

# CORPORATE INCOME TAX OF SMES IN VIETNAM - KEY ISSUES AND POLICY RECOMMENDATIONS

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**Abstract:** *Financial difficulties are always a problem that hinders the development of SMEs in Vietnam. The corporate income tax (CIT) policy for SMEs is a typical measure of Government in supporting these enterprises. However, the CIT policy remains a range of limitations that reduce its effectiveness. These issues include tax evasion and avoidance; the limited effectiveness of tax incentives; the problem with fairness in tax treatment; ineffective impact on SMEs; the burden of compliance costs; not support enterprises in scientific and technological innovation. Based on the analysis, this paper has proposed some policy recommendations with the purpose of enhancing the effectiveness of CIT policy for SMEs in the coming time.*

• Keywords: *corporate income tax, SMEs, compliance cost, tax incentives, tax evasion and avoidance.*

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Tóm tắt: *Khó khăn về tài chính luôn là vấn đề cản trở sự phát triển của các DNVVN tại Việt Nam. Chính sách thuế thu nhập doanh nghiệp (TNDN) đối với DNVVN là một biện pháp tiêu biểu của Chính phủ trong việc hỗ trợ các doanh nghiệp này. Tuy nhiên, chính sách thuế TNDN vẫn còn nhiều hạn chế làm giảm hiệu lực của chính sách. Những vấn đề này bao gồm trốn và tránh thuế; hiệu quả của các ưu đãi thuế còn hạn chế; vấn đề về công bằng trong đối xử thuế; tác động không hiệu quả đến các DNVVN; gánh nặng chi phí tuân thủ; không hỗ trợ doanh nghiệp đổi mới khoa học và công nghệ. Trên cơ sở phân tích, bài báo này đã đề xuất một số khuyến nghị về chính sách nhằm nâng cao hiệu quả của chính sách thuế TNDN đối với DNVVN trong thời gian tới.*

• Từ khóa: *thuế thu nhập doanh nghiệp, doanh nghiệp vừa và nhỏ, chi phí tuân thủ, ưu đãi thuế, trốn và tránh thuế.*

## 1. Overview of Vietnamese SMEs

According to the General Statistics Office, by the end of 2020, there are about total 811,538 enterprises. Of which, only 66.8.0% of enterprises are operating, equivalent to 541,709 enterprises. Micro and small-scale enterprises account for

the highest proportion of the total number of enterprises (accounting for 98%). On December 31, 2019, there were 449,031 micro-sized enterprises, accounting for 67.2% of enterprises nationwide; 179,319 small-scale enterprises (26.8%); 22,788 medium-sized enterprises, equivalent to 3.4%; and 17,367 large-scale enterprises, accounting for only 2.6%.

Large-scale enterprises generate the highest net revenue in the entire enterprise sector of the country. In the period 2016-2019, this sector, in average, generates 15.8 million billion VND, accounting for 72% revenue of the entire business sector, an increase of 85.6% compared to the average period of 2011-2015. On the other hand, medium-sized enterprises generated 2.2 million billion VND, equal to 9.9%, up 85.6%. Small-scale enterprises generated nearly 3.4 million billion VND, accounting for 15.2%, up 46.5%. Finally, micro enterprises contributed the lowest proportion of total net revenue of the entire enterprise sector with 638.5 trillion VND, make up only 2.9%.

Regarding pre-tax profit in the period 2016-2019, each year operating enterprises generate 843.5 trillion VND, an increase of 84.1% of the average profit in the period 2011-2015. In which, large-scale enterprises generated 860.8 trillion VND of pre-tax profit per year, up 87.5%; medium-sized

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enterprises generated 29.6 trillion VND, grown by 85.1%; small-scale enterprises generated 1.5 trillion VND (in the period 2011-2015, enterprises in this area lost 3.0 trillion VND per year); micro enterprises lost 48.5 trillion VND (increasing their loss by 34.5 trillion VND compared to the previous period 2011-2015).

