The Effectiveness of Corporate Tax Incentives in Attracting Foreign Direct Investment: The case of Vietnam

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***Abstract* – Foreign investment plays an increasingly important role in the socio-economic development of developing countries including Vietnam. In order to attract foreign investment, Vietnam has issued many incentives to enhance the attractiveness of the investment environment, in which tax policies, especially corporate income tax policies are always paid attention and commonly used. By using qualitative research method, author evaluates the process of adjusting and implementing corporate income tax policies in Vietnam to attract foreign investment and compare the correlation with other countries in ASEAN. Research results show that Vietnam's corporate income tax policy has been significantly improved, the current corporate income tax rate is 20%, down nearly 38.5% since 1990. Compared to ASEAN countries, Vietnam's corporate income tax incentives policies are quite similar, which has helped improve Vietnam's comparative advantage in attracting investment, contributing to actively mobilizing FDI capital into Vietnam during this time. However, Vietnam 's corporate income tax incentives policies are mainly made for reducing tax rates, applying tax exemption time which created loopholes for FDI enterprises to avoid and evade taxes illegal.**

Keywords – Tax policy, corporate income tax, tax rates, tax incentives, FDI, Vietnam, ASEAN

I. INTRODUCTION

In current, most developing countries have introduced tax incentive policies for investment activities in general and foreign direct investment in particular, such as reduction of tax rates, time-related tax exemption and reduction... According to researches by Van Parys S. and James S. [1], the application of tax incentive policies together with other encouraging investment policies have contributed to the achievements of economic development in new industrial countries such as Korea, Taiwan, Singapore. However, the impact and effectiveness of tax incentive policies still have different views between researchers and policy makers.

Of all types of tax incentives, time-limited tax exemption and reduction have been most popularly applied, especially in developing countries. According to researches by James S. [2] and Keen M. [3], 80% of countries in the Saharan region have applied a time-limited tax exemption and reduction, and the rate in Latin American and the Caribbean region is 88%. Similar to other countries in the world, ASEAN countries such as Philippines, Thailand, Indonesia, Vietnam have also applied this incentive policy quite popularly to encourage and attract domestic and foreign investment.

Over the past 30 years, along with the tax reform process, Vietnam's tax incentive policy has gradually improved. Current forms of tax incentives in Vietnam include: incentives on corporate income tax rates, tax exemption and reduction (time-limited tax exemption and reduction). The application of tax incentive policies together with investment incentive policies have positively impacted on the significant increasing of quantity and quality of FDI projects to Vietnam.

II. MATERIALS AND METHODS (MODEL)

To illustrate scientific research, we used some of the scientific methods such as observation, analysis, synthesis, generalization, induction, deduction, analogy, comparison. Besides, expert assessments and correlation analysis methods were also used. Data from General Statistics Office of Vietnam (GSO), General Department of Taxation (GDT of Vietnam) statistical tax reporting forms, Foreign Investment Agency of Vietnam reports and other departmental information was used.

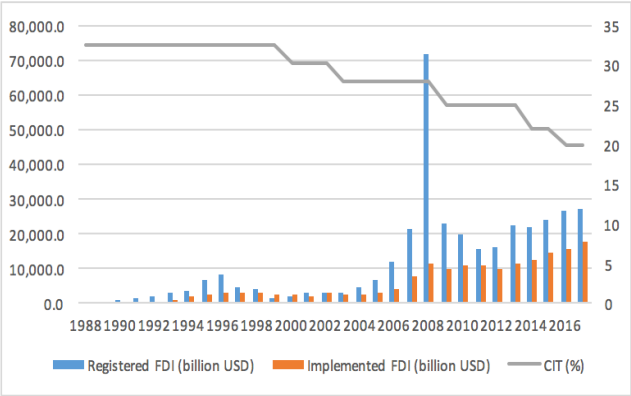
III. RESULTS AND DISCUSSION

ADJUSTMENT OF CORPORATE INCOME TAX POLICIES AND FDI INFLOWS INTO VIETNAM IN RECENT YEARS

In the period before 1999, together with the promulgation of the Foreign Investment Law (1987), Vietnam's tax system was operated in accordance with a multi-sector economy, in which FDI was defined as a prioritized economic sector.

