

Managing permanent establishment risk through tax treaties

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I. Definition of Permanent Establishment

I. Definition of Permanent Establishment

Under the Vietnam domestic regulations (Law on CIT):

A Permanent Establishment of a foreign enterprise is business establishment through which the foreign enterprise conducts all or part of its business operation in Vietnam, including:

Branches, offices, factories, means of transportation, mine, oil fields, or other natural resource extraction sites in Vietnam

Construction sites, installation and assembly works

Establishment providing services, including consultancy services via its employees or other entities

Agent for a foreign enterprise

Representative in Vietnam with authority to enter into contracts in the name of the foreign enterprise; or regularly delivers goods or provides services in Vietnam.

I. Definition of Permanent Establishment (Cont.)

Whereas, the term “Permanent establishment” in general, including:

- ❖ A place of management, a branch, an office, a factory, a workshop, a mine, an oil or gas well, a quarry or any other place of extraction of natural resources; and, a warehouse
- ❖ A building site, a construction, installation or supervisory activities in connection therewith, constitute a permanent establishment if such site, project or activities last more than six months or three months (depending on each DTA);
- ❖ Furnishing consultancy services through employees or other personnel provided that such activities last for a period or periods aggregating more than six months within any twelve-month period;
- ❖ Having in Vietnam a dependent agent – that devote wholly or most of their agency activities for that enterprise
- ❖ Giving for a person in Vietnam an authority to habitually negotiate and conclude contracts in the name of the enterprise; or conclude contracts in his name but bind obligations and duties of that enterprise; OR has no such authority, but the right to habitually represent that company to deliver goods in Vietnam.

I. Definition of Permanent Establishment (Cont.)

Notwithstanding the above, the term “Permanent establishment” shall be deemed not to include:

- ❖ the use of facilities solely or the maintenance of a stock of goods for the purpose of storage or display of goods or merchandise belonging to the enterprise OR, processing by another enterprise;
- ❖ the maintenance of a fixed place of business solely for the purpose of purchasing goods or merchandise or of collecting information; or, carrying any other activity of a preparatory or auxiliary character, for the enterprise;

II. General introduction on the avoidance of double taxation agreement (“DTA”)

II. General introduction on DTA

➔ As of August 10, 2016, Vietnam has signed DTA with 76 countries / territories in the world

➔ **Benefits for entering into the DTA**

- ❖ Prevent double taxation of income earned in one jurisdiction by a resident of the other jurisdiction
- ❖ Reduction or exemption of tax on certain types of income.
- ❖ The tax amount already paid in the contracting state shall be deducted from the tax amount payable in country where that company being a resident
- ❖ Exchanging information with foreign tax authorities to prevent tax evasion



II. General introduction on DTA (Cont.)

General application principles

- ❖ Taxes under the application scope of DTA → **CIT and PIT**
- ❖ Prevailing provisions for any difference between the domestic laws and DTA → **The provisions of DTA**
- ❖ Heavier tax obligations created by the DTA → **No**
- ❖ Undefined terminology in DTA → **Follow domestic laws**

III. Tax treatment for some common incomes under the DTA

III. Tax treatment for some common incomes under the DTA (Cont.)

Business profits

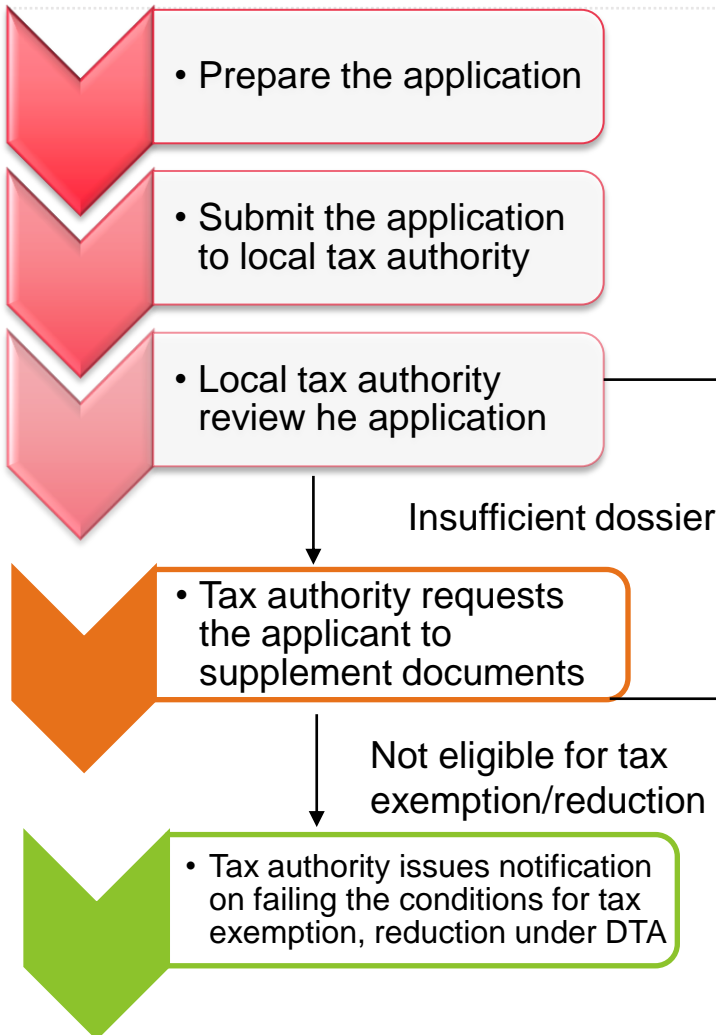
- The profits of an enterprise of a Contracting State shall be taxable only in that Contracting State, unless the enterprise carries on business in the other Contracting State through a permanent establishment (herein after referred to as “PE”) → the profits attributable to that permanent establishment may be taxed in the other Contracting State
- In determination of the profits of a PE, there shall be allowed as deductions expenses which are incurred for the purpose of the business of such PE