In term of capital of enterprises: By the end of 2019, the total capital for production and business of all operating enterprises is 43.3 million billion VND, mainly in the area service sector (accounting for 65.7%); 59.8% of that capital is from non-state enterprises. According to enterprise scale, 66.6% of capital belongs to large enterprises, equivalent to 28.8 million billion VND; micro and small enterprises attracted 11.3 million billion VND for production and business, accounting for 26.0% and the remain part was of medium-sized enterprises with 3.2 million billion VND.

In the 2020-2021 period, over 90% of SMEs have temporarily closed or stopped operating due to the impact of the Covid-19 pandemic. The obstacles that SMEs face are difficulties in accessing customers; interrupted and broken supply chain; imbalanced cash flow and difficulties in labour management. Some businesses are also affected by other problems such as reduction in orders and output, delayed investment progress or even cancelling projects. In addition, businesses also incur additional costs to prevent the COVID-19 epidemic...

It is apparent that SMEs in Vietnam have a small capital scale but account for a large proportion of the number of active businesses. SMEs are considered as a driving force for economic growth of economy when they make important contributions to the state budget, create jobs for a large number of workforce, and help diversify industries and sectors. However, financial difficulties are always a problem that hinders the development of these businesses. The Government, therefore, has implemented many different measures to provide financial support to SMEs. The corporate income tax (CIT) policy for SMEs is a typical one.

In recent years, this is considered as a support tool that has the most direct influence on the financial resources of SMEs. CIT policies are adjusted from time to time in accordance with

the context of the economy. This policy has made important contributions to the growth of the small business sector. However, beside the achieved results, the CIT policy still has many limitations that reduce its effectiveness. The study will address the problems and shortcomings of the CIT policy for SMEs by some appropriate policy recommendations.

## 2. Method of research

In order to analyze the issues relating the CIT of SMEs in Vietnam, the research uses the synthesis method for the secondary data from Vietnam ministry of Planning and Investment and General Statistics Office of Vietnam as well as the data of CIT from Ministry of Finance. Additionally, the paper also synthesizes and analyzes the CIT regulations as well as experts' opinion about CIT of SMEs over the periods of time. Based on the gathered information, the author is going to investigate the shortcomings of the SMEs' CIT. Some policy recommendations will be proposed to alleviate the issues with the purpose of enhancing the efficiency of CIT for SMEs.

## 3. Corporate income tax of SMEs in Vietnam and key issues

### 3.1. Corporate income tax policy for SMEs

#### *Regulations on interest rates*

Most CIT adjustments are tax rate adjustments. Currently, there are no specific regulations on tax rates for SMEs, but the government has separate preferential regulations for these enterprises from time to time with the aim of overcoming difficulties and promoting the development of this sector. The growth of SMEs helps to ensure long-term revenue for the budget, and the CIT rates tend to decrease over the years.

Before July 1, 2013, the generally applied CIT rate was 25%. In which, there are special incentives for SMEs, especially some 30% of CIT reduction. This is considered the initial move of the state on CIT preference for SMEs in Vietnam. The urgent implementation of this incentive for SMEs has made an important contribution to helping businesses stabilize production and business activities, especially in the period after the 2008-2009 global financial crisis.

The CIT Law dated June 19, 2013 stipulates that enterprises with a total annual revenue of 20

billion VND or less will be applied 20%, while the general tax rate is 22%. This preferential rate is applied during the period from July 1, 2013 to the end of 2015. In addition, in the period 2012-2014, due to the difficult economic situation, the Government has proposed a number of resolutions to supplement additional incentives on extending the tax payment period for some groups of businesses. Since 2016, there has been no specific preferential policy for SMEs when all businesses pay CIT at the same general tax rate of 20%.

In 2017, the Law on Support for SMEs 04/2017/QH14 was passed under which SMEs are allowed to apply for a limited period of lower CIT rate than usual. Some proposed tax incentives for SMEs include businesses with a total annual revenue of less than 3 billion VND and the average number of employees participating in social insurance of no more than 10 people each year. These enterprises will only have to pay 15% of revenue for CIT. For enterprises with an average annual number of employees of 100 people or less, combined with the condition that the total annual revenue is from VND 3 billion to VND 50 billion, the tax rate of 17% will be applied. Exemption from corporate income tax for 2 consecutive years when there is taxable income for newly established small businesses and micro enterprises from business households. However, these drafts are still in the process of analysis and have not been applied.

