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General tax update for financial institutions in Asia Pacific

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Australia

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Tax update

Legislative developments

Further amendments to general anti-avoidance rules

Further to the previous edition of the Tax Update, proposed amendments to the general anti-avoidance rules have since been enacted and apply to transactions entered into from 16 November 2012.

The general anti-avoidance rules apply where a taxpayer obtains a tax benefit as a result of the entry into or carrying out of a scheme with the dominant purpose of obtaining that tax benefit.

The amendments modify the rules for determining what constitutes a tax benefit by providing a new framework for determining the "alternative postulate". The new framework requires one to ignore resulting income tax liabilities when determining a reasonable alternative postulate.

Thin capitalisation changes to arms length debt test

On 16 December 2013, The Board of Taxation (BoT) released a discussion paper for the review of the thin capitalisation arm's length debt test. The purpose of the discussion paper is to consider the options for making it easier to comply with, administer and clarify eligibility requirements. The arm's length debt test is intended to provide a carve-out from the thin capitalisation rules for a level of debt which is considered to be 'commercial or independent'. The test focuses on what businesses acting at arm's length would borrow and what independent commercial lenders would lend to the business.

Debt/equity rules: BoT review

During August 2013, the BoT undertook industry consultation to review the effectiveness of the current debt/equity rules in Division 974 - which characterise debt and equity interests for tax purposes based on their economic substance. In particular, the Board canvassed views on the following issues:

1. Issues and experience with the debt/equity rules
2. Whether the debt/equity rules are operating effectively and consistent with their purpose
3. Misalignments between the debt/equity rules and other income tax rules
4. Inconsistencies between Australia's and other jurisdictions debt/equity rules that could give rise to cross border tax arbitrage.

Offshore banking unit: integrity measures

As part of the 2013-2014 Federal Budget, the Government announced a proposal to limit the types of arrangements that are eligible for the Offshore Banking Unit (OBU) concession, including certain dealings with related parties. However, following consultation, the Government announced that it would instead address the perceived integrity issues through a targeted integrity measure and that related party arrangements would continue to be eligible. On 30 January 2014, the Assistant Treasurer confirmed that the new targeted integrity measures will commence from 1 July 2015.

Proposed bank deposit levy

On 2 August 2013, the Treasurer announced a proposal to establish a Financial Stability Fund for the sole purpose of meeting funding assistance to avoid the collapse of any Australian Authorised Deposit-Taking Institution (ADI). The fund

would obtain money through imposing a 0.05% levy on deposits of up to $250,000 commencing from 1 January 2016. No further updates have been provided on this matter by the Treasurer.

Investment Manager Regime

On 31 January 2014, an updated exposure draft for the third and final element of the Investment Manager Regime (IMR) was released. The exposure draft legislation aims to remove tax impediments to foreign managed funds invested either into or through Australia. Under this legislation, the gains of qualifying foreign funds from the disposal of certain financial arrangements will be exempt from Australian tax.

Cases

- Decision - Commissioner of Taxation v Ludekens - promoter penalties

  This is the first case in Australia dealing with the operation of the promoter penalty rules, which have been in force since 2006 and seek to prevent the promotion of tax avoidance schemes.

  On 29 August 2013, the Full Federal Court of Australia (FCAFC) handed down its decision in favour of the Commissioner, holding that there was a 'tax avoidance scheme' and the 'promotion' of that scheme to investors. Accordingly, the Commissioner was entitled to impose civil penalties on the alleged scheme promoters under the promoter penalty rules.

- Appeal - Commissioner v Macquarie Bank Limited - Part IVA

  The High Court of Australia (HCA) has refused the Commissioner of Taxation special leave to appeal from the decision of the Full Federal Court of Australia (FCAFC) in Commissioner of Taxation v Macquarie Bank Limited [2013] FCAFC 13 (the Mongoose case).

  The FCAFC unanimously dismissed the Commissioner's appeal and held that a member of a consolidated group was not subject to the anti-avoidance rules in respect of a capital gain it made from selling shares as there was no tax benefit under the scheme. This was principally because the Commissioner had identified the subsidiary as the taxpayer who had received the tax benefit, whereas under the consolidation regime, only the head company of the group can be liable for tax and therefore only it can obtain a tax benefit.

Taxation rulings and determinations

- ATO TD 2014/D1 Income tax: can section 177EA of the Income Tax Assessment Act 1936 apply to a 'dividend washing' scheme of the type described in this Taxation Determination?

  The Draft Determination considers the application of the anti-avoidance rules to dividend washing schemes. A dividend washing scheme involves the disposal of a parcel of shares ex-dividend and then immediately reacquiring an equivalent parcel on the special cum dividend market, so that the dividend (and franking credits) is received on both parcels of shares. The Commissioner's view is that the anti avoidance rules will generally apply to a dividend washing' scheme. The Draft Determination, when finalised, will apply retrospectively.

Other developments

- On 20 December 2013, the Treasurer announced final terms of reference for the Government's Financial System Inquiry. The purpose of the Inquiry is to examine how the financial system could be developed to best meet Australia's evolving needs and support Australia's economic growth. From an Australian tax perspective, the Inquiry will consider the taxation of financial arrangements, products and institutions and whether any of these elements impose on the efficient and effective allocation of capital by the financial system.
- On 14 December 2013, the Assistant Treasurer announced the outcome of consultations over the backlog of 92 announced but unlegislated tax and superannuation measures (some of which date back to 2001). For those measures that will proceed, the Government intends that the legislation be passed by Parliament before 1 July 2014.

  Some of the measures that will proceed include:

  - Tightening of the safe harbor limits under thin capitalisation;
  - New Managed Investment Trust (MIT) regime and MIT withholding tax changes;
  - Income tax treatment of instalment warrants.

Those that will not proceed include:

- The repeal of section 25-90 which allows a deduction for interest incurred in deriving non-assessable non-exempt dividend income from a foreign subsidiary;
- Review of the foreign sourced income anti-deferral regime (ie controlled foreign company rules);
- Symmetric treatment of related party bad debts.

- International Structuring and Profit Shifting (ISAPS) program

  In response to the OECD's "Base Erosion and Profit Shifting" project, the ATO has commenced the ISAPS field review programme which will focus on both corporate tax and international transfer pricing aspects of complex and high value cross-border transactions (including financing transactions, intellectual property and corporate restructures).

  The ISAPS reviews are expected to commence in 2014 and will result in an ATO risk rating or escalation to audit.

- ATO Questionnaire - online banking systems and platforms

  The ATO has issued a questionnaire to foreign banks with operations in Australia regarding services and products being provided to Australian customers via their online banking platforms. The questionnaire is focussed on ensuring appropriate transfer pricing policies and documentation.

China

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Establishment of the China (Shanghai) Pilot Free Trade Zone in Shanghai

On 3 July 2013, the State Council of the People's Republic of China approved a proposal to relax foreign exchange controls in the Shanghai bonded trade or port zones. On 22 August 2013, the State Council of the PRC has officially approved the establishment of the China (Shanghai) Pilot Free Trade Zone ("FTZ"). The new policy package is the central government's latest initiative to promote Shanghai's ambitions as a global business hub and international financial centre.

PRC enterprises established in the FTZ could progressively and freely exchange currency (between foreign currency and RMB) without any foreign exchange control. This is aimed at promoting offshore investments and offshore financing of the PRC enterprises. It is also expected that the trading within the FTZ will be free of Customs Duty. This would therefore be beneficial and in turn help promote the development of, amongst other, the transportation, logistics and ancillary industries.

It is anticipated that certain financial services-related measures could cover:

- RMB convertibility
- Interest rate liberalization
- Cross-border use of RMB
- Foreign debt control relaxation
- Cross-border financing

On 2 December 2013, the People's Bank of China issued opinions on providing financial support for the development of China (Shanghai) Pilot FTZ. The guidance has five areas of focus:

- Innovation in the bank account system
- Facilitation of foreign exchange conversion in investment and financing
- Expansion of cross-border use of RMB
- Acceleration of interest rate liberalization
- Deeper reform of foreign exchange administration

VAT reform pilot program enters into Phase II – expanded scope and significant changes

On 12 December 2013, China's Ministry of Finance ("MOF") and the State Administration of Taxation ("SAT") jointly issued Caishui [2013] No. 106 ("Circular 106") to implement the expansion of the VAT reform pilot program to the railway transportation industry and postal services industry from 1 January 2014. The telecommunications sector, which had previously been expected to be brought within the VAT reform pilot program concurrently, was expected to transition to VAT from 1 April 2014. However, this has been delayed and the industry is waiting for further notice from SAT. In addition, Circular 106 further expands the scope of the VAT reform pilot program in some existing industries which are already subject to VAT.

Importantly, Circular 106 also makes significant changes to the VAT treatment of a number of areas which are already subject to the VAT reform pilot program and have been problematic for businesses in those industries – specifically, international goods transportation agency services and the finance leasing industry. Finally, Circular 106 extends certain preferential policies such as offshore outsourcing services VAT exemption policies.

Financial sector faces issues on transition to VAT

The financial services sector in China will need to consider certain transitional issues in the shift to a VAT system. Early indications from China's MOF suggest that modern principles of VAT would be applied to a VAT system in China, as well as application of VAT to many types of financial services. The VAT system for the financial services sector in China could potentially be very broad.

