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VIETNAM BRIEFING

From Dezan Shira & Associates

Representative Office in Vietnam: Procedures and Compliances for Setting Up and Dissolution

How to Set Up an RO P.04

Dissolving an RO P.06

Securing Against Tax Incompliance P.08

Introduction

ALBERTO VETTORETTI
Partner
Dezan Shira & Associates

Vietnam continues to showcase strong growth patterns despite the ongoing COVID-19 pandemic, leading investors to favorably consider the country as an ideal location for new investment, relocation of operations, or expansion of existing entity. In fact, foreign investors appear undeterred by the current travel restrictions and are planning to set up fresh companies, factories, or warehouses or expand their operations.

In the first half of the year, Vietnam also rose to become the second biggest supplier to the US after China, emerging as a prominent beneficiary of the ongoing US-China trade hostilities. Since Vietnam has been able to contain the pandemic better than most countries, it is no surprise that foreign investors remain keen on doing business in the country.

In this context, it is important to understand the prevailing office types and structures in the country. For foreign businesses looking to enter Vietnam, the representative office (RO) structure is a popular vehicle for investment due to a variety of factors.

In this issue of Vietnam Briefing magazine, we look at the process to set up an RO, including establishment procedures and the timeline involved. We then examine the viability of RO operations and the RO dissolution process. In the last article we look at tax obligations involved with dissolving an RO.

This magazine is based on Dezan Shira & Associates' years of experience in supporting foreign enterprises in Vietnam. For more information and advice on how to plan for market entry or restructuring your investment into Vietnam, please contact us at vietnam@dezshira.com.

Best regards,

Alberto Vettoretti

Asia Briefing Ltd. Unit 507, 5/F, Chinachem Golden Plaza, 77 Mody Road, Tsim Sha Tsui East Kowloon, Hong Kong.

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This Issue's Topic

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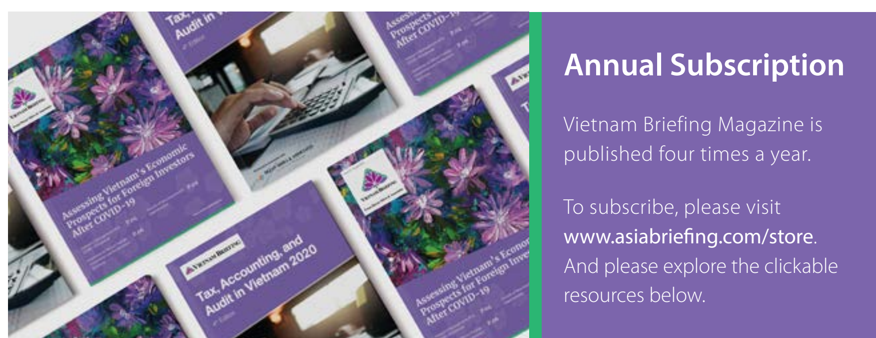
Table of Contents

How to Set Up an RO P.04

Dissolving an RO P.06

Securing Against Tax Incompliance P.08



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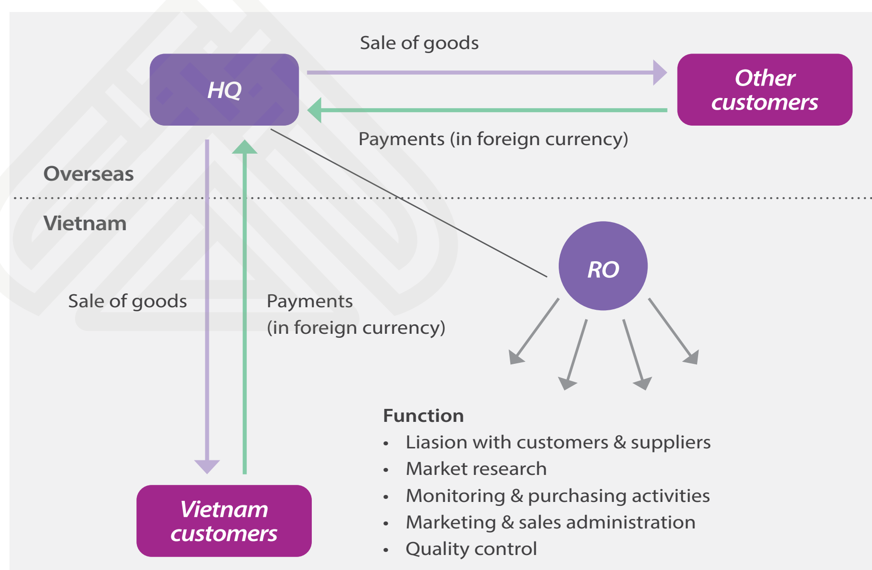
How to Set Up an RO

By Dezan Shira & Associates

As Vietnam's economy continues to grow, despite the pandemic, foreign investors are increasingly choosing the Southeast Asian nation to combat rising costs in China and other unpredictable scenarios, such as trade shocks.