Interest payments, Dividends, royalties

- Interest payments/ dividends/ royalties arising in a Contracting State and paid to a resident of the other Contracting State may be taxed in that Contracting State under its domestic law (if any)
- However, the tax shall not exceed the tax rate as stipulated in DTA of the gross amount of the interest payments/ dividends/ royalties

IV. DTA application procedure for Corporate Income Tax

IV. DTA application for Corporate Income Tax - Application procedures



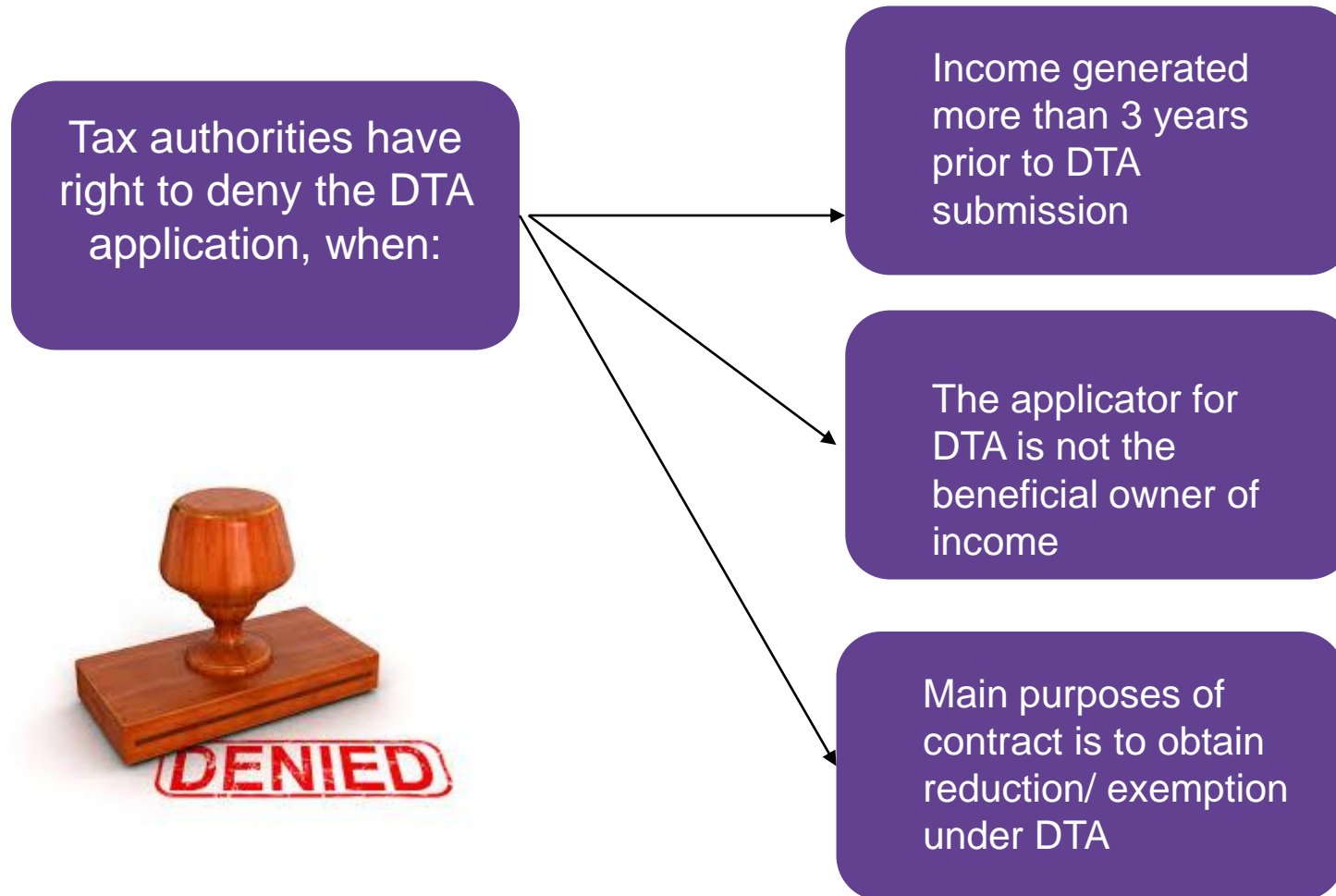
- ❖ Form 01/HTQT
- ❖ Legalized copy of tax resident certificate issued by the tax authority in the Contracting country of the year before the year submission of the DTA application
- ❖ Certified/ Notarized contract signed between the foreign contractor and the Vietnamese party:
- ❖ Tax officer prepares the report after checking the DTA application
- ❖ Legalized authorization letter for person who sign the DTA dossier (if not the legal representative)
- ❖ Legalized copy of Business Registration Certificate of the foreign contractor
- ❖ Other documents that the tax authority may request during the process of assessment of the application dossier
- ❖ Approve the application for tax exemption, reduction
- ❖ Issue the decision on approval of the tax exemption, reduction under DTA
- ❖ Deadline: 15 days before the deadline for declaring tax, the Vietnamese party, which signs the contract or makes payment to the foreign contractor, shall submit the above application to the local tax authority..

