Bloomberg BNA

TAX PLANNING INTERNATIONAL

ASIA-PACIFIC FOCUS

International Information for International Business

March 2017

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Vietnam

Challenges in Applying DTAs for Tax Protection

In the context of the current fast growing global trade, tax treaties play a key role in boosting international cooperation by eliminating double taxation on cross-border income. They enhance information exchange, among tax authorities, in combating international tax evasion. It is therefore worthwhile for foreign contractors as well as their Vietnamese business partners to equip themselves with the knowledge of the existing Double Tax Agreements ("DTAs") in Vietnam.

Overview of DTA in Vietnam

Vietnam has concluded DTAs with 76 countries including Japan, Germany, the United Kingdom, China, Denmark, Hong Kong and Canada to encourage foreign investment and economic growth. DTA provisions generally provide protection for tax residents of one contracting country by allowing them to exempt some income or gains from taxes or credit the tax paid in their home country against the taxes due in the others. Therefore, foreign contractors who have taxable income arising in Vietnam and are tax residents of countries who have signed tax treaties with Vietnam are eligible to apply for tax protection under DTA provisions.

How to Apply DTAs in Vietnam

Technically, to claim tax exemption/reduction under a DTA, the critical conditions are:

(i) the foreign contractor has not constituted a permanent establishment ("PE") in Vietnam; and

(ii) the written evidence of being tax resident in countries entering a DTA with Vietnam is available.

The definition of PE varies in domestic law and different DTAs. In case there is conflict between domestic regulations and the DTA, the provisions in the DTA will prevail.

Application for tax protection under a DTA is not automatically applied. The taxpayers need to self-assess their cases within 15 days before commencing the assignment/contract in Vietnam. The foreign contractor must send to the Vietnamese party a dossier of notification of eligibility for tax exemption or reduction under a DTA for submission to the local tax authority. The dossiers should include:

- a notice of eligibility for tax exemption or reduction under the DTA;
- an original copy of certificate of residence granted by the tax authority of the country of residence in the year preceding the year of notification of eligibility for tax exemption or reduction; and
- a copy of the contracts and other relevant supporting documents.

Fifteen days before the expiration of its contract or the end of the tax year, whichever comes earlier, the foreign party shall send the certificate of residence of that tax year to the Vietnamese party for further submission to the tax authority.

Failing to submit the above notification, the Vietnamese party must withhold and pay tax on behalf of the foreign party but the refund can still be claimed (with three years limitation depending on each DTA). The refund procedures are normally more time-consuming and challenging.

Challenge in Applying DTAs in Vietnam in Practice

Since DTAs provide comprehensive guidance, the implementation of the provisions on tax protection under a DTA depends on Vietnamese domestic regulations, interpretation and practice of the Vietnamese tax authorities. In addition, DTA application for tax exemption or reduction will be assessed by the provincial tax authority where the project is located instead of General Department of Taxation. As a result, the conditions and procedures for DTA application are not consistent nationwide and it mostly depends on the interpretation of each provincial tax authority. This is considered as the major obstacle faced by foreign contractors, in approaching and using this tool for double tax elimination purposes. As a consequence of not having regular guidance from the top level of the tax authorities, and lacking experience in DTA administration makes the process of DTA relief time-consuming and requires alot of paper work.

Secondly, the tight deadline for submitting DTA applications as mentioned above (i.e. only 15 days) is another challenge that foreign contractors have to cope with. The exchange of tax information by one country to another is not robust and active enough to support the taxpayer in obtaining necessary documents in a timely manner.

In addition, the tax reduction/exemption under DTAs is mainly conducted on a self-declaration and self-responsibility basis without the opinion of the tax authorities at the time of submitting the DTA application dossier. Hence, this exposes contractors to the risk of being challenged by the tax authorities upon the tax audit and will likely lead to tax claw back, interest for late payment and penalties imposed on wrong declaration in case the taxpayers have a wrong interpretation and assessment in applying the DTA.

One point to note is that the Vietnamese General Taxation Department has started understanding the difficulties of foreign partners when doing business in Vietnam and is trying to reduce the volume of paperwork by issuing regulations, issuing guidance on the implementation of DTAs from central to provincial tax departments, and reducing the complicated administrative procedure for taxpayers, in order to encourage the international cooperation and to attract foreign investment to Vietnam. However, the side effect of updating and changing regulations continuously is that it causes confusion for the taxpayers who are not be able to follow and adopt the new laws in a timely manner.

In light of the above, it is recommend that foreign contractors, as well as Vietnamese parties, review all business contracts carefully to access the PE risk and the possibility of applying DTAs before preparing and submitting the notification of tax exemption under the DTA.

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