

# BUSINESS ISSUES BULLETIN

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## DOING BUSINESS IN VIETNAM: Policies improve in 2007 but obstacles remain

According to the Doing Business 2008 report published jointly by IFC and the World Bank, Vietnam has made improvements to its business environment and consequently has risen in the global ranking for overall ease of doing business. Legal reforms were particularly noteworthy in the two important areas of investor protection and access to finance. While these are expected to stimulate growth of the business sector, further advances will require greater dedication to policy application. More specifically, Doing Business 2008 and other reports show that the economy would benefit from the installment of fluid and reliable information sharing systems, increased corporate accountability, and the elimination of excessive tax administration requirements - all of which are eagerly anticipated by the business community.

This bulletin discusses improvements made over the past year and summarizes important obstacles that continue to affect the business environment. Information has been sourced from various World Bank, IFC, CIEM (Central Institute of Economic Management) studies and reports, and contributions from public and private sector representatives made through the Vietnam Business Forum.

### Improved regulations on secured transactions ease access to finance

The passing of the 2005 Civil Code and the recent Decree 163/2006 on secured transactions have opened up new avenues for lending by allowing businesses to use moveable assets as collateral. This should directly benefit small and medium enterprises, as normally most of their assets are moveable (i.e. inventory, vehicles, equipment and receivables); in Vietnam these assets are estimated to be collectively worth billions of dollars. The new legislation also improves protection for creditors by legally clarifying the priority security interests of creditors on collateral, and by facilitating the enforcement process in default cases, including the availability of out-of-court procedures.

However, the Doing Business 2008 report suggests a need to further improve the infrastructure for registering security interests as well as for credit information access. The secured transactions registration system needs to be upgraded to

an easy-to-access web-based version in order to enhance information flow and provide quick and accurate information for lending decisions. As it now stands, access to information on personal and corporate creditworthiness is unavailable, and the establishment and operation of a private credit bureau is dependent upon the enactment of a comprehensive legal framework. Until these needs are met, banks will remain hesitant to lend and SME growth will be impeded. This will also limit the impact of the aforementioned Civil Code and Decree on improving access to finance for SMEs.

### Investor protection strengthens, but further reform still needed

The new Enterprise and Security Laws have bolstered investor protection by mandating investor involvement in the firm's decision-making process and enhancing disclosure requirements for related-party transactions. The laws have also introduced fiduciary responsibilities for directors to ensure proper conduct and

better safeguard investor and company interests.

Despite these reforms, much remains to be done to secure investor confidence. Vietnam still ranks among the countries with the lowest level of investor protection as the new laws do not provide effective enforcement of the new regulations.<sup>1</sup> Commercial tribunals have no jurisdiction over investor suits against directors, and consequently, director liability is among the lowest in the world.

### Enterprises burdened by administrative tax procedures

A recent CIEM study on tax administration<sup>2</sup> showed that firms in Vietnam average more than 1,900 hours annually in dealing with tax procedures. This includes applications for tax codes (15 hours), buying or registering VAT invoices (93 hours), paying corporate income tax (51 hours), paying VAT (more than 1,700 hours - most of which is spent clarifying documentation and reporting to tax authorities),<sup>3</sup> and dealing with tax investigations (more than 58 hours). While some feel that the time allotted for corporate accounting should be counted separately, the bottom line is that tax procedures remain a complex burden to enterprises.

The Doing Business 2008 findings are

*(Continued in page 4)*



International Finance Corporation  
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The Business Issues Bulletin provides those interested in business issues with a short summary and analysis of a particular topic affecting the business environment in Vietnam, and exposure to different opinions held by various stakeholders on the topic.

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(1) The IFC/World Bank report Doing Business 2008 ranks Vietnam 165th of 178 on the Investor Protection Index. This Index measures the strength of minority shareholder protection against misuse of corporate assets by directors for their personal gain. It is the average of three other indexes: transparency of transactions (Extent of Disclosure Index); liability for self-dealing (Extent of Director Liability Index); and shareholders' ability to sue officers and directors for misconduct (Ease of Shareholder Suit Index).

(2) The primary results of this report were presented by CIEM at the workshop Cost in time of enterprises to meet tax requirements, 31 July 2007 in Hanoi.

(3) There is some disagreement as to the accuracy of the number of hours that enterprises spend on VAT procedures. According to feedback from the Tax Office, this number is equivalent to 245 working days and includes the time for daily corporate accounting, thereby exaggerating the tax administrative burden.

