F1 – Project-Stage 8: Filing and Managing Income Taxes

TCHE322

Lawrence et al (2011). Chapter 3
CFA Level 3, Volume 4
CFP Handbook (2015). Chapter 45
Law on personal income tax of Vietnam, 2007 and relevant regulations

Personal finance planning

Personal finance planning process

1. Define financial goals.

2. Develop financial plans and strategies to achieve goals.

3. Implement financial plans and strategies.

4. Periodically develop and implement budgets to monitor and control process toward goals.

5. Use financial statement to evaluate results of plans and budgets, taking corrective action as required.

6. Redefine goals and revise plans and strategies as personal circumstances change.

Essential Information of personal financial plans *

1. A summary of the goals

2. Significant assumptions and justification

3. Estimates

4. Recommendations

Tax

- Asset acquisition
- Liability and insurance
- Savings and investment
- Employee benefit
- Retirement and estate

5. A description of limitations on the work performed

6. The recommendations in the engagement should contain qualifications to the recommendations if the effects of certain planning areas on the client's overall financial picture were not considered.

** Adapted from Paragraph .35, Statement on Standards in Personal Financial Planning Services No. 1*

Schedule of lectures

Project topic covered

- Taxation planning and Income tax
- Tax filing

Groupwork project activities

- Identify your income tax
- Tax calculation
- Expected outcome: Taxation planning

Tax planning

The end goal of tax planning for financial planners is ***maximizing the client's after-tax wealth.***

- Understanding taxation system and our taxes
- Tax avoidance and tax evasion*

General principles of taxation

Taxation of the components of return:

- Income tax.
- Gains tax.
- Wealth or property tax.
- Stamp duties
- Wealth transfer tax

The tax status of the account

- Taxable account
- Tax-deferred account
- Tax-exempt account

Taxation of the components of return:

- *Income Tax.* Income tax is calculated as a percentage of taxable income, often with different rates applied to various levels of income. Wages, rents, dividends, and interest earned are commonly treated as taxable income. Cross-border investments, common in the portfolios of many wealthy families, may also create taxable income in the investor's home country as well as in the country in which the investment is located.
- *Gains Tax.* Capital gains are the profits based on price appreciation that result from the sale of an asset, including financial assets. Gains are often distinguished from income and taxed at different rates.
- *Wealth or Property Tax.* A wealth or property tax most often refers to the taxation of real property (real estate) but may also apply to financial and other assets. Such taxes are generally assessed annually. Comprehensive wealth taxes apply in a limited number of countries but are increasingly being considered by other countries as a mechanism to raise revenue.
- *Stamp Duties.* a tax on the purchase price of shares or real estate. Foreign investors may be subject to higher rates than domestic investors.
- *Wealth Transfer Tax.* A wealth transfer tax is assessed as assets are transferred from one owner to another using some mechanism other than an outright sale/purchase transaction. Examples of wealth transfer taxes include "estate" or "inheritance" taxes paid at the investor's death and "gift" taxes paid on transfers made during the investor's lifetime. In some cases, these taxes are the responsibility of the person transferring the asset; in other cases, these taxes are imposed on the recipient.

The tax status of the account

- In a **taxable account**, the normal tax rules of the jurisdiction apply.
- For a **tax-deferred account**, investment and contributions may be made on a pre-tax basis and investment returns accumulate on a tax-deferred basis until funds are withdrawn, at which time they are taxed at ordinary income tax rates.
- In a **tax-exempt account**, no taxes are assessed during the investment, contribution, or withdrawal phase, nor are they assessed on investment returns.

➢ The tax status of an account is an important factor in understanding the tax implications of investment and wealth management decisions.

Exhibit 2 Tax Status by Type of Investor and Account

Type of Investment Account	Typical Tax Status
Individual Investor	
Individual Brokerage Account	Taxable
Individual Retirement Account	Tax-deferred
Roth IRA (US)	Tax-exempt
Personal Trust	Taxable
Charitable Trust	Tax-exempt
Institutional Investor	
Foundation	Tax-exempt
Corporation	Taxable
Corporation – Nonprofit	Tax-exempt
Insurance Company	Taxable
Pension Fund	Tax-exempt
Superannuation Fund (Australia)	Taxable at a discounted rate
Endowment	Tax-exempt
Sovereign Wealth Fund	Tax-exempt

