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Tax update

Legislative developments

- On 22 November 2010, *Tax Laws Amendment (2010 Measures No. 4 Bill) 2010* was passed by the Senate without amendment and now awaits Royal Assent.

As outlined in Issue 37, the Bill proposes to amend the Taxation of Financial Arrangements (TOFA) regime to make minor policy refinements and technical amendments and corrections to the provisions. In particular, the Bill seeks to increase the clarity of the taxation treatment of financial arrangements. The amendments, if enacted, would generally apply for income years commencing on or after 1 July 2010.

The Bill will also amend the Australian foreign currency gains and losses provisions to extend the scope of a number of compliance cost saving measures, and to make technical amendments to ensure that the provisions operate as intended. If enacted, the amendments to the Australian foreign currency gains and losses provisions would apply from 17 December 2003.

- On 25 November 2010, *Tax Laws Amendment (2010 Measures No. 5 Bill) 2010 (TLAB 5)* was introduced into the House of Representatives.

TLAB 5 proposes to amend the "capital protected borrowing" provisions. These provisions seek to ensure that a capital protected borrowing is treated as a loan and put option (ie the capital protected feature) for Australian tax purposes. As a consequence, a portion of the interest expense is effectively attributed to the cost of the put option (based on a "benchmark interest rate") and may be characterised as capital in nature and therefore non-deductible.

TLAB 5 seeks to change the benchmark interest rate which is used to determine the cost of capital protection to the Reserve Bank of Australia's Indicator Lending Rate for Standard Variable Housing Loans plus 100 basis points.

Broadly, the new benchmark interest rate will apply to capital protected borrowings entered into after 13 May 2008 (and certain capital protected borrowings entered into before this date).

Australian case law

- On 30 August 2010, both the Commissioner of Taxation and the taxpayer lodged appeals with the Full Federal Court of Australia against a single judge of the Federal Court of Australia's decision in *Citigroup Pty Limited v Commissioner of Taxation [2010] FCA 826*.

As noted in Issue 37, the case considered whether Australia's anti-avoidance regime applied to entitle the Commissioner of Taxation to cancel foreign tax credits to which the taxpayer is otherwise entitled (for the income years ended 31 December 2003 to 2004) in consequence of its participation in two Hong Kong bond transactions.

Taxation rulings/determinations

- On 20 October 2010, the Australian Taxation Office (ATO) released its first TOFA Taxation Determination (in draft), TD 2010/D3.

TD 2010/D3 expresses the Commissioner of Taxation's view that where an equity interest is a financial arrangement under both the "general financial arrangements" definition and the specific "equity interest financial arrangements", the specific rules will override the general rules.

- On 27 October 2010, the ATO issued Taxation Ruling TR 2010/7 regarding how Australia's thin capitalisation rules interact with Australia's transfer pricing rules.

By way of background, in accordance with Australia's thin capitalisation rules, debt deductions incurred by a taxpayer in relation to its debt capital may be denied tax deductibility where the level of debt capital exceeds the safe harbour debt limits in the thin capitalisation rules.

The Commissioner of Taxation expressed the following principles in TR 2010/7 regarding the interaction of Australia's thin capitalisation rules and Australia's transfer pricing rules:

- The transfer pricing provisions are applied before the thin capitalisation provisions in determining the deduction allowable for the pricing of debt. In this regard, the transfer pricing provisions require an arm's length consideration to be used for the pricing of debt (ie where the transaction is not at arm's length).
- The thin capitalisation provisions then operate to adjust the amount of debt deductions determined based on that arm's length consideration.

In terms of determining the arm's length interest rate (being the arm's length consideration in certain related party transactions), TR 2010/7 indicates that this should be determined using the method which provides the most reliable indication of the interest rate that would have been used in a similar transaction between independent parties dealing at arm's length. Where direct comparable data is present, the "comparable uncontrolled price" method is likely to be the most appropriate method.

The retrospective application of the ruling has potentially significant implications for taxpayers who have complied with the thin capitalisation safe harbour rules and priced their international related party loans consistently with established practice relating to a 1992 taxation ruling issued by the ATO. These companies could potentially face future ATO challenge in some circumstances.

For completeness, it is noted that the ATO has launched a new transfer pricing project, the Strategic Compliance Initiative. There are five focus areas for this initiative which includes business restructures, related party loans and guarantee arrangements, foreign banks and the impact of the global financial crisis.

- On 2 December 2010, the ATO issued Taxation Determination TD 2010/20 stating that the general anti-avoidance rules in Part IVA of the ITAA 1936 will apply to inward investing permanent establishment structures that have a dominant purpose of obtaining double tax relief (also known as treaty shopping).

However, TD 2010/20 appears to indicate that, if the inward investment structure has no commercial substance, the ATO is willing to look through the investment structure to the investor level.

TD 2010/20 has prospective and retrospective application.

- On 2 December 2010, the ATO issued Taxation Determination TD 2010/21 regarding whether a permanent establishment entity can make an income gain from the disposal of an investment in shares.

TD 2010/21 states that the profit on the sale of shares in a company acquired in a leveraged buyout is likely to be treated as being on revenue account unless the specific facts and circumstances indicate otherwise.

TD 2010/21 has prospective and retrospective application.

Other developments

- On 18 October 2010, the Assistant Treasurer and Minister for Financial Services and Superannuation released a discussion paper on the design and implementation of the Government's proposed new income tax system for a managed investment trust (MIT).

The discussion paper outlines the “implementation and design details” of the new tax system for MITs and identifies aspects of the new tax system for which industry input is desirable.

Ultimately, the Federal Government is proposing a new tax system for MITs with certain key features, including:

- An elective “attribution” system of taxation under which investors will be taxed only on the income that the trustee allocates to them on a fair and reasonable basis, consistent with their entitlements under the trust deed or the trust’s constituent documents;
- Establishing the ability to deal with “under” or “over” distributions within a five per cent cap so that trusts are not required to reissue distribution statements and investors are not required to revisit tax returns; and
- The removal of double taxation that can arise in certain circumstances.

We note that certain key features of the new tax system for MITs have already been implemented. This includes the ability for a trustee of a MIT to choose to apply the capital gains tax regime to the disposal of eligible assets and the application of a reduced rate of final withholding tax (being 7.5 percent) to certain fund payments made from a MIT to a foreign investor.

- The ATO has published a revised draft International Dealings Schedule –financial services 2011 (IDS-FS 2011) which will need to be prepared and lodged with the 2011 income tax return of the following entities:
 - A financial services entity (excluding super funds) with a gross turnover of at least \$250 million;
 - General or life insurance entity; or
 - Foreign bank.
- The International Dealings Schedule will replace the need to complete the Schedule 25A and thin capitalisation schedule for the 2010-11 income year.

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Tax update

Unilateral interpretation and practice guidelines for the implementation of the PRC / Singapore tax treaty

On 26 July 2010, the State Administration of Taxation (SAT) issued a tax notice, *Guoshuifa [2010] No. 75* (Circular 75), setting out its interpretation of the provisions and protocols of the double tax agreement between the PRC and Singapore (PRC-Singapore DTA), which was signed on 11 July 2007, as amended by two protocols.

Circular 75 is a unilateral interpretation and practice guideline issued by the SAT for the implementation of the PRC–Singapore DTA. The interpretation of the PRC-Singapore DTA as stated in Circular 75 is also applicable to other DTAs which the PRC has entered into with other countries, where the relevant provisions are identical or similar to the PRC – Singapore DTA and Circular 75 will prevail over any previous inconsistent interpretations. Hence, Circular 75 will have an impact on Singapore tax residents as well as other treaty residents from jurisdictions with comparable DTAs with the PRC.