### Improved regulations on secured transactions ease access to finance



Vietnam is shifting its focus from a public credit registry operated by the State Bank of Vietnam to the creation of a private credit bureau that will provide more credit information and will cater to the retail and SME credit markets. As it now stands, the legal framework pertaining to credit information is limited to the provision of information to a public registry. It is, therefore, critical that the legal framework for private credit reporting be established.

The creation and operation of effective private credit information sharing must not be impeded by the legal environment. Libel and similar laws have the potential of stifling good faith reporting by credit information providers. Private credit information bureaus should be guaranteed with sufficient legal protection so that they are encouraged in their activities. This must be done without the elimination of incentives for maintaining the highest levels of accuracy.

In some cases, fair use of information has led to the passage of legislation authorizing and regulating private credit information bureaus. This removes any doubt as to the legal viability of such entities and helps to create greater regulatory certainty, which can lead to an increase of entrants to the credit information marketplace.

The creation of a legal framework by which private credit bureaus can successfully operate to support both lenders and borrowers is vital. Trust in the system and compliance with legislation is key. The legal framework needs to detail the rules of engagement whereby all parties are aware of their rights as well as their obligations in order to ensure confidence in information holding and sharing. Rules enforcing the principles of reciprocity, transparency, security,

collection, usage and preservation, need to be established within the legal framework.

*Mr. Colin Raymond, Credit Bureau Advisor  
Global Credit Bureau Team, IFC*



Many Vietnamese bankers want a modern web-based registry. The most effective way to conform to modern registry best practices is to implement an electronic registry based on the worldwide web. Such a registry permits a secured creditor to register a simple notice of security interest (mortgage or other interest) via the internet. The increase in accessibility, accuracy, speed, simplicity and cost-effectiveness of such a registry

will grease the wheels of commerce and increase the access of Vietnamese businesses to the capital they need to start and to grow.

It will take a long time for Vietnam to develop this system using locally developed software. The alternative is to adapt existing web-based software for modern secured transactions systems to the specific needs of Vietnam. There are a number of international software firms that have already developed such software and have customized it to various country situations. Since the core code exists and the developers have domain knowledge, it would be much faster for them to develop modifications to the software, convert labels, instructions, etc. to the Vietnamese language, test the modified software, install the software and do acceptance testing.

*Mr. Everett Wohlers  
IFC consultant specializing in secured transactions*

### Investor protection strengthens, but further reform still needed



With respect to laws and regulations, Vietnam has a decent rank regarding protecting investors as it has followed regional standards and practices. Moreover, ASEAN standards on corporate governance are even more advanced than those in other regions. The one remaining obstacle, however, is the lack of clear regulation on corporate policies for strategic shareholders. It is, therefore, unsurprising that we have seen a number

of firms issuing shares under favorable conditions to larger shareholders and/or related persons.

This action obviously harms the small shareholder. Current corporate governance and investor protection in non-listed, publicly-owned corporations is poor, regardless of the obligations imposed by both the Enterprise Law and Securities Law for transparent information disclosure. Furthermore, a lack of understanding of corporate governance practices and related laws and regulations among investors and their incapacity to organize advocacy to protect their own interests can be attributed to the current poor enforcement.

In some countries, an association of investors or a Securities Commission will act on behalf of the investors to protect their interests and take any violations to court. This does not happen in Vietnam. It is difficult for small investors to obtain legal advice or to

unite for better representation. Furthermore, disciplinary measures for market violating behavior are often specified in separate implementation documents (either decrees or circulars) and the laws only provide general principles. For instance, detailed penalties for violation of securities market rules are specified in Decree No 36, which implements the Securities Law. This makes it is very difficult for investors to stay up to date.

*Ms. Vu Thi Kim Lien, Vice President  
State Securities Commission*



The Enterprise Law and Security Law have improved investor protection. However, there are thousands of legal documents to comply with, and businesses are having a hard time staying on top of them all. There are enough laws and regulations now, but the dissemination of these laws and regulations to those affected has not been done well. Laws and regulations should be more concise and clear for understanding and application. In

implementation, the State Securities Commission, Business Registration Office and the Courts are supposed to provide protection mechanisms for investor interests. Yet these organizations do not actively monitor and prevent market-violating behaviors. Punitive

measures for violations are inefficient, and fines are usually insignificant. Therefore, it is more productive at this point in time to help investors improve their knowledge on related laws and regulations, so that they can better protect their own interests.

