GLOBAL MINIMUM TAX AND ITS POTENTIAL IMPACTS ON VIETNAM

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1. Introduction

Since 2013, the OECD and the G20 have been leading the Base Erosion And Profit Shifting (BEPS) Initiative to develop a fair and competitive global economy, ensure fairness in the tax system between countries, and combat tax evasion. The initiative has two main pillars: (1) Tax allocation, which assesses profit allocation and allocation principles; and (2) Ensuring that all international operating companies pay a minimum tax rate. On October 8, 2021, the OECD/G20 Inclusive Framework on BEPS (IF) issued a statement on the "Two-Pillar Solution to Address the Tax Challenges Arising from the Digitalisation of the Economy". Under pillar II, large companies with global consolidated revenue of at least EUR 750 million for at least two years prior to the review year will be subject to a minimum tax rate of 15%. Companies with a tax rate lower than 15% in the country where they invest will have to pay the remaining "shortfall" compared to the 15% tax rate for the country where they have their headquarters.

Countries like South Korea, Hong Kong, Singapore, and Japan, which have significant foreign investment in Vietnam, will revise their domestic laws in 2023 to implement a global minimum tax in 2024. If foreign businesses in Vietnam still enjoy corporate income tax breaks, countries with parent companies will require them to pay more corporate income tax to meet the global minimum tax rate of 15%.

Vietnam relies heavily on tax incentives to attract investments due to limitations in infrastructure, labor force quality, legal system, and political environment. A global minimum tax will significantly affect Vietnam's investment climate, but the impact depends on businesses' investment goals, level of tax incentives, and global consolidated revenue. This policy's effects on Vietnam are both positive and negative.

2. Potential impacts of Global Minimum Tax on Vietnam

2.1. Impacts on overall attractiveness of the investment environment

After implementing the global minimum tax policy, Vietnam's main criterion for attracting large foreign investors will no longer be tax incentives, which will reduce its competitive advantage. Tax exemptions and reductions have been important tools in attracting FDI to Vietnam for years. Corporate income tax has been gradually adjusted from 32% to 20%, and many preferential tax policies for corporate income tax have been applied. This has made Vietnam an attractive investment destination for international investors and has resulted in numerous high-tech projects from large corporations and multinational companies with increasing investment capital.

The GMT agreement will cause FDI enterprises to pay more taxes to the highest parent company's country, which will affect their capital and production plans and make investing in Vietnam less attractive. Additional domestic taxes in Vietnam have caused investors to lose interest, leading them to focus on other aspects of each country, such as infrastructure, labor costs, government support, legal protection policies, simple administrative procedures, and new preferential policies. Although Vietnam has made significant improvements, these factors remain weaknesses in attracting FDI.

The level of impact this agreement will have on Vietnam hinges on the scope and subject matter of the Global Minimum Tax Agreement adjustment. For those subjects that fall outside the scope of adjustment, domestic laws will still remain in effect.

2.2. Impacts on the state budget

In Vietnam, the standard corporate income tax rate is 20%. However, enterprises can receive incentives, such as preferential tax rates and tax exemption/reduction periods, based on investment and special investment incentives. These incentives can range from 0% to 10%. Subsidiary companies in Vietnam may even have a lower effective tax rate than the preferential rate. According to the General Department of Taxation, foreign-invested manufacturing companies paid an actual corporate income tax rate of 8%, while domestic enterprises paid over 14.5% and state-owned enterprises with large capital scales paid over 16%.

Corporate income tax revenue accounted for 18-21% of the domestic budget revenue from 2020 to 2022. Foreign-invested enterprises' corporate income tax revenue is expected to contribute 7.5-8.5% of the domestic budget revenue and 39-41% of the total revenue from corporate income tax.

If Vietnam does not implement a global minimum tax, it will not impact the state budget revenue from corporate income tax. In this scenario, the tax incentives for current businesses will be collected by developed countries with businesses investing in Vietnam, and will be added to the budgets of those countries.

On the other hand, if Vietnam adopts the Qualifying Domestic Minimum Top-Up Tax (QDMTT), it will be able to levy additional taxes on FDI businesses that are currently benefiting from tax rates lower than the minimum 15% in Vietnam. This will result in an increase in state budget revenue.

Additionally, by implementing the global minimum tax (IIR and UTPR regulations) on Vietnamese enterprises that invest abroad and have subsidiaries in other countries with a lower actual corporate income tax than the minimum level, the government can collect additional corporate income tax from these companies, thereby increasing state budget revenue.

2.3. Impact on businesses investing in Vietnam when applying GMT

By implementing Pillar 2 principles, Vietnam's current tax exemptions and reductions for foreign investors may become less effective. Vietnam's investment tax incentives include time-limited tax exemptions and reductions for new and expanded investments: 4-year exemption and 9-year reduction, or 2-year exemption and 4-year reduction. FDI enterprises during the incentive period pay an average of 12.3%, with some large corporations paying only a few percent, instead of the normal tax rate of 20%.

