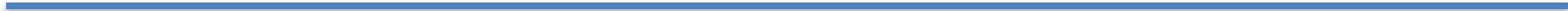
FRASERS
LAW COMPANY

TAX UPDATE

FEBRUARY 2022

TAXATION OF CROSS-BORDER MERGERS AND ACQUISITIONS



AT A GLANCE

The Vietnam tax environment for mergers and acquisitions (M&A) has been evolving over the past few years. Before investing in Vietnam, foreign investors who have been targeting established businesses in Vietnam should consider the acquisition purposes, the substance of the target business, economic benefits and the health of the economy before deciding on the type of acquisition: equity vs assets.

Tax is one of the most important elements for consideration during transaction structuring; a good tax planning strategy can bring significant benefits in the structuring plan.

In this Tax Update, we will discuss popular types of business transfer and our recommendations from a Vietnamese tax perspective. This article will address three fundamental decisions that face a prospective buyer:

- What should be acquired: the target's assets or its equity?
- What should be the acquisition vehicle?
- What issues should be considered in financing the acquisition vehicle?

Although they are improving, the tax laws and regulations in Vietnam are changing rapidly and the interpretations often aggressively favour the Vietnamese tax authorities. Investors in Vietnam should not expect the same degree of legal certainty that is available in more developed jurisdictions.

TABLE OF CONTENTS

1 MARKET OVERVIEW 4

2 LEGISLATION CHANGES IN 2021 4

3 TYPES OF BUSINESS TRANSFER - ASSET TRANSFER VS EQUITY TRANSFER 5

3.1 Asset Transfer 5

3.2 Equity Transfer 6

3.3 Choice between asset transfer and equity transfer 8

4 OTHER CONSIDERATIONS 11

4.1 Corporate seller of shares/interest 11

4.2 Individual seller of shares/interest 11

4.3 Indirect Shares Transfer 11

ANNEX 1 13

ABBREVIATIONS 13

KEY CONTACTS 14

1 MARKET OVERVIEW

After nearly two years of disruption due to the COVID-19 pandemic, we have witnessed increased M&A opportunities. According to expert estimates, the global value of M&A deals could have reached US$6 trillion in 2021, as businesses continue to utilise affordable capital investment and prospects in recovering from the pandemic. Along with global trends, M&A activities in Vietnam are forecast to continue to rise as cheap capital and pent-up demand is likely to help the market spring back into action.

In the first 10 months of 2021, Vietnam is estimated to have attracted US$8.8 billion in total M&A deals, representing 17.9% growth compared with 2020, or a 13% growth compared with pre-pandemic 2019, while the number of deals slightly declined. Many M&A buyers, sellers, and consultants are experiencing very busy times to clinch deals in Vietnam. It is expected that the market will witness an explosive increase in both the number of M&A deals and value post-pandemic as Vietnam is one of the bright spots attracting the attention of international investors.

Indeed, in the public sector we note that VN-Index at Ho Chi Minh Stock Exchange (HOSE) increased by 35.7% in 2021 and HNX-Index at the Hanoi Stock Exchange (HSE) increased by 133% in the same period compared with 2020 respectively.

2 RECENT LEGISLATIVE CHANGES

The past year or so has seen numerous legislative amendments which impact upon merger and acquisition transactions in Vietnam.

The new Law on Tax Administration which came into effect on 1 July 2020 provides the responsibilities of commercial banks and intermediary payment service providers to withhold and pay the tax liabilities of overseas suppliers having no permanent establishment in Vietnam and engaging in an e-commerce business or digital-based business with organisations and/or individuals in Vietnam.

The filing requirements for mergers have been broadened under the new Law on Competition (i.e. apart from just examining the market shares of participating parties, now the transaction value as well as the participating parties' total combined asset value and total combined revenue in Vietnam are also taken into account), meaning the likelihood of at least a filing notification to Vietnam's Competition authority is vastly increased.

