



General tax update for financial institutions in Asia Pacific

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Highlights

Australia

- Changes in legislation
- Court cases
- Other tax developments

Hong Kong

- Court case
- Proposed exemption of offshore funds
- Double Taxation Avoidance Agreement between Hong Kong and Thailand

India

- Comprehensive Economic Cooperation Agreement between India and Singapore

Indonesia

- Closer scrutiny of “beneficial ownership”

Korea

- Tax treaty between Korea and U.A.E. is now effective
- Interpretative rulings and judicial cases

Malaysia

- Recent exemption order gazetted
- Proposed Goods and Services Tax on Financial Services

New Zealand

- Reform on Trans-Tasman Imputation Credits
- Double Taxation Avoidance Agreement between New Zealand and Spain
- Anti-avoidance and specific valuation rules – proposed rewrite

Philippines

- Recent Regulation on Abatement of Surcharges on Amended Returns

Singapore

- Tax Incentive Scheme on Asset Securitisation Market

Sri Lanka

- Tax Treaties

Taiwan

- New Tax Ruling on Offshore Underwriting Fees
- Clarification of Business Tax Rate for Non-Performing Loans

Country

Australia



Tax update

Changes in legislation

- In connection with the Federal Budget 2005-06 (handed down on 10 May 2005), important changes have been announced in relation to the operation of Australian Capital Gains Tax ("CGT") in respect of non-residents. The proposed rules will be aimed at ensuring that, going forward, non-residents will only be subject to Australian CGT on real property, and business assets of Australian branches. As an integrity measure, CGT will apply to non-portfolio interests in interposed entities (Australian or non-resident) where the value of such an interest is wholly or principally attributable to Australian real property.
- On 17 June 2005, the Government released Exposure Draft Legislation intended to provide tax relief for foreign shareholders in relation to non-Australian sourced income earned through an Australian corporate entity. Where such income – known as conduit foreign income ("CFI") – is earned by an Australian company, it can be repatriated to its foreign shareholders free of Australian dividend withholding tax. Broadly, CFI includes non-portfolio dividends, any portion of foreign income upon which foreign tax has been paid, and certain types of capital gains.
- On 26 June 2005, the New International Tax Arrangements (Foreign-Owned Branches and Other Measures) Act 2005 received Royal Assent. Amongst other things, the Act includes the following measures:
 - The existing separate entity treatment currently provided to Australian branches of foreign Authorised Deposit-taking Institutions ("ADI") will be extended to include Australian branches of certain foreign financial institutions. Separate entity treatment allows a branch to be treated as a separate legal entity from a parent company for numerous Australian taxation purposes such as thin capitalisation grouping and transfer of losses;
 - Prior to the amendments, unfranked dividends received by a non-resident that were attributable to its Australian permanent establishment were subject to Australian dividend withholding tax. Under the new provisions, such dividends will instead be taxed on a net assessment basis; and
 - Australia's controlled foreign companies ("CFC") rules will be amended to prevent certain instances of inappropriate taxation, including taxation of unrealised gains that accrued prior to an Australian resident acquiring an interest in the CFC.
- On 29 June 2005, the Tax Laws Amendment (2005 Measures No. 1) Act 2005 received Royal Assent. Amongst other things, the Act includes provisions to ensure that the goods and services tax (GST - Australia's equivalent of VAT) applies to transactions involving non-residents who supply options or other rights over assets connected with Australia.

Court cases

- On 8 July 2005, the Full Federal Court in *HP Mercantile Pty Limited v Commissioner of Taxation [2005] FCAFC 126* (known as the 'Recoveries Trust' case) dismissed an appeal by the taxpayer. The Court upheld the decision that, where a company incurs due diligence costs and debt collection costs in the process of acquiring and collecting debt, there is no entitlement to credit for any GST paid on those costs.

- On 27 July 2005, the taxpayer appealed to the Full Federal Court in *Calder v Commissioner of Taxation* [2005] FCA 911. The Federal Court had earlier decided that a tea-tree investment project managed by the taxpayer was a "tax-avoidance scheme" for the purposes of Part IVA (Australia's general anti-avoidance provisions). The Federal Court held that the project was structured to maximise tax benefits, and that without these benefits, the commerciality of the project would have been substantially endangered. This was enough to indicate that the dominant purpose of the scheme was to obtain a tax benefit, so that the anti-avoidance provisions applied to disallow the deductions to the taxpayer.