*Mr. Nguyen Hoang Hai, General Secretary  
Vietnam Association of Financial Investors*

Vietnamese firms have made initial improvements in protecting investors, and, to some extent, already follow international standards for transparency and disclosure. However, majority shareholders with controlling rights are not effectively prevented from acting in

their own interests, rather than the common interests of all shareholders. To improve the protection for small investors, there is a need to clarify punitive measures applied for violations by the Executive Board (i.e. member of the Board of Directors, member of the Management Board), and to specify mechanisms and instruments for small investors to protect their rights. In addition, information dissemination and education on legal documents and good corporate governance practices are definitely needed to strengthen the knowledge of both the members of an enterprise's Executive Board and the investors.

*Ms. Pham Chi Lan, Economic Expert*

## Enterprises burdened by administrative tax procedures



Generally, tax issues are always a concern for businesses. The approach to developing tax regulations and procedures is usually to fix immediate issues rather than address fundamental, long-term issues. For instance, with the value added tax, corporate income tax, excise tax, and export tax, tax authorities have ineffectively managed the filing of original transaction documents (e.g. purchasing invoices), which are critical for keeping track of firm invoice issuance. If the tax authorities manage invoices more efficiently, i.e. by strictly applying punitive measures for legal violation, then illegal purchasing and improper issuing of invoices by firms would be prevented. This would also help save labor costs and reduce both the time it takes for tax authorities to check every time a firm wants to purchase an invoice book and time spent by tax authorities at the firm.

Another problem is the lack of internal supervision. There is no system for penalizing corruption or disruptive tax official behavior. As long as the amount of tax payable can be negotiated between the firm and the tax official, there will be corruption and an unfair business environment. Finally, taxation policies are still ambiguous for firms. There are so many policies and rules that no SME can afford to invest sufficient time and personnel into fully understand all the existing legal requirements.

*Mr. Nguyen Minh Hoang, Director  
Hoang & Thang Tax Consulting Co. Ltd.*

The lack of transparency in tax collection means a firm requires extra time to fulfill business-related tax obligations. If all tax claim forms, tax calculation methods, and tax regulations were truly transparent, then firms and tax authorities could quickly agree on the amount of tax to be paid. For example, one often-argued issue is which criteria should be used to identify reasonable and legitimate expenses. This is a grey area in the regulations and has led to illegal negotiating between tax officers and firms. Another reason for ineffective tax enforcement is that tax regulations are too complicated both for the enterprise and the tax officers. Furthermore, different tax offices have different interpretations on a piece of tax regulation - which then leads to questions on tax officer qualifications.

There is also the problem of poorly qualified accountants at firms. Tax consulting services have yet to be effectively utilized by SMEs. Most of the time, they are temporarily fixing accounting data and documents to deal with ad-hoc requirements, instead of

creating internal reporting systems.

Tax reform has recently focused on revising rates. More reforms are also needed for administrative procedures. Simplified tax administration will strengthen the effectiveness of tax collection and create a fair environment for enterprises. One positive development has been the initial reform on tax administration that enables enterprises to calculate and submit their own tax payments, with tax authorities conducting post investigations. But more reforms along these lines are necessary. For example, firms should be allowed to issue invoices themselves. Tax authorities should not reserve the right to print and sell invoice books to enterprises. This does not lead to effective tax management. This method of examination (both before and after selling invoice book to enterprises) costs firms time and money. It also contributes to negative behavior in the market, such as illegal trading of invoice books.

*Ms. Pham Chi Lan, Economic Expert*



The present tax administration procedures are too complicated for businesses. Too many unclear and overlapping regulations and requirements exist. Although a number of tax administration reforms have recently taken place - like the one-stop shop model, for instance, tax procedures are still a burden. In most cases, firms need to make repeated visits to tax offices, even when it is just for an individual procedure. Also, tax declaration forms are inconsistent. Different local tax offices may have different forms and verifications, and many of them are not in compliance with the forms mandated by the General Tax Department. This just confuses everyone, especially those having business activities in different localities. Further, tax regulations at the central level are changing quickly but regulations at local offices stay the same. This leads to problems when firms apply the most updated regulations, which are then refused by the uninformed local tax offices.

Recently, there has been an initiative across tax offices to computerize all administrative work. Unfortunately, data entry has been poor, resulting in many errors and discrepancies (even in big cities such as Hanoi and HCM City). Although these errors are made by tax officials, firms will be fined for discrepancies if they can not correct them in time. This means that firms need to make formal requests for tax-related data revision and meet with the relevant tax officials to check for mistakes against the related documents. Firms must then visit the information center to request that incorrect data be re-entered into the computer system. So in reality it is the

► responsibility of the enterprise to fix all mistakes - at their own expense. While the laws stipulate that tax authorities work 'on-site' for about three to five days for each inspection, enterprises need a lot more time to collect requested documents, and to fix

discrepancies with tax authorities on inspection results. In reality, a tax investigation takes at least three months.