With its positive business environment, stable political climate, and low wages, it is no surprise that several foreign investors want to gain entry into Vietnam, set up, and expand business operations there.

There are several market entry options for businesses to consider when entering Vietnam. However, in this issue, we will look at the representative office (RO) option – steps to set up and things to consider when dissolving an RO, particularly with regards to tax compliances.



Setting up an RO

A representative office offers a simple and low-cost option for companies seeking to gain a better understanding of the Vietnamese market. As such, this option is among the most common for first-time entrants to the Vietnamese market and often precedes a larger presence within the country.

Due to the limited scope of operations, the mandatory tax and licensing procedures of an RO are often simple compared to those of a wholly foreign-owned company. As an RO cannot generate revenue and is not subject to an audit, most foreign investors assume that they are subject to minimal taxes, thereby not paying attention to bookkeeping and adequate documentation.

What are ROs permitted to do?

ROs are permitted to engage in the following activities:

1. Conducting market research;
2. Acting as a liaison office for its parent company; and
3. Promoting the activities of its head office through meetings, and other activities, that leads to business at later stages.

Representative offices are dependent on their parent company and are not allowed to generate their own profits or enter directly into contracts. They are also not allowed to issue invoices.

What do you need to get a license?

Pre-licensing checklist for setting up a RO:

1. File an application for setting up a RO with company chop or seal;
2. Appointment letter of Chief of RO with identification documents and company seal;

3. Power of attorney in favor of consultant to submit the application dossier;
4. Certificate of Incorporation for the Company and/or Business Registration Certificate of the Company;
5. Audited financial report of the company for the latest fiscal year;
6. Memorandum of Understanding (MoU) of leasing office or leasing contract; and
7. Documents providing legal rights of landlord regarding the right of leasing office.

For steps 1 to 6, the foreign entity would require one notarized and consularized copy of each document and a translated copy in Vietnamese by a Vietnamese competent authority such as the Vietnamese embassy and in Vietnam - the People's Committee offices, public notaries under the department of justice, law firms and agencies.

A signed leasing contract is also required before registering an RO in Vietnam.

What do you need to do after you get the license?

Post-licensing checklist for setting up an RO:

8. Make a seal for the RO;
   » License on the establishment of RO
   » Passport of Chief of RO if a foreigner or passport/ID card if Chief is Vietnamese
9. Register a tax code for RO;
   » Declaration to register a tax code
   » Power of attorney
   » Certificate of seal registration
   » Certificate of RO in Vietnam
10. Open a bank account of RO; and
    » License on the establishment of RO
    » Certificate of seal registration
    » Certificate of tax code registration
    » Letter of authorization appointing the authorized signatories of the bank accounts
11. Announcement of the establishment of an RO of the company.

For steps 8 to 10, notarized and translated documents will be required to complete the process.

How long does it take to set up an RO?

ROs can be set up in six to eight weeks. We recommend hiring a professional services firm to deal with the myriad of laws and procedures and ensure all compliance obligations are met. Given the absence of in-country revenue and associated licensing requirements, the setup process for this option does not entail as many bureaucratic procedures as others.

An RO license is valid for five years but can be extended for another five years.

Timeframe to Set up a Representative Office (RO)

Steps		Estimated timeframe
1	Operation License Application	15 working days
2	RO Seal Registration	7 working days
3	RO Tax Code Application	10 working days
4	Bank Account Registration	20 working days
5	Declaration of Labor Usage*	1 working day
6	Employee's Registration for Social Insurance Fund*	1 working day
7	Trade Union Registration*	1 working day

** If hiring new employees*

What comes next?

Hiring, tax, and reporting.

There is no cap on the number of local and expatriate employees that a representative office can hire if their employment is properly documented.