The new Law on Securities, Law on Investment, Law on Enterprises and Law on Public – Private Partnership Investment that came into effect from 1 January 2021 are overall expected to positively impact M&A activities in Vietnam. In particular, the new Law on Investment offers certain incentives, especially in innovation, research and development, and the manufacturing industry, while the new Law on Securities confirms the removal of foreign ownership restrictions in public companies operating in unconditional business sectors.

3 TYPES OF BUSINESS TRANSFER - ASSET TRANSFER VS EQUITY TRANSFER

When making an investment, an investor may cherry-pick a specific part of a business (e.g. an asset, a business line or a project), or an entire company for acquisition purposes. Technically, an acquisition of a business can appear in the form of an asset transfer or an equity transfer. The choice of method of acquisition is affected by factors such as the potential corporate income tax ("CIT") rate on gains, value-added tax ("VAT"), transfer taxes and other tax attributes. In practice, many M&A investors would select an acquisition of equity due to being able to take advantage of the tax losses and tax incentives, as well as other licensing issues. However, assets deals may be more appropriate in certain cases due to the potential liability issues and the ability to re-base the asset value for tax depreciation purposes.

3.1 Asset Transfer

The advantage of an asset transfer is that the purchaser can avoid historical tax liabilities. The acquisition of assets must be supported by legitimate documents including the asset acquisition contract, invoices, and other supporting documents (such as sales invoices and sales contracts).

Purchase price: The value of an asset subject to acquisition is mutually agreed between the seller and the buyer and must be clearly indicated in the asset acquisition contract.

Notwithstanding the above, the transfer price of assets can be subject to challenge by the tax authorities where it can be concluded as not being consistent with the market value as deemed by the tax authorities based on their database. This could lead to additional tax payable being payable on the additional gain. Thus, it is important that the transfer valuation should be commercially justifiable.

Goodwill: Acquired goodwill may be amortised over a maximum period of 3 years. In a group context, goodwill is amortised in the entity and any loss arising is not available to be offset against profits of other group companies.

Depreciation: Tax regulations allow the cost of acquired assets to be written off against taxable profits in the form of tax depreciation expense, provided that certain conditions are satisfied.

Depreciation of both new and used fixed assets is calculated based on the historical cost and useful life of the fixed assets within the regulated timeframe. Generally, the depreciation timeframe for plant and equipment is from 2 to 30 years, whilst for intangible assets, it is from 2 to 20 years, depending on the the particular types of assets or equipment.

VAT: Typically, the sale of assets will require an invoice for the buyer to record the value of the assets in the new entity, as well as to register some certain asset ownership where required. VAT should apply accordingly on those assets subject to VAT. Most assets in Vietnam are subject to VAT upon being transferred. The standard VAT rate is 10%, while other tax rates of 0%, 5% and VAT exemption can be applied to some specific types of assets.

The seller is required to issue VAT invoices for the sale of the assets and VAT must be added to the sales price and indicated in the invoice issued. Such VAT becomes input VAT of the buyer provided that the assets are used in business activities that are subject to VAT.

Enterprises are not required to declare and pay VAT in the following types of transactions:

- Capital contribution in the form of assets for establishing an enterprise;
- Transfer of assets between dependent accounting entities;
- Transfer of assets on de-merger, division, consolidation or conversion of form of the enterprise.

Stamp duty (or asset registration tax): Acquisition of assets is subject to asset registration tax. When an asset subject to registration tax is transferred, the newly registered asset owner is required to pay stamp duty.

Specific asset registration tax rates apply to certain types of assets listed in the regulations: for instance, the tax rate for land and real estate is 0.5%, while for cars or means of transportation it is from 2% to 10%. Asset registration taxes are not applicable to shares transfers. Stamp duty is capped at 500 million Vietnam dong (approximately US$21,760) per asset except for cars with fewer than 10 seats, aircraft and yachts. In practice, stamp duty payable upon the transfer of assets is considered as immaterial.

Tax attributes: In an asset transfer, unused tax losses remain with the company which transfers the assets. Tax losses and tax incentives cannot be transferred in an asset transfer. In common practice, if an investor wants to preserve the tax attributes upon acquisition, equity transfer is required to acquire the entire business, where certain conditions and limitations shall apply, as discussed below.