Overseas financial institutions which have invested into China through non-resident holding companies should be aware of the tax impact of Circular 75 on their PRC-sourced passive income (such as dividends, interest, royalties and capital gains). In this respect, it is important to note that Circular 75 emphasises the importance of the beneficial ownership requirement for the claiming of tax treaty benefits by non-residents in relation to the receipt of dividends, interest and royalties. The requirements in Circular 75 are similar to those outlined in another tax notice, *Guoshuifan [2009] No. 601* (Circular 601). For detailed discussions on Circular 601, please refer to Issue 1 of the Non-PRC Tax Resident Enterprise Tax Series: Beneficial Owner & Indirect Disposal. A link to this publication is provided below:

<http://kpmg.com/CN/en/IssuesAndInsights/ArticlesPublications/Documents/Beneficial-ownership-indirect-disposals-201003.pdf>

Under the PRC-Singapore DTA, the 10 percent PRC withholding tax on dividends, interest and royalties is reduced to the respective rates below under the following circumstances:

Dividends: 5 percent if the Singapore resident holds directly at least 25 percent of the shares in the PRC dividend-paying company at any time during the 12 month period preceding receiving the dividends

Interest: 7 percent if the Singapore resident is a bank or financial institution

Royalties: 6 percent if the Singapore resident derives lease rentals on industrial, commercial or scientific equipment; otherwise no reduction on withholding tax rates on royalties.

Given this, it is important for non-resident holding companies to establish “commercial substance” in the chosen tax treaty jurisdiction and to demonstrate “reasonable business purposes” for the chosen structure, in order to enjoy the tax treaty benefits.

The issuance of Circular 75 reflects the PRC tax authority’s commitment to strengthening the administration of access to treaty benefits. It also shows the SAT’s effort in improving the technical knowledge of the PRC local tax authorities to avoid inconsistencies in local interpretations and practices concerning the implementation of DTAs across the country.

Unification of the Urban Maintenance and Construction Tax and Education Levy for domestic enterprises and foreign investment enterprises

The PRC State Council issued a notice, *Guofa [2010] No. 35* (Circular 35), on 18 October 2010 which removed the exemption for Urban Maintenance and Construction Tax (UMCT) and Education Levy previously granted to foreign investment enterprises (FIEs) and foreign enterprises. As such, the levies will apply uniformly to all domestic enterprises, FIEs and foreign enterprises effective from 1 December 2010 (i.e. the tax filing of December 2010 which will be reported in January 2011).

UMCT and Education Levy are calculated based on the total amount of turnover taxes (which includes business tax (BT), value added tax, and consumption tax) payable. UMCT is levied from 1 percent to 7 percent depending on the location of the PRC company and the Education Levy rate is levied at a rate of 3 percent on the turnover taxes payable. As a result, overseas financial institutions which have provided services to PRC companies / individuals or financial institutions which have established FIEs to provide services (whether onshore or offshore) will be subject to additional BT at a rate of up to 0.5 percent. This is made up of UMCT of up to 7 percent and Education Levy of 3 percent multiplied by the BT rate of 5 percent, i.e. 5 percent BT x (7 percent UMCT + 3 percent Education Levy).

For further information on Circular 35, please refer to Issue 15 of China Alert. A link to this publication is provided below:

<http://kpmg.com/cn/en/IssuesAndInsights/ArticlesPublications/Newsletters/ChinaAlerts/Documents/china-alert-1011-15.pdf>

Relaxed recognition criteria for service outsourcing enterprises

On 5 November 2010, the Ministry of Finance, State Development and Reform Commission, SAT, Ministry of Science and Technology and Ministry of Commerce jointly issued a circular, *Caishui [2010] No.65* (Circular 65), to abolish *Caishui [2009] No. 63* (Circular 63), which was issued in April 2009. Circular 65 introduces, for the first time, certain tax incentives and financial subsidies for qualified Advanced Technical Service Enterprises (ATSE) as part of their policy to align with the State Council's support of the service outsourcing industry with effect from 1 July 2010 and relax some of the recognition criteria for an ATSE.

Circular 65 sets out the 21 pilot cities which are under the ATSE regime, the tax incentives (summarised below) and financial subsidies granted to companies which are qualified and approved as ATSEs, the qualifying criteria, the qualifying advanced technological offshore outsourcing services, and the application procedures and documents.

Pursuant to Circular 65, a qualified ATSE can enjoy the following tax incentives from 1 January 2009 to 31 December 2013:

- Preferential CIT rate of 15 percent;
- BT exemption for "offshore outsourcing service income"; and
- Pre-CIT deduction of actually-incurred staff education charges, up to a limit of 8 percent of the total payroll (standard deduction rate is 2.5 percent).

Offshore outsourcing service income refers to outsourcing service income received from overseas parties for Information Technology Outsourcing (ITO), Business Process Outsourcing (BPO) or Knowledge Process Outsourcing (KPO) services rendered by the ATSE or its subcontracting companies.

Hence, overseas financial institutions which have established FIEs to provide offshore outsourcing services should consider whether the services provided fall within the scope of qualifying ITO, BPO or KPO services and whether the FIEs satisfy the qualifying criteria to enjoy the above tax incentives.

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New Double Taxation Agreements (DTAs) with France, Japan, New Zealand and Switzerland

Hong Kong has signed new DTAs with France, Japan, New Zealand and Switzerland on 21 October, 9 November, 1 December and 6 December 2010, respectively.

The new DTAs provide the following maximum rates of withholding taxes:

	Dividend (note 3)	Interest (note 3)	Royalty (note 3)
France	10 percent	10 percent or nil (note 2)	10 percent
Japan	10 or 5 percent (note 1)	10 percent or nil (note 2)	5 percent
New Zealand	15 percent, 5 percent or nil (note 1)	10 percent or nil (note 2)	5 percent
Switzerland	10 percent or nil (note 1)	Nil	3 percent

Notes:

- 1 The lower rates apply if the beneficial owner of a company is greater than a specific percentage.
- 2 The lower rate applies to interest payments to certain financial institutions or the Government of the other contracting state.
- 3 The entitlement to the treaty benefits under the above DTAs are subject to meeting specific requirements, e.g., beneficial owner requirements, substance requirements and/or limitation of benefits clause, depending on the specific requirements of the DTA.

The DTAs will be effective once ratification procedures have been completed by both sides.

Treaties coming into effect

The following DTA have completed their formal ratification procedures:

- The DTA between Hong Kong and the United Kingdom of Great Britain and Northern Ireland, signed on 21 June 2010.
- The DTA between Hong Kong and Brunei, signed on 20 March 2010.
- The DTA between Hong Kong and Austria, signed on 25 May 2010.

According to the relevant Articles of the DTAs, the DTAs will have effect for any year of assessment beginning on or after 1 April 2011 (1 April 2012 for the Austrian DTA) in Hong Kong.

Special stamp duty on transfer of residential property

On 19 November 2010, the Financial Secretary, Mr John Tsang, announced a new Special Stamp Duty (SSD) on transactions in residential property in a bid to address perceived concerns over increases in property prices. The SSD is subject to the enactment of the requisite legislative amendments.

The SSD is to be imposed at penal rates, ranging from 5 percent to 15 percent depending on when the property is brought and sold. The SSD will be effective for residential properties acquired on or after 20 November 2010 and resold within 24 months or less and will be in addition to the ad valorem rates of stamp duty already imposed (up to 4.25 percent).

For further details, please refer to Issue 28 of the Tax Alert. A link to this publication can be accessed below.

<http://www.kpmg.com/cn/en/IssuesAndInsights/ArticlesPublications/Newsletters/Tax-alert/Documents/tax-alert-1011-28.pdf>

India

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Tax update

Under the non-discrimination clause in the India-USA tax treaty, a non-resident should be given the same treatment as resident taxpayers. Accordingly, payments made to USA entities cannot be disallowed on account of non deduction of tax at source.

Recently, the Mumbai bench of the income-tax Appellate Tribunal (the Tribunal) in the case of *Central Bank of India*¹ (the taxpayer) held that the taxpayer was not liable to withhold taxes while making payments to USA based credit card agencies in view of the non-discrimination clause under Article 26(3) of the India-USA tax treaty (the tax treaty). Accordingly, such payments should not be disallowed as a deduction under the Income-tax Act, 1961 (the Act) on the basis that tax was not deducted at source while making payments to non-residents.