Income tax

- Understanding our tax bracket
- Being aware of marginal tax rate
- Defining taxable income
- Tax deductions and tax credits
- Understanding Taxes on Your Investments/assets

Income tax in Vietnam

- ✓Law on tax administration 38/2019/QH14
- ✓Law on personal income tax 2007 04/2007/QH12, Law Amending and supplementing a number of articles of the Law on personal income tax 2012, 26/2012/QH13
- ✓Resolution 954/2020/UBTVQH14 - Changes to personal income tax exemptions
- ✓Decree 126/2020/ND-CP - Elaboration of the Law on tax administration
- ✓Circular 92/2015/TT-BTC - guidelines for vat and *personal income tax incurred by residents doing business*, amendments to some articles on personal income tax of the law no. 71/2014/QH13 on the amendments to tax laws and the government's decree no. 12/2015/Nđ-cp dated February 12, 2015 on guidelines for the law on the amendments to tax laws and decrees on taxation
- ✓Circular 111/2013/TT-BTC - The implementation of the Law on personal income tax, Circular 92/2015/TT-BTC
- ✓Official Dispatch No. 636/TCT-DNNCN - *Guidelines for personal income tax finalization*

Income tax bracket in Vietnam – from salaries, wages

The progressive tax table

For residents

Level	Assessable income/year (million VND)	Assessable income/month (million VND)	Tax rate (%)
1	Up to 60	Up to 5	5
2	Over 60 to 120	Over 5 to 10	10
3	Over 120 to 216	Over 10 to 18	15
4	Over 216 to 384	Over 18 to 32	20
5	Over 384 to 624	Over 32 to 52	25
6	Over 624 to 960	Over 52 to 80	30
7	Over 960	Over 80	35

Assessable income = Taxable income - Deductions

Taxable income: incomes from salaries, wages, and those of nature of wages and salaries receive from employers under Articles 2.2 Circular No. 111/2013/TT-BTC

Deductions: including family deductions (including deductions for the taxpayer and for dependents); insurance premiums and voluntary retirement funds; charitable, humanitarian, and academic donations

Tax deductions in Vietnam

✓Circular 111/2013/TT-BTC - **Article 9. Deductions**

✓Circular 92/2015/TT-BTC

E.g. The contributions to the voluntary pension fund and payment for voluntary pension insurance are deducted from the taxable income.

Maximum deduction: VND 01 million/month if the employee participates in voluntary pension plans as instructed by the Ministry of Finance

Marginal tax rate

- The marginal tax rate is the combined income tax rate that applies to an incremental dollar of investment income that the investor earns.

Measuring tax efficiency with after-tax return

- **After-tax holding period return:** Returns are adjusted for the tax liability generated in the period. This measure allows an investor to judge the tax efficiency of an investment strategy, including how returns are affected by taxes on interest, dividends, and realized capital gains. After-tax holding period returns can be geometrically linked and annualized in the normal way.

$$R' = \frac{(\text{value} - \text{value}_0) + \text{income} - \text{tax}}{\text{value}_0}$$

Equivalent to $R' = R - \dfrac{\text{tax}}{\text{value}_0}$

- value-value$_{0:}$: change in value
- R': pre-tax holding period return
- R: pre-tax holding period return

$$R = \frac{(\text{value} - \text{value}_0) + \text{income}}{\text{value}_0}$$

If after-tax returns are calculated monthly, the cumulative after-tax return, R_G' :

$$R_G' = \left[\left(1 + R_1'\right)\left(1 + R_2'\right)\ldots\left(1 + R_n'\right)\right]^{1/n} - 1$$

- **Tax-efficiency ratio (TER)** is simply the after-tax return divided by the pre-tax return:

$$\text{TER} = \frac{R'}{R}$$

Case study

Cary bought 1,000 shares of Microsoft (MSFT) in her brokerage account for $130 per share at the beginning of the month and sold all 1,000 shares at the end of the month for $155 per share. She also received a dividend on MSFT of $0.50 per share during the month. Ignoring any transaction costs

a. Calculate after-tax return and tax efficiency ratio.
b. Discuss the tax efficiency of Cary's MSFT investment. How could the tax efficiency have been improved?
c. Discuss the tax efficiency of this same trade assuming a sale price of $120 per share.
d. How about in Vietnam?

Income Tax Rates by Jurisdiction	
US Federal income tax rate	37.00%
NY State income tax rate	8.82%
NY City income tax rate	3.88%
Federal net investment income (NII) tax rate	3.80%
Total tax rate on ordinary investment income	53.50%

Some asset classes qualify for preferential income tax rates.