Other tax developments

- On 29 June 2005, the Australian Taxation Office ("ATO") released public ruling TR 2005/11: Branch funding for multinational banks. This ruling deals with the attribution of a bank's income, expenses and profit between an Australian bank and its foreign permanent establishment or a foreign bank and its Australian permanent establishment. Broadly, arm's length interest charges on inter-branch funds transfers will be accepted as an appropriate means of allocation by the ATO.
- On 30 June 2005, the transitional period during which "at call" loans would be treated as debt interests for Australian income tax purposes expired. From 1 July 2005, "at call" loans may now be treated as equity interests.

Hong Kong



Court case

Baring Securities (Hong Kong) Limited v Commissioner of Inland Revenue

As reported in our June update, on 1 June 2005 the Court of First Instance allowed an appeal by Baring Securities (Hong Kong) Limited (now known as ING Barings Securities (Hong Kong) Limited) against a decision of the Inland Revenue Board of Review. Subsequent to the release of our last publication, the Commissioner of Inland Revenue has recently lodged an appeal to the Court of Appeal against the decision made by the Court of First Instance.

In the judgement from the Court of First Instance, it was ruled that the commission, marketing and placement income earned from the taxpayers' securities brokerage activities were offshore sourced and non-taxable.

Proposed exemption of offshore funds

In order to reinforce the status of Hong Kong as an international financial centre by increasing its attractiveness to offshore fund managers, the Inland Revenue Department has introduced an Offshore Fund Exemption rule to exempt offshore funds or funds related entities meeting specific requirements from profits tax. The proposed rule has recently been gazetted.

Two sets of provisions have been proposed to be enacted in the Inland Revenue Ordinance – the Exemption Provisions and the Deeming Provisions.

Broadly, the Exemption Provisions state that a profits tax exemption would be granted to non-residents on profits derived from securities trading transactions carried out in Hong Kong through brokers/ approved investment advisors. In order to be entitled to the exemption, the non-resident person must not carry on any other business in Hong Kong.

The Deeming Provisions, on the other hand, would deem assessable profits to arise to a resident holding a beneficial interest in a tax-exempt non-resident, equal to their proportionate share of profits earned by the non-resident from Hong Kong securities trading transactions carried out through brokers/ approved investment advisors in Hong Kong. The deeming provisions would not apply if the resident, alone or with his associates, holds less than 30% of the offshore fund unless the offshore fund is associated. The effect of the deeming provisions is to discourage residents acquiring interests in the offshore funds to trade Hong Kong securities the gains on which would be tax-exempt to the non-resident.

To date, comments are still being sought from industry groups in respect of the contents of the draft legislation. Thus it is unsure at this stage whether the draft legislation will be enacted in its current form.

Double Taxation Avoidance Agreement between Hong Kong and Thailand

Hong Kong and Thailand signed a Double Tax Agreement (“DTA”) for the avoidance of double taxation and the prevention of fiscal evasion with respect to taxes on income on 7 September 2005. The DTA is based on the OECD model convention and is the first comprehensive DTA that Hong Kong has signed with an Asia-Pacific country.

The DTA will apply in Thailand and Hong Kong from 1 January and 1 April respectively in the calendar year next following that in which the DTA enters into force. The DTA will enter into force once it has been ratified by both governments.

The DTA provides limited benefits in relation to Thai withholding taxes on royalties, interest and dividends as the non-treaty rates in Thailand are already quite low. Hong Kong does not impose withholding taxes on interest or dividends under domestic law. Hong Kong’s non-treaty rate on royalties of 5.25% may be reduced under the treaty to 5% in certain circumstances.

Under Thai domestic law, profits remitted by a Thailand branch to a Hong Kong head office are currently subject to a 10% withholding tax. This branch remittance tax should be eliminated under the treaty.

The exchange of information article is similar to the more restrictive 1995 version of the OECD model convention.

India



Comprehensive Economic Cooperation Agreement between India and Singapore

The Government of India and the Government of Singapore signed a Comprehensive Economic Cooperation Agreement ("CECA") on 29 June 2005 which is in effect a protocol that amends the Double Tax Avoidance Agreement between India and Singapore. The Protocol came into effect from 1 August 2005.

A number of changes have been proposed under the CECA and are discussed as follows:-

Royalties and fees for technical services

In respect of royalties and fees for technical services performed in either country, and payable to a resident of the other country, the withholding tax rate shall not exceed 10 percent. Previously, the withholding tax rate was 15% on the gross amount.

Capital gains

Capital gains arising from the transfer of any property (including shares but excluding any immovable property or property forming any permanent establishment) in one country by a resident of either country, would be taxed only in the country where the transferor is a resident. This is however subject to the Limitation on Benefits clause set out below. Previously, the capital gains arising from the transfer of shares were not tax exempt.