IV. DTA application for Corporate Income Tax (cont.)

Additional notes

- All documents issued by the foreign organizations need to be notarized by the Public Notary in the original country; and, legalized by the Vietnam Embassy or Consulate in the original country
- Name of person signing the DTA application must be included in the Incorporation Certificate of the foreign contractor, otherwise the authorization letter must be in place
- The tax resident certificate must be obtained for all years that the income would like to seek for the exemption/ reduction
- The tax authority will not provide the confirmation on approval/ rejection of the DTA application, until the tax audit happens
- For income from service performed outside of Vietnam, perform via email/ telephone, all evidences proving the service surrender must be provided to the tax authority.
- The Vietnamese party is still required to declare the income seek for tax exempted, the amount of CIT to be exempted will be declared accordingly

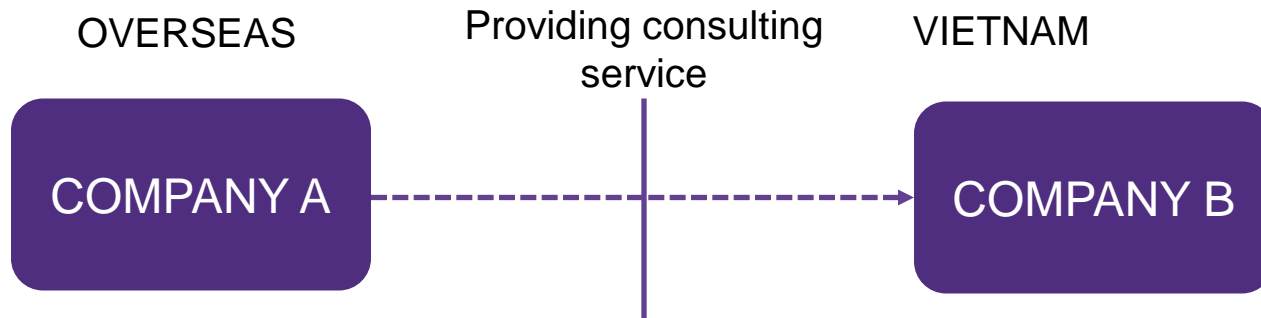
IV. DTA application for Corporate Income Tax –



V. CASE STUDY

V. CASE STUDY

Case study 1



Background:

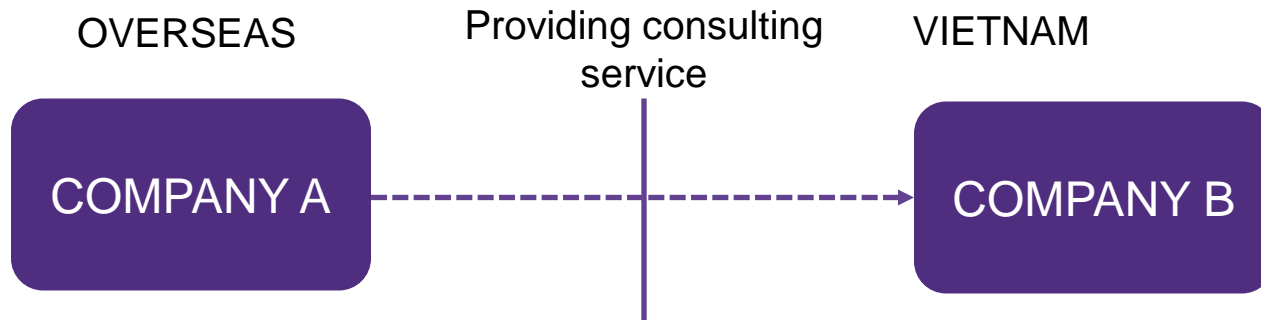
- Company A in overseas enters into the service agreement with Company B to provide consulting service in Vietnam
- **Scenario 1:** Company A will assign its employees to Vietnam to perform the service. The expected duration is 2 months.
- **Scenario 2:** Company A only provides the consulting via telephone, conference/video conference and emails. The expected duration is 12 months.

Questions:

Will Company A create permanent establishment in Vietnam and what is the tax treatment in these circumstances?