The taxpayer issued credit cards to its customers which were affiliated with two USA based international agencies i.e. MasterCard and VISA. The international agencies facilitate credit card transactions for a number of issuing banks.

These agencies also provided customised software and hardware to the member banks to facilitate the transactions made through credit cards. The agencies charged the member banks for various services provided. The amount charged depended upon the volume of transactions. The taxpayer made payments to these agencies on which tax was not deducted. The Assessing Officer (AO) disallowed the taxpayer's claim of deduction of payments made to the non-resident agencies under the provisions of the Act.

On appeal, the Commissioner of Income-tax (Appeals) [CIT(A)] argued that the US companies have permanent establishments in India through their networking computers and leased telephone lines. Therefore, the income received by non-residents was taxable in India and the CIT(A) confirmed the order of the AO.

On second appeal, the Tribunal held that Article 26 of the tax treaty protects the interest of the non-residents vis-à-vis residents. Article 26 of the tax treaty provides that payments made to the non-residents are treated similarly, i.e. deductible, under the same conditions as if the payments were made to a resident. Further, the exceptions provided in Article 26(3) were not applicable to the present case since Article 12(8) of the tax treaty does not apply to the taxpayer as there was no relationship between the taxpayer and the non-residents.

Accordingly, the Tribunal held that the deduction for the expenditure should not be disallowed under the Act on the basis that tax was not deducted at source from the payments made to non-residents, regardless of whether the payments were taxable in India.

Provisions of Minimum Alternate Tax do not apply to Banking Companies

In the case of *Krung Thai Bank PCL*², the Mumbai bench of the Income-tax Appellate Tribunal (the Tribunal) held that the Minimum Alternate Tax (MAT) provisions would apply only if the taxpayer is required to prepare its profit and loss account in accordance with the provisions of the Companies Act.

The taxpayer is a foreign bank operating in India through a branch office. As per the profit and loss account, the taxpayer derived profits of INR 7.83 million. However, in its income tax return, the taxpayer declared NIL income after making adjustments under the normal provisions of the Act and the setting off of prior years tax losses. The taxpayer did not

¹ Central Bank of India v. DCIT (ITA No. 4155/M/2003, 4156/M/2003 and 4157/M/2003)

² Krung Thai Bank PCL v. Jt Director of Income-tax – International Taxation (ITA No. 3390/Mum/2009) (Mum)

compute a tax liability under the MAT provisions.

The AO re-opened the taxpayer's assessment for the reason inter-alia that the taxpayer had not computed its tax liability in accordance with the MAT provisions. The Commissioner of Income-tax (Appeals) upheld the assessment made by the AO.

On appeal, the Tribunal held that the MAT provisions of the Act only apply if the taxpayer is required to prepare its profit and loss account in accordance with the provisions of the Companies Act. The starting point of computing the MAT is the profit and loss account. In the case of banking companies, they are exempt from preparing accounts under the Companies Act. The final accounts of the banking companies are prepared in accordance with the provisions of the Banking Regulation Act and the MAT provisions cannot be applied to banking companies.

Supreme Court overrules the decision of the Karnataka High Court in the case of Samsung Electronics Co. Ltd.

In the case of *GE India Technology centre*³ the Supreme Court overruled the decision of the Karnataka High Court (HC) in the case of *Samsung Electronics Co. Ltd.* The Karnataka HC in *Samsung Electronics Co. Ltd* held that the taxpayers were obligated to withhold taxes on payments made to non-residents only if they prima facie bear the character of income.

The Karnataka HC observed the following:

- The requirement of deducting tax at source under Section 195 of the Act has to be strictly followed by the payers.
- It is not for the payer to decide whether the payment made to a non-resident would constitute income chargeable to tax in India. Such a question is determined by the AO.
- The payer can be relieved from the withholding obligation only by obtaining clearance under the provisions of the Act.

On appeal, the Supreme Court (SC) overruled the decision of the Karnataka HC in the case of Samsung Electronics Co. Ltd and held that withholding requirements would be triggered only if payments to non-residents constitute income chargeable to tax in India.

The SC further observed that:

- The words "chargeable under the provisions of the Act" indicate that payments made to non-residents should take the character of income chargeable to tax in order to trigger a withholding tax obligation.
- Payments which do not arise out of any contractual obligation and are made voluntarily cannot be regarded as income under the Act. Payers are obligated to withhold tax on income payments and composite payments i.e. payments which have an element of income embedded therein.
- In the case of composite payments, the obligation to withhold tax under Section 195 of the Act is limited to the proportion of income comprised in the payment based on the "principle of proportionality".
- The fact that the effect of tax treaties can be considered while making payments in the nature of royalties and fees for technical services to non-residents only strengthens the argument that the presence of income chargeable to tax is imperative to trigger the requirement of deducting tax at source.
- Application to the AO under Section 195(2) of the Act is necessary only when the payer is unsure of the portion of the payment which would be subject to withholding tax or the quantum of withholding tax. Section 195(2) of the Act is only a safeguard as observed in the Transmission Corporation case.
- Thus the principle of Section 195 of the Act is that the underlying payment should bear the character of income. If the payment is not in the nature of income, the taxpayer cannot be held as an "assessee in default" for failure to withhold tax.

The Supreme Court, based on the above observations, referred the Case back to the Karnataka HC to consider the issue on

³ GE India Technology Centre Private Limited v. CIT

⁴ Besix Kier Dabhol S.A. v. DDIT (ITA No.4249/ Mum /07)

its merits and to decide whether payments made to the suppliers were royalty payments, which would give rise to income chargeable to tax in India.

Mumbai Tribunal rules that interest paid by a PE to Shareholders for loans taken cannot be disallowed in absence of “thin capitalisation rules” nor can such interest be disallowed by applying the provisions of Article 7(3)(b) of India – Belgium Tax Treaty

In case of *Besix Kier Dabhol S.A*⁴, the Mumbai Tribunal held that interest paid by the Permanent Establishment (PE) to shareholders of a Foreign General Enterprise (GE) should be deductible as India does not currently have any thin capitalisation rules. The taxpayer, a Belgian JV company, (i.e. a GE in the present case) was set up to conduct a project involving the construction of a fuel jetty and breakwater through its PE in India. The taxpayer had issued capital of approximately INR 3.8 million held in the ratio of 60:40 by the two shareholders. The PE of the taxpayer had also borrowed funds of approximately INR 941 million from shareholders of the GE in the same ratio of their equity participation. This capital structure resulted in a debt-to-equity ratio of the taxpayer being 248:1. The interest paid by the PE to the shareholders of the GE on the above debts was claimed as a deduction by the taxpayer.

The Indian tax authorities disallowed this expense on the following grounds:

- Since the debt-to-equity ratio was 248:1 which was unusually high and the taxpayer was so thinly capitalised, its debt capital should be recharacterised as equity capital for the purpose of examining the deduction for interest. Hence, payment of interest was not allowed on the ground of thin capitalisation.
- The payments made by a branch office to its Head Office (HO) will not qualify as a deduction under the Act as these payments were made “from self to self”. Under Article 7(3)(b) of the tax treaty, interest on monies lent by the HO to branches are not considered as interest payments. Reliance was also placed on the OECD Commentary and Commentary of Klaus Vogel on Double Taxation convention to support this position.
- The taxpayer has allegedly violated Reserve Bank of India (RBI) guidelines in respect of approval for setting up a project office. Under the guidelines, a PE is required to meet all its expenses from inward remittances received from its HO and the PE cannot borrow from any person in India without prior permission from RBI and the PE had not obtained such approval in the present case.

On appeal the Tribunal held that India does not have any thin capitalisation rules, although thin capitalisation provisions are proposed to be introduced in the Direct Taxes Code Bill, 2010 (DTC). The thin capitalisation rules therefore cannot be applied in the present case. Furthermore, no limitation of benefits or anti-abuse provisions are set out in the relevant tax treaty, accordingly, it is not open to the revenue to apply such anti-abuse provisions. Thus, the Tribunal held that the interest payment should be deductible.

