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Tax Implications on Vietnam's Bond Market

Through the long process of formation and development, the bond market in Vietnam has been growing in both depth and scale, proving its role as a medium for long-term capital mobilization, in the economy, as well as addressing the shortfall of the State budget.

Currently, there are four types of bonds issued and traded on Vietnam's bond market, including:

- ***Government bonds*** issued by the Ministry of Finance to raise funds for the State budget or specific investment projects and programs within the scope of the State's investment;
- ***Government guaranteed bonds*** issued by enterprises, financial and credit institutions and social policy banks prescribed by the Law on Public Debt Management;
- ***Municipal bonds*** issued by People's Committees of centrally-affiliated provinces and cities to raise funds for the local projects; and
- ***Corporate bonds*** issued by businesses of all economic sectors.

Generally, a bond is an instrument of indebtedness of the bond issuer to the holder; in which, the issuer owes the holders a debt and has an obligation to pay the holder interest depending on the terms of the bond. During the tenor of the bond, the holder may transfer its ownership of the bond to another investor. Or, the issuer may redeem the bonds either under, at or above the principal value of the bond.

Recently, Vietnam has become an attractive market for foreign organizations choosing to follow the indirect investment through bonds, rather than being shareholders to ensure their benefit (i.e. fixed interest payment regardless of the financial status of the investee entities).

In this context the foreign organizations as bond holder shall receive two main sources of income from their investment in bonds, including interest payments and redemption payments. Consequently, the foreign organization shall be subject to Foreign Contractor Tax ("FCT"), which consist of Corporate Income Tax ("CIT") and Value Added Tax ("VAT") on the above income derived in Vietnam. In which, interest from bonds investment shall be regarded as "income from loan interest" and subject to FCT of 5 percent CIT and exemption from VAT; while, the redemption of bonds at the principal value shall not attract any taxes in Vietnam as there is no gain.

However, the current FCT regulations do not clearly provide guidance on the treatment on the applicable withholding tax rate in the case of redemption of bonds at a profit (i.e. over the principle value); therefore, the tax authorities may treat income from redemption of bonds over the principal value as either "income from securities transfers" or "income from loan interest." The reason being the definition of securities transfer under the CIT regulations includes income derived from the transfer of stocks, bonds, fund certificates and securities of other kinds; consequently, the redemption of bonds can be regarded as transfer of bonds from the bond holder to the issuer and subject to FCT, inclusive of 0.1 percent CIT on the transacted price and exemption from VAT.

On the other hand, as it has a close similarity to the nature of loan interest, any redemption premium (i.e. the difference between the redemption price and the cost of the bond redeemed) may be treated as income from loan interest rather than income from securities transfer. Income from loan interest includes income of the lender from loans in any form, income from deposit interest, income from contractual deferred payment interest, income from bond interest, bond discount, and income from deposit certificates. In which, income from bond discount means bonds are issued below par and redeemed at par; then, such income shall subject to FCT as income from loan interest with CIT rate of 5 percent on the difference between the bond discount and the par value; and exemption for VAT. Accordingly, unclear regulation may also lead to the possibility of imposing the same treatment to redemption of bonds above par as was applied to the case of income from bond discount.

Therefore, there is no definite conclusion as to which the above mentioned scenarios would prevail since the benchmark for the decision also depends on the amount of interest received and gross proceeds per transaction.

Below is an estimation of the tax liability imposed on redemption of bonds over par in comparison using the above two tax treatments. Based on the following example, it appears that tax treatment on the redemption of bonds over par under the tax treatment of securities transfer it more beneficial for foreign organizations in particular:

Principal value of the bonds: 600 billion dongs Total redemption amount: 700 billion dongs	Income from loan interest (5% on the interest received)	Income from securities transfer (0.1% on the transacted price)
	Interest received amounting to 100 billion dongs; therefore, the estimated tax liability is 5 billion dongs	The transacted price means total redemption amount of 700 billion dongs; therefore, the estimated tax liability is 700 million dongs

The Vietnam Government applies self-declaration for tax in Vietnam, where the taxpayers will determine the taxable income, the applicable tax rate by themselves; then, declare and pay taxes directly to the State budget. The tax authorities only carry out tax inspections in accordance with their schedule and collect any additional tax liability on any under-declared income or wrong declaration. The administrative penalty is 20 percent on the under-declared tax liability; or one to three times for tax evasion; and late payment interest of 0.03 percent per day. Accordingly, in order to avoid any unexpected wrong declaration due to the unclear regulations on the redemption of bonds over par, it is highly recommended to seek for specific guidance from the local tax authority.

Although the scale of the Vietnam market is smaller than other regional countries, the speed of development holds a promising future for the Vietnamese bond market. Therefore, examining the tax implica-

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tion on major categories of bonds and analyzing some of the tax consequences may mitigate potential risks when redeeming bonds in Vietnam.

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