Tax policies stipulate tax rate of corporate income tax of the foreign-invested sector at 32.5% (including tax on transfer of profits abroad from 5% to 10%), the tax incentive rates are 10%, 15%, 20% depending on each investment project, tax exemption for up to 2 years from the start of the business with profit and a 50% reduction of tax for up to the next 2 years. In the first period, 1988-1990, FDI into Vietnam was relatively low due to the new Law on Foreign Investment. However, at a later stage, from 1991 to 1996 there was a rapid increase in FDI (registered FDI in 1995 was 5.5 times higher than in 1991 and reached nearly $8.5 billion in 1996, an increase of 45% compared to the previous year), which effectively demonstrated attractive policies, including tax incentive policies in this period [4].

The Asian financial crisis (1997) had a strong impact on the investment environment, FDI declined rapidly to $ 4.65 billion in 1997; $ 1.56 billion in 1999. However, the decline in FDI into Vietnam during this period was affected by the general crisis of the Asian economy, not affected by Vietnam's tax policy.



Source: compiled by the author on the statistical yearbook of the Vietnamese Statistical Office in 2000, 2005, 2010, 2015, 2018.

Fig 1. Tax rates of corporate income tax and FDI in Vietnam in the period from 1988 to 2017.

In this context, Vietnam has amended the Foreign Investment Policy (1999) with more incentives, tax obligation is slightly reduced for foreign investors, by reducing the average corporate income tax down to 30.25% (reduce tax on transfer of profits abroad to 3% to 7%) [5]. FDI inflows in the period from 2000 to 2003 tended to recover, the amount of FDI into Vietnam reached about $ 3 billion, the capital implemented at $2.5 billion, this could be due to the impact of policy adjustment for corporate income tax in Vietnam with Asian crisis recovery.

In 2003, the National Assembly of Vietnam promulgated the new Corporate Income Tax Law (No. 09/2003/QH11 dated June 17, 2003), validated from 2004 to regulate the tax rate of 28% for FDI enterprises and domestic enterprises (abolishing the tax on transfer of profits abroad), and continue to inherit tax incentives (tax rates of 10%, 15% and 20%; exemption of corporate income tax up to 4 years, 50% reduction for the next 9 years depending on the project). In 2005, Vietnam promulgated the Investment Law and right after, it can be seen that the result of FDI attraction increased significantly, registered and implemented FDI in 2005 increased compared to 2004 (registered FDI from $4.5 billion in 2004 to $6.8 billion in 2005, implemented FDI from $2.8 billion in 2004 to $3.3 billion in 2005), especially the sudden increase in registered FDI to $12 billion in 2006 and $ 21 billion in 2007. Changes in FDI inflows in this period were the result of the adjustment of the 2005 Investment Law and the tax incentive policies to attract FDI in 2003-2005 [6].

In 2007, Vietnam joined the World Trade Organization (WTO), in accordance with the signed commitments and international practices, Vietnam promulgated the effective Law on Enterprise Income Tax No. 14/2008/QH12, validated from 2009 with the general corporate income tax rate is 25%, the tax incentives also change (tax incentive rates are 10% and 20%; corporate income tax exemption for up to 4 years., reduction of 50% for a maximum of 9 years for the project applied 10% tax rate, corporate income tax exemption for up to 2 years, a 50% reduction for up to 4 years for projects in difficult socio-economic conditions.