All expatriate hires, including the chief representative, are required to have a work permit. ROs can hire staff directly or use the assistance of recruiting agencies.

An RO is not subject to Vietnamese corporate income tax (CIT). However, it is responsible for declaring its employees' personal income tax (PIT).

In order to determine payable tax, ROs have to undertake a tax audit that checks all revenues and expenses during the tax term to establish grounds for declaring and paying tax.

The RO is also required to send reports of its activities of the previous year to the Ministry of Industry and Trade (MoIT) before January 30 of each year.

Tax liability if RO viewed as permanent establishment

As discussed earlier, an RO is only permitted to do market research activities and act as a liaison office for its parent company. It cannot engage in commercial activities or support the parent company with its commercial activities in Vietnam.

A permanent establishment (PE) is defined as per local laws as well as the double tax avoidance (DTA) agreement between Vietnam and other countries. Generally, the PE definition under a DTA takes precedence over domestic regulations.

If a foreign business wants to convert the RO into a PE but has been carrying out activities as per local laws, it could activate a licensing risk. Therefore, foreign businesses should ensure that their RO performs activities as per the DTA guidelines. In addition, if the RO performs activities that are outside its scope, it may be subject to additional tax in Vietnam.

To avoid any licensing or tax risks in case the RO is treated as a PE, businesses are advised to refrain from getting their ROs involved in buying and selling activities between two parties or any other activities that generates revenue.

Foreign investors looking to establish a presence in Vietnam should use the services of registered local advisors who can ensure their set up process is accurate while complying with the relevant DTAs and local regulations.

Dissolving an RO

By Dezan Shira & Associates

Many investors may choose to close an RO depending on their financial situation or due to non-financial factors, such as upgrading the entity into a foreign-owned enterprise in order to expand their business activities in Vietnam.

Investors that want to expand their business presence in Vietnam will have to reevaluate their RO setup and its limited scope of operation. However, investors should do their due diligence before deciding their next move.

What are the documents needed to close an RO?

- Notice of terminating operations by the RO as per the Ministry of Industry and Trade and signed by the legal representative of the RO;
- List of creditors and unpaid debts, including tax debts and social insurance payments;
- List of employees and benefits;
- Original license of establishment of RO;
- Seal or corporate seal of RO; and
- Documents showing the RO has fulfilled all tax and financial obligations.

It is important to note that investors should be aware that each case requires a specific methodological approach. For example, in certain situation like the pharmaceutical industry, due to recent changes, investors were urged to set up their foreign owned enterprise.

HR issues when migrating from an RO

Typically an RO's employees can be moved to the new legal entity and the RO can be officially closed; however, in some cases, such as the pharmaceutical industry, the RO may need to continue operations in parallel to the FOE for a specific period of time.

To move employees to the legal entity, the labor contract between the employees and the RO must be dissolved and the RO should formulate a mutual termination agreement. If employees do not agree to a mutual termination, then the RO should prepare a labor usage plan describing the situation and showing that the termination of labor contract is necessary to comply with the law. This labor usage plan must be submitted and discussed with the trade union and this process can be time consuming.

Therefore, the management of the RO should try to reach a mutual termination agreement even if this requires additional costs. A termination package provided to the RO's departing employees usually includes:

- Salary until the termination date;
- Prorated portion of any 13th month salary;
- Unused annual leave; and
- Several allowances as applicable.

Additional payments may be negotiated between the RO and employees and may be determined by the level of seniority of the employee.

The RO must also ensure that they have addressed any insurance and tax obligations. Former employees will need to be deregistered with the social insurance organization and all premiums must be updated until the end of the labor contract.

If the investor is upgrading from an RO to a FOE, the newly established organization can sign new employment contracts with the RO's old employees. Ideally, the new contracts should have the same terms and benefits as the contracts with the RO. The new employees will need to be registered with the social insurance program to begin being paid social insurance premiums.