SAT clarifies issues on recognition of Hong Kong tax residency status under the PRC-HK DTA

The SAT, after consultation and agreement with the Hong Kong Inland Revenue Department, issued Announcement 53 of 2013 ("Announcement 53") to simplify the procedures used when Hong Kong tax resident companies and individuals apply for tax treaty relief under the PRC-HK DTA on 13 September 2013. Announcement 53 has taken effect on 1 November 2013.

Announcement 53 is a welcome development as it alleviates the need for a tax residency certificate ("TRC") to be produced by Hong Kong tax residents at the outset of the tax treaty relief application — although, ultimately, a TRC may still be needed if the tax authorities have any doubts regarding the applicant's tax residency status. This places Hong Kong companies and individuals at a comparative advantage over applicants from other jurisdictions, who are required to produce a TRC as matter of course, in complying with tax treaty relief applications procedures under Circular Guoshuifa [2009] No. 124.

New amendments to the PRC Company Law (effective from 1 March 2014)

On 28 December 2013, the Committee of the National People's Congress announced the fourth set of amendments to the PRC Company Law (the "Amendment"), effective from 1 March 2014. The Amendment relaxes the requirements to establish a company in the PRC. In particular, it mainly focuses on:-

- Reduction of the minimum requirement of registered capital;
- Relaxation of the timing for capital contribution; and
- Simplification of the registration procedure for setting up a company

It should be noted though that the registered capital requirements for foreign invested enterprises ("FIEs") are specifically governed by the related FIE Laws which are similar to the articles under the PRC Company Law before the Amendment. Notwithstanding it is reported that the relevant FIE Laws will be updated in line with the Amendment, whether the impact of the Amendment towards the existing FIE Laws is still uncertain. Given that the existing FIE Laws are still valid and have not been revised yet, foreign investors should still comply with the requirements set forth under the FIE Laws until further amendments or notices have been issued.

Business tax ("BT") on transfer of financial commodities

China's State Administration of Taxation ("SAT") issued Announcement [2013] No. 63 ("Announcement 63") on November 2013 (effective from 1 December 2013) to modify the BT treatment on the transfer of financial commodities.

According to Announcement 63, the transfer of financial commodities is no longer to be classified into four categories of stocks, bonds, foreign exchange, and others. Instead, these transactions will be consolidated into one category—financial commodities.

Trading gains and losses of different categories of financial commodities can now be offset across different categories within the same BT reporting period.

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Tax concession introduced for captive insurance companies

Legislation was introduced into the Legislative Council on 8 January 2014 to provide a profits tax concession to captive insurance companies for profits from their business of insurance of offshore risks. Such profits are to be chargeable to profits tax at one-half of the normal rate, that is, 8.25%.

The Inland Revenue (Amendment) (No. 3) Bill 2013 was gazetted on 27 December 2013. The Bill seeks to give effect to the proposal in the 2013-14 Budget that the profits tax on the offshore insurance business of captive insurance companies would be reduced in line with the tax concession currently applicable to reinsurance companies. The Financial Secretary considered that attracting a cluster of large-scale captive insurers in Hong Kong would promote the development of other related businesses, including reinsurance, making Hong Kong's risk management services more diversified.

The objective of the Bill is to reduce by half the profits tax on profits derived from the offshore risks insurance business of captive insurers (which are typically set up to underwrite the risks of companies within the same group to which the captive insurers belong).

Subject to the Bill being passed by the Legislative Council, the tax concession will have effect from the year of assessment 2013-14 onwards.

Unrealised revaluation gains are not taxable - Nice Cheer Investment Limited v CIR [FACV 23/2012]

The Commissioner of Inland Revenue lost his appeal to the Court of Final Appeal, whereby the Court found that unrealised gains recognised at year-end are not taxable. The Court agreed with the lower court that unrealised profits are not chargeable to tax, notwithstanding that they have been recognised in the taxpayer's financial statements in accordance with international accounting standards.

Legislative Council passes Bill to allow Hong Kong to enter into tax information exchange agreements (TIEAs)

The Inland Revenue (Amendment) (No. 2) Bill 2013 was passed by the Legislative Council on 10 July 2013. The Bill allows Hong Kong to enter into TIEAs, which are stand alone agreements on tax information. The Bill also enhances the existing exchange of information (EoI) arrangements under a comprehensive double taxation agreement (DTA). This will allow information exchanged to be used for other non-tax related purposes provided such use is permitted under the laws of both jurisdictions and the competent authority of the supplying party authorises such use.

India

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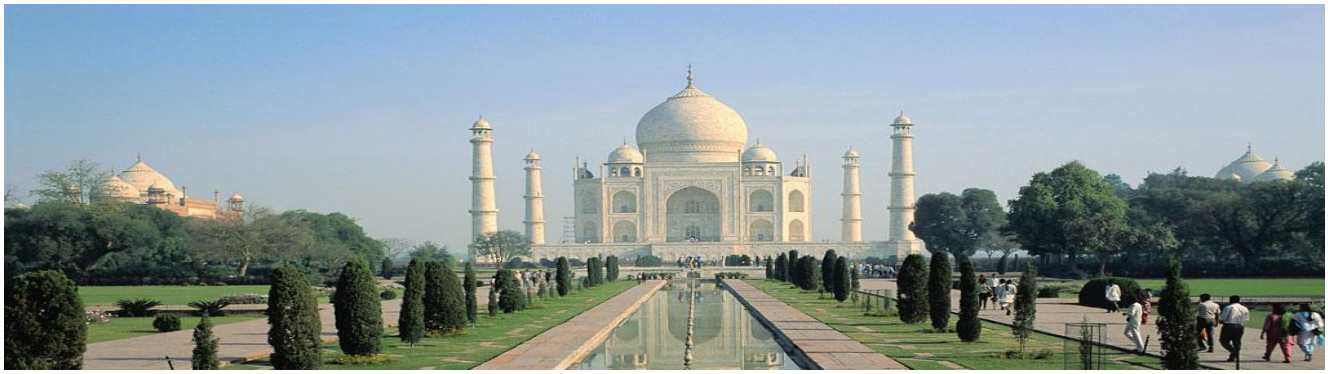

Tax update

Loss on derivative transactions incurred by Foreign Institutional Investor ('FII') is in the nature of capital gains and not business income - Platinum Asset Management Ltd, A/c Platinum Asia Fund, v. DDIT [I.T.A. No. 2787-88/M/2012]

The Platinum Asia Fund and Platinum International Brand Fund (jointly referred as taxpayers) are the sub-accounts of the FII Platinum Asset Management Ltd., registered in Australia and operating in India, registered with the Securities and Exchange Board of India ('SEBI'). The taxpayers are involved in purchase and sale of securities and trading in derivatives in India.

For Assessment Year ('AY') 2006-07, the taxpayers filed NIL return of income respectively and claimed carry forward of short term capital loss after setting off losses from index derivative transactions against short term and long term capital gains respectively.

The assessing officer ('AO') held that the loss arising from index derivative transactions were business losses and assessable under the head business income and could not be claimed as capital loss. Accordingly, the AO taxed the capital gains earned by the taxpayers. The Commissioner of Income-tax (Appeals) ['CIT(A)'] upheld the AO's order.

The issue under consideration before the Income - tax Appellate Tribunal ('the Tribunal') was:

- whether loss from index derivative transactions is in the nature of business loss or capital loss; and
- whether loss arising on derivative transactions can be set off against capital gains arising on sale of shares and if balance loss can be allowed to be carried forward.

Based on the facts of the case, the Tribunal observed and held as follows:

The issue is squarely covered by the previous decision in Platinum Investment Management Ltd, A/c, Platinum International Fund that relied on LG Asian Plus Limited, wherein the following observations were made:

- On a close scrutiny of the SEBI (Foreign Institutional Investors) Regulations, 1995 ('FII regulations') together with Section 115AD of the Income Tax Act, 1961 ('the Act'), seen in the light of the Memorandum explaining the provisions of the Finance Bill, 1993, a FII is allowed to invest only in `securities' and further the income from securities, either from their retention or from their transfer, is to be taxed as per this section alone.
- Once it is noticed that a FII can only 'invest' in `securities' and tax on the income from the transfer of such securities is covered by a special provision contained in Section 115AD of the Act, the natural corollary which follows is that tax should be charged on income arising from transfer of such securities as per the prescription of this section alone, which refers to income by way of short term or long term capital gains.
- If the tax authorities venture to make a distinction between such securities as constituting capital asset or stock in trade, which is not contemplated by the Central Government, as is evident from FII regulations and the definition of FII in Explanation (a) to Section 115AD of the Act, then this provision will become otiose.
- If FII receives any income in respect of securities or from the transfer of such securities, the same can be considered under Section 115AD(1) of the Act alone and Section 115AD(2)(b) of the Act cannot be invoked to construe it as `Business income'.
- From the earlier Press Note (F No. 5(13) SE/91-FIV dated 24 March 1994) issued by the Ministry of Finance, it is abundantly clear that FII's have been considered as 'investors' (and not traders). Secondly, income from the transfer of

securities has been viewed as chargeable to tax under the head 'capital gain,' as long-term or short-term capital gain, depending upon the period for which such securities are held.

- It is noticed that Section 115AD of the Act falls in Chapter XII of the Act which deals with determination of tax in certain special cases. It is a well settled legal position that specific provisions override the general provisions. In other words, if there are two conflicting provisions in an enactment, the special provisions will prevail and the subject matter covered in such a special provision shall stand excluded from the scope of the general provision.
- Further Section 43(5) of the Act defining a 'speculative transaction' is relevant only in the context of income under the head `Profits and gains of business or profession'. It has no application to FII's in respect of securities as defined in explanation to Section 115AD of the Act, income from whose transfer is considered as short term or long term capital gains.
- Income arising from the derivative transactions to the taxpayer, being a FII cannot be treated as business profit or loss, whether speculative or non-speculative, but the same has to be capital gain or loss. Further, loss from derivative transactions is to be considered as short term capital loss on sale of securities eligible for adjustment against short term capital gains on sale of shares.

