

Changing legal landscape for foreign firms

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“The draft decrees are likely to receive heavy scrutiny from various stakeholders and business groups, and their contents should be expected to change, perhaps considerably, before they are issued.”

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At present, it is difficult to say with certainty what constitutes a foreign invested enterprise under Vietnamese laws. Some legislation currently in effect suggests that any amount of foreign ownership constitutes a foreign invested company. Meanwhile, other legislation, also currently in use, is taken by many to mean that an enterprise with a threshold of 49 per cent and upwards constitutes a foreign invested enterprise (FIEs).

Why it is important to know what constitutes an FIE

Many articles and discussion papers have been written by lawyers on this topic. These articles have been written because knowing where this threshold lies, and knowing when a company established in Vietnam becomes an FIE, determines many things - for example, the applicable licensing procedures, the type of licence, the ability to carry out business in certain sectors, whether the company has an obligation to have its annual financial statements audited, and so on.



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For example, there are a number of business sectors which are only open to Vietnamese investors and in which the operation of foreign invested enterprises is restricted. If foreign invested enterprises cannot carry out business or the amount of foreign ownership is capped in such sectors, it is obviously very important to know exactly at what point the company becomes classified as a foreign invested enterprise.

Similarly, this question arises in M&A transactions. Domestically owned Vietnamese companies commonly have a long list of business activities they are licensed to engage in under their business registration certificates. When a foreign investor buys into such a domestic company, the question often arises whether or not the company can continue to carry out all its various business lines, or whether some of them might be subject to restrictions in terms of foreign ownership. If some of the target company's business lines are subject to foreign ownership limitations, the foreign investor's ownership of the target company will be limited to the lowest applicable cap.

Finally, there is also a major difference in terms of the licensing process an application for foreign investment in Vietnam currently needs to undergo if the investment is in a “conditional” sector (also if the investment is very large). Currently, an application by a foreign investor for a conditional sector investment must undergo evaluation, as opposed to just registration. This evaluation includes a rather long and bureaucratic process during which a potentially large number of local, provincial, and governmental stakeholders (which include, for example, various ministries, the Department of Planning and Investment, and People’s Committees) vet and opine on the application and its merits

Legislative changes from 1 July 2015

1 July 2015 will see a major legislative change in Vietnam. The 2005 Law on Investment and Law on Enterprises – the current cornerstone of Vietnam’s investment and company legislation – will be replaced in their entirety after 9 years in force.

The new 2014 Law on Investment and 2014 Law on Enterprises which take effect on that date will, to a certain extent, transform the legislative landscape in Vietnam. They were passed with the aim of improving the ease of doing business in Vietnam, and they touch upon the question of what constitutes a foreign invested enterprise.

Foreign invested enterprise and early reference to a 51% threshold

The new laws were re-drafted a number of times before they were finally passed. Some of the early drafts of the Law on Investment indicated a 51% ownership threshold for foreign investors, which caused – perhaps misguided – anticipation that a company with foreign ownership below this level would have not been considered a foreign invested enterprise.

However, in subsequent drafts this reference to a 51% threshold was removed from the definition of foreign investor, and moved to Article 23 of the Law on Investment.

Definition of foreign invested enterprise post 1 July 2015

The new Law on Investment adopts new terminology. Instead of referring to an “enterprise with foreign owned capital”, as in the 2005 Law on Investment, the new 2014 Law on Investment introduces the term “economic organisation with foreign investment capital”.

Therefore, from 1 July 2015 onwards, a foreign investor will be any company established outside Vietnam; and an economic organisation with foreign investment capital will be an economic entity established in Vietnam with a foreign member or shareholder.

Questions as to whether the new definitions can entirely substitute for the old definitions, which are employed in many other regulations and legislation, have been raised and remain open.

Although the current draft decree guiding the new Law on Investment does not develop the definition of “economic organisation with foreign investment capital” any further, it does rather interestingly state that an “enterprise with foreign invested capital” only means enterprises established prior to 1 July 2015, when the new Law on Investment takes effect.



Usage of tiered company ownership structures post 1 July 2015

The 2014 Law on Investment does something else new too. For the first time it provides regulations on tiered company ownership structures in Vietnam – i.e., situations where a company established in Vietnam establishes another company in Vietnam (which may in turn establish a further company), again in Vietnam. Article 23 of the new Law on Investment will regulate the ability to engage in conditional sector business activities through a tiered ownership structure.

Because of the way Article 23 is drafted, there appears to be a possibility to utilise tiered ownership structures with layers of Vietnam-based subsidiaries to increase access to sectors in which foreign ownership is limited.

For example, a strict reading of Article 23 of the new Law on Investment suggests that a second or third tier subsidiary would not be considered an “economic organisation with foreign investment capital”, even where there is substantial foreign ownership further up the structure.

Only time will tell whether this possibility is mainly theoretical, or whether it will actually provide foreign investors the opportunity, by structuring their investments under a tiered ownership structure in Vietnam, to invest and operate in sectors which would otherwise have been limited to domestic investment.

More clarity expected in forthcoming decrees

The provisions in the new Law on Investment dealing with the above matters raise a number of questions.

A number of decrees are currently being drafted to guide these two new laws, and the first of these are expected to be issued later this month.