Income Tax Rates by Asset	**Tax Rate**	**Requirement**
NY State municipal bond interest income	0.00%	For NY state residents
Out-of-state municipal bond interest income	12.70%	
Capital gains	36.50%	If held longer than 1 year
Qualified dividend income from stocks	36.50%	If held longer than 61 days
US Treasury interest income	40.80%	
Dividend income from REITs	43.50%	
Other fixed-income instruments	53.50%	
Non-qualified dividend income from stocks	53.50%	

Taxable, tax-exempt and tax-deferred accounts: *Capital accumulation*

Value of a tax-exempt account compounds in the usual way with an annual return R

$$\boxed{FV = (1 + R)^n}$$

Value of a taxable account compounds using the after-tax returns

$$\boxed{FV = (1 + R')^n}$$

Value of a tax-deferred account compounds using the pre-tax returns and pays tax only when assets are withdrawn from the account. (Withdrawals are taxed at the applicable income tax rates.)

$$\boxed{FV = (1 + R)^n(1 - t)}$$

Taxable, tax-exempt and tax-deferred accounts: Capital accumulation and asset location

Chen Li lives in a tax jurisdiction with a flat tax rate of 20%, which applies to all types of income and capital gains. Assume that Li has the following account types:

Account 1: ¥1,000,000 invested in a taxable account earning 10%, taxed annually.

Account 2: ¥1,000,000 invested in a tax-deferred account earning 10%.

Account 3: ¥1,000,000 invested in a tax-exempt account earning 10%.

Compute the after-tax wealth for each account at the end of 20 years assuming the accounts are liquidated at the end of the horizon.

Taxable, tax-exempt and tax-deferred accounts: *Asset location*

- **Asset location**—the process for determining whether the assets will be held in a taxable, tax-deferred, or tax-exempt account. Asset allocation must not only consider the appropriate overall asset class mix but must also consider which asset classes are best suited to be held in which accounts.
- A general rule of thumb is to put tax-efficient assets in the taxable account and tax-inefficient assets in the tax-exempt or tax-deferred account. This is only a rule of thumb.

Taxable, tax-exempt and tax-deferred accounts: *Decumulation strategies*

Assume that clients have reached retirement age and will soon be using their retirement assets to support spending needs over their expected remaining lifetime. We examine a **tax-efficient decumulation strategy** for a retirement account.

Retirement accounts are tax-exempt or tax-deferred, they compound at a higher rate than taxable accounts.

A common rule of thumb suggests that it is better to make withdrawals from the taxable account first and allow the retirement account to continue to compound.

A client has 2 accounts, a taxable and a tax-exempt account. Each account has a beginning balance of $1,000,000. We assume a pre-tax rate of return of 10% for both accounts and a 25% effective tax rate on earnings in the taxable account, which equates to an after-tax rate of return of 7.5%. At the end of each year, the investor withdraws $200,000.

Exhibit 8 Withdraw from Taxable Account First (Tax Aware)

Year	Withdrawal from Taxable Account	Withdrawal from Tax-Exempt Account	Year-End Taxable Account Balance	Year-End Tax-Exempt Account Balance
0			$1,000,000	$1,000,000
1	$200,000		875,000	1,100,000
2	200,000		740,625	1,210,000
3	200,000		596,172	1,331,000
4	200,000		440,885	1,464,100
5	200,000		273,951	1,610,510
6	200,000		94,497	1,771,561
7	101,585	$98,415		1,850,302
8		200,000		1,835,332
9		200,000		1,818,866
10		200,000		**$1,800,752**

Exhibit 9 Withdraw from Tax-Exempt Account First (Tax-Indifferent)

Year	Withdrawal from Taxable Account	Withdrawal from Tax-Exempt Account	Year-End Taxable Account Balance	Year-End Tax-Exempt Account Balance
0			$1,000,000	$1,000,000
1		$200,000	1,075,000	900,000
2		200,000	1,155,625	790,000
3		200,000	1,242,297	669,000
4		200,000	1,335,469	535,900
5		200,000	1,435,629	389,490
6		200,000	1,543,302	228,439
7		200,000	1,659,049	51,283
8	$143,589	56,411	1,639,889	
9	200,000		1,562,880	
10	200,000		**$ 1,480,097**	

Tax avoidance vs. tax evasion- Ethical and legal obligations

Tax avoidance—An action taken to lessen tax liability and maximize after-tax income.