Entering 2020, due to the impact of the Covid-19 pandemic, many tax incentives and extension of CIT payment deadline for SMEs are proposed by the government. In two consecutive years, 2020 and 2021, enterprises with a turnover of less than 200 billion VND will be entitled to a 30% reduction in the payable CIT rate. This is considered a financial support move for businesses in general and SMEs in particular that are facing difficulties during this period.

#### *Policies to reduce tax base*

##### *Accelerated Depreciation*

Enterprises operating with high efficiency are allowed to depreciate quickly, but not exceeding twice of the depreciation rate determined by the straight-line method. Accordingly, enterprises have capital to quickly innovate technology for some fixed assets according to current regulations

of the Ministry of Finance on management, usage, and depreciation of fixed assets.

#### *Loss transfer*

Law No. 32/2013/QH13 amending and supplementing several articles of the Law on CIT, adding provisions for loss transfer between quarters and years. Enterprises are allowed to temporarily transfer losses into income (taxable income minus tax-free income) of subsequent years. The period of loss transfer shall not exceed 5 years, counting from the year following the year in which the loss is incurred.

Thus, SMEs that have suffered losses in previous years can allocate those losses in subsequent years to reduce CIT payable. Thus, enterprises can overcome difficult periods and have capital to restructure enterprises and continue carrying out production and business activities.

#### *Regulations on eligible expenses*

The 2013 CIT Law stipulates those eligible expenses are deducted in favour of businesses, helping to reduce CIT payable, and increase after-tax profit. Enterprises can expand capital for reinvestment activities. Enterprises are entitled to deduct all actual expenses incurred in connection with their production and business activities and have full legal invoices and documents. In addition, the costs related to the loss, damaged goods will be included in the deductible expenses.

#### *Tax-free income*

SMEs investing in a number of industries and areas with special difficulties will be exempted or enjoy tax incentives from earning. These include income in the field of agriculture, scientific research and technological development, social improvement, foreign joint ventures, and environmental issues.

#### *Regulations on setting up science and technology development funds*

Law 32/2013/QH13 Amending and Supplementing Law on CIT stipulates: Enterprises are allowed to set up science and technology funds from pre-tax income. The maximum amount of funds that can be set aside is 10% of taxable income. This fund is used to invest and spend in order to enhance the scientific and technological

potential of enterprises and industries, contributing to improving efficiency and competitiveness. The appropriation of this fund will reduce taxable income, helping to lower the burden of CIT payable. This regulation demonstrates Vietnam's determination to pursue science and technology development policy.

### 3.2. Key issues of SMEs' CIT

*Tax evasion and tax avoidance are common and frequent*

To take advantage of tax incentives, SMEs can find ways to keep it as only small and medium-sized businesses to benefit from tax incentives or find ways to evade taxes. Enterprises often determine the lack or incorrect revenue for calculating CIT, accounting for expenses that are not in accordance with regulations when determining taxable income in various forms, such as: declaring CIT exemptions and reductions incorrectly, transfer price or declare loss, late tax payment, tax debt.

Compared with FDI enterprises, the tax evasion and avoidance in SMEs is still much lower. However, along with the development of the market economy, the risk of taking advantage of tax incentives to evade and avoid taxes in SMEs is in the rise. Tax evasion and avoidance leads to reduced tax revenue of government and loss of tax fairness.

*The effectiveness of tax incentives has not been fully assessed*

The calculation of tax expenditures in Vietnam is still limited due to the lack of statistics, so the actual state support for SMEs has not been calculated, which affects the impact assessment of tax incentives to the operation of SMEs.

The actual tax rate paid to a group of enterprises will be calculated based on the total current CIT amount of this group and the total profits of the tax paying enterprises. The analysis above has shown that estimating tax spending using enterprise survey data has limitations such as inaccurately reflecting the tax base, increasing the actual tax rate paid by enterprises in unreasonable way. These limitations may cause the lower estimate level compared with the actual tax expenditure figure. Thus, the spending figure of CIT for the whole economy will be at least twice as high as the figure

estimated by the study from the enterprise survey data sets.