Following the decision of the Co-ordinate Bench of the Tribunal, the Tribunal held that income from derivative transactions in case of the taxpayers cannot be treated as business profit or loss.

Danish fiscally transparent entity eligible for tax treaty benefits - DDIT vs. A.P. Moller [I.T.A. No. 5825/Mum]

A.P. Moller ('the taxpayer') is a fiscally transparent partnership firm existing under the laws of Denmark. The taxpayer is the managing owner of two shipping companies that are tax resident of Denmark as the effective place of management is in Denmark. The taxpayer filed corporate tax return on their behalf throughout the world including India. The taxpayer is not the beneficial owner of nor is entitled to any shipping income and only receives management fees from the two shipping companies.

The AO denied the benefits of the India- Denmark Tax Treaty ('the treaty') in respect of management fees received on the ground that taxpayer is a partnership firm which is a transparent entity for the purpose of taxation in Denmark i.e. it is not liable for tax and therefore, it is not a tax resident of Denmark for the purpose of Article 4 of the treaty. CIT(A) upheld the AO's order.

One of the issues under consideration before the tribunal was whether the taxpayer is entitled to the benefits of the treaty.

Based on the facts of the case, the Mumbai Bench of the Tribunal observed and held as follows:

- Even though the partnership firm is a transparent entity but once its income and profits is taxed in the hands of the partners, the treaty benefits should be extended to the partners.

Under Danish law, partnership income is taxable in the hands of its partners and therefore, the entire income earned by the partnership firm can be said to be fully taxable in Denmark. Accordingly, once the income of the partnership is taxed in Denmark, irrespective of the fact that the same is taxed in the hands of the partners, the entity should be treated as a tax resident of Denmark and is thereby, entitled to benefits of the Danish treaty.

Non residents entitled to benefits of 10 percent tax rate on long term capital gains on listed securities - Cairns UK Holding Limited [Writ Petition (Civil) No. 6752/ 2012 (Delhi High Court)]

Cairns UK Holding Limited ('the taxpayer'), is a company registered in Scotland, sold shares of an Indian company which was listed on the Bombay Stock Exchange to a Malaysian company by way of an off-market sale. The taxpayer computed long-term capital gains as per the first proviso to Section 48 of the Act.

The taxpayer approached the Authority for Advance Rulings (AAR) for deciding on whether the lower tax rate of 10 percent would be applicable for computing the tax payable on long-term capital gains earned by the taxpayer. The AAR held that the lower rate of 10 percent was available only if the second proviso to Section 48 of the Act was applicable while computing the gains. As the second proviso to Section 48 of the Act was not applicable to the taxpayer, the lower rate of tax of 10 percent was not available to the taxpayer.

The taxpayer carried the matter to the Delhi High Court (High Court).

The issue before the High Court was whether the long-term capital gains arising to the taxpayer on sale of shares in the Indian company would be taxable at the rate of 10 percent.

Based on the facts of the case and the arguments, the High Court, among other things, observed and held as follows:

- The proviso to Section 112(1) of the Act does not state that an assessee who avails the benefits of the first proviso to Section 48 of the Act is not entitled to the benefit of the lower rate of tax at 10 percent. Also, the benefit cannot be denied because the second proviso to Section 48 of the Act is not applicable.
- If the Legislature wanted to deny the benefit of the lower rate of tax, it would have been specifically stipulated.
- Accordingly, the taxpayer was entitled to apply the lower rate of tax at 10 percent on the long-term capital gains.

Recent developments

New Double Taxation Avoidance Agreement (DTAA) between India and Macedonia signed

The Government of India signed a DTAA with the Government of Macedonia on 17 December 2013. The new DTAA has a Limitation of Benefit (LOB) provision which provides that the benefits of the DTAA will not be available to entity which has formed mainly to obtain benefits under this agreement. The significant aspects of the DTAA are as under:

S. No.	DTAA/ Protocol	Key Highlights
1.	India-Macedonia (To be notified)	Capital Gains from alienation of securities are taxable in India.
		Dividends and interest income taxable in source and resident country. Taxation of Dividends and interest income in source country (Maximum Rate) • Dividend at the rate of 10 per cent on gross basis • Interest at the rate of 10 per cent on gross basis

Source: CBDT press release dated 17 December 2013

Protocol amending the India-Spain tax treaty ('the tax treaty')

India and Spain had signed a Protocol on 26 October 2012 amending the existing tax treaty. The salient features of the protocol are as follows:

LOB clause has been introduced in the tax treaty. The LOB clause provides that the:

- Domestic rules and procedures regarding abuse of law (including tax treaties) are applicable;
- Tax Treaty benefits do not apply to non-beneficial owners;
- Tax Treaty does not prevent both the states from applying their domestic Controlled Foreign Company rules; and
- Benefits derived from the tax treaty will not apply to a resident of one of the states, or in respect of a transaction made by such resident, if the main purpose or one of the main purposes of the creation, existence, set up, registry or presence of the resident, or the transaction made by him, is to obtain treaty benefits that would not otherwise be available.

A new paragraph to Article 10 (Associated enterprises) is included to provide for a corresponding adjustment to profits to be made in a counter party's jurisdiction where an adjustment has been made under this article.

The existing article on exchange of information has been amended to bring the same in line with Article 26 of the OECD Model Convention.

Article on Assistance in collection of taxes has also been incorporated in the tax treaty.

Foreign Portfolio Investors (FPI) to be given similar tax treatment as presently available to Foreign Institutional Investors

In a bid to simplify and rationalize the foreign portfolio investment regime, the SEBI has introduced the FPI regulations. Under the FPI regime, SEBI proposes to harmonize FIIs, sub-accounts and qualified foreign investors (QFIs) into a single investor class with a view to ensure uniform guidelines and provide a single window clearance for different categories of foreign investors.

With respect to taxability of FPIs, SEBI has noted the communication from Department of Economic Affairs to the Central Board of Direct Taxes and SEBI conveying the decision that the three categories of the FPIs (i.e. FIIs, Sub-accounts and QFIs) would be given similar tax treatment as presently available to FIIs.

SEBI has on 7 January 2014 notified the Securities and Exchange Board of India (Foreign Portfolio Investors) Regulations, 2014 to put in place a framework for registration and procedures with regard to foreign investors who propose to make portfolio investments in India.

CBDT has further issued a Notification which provides that FPI registered under SEBI (Foreign Portfolio Investors) Regulations, 2014 shall be treated as FII for the purpose of Section 115AD of the Act (Section 115AD of the Act enlists the beneficial tax rates that are applicable to FIIs).

Indonesia

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Tax update

Tax interest concession for Indonesian Mutual funds continued

Indonesia imposes withholding tax ("WHT") on income received and/or earned by taxpayers in the form of interest. Under Indonesian Income Tax law number 7 of 1983 ("ITL"), as lastly amended by Law number 36 of 2008, interest is broadly defined as including premiums, discount and compensation for loan repayment guarantees. Generally, 15% WHT is to be withheld and remitted by the payee to the Indonesian Tax Authority for interest received or accrued to resident Indonesian entities and permanent establishments ("PE") as opposed to 20% (or the reduced WHT rate under the applicable double tax treaty) for payments to non-residents, other than those having a PE in Indonesia.

For purposes of stimulating growth within the mutual fund sector and attract more investors, the government promulgated Government Regulation ("GR") No 16/2009 whereby a tax concession was afforded to the mutual funds industry wherein interest received and/or discount of bonds redeemed by taxpayers constituting mutual funds registered at the Capital Market and Financial Institution Supervisory Board was allowed the following reduced final WHT as stipulated therein:

- 0% (nil percent), for 2009 up to 2010;
- 5% (five percent), for 2011 up to 2013;
- 15% (fifteen percent), for 2014 and onwards.

In light of the above, Indonesian mutual funds, as from 1 January 2014, would have been subjected to 15% final WHT on any interest received and/or discounted bonds redeemed. However, the capital supervisory authority has enacted and released GR No 100/2013 on 31 December 2013 which has extended the application of the 5% final WHT on the portfolio of bonds held by mutual funds up until 2020. Hence, the concessionary rate of 15% is further reduced to 5% as from 1 January 2014 with a subsequent increase in the final WHT to 10% as from 1 January 2021.

Treaty Update: Indonesia-Croatia Double Tax Treaty

On 24 February 2012, Indonesia ratified a number of pending double tax treaties, including Croatia, which was signed on 15 February 2002, by way of Regulation No.19/2012. Furthermore, the Director General of Taxation ("DGT") has issued Circular Letter No. SE-41/PJ/2013, dated 27 August 2013, to stipulate the enforcement of the Double Tax Avoidance ("DTA") Agreement between the Government of the Republic of Indonesia and the Government of the Republic of Croatia, which was signed on 15 February 2012. In addition, the provisions of the Croatia-Indonesian shall be applicable effectively in connection with income the tax of which is withheld/collected in country of source of income which is received or earned, on or after January 1, 2013 and in connection with tax on other incomes, as from fiscal year that starts on or after January 1, 2013.

