



February 2005

Indochina notes

Legal updates on investment, infrastructure and finance

Contents

Highlights of 2004

Investment

Infrastructure

Banking and finance

Administrative environment

Highlights of 2004

January

The new Law on Corporate Income Tax (CIT) and its implementing regulations, Decree 164 of the Government and Circular 128 of the Ministry of Finance (MOF), became effective. Under the new law, a single standard tax rate of 28 per cent applied to domestic enterprises and new foreign-invested enterprises (FIEs) established after the beginning of the year. This represented a 4 per cent reduction in CIT for domestic businesses and branches of foreign organisations, and a 3 per cent increase for new FIEs. The effect on new FIEs was offset by the abolition of the profit remittance tax.

The Prime Minister approved the Air Services Agreement between the US and Vietnam. Air services between the two countries duly started in December 2004.

March

Personal income tax (PIT) burdens were reduced by increasing the minimum tax threshold for locals to 5m dong per month (previously 3m dong) and reducing the maximum PIT rate to 40 per cent (from 50 per cent). The surtax of 30 per cent imposed on Vietnamese employees whose after-tax income exceeded US\$1000/month was also eliminated.

The MOF abolished tax refunds for foreign investors that reinvested profits derived from investments in Vietnam.

April

To reduce the disparate treatment for European credit institutions arising out of the US – Vietnam Bilateral Trade Agreement, the State Bank of Vietnam (SBV)

allowed European banks to accept deposits of dong amounting to 250 per cent of their chartered capital from Vietnamese with which they do not have a credit relationship.

May

Domestic investment regulations were improved. For the first time since the 1999 Law on Enterprises radically reformed the Vietnamese business environment, the government revised the regulations. Decree 125 confirmed that foreign organisations purchasing shares in a domestic company have the right to nominate a person (not restricted to Vietnamese citizens) to the board of management.

June

Settlement of civil disputes should be greatly improved by the issuance of the first-ever Civil Procedure Code. The Code unifies the procedural rules for all non-criminal and non-administrative disputes. It sets out the principles for the conduct of labour, economic, family and other civil disputes and the jurisdiction of the People's Courts.

A new Bankruptcy Law was passed. It improves on the old law by specifying that only one condition has to be satisfied for bankruptcy, namely that a business is not able to pay a due debt upon request by a creditor. The new law also provides clearer procedures for bankruptcy petitions.

The National Assembly also passed an Amended Law on Credit Institutions. It allows foreign credit institutions to

open subsidiaries and to contribute capital to and buy shares of Vietnamese banks. Banks were also officially given autonomy on whether to lend with or without security.

August

Decree 152 restated the tax preferences available to newly established developers and enterprises operating in industrial zones (IZs) and export processing zones (EPZs): CIT rates will be 20 per cent for service enterprises in IZs; 15 per cent for service enterprises established inside EPZs and production enterprises established inside IZs; and 10 per cent for developers of IZs and EPZs, and export processing enterprises.

September

The legislation governing telecoms was further developed by Decree 160, which implements the Ordinance on Post and Telecommunications.

October and November

Various important decrees in relation to land were issued. The main one was Decree 181, which combined and developed numerous existing decrees, including Decrees 64, 88, 11, 09, 69, 17, 79, 85, 163, 04, 66, and 68 and some provisions in other decrees. Decree 181 specifically prohibits real estate developers from transferring land use rights without constructing a building on it in accordance with the approved plan.

With the issuance of Decree 188 the land price was amended to reflect the market price. The maximum land price is up to 67m dong per square metre.

December

The first Electricity Law was signed into law by the President. It established the framework for the electricity market for the foreseeable future. Competition will begin in generation, with EVN as the sole purchaser. Competitive wholesale markets and competitive retail markets are to follow, but this may be years down the road.

A Competition Law was also passed. This is the first law comprehensively governing competition. It controls unhealthy competitive practices, practices in restraint of competition, abuse of dominant market position or monopoly position, and economic concentration.