Looking at the change in FDI inflows, we notice that in 2008, Vietnam achieved a record of attracting FDI with more than $ 71 billion, implemented FDI reached $ 11.5 billion. This result is due to many reasons:

- Registered FDI in the years prior to the crisis increased implementation FDI into Vietnam in this period;
- Vietnam joined WTO in 2007;
- The adjustment of corporate income tax in 2008 with incentives to reduce corporate income tax rates [7].

However, foreign inflows into Vietnam are not out of the world's trend [8]. Although it is still an attractive destination for foreign investors, the strong influence from the world financial crisis made the amount of registered FDI into Vietnam in 2009, decreased sharply to more than $ 23.1 billion and continued to decline to $ 19.88 billion in 2010 and $ 15.6 billion in 2011.

From 2012 to 2015, with policies to attract and encourage investment, FDI into Vietnam is relatively stable and on the rise over the years, from $ 16.34 billion in 2012 to $ 24.1 billion in 2015 and nearly USD 26.9 billion in 2016. The Corporate Income Tax Law amended in 2013 (No. 32/2013/QH13) stipulated that the corporate income tax rate is 22% from January 1, 2014 and continued to decrease to 20% from 01 January 2016, contributed a significant part to attracting FDI into Vietnam in this period. In addition, the tax incentives are also changed (the corporate income tax rates of 10%, 15% or 17% are applied within 10 years or 15 years; tax exemption for up to 4 years, 50% reduction of tax for a maximum of 9 years for the project applied the 10% tax rate, tax exemption for up to 2 years, 50% reduction of tax for a maximum of 4 years for the investment project in the locality or investment incentive fields.

Research shows that Vietnam's corporate income tax incentive policies are quite similar to regional countries [9], which has significantly increased comparative advantage in attracting foreign investment into Vietnam in the past time (see table I). On the other hand, the current corporate income tax rate of Vietnam has decreased significantly, about 38.5% compared to 1990, the adjustment of corporate income tax rate in the recent time is appropriate with the common ground of countries in the world and in the region, with the tendency to

gradually reduce the common tax rates of countries to create attractiveness and attract investment. ASEAN countries and some Asian countries, typically Malaysia, dropped from 28% in 2005 to 27% in 2007 and 26% in 2008 and 25% from 2009 and 24% from 2016. Thailand has reduced the tax rate from 30% to 23% in 2012 and from 2016 to 20% (Table II). According to Oxfam (2016), Vietnam's corporate income tax rate in ASEAN is higher than that of 2 countries (Brunei, Singapore), which is equal to 2 countries (Cambodia, Thailand) and lower than the other 5 countries [10].

TABLE I. TAX INCENTIVE FORMS OF VIETNAM AND SOME ASEAN COUNTRIES

	Time-limited tax reduction and exemption	**Corporate income tax rates incentives**
Singapore	Exemption or reduction of corporate income tax for 5-10 years for investment profits in pioneering industries, tax reduction for extended investment.	Reduce tax on taxable income to 300,000 SGD with tax rates of 0% and 8.5% in the first 3 years.
Philippines	Tax incentives from 6 to 8 years for investment profits in pioneering industries and investment projects in underdeveloped areas; from 4 to7 years tax exemption for other investment projects.	Tax exemption from 4 to 8 years for enterprises with investment activities in export processing zones.
Thailand	Tax incentives from 3 to 8 years for income from investment projects by region (regions 1,2,3).	Reduce 50% tax rate for 5 years for enterprises investing in encouraged investment areas.
Indonesia	Tax incentives from 3 to 8 years for new businesses.	Probably reduce up to 30% tax rate for 6 years for real investment projects.
Vietnam	Tax exemption for 4 years and 50% tax reduction for the next 9 years or tax exemption for 2 years and 50% tax reduction for the next 4 years (depending on the project by sector or locality, including extended investment) .	Prioritized invested projects are entitled to incentive tax rates of 10%, 15% or 17% in 10 years or 15 years.

Source: Research report: Evaluation of tax preferential policies in Vietnam (2016), Oxfam.

