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UPDATE ON FOREIGN CONTRACTOR WITHHOLDING TAX

Recently, there have been a number of developments on foreign contractor withholding tax (“FCWT”) regulations, which we would like to summarise herewith for your awareness and further implementation.

FCWT on Supply of Goods under DDU or DDP Terms

- On 14 February 2011, General Department of Taxation (“GDT”) issued Official Letter **518/TCT-CS** (“OL 518”) providing detailed instructions for 2010 Corporate Income Tax finalization which also **highlighted** a notable guidance on Vietnamese FCWT applicable to the supply of goods attached with inland transportation services.
- Before there were different views in regarding FCWT rates applicable to this activity. One of the widely accepted views is that the FCWT rates applicable to trading activities, being CIT of 1% and VAT exempt under Circular 134/2008/TT—BTC should apply. However, OL 518 provides an **example** in which goods are **delivered within the territory of Vietnam** (i.e. term of trade DDU or DDP, the foreign supplier is responsible for domestic transportation). Accordingly, in case the value of goods and transportation (*both overseas and domestic transportations*) cannot be separated, a **CIT rate of 2%** shall be imposed on the total contract amount.
- It can be interpreted that GDT currently views inland transportation is similar to other services attached with supply of goods such as installation, training, operation and commissioning services. If this is the case, then it is likely that **VAT rate of 3%** should also be imposed if values of goods and services are not separately presented in the contract. This VAT aspect is, however, not mentioned in OL 518.

FCWT on Design Services

- The General Department of Taxation has issued the Official Letter **1143/TCT-HTQT** on 05 April 2011 which expresses an interpretation that income from **design services** of foreign contractor is considered as royalty income and thus is subject to Vietnamese FCWT rate of **10% CIT and nil VAT**. In addition, eligibility of CIT exemption under Double Taxation Agreement (“DTA”) may be limited in this case.
- However, for local tax purposes, the above interpretation, in our view, is **inconsistent** with the current regulation stipulated under the Circular 134/2008/TT-BTC of the Ministry of Finance dated 31 December 2008.

Specifically, point b2, article 3.2, section III, part B of Circular 134 provided an example which clearly stated that “*FCWT rate of services sector* (i.e. 5% CIT and 5% VAT) *shall be applied to design works*”.

- For DTA purposes, it is, however, possible that design fees could be classified as royalty income depending on the specific provision of the relevant DTA.

Re-registration of Tax Code for Foreign Contractors

- As discussed in our Tax Alert in September 2010, foreign contractors who directly file tax with local tax office and have several contracts in Vietnam is required to re-register to be granted new **13-digit tax codes** for *contracts other than the first contract* in Vietnam in accordance with the Official Letter 2907/TCT-KK dated 05 August 2010 issued by the General Department of Taxation.
- To give further guidance on this matter, on 27 January 2011, General Department of Taxation has issued the Official Letter **378/TCT-KK** which stated that the *first contract* is considered as the earliest **contract currently under progress**.
- Nevertheless, in practice, we observe **no** foreign contractor has successfully completed this procedure up to date due to the lack of detailed guidance on requirements on tax finalization and input VAT refund in this case.
- At this moment, to facilitate foreign contractors to comply with the OL 2907, a number of local tax offices has **verbally accepted** the following approaches:
 - Foreign contractors may cancel the current 10-digit tax code and register a new 13-digit tax code **without** requirements on tax finalization and input VAT refund application. Any outstanding tax liabilities under the current 10-digit tax code shall be **automatically transferred** to the new 13-digit one by local tax authorities.
 - Foreign contractor may **use** the current 10-digit tax for tax filing until termination of contract. 13-digit tax code shall be granted to new contracts only.

Should you have any concern in the implementation of the provisions mentioned above, please feel free to contact us for further clarification.

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