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PERSONAL INCOME TAX POLICY TOWARD SUSTAINABILITY AND FAIRNESS

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ABSTRACT

Tax-benefit microsimulation models can be utilized to address a range of policy questions. In Vietnam, the personal income tax system has seven tax brackets, but its current progressive taxation has been deemed unreasonable due to its numerous steps with narrow intervals, resulting in abrupt tax step jumps. To improve the competitiveness of the economy in attracting foreign experts and skilled workers and incentivize labor efforts, we have proposed three scenarios for personal income tax brackets in Vietnam. The results indicate that a change in tax brackets, which involves increasing tax revenue and reducing inequality, is the more favorable option. However, changing the base tax deduction and additional tax deduction per dependent did not lead to desirable outcomes. These findings emphasize the importance of designing tax policies that achieve multiple objectives and are tailored to the specific circumstances of the situation.

Keywords: personal income tax, tax revenue, inequality, tax brackets, base tax deduction.

1. Introduction

Personal income tax is a crucial revenue source for the State budget and has been utilized in developed countries for a significant period. It is applicable to all taxpayers, regardless of their occupation or social status. This direct tax is calculated based on an individual's income after tax-free income and family deductions have been deducted. Contributing to the development of the country is every citizen's duty and right. The personal income tax system is based on the principle of fairness and ability to pay, ensuring that individuals with lower incomes have the means to support themselves and their families. As trade liberalization has gradually led to reduced import and export taxes, personal income tax has become increasingly vital in reforming State budget revenue and serves as an indicator of economic development. With the emergence of new business forms and diversification of individual income sources, it is necessary to update and supplement the regulations in accordance with fairness and expand the taxable income base

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to meet objectives and requirements.

The proposal for personal income tax reform in Vietnam is motivated by two factors, including tax bracket and tax base deduction.

Firstly, to improve income tax management and compliance, we suggest reducing the number of tax brackets and expanding the income range in each tax band. This proposal aligns with global trends and takes into account Vietnam's economic and social context, living standards, and international practices. The adjustment aims to encourage labor efforts, enhance economic competitiveness, and simplify tax administration and collection.

Secondly, we recommend adjusting the tax base deduction and additional tax deduction per dependent to reflect the current circumstances, as the current policy is more appropriate for the Vietnamese economy than 15 years ago. Adjusting the deduction will stimulate household spending, boost social consumption, and improve living standards, contributing to the interests of both the government and taxpayers.

2. Methodology and data

Tax-benefit microsimulation models for developing countries: Tax-benefit microsimulation models are powerful tools that combine representative household- level data on incomes and expenditures with detailed coding of tax and benefit legislation. These models allow policymakers and researchers to apply user-defined policy rules to microdata and calculate the static effects of these rules on household income, poverty, inequality, and government budgets.

As many developing countries are gradually building up their social protection systems and financing public spending through domestic tax revenues, understanding thesystem-wide impacts of different policy choices is crucial. Tax-benefit microsimulation models are well-suited for this purpose, and the UNU-WIDER and Southern African Social Policy Research Insights (SASPRI) have launched SOUTHMOD, a research project that focuses on developing tax-benefit microsimulation models for selected developing countries in Africa, Latin America, and Southeast Asia.

Each model has been developed in cooperation with local partners, including researchers, tax authorities, and government ministries. The models are based on national household surveys and provide representative results on both national and sub- national levels. These models are useful for policymakers and researchers who want to evaluate and compare different policy scenarios or reforms.

SOUTHMOD models: The SOUTHMOD models are a user-friendly and versatile tool for both

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policymakers and researchers. By applying policy rules to household survey data, the models calculate individual entitlements to benefits and liabilities for taxation, providing output at the individual and household levels. This data can be analyzed to gain insights into the impact of social benefits on poverty and inequality and to estimate the number of beneficiaries and taxpayers and their characteristics.

The models also allow for simulating hypothetical changes in social protection benefits and taxes, making it possible to evaluate alternative or planned tax-benefit reforms. However, the models have certain limitations, such as not accounting for corporate firms and certain tax-benefit policies due to limitations in survey data. The models are also static and do not simulate changes in behavior or macroeconomic effects, though advanced users can opt to model such changes. The one exception where macroeconomic effects are considered is the COVID-19 pandemic.

VNMOD model: Since 2016, the Central Institute for Economic Management (CIEM) and the United Nations University - World Institute for Development Economic Research (UNU-WIDER), with support from KU Leuven and Southern African Social Policy Research Insights, have been collaborating to develop VNMOD - a tax-benefit microsimulation model for Vietnam. With additional data waves on household living standards surveys, the VNMOD team has made progress in simulating various types of taxes, social insurance contributions, and benefit policies. In response to the COVID- 19 pandemic, VNMOD has been adapted to analyze the distributional effects of associated policy responses.

