NATIONAL INTEREST ANALYSIS: CATEGORY B TREATY

SUMMARY PAGE

Exchange of Letters, done at Hanoi on 1 November 2000 and Canberra on 5 August 2002, constituting an Agreement to amend the Agreement between the Government of Australia and the Government of the Socialist Republic of Vietnam for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income, done at Hanoi on 13 April 1992, as amended by an Exchange of Notes done at Canberra on 22 November 1996

Date of Tabling of the Proposed Treaty Action

1. 15 October 2002

Nature and Timing of Proposed Treaty Action

2. It is proposed to bring into force an Exchange of Letters to amend Article 23 of the Agreement between the Government of Australia and the Government of the Socialist Republic of Vietnam for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Income, done at Hanoi on 13 April 1992 ("the 1992 Agreement"), as amended by an Exchange of Notes done at Canberra on 22 November 1996 ("the 1996 Exchange of Notes") (hereinafter referred to as "the Agreement") to reflect changes made to the Law on Foreign Investment in Vietnam.

3. The amendments set out in this Exchange of Letters done at Hanoi on 1 November 2000 and Canberra on 5 August 2002, will enter into force once both countries have notified each other by an Exchange of Letters that they have completed their respective domestic requirements for its entry into force. It is proposed that Australia provide such notification to Vietnam before the end of 2002.

4. The Vietnamese tax authorities have notified Australia of changes made to the Vietnamese laws specified in the tax sparing provisions of paragraph 5 of Article 23 of the Agreement. Specifically, the *Law on Foreign Investment in Vietnam 1987* and *Decree No. 18-CP on implementing regulations of the Law on Foreign Investment in Vietnam dated 16 April 1993* has been repealed and replaced by the *Law on Foreign Investment in Vietnam 1996* and the *Government Decree No. 12/CP dated 18 February 1997 on the implementation of the Law on Foreign Investment in Vietnam*, and by *Government Decree No. 24/2000/ND-CP dated 31 July 2000 on the implementation of the Law on Foreign Investment in Vietnam.* (*Decree No. 24/2000/ND-CP* has superseded *Decree No. 12/CP* since 1 August 2000). Vietnam is seeking Australia's agreement that the relevant tax incentives in the 1996 and 2000 laws are substantively the same as those previously agreed between the two countries and that the tax sparing provisions of Article 23 of the Agreement be amended to apply to these replacing incentives.

5. The replacing articles substantially replicate the original articles referred to in the Agreement. Accordingly, Article 23 of the Agreement needs to be updated to restore the operation of the provisions to their pre-1997 position.

Overview and National Interest Summary

6. The key objectives of the Exchange of Letters are to ensure that:
   - the Agreement continues, as intended, to promote closer economic relations with Vietnam while improving the integrity of the tax system; and
   - Australian residents continue to receive the benefits of the concessional tax treatment allowed by the Vietnamese Government.

Reasons for Australia to Take the Proposed Treaty Action

General Benefits

7. The Exchange of Letters enables the tax sparing concessions which were part of the Agreement negotiated between Australia and Vietnam to continue as intended. The Exchange of Letters honours our commitment as agreed, and is in the spirit under which the Agreement was negotiated. Hence they will assist in:

- promoting the flow of investment, trade and skilled personnel between Australia and Vietnam;
- improving the integrity of the tax system; and
- developing and improving bilateral relations with Vietnam.

Promoting the flow of investment, trade and skilled personnel

8. Australian exports to Vietnam are diverse. Education and training is currently the largest single export accounting for more than $A80 million per annum. Major merchandise exports include aluminium, wheat, cereals, dairy products and cotton. There are currently more than 100 Australian companies registered in Vietnam. Apart from the education sector, Australian companies are present in telecommunications, banking, accounting, engineering and the legal and insurance sectors. The majority of Australian investments are in the southern provinces around Ho Chi Minh City.

9. Over the last five years, Australian exports to Vietnam have increased by an average of 17.6% per annum. In 2001, Australian exports to Vietnam reached more than $A499 million, up from $A329 million in 1999, an increase of 39%. The volume of Vietnamese imports into Australia has grown by an average of 40% per annum over the last five years. In 2001, crude petroleum represented 85% of Vietnam's $A2.092 billion worth of exports to Australia. In 2001, two-way trade between Australia and Vietnam totalled $A2.592 billion, up from $A1.661 billion in 1999.[1]

10. The Agreement (as updated by the Exchange of Letters) will help promote the already substantial flow of investment, trade and personnel between Australia and Vietnam by continuing the existing tax sparing arrangements that are designed to encourage investment into Vietnam.

11. The Exchange of Letters will also encourage the flow of investment, trade and skilled personnel by providing a reasonable element of legal and fiscal certainty within which cross-border trade and investment can be carried on.

Improving the integrity of the tax system

12. The Exchange of Letters will improve the integrity of the tax system by updating the existing Agreement to ensure it accommodates both countries' domestic law. The Exchange of Letters will also enhance the efficiency and effectiveness of Australia's tax treaty network.