3.2 Equity transfer

The first purpose of acquisition of the target company's equity is to preserve tax attributes of the company. In most cases, foreign ownership is not restricted unless specifically provided for under Vietnam's World Trade Organization ("WTO") Commitments for certain industries and sectors. This liberalisation has created a more open investment environment for investors, especially combined with the gradual removal of restrictions on the capital holding ratio of foreign investors in specific sectors, also in line with WTO Commitments.

Capital gains tax

For foreign corporate sellers/transferors, the tax treatment on capital gains is different depending on the corporate form of the target company. In particular, the transfer of contributed capital in a Vietnamese limited liability company is subject to CIT at 20% on the gain, whereas gains earned by a foreign investor from selling securities (i.e. bonds, shares of public joint-stock companies, irrespective of whether they are listed or non-listed) are subject to CIT at a deemed rate of 0.1% of the gross sales proceeds (replacing the capital gains tax applicable on net gains).

A foreign individual investor who is a non-tax resident in Vietnam and earns income from the transfer of capital/securities in a Vietnamese limited liability company/joint stock company is subject to personal income tax ("PIT") at a rate of 0.1% on the gross sales proceeds.

Tax treaties may provide certain protection from the above taxes. Use of an offshore holding company may also provide certain opportunities for tax mitigation on exit.

Tax indemnities and warranties

The tax exposures of a target company are transferred to the buyer after a shares purchase transaction is completed. Therefore, the buyer should pay much attention to the target company's tax compliance status. For this reason, tax due diligence exercises are important for identifying significant tax issues in M&A transactions. In recent transactions, high tax exposure has been one of the major deal breakers.

As a target company's contingent liabilities are transferred to the buyer, the tax indemnities and warranties for contingent tax liabilities should be thoroughly addressed in the transaction agreements. Statute of limitations, ultimate parties responsible for the compensation, definition of tax-related items, exceptions, associated penalties/interests, etc., become more and more important in the transaction agreements.

Tax incentives

The target company shall continue to apply and enjoy tax incentives (where available) for the remaining period after the acquisition.

Tax losses

Tax losses of a company can be carried forward for up to five years, starting from the year in which the losses are first incurred. Accordingly, losses incurred by the target company prior to the transaction may continue to be offset against the taxable income of the company after the acquisition. There are no specific shareholder continuity tests in Vietnam. There is currently no group relief for losses in Vietnam.

3.3 Choice between asset transfer and equity transfer

As an equity transfer will result in the ownership of the target company, investors normally would select equity transfer if the target company has invested in specialised or conditional investment sectors such as heavy-industry manufacturing, pharmaceuticals, logistics, etc., and/or includes land transfer, which leads to a preservation of licensing benefits of the target company. Besides the licensing benefits, the investor would also inherit tax incentives, tax losses or tax refunds of the target company.

Another advantage of equity transfer is that purchases of capital will not be subject to VAT, stamp duty and other burdensome administrative compliance measures, in comparison to an asset transfer. Meanwhile, the main disadvantage of an equity acquisition is that the purchaser is fully responsible for all the historical or inherent liabilities, including tax and financial liabilities, of the target company.

On the other hand, the most recognisable advantage of an asset purchase is that the purchaser will not inherit any historical tax liabilities of the target company, but at the same time any current tax losses or tax incentives will not be inherited. The purchase price for the assets can also be fully depreciated or amortised for tax purposes. However, the foreign investor may need to establish a legal entity in Vietnam to acquire the assets and this may be time consuming.

An investor would commonly consider the asset purchase option if the target company is not entitled to tax incentives, has significant historical tax issues and it is not too challenging to establish an new entity in the relevant business sector.

Pre-sale dividends

In certain circumstances, the seller may prefer to realise part of the value of their investment as income by means of a pre-sale dividend. The purpose is that after-tax retained earnings can be freely distributed to the corporate investor without paying further Vietnam withholding tax (WHT). Therefore, the dividend reduces the proceeds of sale and the gain on sale. As the rules in this area are not clear and interpretation by the local tax authorities is inconsistent, each case should be examined on its facts before entering a proposed transaction.