For example, if a resident of Singapore disposed of shares in an Indian Company and derived therefrom a capital gain. The aforesaid capital gain would only be taxed in the country where the transferor is a resident, i.e. Singapore, subject to the Limitation on Benefits clause.

Limitation on Benefits ("LOB")

A tax resident of either of the countries will not be entitled to the favourable capital gain tax treatment if the relevant transactions were arranged primarily for the purpose of taking advantage of the favourable capital gains tax clauses, or the taxpayer is a shell or conduit company (i.e. a company being a resident of a Contracting State with negligible or nil business operations or with no real and continuous business activities in the Resident State).

Under the LOB clause, even if the company has no real and continuous business activities or has negligible business operations, a company would not be considered as a shell or conduit company if it satisfies the following:-

- it is listed on a recognised stock exchange of the Contracting State; or
- its total annual operating expenditure is not less than SG\$ 200,000 in one Contracting State or not less than INR 50,00,000 in the other Contracting State in the immediately preceding 24-month period from the date of transfer of the property.

Exchange of Information

The protocol also provides that on the request of either country, the Revenue Authority of the requestee country shall collect and share all information that it is competent to obtain for its own purposes and under its local legislation with the requestor country.

Indonesia



Closer scrutiny of “beneficial ownership”

Under the domestic Indonesian tax law, a non-resident is subject to withholding tax at the rate of 20% on income received from Indonesia. With respect to dividends, interest and/or royalties, this rate can be reduced by tax treaty where the recipient is the beneficial owner of such income.

Although it is within the power of the Indonesian Tax Office (ITO), the ITO has not required proof of “beneficial ownership” before allowing for the application of the treaty benefits. Non-residents have been able to take advantage of the reduced treaty rates simply by obtaining a “Certificate of Domicile” from the competent tax authority in their country of residence and providing the same to the Indonesian recipient.

A Circular Letter SE-04/PJ.34/2005 was issued on 7 July 2005 to clarify the meaning of “beneficial owner”. This has the implication that a non-resident’s status as the “beneficial owner” could be subject to closer scrutiny by the ITO. In the circular, a beneficial owner is described as “the actual owner of the income in the form of dividend, interest and/or royalty, whether an individual or corporate taxpayer, who is fully entitled to directly enjoy the benefits of such income.” Specifically excluded from this definition are “special purpose vehicles” whether in the form of a conduit company, paper box company, pass-through company or other similar type of companies. If the recipient of the income is not the beneficial owner, withholding tax will apply at the normal rate of 20%.

Although the circular was intended to clarify the meaning of “beneficial owner”, no real definition or clarity is provided. Although not specifically mentioned, the ITO’s considerations should be of a number of factors to determine beneficial ownership, including the substance and operations of the offshore entity. Depending on how rigorously the ITO scrutinises beneficial ownership, it could have an impact on various transactions currently in place or under consideration as to whether a reduced tax treaty rate can still be applicable. In particular, nominee arrangements and intermediary finance companies could be at risk. There are indications that the ITO in its audit activity will take an aggressively negative approach in determining beneficial ownership.

As this is a new regulation, it is not clear at this stage as to how it will be implemented in practice. As such, companies can either wait and see how the issue evolves in the future; or alternatively, if a non-resident is concerned that he or she may not qualify as the “beneficial owner” of income (dividends, interests, or royalties), and requires more certainty as to whether they would be eligible for the treaty benefits, a special ruling can be obtained from the ITO to confirm whether the treaty benefits will be applicable.

Korea



Tax treaty between Korea and U.A.E. is now effective

The United Arab Emirates ("UAE")-Korea Tax Treaty was signed on 22 September 2003 in Dubai. The Tax Treaty has now come into effect as of 2 March 2005.

Interpretative rulings and judicial cases

1. Small Medium Enterprise ("SME") shares with no clear value and are transferred by a majority shareholder, between 1 January 2005 and 31 December 2006, are exempt from appraisal premium.

(Seomyon 4 Team 467, 2005.3.30)

On 31 December 2004, a new regulation (Article 100(2)) was added to the Tax Incentive Limitation Law ("TILL"). Under the newly added regulation, shares in a SME that are bequeathed or gifted by the majority shareholder, on or before 31 December 2006, are exempt from the 10% or 15% premium that generally applies to the appraised value.