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[1] Figures from Department of Foreign Affairs and Trade.

Contributing to bilateral relations with Vietnam

13. The Exchange of Letters is expected to make a positive contribution to Australia's bilateral relations with Vietnam. Australia agreed to tax sparing with Vietnam in the 1992 Agreement. The Exchange of Letters confirms our commitment to tax sparing as negotiated.

14. Australia's bilateral relationship with Vietnam is politically, strategically and economically important. During the 1980s, when Vietnam was internationally isolated, Australia provided aid to Vietnam through multilateral organisations such as the United Nations Development Program and Australia was one of the first countries to restore its bilateral aid program to Vietnam following the withdrawal of the Vietnamese presence from Cambodia and the signing of the Paris Peace Accords in October 1991. Australia is one of the largest aid donors to Vietnam.

15. A number of high level visits between Vietnam and Australia have served to maintain and deepen the bilateral relationship over the last decade. Mr Downer has visited Vietnam on five occasions, most recently in July 2001, reaffirming the priority the Australian Government places on closer engagement with Vietnam. Other recent high-level visits to Vietnam have encouraged the strengthening of our relationship in the areas of trade, immigration and multicultural affairs, defence, agriculture science, sport, technology and the environment. An official level Government-to-Government dialogue on regional security issues was launched in April 1998, and has developed into a substantive forum covering a wide range of issues. The program of bilateral activities undertaken with Vietnam is expected to continue to grow and provide support to the already substantial relationship.

Specific Benefits of the Exchange of Letters

Explanation of tax sparing arrangements

16. Australians are taxed on their world-wide income. When an Australian invests overseas, Australia taxes income from that foreign investment. There could be double taxation if the host country also taxes that income. One way Australia prevents double taxation is by giving a credit against Australian tax, for the tax paid to the host country.

17. Sometimes countries will offer tax incentives to encourage overseas investment. For example, certain investments may be exempted from tax in the country. However, because Australia fully taxes that foreign income, the effect of the exemption is nullified by Australian taxation. Although Australia grants a credit for foreign taxes paid, because of the exemption, no foreign tax is paid and the credit is nil.

18. The tax effectiveness of the exemption may be restored by a tax treaty. Where a country grants a tax concession (ie tax is *spared*) Australia essentially agrees to give the investor a credit for tax that *would* have been paid to that country, but for the concession. This is done in a specific ("*tax sparing*") provision in the treaty between the Australia and the country. This article restores the tax effectiveness of the country's concession.

Tax sparing in this treaty

19. The Exchange of Letters refers to the provisions under Vietnamese law, which give exemptions or deductions from Vietnamese tax, and which Australia provides tax sparing for. Tax sparing permanently expires for Vietnam in the year ending 30 June 2003.

20. The Exchange of Letters is essentially an administrative arrangement to ensure that the tax sparing provisions continue to apply as originally intended and agreed to in the 1992 Agreement, and specifically listed in the 1996 Exchange of Notes. There are no real substantial changes to these provisions as the new incentives are of the same general type as the original incentives.

21. The Exchange of Letters has largely been entered into to ensure that the tax sparing provisions of the Agreement can continue to apply in respect of the agreed Vietnamese incentives following changes to the Vietnamese legislation.

22. If the Exchange of Letters does not enter into force, Australians will no longer be able to claim the tax sparing concessions agreed upon earlier. Australian businesses have made investment decisions and entered into arrangements based on the expectation that the list of concessional activities will apply until the income year ending June 2003. Failure to bring the Exchange of Letters into force will result in Australian businesses paying Australian taxes on profits from their Vietnamese investment activities contrary to the agreement Australia entered into with Vietnam. Hence the Exchange of Letters will clarify the operation of the tax sparing provision to Australian investors and provide certainty.

Obligations

23. Article 23 of the Agreement lists the Vietnamese tax incentives to be tax spared. Listed incentives are targeted towards fostering genuine economic development and relate to active business income (eg. the construction of power production infrastructure, the development of ports to facilitate export processing, the expansion of heavy industry and the plantation of new forests for commercial exploitation). There is also provision for new or additional incentives to be tax spared after evaluation and acceptance by Australia.

24. This Exchange of Letters updates the list of tax incentives to be tax spared under Article 23 of the Agreement to reflect changes made to the Law on Foreign Investment in Vietnam.

25. In relation to income tax, the tax sparing benefit is provided to Australian residents for the ten years commencing on the date of effect of the 1992 Agreement – that is, from 1 July 1993 to 30 June 2003. The provisions will then permanently expire.

26. In its Report No. 7 on treaties tabled on 11 February 1997, the Joint Standing Committee on Treaties in its consideration of the 1996 Exchange of Notes, recommended that the Department of Foreign Affairs and Trade and the Australian Taxation Office (ATO) keep under review the exclusion of accounting and audit services from tax sparing incentives in the Agreement and, if Vietnamese legislation is amended, commence negotiations to remove that exclusion.