While thin capitalisation rules exist in Belgium, the Tribunal held that the Indian tax authority cannot apply Belgian rules to the taxpayer when computing its taxable income in Indian PE. Any application of thin capitalisation rules to the PE of the Belgian enterprise would be clearly contrary to the non-discrimination article, i.e. Article 24(5), of the tax treaty.

The Tribunal also observed that only the Indian profits of the taxpayer were taxed in India. Since the only business carried out by the taxpayer was the project in India, its entire profits will be taxable in India and all its expenses incurred to produce income taxable in India are deductible. It was also held that the payment of interest to shareholders could not be considered as “payment to self” as the shareholders were unrelated parties with separate legal personality.

Under the provisions of the tax treaty, in determining the profits of the PE, all expenses incurred for the business of the PE were deductible subject to the limitations under domestic tax laws and specific limitations set out in the Articles of the tax treaty itself. One of the limitations set out under Article 7(3)(b) of the tax treaty is that interest paid for the purpose of the avoidance or erosion of the tax base in the source country is not deductible unless it is towards the reimbursement of actual expenses. However, this limitation should not affect the taxpayer since this was its only business carried on and the interest was paid to third party shareholders. Thus, the borrowing was tax neutral so far as the provisions of the tax treaty were concerned given the fact that the GE had a corresponding liability of the payment of the same to its shareholders.

With respect to the disallowance on the ground of alleged violation of RBI guidelines, it was held the deduction on interest payments was allowable under a specific provision of the Act and that therefore the general provision of the Act was not applicable. Furthermore, the deductibility of the expense should not be impacted by a violation of RBI guidelines.



Tax update

Mutual Agreement Procedure DGT Regulation No. PER-48/PJ/2010

Mutual agreement is an agreement conducted between the Indonesian Tax Authority and the tax authority of a treaty partner country to resolve issues arising from the implementation of a double tax avoidance agreement (DTA).

A Mutual Agreement Procedure (MAP) can be initiated through one of the following:

- Request by an Indonesian domestic taxpayer.
- Request by an Indonesian citizen who has become a taxpayer in a treaty partner country and seeks to apply the non-discrimination provision of the DTA.
- Request by a treaty partner country.
- Other requests to be agreed at the discretion of the Director General of Taxation (DGT).

Request from Indonesian domestic taxpayer

If the request is made by an Indonesian domestic taxpayer on the basis of transfer pricing practice, improper tax imposition by a treaty partner country or taxpayer status determination, the taxpayer making the request must provide the following information to the DGT:

- Its name, tax ID, address, and nature of business of the requestor;
- In the case of transfer pricing issues, the information outlined above must also be provided for any related entity in the treaty partner country;
- Description of the actions taken by a treaty country that is not in alignment with the DTA;
- Confirmation that the requestor is applying for objection, correction or appeal regarding the matters on which the MAP is requested;
- Fiscal year to which the request is addressed;
- Description of the transaction on which the treaty partner country made an adjustment and details of the adjustment;
- The requestor's position on the adjustment made by the treaty partner country;
- The requestor's contact person for the purpose of the MAP;
- Treaty partner country contact information; and

- Description of the relevant tax treaty provision that is not being followed.

The tax office will examine the application and documents upon acceptance and forward the request to the DGT within 30 days of receipt or if rejected, notify the requestor within 15 days of receipt.

The request will be rejected in the event of untimely submission (subject to the timeline set forth in applicable tax treaties), or if the requestor is applying for an objection or appeal proceeding regarding the matter on which the MAP is requested.

Request from an Indonesian citizen with taxpayer status in a treaty partner country

Pertaining to this type of request, the information requested is similar to points 1, 5, 8, and 9 above. In addition a description of the actions taken by the treaty partner country that is perceived to be discriminating by the requestor must also be provided. The request must be addressed directly to the DGT via Director of Taxation Regulations II.

The requestor will be involved in the MAP negotiation. As a part of this involvement, the DGT will request written confirmation of agreement on the draft MAP from the requestor. The DGT will also inform the requestor in the case of cessation of the MAP process due to a specific request, lack of information, incorrect information provision, rejection of MAP draft, objection or appeal proceedings.

Request from treaty partner country

A MAP request may be submitted by a treaty partner country in the case of:

- Improper tax assessment on a permanent establishment in Indonesia;
- Transfer pricing adjustments;
- Corresponding adjustments in relation to a transfer pricing adjustment (the corresponding domestic taxpayer must also submit a separate MAP request);
- Improper tax withholding by an Indonesian entity; and
- Dual residence resolution.

The request from the treaty partner country will be forwarded by the DGT to the tax office in which the domestic related entity is registered.

If the party related to the issue does not apply for an objection or appeal on the issues on which the MAP is centered, the DGT has the right to cease the MAP process and reject the MAP request. The requestor (via its permanent establishment) may also submit a request to amend, reduce, or object to a tax assessment from the DGT.

MAP processing at the DGT's discretion

The DGT may arrange for an MAP with a treaty partner country without any request for the purpose of:

- Reviewing a previously agreed mutual agreement due to an indication of error;
- Requesting a corresponding adjustment due to a transfer pricing correction;
- Interpreting provisions of the DTA; and
- Other purposes related to the implementation of the DTA.

The DGT may request information or documents from Indonesian taxpayers via the tax office in which the entity is registered.

KPMG Notes:

The regulation provides guidelines for taxpayers in requesting for MAP in relation to the implementation of a DTA. The

requests will be addressed with relevant information requirements, timeline and resolution escalation.

It is critical that in submitting the request to the DGT, complete and accurate information is provided to support the request including an opinion on the improper tax treatment giving rise to the MAP request. To effectively provide such an opinion, the requestor will need information on the actual tax treatment in the treaty partner country and the transaction structure as recognized by the corresponding entity. It will be helpful if the requestor could provide information on the related entity in treaty partner country. The requestor should also examine or seek guidance on the application of the DTA before providing the DGT with the opinion.

A potential exposure may arise in the event that the DGT requests for a MAP arrangement at its discretion. This is especially true if the MAP is requested to seek a corresponding adjustment based on a transfer pricing correction with which the taxpayer disagrees. Although the taxpayer will be notified by the DGT regarding its MAP request, the taxpayer may have very little control over the outcome of the process. This condition is aggravated if a tax objection or tax appeal is pending for the issues concerned. The regulation does not prohibit the taxpayer from proceeding with the tax objection or tax appeal in this case but the result of the MAP will certainly impact the decision of the objection or appeal.

VAT on Banking Services **DGT Circular No. SE-121/PJ/2010**

This Circular relates to the categorisation of services offered by banks as to non-taxable financial services and taxable services for VAT purposes. Generally, services that are financing in nature i.e. earn interest or other non-financing services provided directly by a bank to their customers will be considered as non-taxable financial services. All other services that are not covered by the above are considered taxable services.

The Circular sets out banking services that are taxable and non-taxable based on the Banking Law's definition of banking services. Generally, the following activities are exempted from VAT under this Circular:

- Collection of funds (via various types of deposits);
- Granting of loans;
- Funds placement at, borrowings from or lendings to other banks;
- Factoring and credit card business;
- Sharia-based financing;
- Issuance of indebtedness;
- Own risk guarantee on short term securities; and
- Other activities not violating the Banking Law and other laws.

The Circular also specifies banking services that will be subject to VAT, which includes the following:

- Funds transfer for non-customers of the bank;
- Funds placement in securities not listed in the exchange market for non-customers;
- Payment collection from securities and settlement with or between third parties;
- Providing space for storage of goods and effects;
- Contractual safekeeping;
- Buying, selling and guaranteeing securities for or with instruction from customers; and
- Other activities not violating the Banking Law and other laws.

The circular also addresses the delivery of foreclosed assets. It is emphasized that the sale of a foreclosed asset is subject to VAT.

Banks engaged in the provision of services classified as taxable services are required to be registered as taxable enterprises and comply with the relevant VAT compliance obligations, including the preparation of tax invoices according to prevailing laws.

