



LAOS

2004 FOREIGN INVESTMENT LAW IMPLEMENTING DECREE

A new Law on Promotion of Foreign Investment which makes substantial changes to the tax treatment of new foreign investors in the Lao PDR came into force in late 2004, but it was not until 12 October 2005 that an implementing decree was issued for the law. We elaborate below some of its provisions.

Promoted Zones

Under the 2004 law, investors in “promoted activities” are entitled to one of 3 packages of tax incentives, depending on which part of Laos they invest in. The more infrastructures there are in the zone invested in, the less incentives are offered. The 3 different zones are now identified in the Decree. The zones cover the whole country. The incentives offered are considerable:

Zone 1:	<ul style="list-style-type: none"> • 7-year exemption from profit tax (the company income tax) • After that, profit tax rate of 10% (against a standard rate of 35%)
Zone 2:	<ul style="list-style-type: none"> • 5-year profit tax exemption • 3 years at 7.5% profit tax rate • After that, 15% profit tax
Zone 3:	<ul style="list-style-type: none"> • 2-year profit tax exemption • 2 years at 10% profit tax • After that, 20% profit tax rate

The law states that these exemptions start from an enterprise’s “commencement of operation” (other than for tree planting activities, where they start from the date the enterprise “starts making a profit”). No explanation is given in the law or decree as to what constitutes either commencing operations or starting to make a profit and these would appear to be fertile fields for dispute with the Lao tax authorities in future.

Conditions for Promoted Activities

The decree also imposes requirements as to the amount of capital investment required (and in some cases other additional requirements) in order to qualify for the tax incentives set out in the law, depending on which of the “promoted activities the investor will be engaged in. These requirements are not mentioned in the law itself. The requirements are:

Manufacturing for export:	Minimum capital US\$300,000 Export 80% of total production
Agro-forestry, manufacture agro-forestry goods and handicrafts:	Minimum capital US\$300,000
Industrial processing, industry using high technology, environmental protection:	Minimum capital US\$500,000 (for scientific research and analysis the figure is US\$100,000 only) Use 100% new machinery
Investment in public health, education, producing education materials, training:	Minimum capital US\$100,000
Production of raw materials, components and equipment for industrial production:	Minimum capital US\$500,000
Tourism and transit services:	Minimum capital US\$500,000
Production of construction materials:	Minimum capital US\$ 1 million At least 30% Lao ownership

Investors who do not meet the minimum capital levels (or satisfy the other conditions imposed) for their activity, or who are investing in non-promoted activities are subject to the normal 35% profit tax rate imposed under the Lao Tax Law. Previously, all foreign investors were entitled to a 20% profit tax rate, and further incentives could be negotiated on a case by case basis.

Import Duties

Foreign investors who are entitled to any of the tax incentives mentioned above are also exempt from import duties and taxes. Restricting these benefits to only investors in “promoted activities”, who are themselves of at least a minimum size, is another change from the previous position where all foreign investors received concessions on import and export duties and taxes.

The exemption is given on the importation of equipment, spare parts and vehicles directly used in production and on raw materials that are not sufficiently available domestically. It also applies to the import of semi finished products for further processing and re-export.

The only tax concession given under the old Foreign Investment Law which continues to be available to all foreign investors under the new law (regardless of their size or activity) is the 10% flat personal income tax rate applicable to foreign employees of an enterprise.

Capital Contribution

Another significant financial change made by the implementing decree which, while not directly tax-related, bears mentioning is the timing of the capital contribution. Previously investors were required to bring half of their share capital into Laos immediately upon obtaining a foreign investment licence, and the balance within 2 years. Now, 20% of an investor’s share capital must be brought into the country within 60 days from the date of incorporation of its local vehicle, with the remainder within the next 2 years.

2005 NEW TAX LAW

While the new law largely restates the repealed 1995 law, there are various changes to the system that was evolving under the old law:

Business Turnover Tax (BTT)

Under the old law, BTT was imposed on importation, the first sale of goods and provision of services. Under the new law, BTT is still imposed on importation and on the provision of services, and is also imposed on all sales (i.e. not only first sale). Previously there were zero, 3%, 5% and 10% BTT rates – now there are only zero, 5% and 10% rates, meaning that in many cases applicable rates have been increased on the sale of the same item or service.

