KPMG

General tax update for financial institutions in Asia Pacific

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TAX

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Australia

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Tax update

Legislative developments

- TOFA– on 26 March 2009, the Tax Laws Amendment (Taxation of Financial Arrangements) Bill 2008 (TOFA Bill) received Royal Assent.

  As discussed in Issue 30, broadly, the TOFA regime has the potential to deliver compliance cost savings for taxpayers by, at the option of the taxpayer, aligning the tax treatment of financial arrangements with the accounting treatment. Financial institutions should welcome this change.

  The TOFA Bill will apply for income years commencing on or after 1 July 2010, unless a taxpayer elects to apply the amendments for income years commencing on or after 1 July 2009.

- New Temporary Investment Allowance – on 25 February 2009, the Federal Government released the exposure draft legislation, Tax Laws Amendment (Small Business and General Business Tax Breaks) Bill 2009, for public comment, which was completed by 10 March 2009. The release of the draft legislation follows the Government's announcement on 3 February 2009 to provide small and general businesses buying eligible assets with a temporary investment allowance of up to 30 cents in every dollar.

  Broadly, "eligible assets" of $10,000 or more for a general business (or $1,000 or more for a small business) may qualify for the investment allowance. An "eligible asset" for the purposes of the temporary investment allowance refers to tangible depreciating assets, including most items of plant and equipment.

  The media release issued on 3 February 2009 and the Explanatory Memorandum to the draft legislation advise the following:

  - For assets acquired within the period 13 December 2008 to 30 June 2009, where the asset is also installed before 30 June 2010, the deduction will be equal to 30 percent of the asset's cost.

  - For assets acquired within the period 1 July 2009 to 31 December 2009, where the asset is also installed before 31 December 2010, the deduction will be equal to 10 percent of the asset's cost.

  The temporary investment allowance is only available in respect of assets that a taxpayer "starts" to use in Australia for the principal purpose of carrying on a business and will be in the form of an additional tax deduction. Accordingly, the allowance will not diminish or alter the tax depreciation of the asset.

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- The allowance forms part of the Government's Economic Stimulus Package which is intended to strengthen the Australian economy and may be particularly relevant for financial institutions that undertake asset leasing arrangements.

Other tax development

On 22 January 2009, the Australian Taxation Office (ATO) issued Taxpayer Alert 2009/2 *Certain cross-border Prepaid Forward Purchase Agreements*, which warns multi-national businesses to be cautious before entering into cross-boarder financing arrangements involving certain prepaid forward purchase agreements.

These arrangements attempt to convert a loan from a resident company to a foreign subsidiary into a future equity investment in the subsidiary in order to decrease their Australian tax liability.

The ATO advised that these arrangements may not be effective under Australian tax law or anti-avoidance legislation and that taxpayers who are unsure of their tax obligations should seek independent advice or contact the ATO.

Taxpayer Alert TA 2009/2 is effective from 22 January 2009.

China

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Tax update

Qualified Foreign Institutional Investors (QFII) are subject to withholding tax (WHT) of 10 percent on PRC-sourced dividend and interest income.

The old Foreign Enterprise Income Tax (FEIT) regime did not specifically address the FEIT treatment of QFIIs. Caishui [2005] No. 155 exempts QFIIs from PRC Business Tax on gains derived from the disposal of A-shares or other investments.

According to the new Corporate Income Tax (CIT) Law and the Implementation Rules, a non-resident enterprise is subject to WHT of 10 percent on its PRC–sourced dividend and interest income that is not effectively connected with any establishment or place of business in the PRC.

A recent tax notice Guoshuihan [2009] No. 47 (Circular 47) clarified the new CIT Law and the Implementation Rules, whereby WHT is levied at a rate of 10 percent on a QFIIs' PRC-sourced dividend and interest income upon payment or accrual of interest by PRC resident enterprises.

An eligible QFII may apply for relief under any relevant tax treaty. Upon approval from the PRC authority, QFIIs can enjoy the preferential treatment as provided in the relevant tax treaty, e.g. a WHT rate of lower than 10 percent, which may result in a tax refund.