V. CASE STUDY (Cont.)

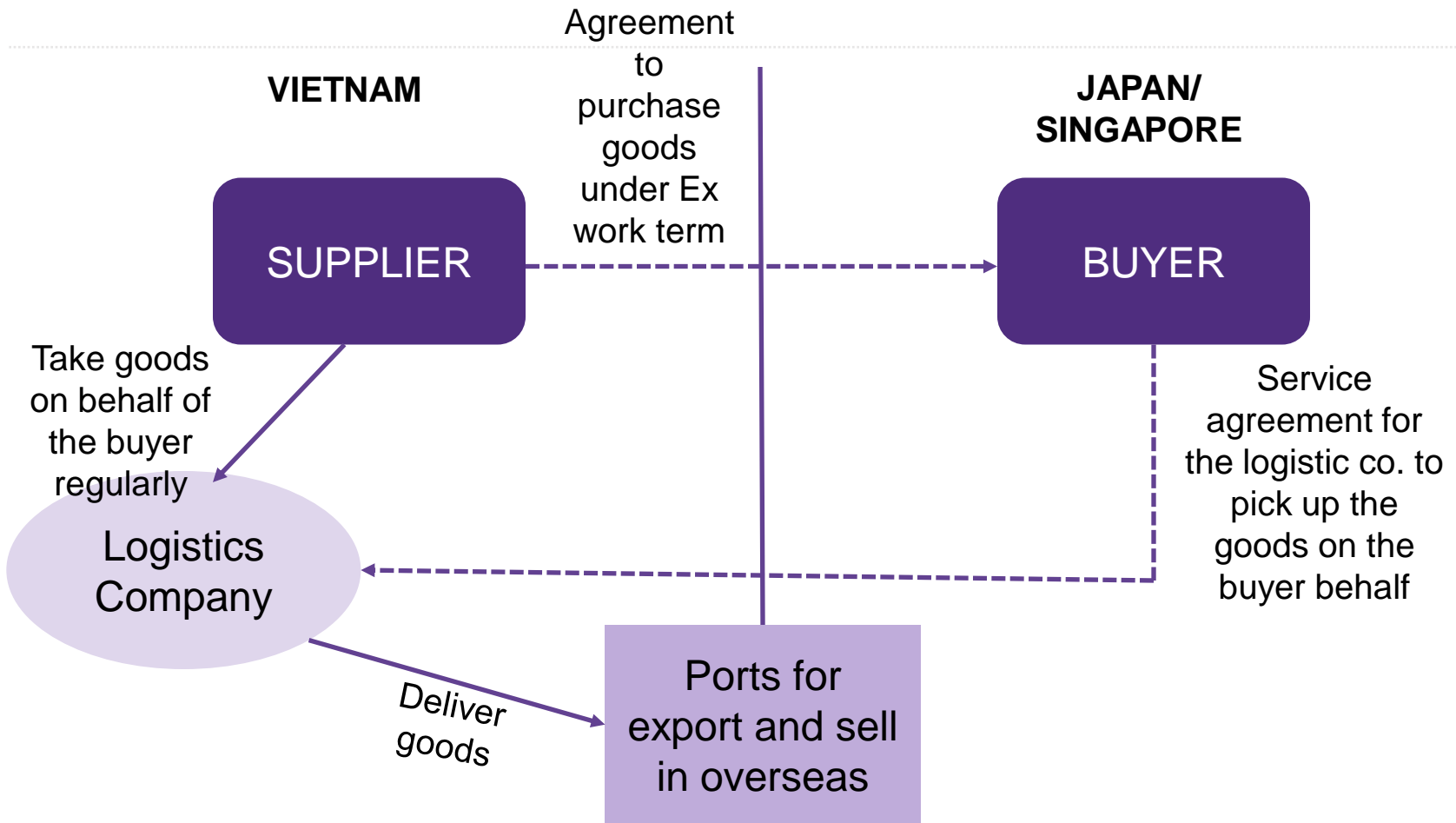
Case study 1



Scenario	Create PE in VN?	Tax implication
Company A will assign its employees to Vietnam to perform the service. The expected duration is <u>2 months</u> .	No	- Will be taxed in Vietnam - Have chance to seek tax exemption/reduction under DTA
Company A only provides the consulting <u>via telephone, conference/video conference and emails</u> . The expected duration is 12 months.	No	