It is worthwhile to mention the salient features of the Croatia-Indonesia DTA considering that the conclusion date was 15 February 2002 and only entered into force on 16 March 2012 effective 1 January 2013.

The following salient features are relevant and noted under the Croatia-Indonesia Double Tax Treaty:

- The withholding tax rate on dividends, interest and royalties may be reduced to 10%, where the recipient is the beneficial owner of the income. Furthermore, under the term PE, this will include a building site or construction, assembly or installation project or supervisory activities in connection therewith, but only where they last more than 6

months. In respect of the furnishing of services, including consultancy services by an enterprise of a Contracting State through employees or other engaged personnel in the other Contracting State, provided that such activities continue for the same project or a connected project for a period or periods aggregating more than 3 months within any twelve month period and/or the use of an installation or drilling rig or ship in a Contracting State to explore for or exploit natural resources constitutes a permanent establishment only if such use is for more than 120 days.

Japan

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Tax update

Change of international taxation principle applied to a foreign company

The international taxation principle applied to foreign companies under domestic tax laws will be changed from the entire income principle to the attributable income principle[*1], which is in line with Article 7 (Business Profits) of the OECD Model Tax Convention amended in 2010[*2].

[*1] Under the entire income principle, a foreign company with a permanent establishment ('PE') in Japan is liable for corporate tax on all Japanese source income (in principle) regardless of whether such income is attributable to the PE. On the other hand, under the attributable income principle, the business income attributable to the PE of such foreign company is subject to corporate tax and the Japanese source income not attributable to the PE is taxed in the same way as Japanese source income earned by a foreign company without a PE in Japan (i.e. in principle, subject to withholding tax only, except for certain capital gains, etc.).

[*2] Article 7 of the OECD Model Tax Convention and the Commentary thereon were amended in 2010 to be in line with the Authorised OECD Approach ('AOA'). The AOA is an approach to calculate income attributable to a PE, which was publicized in the 'Report on the Attribution of Profits to Permanent Establishments' released in 2008 and 2010. Under the AOA, external transactions, assets, risks and capital attributable to a PE are determined based on functions performed by the PE and other related facts, and internal dealings are recognized at an arm's length price ('ALP').

Income Attributable to a PE

(1) Income attributable to a PE

Income attributable to a PE will be the income that the PE would have earned if it were a distinct and separate enterprise from its head office.

(2) Internal dealings

In calculating income attributable to a PE, profits/losses derived from internal dealings will be recognized.

The transfer pricing rules, etc. will be applied to internal dealings as follows:

- If income attributable to a PE is less than it should be since the price of an internal dealing is not an ALP, the price should be adjusted to the ALP in the same way as a transaction with a related overseas party under the transfer pricing rules.
- Special provision to extend the statute of limitations for corrections, rules of inquiry and inspection to third parties engaging in the same activities and the estimation clause will be applied to internal dealings in the same way as those under the transfer pricing rules.
- The deductibility of an internal dealing will be denied in the same way as a donation to a related overseas party where the internal dealing is comparable to a donation from a PE to its head office.

Neither internal guarantees nor internal reinsurance between a PE and its head office will be recognized in calculating income attributable to the PE.

Internal interest for non-financial institutions and internal royalties will not be recognized if a tax treaty including a provision equivalent to Article 7 of the pre-2010 amendment OECD Model Tax Convention is applied.

Provision of start-up funds from the head office to its PE and profit distributions from a PE to its head office will be deemed as capital transactions; i.e. such transactions will not generate profits/losses.

Deemed payments of internal interest, etc. from a PE to its head office will not be subject to withholding tax in Japan.

(3) Calculation of income attributable to a PE

A provision prescribing that mere purchase by a PE of goods or merchandise for its head office does not generate any profits will be abolished. (If a tax treaty including such provision is applied, the provision of the tax treaty will be applied.)

Where common costs incurred for businesses of both a PE and the head office are allocated to the PE based on reasonable allocation keys, such allocated costs will be allowable in the hands of the PE. Note that if evidence regarding the cost allocation is not preserved, the deductibility will be denied, in principle.

When all assets of a PE are sold, capital gains/losses incurred from the sales will be recognized as income attributable to the PE.

When a PE is closed, built-in gains/losses in assets attributable to the PE will be recognized as income attributable to the PE for a fiscal year including the closure day. If the PE has deferred revenue/expenses, such revenue/expenses will be realized in a fiscal year including the closure day. The tax losses carried-forward for income attributable to the PE will expire upon the closure of the PE.

(4) Allocation of capital to a PE/Limitation on deductibility of interest expenses

When the amount of capital of a PE is smaller than the capital attributable to the PE (capital to be attributable to the PE if the PE were a distinct and separate enterprise from its head office), interest expenses (including internal interest and interest expenses allocated to the PE) corresponding to such deficient portion will not be allowed in calculating income attributable to the PE.

The amount of capital attributable to a PE of a foreign company will be calculated by using either of the following approaches: (The chosen approach should be applied consistently.)

i. Capital allocation approach

$$\text{Amount of capital of the foreign company} \times \frac{\text{Amount of assets attributable to the PE}}{\text{Amount of assets of the foreign company}}$$

- In principle, the amount of 'assets of the foreign company' and 'assets attributable to the PE' will be the amount of the risk-weighted assets (i.e. the amount of assets calculated considering credit, market and operational risk, etc.). The book value of assets may be available for non-financial institutions.
- Although the amount of 'capital of the foreign company' and 'assets of the foreign company' will be, in principle, those on a stand-alone basis, the amounts on a consolidated basis will be applied for certain cases; e.g. where the capital ratio of the foreign company is extremely low.

ii. Thin-capitalization approach

$$\text{Amount of assets attributable to the PE} \times \frac{\text{Amount of capital of a comparable company}}{\text{Amount of assets of a comparable company}}$$

- A 'comparable company' means a company carrying on business in Japan, which is similar to the PE's business in the type and scale, etc.
- The amount of 'assets of a comparable company' and 'assets attributable to the PE' will be the amount of

the risk-weighted assets.

- Non-financial institutions will be allowed to use the debt-equity ratio of a comparable company instead of the capital ratio.
- When the capital ratio of a comparable company is extremely low, such ratio will not be available.

(5) Deduction of interest attributable to a PE carrying on banking or securities business

When the regulatory capital of a foreign company carrying on banking or securities business includes a portion being treated as debt, interest paid by the foreign company on such portion will be deductible in calculating income attributable to the PE to the extent of such interest allocated to the PE in proportion as the allocation of capital discussed in (4) above.

(6) Application of thin-capitalization rules and earnings stripping rules

The thin-capitalization rules will not be applied to a PE in response to the introduction of the new rule discussed in (4) above.

Internal interest will be included in 'interest payments to related persons' subject to the earnings stripping rules. Even when interest allocated to a PE carrying on banking or securities business discussed in (5) includes interest paid to related persons, such interest will not be treated as 'interest payments to related persons' subject to the earnings stripping rules.

Korea

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Tax update

Amendment to Korea Local Tax Law

On January 1st, 2014 amendments were made to the Korea Local Tax Law, establishing regulation 'Special Collection of Local Corporate Income Tax'.

The details of Local Income Tax Law Article 103, Item 29 are as follows:

When subject to withholding tax for payment of interest income and investment trust gain to a domestic corporation

- Under previous tax law, only interest income is subject to 14% withholding tax, Local Corporate Income Tax is not subject to special collection.
- Under newly established regulation, Local Corporate Income Tax also becomes subject to special collection. Therefore, total amount of 15.4% is withheld.

In relation to withholding tax of financial institutions, a system change is required for operation purpose therefore, a grace period of 1 year is applied.

This change will be applicable from January 1, 2015.

Malaysia

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Tax update

2014 Budget Highlights

The Malaysian Prime Minister and Minister of Finance, YAB Dato' Sri Mohd. Najib Tun Abdul Razak, presented the 2014 Budget on 25 October 2013. Some of the key changes and proposals are as follows:

Implementation of Goods and Services Tax ("GST")

GST, a consumption tax based on the value-added concept, is proposed to be implemented effective from 1 April 2015 with a standard rate of 6%. GST will replace the existing sales tax and service tax.

The proposed threshold for registration under the GST is an annual sales value of RM500,000 or more.

Generally, it is proposed that the provision of financial services will qualify for GST exemption while the provision of international financial services may be zero-rated. However, the exemption will not be extended to fee-based services which will be treated as standard rated supplies and subject to GST.

Currently, various GST Guides have been issued by the Royal Malaysian Customs Department. However, the new GST Bill has yet to be tabled in the Parliament.

Corporate Income Tax Rate

It is proposed that the corporate tax rate to be reduced by 1% to 24%. For small and medium companies (i.e. resident companies with a paid-up ordinary share capital of up to RM2.5 million), the tax rate for chargeable income of up to RM500,000 is proposed to be reduced by 1% to 19%. The remaining chargeable income is proposed to be taxed at a reduced rate of 24%.

The proposal is effective from Year of Assessment ("YA") 2016. However, the law to effect the reduction in rates has yet to be tabled and passed in the Parliament.

Real Property Gains Tax ("RPGT") Rates

It is proposed that the RPGT rates on gains arising from the disposal of real properties and shares in real property companies be revised as follows:

Disposal	Proposed RPGT Rates		
	Companies	Individuals (Citizens & Permanent Residents)	Individuals (Non-Citizens)
Within 3 years	30%	30%	30%
In the 4th year	20%	20%	30%
In the 5th year	15%	15%	30%
In the 6th and subsequent years	5%	0%	5%

The proposal is effective for the disposal of real properties (including shares in real property companies) from 1 January 2014. To effect the proposal, the Real Property Gains Tax (Exemption) Order 2012 has been revoked by Real Property Gains Tax

(Exemption) (Revocation) Order 2013 with effect from 1 January 2014.

