vietnam tax treaty, art. 12(2) (2008): "7 percent of the gross amount of the royalties if they are made as a consideration for the use of, or the right to use, any patent, design or model, plan, secret formula or process; and 10 percent of the gross amount of royalties in all other cases."

[i]The Netherlands-Vietnam tax treaty, art. 12(2) (1995): "[S]uch royalties may also be taxed in the Contracting State in which they arise, and according to the laws of that State, but if the recipient is the beneficial owner of such royalties the tax so charged shall not exceed: (a) 5 percent of the gross amount of the royalties if they are paid as consideration for the use of, or the right to use, any patent, design or model, plan, secret formula or process, or for information concerning industrial or scientific experience; (b) 10 percent of the gross amount of the royalties if they are paid as consideration for the use of, or the right to use, a trade mark or for information concerning commercial experience; and 15 percent of the gross amount of the royalties in all other *cases*."

[j]Second protocol of the Singapore-Vietnam tax treaty, Art. VII(4) (1994): "Gains derived by a resident of a Contracting State from the alienation of shares, other than shares of a company quoted on a recognized stock exchange of one or both Contracting States, deriving more than 50 percent of their value directly or indirectly from immovable property situated in the other Contracting State may be taxed in that other State."

[k]Under Hong Kong-Vietnam tax treaty, arts. 13(4), 13(5), and 13(6), and the protocol, art. 3 (2008), capital gains are exempt unless: (a) the company has value of assets consisting of 50 percent (or more) of immovable property; or (b) the alienation of shares is 15 percent (or more) of the entire shareholding of the Vietnamese company.

[l]*Id.* at art. 13(4): "Where a resident of a Contracting State owns all or virtually all of the shares in a company which is a resident of the other Contracting State (other than a company of which the shares are quoted on a stock exchange) and the property of such company consists principally of immovable property situated in that other State, any gain derived by such resident from the alienation of shares in that company may be taxed in that other State."

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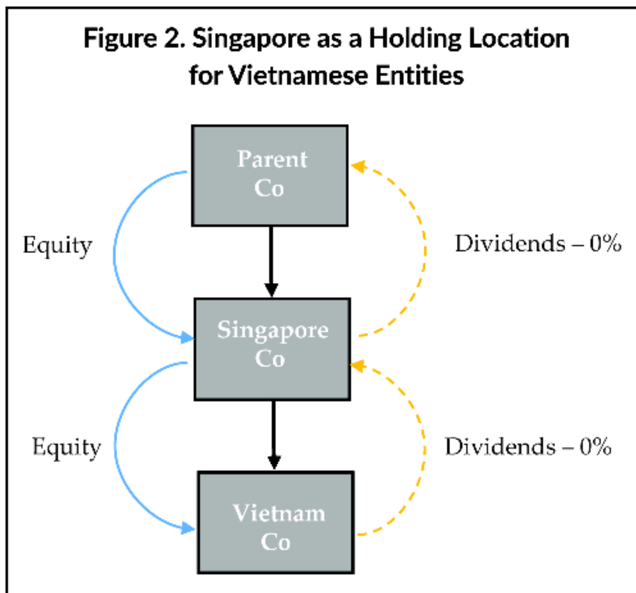
Figure 2. Singapore as a Holding Location for Vietnamese Entities



Status of the BEPS Project and GLOBE Rules

Vietnam is not an OECD member country. However, on June 21, 2017, Vietnam became the 100th country to join the OECD inclusive framework to implement BEPS minimum standards.[8] On February 9, 2022, Vietnam signed the Multilateral Convention to Implement Tax Treaty Related Measures to Prevent Base Erosion and Profit Shifting (MLI). The MLI will modify 75 of Vietnam's tax treaties and implement Vietnam's positions on BEPS action 6 (preventing treaty benefits in inappropriate circumstances).

Vietnam's policies for attracting foreign direct investment include offering tax incentives to companies that invest in specific sectors and locations. The Vietnamese government has established a working group to examine the effect of the OECD pillar 2 project and what a minimum tax would mean for Vietnam's attractiveness to foreign investors. Although Vietnam has not given any firm commitment regarding a timeline for implementing the pillar 2 proposal, it is expected to do so along with other countries in the region and will adjust its investment policies to adopt the global minimum tax.[9] As more countries commit to introducing rules to adopt the pillar 2 GLOBE model rules, Vietnam and other countries offering substantial tax incentives may find that, for Vietnamese subsidiaries of multinational enterprises paying low rates in Vietnam because of tax incentives, the parent companies' jurisdictions may impose top-up taxes to reach an effective tax rate of 15 percent.

There are several tax policy considerations for Vietnam regarding adopting the GLOBE rules, including whether to introduce a qualified domestic minimum top-up tax so no further top-up tax is required, or amending its tax incentives to minimize the effect of the top-up tax in another country.

Conclusion

Recent global tax developments are forcing MNEs to look more closely at their international tax strategies, particularly requirements to build substance and deal with domestic and treaty antiabuse rules, as well as the potential effects of a minimum tax.

Although Vietnam is a non-OECD member, it has joined the inclusive framework to implement the BEPS minimum standards and signed the MLI. If Vietnam decides not to introduce rules to implement the OECD pillar 2 GLOBE rules, the tax incentives that Vietnam provides may be clawed back in another country. MNEs that meet the thresholds for the GLOBE rules and receive incentives in Vietnam will not benefit from them because the tax will be paid elsewhere as a top-up tax.

In comparison with other jurisdictions in Asia, Vietnam has a competitive tax system with no withholding tax on dividends paid to corporate shareholders, and withholding taxes on interest of 5 percent and 10 percent on royalties. Further, Vietnam offers substantial incentives for foreign investors in specific sectors and locations, making Vietnam an attractive location to MNEs and foreign investors.

When international tax planning for investments in Vietnam, MNEs should be aware of recent cases and rulings issued by the tax authorities, Vietnam's antiabuse rules, issues with the interpretation of tax treaties, and the approval process for claiming treaty relief. Also, planning when exiting investments in Vietnam is required, including at an offshore level, because Vietnam

[8] *See* OECD, "OECD Welcomes Viet Nam's Commitment to Implement the Internationally Agreed Standards to Tackle Tax Evasion and Avoidance" (June 21, 2017).

[9] *See* "Vietnam to Develop Policies to Adapt to Global Minimum Tax," Vietnam Plus, Mar. 22, 2023.

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has rules for taxing indirect transfers of shares in Vietnamese companies.

As of the time of this writing, Singapore is the leading holding jurisdiction for structuring investments in Vietnam, offering tax efficiency for companies and investors that can build substance in the country. ■

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