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Vietnam

Overseas Loans and Tax Treaty Protection

During business operations enterprises can take loans granted locally and/or from offshore to finance their current or long-term investments. For cross-border loans, they are classified into two types, i.e. government debts and non-government debts. This article focusses on non-government debts—administration compliance, domestic tax and tax treaty protection.

Obligatory Registration Requirements and Tax Implication on Cross-border Loans

For the borrower, the interest expense is normally deducible for Corporate Income Tax ("CIT") purposes if it meets the following criteria:

- Vietnamese authorities strictly control foreign currency cash flow. Accordingly, under the laws, a registration dossier has to be submitted to the State Bank of Vietnam prior to disbursement for medium- and long-term overseas loans (more than one year) while short-term loans lasting less than one year are not required to be registered. The mentioned registration will enable the borrower to repay the principal and interest to the lender in the future. In addition, the local tax authority will check the registration to determine whether the interest is a deductible expense for CIT purposes.
- Enterprises must ensure that the purpose of the loans is in line with their licensed business activities. It should be noted that the loan agreement should have all relevant terms and conditions, even if the loan is from the parent company or other related party.
- In addition the interest rate for internal transactions should comply with the arm's length principle as it will fall under transfer pricing control.

For the lender, as they are conducting business in Vietnam without setting up a legal entity, they are subject to Vietnamese Foreign Contractor Tax ("FCT") comprising two factors:

- FCT–Value Added Tax; and
- FCT–CIT.

For loan transactions, they are only subject to FCT–CIT of 5 percent and exempt from FCT–VAT. Accordingly, within 10 days from overseas remittance, the borrower is required to declare and pay Vietnamese FCT–CIT to the local tax authority.

Tax Treaty Protection

Vietnam has entered into Double Taxation Agreements ("DTAs") with approximately 70 countries. Most of the treaties have provisions specifically related to interest income and also assure the principle of most favored nations that Vietnam offers to the contracting countries.

According to the DTAs, interest arising in Vietnam and paid to a resident of the other contracting state, may be taxed in Vietnam under Vietnamese regulations. However, if the recipient is the beneficial owner of the interest the tax so charged shall not exceed 10 percent to 15 percent of the gross amount of the interest subject to each Agreement. This means that the tax treaty also ensures the principle of the most favored nation treatment that Vietnam offers to contracting states.

Based on most DTAs, the tax rate on loan interest ranges from 5 percent to 15 percent, while the current Vietnamese withholding FCT–CIT rate on interest is 5 percent under domestic law as mentioned above.

The DTAs protect the lenders not governed by domestic law in two ways:

(i) foreign tax credit; and

(ii) overseas tax exemption.

Accordingly, under foreign tax credit, Vietnamese tax paid for the income derived in Vietnam by a resident of another contracting country should be allowed as a tax credit in the home country.

Alternatively, the lender could apply tax exemption protection upon satisfying the required criteria, for example, the DTA application for a loan from a French resident party, DTA application for loan provided by the Korean Central Bank, etc.

Tax treaty claims are not automatically granted to beneficiaries unless conditions for tax exemption/reduction are satisfied. The applicant is mandatorily required to submit the application dossier package prior to the transaction date (i.e. before signing the contract) and it is subject to the final approval/assessment from the tax authority.

Conclusion

Withholding tax levied on interest might significantly affect the cost and benefit of a cross-border loan. Enterprises entitled to tax exemption under tax treaty protection, can potentially benefit from lower borrowing costs by funding their subsidiaries from overseas. However, overseas lenders should note that 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.

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