Accelerated Capital Allowances on Information Technology and Communication ("ICT") Equipment

It is proposed that companies continue to be given accelerated capital allowances at the rate of 100% on the cost of acquisition of ICT equipment. The proposal is effective from YA 2014 to YA 2016.

However, the Income Tax Rules to effect the change have not been gazetted yet.

Tax Incentive Package in Line with GST Implementation

To support the smooth implementation of GST, enhance tax compliance and reduce the cost of doing business, it is proposed that the following incentives be given:

i. secretarial fees and tax filing fees be given tax deductions of up to RM5,000 and RM10,000 respectively for a YA; and

ii. expenses relating to training of employees in accounting and information and communication technology be given double deduction.

The proposal for item (i) is effective from YA 2015 whilst the proposal for item (ii) is effective for YA 2014 and YA 2015.

However, the Income Tax Rules to effect the above proposals have not been gazetted yet.

Deduction for Interest on Money Borrowed

It is proposed that interest on money borrowed is only allowed a deduction against a source of income when such interest is due to be paid. However, the deduction would be given in the year the interest is payable.

The proposal is effective from YA 2014 with the gazette of the Finance Act 2014 on 23 January 2014.

Deductions disallowed due to failure to furnish information

It is proposed that tax deductions be disallowed on expenses where the taxpayer has failed to furnish, within the specified timeframe, information requested by the Director General of Inland Revenue Board ("DGIR") concerning wholly or partly the deduction claimed on the expenses.

The proposal is effective from YA 2014 with the gazette of the Finance Act 2014 on 23 January 2014.

Tax Deduction for Takaful Businesses

Presently, the tax laws do not provide any tax deduction for management expenses incurred by General Takaful operator adopting the Mudharabah model and commission expenses incurred in respect of the Shareholders' Fund. It is proposed that a deduction be given to:

i. management expenses incurred by the General Takaful Fund in respect of the General Takaful business; and

ii. commission payable and discounts allowed by the Shareholders' Fund in connection with the General Takaful business.

The proposal is effective from YA 2014 with the gazette of the Finance Act 2014 on 23 January 2014.

Given the proposal is only effective from YA 2014 and not retrospective, the tax deduction issues on the above expenses remain unresolved for prior years.

Withholding Tax on Profit Distributed or Credited to Participants for Takaful Funds

Currently, withholding tax is applicable on profits distributed or credited out of family fund, family re-takaful fund or general fund to a participant other than participant which is a resident company.

It is proposed that withholding tax will apply only where a tax deduction has been claimed by the takaful operator on such profits distributed.

The proposal is effective from YA 2014 with the gazette of the Finance Act 2014 on 23 January 2014.

Deemed Interest on Loans or Advances to Director

It is proposed that where a company provides any loans or advances from its internal funds to its directors, the company shall be deemed to have gross interest income from such loans or advances. The sum of interest of is calculated based on a prescribed formula and the rate of interest is based on the average lending rate of commercial banks published by the

Malaysian Central Bank or such other reference rate as prescribed by the DGIR.

The proposal is effective from YA 2014 with the gazette of the Finance Act 2014 on 23 January 2014.

Submission of Income Tax Returns

It is proposed that all companies must file their tax return on an electronic medium or by way of electronic transmission and the tax return filed must be based on audited accounts.

The proposal is effective from YA 2014 with the gazette of the Finance Act 2014 on 23 January 2014.

Appeal Against an Assessment

It is proposed that an appeal against an assessment is no longer applicable to a deemed assessment under the Self Assessment System, except where a person who is aggrieved by such deemed assessment as result of complying with the Public Ruling issued by the DGIR.

The proposal is effective upon coming into operation of the Finance (No 2) Act 2013 on 23 January 2014

Tax Audit Framework

The Malaysian Inland Revenue Board ("MIRB") has issued the framework for tax audit, petroleum tax audit and transfer pricing audit.

Generally, the framework sets out the administrative process relating to tax audit and the framework on transfer pricing audit also contains section on offsetting/corresponding adjustments.

The full text of the framework can be accessed from the MIRB's website at

http://www.hasil.gov.my

Tax Investigation Framework

The MIRB has issued an updated framework for tax investigations.

The full text of the framework can be accessed from the MIRB's website at

http://www.hasil.gov.my

MIRB's Guidelines

The MIRB has issued the following guidelines:

- **Guidelines for Income Tax Treatment of Malaysian Financial Reporting Standards ("MFRS") 5: Non-Current Assets held for Sale and Discontinued Operations**

  The guidelines deal with the time at which non-current assets classified as being held for sale, are deemed to be disposed of for tax purposes.

- **Guidelines for Income Tax Treatment of MFRS 123: Borrowing Cost**

  The guidelines explain the income tax treatment arising from the capitalisation of interest pursuant to MFRS 123.

- **Guidelines for Income Tax Treatment of MFRS 140: Investment Property**

  MFRS 140 requires entities to determine the fair value of investment properties for accounting purposes. The guidelines explain the income tax treatment arising from the adoption of MFRS 140.

- **Responsibility to Submit Details of Payments to Agents, Dealers or Distributors in Form CP58 (Malay version only)**

  The guidelines provide guidance on the duty to submit particulars of payments to agents, dealers and distributors in prescribed form (i.e. Form CP58)

  For further information regarding the Form CP58, please refer to Issue 47.

The full guidelines can be accessed from the MIRB's website at

http://www.hasil.gov.my

Tax Exemption Order

Income Tax (Exemption) (No.10) Order 2013

The above Order exempts BNM Kijang Berhad or any holder of Sukuk Kijang issued or to be issued in accordance with the

Shariah principle of Ijarah by BNM Kijang Berhad from the payment of income tax in relation to any income derived from Sukuk Kijang.

The Order is effective from 12 August 2013.

Public Rulings

The MIRB has recently issued, amongst others, the following Public Rulings:

- (a) Public Ruling No. 5/2013: Taxation of Unit Holders of Unit Trust Funds
  (b) Public Ruling No. 6/2013: Unit Trust Funds Part II – Taxation of Unit Trusts
  (c) Public Ruling No. 7/2013: Unit Trust Funds Part I – An Overview

  The Rulings are in respect of unit trusts other than a Real Estate Investment Trust (REIT) or Property Trust Fund governed by the Securities Commission.

  The Rulings explain the tax position of unit holders who receive income distribution from unit trusts, taxation of unit trust and property trust funds and also provide an explanation in general on the unit trust fund including property trusts based on the guidelines issued by the Securities Commission.

- **Public Ruling 9/2013: Special Deduction for Expenditure on Treasury Shares**

  The Ruling explains the tax treatment of cost incurred by companies in acquiring treasury shares which are offered to employees under an employee share scheme.

- **Public Ruling 10/2013: Taxation of Business Trust**

  The Ruling explains the tax treatment accorded to a business trust registered with the Securities Commission.

- **Public Ruling 11/2013: Pre-Operational Business Expenditure**

  The Ruling replaces Public Ruling 2/2010 and outlines the deductions allowed for certain expenditure incurred prior to the commencement of a business.

The full text of the Public Rulings is available at

http://www.hasil.gov.my

Goods and Services Tax (GST) Guides

The Royal Malaysian Customs has released GST Industry Guides to assist businesses in understanding the GST and its implications on commercial banking, fund management, hire purchase and credit sale, insurance and takaful, islamic banking, leasing, money lending operation, share issuing house as well as trustee services.

The full text of the guides is available at

http://gst.customs.gov.my/

Double Taxation Agreement ("DTA")

Malaysia – Hong Kong and India

The Malaysian Government has ratified the DTAs with Hong Kong and India on 28 December 2012 and 26 December 2012 respectively and the DTAs took effect from 1 January 2013.

Mauritius

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Tax update

- The Finance Act 2013 provides that Tax Deducted at Source (TDS) applies on payment of interest, other than exempt interest, to any person other than a company resident in Mauritius. Previously, only payment of interest to non-residents was subject to TDS. The TDS rate remained unchanged at 15%. The TDS rate is subject to the relevant double taxation agreement which Mauritius has with the country of residence of the recipient of interest.
- Acquisition of patents now qualifies for capital allowance at the rate of 25% on base value.
- The Finance Act 2013 now provides for updated rates of special levy applicable to banks for years of assessment 2014 and 2015. The levy will now be calculated at the rate of 10% on chargeable income for Segment A activities for years of assessment 2014 and 2015 instead of 3.4% of book profit and 1% of operating income. The levy on Segment B activities (i.e. banking transactions with non residents and corporations holding a Global Business License) is being left unchanged, that is 3.4% on book profit and 1% on operating income. Thereafter, as from year of assessment 2016 the rates will be 1.7% on book profit and 0.5% on operating income applicable for income derived from both Segment A and Segment B activities.
- Amendment has been brought to clarify that the income derived by a registered owner of a foreign vessel from the operation of the vessel which is exempt from income tax includes income derived from chartering of the vessel.
- As from the year of assessment 2015, the limitation to the income tax exemption for private freeport developers is removed such that they will also be exempt from income tax indefinitely similar to freeport operators. However, income derived from the provision of goods and services on the local market shall remain taxable at the rate of 15%.
- Corporate Social Responsibility (CSR) charge equivalent to 2% on prior year chargeable income now applies to resident sociétés as from year of assessment 2015. Resident sociétés holding a Global Business License will be excluded from this requirement.
- Refund of tax by the Mauritius Revenue Authority (MRA) in respect of refund of excess income tax and upon determination of objections shall be made with interest at prevailing repo rate determined by the Bank of Mauritius.

