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KEEPING UP GROWTH: BUILDING A MODERN TAX ADMINISTRATION IN VIETNAM, 2004–2015 (SHORT VERSION)

This summary draws on an ISS case study with the same title can be found on the ISS website. Leon Schreiber drafted the full case based on interviews conducted in Hanoi, Vietnam in May 2018. Case published August 2018. Summary published in May 2019.

BACKGROUND

As Vietnam gradually became a middle-income country during the early 2000s, its tax agency struggled to keep up. During the decade and a half following the Communist Party–led government's 1986 decision to establish a market-based economy, local entrepreneurs launched businesses, foreign investors poured into the country, and the average annual rate of economic growth soared to 7.5%. But tax revenues declined as the General Department of Taxation (GDT), which had previously collected almost all of the country's taxes from a small group of state-owned enterprises, strove to keep pace.

By the early 2000s, the government was deeply worried about the GDT. Even as the country's economy was growing, the department's revenue collection was shrinking. By 2000, total taxes collected had declined to US$5.8 billion from US$6.3 billion in 1996, lowering the country's tax-to-GDP ratio to 14.8% from 18.5%. Originally designed to collect revenues from a handful of state-owned enterprises in a tightly centralized economy, the GDT was simply not geared to interact with millions of taxpayers operating in a vibrant private economy.

In 2004, the department established an internal reform team and adopted a strategy to make sure those who could pay covered their fair shares of the costs of government services.

KEY ISSUES

- Designed to collect revenue from state-owned enterprises in a centralized economy, the DGT was unable to keep up with the growth of Vietnam's economy after market-based reforms were in place.
- Although the legislature had replaced an ineffective general sales tax with a value-added tax (VAT) and created a corporate income tax in 1999, Vietnam still had a narrow tax base.
- Under existing laws, the GDT had no authority to issue taxpayers a single identification number that they could use for all tax types. Taxpayers had to consult with different officials to register and pay for each type of tax separately.
- The GDT lacked the legal authority to empower individuals and companies to assess their tax bills on their own. As a result, tax officials were required to visit every payer, examine financial records, and calculate taxes due. As the number of enterprises exploded, that system became untenable.
- The GDT's organizational structure was fractured along tax types, with different units responsible for administering different taxes. Businesses each year made an average of 32 payments and spent 1,050 hours complying with tax requirements.
- The GDT's lack of a central information database and its staff's inadequate education and skill levels imposed another constraint on effectiveness. Corruption was also a problem.
- Private citizens in Vietnam were unaccustomed to paying taxes and were slow to sign up. In 2005, there were still only 2 million registered taxpayers out of a total population of more than 80 million.

REFORM STRATEGY

Assigned in 2004 to lead reform, GDT veteran Le Hong Hai recruited a team of experienced and reform-minded officials from the GDT's national headquarters as well as from provincial and district offices to explore ways of modernizing Vietnam's tax system. The team devised a plan with help from the International Monetary Fund (IMF) and then tested it with a pilot project aimed to "develop a modern, fair and transparent tax administration, promote voluntary compliance with a balance between good taxpayer service and effective enforcement, and enhance revenue collection."

Topping the list of problems needing attention was fragmentation of the legal framework as it related to tax administration, which made it nearly impossible for the GDT to track individual taxpayers and build risk assessment profiles. The plan also noted the lack of effective coordination and information sharing between the tax administration and other government agencies. It further emphasized taxpayers' lack of knowledge about tax laws and compliance procedures as well as the public's negative perceptions of the GDT. Other problems included deficient professional skills, inadequate staff training, and the GDT's lack of a computerized system that could meet the requirements of modern tax administration.

In response to those shortcomings, the strategy set forth administrative priorities: to organize the GDT's suboffices by function rather than by tax type, to hire and train more officers to deal with the expected increase in taxpayer numbers, to upgrade the department's IT systems, and to unify the legal framework related to tax administration. The strategy also called for more information sharing between the GDT and other state bodies and more programs to inform taxpayers of their obligations, with the goal of increasing voluntary compliance.

ACTIONS TAKEN

In November 2006, the National Assembly adopted the most fundamental of the GDT's proposed legal reforms when it passed a new tax administration law, which became effective on July 1, 2007. The law created the foundation for radical change by (1) unifying administrative procedures for all tax types, (2) making taxpayer self-assessment compulsory based on the successful pilot project, (3) mandating that the GDT use a single set of identification numbers across all tax types, (4) enabling the office to issue tax clearance certificates that indicated whether a taxpayer's affairs were in order, (5) and requiring other government departments as well as certain private institutions, including commercial banks, to share information with the GDT.

The legal changes did not end there. In 2007, the National Assembly for the first time introduced a universal personal income tax, thereby replacing a wealth tax that had collected revenues from only the country's richest people. The new tax sharply expanded the country's potential tax base.

In 2008, the National Assembly amended the VAT system originally introduced in 1999. The new law reduced the number of VAT rates applicable to different types of products to three from four, which made it easier for the GDT to administer. Even more important, the VAT law exempted microenterprises from paying any VAT or corporate tax if their annual turnovers were less than 100 million dong (about US$5,800 in 2008). Larger so-called household businesses did not have to keep detailed accounting books and were required to pay only a presumptive tax.