3. Proposal scenarios to model

The following policy questions can be addressed through the use of tax-benefit microsimulation models:

Firstly, how can income disparities be reduced? One potential policy option is to raise taxes on the wealthy, which can help to close the income gap between different classes in society and result in a more equal distribution of income.

Secondly, how can low-income individuals be supported? The PIT Framework Adjustment Policy offers one approach by potentially lowering taxes or providing tax exemptions and reductions that can be used for education, business, or savings, thus enhancing the income of those with low earnings.

Thirdly, how can the state budget be increased to fund essential services? One option is to increase PIT, which can contribute to the state budget and support investments in health and education programs. This can, in turn, boost productivity and potentially lower the cost of public

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services.

In Vietnam, Personal Income Tax (PIT) is a direct tax levied on the income of individuals. The tax is collected by the tax authorities on a monthly basis through employers, or by individuals who earn income from other sources such as self-employment or business. Vietnam's PIT has seven tax brackets ranging from 5% to 35% for residents, and a flat rate of 20% for non-residents. The tax brackets for residents are as follows:

Table 1. The tax brackets for residents in Vietnam

Tax brackets	Yearly taxable income (VND million)	Monthly taxable income (VND million)	Tax rate (%)
1	Up to 60	Up to 5	5
2	From 60 to 120	From 5 to 10	10
3	From 120 to 216	From 10 to 18	15
4	From 216 to 384	From 18 to 32	20
5	From 384 to 624	From 32 to 52	25
6	From 624 to 960	From 52 to 80	30
7	Above 960	Above 80	35

(Source: General Department of Taxation)

However, the current progressive taxation is deemed unreasonable due to its numerous steps with narrow intervals, resulting in abrupt tax step jumps when aggregate income increases by the end of the year. This unnecessarily increases the amount of tax payable without significant additional tax. Vietnam can review its tax structure and consider reducing the number of tax steps from 7 to 5 while widening the income gap in the tax bands and implementing stricter regulations for those with higher incomes. This move will simplify tax declaration and payment, and improve the competitiveness of the economy in attracting foreign experts and skilled workers in a highly competitive global market. Additionally, adjusting the gap between tax tiers to match the current changes in living standards can incentivize labor efforts.

We aim to devise effective scenarios for personal income tax brackets in Vietnam. Our proposals will focus on suggesting appropriate tax bands for Vietnamese taxpayers while ensuring minimal impact on budget revenues and decreasing inequality. We have come up with three scenarios for consideration:

In the first scenario, we suggest changing the income tax band from 7 to 5 levels and widening the income gap in each band. In this scenario, we recommend no change in the base tax deduction and additional tax deduction per dependent.

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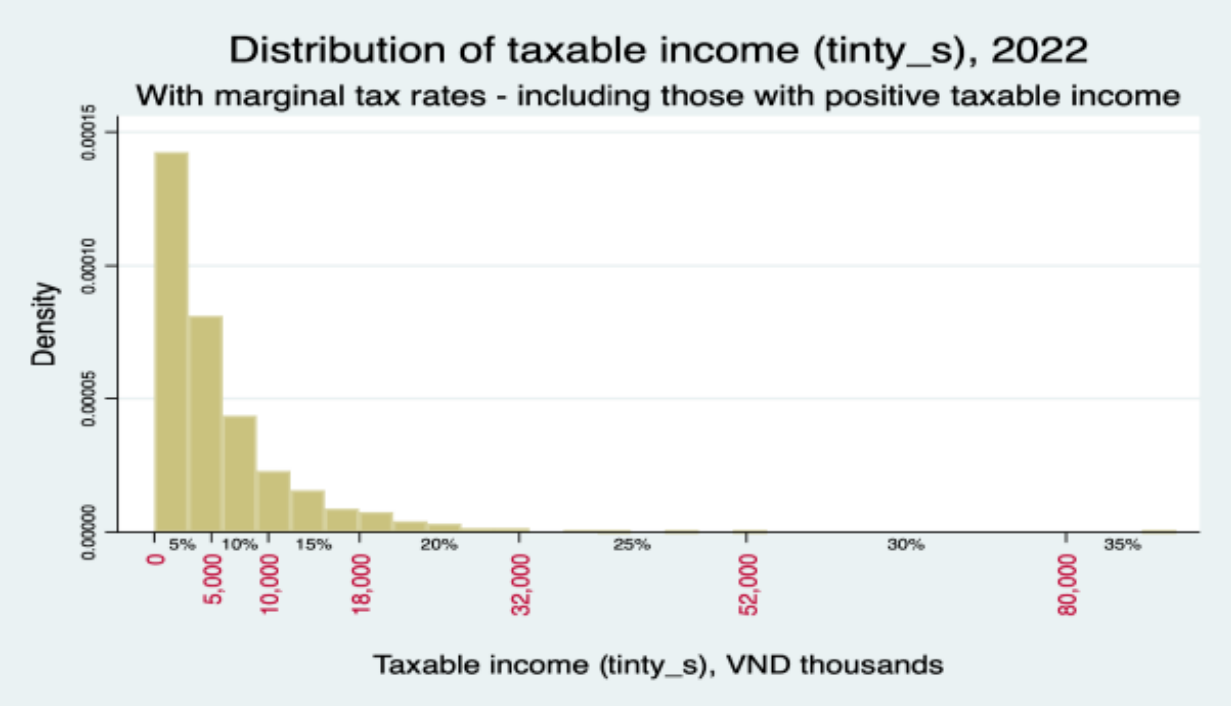
Figure 1. Distribution of taxable income in 2022