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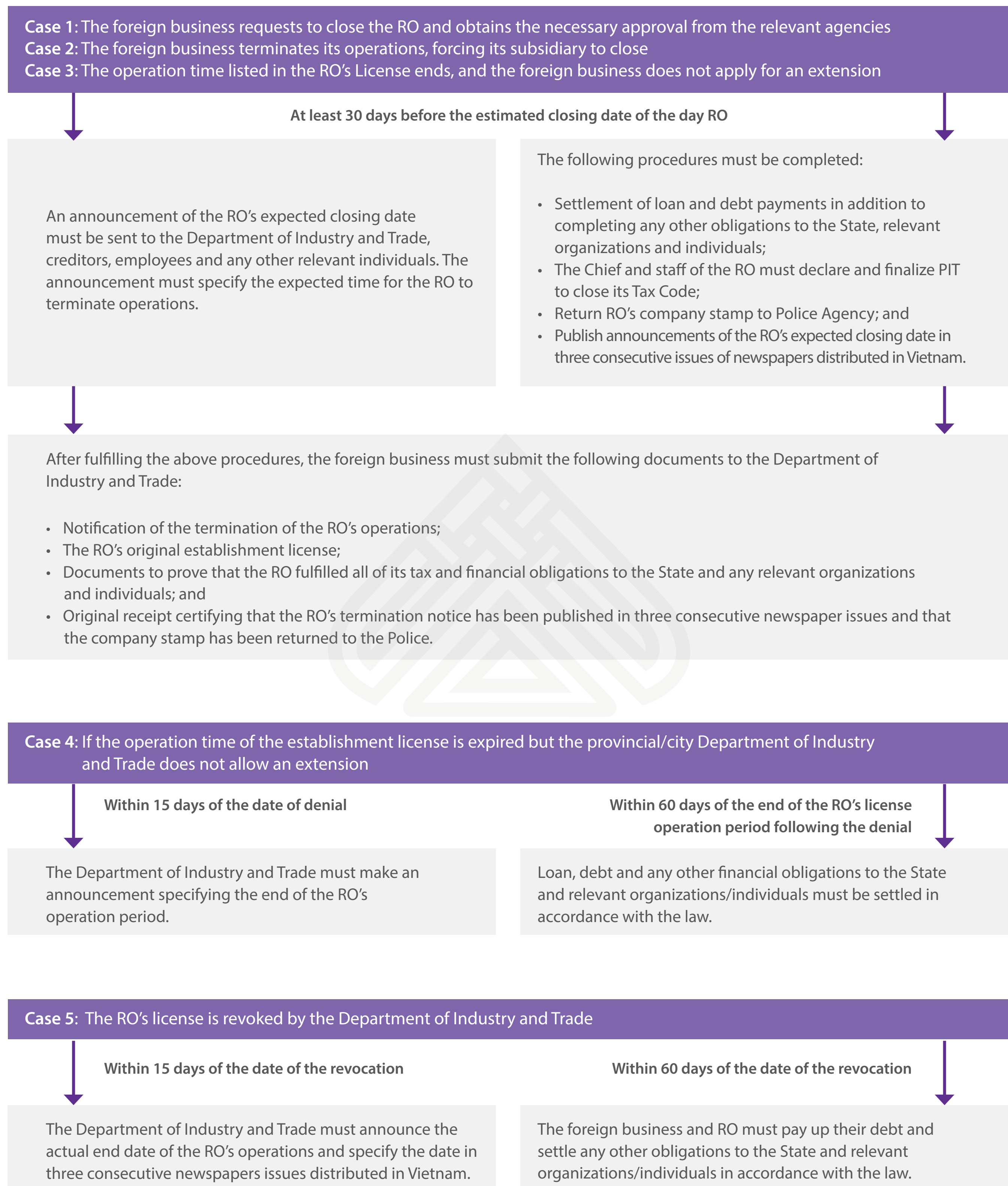
Procedures to close down a RO



Case 1: The foreign business requests to close the RO and obtains the necessary approval from the relevant agencies
Case 2: The foreign business terminates its operations, forcing its subsidiary to close
Case 3: The operation time listed in the RO's License ends, and the foreign business does not apply for an extension

At least 30 days before the estimated closing date of the day RO

An announcement of the RO's expected closing date must be sent to the Department of Industry and Trade, creditors, employees and any other relevant individuals. The announcement must specify the expected time for the RO to terminate operations.

The following procedures must be completed:

- Settlement of loan and debt payments in addition to completing any other obligations to the State, relevant organizations and individuals;
- The Chief and staff of the RO must declare and finalize PIT to close its Tax Code;
- Return RO's company stamp to Police Agency; and
- Publish announcements of the RO's expected closing date in three consecutive issues of newspapers distributed in Vietnam.