To enable the GDT to carry out its ambitious reforms, the government in 2005 approved the tax office's request to hire an additional 3,500 employees and provided the department with an injection of funding. Next, in line with the IMF's earlier recommendation, the GDT upgraded Hai's reform team into a permanent unit with overarching responsibility for rolling out business process reforms at all 758 tax offices across the country.

To transform the offices into one-stop shops, the GDT replaced the individual divisions for various taxes with functionally defined departments and created a new, front-office taxpayer services department. It meant that each taxpayer had to interact with only one front-office customer service representative, who could provide information and guidance on issues related to all tax types. The GDT further eased the burden on taxpayers by creating a systematic risk assessment framework to classify companies according to the likelihood they would fail to pay, would make incorrect payments, or would pay late. By classifying as low risk the companies that always paid what they owed, the GDT aimed to free resources so it could focus on higher-risk payers.

Even with a new legal framework and revamped business processes in place, the lack of a modern, centralized IT system posed an acute risk to the GDT's ability to keep up with the country's steadily expanding tax base. To make full use of the GDT's newly acquired authority to issue a single set of identification numbers for the creation of a nationwide database and to implement its plans for building a data-driven risk assessment framework, Hai, who was promoted to deputy director general in 2006, worked closely with a World Bank senior economist to design a project plan for obtaining a taxation database system. That effort culminated in the World Bank's approval of Vietnam's Tax Administration Modernization Project (TAMP), under which the World Bank committed US$80 million to purchase and install an IT system, provide staff training, and help the GDT simplify and adjust business procedures in order to align them with the new digital system.

When TAMP bogged down in bidding problems, the GDT turned to a domestic IT company that ultimately devised a workable system—though its patchwork of different functions made it difficult for the GDT to use the database for sophisticated analytics and risk management work. Even though the World Bank's project had failed to procure a comprehensive database system, TAMP made a valuable contribution to helping improve anticorruption measures and staff capacity. Some of the money spent on the project went for training, including establishing a tax college, and for developing a more robust performance-monitoring system that emphasized quality of operations, reductions in compliance costs, improvements for good governance, and cost efficiency. Hai's team also focused on introducing new practices that would further limit bribes, including a policy that required 25% of staff to move to new positions every year. The idea behind the rotation policy was to reduce opportunities for officials to transform their offices into their own personal fiefdoms.

To improve its image with the public, the GDT upgraded its small communications unit to become a full department. With the department housed at headquarters providing oversight and supervision, each provincial and district office also created a communications team. A key innovation was the training of private tax advisers. Established under the tax administration law that became effective in mid 2007, the advisers had an incentive to recruit new taxpayers to expand their customer base and, in the process, the country's tax base. Training the advisers so that they would deliver good services aided in that goal and bolstered the tax system's image.

Another core function of the communications team was to translate laws and regulations into plain language to inform the public. Plus, to make sure the country's 4.66 million business households paid their fair shares of the presumptive lump-sum tax, local officials posted in public places lists of the name of all of the people who had to pay. Doing so enlisted the public in identifying possible evaders and boosted compliance.

RESULTS

Vietnam's first-ever tax administration reform plan, which guided the GDT's work from 2005 to 2010, yielded impressive results. According to a 2011 IMF report, the country's tax revenues as a share of GDP increased from an annual average of 19.6% during 2001–04 to an average of 23.7% during 2005–08 before easing to 22.38% in 2010. Thanks in part to the introduction of a presumptive turnover tax that let household businesses pay simple annual lump sums, the number of registered taxpayers in the country grew rapidly from 2 million in 2005 to 15 million by 2014.

The IMF praised the GDT's "tax policy reforms [as] positive steps toward building a tax system conducive to economic development and dealing with increased exposure to the global economy." It similarly pointed out that the reforms in the tax office's operations "have better positioned the GDT to administer an increasingly-market-oriented economy."

However, there were shortcomings. Legislatively approved tax loopholes intended to attract foreign investment were significant drags on revenue, and because domestic businesses preferred to remain under the smaller and simpler presumptive turnover tax system, many failed to graduate into the formal corporate tax system. As a result, the tax-to-GDP ratio reversed after 2010, declining from 22.38% to 18.22% in 2015. That was well short of the target of 23% to 24% that the government had set in its 2011–15 socioeconomic development plan. Nonetheless, overall tax revenues (in constant 2010 US dollars) nearly tripled in a decade, increasing from US$11.7 billion in 2005 to US$26 billion in 2010 and to US$32 billion in 2015.

Another unresolved issue was that despite the GDT's reorganization, compliance with formal corporate tax procedures (excluding the presumptive turnover tax) still required as many payments and nearly as much time from firms in 2015 as in 2006.

LESSONS LEARNED

- Vietnam's highly centralized government, together with the government's ability to muster the political will to carry out ambitious goals, was a distinct advantage in reformation of the tax system and empowered reformers at all levels.

- Conversely, the presumptive turnover tax provided small businesses with an incentive to remain small—or to organize themselves in such as a way as to appear small.
- In the long run, giving generous tax incentives to encourage foreign investment resulted in significant revenue losses and put domestic businesses at an unfair disadvantage. In addition, the policy of generous tax incentives to encourage foreign investment opened the door to corporations that used their international status to avoid paying Vietnamese taxes.