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CONTENTS

- 140 Editorial
Chris Evans
- 144 Corruption, complexity and tax evasion
Vito Tanzi
- 161 Corruption, taxation, and tax evasion

CONTENTS CONTINUED

333

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Tax corruption and private sector development in Vietnam*

Ngoc Anh Nguyen,¹ Quang Hung Doan² and Binh Tran-Nam³

Abstract

This article aims to examine the impact of tax corruption on private sector development in Vietnam. It is motivated by two separate but related considerations. First, despite the seriousness of the phenomenon of corruption, there is a paucity of rigorous empirical research of corruption, particularly tax corruption, in Vietnam. Secondly, ineffective control of corruption is viewed as a cause of Vietnam's recent total factor productivity (TFP) slowdown or its poor industrial policy, both of which may hamper Vietnam's progress as a low middle-income country. Without some understanding on the impact of tax corruption on the economy, it may not be possible to devise the most effective anti-corruption policy and measures.

After a brief literature review that focuses on tax corruption, various conceptual issues relating to tax corruption are discussed and clarified. The extent of petty tax corruption in Vietnam is then discussed, followed by a review of findings and implications of recent studies on how tax corruption impacts on private sector development in Vietnam.

Vietnam's transition from an inward-looking, centrally-planned economy to an outward-looking, market-based economy formally commenced in 1986 although substantial, irreversible changes only took place in 1989 (World Bank, 1993, pp. i-ii). After three decades of economic reform, Vietnam has achieved certain commendable outcomes, especially in terms of economic growth, poverty reduction and macroeconomic stability. From being one of the 30 poorest countries in the world in the early 1990s,

obtained income. Thus, tax corruption involves a very important intersection of corruption and tax evasion.

There are several strands of research on tax corruption that can be identified in the general literature on tax corruption. These areas are: (i) determinants of tax corruption; (ii) impact of corruption on tax compliance including firm tax evasion; and (iii) strategies to reduce tax corruption. Each of these strands will be briefly

innovation (Nguyen, Doan, Nguyen & Tran-Nam, 2016), firm strategy (Nguyen, Ho, Le & Nguyen, 2016) and household business sector (Dang et al., 2016). They were published in a special issue of *Crime, Law and Social Change* in 2016 and have remained the most comprehensive, up to date and authoritative set of studies on corruption in Vietnam. While most of these studies are concerned with general corruption, the findings can plausibly carry over to tax corruption. In the only study that focused on tax corruption, Dang et al. (2016) found that: (i) bribes result from both extortion and collusion, and (ii) bribe payments are often perceived as a normal cost of doing business.

It is noted that while the above classification also applies to general corruption, the frequency and scale of bribery are most severe in the case tax corruption, at least in the context of Vietnam.

3.2

For any given specific definition of tax corruption, exact measurement of tax corruption is impossible for a number of obvious reasons. First, due to its secret and illegal nature, direct and systematic observations of tax corruption are not possible. Secondly, as discussed previously, tax corruption has several different dimensions and it may not be possible to combine these aspects into a single measurement or index. Thus, it is very problematic to arrive at a set of measures of tax corruption which are comparable across countries and consistent over time.

Broadly speaking, there are two different approaches in measuring tax corruption, namely objective measurement and subjective measurement. An objective measurement of tax corruption may include, for example, the frequency and the amount of bribery that a taxpayer makes to tax officials. Such information can in principle be collected from taxpayers through the means of a questionnaire- or interview-based survey. In addition to the conventional data problems arising from survey research, it is unclear whether respondents truthfully reveal the full extent of their bribery behaviours. An objective measurement of tax corruption can be further categorised into an absolute measure (e.g., the average dollar value of the tax-related bribes) or a relative measure (e.g., the ratio of bribe payments to official tax liability or the ratio of bribe payments to firm's total costs or profits).

A subjective measurement of tax corruption seeks to obtain (normally informed) views/perceptions of relevant stakeholders such as tax officials, business entities, the institutional agencies (including donors) and individuals through questionnaire-based surveys. This is by far the most widely-used approach in gauging the level of tax corruption in countries around the world, including Vietnam.

Objective and subjective measurements of tax corruption discussed above constitute direct measures of tax corruption. An additional means to assess the extent of tax corruption is to rely on a set of indirect measures, which can be either objective or subjective. For example, it is well al ntint 04 Tf1hW* nBT/F2 11.04 Tf1 0 0 1 167.66 515.71 Tm0 g

Finally, perception of tax corruption itself reinforces the public's perception of general corruption which is a serious threat to the political legitimacy of the government, including in one-party countries such as Vietnam.

There is a range of primary evidence, both anecdotal and documented, that Vietnam

4.2

5.1

Following its reunification in 1975 Vietnam officially adopted a central planning economic regime throughout the country. Such a policy choice, coupled with other external difficulties, produced disrupting economic failure in Vietnam. This necessitated the introduction of *Doi Moi* (economic renovation) in 1986, which saw the emergence of the private sector in 1989: agriculture was decollectivised, private land use rights established, the majority of prices and the financial sector liberalised, many restrictions on private sector activity eliminated and trade and investment opened up (see, for example, Tran-Nam, 1999).