Circular 47 does not stipulate an effective date. However, given that Circular 47 was issued to clarify the provisions of the new CIT Law and the Implementation Rules which were effective 1 January 2008, Circular 47 should technically also be effective from 1 January 2008.

Circular 47 is still silent on the CIT treatment of PRC-sourced gains that QFIIs derive from the disposal of A-shares or other investments.

Hong Kong

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Tax update

Hong Kong Budget 2009/10

On 25 February 2009, the Financial Secretary, John Tsang, delivered his Budget Speech to the Legislative Council for 2009/10 financial year. To consolidate Hong Kong's position as an international finance centre, the Government announced the following initiatives:

- Islamic financial products

  To develop and increase financial co-operation with emerging markets, the Financial Secretary made specific reference to creating a level playing field for Islamic financial products vis-a-vis conventional products. This proposal includes making any necessary changes to or clarifications of the arrangements for Stamp Duty, Profits Tax and Property Tax.

- Hong Kong Government bonds

  To further promote the sustainable development of Hong Kong's bond market, a programme to issue Government bonds will be implemented. The sums raised will be credited to a newly established fund which will not form part of the fiscal reserves and will be separately managed. Following consultation with the relevant trade sectors, resolutions for issuing bonds under the programme and for establishing the fund will be put to the Legislative Council as soon as possible.

- Exchange of tax information

  Further to the above, the Government has proposed to put forward legislative proposals to align Hong Kong’s arrangement for the exchange of tax information with international standards by the middle of 2009.

Details of the Hong Kong Budget Summary can be found on the Hong Kong Government Website at http://www.budget.gov.hk/2009/eng/speech.html

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India

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Tax update

Cases update

Single return of income for Mauritius Protected Cell Company (PCC) consolidating profits / losses of all cells of the PCC

The Mumbai Tribunal in a recent decision in *Nicholas Applegate South East Asia Fund Ltd and others V. ADIT* reported in 309 ITR 325 (ITAT Mumbai Third Member) 2009 has held that the technical defect in the return of income filed within the due date can be corrected by revision and the revised return of income filed is treated as valid and filed within the due date. As per the Indian Income-tax Act, 1961 (the Act) a loss can be carried forward only if the return of income is filed within the due date.

The returns of income of four cells of a Mauritius PCC for the assessment year 2001/02 were filed within the time prescribed under section 139(1) of the Act on 30 October 2001. Subsequently, the taxpayer realized that a consolidated return for all four cells was required to be filed. Therefore, a revised return of income was filed by the Mauritius PCC on 29 October 2002 consolidating the income / loss of all four cells without any change to the total loss carried forward.

The Tax Officer was of the view that the return filed on 29 October 2002 was to be considered the original return and the four returns filed separately by the four cells on 30 October 2001 were invalid. The consolidated return filed on 29 October 2002 was belated and therefore the question of the carry forward of losses suffered by the taxpayer did not arise. The loss claimed was not allowed. The matter was taken up before the first appellate authority which dismissed the appeal and accepted the Tax Officer's view. The taxpayer lodged a second appeal to the Income-tax Appellate Tribunal.

As there was a difference of opinion between the members of the Tribunal, the matter was referred to the Third member.

The Tribunal held that the benefit of a carry forward of loss should not be denied to the taxpayer as it had filed returns of loss before the due date within the time allowed under section 139(1) of the Act. The Tribunal noted that the four returns of loss were bonafidely filed and on discovery of the mistake, the taxpayer had filed a consolidated return, in which figures of the four different returns were consolidated and the total loss was shown. In such a situation, it is not correct to hold that the returns filed earlier were invalid, ineffective and of no legal consequence. This revised return would in such circumstances relate back to the date of filing of the original returns. The revised return has to be considered with the original four returns, which contained complete information for making an assessment. The technical mistake in the four returns was rectified upon filing of the consolidated return. When the total information needed by the Revenue was fully furnished in the consolidated return, the return in substance and in effect conformed to the requirement of the provisions of the Act.