After fulfilling the above procedures, the foreign business must submit the following documents to the Department of Industry and Trade:

- Notification of the termination of the RO's operations;
- The RO's original establishment license;
- Documents to prove that the RO fulfilled all of its tax and financial obligations to the State and any relevant organizations and individuals; and
- Original receipt certifying that the RO's termination notice has been published in three consecutive newspaper issues and that the company stamp has been returned to the Police.

Case 4: If the operation time of the establishment license is expired but the provincial/city Department of Industry and Trade does not allow an extension

Within 15 days of the date of denial

The Department of Industry and Trade must make an announcement specifying the end of the RO's operation period.

Within 60 days of the end of the RO's license operation period following the denial

Loan, debt and any other financial obligations to the State and relevant organizations/individuals must be settled in accordance with the law.

Case 5: The RO's license is revoked by the Department of Industry and Trade

Within 15 days of the date of the revocation

The Department of Industry and Trade must announce the actual end date of the RO's operations and specify the date in three consecutive newspapers issues distributed in Vietnam.

Within 60 days of the date of the revocation

The foreign business and RO must pay up their debt and settle any other obligations to the State and relevant organizations/individuals in accordance with the law.

Securing Against Tax Incompliance

By Dezan Shira & Associates

In this section, we look at the tax obligations associated with the dissolution of an RO.

It is common for the ROs' chief representative officers (CRO) to think that their tax status is in compliance, as long as they fulfill their statutory obligations on annual reporting, personal income tax (PIT), and social health and unemployment insurances (SHUI) for their employees. Such ROs are at the risk of attracting significant penalties, often due to a lack of required documentation for business expenses, when an audit is conducted by tax authorities.

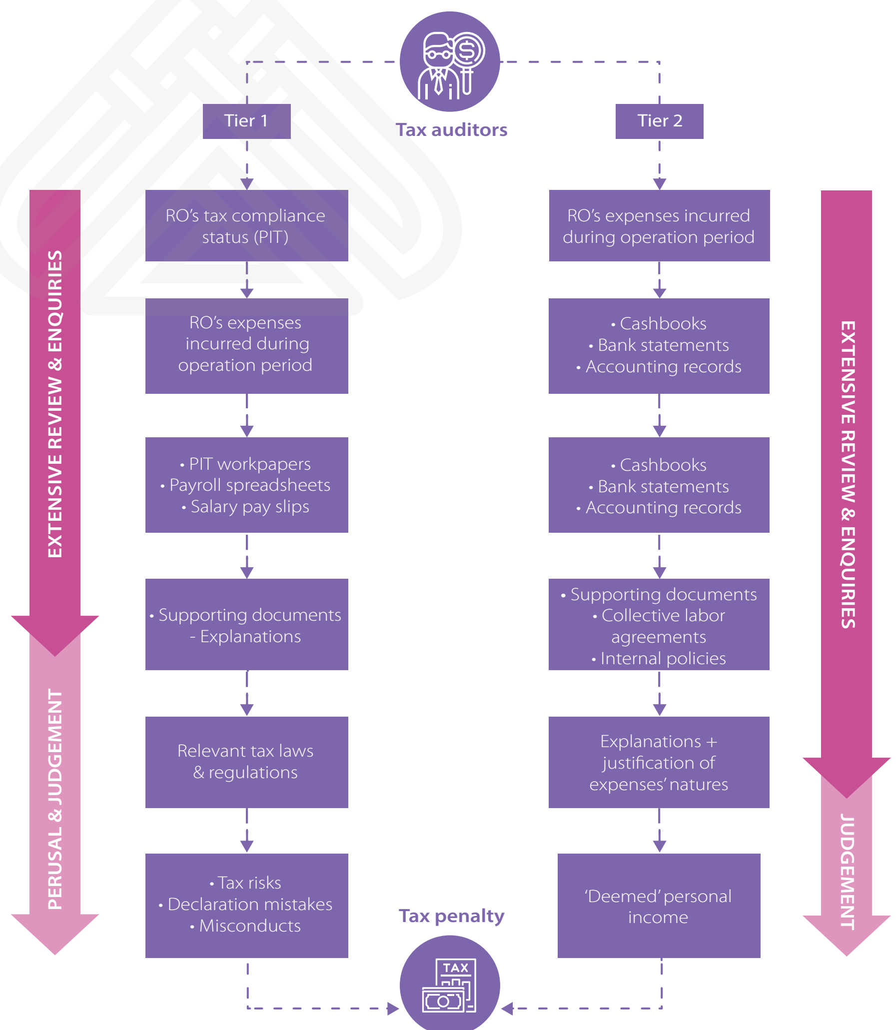
A tax audit is unlikely to occur unless authorities suspect the RO is engaging in illegal activities. If nothing is out of place, audits will only happen when the RO goes into dissolution mode, which may occur years after the RO began operations.