(Source: Vietnam living household standard survey (VLHSS))

Based on Figure 1, most taxpayers fall under band 1 and band 2 in the current tax schedule, and the narrow gap between bands causes taxpayers to move easily from lower to higher bands with higher income tax rates. The number of taxpayers with high taxable income (above 50 million) accounts for a small proportion, so we recommend keeping the high tax rate for this group to increase tax revenue without affecting too many people. Specifically, the tax bands are proposed as follows. We propose two situations and choose the optimal situation.

Table 2. Proposed tax brackets for personal income tax

Tax brackets	Situation 1		Situation 2	
	Monthly taxable income (VND million)	Tax rate (%)	Monthly taxable income (VND million)	Tax rate (%)
1	Up to 7	5	Up to 10	5
2	From 7 to 20	15	From 10 to 25	15
3	From 20 to 50	25	From 25 to 60	25
4	From 50 to 80	30	From 60 to 100	30
7	Above 80	35	Above 100	35

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In the second scenario, we suggest no change in the tax schedule but an increase in the base tax deduction and additional tax deduction per dependent. The proposed increase in base tax deduction is based on several reasons. One reason is to adjust for inflation and changes in the cost of living. As the cost of living increases, taxpayers may find it more difficult to meet their basic needs and may have less disposable income available to pay taxes. Increasing the tax base deduction can help offset this effect and reduce the tax burden on lower-income earners. Another reason for increasing the tax base deduction is to promote fairness and reduce income inequality. By increasing the deduction, the government can ensure that taxpayers with lower incomes are not disproportionately burdened with taxes. This can also help to stimulate economic growth, as lower-income earners may have more disposable income available to spend on goods and services. Overall, increasing the tax base deduction can help to create a more equitable and fair tax system, while also supporting economic growth and reducing the tax burden on those who can least afford it. We propose two situations and choose the optimal situation.

Table 3. Proposed deduction for personal income tax

Proposed deduction	Situation 1	Situation 2
Base tax deduction	13 million	15 million
Additional tax deduction per dependent	6 million	8 million

Finally, we suggest combining the changes in tax band and base tax deduction in the optimal cases in scenarios 1 and 2 to achieve a fair and balanced tax system.

4. Results

Scenario 1: Change in tax schedules.

The impact of changing tax schedules on revenue and inequality can vary depending on the situation. In situation 1, increasing the tax rate leads to a notable increase in tax revenue by VND 532.30 billion. Additionally, the Gini coefficient decreases by 0.0001, which suggests a reduction in inequality. On the other hand, in situation 2, a decrease in tax revenue by VND 4,759.06 billion is observed after the tax brackets are changed. Moreover, the Gini coefficient increases by 0.0004, indicating a rise in inequality. These findings highlight the importance of carefully considering the potential outcomes of altering tax brackets in different situations.