In a response recently issued by the National Tax Service ("NTS") to an inquiry as to whether SME shares transferred by a majority shareholder are eligible for the exemption under Article 100(2) of the TILL, the NTS interprets that Article 100(2) applies to the transfer of such shares. According to the NTS interpretation, an additional premium of 10% or 15% will not apply to the transfer of shares in a SME by a majority shareholder between 1 January 2005 and 31 December 2006.

2. Deductibility of voluntary severance payments (Seomyon Team 2-633, 2005.5.02)

In July 2005, the NTS issued a new authoritative interpretation that allows a taxpayer to deduct voluntary severance payments (payments made to staff members who elect to participate in an early retirement scheme) as direct expenses for tax purposes, instead of offsetting the payments against the severance reserve.

In previous NTS authoritative interpretations, including an interpretation issued late January this year, voluntary severance payments had to be offset against severance reserve.

These earlier NTS rulings were not consistent with the Korean Generally Accepted Accounting Principles (K-GAAP), under which, voluntary severance payments are treated as non-operating expenses for accounting purposes. Furthermore, in a National Tax Tribunal (NTT) decision (Kukshim 2003 Seo 137, 2003.5.12), the NTT ruled that voluntary severance payments should be treated as deductible expenses in line with K-GAAP.

The new ruling brings the tax treatment of voluntary severance payments in line with the K-GAAP regulations and the NTT's position.

Malaysia



Recent exemption order gazetted

Interest income derived by non-resident companies in respect of loans for technology development from approved Multimedia Super Corridor ("MSC") status companies are specifically exempt from Malaysia income tax. This has retrospective effect from 1 October 2002.

In accordance with the new exemption rule, an "approved MSC status company" means a company which has been awarded the MSC status by the Government of Malaysia, and operates either as a regional IT solutions hub, regional internet exchange, regional data center, regional internet data center and regional call center, and where such companies are located in the area of Cyberjaya, Technology Park Malaysia-Phase I, University Putra Malaysia, Malaysia Technology Development Corporation Incubator I and the Petronas Twin Towers.

Proposed Goods and Services Tax (GST) on Financial Services

The Taxation Review Committee ("TRC") was set up to review the taxation system in Malaysia. The TRC has proposed to the Government that certain financial services should be exempt from GST (GST is proposed to be implemented in 2007). Standard rating has been proposed to apply to the provision of advisory services, fee based activities as well as the outsourcing of data processing, telephone help desk, and cheque clearing services, etc.

The industry groups have been asked to comment on the proposals. More developments in this area are expected as responses from the industry are collated and the final proposal drafted and shaped.

New Zealand



Reform on Trans-Tasman Imputation Credits

The Minister of Revenue announced on 21 July 2005 that the Government intends to change the rules governing Trans-Tasman imputation credits. Specifically, imputation credits will no longer be able to be attached to dividends paid to New Zealand investors if the dividend is deductible as interest in Australia. This will typically apply to dividends paid in respect of redeemable preference shares, as Australia generally treats these dividends as interest.

This measure is intended to prevent what the Government considers to be inappropriate streaming of imputation credits to New Zealand residents, who are able to make use of them (unlike Australian residents).

The proposed rule will apply:

- From announcement for new share issues; and
- From 1 April 2006, for shares issued within a group.

Double Taxation Avoidance Agreement between New Zealand and Spain

New Zealand and Spain have signed a Double Tax Agreement on 28 July 2005 for the avoidance of double taxation and the prevention of fiscal evasion with respect to taxes on income. This will come into force once both countries have given legal effect to it.

Anti-avoidance and specific valuation rules – proposed rewrite

On 25 August 2005, the Inland Revenue issued Rewriting the Income Tax Act: Exposure Draft - Part G, for comment and discussion by 31 October 2005.

The document is part of the continuing process of rewriting the Income Tax Act in plain English. It contains draft legislation for the rewrite of Part G (on avoidance and non-market transactions) of the Income Tax Act 2004, which relates to special rules that modify the way other Parts of the Act operate when tax avoidance occurs or when specific valuation rules are provided for certain transactions.

The main changes to Part G have been to reorder the subparts, improve the clarity of the law, modernize the style and language and remove redundant material.