KPMG Notes:

The Circular refers to the Banking Law which defines banking services. Based on this definition, the Circular distinguishes taxable services and non-taxable financial services. Point 3 of the Circular characterises non-taxable financial services as services that are financing in nature and earn interest and non-financing services are defined to be services rendered directly by the banks to their customers.

We noted that some types of income, such as those generated from customers due to transfer activities via telex, swift, SKN and income from transactions / issuance of bank drafts, traveler checks, and payment orders, are included in the list of taxable activities despite the fact that the activities may be performed by the bank directly for its customers and qualify as services rendered directly to customers. Fund transfers, for example, are part of fund collection activity. Under the Circular's definition, such services should not be taxable.

The imposition of VAT on the sale of foreclosed assets will present the banking industry with a considerable challenge in revenue recovery.

The tax invoice administration introduces tax reporting complexities that may not be familiar to the banking industry since the Circular refers to the current law and the generally accepted tax invoice administration (standard tax invoice). Currently, a VAT invoice is required to be furnished on a per-customer basis. Without special arrangements to substitute the current VAT administration with a simplified approach, the volume of the transactions requiring a tax invoice will pose a substantial issue. The industry may need to engage in further discussions with the authority to determine the best solution to accommodate the industry's concerns without contradicting the prevailing regulations.

It is noted that the Circular includes "other activities not violating the Banking Law and other laws" in both taxable and non-taxable services. This ambiguity will generate uncertainty on other banking services currently not covered in the Circular.

A list of banking products / services / income attached to the Circular provides an example of transactions that are subject and not subject to VAT, however, other activities may also be included in the banking business categories currently defined.

Finally, there is no effective date stipulated in the Circular. Since the circular refers to the new VAT Law, the Tax Office may take the view that it is effective from the date of the new Law (1 April 2010).

Korea

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Tax update

Tax revision proposal regarding adoption of IFRS("K-IFRS") from FY 2011

Korean financial institutions, including branches of foreign corporations, will be required to report based on K-IFRS from the year ending 31 December 2011 and there may be potential differences in the calculation of income and expenses caused by the first adoption of K-IFRS. For corporate income tax filing, financial statements based on K-IFRS may be used to calculate corporate income taxes. However, the Ministry of Strategy and Finance (MOSF) has announced 3 basic principles of tax law changes on 19 August 2010 as shown below;

- Principle 1: Maintaining the same tax treatment for the same transactions
- Principle 2: Minimising tax adjustments for corporate income tax filing purposes through the adoption of K-IFRS
- Principle 3: Accepting reasonable accounting treatments for tax purposes but any excessive tax burden may qualify for relief

K-IFRS is significantly different from K-GAAP and in principle the current corporate tax law in Korea is based on K-GAAP. The difference between taxable income and accounting income will increase despite the principles announced by the MOSF. Corporate entities are likely to be faced with additional tax liabilities, compliance costs and/or tax costs to resolve the discrepancies.

Principle 1 – Maintaining the same tax treatment for the same transactions

A supplementation of the tax law will be introduced to mitigate the discrepancy in the extent of a tax burden due to the difference in accounting treatment for K-IFRS companies and K-GAAP companies.

Under this principle, the transaction which has the same economic substance under the new accounting standards will be maintained to be subject to the same tax burden.

For example, under K-IFRS, certain preferred stocks are recognized as liabilities but are treated as equities pursuant to K-GAAP. However, for tax purposes, preferred stocks will continue to be treated as equity regardless of the adoption of K-IFRS in Korea.

Principle 2 – Minimising tax adjustments for corporate income tax filing purpose through the adoption of K-IFRS

Where the tax costs for adjustments made due to the introduction of K-IFRS in Korea are excessive (e.g. valuation gains and losses on foreign currency assets and liabilities), the accounting treatment may be accepted for tax purposes.

Principle 3 – Accepting reasonable accounting treatments for tax purposes but excessive tax burdens may qualify for relief

If the accounting treatment under K-IFRS reflects the true economic substance and is reasonable for tax purposes, the accounting treatment may be accepted for tax purposes even though it may increase the tax burden (e.g. bad debt expense). However, a relief plan may be in place if the tax burden is extremely burdensome on the first adoption of K-IFRS.

Revocation of the tax exemption for interest income on KTB and MSB earned by a foreign investor

Interest income and capital gains on Korean Treasury Bonds (KTB) and Monetary Stabilization Bonds (MSB) earned by foreign investors are exempt from withholding tax in Korea after 21 May 2009. However, a proposal to revoke this exemption for foreign investors was submitted to the Strategy and Finance Committee of the National Assembly on 12 November 2010. This revised provision to revoke the tax exemption has been passed on 30 December 2010. However, income earned by foreign investor from KTB or MSB acquired prior to 12 November 2010 are still be subject to previous provision, not being subject to withholding tax.

Malaysia

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Tax update

2011 Budget Highlights

The Malaysian Prime Minister YAB Dato' Sri Mohd. Najib Tun Abdul Razak, also the Minister of Finance, presented the 2011 Budget on 15 October 2010. The major changes are as follows:

- Withholding Tax

Where a payer fails to deduct and remit withholding tax within the due date of payment but claims a deduction for the payment in the tax return, it is proposed that the Director General of the Inland Revenue Board may impose a penalty of up to 100 percent on the tax undercharged where no prosecution is instituted. Generally, the penalty applies if the withholding tax together with the late payment penalty are not subsequently paid by the due date for the submission of the tax return.

The proposal is effective from 1 January 2011.

- Issuance of Islamic Securities

To strengthen Malaysia's position as the leading sukuk market, the Government has launched the world's first Syariah-complaint commodity trading platform known as Bursa *Suq Al-Sila'*.

To encourage innovation and promote transactions in Bursa *Suq Al-Sila'*, it is proposed that expenses incurred in the issuance of Islamic securities under the principles of Murabahah and Bai' Bithaman Ajil based on tawarruq will be allowable as a tax deduction in Malaysia. The deduction is available provided the issuance of such securities is approved by the Securities Commission or the Labuan Financial Services Authority.

Tawarruq is a type of transaction where a person buys commodity at a deferred price, then sells it to a third party (other than the original seller) for an immediate cash price.

The proposal is effective from Year of Assessments (YAs) 2011 to 2015.

- Service tax rate

It is proposed that the service tax rate on all taxable services be increased from 5 percent to 6 percent commencing from 1 January 2011.

However, the specific rate of service tax imposed on credit cards and charge cards of RM50 per year on principal cards and RM25 per year on supplementary cards remains unchanged.

Recent Remission Order Gazetted

Stamp duty on any instrument executed between a customer and a financier in accordance with the Shariah approved by the Shariah Advisory Council on Islamic Finance (established under the Central Bank of Malaysia Act 2009) pursuant to the change of scheme for financing an existing loan from conventional to Shariah, is remitted based on the Stamp Duty (Remission) Order 2010. The stamp duty remittance is available to the extent that the duty was paid on the balance of the principal amount of the existing loan.

Double Taxation Agreement (DTA)

Malaysia – Laos

The new DTA between Malaysia and Laos has been gazetted and has the following maximum rates of withholding tax:

Types of Payment	Rate
Interest	10 percent
Royalties	10 percent
Technical Fees	10 percent

Note: The DTA has not yet entered into force.

Mauritius

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Tax update

The Finance Act 2010 was enacted on 24 December 2010. The main changes relevant to financial institutions are:

- The existing special levy on profitable banks of 1 percent of operating income (net interest income plus other gross income) plus 3.4 percent of book profits (IFRS net profits) is maintained until the year of assessment 2012.
- From 1 January 2013 and every subsequent year of assessment thereafter, the special levy will be 0.5 percent of operating income plus 1.7 percent of book profits.

One-off charge on banks

- For the year of assessment 2011, every bank⁵ shall create a one-off charge on its Segment A activities (i.e. transactions with residents of Mauritius) for an amount equivalent to 0.5 percent of its turnover plus 1.25 percent of its book profit.
- The one-off charge shall be contributed to a private equity fund newly created by the government.
- Where contribution to the new private equity fund is less than the one-off charge, the difference shall be remitted to the Director-General at the time the company submits its tax return for the year of assessment 2012.