- Regulations allow eligible taxpayers to claim certain deductions, credits, and adjustments to income

Tax evasion—The failure to pay or a deliberate underpayment of taxes.

- Tax evasion is illegal. One way that people try to evade paying taxes is by failing to report all or some of their income.

Intentional falsification of tax relevant information

Tax Evasion

- Non-declaration of financial assets in offshore financial accounts
- Trade Mispricing
- VAT fraud
    - Missing trader fraud / carousel fraud
    - Misclassification of goods
    - Smuggling of goods
- Bribing tax officials
- Abuse of tax incentives by falsely claiming eligibility

Exploiting the legal scope for discretion of the tax system running counter to the purpose of the tax law

Tax avoidance

Profit Shifting

- Pricing of intercompany tangible goods transactions/ barter trade
- Increase in intercompany debt
- location of central services and intangible assets

Bargaining for tax incentives

Differentiates between tax avoidance efforts which occur within legal boundaries and tax evasion, that is illegal attempts to evade taxes, one has to bear in mind that this distinction is far less clear in practice.*

Three key tax planning strategies

- Timing (deferring (tax deferred income) or accelerating taxable income and tax deductions)
- Income Shifting (shifting income from high to low tax bracket/rate taxpayers)
- Conversion (converting income from high to low tax rate activities) considering the after-tax return of different investments.

Basic Portfolio Tax Management Strategies

Basic portfolio tax management strategies fall into two categories:

- Structuring a client's investments in a legitimate manner to reduce the amount of tax owed. Examples include:
  - holding assets in a tax-exempt account versus a taxable account;
  - investing in tax-exempt bonds instead of taxable bonds;
  - holding assets long enough to qualify for long-term capital gains treatment; and
  - holding dividend-paying stocks long enough to pay the more favorable tax rate.
- Deferring the recognition of certain taxable income until some future date, allowing investors to benefit from the compounding of pre-tax rather than after-tax portfolio returns. In a progressive tax system, investors may also benefit from deferring taxes to a future date if they anticipate their tax rate will be lower in retirement. Other examples of tax deferral strategies include:
  - limiting portfolio turnover and the consequent realization of capital gains
  - selling securities at a loss to offset a realized capital gain (i.e., **tax loss harvesting**).

Tax filing

In Vietnam: Form 02/QTT-TNCN

Access your tax account here

Groupwork project activities

- Tax calculation - Mini case study
- Identify the tax rate in Vietnam
  - Capital investment
  - Capital transfer
  - Real estate transfer
  - Winning prizes
  - Inheritance and gift
  - Business

Mini case study

- Minh Oanh has a child born on 01/6/2005, a house worth 3 billion VND, earns an income of 20 million VND from wages and remuneration in the month, and pay 7% of wages for social insurance premium, 1.5% of wages for health insurance premium and makes no charitable donations.
- Oanh is a shareholder of joint-stock company Minh Yen (listed at the Stock Exchange) (holding 10,000 shares). She also owns a 4-plex in Phu My Hung area giving her an earning of 80 million VND per month.
- In February 2022, she transferred 2,000 shares of company Minh Yen at a price of 30,000 VND per share. Besides, she bought 5,000 shares of DEF at the price of 50,000 VND per share. In March 2022, company Minh Yen paid dividend in cash at 1,000 VND per share and Hoa also received 500 shares paid as dividend by company DEF.
- In 2023, she sold her house at the price of 4 billion VND. Three companies had the same dividend policy. In August 2023, she transferred 2,000 shares of DEF at a price of 110,000 VND per share. In November 2023, she has exchanged cash for chips 3 times since he gets in and gets out of the game center. The total value of 3 exchanges is 500 USD. Chips are exchanged for cash twice with a total value of 2,500 USD.
- Calculate the income taxes of Minh Oanh in 2022 and 2023, assuming USD/VND=22,500. Give her some recommendations to minimize her taxes.

Taxation and Other Costs in Vietnam

Consideration	Paid by Employee	Paid by Employer
Personal Income Tax	5-35%	-
Social Security - Social Insurance	8%	17.5%
Social Security - Health Insurance	1.5%	3%
Social Security - Unemployment Insurance	1%	1%
Trade Union Fees	-	2%

Please note these rates are amended from time to time.