Vietnam has over 1,100 MNE subsidiary companies, generating more than 750 million euros in global revenues. Around 70 of them are profitable. In processing and manufacturing industries, there are currently 335 projects with registered capital over 100 million USD operating in economic and industrial zones. These high-tech enterprises include Samsung, Intel, LG, Bosch, Sharp, Panasonic, Foxconn, and Pegatron. They enjoy a corporate income tax incentive of less than 15%. The total registered capital of these projects accounts for nearly 30% of total FDI capital in Vietnam, which is about 131.3 billion USD.

Companies with global revenues of 750 million euros or more will be subject to a minimum global tax rate of 15% under Pillar 2 principles. If the subsidiary company has an “effective” tax rate lower than 15% in the host country, the investing country will be subject to a top-up tax on the difference between the minimum global tax rate of 15% and the effective tax rate in the host country. This means that previous tax incentives will no longer exist or be significantly reduced, and investment incentives will be less effective in many cases.

This new tax policy not only affects the current businesses operating in Vietnam, but also those who desire to invest and expand, as well as potential investors who are considering their location choices for investment activities because investment incentives are always their top concern.

Note that this impact will still exist even if Vietnam does not participate in implementing Column 2 but countries investing in Vietnam (for example: Japan, South Korea, etc...) participate in implementing Pillar 2.

2.3. Impacts on Vietnamese enterprises investing abroad

Vietnam is not only an attractive destination for investment, but also boasts investors who are expanding their reach beyond its borders. These investors include Military Industry and Telecoms Group (Viettel), Vietnam Oil and Gas Group (PVN), Vingroup Corporation, Vietnam Rubber Group (VRG), Vietnam National Petroleum Group, and commercial banks. As of March 20th, 2023, Vietnam has successfully implemented 1,625 foreign investment projects, with a total investment capital of nearly USD 21.9 billion, according to the Ministry of Planning and Investment (2023). Among these projects, 141 are state-owned enterprises, with a total investment capital of nearly USD 11.67 billion, accounting for almost 53.3% of the country's total investment capital. Vietnam's outbound investments are primarily concentrated in the mining sector (31.8%) and agriculture, forestry, and fisheries (15.7%). The countries that receive the most investment from Vietnam are Laos (24.5%), Cambodia (13.5%), and Venezuela (8.3%)...

With the introduction of the Global Minimum Tax, if a subsidiary of a Vietnamese corporation invests overseas and the effective tax rate in that country is lower than 15% (such as investing in countries with low tax rates or preferential treatment), the Vietnamese corporation will be subject to additional top-up tax.

2.5. Impacts on current legal policy

Managing taxes is a challenge for governments in the digital and global economy, especially for multinational corporations (MNEs). MNEs use transfer pricing mechanisms to evade taxes, which reduces state budget revenue. To address this problem, the global minimum tax has been proposed to reduce the incentive for MNEs to evade taxes. This could help reduce the loss of state budget revenue in Vietnam due to transfer pricing practices of MNEs.

The complex nature of MNEs' structure and operations makes it hard for tax authorities to manage transactions between member companies. This is especially true when new business models emerge, requiring tax authorities to adapt management methods and strengthen cooperation with other tax authorities worldwide.

Although the global minimum tax has been agreed upon in principle, some details need to be specified that may affect multinational corporations. Under the MLI Convention, Vietnam has the right not to apply certain provisions regarding tax elimination and collection rights of residents in their own country.

Implementing the global minimum tax may require reforming tax management systems, administrative procedures for investments, and careful scheduling by relevant ministries, sectors, and localities. Sharing information and tax obligations among multinational corporations requires a strong tax management system with international cooperation and capacity, which can pose challenges for developing countries like Vietnam that lack adequate tax management capacity. Therefore, Vietnam needs to reform taxes and administrative procedures and innovate its FDI attraction policies to better comply with GloBE rules in the future.

3. Conclusion

In 2023, Vietnam could attract foreign investment by reaching a significant milestone. With the current global volatility, many countries are at risk of financial crises and are taking measures like restructuring production scales, downsizing staff, or relocating to places with lower administrative procedures, energy costs, and tax burdens. Multinational corporations need to reassess their investment strategies to minimize the impact of the global minimum tax policy. Recent movements of corporations show that foreign investment still flows into ASEAN. Investors are monitoring the actions of receiving countries' governments on the issue of global minimum tax. Therefore, the Vietnamese government should research and develop investment incentive policies to gain advantages over other countries.

Vietnamese government must create a more attractive investment environment to gain new investors and keep current ones. This requires decisive action programs to domesticate the rules of Pillar 2, reviewing and developing laws related to incentive policies and investment support. This poses a challenge and an opportunity for Vietnam to attract foreign investment. Reviewing existing tax incentives and issuing new ones requires careful evaluation of its impact and takes time to amend legal documents.