

Amendment to the double taxation agreement between Australia and Vietnam

Background¹

- 2.1 *The 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 (the 2002 Exchange of Letters) seeks to reflect changes made in Vietnamese law relating to foreign investment.*
- 2.2 *The 2002 Exchange of Letters amends Article 23 of 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 Agreement) and amended through an Exchange of Notes done at Canberra on 22 November 1996 (the 1996 Exchange of Notes). Article 23 of the*

1 Unless otherwise specified, the material in this Chapter has been drawn from the National Interest Analysis and Regulation Impact Statement for the *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*, and evidence received at a public hearing held in Canberra on 21 October 2002.

Agreement provides that Vietnamese tax incentives to be spared are to be determined in letters exchanged for that purpose between the Treasurer of Australia and the Minister of Finance of Vietnam. In August 1999 and November 2001 the Vietnamese tax authorities notified Australia of changes made to the Vietnamese laws as provided for in paragraph 5 of Article 23 of the Agreement.²

- 2.3 Vietnam is seeking Australia's agreement that the relevant tax incentives in the 1996 and 2000 laws will remain 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.
- 2.4 Tax sparing is an arrangement where tax foregone by a foreign country on the income of an Australian resident is deemed to have been paid. Thus the tax foregone is credited as if it were actually paid.³
- 2.5 The 1996 Exchange of Notes listed the current Vietnamese tax incentives for which Australia would provide tax sparing. These arrangements are targeted to foster genuine economic development and relate to active business income, for example, 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. Tax sparing arrangements are not available for banking, insurance, consulting, accounting, auditing or commercial services of any kind. (These services were originally excluded from Vietnamese development incentives under a provision of the *Law on Foreign Investment in Vietnam 1987*).

2 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* have been repealed and replaced by the *Law on Foreign Investment in Vietnam 1996*; *Government Decree No. 12/CP dated 18 February 1997 on the implementation of the Law on Foreign Investment in Vietnam*, and *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).

3 Tax sparing was addressed in *Report 48: Treaties Tabled in August and September 2002*, where the Committee considered a proposal to extend tax sparing arrangements with Malaysia to 30 June 2003.

Proposed treaty actions

- 2.6 The Agreement and 1996 Exchange of Notes provided for tax sparing arrangements to continue until 30 June 2003 when they will expire permanently.
- 2.7 The 2002 Exchange of Letters substantially replicates the conditions implemented by the original provisions of Article 23 of the Agreement as amended by the 1996 Exchange of Notes, and ensures that tax sparing concessions will continue to apply as intended until the date of their expiry. No additional costs are expected as a result of the proposed treaty action. Changes will be notified in the *Gazette* after the 2002 Exchange of Letters enters into force. Implementing legislation is not required.
- 2.8 No action is required by the States and Territories and no change to the existing roles of the Commonwealth or the States and Territories in tax matters will arise as a consequence of this treaty action.

Evidence presented and issues arising

- 2.9 The Committee was advised that the benefits following from ratification of the 2002 Exchange of Letters, apart from fulfilling the commitment to tax sparing under the treaty as agreed, would include the continuation of the promotion of the:
- already substantial flow of investment and trade between Australia and Vietnam by continuing the existing tax sparing arrangements that are designed to encourage investments into Vietnam.⁴
- 2.10 The Committee was also advised that the acceptance of the proposed treaty action would:
- contribute ... to developing and improving bilateral relations with Vietnam ...[and] provide a reasonable element of legal and fiscal certainty within which cross border trade and investment can be carried on.⁵

4 Paul McBride, *Transcript of Evidence*, 21 October 2002, p. 3.

5 Paul McBride, *Transcript of Evidence*, 21 October 2002, p. 3.

Trade relations with Vietnam

- 2.11 Two way trade between Australia and Vietnam has increased from \$A1.1661 billion in 1999 to \$A2.592 billion in 2001.
- 2.12 In 2001 Australian exports to Vietnam reached more than \$A499 million. This figure constituted an increase of 39 percent from the 1999 figure of \$A329 million. The largest single export is education and training, which accounts for more than \$A80 million per annum. Other major exports include aluminium, wheat, cereals, dairy products and cotton. Over the last five years the volume of exports to Vietnam has increased by an average of 17.6 percent per annum.
- 2.13 In 2001 the volume of imports from Vietnam to Australia reached \$A2.092 billion. The export of crude petroleum from Vietnam to Australia represented 85 percent of this figure.