Tax Ruling 142 (TR 142)

- Tax Ruling TR 142 clarified that income should be declared on an accrual basis and subject to tax in the year it is accrued in the Financial Statements.

Tax Ruling 143 (TR 143)

- Based on the facts of TR 143, a Mauritius Company was intending to make a dividend distribution to its shareholders in kind of the shares it holds in its subsidiary. It was held that 'dividend in kind' falls under the definition of 'dividend' under the Income Tax Act. Such dividend being paid by the Mauritian company is exempt from income tax. The ruling further emphasized that where in case the arm's length value of the shares exceed the amount of dividend payable, the excess would not qualify as dividends but would rather be considered as benefit to shareholder and be taxable as 'any other income'.

New Zealand

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Tax update

Tax Bill changing the tax treatment of foreign superannuation nearing enactment

The Taxation (Annual Rates, Foreign Superannuation and Remedial Matters) Bill ("the Bill") introduced to Parliament in May of last year is nearing enactment. The key change is that Bill changes the tax treatment of interests in foreign superannuation schemes.

From 1 April 2014, interests in foreign superannuation schemes will be taxed only on withdrawal from the scheme. (The current rules are complex and not well understood, which has resulted in widespread non-compliance.)

The taxable percentage of a foreign superannuation withdrawal (between 0 and 100%) will be based on how long the holder of the interest has been New Zealand tax resident. Withdrawals in the first four years of tax residence are exempt.

An amnesty is proposed if no tax has previously been paid on foreign superannuation interests. This requires those who have not paid tax on past foreign superannuation withdrawals (between 1 January 2000 and 31 March 2014) to pay tax on 15 percent of these amounts. If the amnesty is applied no sanctions (interest or penalties) will apply.

The Bill has recently been reported back by a Parliamentary Select Committee, which made a number of recommendations to improve the operation of the new rules, in response to public submissions.

The Bill will be enacted from 1 April 2014.

Tax Bill changing treatment of employee allowances and extending thin capitalisation restriction introduced in late 2013

The Taxation (Annual Rates, Employee Allowances and Remedial Matters) Bill ("November Bill") was introduced to Parliament in November 2013.

The November Bill contains an assortment of legislative amendments, including the following key proposals:

- **Employee allowances** – changes are proposed to the way employer provided accommodation and accommodation allowances are taxed. (This follows the release in December 2012 of an Inland Revenue statement that such allowances are generally taxable – see our June 2013 update.) Under the changes, accommodation and accommodation allowances can be provided tax-free for up to two years (longer in certain circumstances), if certain conditions are met. Meal allowances provided to employees in connection with work related travel may also be provided tax free for up to three months.
- **Thin Capitalisation extended** – The thin capitalisation changes reported in the June 2013 update have been incorporated into the November Bill. The key change is that the thin capitalisation rules will now limit excessive interest deductions where multiple non-resident shareholders own 50% or more of a company and "act together" (including if shareholder debt is issued proportionately to equity).
- **Foreign currency denominated sales contracts** – New Zealand IFRS taxpayers will be allowed to follow their accounting treatment for foreign currency denominated agreements for the sale and purchase of property and services ("ASAPs") to reduce complexity and volatility under New Zealand's financial arrangement rules, from the 2014-2015 income year.

- **Foreign Account Tax Compliance** – The November Bill introduces amendments to bring into domestic law any agreed Inter-Governmental Agreement ("IGA") between New Zealand and another country, to clarify the reporting obligations of New Zealand financial institutions under foreign law. Principally, the rules are designed to accommodate obligations under the United States law known as the Foreign Account Tax Compliance Act (or "FATCA"). However, they will also apply to other similar agreements.

Inland Revenue focus on multinationals: 2013-2014

In late 2013, Inland Revenue released its 2013-2014 compliance guide for business taxpayers. The focus for the 2013-14 period is on New Zealand and foreign multinational businesses.

The issues identified in Inland Revenue's compliance guide align with those in the OCED's Base Erosion and Profit Shifting Action Plan, released in July 2013.

The key areas of Inland Revenue's focus include:

- **International financing** – e.g. structured financing arrangements, hybrid instruments, unusual financing and exotic financial products, interest rates on inbound loans of more than $10m and all outbound loans (zero or low interest loans). The concern is international profit shifting using related party debt and the effectiveness of New Zealand's tax rules in combating such profit shifting. (The changes to extend thin capitalisation are part of the response to this concern.)
- **Transfer pricing** – Inland Revenue's concerns with transfer pricing include:
    - lack of documentation or material "untested" transfer pricing transactions;
    - payments (e.g. royalties/management fees) not supported by the substance of the services provided to New Zealand;
    - No or low recovery of costs incurred by New Zealand entities, such as for local R&D; and
    - Persistent New Zealand losses or abnormally high foreign profits.
- **Hybrid arrangements** – where a hybrid structure or instrument results in inconsistent tax treatments across borders. For example, where a cross-border funding instrument is treated as debt in New Zealand but equity in the foreign jurisdiction (e.g. Australia).

Court of Appeal decision in Sovereign Assurance Company Limited & Ors v CIR

The case related to the industry of life reinsurance and the decision confirmed that the financial arrangement rules apply to the upfront commission payments which were repaid and a further finding that such payments are capital in nature and therefore not immediately taxable or deductible. This decision is based on law in effect prior to the 1 July 2010 changes to New Zealand's life insurance income tax rules.

Inland Revenue's interpretation of the current law is that where a life reinsurance contract involves upfront commission payments, the whole contract and not just the commission payments as in Sovereign is subject to the financial arrangements rules.

The effect of this is that all income and expenditure flows from these contracts will have to be spread over the term of the reinsurance agreement and upfront commission payments will not be immediately deductible or taxable. We expect that Inland Revenue will continue to review such contracts particularly as relevant transitional rules expire over the next four years. There are also indications that a policy review may be undertaken by Inland Revenue. Life insurers will need to consider the advantages and disadvantages of Inland Revenue's position.

Double Tax Agreement Update

- New Zealand's new Double Tax Agreement with Japan, which provides for lower withholding tax rates on interest, dividends and royalties was formally ratified in September 2013, and comes into effect from 1 January this year.
- A Double Tax Agreement with Papua New Guinea, signed in late 2012, comes into effect from 1 March this year
- In August 2013, New Zealand signed a Double Tax Agreement with Vietnam. The new treaty is still to come into force.
- A new Double Tax Agreement with Canada is also awaiting ratification.

Philippines

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Tax update

Guidelines on preservation of books of accounts and other accounting records [Revenue Regulations (RR) No. 017-13]

The (Bureau of Internal Revenue) BIR issued RR No. 17-2013 dated 27 September 2013 which clarifies the retention period and prescribing guidelines on the preservation of books of accounts and other accounting records.

Retention Periods

All taxpayers are required to preserve their books of accounts, including subsidiary books and other accounting records, for a period of ten (10) years reckoned from the day following the deadline in filing a return, or if filed after the deadline, from the date of the filing of the return, for the taxable year when the last entry was made in the books of accounts.

If the taxpayer has any pending protest or claim for tax credit/refund of taxes, and the books and records concerned are material to the case, the taxpayer is required to preserve his/its books of accounts and other accounting records until the case is finally resolved.

Unless a longer period of retention is required under the National Internal Revenue Code (Tax Code) or other relevant laws, the independent Certified Public Accountant (CPA) who audited the records and certified the financial statements of the taxpayer, equally as the taxpayer, has the responsibility to maintain and preserve copies of the audited and certified financial statements for a period of ten (10) years from the due date of filing the annual income tax return or the actual date of filing thereof, whichever comes later.

Examination and Inspection

All books, registers and other records, and vouchers and other supporting papers required by the BIR shall be kept at all times at the place of business of the taxpayer, subject to inspection by any internal revenue officer, and upon demand, the same must be immediately be produced and submitted for inspection (Section 20 of Revenue Regulations No.V-1). They may be examined and inspected for purposes of regular audit or extraordinary audit, requests for exchange of information by a foreign tax authority under Sections 6 and 71 of the Tax Code, and in the exercise of the Commissioner's power to obtain information under Section 5 of the Tax Code, among others.

Examination and inspection of books of accounts and other accounting records shall be done in the taxpayer's office or place of business or in the office of the BIR.

Amendments on the due process requirements for the issuance of deficiency tax assessments [Revenue Regulations No. 18-2013]

The BIR issued RR No. 18-2013 dated 28 November 2013, which amends certain sections of RR No.12-99, relative to the due process requirements for the issuance of deficiency tax assessments.

RR No.12-99 implements the provisions of Tax Code. RR No.18-2013 amends the due process requirement in the issuance of deficiency tax assessments and mode of procedures in computing for the tax and/or applicable surcharge of RR No.12-99.

The amendments are as follows:

- The removal of the Notice of Informal Conference prior to the issuance of a Preliminary Assessment Notice (PAN).