*The fairness in tax treatment is not guaranteed*

Enterprises receiving tax incentives have a lower actual tax rate than the general tax rate, but businesses still use public goods and services like enterprises which pay full tax. This can create inequality among businesses, especially in the context that many businesses take advantage of loopholes in the tax administration process to receive tax incentives.

The implementation is sometimes unfair, due to the way SME is defined. There are many businesses that can have very large revenue due to activities in areas such as commerce but are still SME.

Revenue is the basis for determining the current CIT incentives for SMEs. This requires the agency to find a way to calculate the businesses' revenue, thus incurring costs in the management process. Besides, there are also businesses with the same revenue scale but different profit rates in various business lines. Industries with high margins will have higher income levels and benefit more from this regulation. The calculation of tax on revenue therefore does not ensure fairness in terms of economic benefits for businesses. Therefore, changing the income threshold for the revenue threshold will ensure more fairness and reasonableness for businesses.

*Effectiveness of impact on SMEs is not high*

Although there have been many incentives for SMEs, in the tax spending structure, large enterprises is still the group that enjoys the most tax spending. Specifically, in 2016, as per the statistics of Nguyen Duc Thanh, Pham The Anh, Nguyen Tien Dung, Hoang Thi Chinh Thon, large enterprises in terms of both number of employees and capital enjoy incentives. These enterprises were operating in two industries: Trade & services and Industry & construction. Additionally, non-state enterprises accounted for 70% of the large enterprises with the largest tax spenders.

The numbers show that tax incentives have unintentionally increased advantages for large enterprises, which can be a risk for the group of SMEs. Large enterprises inherently have the advantage of scale, receiving more tax incentives will increase the advantages compared to SMEs

and thus affect the competitive advantage of these businesses. Calculations show that the group of enterprises with a tax expenditure ratio of over 100 billion, belongs to the industry, has foreign investment capital. The number of enterprises with all 3 above characteristics is nearly 1.6 thousand enterprises (accounting for 1% of the total number of enterprises with positive profits), but tax expenditure of this group accounts for 41% of total tax expenditure. The actual tax rate paid by this group is 8% and 90% of the enterprises of this group are in industrial zones.

*The burden of compliance costs remains relatively high*

Since the Law on Support for SMEs took effect from January 1, 2018, there have been no preferential policies and laws on separate CIT rates for SMEs. The application of various preferential tax rates in different periods, together with the unclear provisions on tax exemptions and incentives, make the CIT Law complicated. As a result, there are compliance costs for businesses in tax declaration and payment.

*The effectiveness of supporting enterprises in scientific and technological innovation is not high*

The maximum level of deduction for the science and technology fund is only 10% of the annual taxable income. The 10% level is relatively small because the cost of science and technology investment accounts for a large part of the activities of enterprises. Especially in the context of the current 4.0 science and technology revolution, most SMEs find it difficult to compete in terms of capital and scale with large-scale enterprises, so development based on the technology platform is being considered as an advantage of SMEs. Many businesses spend a relatively high percentage on science and technology development. Therefore, the 10% regulation as currently applied does not really encourage SMEs to improve their level of science and technology.

#### **4. Policy recommendations**

##### ***Focus on the targeted preferential recipients***

It is necessary to review current tax incentives to attract investment effectively, and at the same time, to minimize the issuance of new policies that reduce state budget revenue. The Government should narrow the schedule tax incentives for fields that have developed in width and depth without

maintaining investment attraction policies, areas in economic zones but on the list of areas with conditions favorable socioeconomic conditions. Preferential policies are only applied selectively to a number of specific industries, especially enterprises in the field of science and technology.

In order to achieve the goal of a simple and suitable tax incentive policy, it is necessary to apply CIT incentives in the direction of regardless of new investment projects and expansion investment projects. This is considered a solution to help increase investment capital for the entire economy in general and SMEs in particular.

