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The New Income Tax Regime in Lao PDR under the Law on Income Tax

Introduction

In June 2019, National Assembly ("NA"), the legislative branch of the State, passed a motion approving the adoption of the Law on Income Tax No. 67/NA dated 18 June 2019 ("Law on Income Tax"). This enactment of a separate instrument applicable specifically to income tax notably deviates from the previous approach of tax legislation in Lao PDR. Previously, income taxes, both personal and corporate, are subjected to general taxation law. More importantly, in fact, the Law on Income Tax demonstrates laudable attempts by the regulators to introduce a more progressive and investor-friendly income tax system in Lao PDR. This article will explore and discuss details of the important changes to income tax system under the new law and their potential impacts.

General Information

It is important to note that despite the draft having been approved by the NA in June 2019, in July 2019, the Ministry of Finance ("MOF") had organised an official consultation session with representatives from the NA, MOF, Ministry of Public Works and Transport, governmental departments and other relevant sectors. The meeting considered proposed revisions submitted by the members of NA in relation to new tax legislations, including the Law on Income Tax, and revised draft laws as necessary to be reported to the meeting of the National Assembly Standing Committee for final approval before proceeding with promulgation process. Following the conclusion of the aforementioned finalisation process, on 3 February 2020, the Law on Income Tax was formally published in the Lao Official Gazette. On 11 February 2020, the MOF issued a notification for all new tax laws approved in 2019, including the Law on Income Tax, to be effective from 1 January 2020. It also permits any taxpayers who made their regulatory filing for January 2020 according to the previous law to recompile and revise their tax liabilities.

Corporate Income Tax: Profit Tax

By adopting the Law on Income Tax, general profit tax rate for commercial enterprises in Lao PDR will be reduced from the currently applicable rate at 24% to 20%. As enterprises operating in tobacco manufacturing, distribution and importation are to be levied with an additional profit tax rate of 2% from the general rate to be forwarded as contribution to the Tobacco Control Fund since the adoption of the Law on Tobacco Control No. 07/NA dated 26 November 2009, this reduction of general profit tax rate will also result in the tobacco industry being subjected to less tax liability at the rate of 22% instead of 26% under the previous law. The more remarkable changes to the profit tax system however is rather the introduction of increased and decreased profit tax rate for some particular sectors as below:

No.	Industries	Previous Profit Tax Liability	Profit Tax Liability under the Law on Income Tax
1	Businesses related to mineral excavation concession	24%	35%

2	Businesses related to capacity building activities, such as school, training institute, and other educational facilities	24%	5% after the expiry of tax exemption period under relevant investment promotion laws
3	Businesses related to the establishment of advance medical hospital, medicine and medical equipment manufacturing factory, and treatment by, and manufacturing of, traditional medicine	24%	5% after the expiry of tax exemption period under relevant investment promotion laws
4	Businesses related to new innovative and eco-friendly technology application, efficient use of natural resource and clean energy in production activities	24%	7% after the expiry of tax exemption period under relevant investment promotion laws
5	Businesses of listed company in security markets	5% deduction from general rate (24%) for a period of four years after the registration date and general rate then applies	13% for four years after the registration date and general rate then applies

No.	Industries	Previous Compulsory Profit Tax Liability	Compulsory Profit Tax Liability under the Law on Income Tax
1	Agricultural and handicraft manufacturing business	3%	7%
2	Industrial manufacturing and processing activities	3%	10%
3	Trading activities	5%	15%
4	Services activities	5% to 25% depending on activities	15%

The rates of compulsory profit tax, also sometimes referred to as deemed profit tax, to be levied on annual gross income of businesses operating without proper account book and non-residential entities that accrue income in Lao PDR are also drastically increased in several sectors as below:

Although there are some activities that benefit from the imposition of a flat compulsory profit rate in service sector, such as entertainment, land development and brokerage services, in general, the compulsory profit rates under the Law on Income Tax negatively impact business units.

It does not take into account foreign entities generating income in Lao PDR, particularly in trading, manufacturing, logistics and plantation industries, which will be subjected to a significantly higher compulsory tax rate in comparison to the rate under the previous law if compulsory profit tax rate is to be applied. There is also no fixed compulsory profit tax rate specifically applicable to foreign importers, which were subject to the flat compulsory profit tax of 10% under the Tax Law. As importation may be considered trading businesses, it is likely that a flat rate of 15% of annual profit which applies to all trading and service activities will also be applicable to foreign importers. This more aggressive use of compulsory profit tax rate may be interpreted as an attempt of the regulators to encourage proper bookkeeping by local businesses and promote direct investment of foreign traders to further transparency in the tax administration.