Investment

Vietnam-EU early harvest agreement

On 9 October 2004, the European Community concluded bilateral negotiations with Vietnam on accession to the World Trade Organisation (WTO). The results provide important commitments on both goods and services of benefit to European Community business. The two entities subsequently entered into an 'early harvest agreement' to bring forward the implementation of certain commitments by both partners. The European Union (EU) will suspend textile and clothing quotas. In return, EU companies will benefit from certain Vietnamese concessions as follows.

- EU companies will have an enforceable legal framework, prior to WTO accession, that guarantees them equal treatment with US and Japanese companies under their respective bilateral agreements.
- Vietnam will open or further open selected sectors for EU operators.
- Vietnam agreed to lower tariffs on EU textiles and beverages and provide improved access for EU pharmaceutical products. It will also allow foreign-owned pharmaceutical companies to manufacture in Vietnam.
- Current EU operators in the telecoms sector received concessions and EU companies received concessions in construction services, computer services, engineering and architectural services and urban planning.
- Additional licences will be awarded to EU companies in the life insurance and distribution sectors. EU distribution companies already present in the market will be allowed to open new stores. New licences will open hitherto closed markets for foreigners in computer reservation system services, environmental services and real estate. EU shipping lines will be allowed to conduct a number of agency activities.

State-owned enterprise reform

Financial performance

State-owned enterprises (SOEs) are notoriously inefficient. Part of this stems from a marvellous lack of accountability. Many an SOE boss has benefited from the

concept of 'collective accountability', as lack of accountability is euphemistically known. The government, on 3 December 2004, issued Decree 199 with regulations on financial management of SOEs, which should make some SOE bosses sit up slightly.

Decree 199 stipulates that the (General) Director of a SOE will be dismissed if any of the following occur: (i) he reports untruthfully on the SOE's financial status twice or more, or only once if that causes serious consequences (if only Sarbanes-Oxley were so generous!), (ii) he causes the SOE to lose money or to fail to obtain the required return on equity in two consecutive years or in two out of three consecutive years (perhaps Sarbanes-Oxley is not so bad after all), (iii) he fails to submit a request for bankruptcy even though the SOE is insolvent, and (iv) he fails to reorganise, dissolve or convert the ownership of the SOE even though the SOE is required to do so.

Equitisation

The equitisation process in Vietnam has been said to demonstrate Einstein's theory of invariants, as the pace seems to stay constant under various transformations. The government is attempting another transformation, with Decree 187 dated 16 November 2004.

The first legislation on equitisation of SOEs, Decree 44, was introduced in 1998 but replaced by Decree 64 in 2002. This failed to impress the vested interests and to date only about 5 per cent of SOEs (by value) have been equitised.

Under Decree 187, the types of SOEs that may be equitised have been expanded. However, equitisation will only occur if the SOE is not in a category (under Decision 155 of the Prime Minister dated 24 August 2004) in which the state has to continue to own 100 per cent.

Unlike Decree 64, Decree 187 now deals in detail with the valuation of an equitised SOE. SOEs to be equitised can be valued on a book value, discounted cashflow or other basis.

In an equitisation, shares have to be offered in the following order:

- employees are entitled to purchase up to 100 shares for each year of employment at a discount of 40 per cent – under Decree 64, an employee could only purchase 10 shares per year of employment at a 30 per cent discount;

- strategic investors, such as suppliers to or customers of the SOE, are entitled to purchase up to 20 per cent of the issued shares at a discount of 20 per cent – under Decree 64 they were entitled to a 30 per cent discount; and
- other investors (including foreign investors) are entitled to purchase at least 20 per cent of the charter capital (30 per cent under Decree 64).

Decree 187 contains stricter requirements on who values a SOE. Now only SOEs with a total asset value of less than 30bn dong may conduct their own valuations. A SOE with a total asset value of 30bn dong or more must be valued by a qualified organisation. The selection of a foreign valour requires the approval of the MOF.

Profit remittance

In Circular 124 dated 23 December 2004 the MOF confirmed that foreign investors are allowed to remit abroad: (i) profits from investments in accordance with the Law on Foreign Investment, (ii) capital gains (after fulfilling CIT obligations), and (iii) refunds of CIT as a result of reinvestment of profits or due to overpayment.