Researching to apply a new form of CIT incentives for suitable businesses has been effectively applied by many developed and developing countries (reduction of tax on investment, allowing to be included in deductible expenses). They will enjoy a higher rate than those actually spend on area encouraged by the State, such as spending on research and development, environmental protection, etc., in order to encourage stable and long-term investment.

##### ***Building a taxable income threshold to identify SMEs***

Revenue is the criterion to determine whether SMEs are eligible for tax incentives. Enterprises with a turnover of 20 billion VND or less will enjoy a preferential tax rate of 20% (the common tax rate is 22%). To overcome the problem of tax unfairness, it is necessary to apply a taxable income threshold based on the actual income (profit earned) of the business instead of the revenue. In addition, the use of progressive tax rates can be considered to help automatically regulate the resources of enterprises. To ensure the number of businesses to enjoy incentives and encourage businesses, proceed to apply from 0-10 billion VND, enjoy 15% interest, from 10-20 billion VND, apply 17% as proposed by the Law on SMEs support. The figure of 10 billion VND will help expand the beneficiaries of tax incentives, but it will cause a large loss of state budget revenue. However, this tax spending will be considered a source of investment and development of the economy. According to the multiplier model, it will help increase output for the economy. The difference between the two tax rates of 15% and 17% is not too large, it can prevent tax avoidance

of businesses with incomes over 10 billion VND. Businesses will be not afraid of expanding their operation scale for fear of tax. The division of these two tax rates may lead to reduction in the state budget's revenue, but it will create the motivation to restore production activities for enterprises, especially in the context that SMEs are heavily affected by Covid-19 pandemic. Due to these policies, they generate more revenue and create added value to the economy.

### ***Special incentives for newly established SMEs***

CIT incentives focus on many prioritized localities and industries but lack incentives for newly established SMEs. Newly established businesses are subject to many difficulties, especially financial difficulties. In the current Covid-19 context, the number of bankrupt businesses is relatively large, especially small and medium sized enterprises. In order to revive businesses in the coming time, the topic proposes to apply CIT exemption for newly established businesses in the first 2 years with income not exceeding 20 billion VND. This regulation will create conditions for newly established enterprises to accumulate more capital for their further development. To avoid the situation that many enterprises make profit by shutting down their business operations, dissolving and then establishing new ones, tax administration agencies need to build a system to manage business information. In addition, place of registration of production and business is also classified according to information about the owner and representative of the enterprise. It can minimize the loss of revenue due to businesses evading taxes.

### ***CIT incentives promote research and development activities in SMEs***

Science and technology development is an inevitable trend of the economy. Promoting research and development by domestic enterprises will support other industries to develop together. Apparently, there is an increasing number of businesses based on technology to operate. Many domestic enterprises must rely on some foreign enterprises and large enterprises. To be able to make the most of domestic resources, it is necessary to have a clear policy and to take advantage of all domestic resources. In fact, the state has a policy to encourage enterprises to invest in science and

technology (no more than 10% of taxable income), but the level of incentives as analyzed above is still relatively low and unsatisfactory. Especially investing in technology development requires a lot of capital and the payback time is slower than many commercial lines. Therefore, the psychology of SMEs is quite hesitant to participate in this field. To ensure the mobilization of resources in the economy, the state needs to adjust incentives for these enterprises. Therefore, 100% of actual expenses invested in scientific and technological research and development should be deducted when calculating CIT. This regulation ensures that only enterprises that invest in scientific and technological research and development are eligible for incentives.

### ***Implement accelerated depreciation for SMEs***

In order to help SMEs turn capital quickly and improve production and business efficiency, there should be separate regulations on depreciation for these businesses. The author proposes to allow SMEs to depreciate 70% of machinery and equipment; measuring and testing tools; equipment and means of transport... In the context of the rapid development of science and technology, businesses need to continuously invest in renewing machinery and equipment to improve productivity and meet the needs of the market. With the regulation of 70%, enterprises only need about 2 years to return their investment in fixed assets, speed up capital turnover, improve production and business efficiency; encourage enterprises with investment capital to renew fixed assets for production and business activities.

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