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Vietnam's Employee Shares Ownership Plan: Tax Implications

Retaining key personnel has always been a company's prerequisite policy in paving the way to prosperity. Employee Shares Ownership Plan ("ESOP") has long been considered a good management tool and compensation benefit, for the retention of human capital, as well as a good solution for those companies with limited cash flow. ESOP is not a new term, however its important tax implications have been continuously provoking controversy. This report investigates the Personal Income Tax ("PIT")'s exposure under ESOP schemes, which provide beneficiaries a better understanding and thus the ability to minimize the tax risk.

Employee Shares Ownership Plan ("ESOP")

ESOP can simply be understood as employees' benefit plan with agreed terms and conditions. An employee shares ownership is defined as an allocation of shares that will be granted to specified employees in the future, prevalently in the form of shares options and/or shares ownership. Under such a scheme, employees typically must wait for a vesting period to elapse, before they are granted an ownership or a right to exercise the option, and buy the company shares at a lower strike price than that of the prevailing market. Employee ownership can be accomplished in a variety of ways in which employees can buy shares directly, be allocated shares as a bonus, receive shares options, obtain shares through a profit sharing plan, etc. General stages of an employee incentive plan include:

- Formulation—Employer plans and formulates a strategy to compensate employees;
- Grant—Employees are granted shares option or shares ownership at a point of time, in the future subject to the conditions of the plan and associated agreements;
- Vesting—Employees are entitled to their redemption rights;
- Exercise—Employees redeem their right and/or acquire shares; and
- Sale—Employees realize cash proceeds by selling their shares.

ESOP Taxation

PIT on income from wages, and remuneration and income from securities transfer are two important tax liabilities under an ESOP. The specific tax treatment is stipulated under Circular No. 111/2013/TT-BTC dated August 15, 2013.

Taxable Income from Wages and Remunerations

Income from wages and remuneration include rewards in cash or in kind in any shape or form, for instance, rewards in the form of securities. Accordingly, the first taxable event would arise at the time of the allotment of shares or when the employees exercise the option. Nevertheless, employees are not required to declare and make tax payment until shares of the same type are sold or transferred. With regard to shares option scheme, the difference between the fair market value on the exercise date and the amount actually recovered by the employees would be treated as salaried income. In case of a shares ownership scheme, the total sales proceeds in monetary value would be considered as employment income. Accordingly, employers are responsible for computing the benefit under an ESOP scheme, as part of the salary income and withhold tax liabilities from employees.

One of the most noteworthy considerations in terms of employment income in Vietnam is residency status. Particularly, resident individuals are taxed on their worldwide income regardless of where the income is paid or received. Employment income is generally subject to a progressive tax rate ranging from 5 percent and 35 percent. Nonresident individuals on the other hand are only subject to tax on their Vietnam-sourced income, irrespective of where the income is paid and received, at a tax rate of 20 percent.

Nonresidents might be exempt from PIT liabilities under an applicable avoidance of double taxation agreement, provided that certain conditions are met. Tax treaty protection depends on the agreement between the home country and Vietnam, therefore proper tax advice in the relevant tax jurisdictions should be sought out.

Taxable Income from Securities Transfers

The next tax that would be triggered in the event of a share transfer is income from shares or securities transfer. In this regard, the assessable income from transferring shares/securities is the price of each transfer and 0.1 percent PIT calculated on the transfer price will be applied. Specifically, a shares/securities transfer price is determined as follows:

- The transfer price of securities of a public company traded on a Stock Exchange is the transaction price. The executed price is based on the sales price from the transaction at the Stock Exchange. The PIT liabilities will be withheld before the income is paid to the transferor.
- The transfer price of shares in cases other than the above is the price written on the transfer contract or the actual transfer price or the value stated in the accounting book of the transferor at the latest financial statement before the transfer date. The individual will be responsible for PIT declaration and payment upon processing the shares transfer.

Conclusion

An ESOP can produce a greater commitment and increased productivity from employees and, in turn, greater fair market value of an enterprise, provided that employees understand how their work affects the creation of such value. An appropriate ESOP together with full investigation in tax liabilities may enhance the sustainable growth and prevent the company from unexpected tax penalty burdens in the future.

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