Until Circular 124, with certain exceptions, the remittance of profits had to be done on an annual basis. It can now be done on a provisional basis every quarter if the foreign investor pays CIT on a quarterly basis.

Foreign contractor tax

After long and controversial discussions on the new foreign contractor tax regime, the MOF finally issued Circular 05 on 11 January 2005. The new Circular 05 replaced Circular 169 dated 22 December 1998, as amended. A report on the implications of this new Circular will be contained in one of our regular sector updates to be issued soon.

Taxation of foreign indirect investment in Vietnamese companies

The tax regime applicable to foreign investment in domestic companies has not been particularly clear. Until now, there were several possible taxes, including the withholding tax contemplated by Circular 169, but Circular 169 never specified the applicable corporate income rate on the sale of shares. On 20 October 2004, the MOF issued Circular 100. From now on, a 'deemed' corporate tax will be applied to any sale of shares in

domestic companies or investment certificates in investment funds by a foreign investor who does not have presence in Vietnam. The rate is fixed at 0.1 per cent of the sale price. Proceeds from the sale of bonds and dividends from shares are not subject to CIT.

One theoretical problem remains: the 5 per cent profit remittance tax stipulated in article 27 of the Law on Domestic Investment Encouragement applicable to investment in domestic companies by foreign investors. There has been no express repeal of this tax, although in practice the MOF agrees that this tax is no longer applicable.

Tax incentives for software companies

Vietnam does not have a software industry as developed as that of India but it does have talented programmers and entrepreneurs with which to challenge that country. As part of its effort to support this fledging sector, the MOF issued Circular 123 dated 22 December 2004 increasing tax incentives for software production and service companies. All such software companies will be entitled to a CIT rate of 10 per cent for 15 years, an exemption for four years after the first profitable year and a 50 per cent reduction for the following nine years. For domestic software companies this compares favourably to the prior rates of 15, 20 or 25 per cent.

Infrastructure

Bauxite exploration and aluminium production

Heisenberg's famous uncertainty principle posits that it is impossible to measure both the speed and location of an object with precision. The location of world-class bauxite deposits in Lam Dong has been known with precision for 30 years. The speed with which they will be developed is imperceptible to the average person. The government, however, is not an average person. Its Official Correspondence 5432 dated 5 October 2004 attempts to develop some momentum with respect to the bauxite and aluminium production projects in Lam Dong and Dak Nong provinces. This Official Correspondence requests:

- the Ministry of Industry (MOI) and the Ministry of Natural Resources and Environment (MNRE) to draw up a Master Plan for quarrying and processing bauxite and to submit it to the Prime Minister in the fourth quarter of 2005;

- the MNRE to conduct a survey and valuation of the bauxite sources in Dak Nong province and to allocate one or two bauxite mines to Vinacoal;
- the People's Committees of Lam Dong, Dak Nong, Lang Son and Cao Bang provinces not to issue any licence for the exploitation of bauxite pending the Master Plan; and
- the MOF, the Ministry of Planning and Investment and the MOI to draw up plans for mobilising capital and implementing Vietnam Minerals Corporation's part of the Lam Dong Bauxite-Aluminium Complex project.

Equitisation of power plants

The Prime Minister has approved a scheme to reorganise SOEs under the Electricity of Vietnam (EVN) in Decision 12 dated 13 January 2005 as part of a larger programme to restructure the power generation sector.

- The Thac Mo Hydropower, Uong Bi Thermopower, Ninh Binh Thermopower, Ba Ria Thermopower, Da Nhim-Ham Thuan-Da My Hydropower, Thac Ba Hydropower, and Pha Lai Thermopower plants are slated to go public this year.
- Six other enterprises affiliated to the electricity sector will also undergo equitisation. The state will hold either no shares in these companies or a limited number.
- The Thu Duc and Phu My Thermopower plants will be converted into one-member limited companies.
- A new finance company under EVN will be established soon.