However, it is noticeable that when Vietnam applied the corporate income tax rate at 25% in 2014, the countries in the region reduced the corporate income tax rate much lower than the tax rate of Vietnam, especially: Korea decreased from 25% to 20%, Singapore decreased from 20% to 19%, while China decreased from 33% to 25% (effective from January 1, 2009). It can be seen that, although Vietnam has made significant improvements in corporate income tax incentives to improve the investment environment, the level of improvement is still slower than some countries in the region [11].

In summary, from the results of attracting FDI into Vietnam from 1990 to 2016, it can be seen that the increase or decrease of FDI flows to Vietnam is due to many reasons. In addition to the impacts of the world economy, the efforts of the Vietnamese government in attracting FDI have achieved certain successes, especially the adjustment of tax policy to attract FDI has contributed to attracting FDI into Vietnam during this period.

TABLE II. REDUCED CIT RATE IN ASEAN-6 PERIOD OF 2007–2016.

Year/ ASEAN-6	Singa-pore	Thai-land	Viet-nam	Malay-sia	Indo-nesia	Philip-pines
2007	20	30	28	27	30	35
2008	18	30	28	26	30	35
2009	18	30	25	25	28	30
2010	17	30	25	25	25	30
2011	17	30	25	25	25	30
2012	17	23	25	25	25	30
2013	17	20	25	25	25	30
2014	17	20	22	25	25	30
2015	17	20	22	25	25	30
2016	17	20	20	24	25	30
Change	−15.0%	−33.3%	−28.6%	−11.1%	−16.7%	−14.3%
Average ASEAN-6 of Change		−19.8%		Average EU-27	−6.12%	

Source: Processed from Tobing and Mukarromah (2015), Delloite and KPMG.

ACHIEVEMENTS OF THE PROCESS OF ADJUSTING OF CORPORATE INCOME TAX INCENTIVES

The renovation of corporate income tax policy towards foreign investment incentives in recent years has contributed to opening up foreign investment into Vietnam and had success in achieving economic growth targets: sustainability. The Tax policy achievements are:

Firstly, creating an increasingly opening investment environment, promoting foreign investment activities in Vietnam, that can be illustrated in the corporate income tax rate gradually be cut down each year, similar to other countries in the region. The corporate income tax rate decreased from 32.5% in 1990 to 22% in 2014 and from 2016 to 20%. Research shows that Vietnam's corporate income tax incentives and corporate income tax rates are quite similar to regional countries, which has significantly increased comparative advantage in attracting foreign investment into Vietnam in the past time.

Secondly, contributing to promoting technological innovation, improving the ecological environment, directing investors to invest in industries, fields and geographical areas in accordance with each stage of the economy. The corporate income tax policy regulates a variety of forms of depreciation of fixed assets to fit into reasonable expenses when calculating corporate income tax, allowing enterprises to deduct the cost of scientific research, rewarding initiatives when calculating

income tax, setting up funds for scientific and technological development. In addition to the investment incentives areas, tax incentive rates are applied including 10% within 15 years, 17% within 10 years; tax exemption for up to 4 years and 50% tax reduction for up to 9 years.

Thirdly, the tax policy is constantly being improved to be in line with international practices. In recent years, Vietnam has continuously expanded the scope of countries signing double tax avoidance agreements to eliminate overlapping taxation, creating a legal framework for cooperation, information exchange and mutual support between the tax authorities of Vietnam and other countries in international tax administration in order to prevent tax evasion on taxes income and assets, while promoting investment.

LIMITATIONS AND SOLUTIONS TO IMPROVE THE EFFICIENCY OF CORPORATE INCOME TAX INCENTIVE POLICIES IN THE FUTURE

Although the process of adjusting corporate income tax policy in recent years has brought many positive results in attracting FDI into Vietnam, but in fact also revealed many limitations:

Firstly, the impact of tax incentives on the allocation of investment resources is still limited, not attracting FDI into areas with particularly difficult socio-economic conditions. FDI attraction results show that FDI enterprises often focus on areas with favorable infrastructure, such as Hanoi and Ho Chi Minh City. Ho Chi Minh, Dong Nai, Binh Duong, Bac Ninh... which are accounted for nearly 70% of the projects and the total investment of the whole country. Meanwhile, the mountainous, remote and provinces are only accounted for nearly 10% of the total investment [12].