Excise Tax

Excise tax is imposed on import or manufacture of goods of a luxury nature – alcohol, tobacco, perfumes, vehicles, fuel and so forth. Previously excise tax was levied on some items at flat figures, and on others at ad valorem rates. Now (apart from fuel, where the Lao government will determine flat and/or ad valorem rates from time to time) only ad valorem rates apply. Presumably, investors who have investment agreements imposing fixed excise tax figures on the products manufactured by them will continue to enjoy those privileges.

Withholding Tax on Foreign Payments

The new law introduces a method of imposing profit tax on foreign companies contracting with Lao entities and “carrying out activities ... which generate income” in the Lao PDR by requiring the Lao entity to withhold profit tax from amounts they pay to the foreign entity.

The tax authorities consider that there is no need for any activities of the foreign entity to physically take place in Laos, or for the foreign entity to have any Lao presence, for the withholding to be required – a contract to provide some services to a Lao entity gives enough Lao nexus. This tax will therefore affect all contracts for services between Lao and foreign companies, including management agreements between related entities.

The new law does not set a rate for the withholding tax. Instead, the withholding is calculated by applying a deemed profit percentage to the contract price being paid by the Lao company, and then applying the 35% profit tax to the profit figure calculated in that way.

The deemed profit percentage varies from industry to industry - 10% for transportation and construction, and 20% for other services. Deemed rates of 5% for trading and 8% for manufacturing are also set, but these are not likely to be applicable in this context.

As an example, assuming a foreign company provided software development services to a Lao company for a fee of US\$100,000. The foreign company would be deemed to make a 20% profit on the fees earned – that is, US\$20,000. Applying a 35% profit tax rate to that produces a profit tax figure of US\$7,000, and that is the figure the Lao company would be obliged to withhold and remit to the Lao tax authorities from the fee paid to the foreign company, resulting in payment of a net fee of US\$93,000 (if there is no grossing-up clause in the relevant contract).

The tax authorities also consider that BTT is applicable to such contracts, and look to the Lao entity to pay the BTT. Strictly speaking, this is not by way of withholding from the amount payable to the foreign party – it is over and above that amount.

Minimum Tax

Under the Lao tax system, taxpayers pay the lesser of the profit tax (calculated on their net income after deductions) and a 1% minimum tax, calculated on their gross revenue. Previously, the minimum tax was payable even by an enterprise that genuinely made losses. Under the new law if the entity's accounts are certified by an approved auditor the enterprise will not be subject to the minimum tax.

Personal Income Tax (PIT) of Lao Employees

The PIT rates for Lao employee have been reduced, and the bracket thresholds have been increased. The top marginal tax rate has been reduced from 45% to 25%.

Income Tax on House Rent, Land Lease and Lease of Property

The tax on income from leases of houses, land or other property has been reduced from 20% to 15%, but no deduction is now allowed to the landlord for repair costs.

Interest on Shareholder Loans Deductible for Profit Tax

Previously interest paid by a company in relation to a loan to the company from a shareholder was not deductible in calculating the company's taxable profit. Such interest is now deductible. Note that in Laos a 10% withholding tax has always been applied to payments of loan interest, whether to a domestic or foreign lender, and whether or not the lender is a shareholder of the borrower.

Tax on Share Sales

The new law says that "profit from the sale of shares" is income which is subject to Lao income tax (Laos imposes a profit tax on business profits and an income tax on specified types of income. However, the same income cannot be subject to both taxes).

Entities "generating income in the Lao PDR" must pay income tax on that income. The applicable tax rate is 10%. The tax is to be collected by withholding when payments are made. Presumably this means that the buyer of shares should withhold tax from the purchase price it is paying, and remit that to the tax authorities.

This is considerably clearer than the position under the old law, but it does still beg some questions, including at least the following:

- How to compute the "profit" on a sale of shares? Is it just the sale price minus acquisition price? Or should some or all of the costs of acquisition be considered? Should ownership and sale of the shares, further capital contributions that might have been made to the company, inflation or other items be considered as well?
- Does a sale made overseas between 2 non-Lao entities "generate income in the Lao PDR"? If not, does that mean the income tax does not apply?
- What amount is a buyer supposed to withhold? It is not just 10% of the sale price but of the "profit".
- Does the buyer have to calculate the profit from sale itself, or can it rely on what is determined and informed by the seller?
- What is the mechanism for a foreign entity with no presence in Laos to withhold and remit this tax?