In practice, while an RO is not subject to a declaration of business taxes (like VAT and CIT), it is still required to maintain adequate bookkeeping records as well as supporting documents of business expenses incurred during its operation. This is similar to a company's accounting documentation to support deductible expenses that are claimed.

Tax audit for dissolution

In addition to examining the PIT declaration and remittance status, tax authorities are also known to look at the RO's cashbooks,

Tax Audit Procedures for Dissolution of Representative Offices



bank statements, and bookkeeping records to review expenses incurred during its operation period.

The expenses are subject to review on a sample basis and the RO will be asked to show relevant supporting documents and provide an adequate explanation to justify the nature of expenses incurred.

If the RO fails to establish the link between the incurred expenses and the RO's operational activities, then it will result in such expenses deemed as additional benefits-in-kind provided to individuals. As per tax authorities, such benefits should be taxed and will be penalized accordingly.

Based on Dezan Shira & Associates' experience of doing tax finalization during the closure of an RO, most of the unpaid taxes and corresponding penalties are imposed on expenses with either insufficient supporting documents or no direct connection with the RO's operations. They are therefore treated as "deemed" personal income.

Traveling expenses for employees

Costs of business trips are almost unavoidable for ROs operating in Vietnam due to the need to send their employees for meeting with potential business partners, training with the parent company overseas, or seeking potential locations for future investment.

It is common to see ROs incur significant business travel costs during their operational periods in Vietnam and then be penalized for additional taxes, which are imposed on such expenses after being audited by the tax authority.

Due to this, several investors believe that the tax authorities do not allow ROs to incur travel expenses. However, travel expenses can be exempted from PIT if the RO can validate that such expenses are necessary for its business development.

Similar to a company's accounting documentation to support deductible expenses, an RO is required to maintain adequate bookkeeping records as well as supporting documents of business traveling expenses.

To justify the direct relationship between the travel expenses incurred and the RO's operation activities, the following supporting documents should be sufficiently maintained:

- The policy for business travel must be specified in the RO's internal financial regulations and the collective labor agreement or employment contracts with their employees. Such a policy should cover the detailed limitation of costs, travel duration, and purposes as well as approval and payments approach (direct payments or reimbursement of actual expenses);
- If the RO provides fixed allowances and per diem for their employees' business trip, such provisions must be detailed in the travel policy as well;
- Assignment letter with details of duration, locations, and purpose of the business trip;
- An e-ticket (online reservation) or tax invoices (booking through flight agencies) and boarding pass;
- Genuine tax invoices or receipts of accommodations, cab fares, and other miscellaneous expenses incurred during the trip; and
- Payment documents.

During an audit, tax officers scrutinize and tend to challenge business travel costs without adequate supporting documents or clear conditions on the RO's business travel policy.

In addition, it should also be noted that the business travel costs might be deemed as employees' taxable benefits if the RO fails to establish a connection between such expenses and the need for the RO's operations.

In this regard, it is recommended that an itinerary specifying the employees' work details during the trip be included as part of supporting documents for business travel expenses. A detailed itinerary is not necessarily required, but it is helpful to provide an adequate explanation in case of future tax audits.

Annual vacations for employees' family members

It is common for Vietnamese organizations, including Ros, to provide their employees with annual vacations as part of their benefits packages.

Occasionally, as a reward for their employees after a successful and productive year, the ROs may invite family members of those employees to join the annual company trip and cover all costs. However, businesses must be aware of the added tax implications.

Annual vacations are typically not counted toward the employees' assessable income for PIT declaration purposes, given that such benefit entitlements are specified in the RO's internal policy or employment contracts. It is important that supporting documents are maintained and payments are made for the organization's employees as a whole – rather than to a specific individual.

If the benefit entitlements are inclusive of the employees' family members, then the case differs.