Secondly, Vietnam also applies high incentive policies for investment projects in some sectors such as agricultural product processing, fisheries, software production and renewable energy. However, up to now, the proportion of investment attraction in the agricultural sector is still quite low. Most FDI is focused on processing, manufacturing and real estate. Analysis of the structure of FDI shows that until the end of 2017, the processing industry accounted for the largest share of FDI, which amounts to $ 186.514 billion, from 12,460 projects (accounting for 58.35%), investment in the real estate sector ranks second with a total investment of $ 53.2 billion (which is 16.65%). Agriculture, forestry and fisheries attracted very few projects with total investments reaching $ 3.52 billion, representing 1.1% of total FDI in Vietnam.

Thirdly, corporate income tax incentives not only create loopholes for foreign tax avoidance enterprises but also generate illegal tax evasion activities. Statistics of Vietnam Chamber of Commerce & Industry (VCCI) shows that each year about 40-50% of foreign direct investment (FDI) enterprises in Vietnam declare losses. In particular, many enterprises suffered losses continuously for many years but continued to operate and even expand their scale [13].

Fourthly, the implementation of policies to attract FDI into high-tech projects is still limited, the incentive policies lack synchronization and clarity. According to the previous regulation, the corporate income tax rate for some projects is 10% during the period of operation, but now there are only incentives for 15 years, extended investment projects are not entitled to incentives [14].

In order to improve the efficiency of corporate income tax incentives to attract FDI into Vietnam, some solutions are given below:

- Vietnam must complete the process of managing corporate income tax to avoid changing prices of FDI enterprises.
- Amending and supplementing corporate income tax incentive policies for FDI projects on the principle of not only with branches and sectors but also with regions and territories [15].
- Romulgating more corporate income tax incentives to attract high-tech industries.
- Vietnam needs to ensure macroeconomic stability and improve competitiveness through economic structural reform.Tax incentives in general and CIT incentives in particular may have the effect of encouraging investment but not the best solution because of macroeconomic stability and a healthy institutional environment as the most important factor in the success of an investment project [16].
- Reform of corporate income tax incentives should be considered in the overall relationship with the tax policy system.

IV. CONCLUSION

In general, the financial incentive regulations related to corporate income tax are adjusted many times in the direction of increasing investment encouragement, making specific and clear conditions for incentives, tax exemption and reduction corporate income tax for reinvestment that ave contributed positively to improving the quantity and quality of projects and foreign investors in Vietnam. By adjusting, innovating and improving this policy, it also contributes to improving the business environment, increasing Vietnam's attractiveness compared to other countries in the region in attracting FDI.

However, the reality of attracting FDI into Vietnam in the past time shows that the application of Vietnam's corporate income tax incentives also reveals many limitations. Although high-level corporate income tax incentives are applied to attract FDI projects into difficult socio-economic areas, some areas such as agriculture, agricultural product processing, fisheries but FDI projects are still limited. The application of corporate income tax incentives in time-limited tax reduction and exemption increases the "cost" of taxes, reduces the value of budget revenues, and creates loopholes for FDI enterprises to avoid taxes and generate activities tax evasion and transfer pricing.

In order for the enterprise income tax incentive policy to be effective in encouraging investment, in the future, Vietnam needs to adjust the incentives system from "profit-based" to "efficiency-based" to encourage investment in high-tech fields as well as implementing synchronous solutions to attract FDI effectively and sustainably.

Acknowledgment

The publication was prepared with the support of the “RUDN University Program 5-100”.

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