V. CASE STUDY (Cont.)

Case study 2

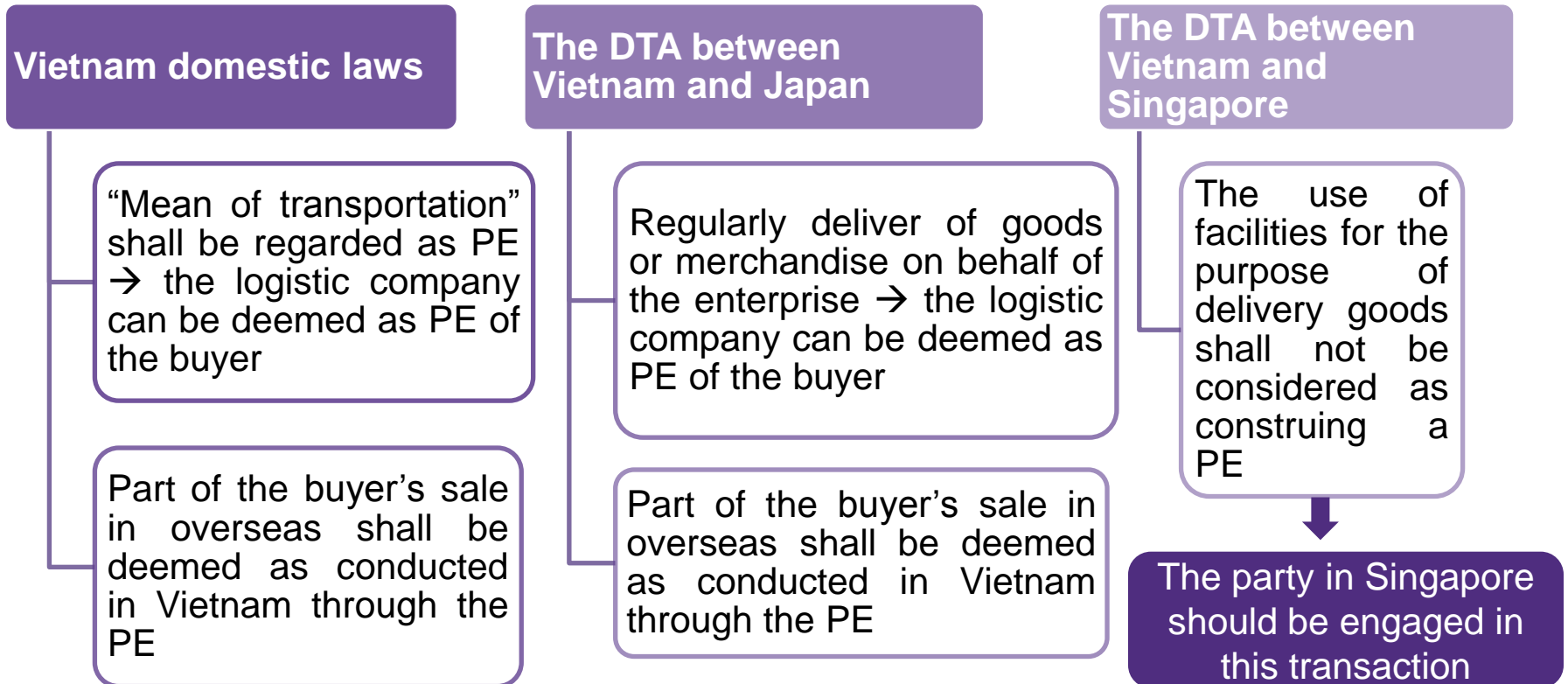


V. CASE STUDY (Cont.)

Case study 2

Questions:

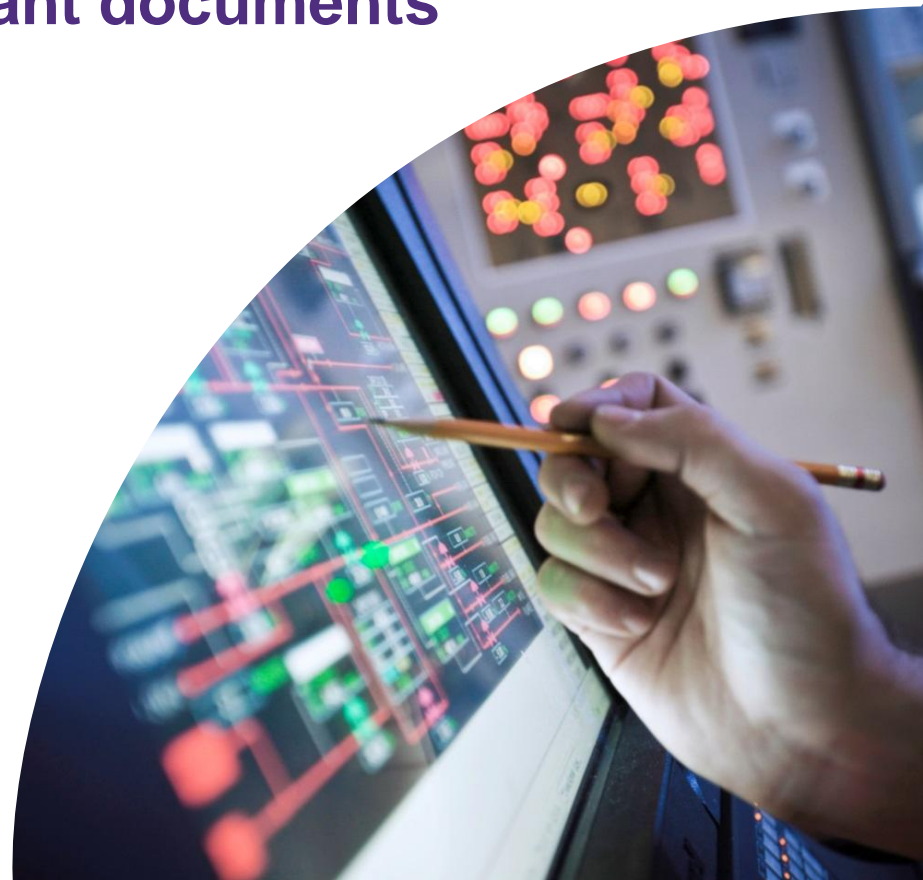
1. Will the Buyer be deemed as creating PE in Vietnam under the domestic law?
2. The Buyer is the multinational company, whether the Company in Japan or Singapore should be the party to be engaged in this transaction to avoid the PE risk?