- Issuance of Formal Letter of Demand and Final Assessment Notice (FLD/FAN) in case of default to respond to the PAN or in case taxpayer responds within 15 days but disagrees with the findings of deficiency tax or taxes.
- Incorporated definitions of the reconsideration and reinvestigation, and their effect on the course of the audit investigation.
- The protest shall specify its nature, whether reconsideration or reinvestigation, date of assessment notice and the applicable laws, rules and regulations or jurisprudence, otherwise, protest shall be void and without force and effect.
- If there are several issues in the FDL/FAN but taxpayer protests against some issues only, undisputed issue/s become final, executory and demandable and the taxpayer shall be required to pay the deficiency tax or taxes attributable to the undisputed issues.
- Submission of supporting document (applies to reinvestigation) within 60 days from date of filing protest, otherwise the assessment shall become final.
- In case of a partial or whole denial of a protest by the Commissioner of Internal Revenue's (CIR) duly authorized representative, the taxpayer may either: (i) appeal to the Court of Tax Appeals (CTA) within thirty (30) days from date of receipt of the said decision: or (ii) elevate his protest through request for reconsideration to the CIR within thirty (30) days from date of receipt of the said decision. No request for reinvestigation shall be allowed in administrative appeal and only issues raised in the decision of the CIR's duly authorized representative shall be entertained by the CIR.
- In case of inaction on the part of the CIR's duly authorized representative within one hundred eighty (180) days from either the submission of the protest or the relevant supporting documents, the taxpayer may either appeal to the CTA within thirty (30) days after the expiration of the one hundred eighty (180) day period; or (ii) await the final decision of the CIR's duly authorized representative on the disputed assessment. These remedies are mutually exclusive.
- In case of denial by the CIR, decision of CIR should be appealed to the CTA within 30 days from receipt of said decision otherwise the assessment shall become final, executory and demandable.
- In case of inaction on the part of the CIR within one hundred eighty (180) days from either the submission of the protest or the relevant supporting documents, the taxpayer's options are to either appeal to the CTA 30 days after the lapse of 180-day period, or await for the final decision of the CIR on the disputed assessment then appeal said decision to CTA within 30 days from receipt of decision.
- Provides for three (3) modes of service of either a PAN, FLD/FAN, or Final Decision on Disputed Assessment (FDDA), as follows:

  1. By personal service
  2. If 1 is not practicable, by substituted service or
  3. by mail, a) registered mail or b) through a reputable professional courier service. If registry or courier service is not available, by ordinary mail.

  Further, service of any of the documents to the tax agent/practitioner who is validly appointed by the taxpayer (following the rules of accreditation of tax agents) shall be deemed service to the taxpayer.
- Section 5.5 of RR No.12-99 is amended to the effect that a delinquency interest, in accordance with Section 249(C)(3) of the Tax Code, will be imposed on a taxpayer in cases of late payment of a deficiency tax assessed.

Submission of Alphabetical List of employees/payees of income payments [Revenue Regulations No. 1-2014]

RR No.1-2014 dated 17 December 2013 amends the provisions of RR No.2-98, as amended by RR No.10-2008, specifically on the submission of Alphabetical List of employees/payees of income payments.

- Requires all withholding agents, regardless of the number of employees and payees, whether the employees/payees are exempt or not, to submit an alphabetical list of employees and list of payees on income payments subject to creditable and final withholding taxes which are required to be attached of the Annual Information Returns (BIR Form No.1604CF/1604E and Monthly Remittance Returns (BIR Form No.1601 C, etc.), under the following modes:

  a. As an attachment in the Electronic Filing and Payment System (eFPS);

  b. Through Electronic Submission using the BIR's website address at esubmission@bir.gov.ph; and

c. Through Electronic Mail (email) at dedicated BIR addresses using the prescribed comma-separated value (CSV) data file format, the details of which shall be issued in a separate revenue issuance. Revenue Memorandum Circular (RMC) No.5-2014 clarifies the provisions of RR No.1-2014.

- Withholding agents without any internet connection/facility may submit the alphalist via email through the e-Lounge facility of the nearest Revenue District Office or Revenue Region of the BIR.
- The submission of alphalist of income payments and taxes withheld lumped into a single amount (e.g. "Various employees", "Various payees", "PCD nominees", "Others", etc.) shall not be allowed.
- Submission of an alphalist which does not conform to the prescribed format resulting to unsuccessful uploading into the BIR system shall be deemed as not received, and shall not qualify as a deductible expense for income tax purposes.
- The manual submission of the alphabetical lists containing less than ten (10) employees/payees by withholding agents under Annual Information Returns BIR Forms No.1604CF and BIR No.1604E shall be immediately discontinued beginning 31 January 2014 and 01 March 2014, respectively, and every year thereafter.

New income tax return forms for taxable year ended December 31, 2013 [Revenue Regulations No. 2-2014]

RR No.2-2014 dated 24 January 2014 prescribes the new BIR forms that will be used for income tax returns (ITRs) filing covering and starting the taxable year ended December 31, 2013.

- The regulations prescribe the use of revised income tax forms with bar codes, and to reflect the changes in information required from said forms. This will also enable the said forms to be read by an optical character reader (OCR) for ease in scanning.
- The new income tax forms are as follows:

  1. BIR Form No.1700 version June 2013 (Annual Income Tax Return for Individuals Earning Purely Compensation Income);

  2. BIR Form No.1701 version June 2013 (Annual Income Tax Return for Self-Employed Individuals, Estates and Trusts);

  3. BIR Form No.1702-RT version June 2013 (Annual Income Tax Return for Corporations, Partnerships and Other Non-Individual Taxpayers Subject Only to the REGULAR Income Tax Rate);

  4. BIR Form No.1702-EX version June 2013 (Annual Income Tax Return for Use Only by Corporations, Partnerships and Other Non-Individual Taxpayers EXEMPT Under the Tax Code, as amended, [Sec. 30 and those exempted in Sec. 27(C)] and Other Special Laws, with NO Other Taxable Income); and

  5. BIR Form No.1702-MX version June 2013 (Annual Income Tax Return for Corporations, Partnerships and Other Non-Individuals with Mixed Income Subject to Multiple Income Tax Rates or with Income Subject to Special/Preferential Rate)

- Amounts stated in the ITRs will be rounded off to the nearest peso.
- Mandatory Itemized Deductions

  A. Corporations, partnerships and other non-individuals are mandated to use the itemized deductions in the following cases:

  1. Those exempt under the Tax Code, [Section 30 and those exempted under Section 27(C), both of the Tax Code] and other special laws, with no other taxable income;

  2. Those with income subject to special/preferential tax rates; and

  3. Those with income subject to income tax rate under Section 27(A) and 28(A)(1) of the Tax Code, and also with income subject to special/preferential tax rates.

  Juridical entities whose taxable base is the gross revenue or receipts (e.g., non-resident foreign international carriers) are not entitled to the itemized deductions nor to the optional standard deduction (OSD).

B. Individual taxpayers who are not entitled to avail of the OSD and thus use only the itemized deduction method are as follows:

1. Those exempt under the Tax Code, and other special laws with no other taxable income [e.g. Barangay Micro Business Enterprise (BMBE)];

2. Those with income subject to special/preferential tax rates; and

3. Those with income subject to income tax rate under Section 24 of the Tax Code and also with income subject to special/preferential tax rates.

- For taxpayers that have already filed their ITRs for the 2013 income, said taxpayers are required to re-file using the new ITRs upon its availability.
- Regulation will take effect fifteen days after its publication in 2 newspapers of general circulation.

Singapore ▲Top

Tax update

In tandem with the Singapore Government efforts to raise the standards of business conduct for funds management firms, the Monetary Authority of Singapore ("MAS") has announced changes to the existing tax regime for funds management.

The following highlights are relevant to the Singapore funds management industry:

Committed capital concession applies in meeting the minimum Asset under Management ("AUM") requirement under the Financial Sector Incentive – Fund Management ("FSI-FM") incentive scheme

The FSI-FM scheme offers a concessionary rate of 10% on income derived by approved funds management company from managing or advising qualifying funds.

Currently, new applicants /existing FSI-FM award recipients seeking a renewal of the FSI-FM incentive will be subjected to an additional requirement of having a minimum AUM of at least S$250 million.

The MAS has also clarified that private equity, real estate and infrastructure fund managers may use the committed capital secured for these funds in the calculation of their AUM for the purpose of meeting S$250 million criteria under the FSI-FM tax incentive.

It is required that the level of committed capital must be legally enforceable through a contract between the investor and the fund at the point of application. The fund manager should also have recourse to recover any capital committed, or to take the necessary remedial action in the event that the investor defaults on his or her commitments. In addition, the fund must demonstrate that a component of payments made to the fund manager for managing its fund is charged based on the committed capital.

Goods and Services Tax (GST) remission for qualifying funds

The Minister for Finance introduced in 2009 a GST remission scheme under which funds that meet the qualifying conditions will be able to recover GST incurred on all expenses (except disallowed expenses under the GST Regulations 26 and 27) from 22 January 2009 to 31 March 2014 based on a fixed recovery rate, without requiring the funds to register for GST.

In this regard, the fixed recovery rate for expenses incurred during the period from 1 January 2014 to 31 March 2014 (date of expiry of the current GST remission scheme) will be 90%. Any extension of the GST remission scheme or otherwise may be expected on or before 31 March 2014.