Annual remittance of dividends abroad may be made only where the company has completed the CIT declaration for the relevant financial year, issued audited financial statements and fulfilled all tax and financial obligations. Profit and/or dividend remittance is not allowed where the financial statements of the target company show accumulated losses.

Acquisition vehicle

Several potential acquisition vehicles are available to a foreign buyer of a company in Vietnam, and tax factors often influence the choice. In addition to local foreign-invested

companies, the main types of vehicles for acquiring equity or assets in Vietnam include the following entities.

Local holding company

Foreign investors using this form of vehicle are likely to require a license from the Vietnam authorities, which can be onerous and time-consuming to obtain. In addition, as there are currently no tax consolidation rules in Vietnam, there is no group tax benefit from including such a vehicle in the structure.

Foreign parent company

Foreign buyers normally choose to use a foreign parent company structure, which produces certain tax benefits. Dividends paid to foreign parent companies are not subject to Vietnam WHT provided that they are paid from after - tax profits of the subsidiary in Vietnam. Interest payments to a foreign parent company (e.g. pursuant to a shareholder loan) are subject to WHT at 5%. Other payments can enjoy lower WHT rates or exemptions under relevant tax treaties.

Tax clearance

A company is required to conduct tax finalisation with the local tax authorities up to the time of the decision on the consolidation, division, merger, demerger or conversion that occurred prior to the transaction.

Repatriation of profits

After fulfilling all tax and financial obligations, foreign investors can repatriate their after-tax profit from Vietnam with no further WHT for corporate investors and with 5% WHT for individual investors.

A foreign parent company is subject to CIT of 20% on the gains arising from a sale of equity or WHT of 0.1% on the gross sales proceeds (when selling shares of a subsidiary, provided the shares are considered as securities under Vietnam law (i.e. the target is a public company).

Foreign investors may seek a tax exemption on income from the transfer of capital in Vietnam under a double tax treaty entered into between Vietnam and the respective foreign jurisdiction where relevant and subject to conditions. Treaty relief is not automatically granted to beneficiaries, and no prior approval from Vietnamese tax authorities is granted. Disagreement and relevant penalties/interest may be imposed only years later during future tax audits. Professional advice should be sought to comply with requirements on tax treaty claims under both domestic laws and treaty provisions.

Non-resident intermediary holding company

An intermediate holding company resident in a favourable treaty territory is a popular structure for deals in Vietnam. However, attention should be paid to Vietnam's new anti-treaty shopping provisions, which were introduced in a circular that applied from 2014 and focused on the substance of the holding company and the transactions. Typical intermediary holding company jurisdictions include Singapore, Hong Kong, some European countries and low-tax jurisdictions.

Choice of acquisition funding

Debt

Investors may choose to fund their acquisition by debt arranged locally or from offshore. However, for Vietnamese legal entities using debt to fund the acquisition, interest expenses incurred may not be deductible for Vietnam CIT purposes.

Under the domestic tax regulations, debt financing arranged locally does not trigger WHT but CIT on income. However, for cross-border financing, an interest WHT rate of 5% shall be applied. Among Vietnam's approximately 75 double tax treaties currently in force, only the double tax treaty with France provides tax exemption for interest on commercial loans. The other treaties generally specify a maximum interest WHT rate that is equal to or higher than the Vietnamese 5% domestic rate.

Deductibility of interest expenses

Interest expenses are typically deductible against taxable income in the Vietnamese entities. There are no thin capitalization rules in Vietnam. However, an equity-to-debt ratio is specified in the investment certificate by virtue of specifying the charter capital (equity) and investment capital. In the past, this ratio was restricted to 30:70. There is now no such restriction, but, in practice, it is difficult to convince the authorities to license a highly leveraged venture.