Transfer Pricing Updates

Notable points on TP compliant documents

Nguyen Vu Minh Tam
Transfer Pricing Manager



1. Update on TP audit/inspection

TP inspection/audit in 2016-2017:

- In 2016, TP audits were conducted on 329 enterprises which reported tax losses, had significant related party transactions, and / or were suspected of abusing TP matters.
- In 2017, the number of TP audits increased to 734 enterprises, which represented a more than 100% increase.

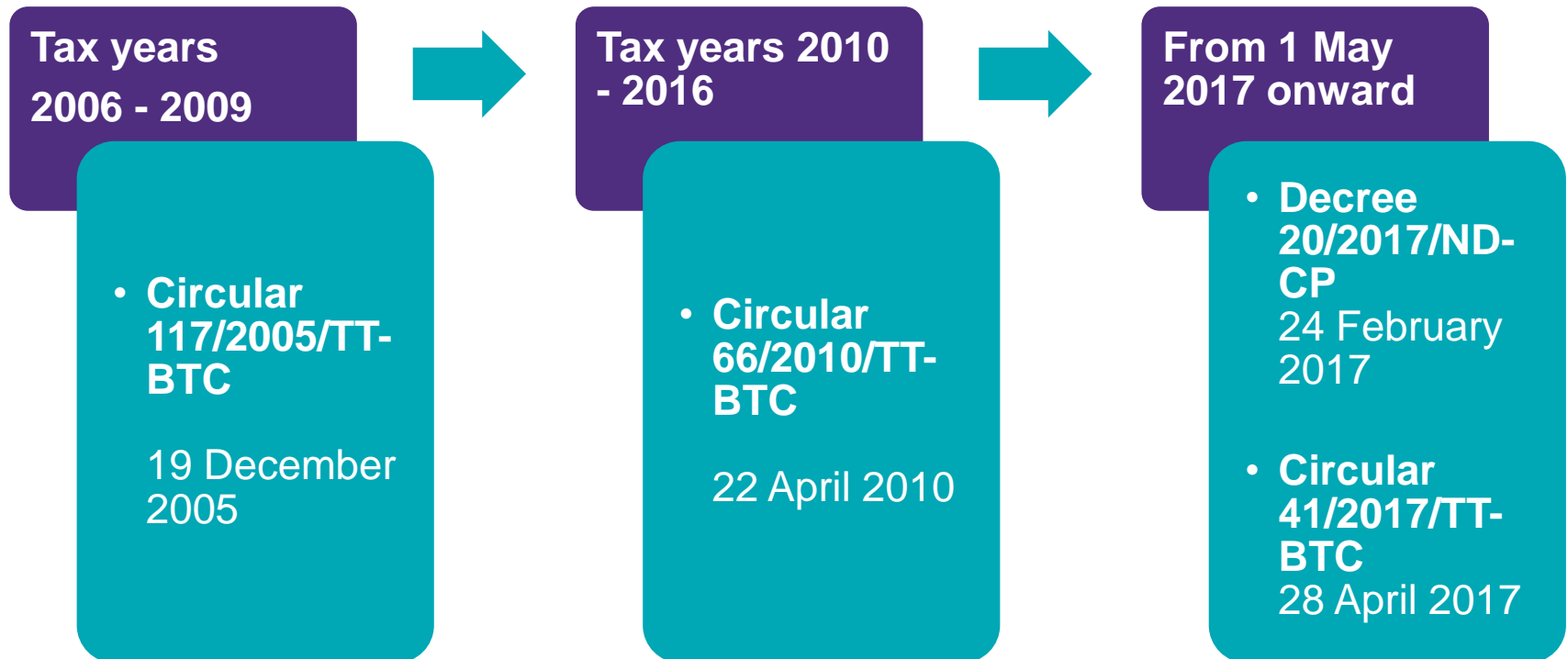
TP inspection/audit plan for 2018:

Official Letter No. 5339/TCT-TTr dated 20 November 2017 has mentioned the focal points on conducting tax audit and inspection plan in 2018:

- Article 2: Enterprise that conducted significant related party transactions, resulted in loss for many years or had lower profitability comparing to other enterprises in similar field/industry.
- Article 6: Enterprises not subject to tax audits/inspections for many years, especially large enterprises and enterprises subject to tax incentives.

In addition, a number of FDI companies in Binh Dương Province have been received Notification from tax authority, asking the taxpayers to comply with TP documentations requirements in order to ensure the submission of sufficient documents according to new TP regulations, i.e. Decree 201 and Circular 41.

2. Legal basis and effectiveness on TP



3. Requirements for compliant documents

Compliant requirement	Circular 66/2010/TT-BTC	Decree 20/2017/ND-CP Circular 41/2017/TT-BTC
TP Forms	Form 03-7/TNDN	<ul style="list-style-type: none"> ▪ Form 01: Information on related party and related party transactions ▪ Form 02: Checklist of information on <u>Local File</u> ▪ Form 03: Checklist of information on <u>Master File</u> ▪ Form 04: Country-by-country profitability report.
TP Documentation	TP documentation report	<ul style="list-style-type: none"> ▪ Local File ▪ Localized Master File ▪ A copy of Country-by-country report

The above documents are required to be prepared on an **ANNUAL BASIS** and **BEFORE** the Corporate Income Tax finalization date.