Category 1 Global Business Licence (GBL1)

- GBL1 companies shall be allowed to:
 - Conduct business in Mauritius.
 - Deal with persons resident in Mauritius or with Category 2 Global Business Licence companies.
 - Hold shares or other interests in a corporation resident in Mauritius.
- The presumed Foreign Tax Credit of 80 percent of Mauritian tax shall continue to be available to GBL1 companies on their foreign source income.
- Domestic operations of GBL1 companies shall be taxable at the rate of 15 percent.
- Interest paid to a non-resident by a GBL1 company out of its foreign source income shall be exempt from income tax.
- A royalty payable to a non-resident by a GBL1 company out of its foreign source income shall be exempt from income tax.
- Expenditure or losses of a GBL1 company shall be attributed to its foreign source income or local source income.
- Where expenditure or losses cannot be directly attributable to either its local source income or foreign source income, the GBL1 shall forward, together with its annual tax return, a certificate from a qualified auditor certifying that such

⁵ Except the Development Bank of Mauritius Ltd

expenditure or loss has been apportioned in a fair and reasonable manner.

Interest income for individuals

- Effective from 1 January 2010, interest income on savings or fixed deposit accounts held with any bank or a non-bank deposit taking institution under the Banking Act and interest income on Government securities and Bank of Mauritius Bills is deemed to be exempt from income tax.
- Where tax has been withheld from interest income in the income year 2010, the individual may claim the tax deducted at source as a credit in two equal instalments from his tax liability in respect of income years ending 31 December 2011 and 31 December 2012.
- As from 1 January 2011, financial institutions shall deduct tax at source at the rate of 10 percent on interest payable only on deposits exceeding Rs5 million.

National Residential Property Tax

- National Residential Property Tax is abolished as from the year of assessment 2011.

Gains from immovable property

- As from 1 January 2011, gains from the sale or transfer of immovable property or interest in immovable property in an income year shall be taxable at the rate of 15 percent.
- The tax on the gains shall be payable at the time the annual corporate tax return is filed.
- The following gains shall be exempt from income tax:
 - Gains derived by a company from the sale or transfer of an immovable property between companies within the same group.
 - Gains derived by a company from the sale or transfer of an immovable property where the transfer is made under the Economic Restructuring and Competitiveness Package.
 - Gains derived by a bank from the transfer of an immovable property to a person pursuant to an arrangement with that person whereby the bank initially purchased the immovable property with a view to transferring the same property to that person.
- Losses incurred from sale or transfer of an immovable property shall not be tax deductible and cannot be carried forward to set off against future gains or profits.

Transfer of shares in a company which owns immovable property

- Where the value of immovable properties forming part of the assets of the company exceeds 95 percent of its total assets and the transfer of shares results in a change of control of that company or results in any increase in the shareholding of the controlling shareholder within a period of 12 months from the date of change of control, the gains derived from the transfer of those shares shall be computed using the following formula:

$$\frac{\text{number of shares transferred}}{\text{total number of shares issued}} \times \text{gains}$$

Societe engaged in property business

- Where an immovable property is registered in the name of a societe and the property is thereafter sold or transferred, the gains derived therefrom shall be taxed at the level of the societe.

Immovable property registered in the name of a trust

- The trustee of the trust shall be liable to pay tax on the gains derived from the sale or transfer of the property.

⁶ Person means any individual, societe (excluding exempt societe) or succession resident in Mauritius

Return of dividends by companies

As from 1 January 2011, every company which pays a dividend in an accounting period shall submit to the Director-General of MRA, in respect of that accounting period, a Return in respect of every person⁶ to whom dividends exceeding Rs50,000 has been paid.

- The Return shall specify the full name, address and such other particulars as may be prescribed.
- The Return shall be submitted within one month after the end of the company's accounting period.
- The Return shall be submitted electronically for companies with total income (including exempt income) exceeding Rs10 million.

New Zealand ▲Top



Tax update

No approved Issuer Levy on interest proposed

The introduction of the Taxation (International Investment and Remedial Matters) Bill on 26 October 2010 recommends the removal of the approved issuer levy (AIL) on interest that is paid in respect of certain debt securities issued to non-residents.

Certain restrictions will apply, in particular, the security must be denominated in New Zealand dollars, offered to the public and amongst other requirements the security must be listed on an exchange registered under the Securities Market Act 1988 or satisfy a widely-held test.

AIL will be considered to be paid when either the 2 percent or the new nil AIL rate applies. This ensures that a nil non-resident withholding tax rate under New Zealand's Double Tax Agreements where applicable, can apply when the borrower and lender are not associated.

The proposed changes will apply to interest payments made on or after the date the Tax Bill is enacted. This is expected to be in July 2011.

NZ – USA Double Tax Agreement (DTA) comes into force

The new DTA between New Zealand and the United States is now in force which amends the 1983 agreement.

The new DTA results in lower withholding tax rates on dividends, interest and royalties between New Zealand and the United States. The new withholding rates apply from 1 January 2011.

NZ – Hong Kong DTA signed

The Government has announced the conclusion of a DTA with Hong Kong. The DTA follows the signing of a Free Trade Agreement with Hong Kong earlier this year.

Withholding rates for interest, dividends and royalties have been decreased.

The withholding rate for dividends has decreased from up to 30 percent and now ranges from nil to 15 percent, depending on the level of shareholding. The withholding rate for interest has been reduced from 15 percent to 10 percent, and a nil withholding rate applies when the interest is paid to a financial institution. The withholding rate on royalties has decreased from 15 percent to 5 percent.

In New Zealand, the withholding rates under the DTA will apply to amounts paid or credited on or after 1 April in the calendar year next following that in which the DTA comes into force. This is expected to be 1 April 2012.

NZ Government retail deposit scheme ends

The New Zealand Government's retail deposit guarantee scheme ended on 12 October 2010. The initial two-year scheme was introduced by the Labour-led government at the height of the global financial crisis two years ago and had \$133 billion worth of securities under guarantee.

A smaller extended retail deposit guarantee scheme, under which eligible depositors would be repaid up to NZD250,000

per non-bank institution in case of default, has started on 12 October 2010 and will run to the end of 2011. This new scheme has just seven entities and NZD2.25 billion deposits under guarantee.

Changes to taxpayer secrecy and information sharing

The taxpayer secrecy rules in the Tax Administration Act 1994 are being amended. Inland Revenue will have greater discretion to release taxpayer information for the purpose of administering the tax system.

Inland Revenue will be able to release information if the communication is considered reasonable, whether or not it is also necessary. This relaxes the current "reasonably necessary" threshold for disclosure. The announcement on 23 November 2010 in the Taxation (Tax Administration and Remedial Matters) Bill also introduces changes to facilitate greater sharing of tax information between Inland Revenue and other government agencies.

Amendments to the Approved Issuer Levy regime

The Taxation (GST & Remedial Matters) Bill has introduced a number of amendments to the Tax Administration Act to clarify the rules regarding AIL.

A New Zealand resident borrowing money from a foreign bank which has a New Zealand branch can now apply the AIL regime for an exemption under a double tax agreement and for non-resident withholding tax purposes.

The amendments clarify the circumstances in which a borrower is eligible to pay AIL and the amendments apply from 1 August 2010.

Philippines

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Tax update

Tax Developments

BIR Ruling No. 051-2010 issued on 7 September 2010

On 7 September 2010, the Bureau of Internal Revenue (BIR) issued a ruling which states that interest income derived by Foreign Currency Deposit Units (FCDUs) from Retail Treasury Bonds (RTBs) issued by the Bureau of Treasury is exempt from the 5 percent gross receipts tax. According to the BIR, the tax exemption enjoyed by FCDUs under the 1977 Tax Code was restored including the exemption from the gross receipts tax.

The ruling modifies BIR Ruling No. DA (FIT-002) 054-2010 dated 28 April 2010 which states that interest income derived by FCDUs from the 3-year and 5-year Multi-Currency RTBs for Overseas Filipino Workers issued by the Bureau of Treasury is subject to the 5 percent gross receipts tax, aside from the 10 percent final withholding tax.