Tax sparing arrangements

- 2.14 The Committee has had ongoing concerns about the manner in which information on double taxation agreements, including tax sparing arrangements, is provided by the Department of the Treasury, and has sought to ensure that such agreements are in fact in the national interest. The Committee was concerned that the Organisation for Economic Co-operation and Development (of which Australia is a member) 'has reflected on tax sparing and generally suggests that there are costs and benefits but on balance it is probably not a good idea.'⁶
- 2.15 Treasury officials advised that, since 1997, it has not been government policy to continue with tax sparing arrangements. The Committee heard that tax sparing benefits countries such as Vietnam:

... in that it helps build their infrastructure, and it also gives an opportunity for Australian companies to invest offshore. It is bad to the extent that, if a company has made an investment decision on a pure tax policy perspective, they should do it based on the facts as presented. Tax sparing tends to steer them down a particular course. It is a bad tax policy for that reason. It also encourages a race to the bottom. If we get a competitive spiral internationally in which every country tries to reduce taxes, then there will be no revenue left to pay for infrastructure.⁷

6 Paul McBride, *Transcript of Evidence*, 21 October 2002, p. 7.

7 Paul McBride, *Transcript of Evidence*, 21 October 2002, p. 7.

- 2.16 In the 1998 report of the OECD's Committee of Fiscal Affairs, three concerns about tax sparing arrangements are identified, namely:
- the potential for abuse offered by tax sparing;
 - the effectiveness of tax sparing as an instrument of foreign aid to promote economic development of the source country; and
 - general concerns with the way in which tax sparing may encourage states to use tax incentives.⁸
- 2.17 The Committee sought specific figures on the historical cost of tax sparing arrangements with Vietnam. Treasury indicated that this information will be able to be provided to the Committee early in 2003. The Committee has been advised that the methodology is currently being developed and available data sources are being identified. The Committee anticipates that future analyses of proposed amendments to existing treaties will be more efficient when this historical data is able to be provided.

Conclusions and recommendations

- 2.18 The Committee accepts, while tax sparing arrangements are no longer preferred government policy, that the Australian Government ought to honour its commitments to tax sparing arrangements with Vietnam until the previously agreed date of 30 June 2003. The proposed Exchange of Letters accomplishes this objective by recognising changes in Vietnamese domestic law, thus providing security for Australian investors in Vietnam. The Committee also accepts that this is conducive to continuing the strong bilateral relations between the two countries.
- 2.19 The Committee acknowledges Treasury's continuing efforts to provide specific details in NIAs on double tax agreements as well as the methodological difficulties of providing fiscal forward estimates of costs and benefits of these proposed treaty actions.
- 2.20 However, the Committee would be in a far better position to weigh future benefits against the costs of proposed tax treaty actions if it were provided with data on past costs and benefits of treaty arrangements. This information would be of particular benefit when the Committee is required to assess an amendment to a tax agreement that continues current arrangements.

8 *Model Tax Convention on Income and on Capital*, Organisation for Economic Development and Co-operation, OECD Committee on Fiscal Affairs, 29 April 2000, p.233.

Recommendation 1

- 2.21 **The Committee supports the *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* and recommends that binding treaty action be taken.**

Recommendation 2

- 2.22 **The Committee recommends that, where proposed treaty actions seek to amend existing international taxation arrangements, the costs and benefits of past tax treaty arrangements be included in the National Interest Analysis.**