The tax-deductibility of interest is limited to 1.5 times the basic interest rate announced by the State Bank of Vietnam (***SBV***) as at the date of the loan. Additionally, medium and long-term foreign loans must be registered with the SBV in order for the interest and related expenses to be deductible.

Under prevailing transfer pricing regulations, deductible interest expenses of enterprises having related-party transactions are capped at 30% of total net operating profit before interest expense, depreciation and amortization ("NOPBID"). The cap includes interest paid to third parties where related-party transactions are in place, even if there are no related-party loans. Net interest expense exceeding the deductible cap (of the current tax year) is eligible for a 5-year carry-forward period starting from the following tax year.

4 OTHER CONSIDERATIONS

4.1 Corporate seller of shares/interest

Under CIT law, foreign corporate investors are subject to 20% tax on any gain when selling the capital contribution in the subsidiary or WHT of 0.1% on the gross sales proceeds when selling shares of a subsidiary, provided the shares are considered as securities under Vietnamese law.

A new draft CIT law has been released proposing to tax the transfer of capital at 2% on gross sales proceeds (not depending on gain/loss position) applicable for both direct and indirect share transfers. It is also further proposed that an internal group restructuring exercise at a no-gain-no-loss position will not be subject to any capital assignment tax. However, the legislation is still in draft status and the exact timeline for discussion and ratification is still not clear.

4.2 Individual seller of equity/interest

Under the Law on Personal Income Tax (PIT), an individual seller is subject to tax on capital investment and capital assignment at the following rates:

Taxable income	PIT rate	
	Resident	Non-resident
Capital investment income (including dividends and interest)	5%	5%
Capital assignment income (direct interest, i.e. holding an interest in a limited liability company)	20% on net gains	0.1% on gross sale proceeds
Capital assignment income (securities transfer, i.e. transfer of shares in joint stock companies, transfer of call options on shares, bonds, treasury bills, fund certificates)	0.1% on gross sale proceeds	0.1% on gross sale proceeds
Real estate transfer income	2% on gross sale proceeds	2% on gross sale proceeds

4.3 Indirect Equity Transfer

Many foreign investors invest into Vietnam by acquiring a special purpose vehicle located overseas, aiming not only to achieve convenience in their business management but also tax efficiency for their future exit plan. Transfer of the offshore holding company is considered as an indirect equity transfer which is also subject to capital gains tax in Vietnam even where the acquisition occurs outside of Vietnam.

Despite the fact that the offshore capital transfer is not easy to determine, as well as the fact that current regulations are unclear on capital gains tax imposed on such offshore transactions, it is important that the Vietnamese entity being the indirect

transferee carefully reviews and has sufficient information and documentation concerning the offshore equity acquisition for tax prudence purposes.

ANNEX 1
ABBREVIATIONS

CIT	Corporate Income Tax
LLC	Limited Liability Company
M&A	Merger and Acquisition
NOPBID	Net operating profit before interest expense, depreciation and amortisation
PIT	Personal Income Tax
SBV	State Bank of Vietnam
VAT	Value Added Tax
WHT	Withholding Tax
WTO	World Trade Organization

KEY CONTACTS

Please contact us if you have any questions relating to this Tax Update.

Mark Fraser
Managing Partner
T: +84 28 3824 2733
E: mark.fraser@frasersvn.com

Phan Xuan Qui
Head of Tax
T: +84 28 3824 2733
E: qui.phan@frasersvn.com

Ho Chi Minh City

Unit 19.01, 19th Floor, Deutsches Haus
33 Le Duan Boulevard, District 1
Ho Chi Minh City, Vietnam
Tel: +84 28 3824 2733

Hanoi

Unit 1205, 12th Floor, Pacific Place
83B Ly Thuong Kiet Street, Hoan Kiem District
Hanoi, Vietnam
Tel: +84 24 3946 1203

Email: legalenquiries@frasersvn.com

Website: www.frasersvn.com

This article provides a summary only of the subject matter covered, without the assumption of a duty of care by Frasers Law Company. The summary is not intended to be nor should it be relied on as a substitute for legal or other professional advice.

© Copyright in this article is owned by Frasers Law Company