Sri Lanka

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Tax update

Budget 2014

- Sri Lanka's banking & financial sector will undergo far reaching structural reforms with consolidation of banks and finance companies in line with economic policy of the Government.
- The 3 year period of IFA (Investment Fund Account) which previously are exempt for Financial Institution will come to an end on 31 March 2014.
- A half tax holiday is offered for a period of 3 years to any Company that lists its shares in Colombo Stock Exchange by 2014, in the proposal the listing period has been extended till 2017, in order to encourage IPO's in Sri Lanka.
- The one-off transaction relating to segregation of composite insurance companies as required under Regulation of Insurance Industry (Amendment) Act No.3 of 2011, will be treated as a continuation of the business and the tax neutrality position will be provided on the same basis for life insurance and general insurance with regard to the following:
    - Carried forward losses of the existing business;
    - Set off of ESC (Economic Service Charge);
    - Transfer of assets and the continuation of the claim ability of depreciation allowances;
    - Set off of unabsorbed VAT credit will be allowed to any general insurance business that is segregated in terms of the provisions of Regulation of Insurance Industry (Amendment) Act.

Income tax

- Interest income on loans provided by a bank to a consortium of professional individuals to construct residential apartments for their use will be taxed at 50% of the applicable tax rate.
- Where a bank acquires another financial company within the same group (Merger/Acquisition) will be entitled for qualifying payment relief over 3 years on acquisition.

Nation Building Tax (NBT)

- The business of banking or finance will be liable for NBT at the rate of 2% with effect from January 1, 2014. The liable turnover with reference to any person engaged in such business will be defined to mean the value addition as computed for the purpose of VAT on financial services (applying the value attributable method).

Taiwan

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Tax update

Proposed Amendment to the Merger and Acquisition Act

Since its enactment in 2002, Taiwan's Merger and Acquisition Act ("M&A Act") has not undergone any major amendments. Recently, the Ministry of Economic Affair proposed an amendment to the M&A Act, which is currently under review by the Legislative Yuan.

Among the changes presented under the proposed amendment, the restriction on the type of consideration that can be used for share swap and spin-off transaction has been relaxed. Corresponding to the aforementioned changes, changes to the tax relief granted under the M&A Act has also been proposed. Pursuant to the proposed change, relief from transfer tax, such as business tax, stamp duty, deed tax, land value incremental tax, will only be granted to spin-off transaction where 65%, or more, of the consideration paid are shares. With respect to exemption from income tax, it will be granted to spin-off transaction only if 80%, or more, of the consideration paid are shares and all of the shares received by the dividing company are transferred to its shareholders.

In addition, the loss-carry-forward period for the prior losses inherited by the surviving company in a merger transaction has been extended from 5 years to 10 years in order to be consistent with the relevant rule under Income Tax Act.

Thailand

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Tax update

Amendment of personal income tax rate

Royal Decree No.575 was issued on 24 December 2013 to amend the personal income tax rate retroactively from 1 January 2013 and will also apply for tax year 2014. One of the key changes is the highest tax rate will be reduced from 37% to 35% for income over THB 4 million.

New items required for tax invoice

In September 2013, the Revenue Department issued a regulation to add new required items in the Tax invoice which will be effective on 1 January 2014. Thus the taxpayer with VAT registration has to amend the format of its "Tax invoice". One of the required new items is the taxpayer ID of the customers. However in December 2013, the Revenue Department postponed the effective date of this requirement to 1 January 2015.

Extension of e-filing due date

The Revenue Department recently extends the deadline for the tax return filing and tax payments via internet for 8 days from the normal due date (for example withholding tax return is due 7th of the month but due date in case of e-filing is 15th of the month). Initially this extension was to end 31 January 2014. The Revenue Department announced on 17 January 2014 to extend the end date from 31 January 2014 to 31 January 2015.

Tax exemption on debt restructuring

On 19 November 2013, the cabinet approved the draft Royal decree regarding the tax exemption on debt restructuring made during 1 January 2013 to 31 December 2014. This is the extension of the previous one which covered the period up to 31 December 2012 only. However until now the Royal Decree has not yet issued. (note: the extension was made in the past on yearly basis but this year (2013) was quite late and due to the political issue in Thailand , it is hard to expect when it will be issued. In the past the extension should be issued before June of the relevant year.)

Vietnam

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Tax update

Purchase, sale and settlement of non-performing loans ("NPL") by Vietnam Asset Management Company

On 6 September 2013, the State Bank of Vietnam ("SBV") issued Circular No.19/2013/TT-NHNN ("Circular 19"), providing for the purchase, sale and settlement of NPLs by the Vietnam Asset Management Company ("VAMC").

VAMC was established under Decree No.53/2013/ND-CP ("Decree 53") issued by the Government on 18 May 2013. Its operation target is to tackle the NPLs of the credit institutions in Vietnam (excluding credit institutions with 100% foreign capital and Joint-venture credit institutions).

Circular 19 provides that credit institutions with NPL ratios of 3% or more must sell those debts to VAMC. Otherwise, the SBV will reinforce some methods regulated at Article 14.5 of Decree 53 to ensure a safe NPL ratio for that credit institution.

Circular 19 provides that VAMC shall issue special bonds and use them to buy NPLs of credit institutions. In addition, Circular 19 also provide detail of methods for settlement of such NPLs.

This Circular takes effect from 15 September 2013.

Providing refinancing loans to credit institutions

On 9 September 2013, the SBV issued Circular No. 20/2013/TT-NHNN ("Circular 20"), regulating the provision of refinancing loans by special bonds of VAMC.

Circular 20 provides that the SBV shall provide refinancing loans through VAMC with the aim to support credit institutions during the process of settling bad debts according to the provisions of Decree 53/2013.

Under Circular 20, conditions for the provisions of refinancing loans are as follows:

- Credit institution must not be subject to special control;
- Credit institution must hold special bonds of VAMC;
- Credit institution must comply with the provisions of Decree 53/2013 and the guidelines of the SBV on provisioning the risks of special bonds.

Circular 20 also provides that the refinancing rate shall be subject to the decision of the Governor of the SBV but not exceed 70% of the par value of the special bonds.

In addition, the refinancing term shall be less than 12 months but not exceed the remaining term of the special bonds.

This Circular takes effective from 15 September 2013.

Registration of Government guaranteed foreign loans and international bonds

On 24 September 2013, the SBV issued Circular No.22/2013/TT-NHNN providing guidance on the registration of Government guaranteed foreign loans, Government guaranteed international bonds, and of changes (e.g. registration procedure, reporting regime, etc.).

This Circular applies to borrowers; issuers of Government guaranteed international bonds, organisations and individuals involved in such activities.

This Circular takes effective from 1 October 2013.

Decree on Anti-Money Laundering

On 4 October 2013, the Government issued Decree No.116/2013/ND-CP ("Decree 116") detailing the implementation of some articles of the Law on Anti-money Laundering.

The Decree 116 specifies methods for customer identification, responsibilities for reporting and providing information and introduces the concept of unusually high value transactions and complicated transactions.

- transactions having unusually high values that do not match the incomes or are not in accordance with the regular value of transactions of customers; and
- the complicated transactions made by means that are not compliant with the nature of such transactions, such as transactions that are made through various intermediaries or a number of accounts which are not necessary.

Moreover, with regard to the customs procedures, any individual carrying foreign currencies, VND, precious metals, and other transferable instruments exceeding the limitation provided by the SBV must make declaration of such to the customs office.

This Decree takes effective from 10 October 2013 and replaces Decree No.74/2005/ND-CP.

Directive on loan classification and settlement of bad loans

On 17 December 2013, the SBV issued Directive No.04/CT-NHNN on loan classification applicable to loans of which payment duration is restructured, and the settlement of bad loans ("Directive 04").

The Directive 04 provides various issues which credit institutions and branches of foreign banks must pay attention, to ensure the quality of bad debts and debt repayment periods.

This Directive takes effect upon the signing date.

New anti-avoidance provision in implementation of Double Tax Avoidance Agreements ("DTAs")

On 24 December 2013, the Ministry of Finance issued Circular 205/2013/TT-BTC ("Circular 205") on implementation of DTAs between Vietnam and relevant countries which are in-force in Vietnam.

Under Circular 205, some notable points related to financial sector are highlighted as follow:

- A new article dealing with general anti-avoidance has been included. In which, DTA entitlement will be denied where:
  - The applicant requests to apply DTA for the tax obligation incurred over 3 years from the date the DTA dossier has been submitted to the Vietnam tax authority; or
  - The main purpose of a business contract is to obtain DTA benefits; or
  - The applicant is not the actual beneficial owner. In this case, a substance over form analysis is required with detail of factors for analysis being dictated in Circular 205.
- When determining the profits attributable to a PE, no deduction will be allowed for the allocation of interest (except for banks), royalties and commissions/service fees.

In addition, Circular 205 provides numerous examples to help clarify the interpretation of DTAs.

This Circular takes effective from 6 February 2014 and replaces Circular No.133/2004/TT-BTC.

Lower CIT rates from 2014 under the amended Law on Corporate Income Tax

On 26 December 2013, the Government issued Decree No.218/2013/ND-CP ("Decree 218") providing guidance on implementation of some articles of the amended Law on Corporate Income Tax which takes effective from 1 January 2014.

Under Decree 218, some notable points related to financial sector are highlighted as follow:

- The standard CIT rate is reduced from 25% to 22% in 2014, and further reduced to 20% from 2016.
- Losses from transfer of immovable property, transfer of investment projects, and transfer of rights to participate in an investment project (except exploiting mineral resources) are allowed to be offset against profits from normal business activities.
- The deductibility cap applying to A&P expenses is increased from 10% to 15% for all enterprises.

This Decree takes effective from 15 February 2014 and replaces Decree No. 124/2008/ND-CP and Decree No.122/2011/ND-CP.

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