BIR ruling No. 006-10 issued on 27 May 2010

On 27 May 2010, the BIR issued a ruling on the implementation of Sec. 17 (c) of the Philippine Deposit Insurance Corporation (PDIC) Charter, as amended. The ruling covers the following:

- All tax obligations of the PDIC for the period from 1 June 2009 to 31 May 2014 shall be contributed to the Tax Expenditure Fund, except those tax obligations that are passed on to clients, (i.e. capital gains tax (CGT) and documentary stamp tax (DST)), and all taxes withheld by PDIC that are considered to be trust funds (i.e. expanded withholding tax (EWT), final withholding tax withheld at source (FWT) and withholding tax on compensation (WC); and
- PDIC's exemption from income tax, FWT from income payments to PDIC and value-added tax (VAT) on assessments will apply to member banks from 1 June 2014 onwards.

For the period from 1 June 2009 to 31 May 2014, PDIC shall request from the Fiscal Incentives Review Board (FIRB) the issuance of the Certificate of Entitlement to Subsidy (CES) for the payment of the following taxes to which PDIC is directly liable on or before their due dates, unless a different period is specifically provided.

- Income Tax
- VAT
- FWT
- Creditable Withholding Tax on interest on loans
- CGT (when borne by the PDIC)
- DST (when borne by the PDIC)
- All other taxes for which PDIC is directly liable.

The ruling also outlined the effect of specific types of taxes collected for PDIC's transactions from 1 June 2009 to

31 May 2014.

- Income Tax and VAT

Income tax and VAT, shall be filed on or before their due dates and paid through the TEF in accordance with Section 2.

- FWT, Creditable Withholding Tax, EWT will be contributed to the TEF

- Payor is Bureau of Treasury (BT)

The BT shall not withhold the FWT on its income payments to PDIC for treasury notes, treasury bonds, treasury bills and other discounted instruments of the PDIC with BT. However, income payments to PDIC shall only be released by BT in accordance with the following schedule: (1) 80 percent of all income payments to PDIC shall be released on coupon payment dates for treasury bonds/notes or purchase value dates for treasury bills and other discounted instruments; (2) the remaining 20 percent shall be released to PDIC upon confirmation from the Department of Budget and Management in favor of BT to cover the payment of the FWT due to BIR.

- Payor other than BT

Withholding agent/s other than BT such as: Philippines government owned banks or private banks, mandated to withhold FWT, CWT and EWT on income payments to PDIC shall withhold and remit the corresponding FWT, CWT and EWT to the BIR for all income payments due to PDIC. The withholding agent/s shall furnish PDIC with a certified photocopy of the BIR Form No. 1601-F and the corresponding Monthly Alphalist of Payees (MAP) showing PDIC as one of the taxpayers subjected to the FWT, CWT and EWT. This shall become the documentary support for payments that are subject to the above taxes.

- WC, FWT and EWT on payments to Suppliers, Contractors and Service Providers of PDIC will be contributed to the TEF. All taxes withheld that are considered to be trust funds (i.e. WC, EWT & FWT) and remitted to the BIR in legal tender on their due dates.

- CGT and DST

CGT and DST borne by the PDIC shall be filed and paid through the TEF in accordance with their due dates. CGT and DST passed on to buyer/s, shall be remitted to the BIR by the buyer in legal tender on their due dates.

Singapore

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Tax update

Enhancements to the recovery of input Goods and Services Tax (GST) for Qualifying Funds

The GST remission scheme which enables funds that meet the qualifying conditions to recover GST incurred on prescribed expenses based on a fixed recovery rate, without having to register for GST, has been enhanced to enable the qualifying funds to recover GST incurred on all expenses. The enhancement takes effect retrospectively from 22 January 2009 and will apply to all expenses (except disallowed expenses under the GST Regulations 26 and 27) incurred from 22 January 2009 to 31 March 2014.

On a related note, the fixed recovery rate for 1 January 2011 to 31 December 2011 is 91 percent.

In addition, with retrospective effect from 22 January 2009, the GST remission scheme will be extended to unit trusts that are approved under the Singapore Central Provident Fund (CPF) Scheme. To qualify for GST remission in the current year, the fund must be a CPF-approved unit trust as at the last day of its preceding financial year.

Withholding tax exemption for specified payments made by relevant funds managed in Singapore by prescribed fund managers

Under Section 12(6) of the Singapore Income Tax Act (SITA), the payment of interest, commission, fee and any other payments in connection with a loan or indebtedness are deemed to be derived in Singapore under certain circumstances.

Correspondingly, where payments to a non-resident fall within the ambit of Section 12(6) of the SITA, such payments are subject to withholding tax under Section 45 of the SITA, unless exemptions are available under the SITA or relief is provided for under a relevant tax treaty.

To enhance Singapore as an Asian hub for funds management, the Minister for Finance introduced a withholding tax exemption for specified funds. The withholding tax exemption only applies to interest payments made by funds that satisfy the conditions for specified fund vehicle tax incentive schemes under the SITA. In addition, such interest payments must be made for the purposes of the trade or business of the fund.

Sri Lanka

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Tax update

Budget 2011

The President of the Democratic Socialist Republic of Sri Lanka presented the Budget for fiscal year 2011 on 22 November 2010.

The Budget proposals were a distinct departure from previous annual budgets in that they focused on amendments to the basic tax regime and proposals to repeal or amend several levies that are extremely onerous. Below is a summary of the budget proposals as applicable to banks & financial institutions.

- Entity based taxes

- Income Tax

The corporate tax rate applicable to banks and other financial institutions, finance, leasing and insurance companies and other specialized banking services will be reduced from 35 percent to 28 percent. However offshore banking activities which were previously taxed at 20 percent will now be taxed at the standard rate of 28 percent.

The current two year exemption applicable to profits earned in foreign currency on services provided in or outside Sri Lanka to a person outside Sri Lanka will be extended. However, the extension does not apply to commissions, discounts or similar types of receipts earned in foreign currency for activities carried out in Sri Lanka.

Profits from investments in listed debentures and equities by unit trusts and mutual funds will be exempt from income tax. Currently, the profit from sale of listed debentures and equities and the dividend income from listed equities are exempt from tax. Hence the proposal will extend the exemption to interest income on listed debentures.

It is proposed that the mandatory requirement to distribute dividends be reduced from 25 percent to 10 percent of the distributable profits to avoid the application of deemed dividends tax. Deemed dividend tax is calculated at 15 percent on 33 1/3 percent of distributable profits subject to adjustments being made for dividend distributions and solvency requirements etc.

- VAT on Financial Services (FS)

Persons carrying on the business of supply of 'financial services' are liable to VAT on FS at the rate of 20 percent based on profits before income tax after certain adjustments.

The budget proposes to reduce the VAT on FS from 20 percent to 12 percent and the tax base will be changed to profits after deducting VAT on financial services but before deducting income tax.

- Economic Service Charge (ESC)

ESC is charged on every person and partnership on 'relevant turnover' quarterly at specified rates, provided that the 'relevant turnover' for the quarter exceeds Rs7.5 million. The applicable rate for banks and financial institutions is 1 percent.

The budget proposes to increase the threshold from Rs7.5 million to Rs25 million per quarter while Unit Trusts and Mutual Funds will be exempt from ESC.

- Social Responsibility Levy (SRL)

SRL which was calculated at 1.5 percent on the income tax liability is proposed to be removed.

- Transactional taxes

- Debits Tax

Debits Tax is chargeable at the rate of 0.1 percent on debits made against specified current and savings accounts and on amounts realised on the encashment of certificates of deposit or travelers cheques. Debits tax is proposed to be abolished with effect from 1 April 2011.

The onus of collecting this tax was on banks and financial institutions and forms the 3rd largest source of tax revenue for the government.

The abolition of Debits Tax would remove a cumbersome administrative burden imposed on banks and financial institutions and will also promote the use of the banking system by all taxpayers.

