

Client Alert

January 2012

Significant changes to Value Added Tax and Enterprise Income Tax

On 27 December 2012, the Government issued Decree No. 121/2011/ND-CP ("**Decree No. 121**") and Decree No. 122/2011/ND-CP ("**Decree No. 122**") to amend its regulations on value added tax ("**VAT**") and enterprise income tax ("**EIT**"), respectively. The new decrees will become effective from 1 March 2012.

1. Changes to the VAT rules

Prior rules did not address the tax treatment and projects implemented according to the Clean Development Mechanism ("**CDM**") framework. Decree No. 121 provides that collections from the transfer of Certified Emission Reductions ("**CERs**") are not subject to VAT declaration or payment.

VAT-exempt services now include issuance of credit cards, factoring service and debt selling.

In principle, the transfer of land use right is VAT exempt. Decree No. 121 provides further guidance on the taxable value with regard to real estate business where the value of the land can be excluded from the taxable value.

The current time limit for adjustment of undeclared input VAT is 6 months from the time when the error occurs. With respect to import VAT and VAT incurred during the pre-operating period, Decree No. 121 allows the taxpayer to adjust the declaration of input VAT in accordance with the law on tax administration, which means that adjusted declaration can be made any time before the tax authority conducts a tax audit or investigation.

2. Changes to the EIT rules

Income from the transfer of CERs is tax-exempt for a maximum period of 1 year from the date of issuance of the CERs.

Under Decree No. 122, a taxpayer can recognise its income arising from re-evaluation of the land use right value for capital contribution over a maximum period of 10 years from the year when the land use right is capitalized.

Lessors that receive rent payment in advance for many years can choose to record the turnover on an accrual basis or cash basis. However, even if turnover is recognised on a cash basis, any income that is eligible for tax incentives, if any, must be allocated for only the number of years eligible

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for tax incentives and the deductible expenses cannot be accrued in advance for the whole lease period.

A welcome change for multi-level sale companies is that commission payments to distributors of these companies will not be subject to the deductibility cap of advertising, promotion, marketing, and expenses, which caused serious concerns and problems on the viability and operation of multi-level sale businesses.

Withholding tax rates on certain payments to offshore entities are adjusted. Fees for management service of restaurants, hotels and casinos will be subject to a withholding of 10% EIT instead of 5% EIT as it is currently. Withholding tax on loan interest payments will be reduced to 5% from 10%. Withholding tax on re-insurance will drop to 0.1% from 2%. More importantly, Decree No. 122 addresses the unclear issue regarding the withholding tax rate on derivative financial services, which will now be subject to a withholding of 2% EIT.

Income not eligible for enterprise income tax incentives will include income from services subject to special consumption tax.

Decree No. 122 also provides further guidelines on the choice of alternative tax incentives, if any, by companies which were granted tax incentives based on export performance or use of domestic materials; such incentives were also phased out and abolished on 1 January 2012 in accordance with WTO commitments.

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