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Table 4. Government revenue and expenditure after changing tax brackets

	VN_2022 (base)	VN_2022_ band_1	Difference to base	VN_2022_ band_2	Difference to base
Government revenue through taxes, SSC and indirect taxes	739,933.15	740,465.45	532.30	735,354.08	-4,579.06
... direct taxes	38,801.51	39,333.82	532.30	34,222.45	-4,579.06
... indirect taxes	127,819.37	127,819.37	0.00	127,819.37	0.00
... social security contributions (employer, employee and self-employed)	573,312.27	573,312.27	0.00	573,312.27	0.00
Government expenditure on social transfers	300,365.04	300,365.04	0.00	300,365.04	0.00
... child benefits	7,383.80	7,383.80	0.00	7,383.80	0.00
... social assistance	18,886.63	18,886.63	0.00	18,886.63	0.00
... orphan/widow benefits	0.00	0.00	0.00	0.00	0.00
... disabled benefits	61,976.16	61,976.16	0.00	61,976.16	0.00
... unemployment benefits	1,584.19	1,584.19	0.00	1,584.19	0.00
... pension benefits	210,534.27	210,534.27	0.00	210,534.27	0.00
... agricultural benefits	0.00	0.00	0.00	0.00	0.00

(Source: VNMOD, VHLSS)

After analyzing the data, it can be concluded that situation 1 is the more favorable option. Increasing the tax rate in this situation resulted in an increase in tax revenue, while simultaneously reducing inequality. This indicates that the policy change was effective in achieving both economic and social goals. On the other hand, in situation 2, the tax rate change led to a substantial decrease in tax revenue and a rise in inequality. Therefore, policymakers should consider the potential consequences carefully before implementing tax policy changes. The findings from this analysis demonstrate the importance of ensuring that tax policies are designed to achieve multiple objectives andare tailored to the specific circumstances of the situation.

Table 5. Inequality and the household income distribution after changing tax brackets

	VN_2022 (base)	VN_2022_ band_1	Difference to base	VN_2022_ band_2	Difference to base

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Gini (household income)	0.3584	0.3584	-0.0001	0.3589	0.0004
P80/P20	3.01	3.01	0.00	3.01	0.00
Quantiles of distribution and median					
20th	24,173.26	24,173.26	0.00	24,173.26	0.00
40th	38,574.63	38,574.63	0.00	38,574.63	0.00
50th	44,779.52	44,779.52	0.00	44,779.52	0.00
60th	52,206.03	52,224.87	18.84	52,224.87	18.84
80th	72,803.64	72,836.12	32.48	72,837.43	33.79
Absolute national poverty line, in national currency, yearly	11,226	11,226	0	11,226	0

(Source: VNMOD, VHLSS)

Scenario 2: Change in base tax deduction and additional tax deduction per dependent. The analysis indicates that changing the base tax deduction and additional tax deduction per dependent in either situation led to negative outcomes. Both situations resulted in a decrease in tax revenue and an increase in inequality, indicating that the policy change was not effective in achieving desired economic and social goals. Specifically, in situation 1, tax revenue declined by VND 6,783 billion, and the Gini coefficient increased by 0.0005, indicating a rise in inequality. Similarly, in situation 2, tax revenue decreased by a more significant amount of VND 11,669.23 billion, and the Gini coefficient increased by 0.0009, indicating an even higher increase in inequality. These findings highlight the importance of careful consideration of the potential impacts of policy changes on various economic and social factors.

Table 6. Government revenue and expenditure after changing tax deduction

	VN_2022 (base)	VN_2022_ deduct_1	Difference to base	VN_2022_ deduct_2	Difference to base
Government revenue through taxes, SSC and indirect taxes	739,933.15	733,150.14	-6,783.00	728,263.91	-11,669.23
... direct taxes	38,801.51	32,018.51	-6,783.00	27,132.28	-11,669.23
... indirect taxes	127,819.37	127,819.37	0.00	127,819.37	0.00
... social security contributions (employer, employee and self-employed)	573,312.27	573,312.27	0.00	573,312.27	0.00
Government expenditure on social transfers	300,365.04	300,365.04	0.00	300,365.04	0.00
... child benefits	7,383.80	7,383.80	0.00	7,383.80	0.00
... social assistance	18,886.63	18,886.63	0.00	18,886.63	0.00
... orphan/widow benefits	0.00	0.00	0.00	0.00	0.00
... disabled benefits	61,976.16	61,976.16	0.00	61,976.16	0.00
... unemployment benefits	1,584.19	1,584.19	0.00	1,584.19	0.00

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... pension benefits	210,534.27	210,534.27	0.00	210,534.27	0.00
... agricultural benefits	0.00	0.00	0.00	0.00	0.00

(Source: VNMOD, VHLSS)

Despite the negative outcomes of changing the base tax deduction, situation 1 is comparatively better than situation 2. Although both situations resulted in a decrease in tax revenue and an increase in inequality, the decline in tax revenue was significantly lower in situation 1. Additionally, the increase in the Gini coefficient was relatively lower in situation 1, indicating a more moderate rise in inequality. Policymakers must carefully evaluate the potential effects of policy changes to minimize negative impacts and achieve optimal outcomes. Although neither situation achieved the desired economic and social goals, the findings of the analysis suggest that policymakers should prioritize the development of effective policies that promote equitable economicgrowth.