Banking and finance

Joint stock commercial banks (JSCBs)

On 1 November 2004 the SBV issued Decision 1407 requiring JSCBs to publish their financial reports to shareholders and customers on a quarterly and annual basis. The goal is to make the JSCBs' finances more transparent and therefore to avoid runs on JSCBs such as those that afflicted Asia Commercial Bank a couple of years ago. Prior to publication, the JSCB's financial reports must be certified by independent auditors.

Notice of certain financial information must be provided at the JSCBs' offices and in three consecutive issues of central and local newspapers.

In addition, listed JSCBs have to comply with the disclosure requirements of applicable securities laws.

Foreign exchange transactions

On 10 November 2004, the SBV issued Decision 1452 regulating derivative transactions of credit institutions permitted to deal in foreign currency. This replaces Decision 17 dated 10 January 1998 and only applies to domestic transactions.

Some limited spot, forward and swap transactions were permitted under Decision 17. Decision 1452 expands permitted transactions to include options and other transactions permitted by the SBV. Decision 1452 also gives credit institutions more flexibility by no longer requiring them to obtain a licence to conduct derivative transactions or to submit a report to the SBV.

As with Decision 17, credit institutions are only permitted to conduct swap transactions with economic organisations. For spot, forward and option transactions, credit institutions are also allowed to deal with other organisations and individuals.

Forward, swap and option transactions between dong and US\$ can now go out to 365 days as opposed to the 180 days allowed under Decision 17. The credit institutions and customers are free to negotiate the term for derivative transactions in other foreign currencies.

Decision 1452 also requires foreign currency derivatives transactions to comply with foreign exchange regulations.

Foreign exchange control in the stock market

On 6 December 2004, the SBV issued Decision 1550 on foreign exchange control over foreign investment in the stock market, stipulating the following.

- The broker will open a dong account and a US\$ account with a bank allowed to deal with foreign exchange.
- The foreign investor will remit its US\$ into the broker's US\$ account (presumably under an agreement between the foreign investor and the broker).
- The foreign investor will use its money by placing orders through the broker (eg instructing the broker to sell its US\$ for dong to purchase listed securities, or to use the dong income to purchase US\$ for offshore remittance).

- The broker will comply with the instructions of the foreign investor in dealing with the bank in connection with the US\$ and dong accounts.
- The accounts are supposed to be separate from the broker's other assets, but the decision is imprecise in what is intended by this and what sort of comfort a foreign investor will be able to derive from this or what sort of obligation it may impose on banks.

Decision 1550 does not mention the one-year retention applicable to foreign investors, which had been provided by Decision 998. As Decision 1550 wholly replaces Decision 998, foreign investors in the stock market appear no longer to be subject to the one-year retention period.

Another omission in Decision 1550 relates to securities depository accounts, which foreigners had to open with foreign bank branches licensed to provide the service. It appears that this omission may have been unintentional.

Representative offices of foreign securities and investment organisations

The MOF issued Decision 893 dated 11 November 2004 to regulate the establishment and operation of representative offices of foreign securities companies and investment fund management companies in Vietnam (foreign securities and investment organisations).

A foreign securities and investment organisation wishing to set up a representative office in Vietnam must (i) be permitted to do so by a competent authority in the relevant foreign country (such permission will need to be evidenced by a written document if it is not a right at law), and (ii) have been operating for three years. Applications have to be submitted to the State Securities Committee, the authority in charge of issuing, extending, amending or revoking the representative office licences of foreign securities and investment organisations.

A representative office is not allowed to assign or lend its licence to any other entity. In addition, the employees working for the representative office must not concurrently act or work for other entities in the field of securities and securities trading in Vietnam.

As always, a representative office is not allowed to carry out any business activity.

Administrative environment

National Assembly session

At its recent session, the National Assembly considered some draft laws that can be expected to pass in 2005. These include the Civil Code (amended), the Commercial Law (amended), the Maritime Code (amended), the Law on Pharmaceutical Business, the Law on Tourism, the Law on Environmental Protection (amended), the Law on Intellectual Property, the Law on Residential Housing, the Law on Import and Export Duty (amended), the Mineral Law (amended and supplemented), the Law on Electronic Transactions and the Law on Negotiable Instruments.

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