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COVER STORY

Paying their way

Tax incentives are a perfectly acceptable way of attracting both local and foreign investment and have a host of positive knock-on effects.

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Vietnam has become an attractive investment destination for multinational organizations, with its most engaging attributes being solid economic growth, low-cost manufacturing, a growing middle class representing a large consumer base, and continued positive legislative reforms.

With improvements being made in stabilizing the VND exchange rate and curbing inflation, the country's macro-economic environment has achieved a good level of stability in recent years. Vietnam's appeal to foreign investors is further boosted by its participation in a number of free trade agreements (FTAs), including both collective FTAs as a member of ASEAN and bilateral FTAs.

However, Vietnam is in strong competition with neighboring countries. It has to focus on attracting more foreign investment and at the same time stimulate and grow investments from domestic enterprises. The success of Vietnam in continuing to attract investment from both domestic and foreign enterprises not only depends on economic factors but also on the business environment in general, and how easy or costly it is to do business here. This is because investors will choose the country that offers them the most favorable conditions and create opportunities for them to make money.

Tax incentives are a common tool used by many countries to attract investment and to route investment into specific prioritized areas. This also applies to Vietnam, which is providing various tax incentives to both foreign and domestic investors. In this regard, there is a common misconception that foreign investors in Vietnam are offered more preferential tax treatment. But in fact, Vietnam has a common tax system that applies to both foreign-invested and domestic enterprises. Tax incentives are granted based on the fulfilment of certain conditions on location, sector, or size, and do not depend on the ownership structure. Hence, there is a level playing field for foreign-invested and domestic enterprises. Every investor in Vietnam can study the conditions for tax incentives and structure its business accordingly.

For example, encouraged sectors include education, healthcare, high technology, environmental protection, scientific research, infrastructure development, and computer software manufacturing. These sectors are generally accessible to all investors, meaning that investors, whether domestic or foreign, can invest in such projects if they have the relevant background and experience.

Also accessible to all investors are tax incentives for large-scale manufacturing projects, which by definition would require a certain minimum amount of employees and capital. In practice, many of these large-scale manufacturing projects receiving tax incentives have been implemented by big foreign players. This is, however, not because only foreign investors are eligible to enjoy such tax incentives. This is more because, up until now, big foreign players have been the ones possessing the need and the capacity to implement such projects. But there are also quite a number of sizable domestic enterprises that could generally benefit from these tax incentives.

One of the factors that also needs to be considered in the discussion about tax incentives is the impact of such incentives on the State's tax collections. Until now, the most high-profile beneficiaries of tax incentives have been large manufacturing companies. Viewed in isolation, there is a loss in corporate income tax revenue collected from such companies, because the tax amount collected would have been higher if no tax incentives were granted. However, this view is biased, since it does not consider that these companies contribute indirectly to the collection of other taxes and the growth of the economy in general. Many of these large manufacturing companies employ thousands of employees with workers paying personal income tax. Also, their workers buy goods and services for their personal use and this leads to further collection of value added tax and other indirect taxes. In addition, these enterprises also create indirect jobs and incomes for other companies and businesses. These, in turn, all pay taxes and contribute to the State budget. These multiple effects on the economy need to be recognized.

Another factor in relation to tax incentives is that tax is only one cost component for investors and it may not be the most important factor for investors when choosing their business location. Investors generally follow money and if the overall conditions in a country are favorable to do business, investors will continue to invest.

Vietnam has to ensure that it remains attractive for domestic and foreign investors alike and tax incentives can be one of the measures to attract investment and channel investment into strategic and prioritized sectors or locations. However, tax incentives alone are not enough. Vietnam needs to further improve the business environment and reduce the cost of doing business here in order to be able to compete with other countries in the region. As a member of the WTO and various other free trade agreements, Vietnam will need to take measures to simplify administrative procedures in areas such as import and export, company establishment, and making tax payments.

With a growing commitment to market-oriented reforms, Vietnam could be on the right track and domestic and foreign investors alike will continue investing here if they feel that Vietnam provides them favorable conditions and opportunities to grow their business. ■