Table 7. Inequality and the household income distribution after changing tax deduction

	VN_2022 (base)	VN_2022_ deduct_1	Difference to base	VN_2022_ deduct_2	Difference to base
Gini (household income)	0.3584	0.3589	0.0005	0.3594	0.0009
P80/P20	3.01	3.02	0.00	3.02	0.00
Quantiles of distribution and median					
20th	24,173.26	24,173.26	0.00	24,173.26	0.00
40th	38,574.63	38,574.63	0.00	38,574.63	0.00
50th	44,779.52	44,803.08	23.56	44,803.80	24.28
60th	52,206.03	52,251.29	45.26	52,251.29	45.26
80th	72,803.64	72,899.21	95.57	72,920.46	116.82
Absolute national poverty line, in national currency, yearly	11,226	11,226	0	11,226	0

(Source: VNMOD, VHLSS)

Scenario 3: Combine the changes in tax brackets from situation 1 with the changes in base tax deduction and additional tax deduction per dependent from situation 1.

This resulted in a more comprehensive tax policy change aimed at achieving multiple objectives simultaneously. The analysis of scenario 3 indicated that tax revenue decreased by 6,305.67

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billion VND, and the Gini coefficient increased by 0.0005.

Table 8. Government revenue and expenditure after changing tax deduction

	VN_2022 (base)	VN_2022_combine	Difference to base
Government revenue through taxes, SSC and indirect taxes	739,933.15	733,627.47	-6,305.67
... direct taxes	38,801.51	32,495.84	-6,305.67
... indirect taxes	127,819.37	127,819.37	0.00
... social security contributions (employer, employee and self-employed)	573,312.27	573,312.27	0.00
Government expenditure on social transfers	300,365.04	300,365.04	0.00
... child benefits	7,383.80	7,383.80	0.00
... social assistance	18,886.63	18,886.63	0.00
... orphan/widow benefits	0.00	0.00	0.00
... disabled benefits	61,976.16	61,976.16	0.00
... unemployment benefits	1,584.19	1,584.19	0.00
... pension benefits	210,534.27	210,534.27	0.00
... agricultural benefits	0.00	0.00	0.00

(Source: VNMOD, VHLSS)

The findings suggest that changes in base tax deductions have a greater impact on the wealthy, as they receive more benefits from it. On the other hand, taxpayers in the lower tax bracket tend to pay less tax, so the amount they have to pay is not as significant. This implies that increasing or decreasing base tax deductions does not have a substantial impact on individuals with lower incomes. To address the issue of base tax deductions, policymakers could focus on adjusting tax brackets, which could help to achieve greater equity in the tax system. By making changes to the tax brackets, policymakers could ensure that the tax burden is distributed more fairly across different income groups, without relying heavily on deductions that may not have a significant impact on lower-income earners. This approach could also help to simplify the tax system and make it more transparent, which could improve compliance and reduce the administrative costs of tax collection.

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Table 9. Inequality and the household income distribution after changing tax deduction

	VN_2022(base)	VN_2022_combine	Difference to base
Gini (household income)	0.3584	0.3589	0.0005
P80/P20	3.01	3.02	0.00
Quantiles of distribution and median			
20th	24,173.26	24,173.26	0.00
40th	38,574.63	38,574.63	0.00
50th	44,779.52	44,803.08	23.56
60th	52,206.03	52,251.29	45.26
80th	72,803.64	72,899.21	95.57
Absolute national poverty line, in national currency, yearly	11,226	11,226	0

(Source: VNMOD, VHLSS)

5. Conclusion

In conclusion, tax-benefit microsimulation models can be used to address various policy questions related to income disparities, support for low-income individuals, and increasing state budgets. Vietnam can improve its personal income tax structure by reducing the number of tax steps from 7 to 5, widening the income gap in the tax bands, and implementing stricter regulations for those with higher incomes. The proposed scenarios for personal income tax brackets in Vietnam focused on suggesting appropriate tax bands for taxpayers while ensuring minimal impact on budget revenues and decreasing inequality. The analysis of the proposed scenarios shows that change in tax schedules resulted in an increase in tax revenue while reducing inequality, making it a more favorable option. However, changing the base tax deduction and additional tax deduction per dependent led to negative outcomes in both scenarios, highlighting the importance of careful consideration of the potential consequences before implementing tax policy changes. Overall, tax-benefit microsimulation models can help policymakers design tax policies that achieve multiple objectives and are tailored to the specific circumstances of the situation.

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