4. Form 01

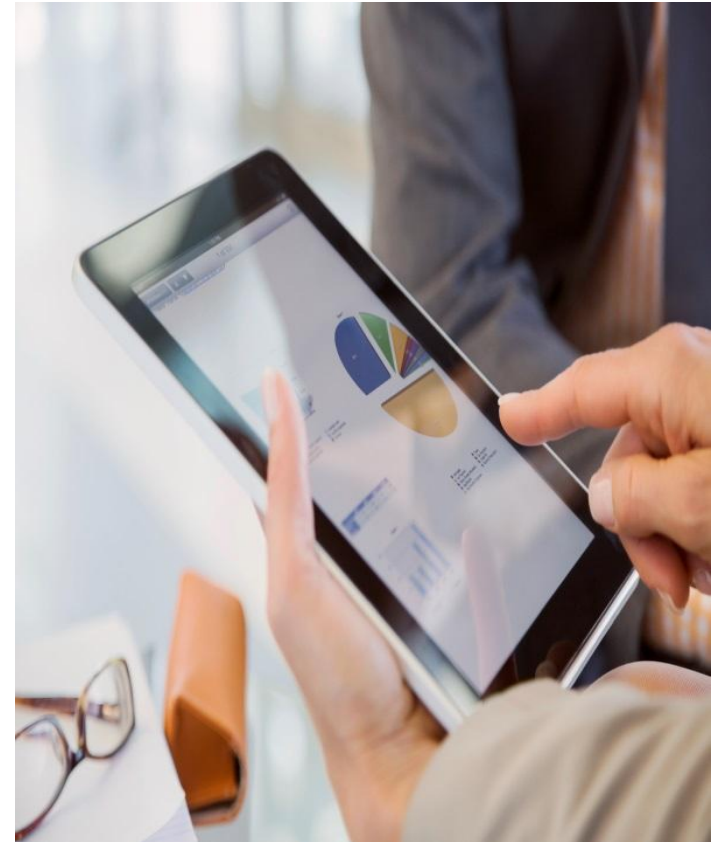
Notable points on Form 01 - Information on related party and related party transactions

- Disclose all relationship category of related party that may arise per each party.
- “Other method” does not exist.
- Disclose **Section III** in term of transactional value instead of Profit and Loss values as regulated in Circular 66/2010/TT-BTC.
- Disclose **Section IV** by segregation of accounting records based on Transfer pricing documentation *or* allocation by appropriate basis.

5. Transfer pricing documentation reports

Notable points for Transfer pricing documentation reports:

- Create declaration basis for Form 01 (Section III and Section IV of Form 01).
- Database for comparable analysis.
- *The benchmarking procedure and result would serve as a basis for profitability adjustment made by taxpayer or a basis in negotiation with the tax authority to avoid the adjustment using secret database.*



6. Benchmarking

Notable points for benchmarking:

- Hierarchy of application for comparison method:



There are several cases that Comparable Uncontrolled Price method is required:

- ✓ Transactions relating to fixed assets;
 - ✓ Loan interest;
 - ✓ Royalty fees;
 - ✓ Transactions relating to goods/services of which assigned prices quoted on the exchanges of commodities or services, etc.
- Request accounting records for examination of CUP method application prior to audit.
 - Difference in **Internal pricing method (setting method)** vs. **Testing method** in disclosure and analysis.

7. Other notable points

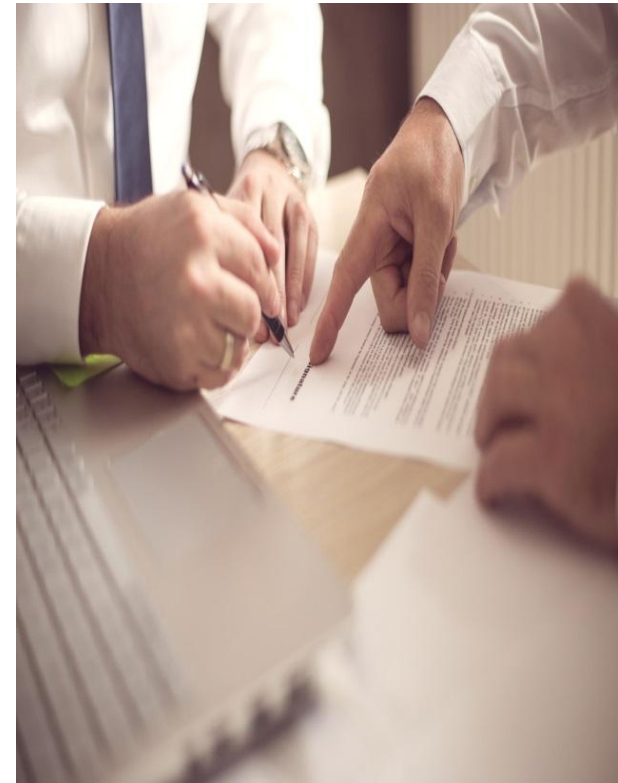
Support service fees, royalty fees:

- Scope & nature of transaction(s) should be clearly documented, together with benefit tests.
- Supporting documents shall be kept in full for tax audits, if any, in the future.
- Separate Benchmarking analysis strongly recommended to defense royalty fees.