*Ms. Dinh Thi Quynh Van, Partner  
PricewaterhouseCoopers (Vietnam) Ltd*

## Construction license is a big obstacle to enterprises



When reviewing issues related to Construction Licensing in Vietnam, we have to take into account the involvement of not only one construction agency, but also many other related agencies and departments. The investor is concerned about how much time they have to spend and how much money they have to pay in order to obtain a construction license. At present, this license is still a big concern for the business community as they have

to deal with many procedures across different state agencies (i.e., departments of construction, land administration agency, zoning and architecture agency, and local authorities, etc.) while there is no focal point (single access point) to coordinate the processing work of these departments and authorities. Most of the related state agencies have been very proud of their work and confirm that they have been very helpful for businesses. However, it is not clear whether they are aware of the complicated procedures and the lack of coordination and communication between different agencies. Also, no agency takes accountability for the overall process. To improve this, the Prime Minister should propose further reforms of public services, especially to strengthen the coordination of different departments involved in licensing.

*Ms. Pham Chi Lan, Economic Expert*

Investors used to be able to start site-work immediately upon receiving approval from the Department of Planning and Architecture for the construction drawings. Nowadays, investors need to acquire extra approvals such as for Fire Security, Environment Security and Design for Infrastructure Facilities before

any site-work can begin. In the case of commercial buildings, approval of the related investment project is also needed. Normally, it takes one or two years to get approval for the construction design from the Department of Architecture and Planning and from the District People's Committee, and it takes an additional year for the other above mentioned procedures. Thus, three years are needed to obtain all approvals, and in some cases, it is even longer. In comparison, the time needed for the actual construction work is also between one and three years! The main reason for the delays is the complexity in related regulations. There are too many legal requirements such that officers from different departments have different understanding and make conflicting decisions. Another paradox of this licensing process is that although the approvals before site-work are very difficult to acquire, post investigation of site-work is very weak. This leads to low-quality of construction and widespread corruption (under use of materials) in this field. The lengthy time period for procedures also puts pressure on investors to shorten the time for site-work to meet with investment schedule. This has led to many technical and labor breakdowns in construction work. The business community recommends that the government apply a one-stop shop mechanism for construction licensing so businesses need to deal with only one authority in this licensing process. Also, the rules for primary and secondary licensing requirements need clarification. Investors should have the right to start their construction work immediately upon the receipt of approval of technical drawings, while other procedures on fire, environment, investment project, etc. should be fulfilled later on during the construction period.

*Mr. Nguyen Van Duc, Vice Director  
Dat Lanh Construction Co., Ltd*

*(Continued from page 1)*

consistent with those of CIEM, concluding that Vietnam's tax administration is indeed burdensome. It finds that Vietnamese firms still average 1,050 hours (unchanged from the previous year) - the equivalent to 130 staff-days - to complete tax-related payment procedures. Tax procedures also include around 32 payments and average as much as 41.6% of annual company profits.

According to CIEM, the recent application of the Law on Tax Management will do little to alleviate the time burden on firms if the necessary improvements to tax procedures are not made. One welcome sign of progress has been the government's initial attempts to simplify business-related procedures by piloting One-stop shop offices in certain provinces, and by applying an electronic (web-based) system for tax declaration and payment purposes.

### **Construction licenses obstructing growth**

The amount of time it takes to obtain a construction license is

clearly impacting business start-ups and factory expansion. *Doing Business 2008* notes that Vietnam has the most expensive building regulations in the region, with the typical procedure for acquiring a construction license requiring 13 different steps, at least 194 days, and costs that can reach 370% of income per capita.<sup>4</sup> Furthermore, a recent inspection in Hanoi and Ho Chi Minh City by the Ministry of Construction found construction licensing procedures in these two cities to take longer than legally permissible, due to unnecessary and irrelevant provincial procedures and ambiguity in the current regulations.<sup>5</sup> Reforms are urgently needed to reduce the time spent and costs incurred. Streamlining and standardizing the procedures across the provinces would be a significant improvement that would benefit the many businesses that operate in more than one province and consequently have to devote time and resources to satisfying each province's particular requirements.

(4) The indicators on dealing with licenses record all procedures required for an entrepreneur to build a warehouse, including obtaining necessary licenses and permits, completing required notifications and inspections, including preconstruction inspections, and obtaining utility connections. *Doing Business 2008*, World Bank.

(5) Complexity in Procedures of Construction License, Saigon Economic Times, dated September 23, 2007.