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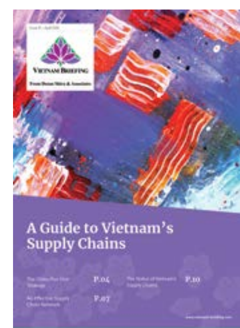

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For tax authorities, family members are not directly related to the RO's daily operations and as such, any payments to them are treated as additional taxable benefits-in-kind to the RO's employees and must be taxed accordingly.

Therefore, ROs are recommended to carry out appropriate tax withholdings and declaration when making benefit payments, which are inclusive of their employees' family members, to avoid the imposition of additional tax and corresponding penalties during future tax audits.

Cash-in-lieu of benefits payments

There are several occasions where the employees, due to personal reasons, are unable or refuse to use the benefits that are offered by the RO as mutually agreed. The benefits might include but are not limited to annual vacations, educational courses, or life insurance. The RO, as a gesture of goodwill, can make cash-in-lieu of benefits payments for those employees.

While such benefits for employees are tax-exempt in most circumstances, cash-in-lieu of benefits payments are not. Under PIT regulations, cash-in-lieu of benefits payments are considered as part of an employees' assessable income.

Therefore, the RO must make appropriate tax withholdings or have such payments counted toward the employees' assessable income for PIT declaration purposes, depending on the mutually agreed PIT filing arrangements.

Traveling expenses for family members of expatriates

Most expatriate employees working for an RO in Vietnam are entitled to the benefits of complimentary visa fees and round-trip airfares. Given that certain conditions are met, the cost to return home for expatriate employees is tax-exempted and does not count toward their assessable income under PIT regulations.

In some instances, the family members of such employees are also covered for their traveling expenses under the internal policy of the RO or its parent company. As such, any benefit entitlements of employees, which are inclusive of their family members, should be treated as additional taxable benefits-in-kind to the RO's employees and taxed.

Based on Dezan Shira & Associates' experience, there have been cases where benefit payments have been accumulated up to a significant amount after a few years of operation without adequate tax withholdings and declaration. Consequently, these are all subject to scrutiny by tax authorities, resulting in additional tax and penalty amounts during a tax audit.

Expenses incurred for expatriate employees of parent company

If an employee of the parent company visits the RO for a short visit – the RO typically covers the travel and accommodation costs.

Some of the common expenses incurred for such employees are visa application fees, flight tickets, accommodations, and meal allowances.

Businesses often make errors thinking that the expenses incurred for the parent company's employees should be similar to those of the RO's employees.

However, as per tax authorities, employees of the RO's parent company are not under the RO's payroll, and any expenses incurred for such employees should be treated as their assessable income and be taxed at the applicable tax rate of 20 percent for non-tax residents accordingly.

Therefore, the rational approach is that traveling expenses incurred for the parent company's employees to visit Vietnam should be paid by the parent company instead.

However, if the traveling costs must be paid by the RO, there should be documented agreements to justify that the RO is only making payments on behalf of the parent company. It is important to note that the expenses may still be subject to inquiries by tax auditors, and they will consider if the RO has solid grounds to justify the nature of such expenses.

In addition to the required travel expense documents, the RO may use supporting evidence such as:

- Internal agreement between the RO and its parent company, which dictates the terms of payment-on-behalf and reimbursements of travel expenses for employees;
- Assignment letter from the parent company showing the duration of the employee's trip in Vietnam;
- Itinerary specifying such employee's work and vacation details during their visit to Vietnam; and
- Evidence of payments and reimbursements of travel expenses between the RO and its parent company.

"Suspect" payments or reimbursements

Investors should be aware that during tax finalization, the tax authority often undertakes a thorough audit of the RO's cashbooks, bank statements, and other bookkeeping records to review the legitimacy of the RO's expenses incurred during its operation.

If any payments or reimbursements are deemed vague or suspicious, it will be subject to an intense review with tax officers requesting extensive supporting evidence.