27. Tax sparing under the Agreement is not available for banking, insurance, consulting, accounting, auditing or commercial services of any kind. Accounting, auditing and commercial projects were originally excluded from the Vietnamese development incentives under a certain provision of the *Law on Foreign Investment in Vietnam 1987* and were accordingly listed in the activities specifically excluded from the scope of the tax sparing provisions of Article 23 of the Agreement. However that provision has been repealed and replaced by another provision in the *Law on Foreign Investment in Vietnam 1996* which refers to "trade and provision of other services" instead of "accounting, auditing and commercial projects". This Exchange of Letters confirms that the words "trade and provision of other services" are taken to include the meaning of the words "accounting, auditing and commercial services of any kind". Therefore the exclusion in Article 23.7(a) would continue to extend to accounting, auditing and commercial services of any kind, as the Vietnamese tax policy has not changed in that regard.

Implementation

28. Article 2(2) of the Agreement provides that the Agreement shall apply to any identical or substantially similar taxes on income, profits or gains which are imposed under the federal law of Australia or the law of Vietnam after the date of signature of the Agreement in addition to, or in place of, the existing taxes. All that is required is that the competent authorities, that is the Minister for Revenue and Assistant Treasurer, and the Minister of Finance in Vietnam, notify each other of any substantial changes which have been made in the laws of their respective states relating to the taxes to which the Agreement applies within a reasonable time. The Treasurer has authorised the Minister for Revenue and Assistant Treasurer to attend to such matters.

29. Once the Exchange of Letters has entered into force, the Minister for Revenue and Assistant Treasurer must publish a notice in the Gazette setting out the changes to the Agreement, as implementing legislation is not required.

30. No action is required by the States or Territories and no change to the existing roles of the Commonwealth, or the States or Territories in tax matters will arise as a consequence of implementing this Exchange of Letters.

Costs

31. This Exchange of Letters merely ensures that tax sparing concessions, which have already been agreed to in the 1992 Agreement, and specifically listed in the 1996 Exchange of Notes, continue to apply as intended until the current tax sparing provisions expire on the 30 June 2003.

32. The new concessions specified in this Exchange of Letters are essentially a rewrite of Vietnam's original concessions. That is, the proposal is essentially an administrative arrangement. This Exchange of Letters would not affect the forward estimates, which are based on the continuation of tax sparing arrangements with Vietnam, because they do not change existing policy or expected revenue.

33 This Exchange of Letters is not expected to result in increased compliance costs for business.

34. The proposed tax sparing is limited to concessions relating to active income (which will generally be derived by Australian residents in the form of exempt dividends), and, for the most part, is related to activities that have already been undertaken.

Consultation

35. In 1997 the ATO established a Tax Treaties Advisory Panel (TTAP) to review proposed tax treaty actions. As advice on double tax agreement matters is largely provided to industry through specialist tax professional firms, membership of the TTAP is composed of tax professional specialists, industry representatives and officials from the ATO, Commonwealth Treasury and the Department of Foreign Affairs and Trade. The TTAP also includes representatives from the Australian Bankers' Association, Certified Practising Accountants of Australia, Business Council of Australia, Corporate Tax Association, Institute of Chartered Accountants, International Fiscal Association, Law Council of Australia, Australian Industry Group, Minerals Council of Australia and Taxation Institute of Australia. The Investment and Financial Services Association and the Australian Stock Exchange Limited became members of the TTAP in 2001.

36. Information on Vietnam’s request to update the tax incentives in the Agreement, was provided to the TTAP in August 1999 and November 2001. The TTAP supported the ATO’s recommendation that Article 23 of the Agreement be updated to reflect changes made to the Law on Foreign Investment in Vietnam.

37. Information regarding this Exchange of Letters has been provided to the States and Territories through the Commonwealth-State-Territories Standing Committee on Treaties' Schedule of Treaty Action. To date there have been no requests for further information.

Regulation Impact Statement

38. A Regulation Impact Statement is attached.

Future Treaty Action

39. Apart from the tax sparing provisions, the treaty actions under consideration do not provide for the negotiation of future legally binding instruments (although this does not preclude the two Governments from agreeing in the future to amendments of the 1992 Agreement).

Withdrawal or denunciation

40. This Exchange of Letters itself does not contain express provisions dealing with withdrawal or denunciation. However, Article 28 of the Agreement provides for termination by either of the parties on or before 30 June in any calendar year beginning after the expiration of five years from the date of entry into force of the 1992 Agreement. The 1992 Agreement entered into force on 30 December 1992. Effectively, this means either Contracting State can now give written notice of termination at any time. If notice were given, the Agreement would cease to have effect in Australia for income tax purposes for the year of income beginning on or after 1 July in the calendar year next following the year in which the notice of termination is given.

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