Philippines



Recent Regulation on Abatement of Surcharges on Amended Returns

The Bureau of Internal Revenue ("BIR") has introduced Revenue Regulations No. 15-2005 on 8 July 2005 which states that reduced surcharge rates (from the original 25% rate) will be available to taxpayers, who rectify their tax returns previously submitted to the BIR to reflect an accurate income figure as well as pay any underpaid taxes. The deficiency taxes, inclusive of interest, will be subject to the respective reduced surcharge rates if they are rectified and paid on or before the corresponding dates as follows:

	Surcharge
July 31, 2005	0%
August 31, 2005	5%
September 30, 2005	10%
October 31, 2005	15%
November 30, 2005	20%
December 31, 2005	23%

In order for taxpayers to avail of the reduced surcharge rates, the following conditions must be satisfied:

- 1 The amended tax returns will need to be filed and payment of the deficiency taxes, inclusive of increments, due thereon should be received by the BIR no later than December 31, 2005.
- 2 If payments of deficiency taxes, inclusive of increments, are paid in instalments, all instalment payments must be made and received by the BIR on or before December 31, 2005, and each instalment payment will be subject to the surcharge rates provided in the table above.
- 3 The amendments made by the taxpayer to the tax returns must involve an upward adjustment of revenues/receipts and/or downward adjustment of deductions.
- 4 Taxpayer has not received a letter of authority, letter notice or discrepancy notices concerning the tax period.
- 5 If arising from or relating to an importation, the taxpayer must submit proof of payments of taxes and duties that have been made to the Bureau of Customs.

This program shall not preclude the BIR from investigating the correctness of the declaration and/or prosecuting criminal violations, if appropriate.

Singapore



Tax Incentive Scheme on Asset Securitisation Market

Details of the tax incentive scheme for approved special purpose vehicle ("ASPV") engaged in asset securitisation transactions were released on 28 June 2005. Under the scheme, an ASPV would enjoy the following tax benefits:

Income Tax

- Income derived from specified asset securitisation transactions entered into during the period from 27 February 2004 to 31 December 2008 (inclusive) will be exempt from Singapore income tax; and
- Any payment to a non-resident from the period 27 February 2004 to 19 May 2007 (inclusive) on over-the-counter financial derivatives in connection with securitisation transactions will be exempt from Singapore withholding tax.

Goods and Services Tax ("GST")

An ASPV is allowed to claim GST on its business expenses at a fixed rate of 76% during the incentive period.

Stamp Duty

A remission of stamp duties has been granted to provide relief for the transfer of assets into an ASPV for specified asset securitisation transactions.

Sri Lanka



Tax Treaties

The Sri Lanka Government recently concluded a Tax Treaty with China.

Taiwan



New Tax Ruling on Offshore Underwriting Fees

Subsequent to the promulgation of tax ruling 0930451691 on 18 May 2004 which treats 100% of the offshore underwriting fee as Taiwan sourced income and taxable, the Ministry of Finance has, on 3 August 2005, announced a new tax ruling, Tai Tsai Shui Tax Ruling 09404552920, that clarifies the relevant business tax treatment for offshore underwriting fees received by offshore banking units ("OBUs").

The new ruling, Tai Tsai Shui Tax Ruling 09404552920, decrees that where an OBU renders underwriting services to Taiwan local companies for issuing securities overseas, the underwriting revenue derived therefrom should be considered as core-business sales revenue of the OBU. The subject underwriting revenue will then be subject to a 2% Gross Business Receipts Tax under Article 11, Paragraph 1 of the Value-added and Non-value-added Business Tax Act.

With the promulgation of this new tax ruling, though specifically addressing OBUs only, it appears that the Taiwan tax authorities may take a more aggressive approach in enforcing business tax to be imposed on underwriting revenue derived by underwriters. It is therefore advisable that underwriters should start examining its potential business tax liabilities, especially underwriters that have permanent establishments in Taiwan.

Clarification of Business Tax Rate for Non-Performing Loans ("NPLs")

Through the Financial Supervisory Commission of the Executive Yuan, a new ruling numbered 943000234 was issued on 12 July 2005 that clarifies the applicable business tax rate for NPLs purchased by an asset management company ("AMC") from another AMC.

Article 15 of the Taiwan Financial Institution Merger Act and tax ruling numbered 920451126 stipulate that AMCs incorporated solely to manage NPLs acquired from financial institutions can enjoy the 2% Gross Business Receipts Tax ("the concessional business tax rate") enjoyed by the banking industry on gains derived from managing NPLs.

However, in managing the NPLs, AMCs may need to re-sell NPLs to other AMCs to expedite the processing of NPLs. Prior to the introduction of this ruling, it was unclear as to whether the concessional business tax rate of 2% would be applicable to the management of NPLs acquired from other AMCs.

This new ruling, however, clarifies that the 2% concessional business tax rate does apply to situations where AMCs manage NPLs acquired from other AMCs.

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