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Benefit of lower rate of tax on long term capital gains is available to non-resident foreign companies even if the indexation benefit is not applicable to them. If legal expenditure is distinctly related to and integrally connected with the transfer of shares, they are admissible for deduction in computing the capital gains.

In *Compagnie Financiere Hamon* reported in [2009] 177 Taxman 511 (AAR) the applicant, a non-resident company, entered into a joint venture agreement with an Indian company. In the course of operating the Indian company, various disputes relating to the joint venture agreement arose among the parties to the agreement, including the Indian company and the applicant and petitions were filed before the Company Law Board (CLB). On instruction of the CLB, with a view of reaching an amicable settlement, two promoters of the Indian company agreed to partly acquire shares held by the applicant which resulted in long term capital gains to the applicant.

Based on these facts, the Authority for Advance Rulings (AAR) following the ruling in *Timken France SA* [2007] 249 ITR 513 (AAR) ruled that the benefit of the lower rate of tax at 10 percent on long-term capital gains cannot be denied to non-resident foreign companies even if they are entitled to relief of foreign currency translation in computing capital gains.

It was further ruled that non-applicability of the indexation benefit would not preclude the non-resident to avail the benefit of the lower rate of tax at 10 percent. Therefore, the tax payable by the applicant on the long term capital gains arising on the sale of originally purchased shares of the Indian company will be 10 percent on the amount of capital gains computed as per the provisions of the Act.

The AAR held that the legal expenditure which distinctly related to and was integrally connected with the transfer of shares, were admissible for deduction in computing capital gains under the provisions of the Act. The sole object of the expenditure incurred towards legal fees should be in connection with the transfer of shares. Legal fees for seeking advice on the methods of transfer and the drafting of agreements or deed of transfer would undoubtedly qualify for deduction.

However, the legal expenditure in the initial period of dispute were not intrinsically linked with the transfer of shares and therefore, not allowed as deduction. Accordingly the matter was sent back to the Assessing Officer (AO) to quantify the admissible amount, as there was no clear picture of the expenditure incurred wholly and exclusively in connection with the transfer of shares.

Partial reimbursement of salary of seconded employee from Korea, whose services were hired by the Indian subsidiary, was not taxable as Fees for Technical Services and, therefore, was not subject to deduction of tax at source

In *Cholamandalam MS General Insurance Co. Ltd., In Re* reported in [2009-TIOL–02-ARA-IT] the applicant was an Indian insurance company which intended to build up business relations with joint ventures and subsidiaries of certain foreign companies. In this regard, the applicant entered into an agreement with a non–resident insurance company from Korea pursuant to which an employee of the Korean company had been seconded to engage in certain specified activities under the supervision and control of the recipient.

Under the agreement, the applicant reimbursed the Korean company only a part of the salary and other benefits payable to the seconded employee. The Korean company continued to be the employer of the secondee. The secondee had no right or authority to conclude any contracts on behalf of the recipient. The Korean company had been deducting tax from the salary paid to the seconded employee and such tax had been deposited with the Tax Department in India.

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The applicant contended that the Korean company had no permanent establishment (PE) in India. Further, no income had arisen in India on account of the payments made to the Korean company, being part reimbursement of salary and expenditure that were payable by the Korean company to the secondee. Accordingly, the payment was not subject to deduction of tax at source. The applicant sought an advance ruling with regard to the same.

The AAR ruled that the amount paid by the applicant was not in the nature of a consideration for offering services of the seconded employee. The AAR ruled that the mere fact that the Korean company provided the services of a technical person and received from the applicant a substantial part of the salary payable from the applicant, it could not be inferred that the part reimbursement represented a fee for technical services (FTS).

The AAR further ruled that the arrangement between the applicant and the Korean company had been conceived in their mutual interest wherein the applicant would be utilising the services of the seconded employee and the Korean company would also benefit because it would not merely promote business relations, but the recipient would, wherever possible, place the re–insurance business with it. Accordingly, the AAR concluded that the parties never contemplated payment of a FTS within the meaning of Explanation 2 to section 9(1)(vii) of the Act or Article 13.4 of the India-Korea Tax Treaty. The essence or substance of the transaction was not deriving income by way of charging a fee for the service.