Instead of requiring business units to file profit tax declaration on a quarterly basis, the Law on Income Tax merely requires that profit tax be filed twice a year on or before 20 July of the fiscal year and 20 January of the year following the end of the fiscal year. One may thus expect that business units will incur less expenses in managing their profit tax liabilities.

Overall, the changes to the profit tax systems demonstrates a more proactive approach by regulators in the utilisation of profit tax system as an administrative tool for controlling and encouraging behaviours of business units. The system aims to create a more simplistic approach to profit tax administration.

Personal Income Tax: Income Tax

The Law on Income Tax also introduces several alterations to the income tax system. In the salary tax system, the range of tax rate in the progressive income tax rate is amended from 0%-24% to 0%-25%. However, the more important change to salary tax calculation is the new allocation of tax base. The amount of taxable income exempted from taxation in salary tax system is increased from LAK1,000,000 to LAK1,300,000. The gap for each tax base level is also widened greatly under the new Law on Income Tax in comparison to the calculation basis previously adopted under the Tax Law (Amend) No. 70/NA , dated 15 December 2015 ("Tax Law"). Ultimately, although the maximum tax rate is increased, the actual tax obligations of individuals with taxable income under salary tax, especially low to middle income earners, will be notably lower in comparison to their current salary tax liability, thereby rendering salary tax a more advance tax system for wealth distribution in Lao PDR.

Taxation on other types of income is also simplified by the imposition of flat rate ranging from 1%-10% depending on source of the taxable transactional income. This means that the Law on Income Tax indirectly abandons the previous approach under the Tax Law which affords preferential taxation to some transaction, such as land-related or share transfer transaction, by levying tax on the difference between original acquisition price and sale price rather than total income from transaction, if relevant parties can provide proof of original acquisition price. In this respect, although flat rate on total transactional amount would support the creation of a more simplistic and transparent tax administration, the risk of imposition of excess taxation on a single transactional amount may potentially be escalated resulting in greater reluctance of tax payer to duly observe their income tax liabilities. Trade-off between simplicity and risk of double taxation may need to further be considered.

Another interesting and rather novel reform to income tax in Lao PDR is the attempt to introduce tax return filing to the system. In principal, the Law on Income Tax maintains that salary tax and transactional income tax are to be withheld, declared and paid monthly by employer or payer of taxable amount similar to the procedure under the Tax Law. Nevertheless, Law on Income Tax requires individuals in Lao PDR who earn income and unregistered business earning in Lao PDR to file annual tax return with information on all earnings and amount of tax paid to the tax authority at the place where he/she has registered with or the place of his/her domicile within 31 March of the next year following the end of fiscal year. It also allows individual tax payers to deduct expenses paid in support of tax payer's family members up to three people at the rate not exceeding five million per person per annum. The adoption of annual tax return filing and deductible expenses regime demonstrates the movement of Lao PDR towards a more self-managed tax assessment and administration, which has been successful both in reducing administration costs and creating mindfulness of tax liabilities amongst tax payers in most developed jurisdictions.

Lastly, the deadline for employer to file salary tax is also extended under the Law on Income Tax from the 15th of following month after the payment of salary to the 20th of the month after the payment of salary is made. This would allow additional time for employers to prepare relevant documentation for salary tax filing, which may encourage further compliance from private sectors as the potential imposition of fine for late tax filing would be minimised.

Conclusion

The Law on Income Tax reflects careful consideration of regulators on the current state of affairs of Lao PDR in relation to the establishment and administration of an investment friendly, simplistic, and approachable income tax system with more emphasis on the function of the system as tax for the distribution of wealth. Albeit, taxation on transactional income may raise concern from tax payer on the risk of double taxation, one would expect that the prospective benefits of the adoption of the Law on Income Tax will outweigh its potential drawbacks.

If you have any questions or require any additional information, please contact **Tuchakorn Kitcharoen**, or the ZICO Law Laos Partner you usually deal with.