8. Exemption from documentation requirements under the cases of "simple functions"

- Till now, no clear definition of “simple function(s)” - Only qualitatively defined.
- Application should be based on guidance from local tax authorities.
- Documentation evidencing “simple functions”, such as Functional Analysis, is strongly recommended.





& PARTNERS

**MARKET OPENINGS
MORE PREFERENTIAL THAN
THOSE UNDER THE WTO'S**

Presented by **Bùi Ngọc Hồng**
Partner – **LNT & Partners**

9 August 2018

AGENDA

1

- Purpose

2

- Specific market openings

3

- Instructions before use

To help structure for cross-border investments, particularly

- ❑ Take advantage of the new market openings: more preferential compared with those under the WTO Commitments
- ❑ Pave the ways for cooperation between local investors and foreign investors

Agenda

1

- Purpose

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2. SPECIFIC (PREFERENTIAL) MARKET OPENINGS



- 1) **Market openings by precedents**
- 2) **Market openings by the ASEAN Framework Agreement in Services (AFAS)**
- 3) **Market openings by other free trade agreements (FTAs):** the case of **retail** in the *Comprehensive and Progressive Agreement for Trans-Pacific Partnership (CPTPP)*

2. SPECIFIC MARKET OPENINGS

2.1 Market openings by precedents

- a) Legal grounds: MFN; Article 10.2(e) Decree 118/2015/NĐ-CP
- b) Examples: The following services are not opened under the WTO Commitments, but the licensing practice presented cases where company is licensed with 100% foreign owned
 - i. Job introduction services (head-hunting);
 - ii. Renting cars without operators

2. SPECIFIC MARKET OPENINGS

2.2 Market openings by the AFAS

Legal ground:

- Article XXIV.4 of the GATT; Article 10.2(b) Decree 118/2015/NĐ-CP
- the AFAS dated 15 December 1994 and Protocol dated 27 November 2015
- Effective of the AFAS (for Vietnam): From **January 2017**

2. SPECIFIC MARKET OPENINGS

2.2 Openings by AFAS (detailed): **property management services**

WTO Commitments	AFAS
No commitment	Restriction free
(management consulting services?)	<i>(prescribed by the Law on Real Estate Businesses)</i>

2. SPECIFIC MARKET OPENINGS

2.2 Openings by AFAS (detailed): **Healthcare/ Medical services**

WTO Commitments	AFAS
Permitted form: wholly foreign owned, JV, Business Cooperation Contract (BCC)	Restriction free
Compulsory minimum investment capital: <ul style="list-style-type: none">- USD20 million/ a hospital;- USD2 million/ polyclinic;- USD200 thousand/ specialty unit	Not required to meet the minimum investment capital

2. SPECIFIC MARKET OPENINGS

2.2 Openings by AFAS (detailed): **transportation**

WTO Commitments	AFAS
<i>Passenger transportation by railway</i>	
Permitted investment form: JV	Permitted investment form: JV
Maximum foreign ownership: 49% of the JV's charter capital	Maximum foreign ownership: 51% of the JV's charter capital
<i>Freight <u>road</u> transportation</i>	
JV; Maximum foreign ownership: 51% of the JV's charter capital	JV; Maximum foreign ownership: 70% of the JV's charter capital

2. SPECIFIC MARKET OPENINGS

2.2 Openings by AFAS (detailed): **Air transport services**

WTO Commitments	AFAS
<i>Aircraft leasing with/ without crew; air freight forwarding services</i>	
No commitment	Restriction free
<i>Aircraft catering services</i>	
No commitment	JV, with maximum foreign ownership at: 49% of the JV's charter capital

2. SPECIFIC MARKET OPENINGS

2.2. Openings by AFAS (detailed): **Supporting services; maintenance and repairing of transportation equipment**

WTO Commitments	AFAS
No commitment	JV is permissible
(~ not open)	Maximum foreign ownership: 51% of the JV's charter capital

2. SPECIFIC MARKET OPENINGS

2.2 Openings by AFAS (detailed): **Recreational park (theme park)**

WTO Commitments	AFAS
No commitment	JV is permissible
(~ not open)	Maximum foreign ownership: 70% of the JV's charter capital

2. SPECIFIC MARKET OPENINGS

2.2 Openings by AFAS (detailed): **Telecom (non-facilities-based services)**

WTO Commitments	AFAS
JV is permissible	JV is permissible
Maximum foreign ownership: 65% of the JV's charter capital	Maximum foreign ownership: 70% of the JV's charter capital

2. SPECIFIC MARKET OPENINGS

2.3. Market openings by other FTAs: **the case of retail service**

WTO Commitments	CPTPP
JV or 100% foreign owned permissible	JV or 100% foreign owned permissible
The opening of the outlets beyond the 1 st one: subject to meeting the Economic Needs Tests (ENT)	Five years after the CPTPP taking effect: ENT is removed.

AGENDA

1

- Purpose

2

- Specific cases

3

- Instructions before use

3. INSTRUCTIONS BEFORE USE

- A. Who to enjoy the more preferential market openings?
- B. The current application practice
- C. Anticipatory for a longer term: the most preferential market openings may still be ahead



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