- Investment Fund Account

Persons engaged in the business of banking and financial services will be required to maintain an investment fund account at the Central Bank of Sri Lanka (CBSL) with effect from 1 April 2010. The purpose of the fund is to encourage long-term investment and the budget proposals are broadly outlined as follows:

Investments will be required to be made for a period of 3 years.

Minimum amount to be invested will be calculated as the aggregate of 8 percent of the profits calculated for VAT on financial services and 5 percent of the adjusted profits calculated for income tax purposes before tax.

The fund can only be utilized to obtain longer term loans at lower rates of interest as specified by the CBSL and the Department of Inland Revenue (DIR).

The interest on such investments will be exempt from income tax.

- Islamic Financial Instruments

In view of the increased interest in Islamic Finance in Sri Lanka it is proposed that amendments will be introduced to facilitate the use of Islamic Finance Instruments in Sri Lanka.

- Relaxation of exchange control regulations to facilitate development of local capital markets (with effect from 22 November 2010)

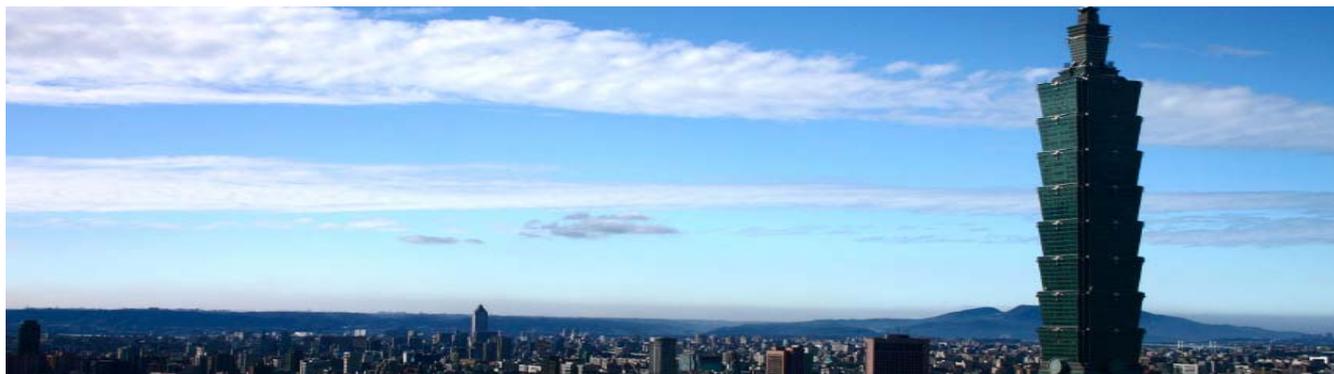
Permission has been granted for the issuance and transfer of listed debentures of companies incorporated in Sri Lanka to foreign investors.

Procedures have been laid out to expedite approvals for companies to borrow from foreign sources.

Permission has been granted to Sri Lankan residents to invest in equity of overseas companies and make payments in respect of the setting up of places of business outside Sri Lanka.

Taiwan

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Tax update

Hot Money Tax

The inflow of short-term foreign funds, also known as “Hot Money” for its speculative nature, into Asia in the wake of the financial crisis has received considerable public attention in Taiwan. The influx of foreign capital has boosted the Taiwan currency and driven up real estate prices. The Government have expressed concerns as the competitiveness of exporters may be threatened by the rising Taiwan currency.

In response, the Ministry of Finance has recently issued a press release addressing the possibility of a “Hot Money Tax”. The MOF have indicated that the government will take measures to control risks imposed by hot money. A lengthy process of introducing amendments to the current tax regulations will need to take place before legislation can be introduced.

While certain countries such as Brazil have introduced a “Hot Money Tax”, the developed countries have yet to implement similar tax regimes to curb foreign inflows. However, the MOF has not excluded the possibility of introducing a similar tax and the MOF will conduct further discussions with the forex regulator.

Thailand

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Tax update

Personal Income Tax : Tax allowance for life insurance premium – pension plan

On 19 October 2010 the cabinet approved the tax amendment which promotes the saving by individuals in pension plan life insurance.

From tax year 2010, the amount of allowance and exemption related to life insurance premiums will increase from THB 100,000 to THB 300,000. The additional amount of THB 200,000 shall be applicable to the life insurance premiums paid for pension plan life insurance but limited to 15 percent of assessable income. This allowance and exemption relates to life insurance premiums if the combined contributions to provident fund and the amount invested in Retirement Mutual Fund does not exceed THB 500,000.

A Ministerial Regulation for this tax measure will be issued.

Amendment of income tax exemption on income received by foreign investors from bonds or debentures issued by the government

According to the Thai cabinet's approval on 12 October 2010, Royal Decree No. 509 dated 1 December 2010 was issued to amend the income tax exemption under Section 5 Octo of Royal Decree No 10.

Section 5 Octo of Royal Decree No 10 provides an income tax exemption for a juristic company or partnership organized under a foreign law and not carrying on business in Thailand for assessable income as follows:

- Interest on bonds or interest on debentures issued by governmental enterprises;
- The difference between the redemption price and the initial price of bonds or debentures initially offered to the public where such price is lower than the redemption price; provided only for bonds or debentures of the government, governmental enterprises, or an institution organized by a specific law of Thailand for the purpose of lending money to promote agriculture commerce or industry;
- Any benefit received from transferring bonds or debentures; provided only for bonds or debentures of the government, governmental enterprises, or an institution organized by a specific law of Thailand for the purpose of lending money to promote agriculture commerce or industry.

Royal Decree No. 509 dated 1 December 2010 was issued to amend the exemption such that foreign investors shall be entitled to the above income tax exemption (under Section 5 Octo of the Royal Decree No 10) only for the aforesaid income on bonds or debentures held by foreign investors before 13 October 2010 where such bonds or debentures were issued before 13 October 2010.

Without the tax exemption, foreign investors which are non-residents of Thailand and not carrying on business in Thailand shall be subject to Thai withholding tax at 15 percent for the aforesaid income under Section 70 of the Revenue Code. A reduced rate or exemption may be available under a tax treaty. However, under Section 70 paragraph 1, the withholding tax shall not apply in the case where a juristic company or partnership organized under a foreign law receives assessable income being interest paid by the government or by a financial institution organized under the specific law of Thailand for the purpose of lending money to promote agriculture, commerce, or industry. Royal Decree No. 509 was issued to amend

the income tax exemption under Section 5 Octo of Royal Decree No. 10 only. Thus, foreign investors should still be exempted from withholding tax on interest on bonds or debentures paid by the government according to the exemption provision under Section 70 paragraph 1. Please note that "interest" has not been specifically defined for the purpose of section 70 paragraph 1.

Vietnam

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Tax update

New guidance on profit repatriation for foreign investors including institutional investors in Vietnam

Under Circular 186/2010/TT-BTC dated 18 November 2010 (Circular 186), with effect from 1 January 2011, provisional remittance of profits to overseas (i.e. quarterly or semi-annually) has been abolished. Accordingly, foreign investors including institutional investors, are only allowed to repatriate profit overseas annually after submission of the audited financial statements and annual tax finalisation return to the local tax authorities or upon the termination of business operations in Vietnam.

Notably, foreign investors are not permitted to remit profits abroad if the financial statements for the relevant year show that the company is in an accumulated loss position.

A foreign investor is required to submit the Notice of Transfer of Profits Abroad to local tax authorities at least 7 days before the remittance.

Draft Circular of tax implication (VAT and CIT) on derivatives services

The Vietnam tax authority is going to issue new regulations related to the Value Added Tax (VAT) and Corporate Income Tax (CIT) implications on derivative services.

Based on the draft Circular, derivative services will not be subject to VAT and the CIT implications will depend on whether the enterprise is a local or foreign organisation:

- For local enterprises, CIT is determined based on the revenue and expenses derived from the services.
- For foreign organisations providing derivative services to Vietnamese parties: depending on specific forms of derivative services, they will generally be subject to CIT at a rate of 2 percent.

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