Based on our practical experience with tax audits for ROs, we provide some examples of payments or reimbursements, which are usually considered "suspect" from a tax authority's point of view:

- Example 1: An RO is allowed by its parent company to cover the flight tickets of its expatriate employees as well as their family members returning to their home country once per year. The chief representative officer of the RO previously had tax advisory experience and knew that the coverage for expenses of expatriate employees' family members are taxable under Vietnamese PIT regulation. In an attempt to sidestep the tax authority, the CRO suggests that flight tickets should be bought through a flight agent so that the booking details are not shown on the issued tax invoices. However, the tax auditor easily identifies those invoices for flight tickets as unreasonable when comparing to other similar payments. Consequently, all flight ticket payments are deemed as the expatriate employees' assessable income and subject to the PIT withholding rate of 10 percent.

- **Example 2**: An RO allows its promotion specialist to incur entertainment expenses, such as business dinners, gifts, and wines when meeting potential business partners. The employee pays for such expenses themselves and keeps the tax invoices, knowing they would receive reimbursements from the RO in the form of a "special responsibility" allowance. Subsequently, the tax authorities audit all payments made to the employees and discover the inconsistency of such allowance payments. The RO is vague on the nature of such allowances and fails to provide an adequate explanation of the nature of payments. As a result, such payments are deemed as "suspect" by the tax auditor and counted toward the employee's assessable income, which is subject to the PIT withholding rate of 10 percent.

- **Example 3**: During a visit of the parent company's staff, the RO decides to throw a party at a luxury lounge for all employees. The party's bill is paid by the CRO's credit card and reimbursed later through the RO's bank account. Upon auditing the RO's bank statements and learning the nature of such reimbursement, the tax auditor imposes an additional tax amount of 20 percent for non-resident as well as an interest penalty at 0.03 percent per day.

Expenses paid to foreign suppliers or services providers

These expenses are commonly disregarded by ROs assuming that such expenses are reasonable for daily operations and where there should be no tax implications involved. Many ROs and tax professionals assume that tax audits of ROs are carried out by tax officers from the PIT division of local tax departments who lack experience in auditing business taxes.

This is a serious misconception, which often costs the RO a substantial amount of additional tax payable and the imposition of penalties upon final tax audit for dissolution.

It is recommended that the RO assess tax implications on their expenses paid to foreign companies or individuals since most of such payments are subject to foreign contractor tax (FCT), also known as 'withholding tax'. FCT is not a separate type of tax but rather comprises of VAT and income tax (either CIT or PIT) imposed on payments from local organizations to foreign companies or individuals.

Such payments are considered as income earned in Vietnam in which the Vietnamese parties are liable to declare and make payments on behalf of the foreign organizations.

Examples of common expenses paid to foreign organizations, which are subject to FCT declaration and remittance by the RO include:

- Renovation and installation of the RO office;
- Purchases of specialized office equipment with installation services attached;
- Subscriptions to specialized software (for example Xero, Slack, and Adobe, etc.);
- Employees' enrolments and memberships of foreign associations (for example CPA Australia, CIMA or CFA, etc.); and
- Training of employees (includes online training).

Practically speaking, if the RO's expenses incurred with foreign organizations are settled by its parent company, there will be no FCT liability.

However, there would be cases where the RO itself must enter and settle contracts with foreign organizations.

Such expenses should be assessed for tax implications; if the transactions are subject to FCT, the RO should carry out the proper tax code registration as well as declaration and remittance of FCT to the state budget to mitigate the risk of ending up with a substantial tax payable amount and penalties imposed upon dissolution.

Apart from genuine mistakes in PIT declaration, these are the most common expenses, which are frequently challenged by the tax authorities during tax audits of ROs.

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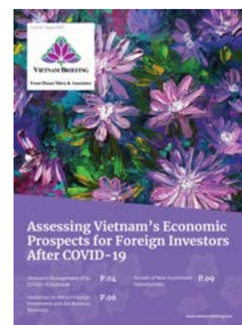

Learn about how Vietnam's contained the pandemic and key incentives from the government to attract and sustain foreign investment and aid business recovery.

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Considering Vietnam's extensive red tape regarding tax, ROs should be aware of the extensive requirements of supporting documents as well as necessary tax procedures and be well-prepared for future potential tax audits.

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Ho Chi Minh City, Vietnam

Hanoi
+84 3942 0443
hanoi@dezshira.com

Room 2708, 27th Floor,
Discovery Complex Office Tower,
302 Cau Giay Street, Cau Giay District,
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Da Nang
+84 28 3930 2828
or +84 903 976 735
danang@dezshira.com

31 Tran Phu Street,
Hai Chau 1 Ward, Hai Chau District,
Da Nang City, Vietnam

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