The most significant legal development for the private sector in Vietnam was the promulgation of the Enterprise Law which came into effect from 1 January 2000. This law replaced the old Private Enterprise Law and Company Law to establish a more favourable business environment for the private sector development. As a result, the number of new businesses has since increased very rapidly. For example, the average number of newly registered enterprises per day during the period 2000-05 was 3.75 times higher than that of the 1991-99 period. This rising trend has accelerated further in recent years. There were 14,453 newly established enterprises in 2000 and this number was estimated to be more than seven times larger in 2010 with 103,170 new businesses (Business Insides, 2011).

Because of its rapid growth and contribution to the economy, Vietnam's private sector is considered to m d to % M % Ê Ê

In spite of the above constraints, the private sector is an engine of innovation and hence productivity and efficiency. In particular, estimates by global management consulting firm McKinsey found that with one additional unit of capital the private sector in Vietnam produces three times the additional revenue compared to SOEs (reported in Kim, 2014). In recent years, Vietnam's efficiency and productivity has stagnated and, as a result, its annual GDP growth has slowed to around 5 per cent. It is argued by many researchers that Vietnam's total factor productivity slowdown has been primarily caused by resource misallocation within its economy and there would be a very substantial productivity improvement if these distortions were removed (Doan et al., 2016, p. 105).

5.2

There are about 10 different types of formal taxes in Vietnam (see PricewaterhouseCoopers, 2017). However, the main taxes that are relevant to businesses are value-added tax (VAT), corporate income tax, excise tax (known in Vietnam as special consumption tax), and import and export taxes. In terms of reporting frequency and burden, VAT and corporate income tax are by far the most significant business taxes in Vietnam.

Businesses in Vietnam are generally required to register with the tax administration (the General Department of Taxation (GDT) or its city and local offices) within 10 working days of their formal establishment. Each registered business will be supplied with a business tax registration certificate and a unique tax code. Businesses then have to report their estimated tax obligations by filing certain forms at a certain frequency depending on each tax type (VAT, corporate income tax, excise tax, import and export taxes).¹³ There is also a regulation on tax payment deadlines according to which enterprises have to pay their taxes arising from the period that corresponds to the frequency of tax payment. Otherwise, they must pay an additional penalty for being late in paying tax dues.

Large enterprises are required to report and pay their VAT liabilities on a monthly basis while SMEs do so on a quarterly basis. There are two ways of calculating VAT, namely, the conventional credit-invoice method and the direct method. Under the direct method, VAT tax liability is calculated by multiplying business turnover by a VAT rate which varies from industry to industry. The direct method is only available for newly established enterprises or enterprises with turnover below VND 1 billion (or USD 45,000).

In contrast to VAT, corporate income tax in Vietnam is reported and paid to the tax authorities on a quarterly basis. Prior to 2014, enterprises were required to file the tax declaration form quarterly in detail and pay that monetary amount. However, since the fourth quarter of 2014, enterprises only have had to estimate their corporate income tax liabilities and pay that amount without any additional declaration. Besides the requirement of estimating and paying corporate income tax in each quarter, the regulation on corporate income tax also requires that the total of estimated taxes should be no less than 20 per cent of total actual tax from the same period. Otherwise,

¹³ For household businesses, the tax authority will assign them a presumptive amount of tax liability and every household business is required to pay this assigned tax obligation.

the enterprises will have to pay the difference and an additional amount of penalty for the late payment of the difference.

As expected, the large business sector has played a key role in tax payment in Vietnam. However, an examination of tax revenue share by business size from 2000 to 2015 reveals three interesting trends.¹⁴ First, the contribution of the large business sector to total tax revenue has declined from about two-thirds (about 66

Medium Manufacturing Enterprises, conducted jointly by Vietnam's Central Institute for Economic Management (CIEM) and the OECD International Development Agency (ODA) (1995-2001). Contact: +84 4 95.32 841.90

Key findings on firm innovation:

1. the findings support the 'greasing-the-wheels' hypothesis of corruption;
2. unofficial payments appear to have a positive and significant effect on general innovation, product innovation, product improvement and, especially, process innovation. While the findings are controversial, it is consistent with the 'greasing-the-wheels' hypothesis of corruption and other previous studies. In the absence of formal and transparent institutions, unofficial payments can provide the certainty needed by businesses to innovate.

5.5

The study by Dang (2016) examined three dimensions of firm performance: investment, employment and per capita income. His research analysis was quantitative, involving 548.2311 (com) 1558 five, involving 548.2311 (com) 1558 five, i1/Atta* nBT/1

5. fifthly and finally, the GDT should consider introducing a formal measure of its productivity as a way to monitor and improve its operation and performance.

The above proposed measures can only work if there is a parallel effort to break the vicious circle of tax corruption among business taxpayers. This typically requires a carrot and stick approach. As mentioned previously, an important component of such a strategy is a thoughtful program to educate both tax officials and taxpayers about the benefits of a healthier tax culture. High-profile prosecutions of a few corrupted tax officials would also be helpful in turning the tax paying culture around. Another helpful development, r0q0.000008871 0 595.32 841.92 reW* nBT/F2 11.04 Tf1 0 0 1 156.98 647.5q0.

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