

Exchange of Letters to amend the tax sparing provisions in the Australia-Vietnam Double Tax Agreement (DTA)

Regulation Impact Statement

1. Specification of policy objective

The objective of the Exchange of Letters is to ensure that the “tax sparing” provisions of the existing DTA reflect changes in the Vietnamese tax incentive legislation.

2. Background

The DTA was signed in 1992. It contains “tax sparing” provisions. "Tax sparing" describes the situation where Vietnam offers certain tax concessions to attract foreign investment. Under the tax sparing arrangements, for the purposes of Australia's foreign tax credit rules, an Australian investor taking advantage of specified Vietnamese tax concessions is deemed to have paid tax actually forgone by Vietnam in granting certain tax incentives. In the absence of tax sparing credits, Vietnamese tax concessions granted to Australian residents could be negated by Australia's foreign tax credit rules, which would effectively "top up" Vietnamese taxes paid to the level of tax that would be payable on an equivalent amount of Australian domestic income.

When the DTA was signed in 1992, Article 23 of the DTA provided that Vietnamese tax incentives to be spared are to be determined in letters exchanged for that purpose between the Treasurer and the Minister of Finance of Vietnam. Notes for that purpose, listing the current Vietnamese tax incentives for which Australia will provide tax sparing were exchanged in 1996.

The Vietnamese tax authorities had written to notify Australia of changes that had been made to Vietnamese tax laws specified in the tax sparing provisions of Article 23 of the DTA as amended by the Exchange of Notes. Specifically, the *Law on Foreign Investment in Vietnam 1987* had been repealed and replaced by the *Law on Foreign Investment in Vietnam 1996* and the *2000 Law Amending and Supplementing a Number of Articles of the Law on Foreign Investment in Vietnam*. Vietnam sought Australia's agreement that the relevant tax incentives in the 1996 and 2000 Law provisions were of a similar nature to those previously agreed between the two countries.

3. Identification of implementation option(s)

An Exchange of Letters between Australia and Vietnam is the only way to achieve bilateral agreement in relation to the above objective. To do nothing would mean that the undertaking we made with regard to tax sparing in concluding the treaty would not be maintained.

4. Assessment of impacts (costs and benefits)

Impact group identification

An Exchange of Letters is likely to impact on Australian residents doing business with Vietnam. The Australian Taxation Office (ATO) will need to administer the changes to the DTA.

When Vietnam opened the market to foreign investment in the late 1980s, Australia entered the market in a significant way. Australia's place in the foreign investment table remained as high as third for much of the early 1990s. However, stronger activity by Vietnam's capital-exporting Asian neighbours and a growth in activity by the United States and West Europeans has seen this ranking move to fifteenth.

Realised Australian investment in Vietnam to January 2000 totalled A\$1.09 billion in 67 projects. Investment flows have focussed on telecommunications (40%), food and beverage processing and packaging (20%), construction and building materials (15%), services (10%), medical and pharmaceutical (10%) and minerals exploration (5%). According to the Vietnamese Ministry of Planning and Investment, there are 102 Australian companies registered in Vietnam.¹

Assessment of costs

The Exchange of Letters is not expected to result in increased administration costs for the ATO. It is also unlikely to result in increased compliance costs for business because no extra burden to comply is placed on them by the Exchange of Letters.

It is difficult to quantify with any degree of precision the tax likely to be foregone by the Australian Revenue in providing tax sparing credits for the Vietnamese tax incentives. Much is dependent on the amount of the income subject to tax sparing, the amount of the Vietnamese tax reduction or exemption applicable in respect of the particular income, the nature of the investment income, the legal structures used by Australians to make these investments, their need to remit or reinvest the income and their ability to utilise the tax spared foreign tax credits. The presently available information and statistics are of little help in this regard. Subject to these qualifications, an annual cost to Australia's Revenue of around A\$1-2 million is estimated for the totality of the tax sparing measures under the DTA. However it must be noted that the treaty action proposed does not incur an additional cost to revenue, it merely facilitates a previous undertaking, the cost of which has already been factored into forward estimates.

Assessment of benefits

Clarification of which Vietnamese tax laws qualify for tax sparing will reduce compliance costs for Australian investors, seeking to take advantage of the tax sparing provisions.

¹ Figures from Department of Foreign Affairs and Trade.

5. Consultation

Information on the Exchange of Letters has been provided to the States and Territories through the Commonwealth-State Standing Committee on Treaties' Schedule of Treaty Action.

The ATO's Tax Treaties Advisory Committee of industry representatives and tax practitioners have been consulted.

The Exchange of Letters will also be considered by the Parliamentary Joint Standing Committee on Treaties which provides for public consultation in its hearings.

The Treasury and the ATO monitor DTAs, as part of the whole taxation system, on an ongoing basis. In addition, the ATO has consultative arrangements to obtain feedback from professional and small business associations and through other taxpayer consultation fora.

6. Conclusion

The Exchange of Letters will clarify the operation of the tax sparing provisions of the DTA. It is the only way to achieve bilateral agreement to ensure that the "tax sparing" provisions of the existing DTA reflect changes in the Vietnamese tax incentive legislation.