Loss emanating from security transactions, even in violation of the Security Contracts (Regulation) Act, 1956, is an allowable business loss. Section 44C of the Act was not applicable in respect of expenses incurred exclusively by Bank branches abroad in respect of NRI Desks maintained by those branches

In *Bank of America NT & SA v. DCIT* reported in (2009) 27 SOT 97 the taxpayer was a non-resident foreign banking company. It had executed a large number of securities transactions, incurred losses in some and profits in others. In the computation of income, the taxpayer claimed a set off of the losses against the gains from such transactions.

The Tax Officer held that the said transactions were executed in violation of the provisions of section 15[1] of the Security Contracts (Regulation) Act, 1956 (SCRA) and, therefore, they were illegal transactions. Further, losses with respect to illegal commercial transactions could not be set off against illegal profits. The first appellate confirmed the action of the AO.

On further appeal to the Mumbai Tribunal (the Tribunal), it held that the taxpayer was engaged in executing normal transactions as well as transactions attracting section 15 of the SCRA. The latter yielded both "losses" as well as "gains". Further, the said transactions were recorded transactions and borne out of the books of account of the taxpayer. Thus, all these transactions, which yielded the losses, formed part of the business of the taxpayer.

Following the decision of the Supreme Court of India in the case of Dr. T.A. Quereshi reported in [2006] 287 ITR 547(SC) where it was held that illegal losses are allowable losses, the Tribunal held that where the taxpayer executed the security transactions, may be in violation of the provisions of section 15 of the SCRA, and the loss generated out of the said transactions, when undisputedly borne out of the books of the taxpayer, was an allowable loss. Therefore, the said loss was eligible for set off as claimed by the taxpayer.

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[1] Section 15 of SCRA states that a member of a recognised stock exchange is allowed to act as a principal provided he has secured the consent and disclosed the same in the note or memorandum or agreement of sale or purchase. In the case of oral consent, as per the first proviso, the Member Broker is given three days to furnish the written confirmation.

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The taxpayer had claimed deduction of expenditure incurred by its overseas branches for its Indian operations in the computation of income and not in the profit and loss account. These expenses were directly connected to the business operations of the bank in India. Expenses were incurred by those branches abroad to earn income for the Indian operations. These expenses were debited under the heading "Staff related expenses" and pertained to staff manning the NRI Desks at various branches outside India. The expenses were directly for the Indian operations and they were not accounted by such overseas branches as deductible under their respective tax laws.

The Tax Officer was of the opinion that provisions of section 44C of the Act restricting the head office expenses were applicable to the taxpayer for the reason that the relevant books of account, details of expenditure, as maintained by the overseas branches were not available for him to verify if the said expenditure is exclusively related to the business of the overseas branches of the taxpayer. The first appellate upheld the action of the Tax Officer.

On further appeal to the Tribunal it was held that that book entries were not very important for determining the correctly assessed income of the taxpayer. The claim could be made through the "Computation of Income" route. Further, provisions of section 44C restricting the head office expenses were inapplicable in a case of expenses incurred exclusively by the Bank's branches abroad in respect of NRI Desks maintained by those branches. Therefore, the Tribunal held that provision of section 44C of the Act was inapplicable in the present case.

Once the power of attorney was filed the defect was removed from the date of filing of the return.

In *Cobra Instalacions Y Services, SA vs DCIT* reported in 21 SOT 613 the taxpayer was a non-resident company. The return of income filed by the Company was signed by its power of attorney holder. However, a copy of the power of attorney was not filed with the return. The Tax Officer while processing the return of income under section 143(1) granted interest on refund due to the taxpayer. Subsequently, the Tax Officer noticed that the taxpayer had not enclosed a copy of the power of attorney along with the return of income. After the Tax Officer advised the taxpayer of the omission, the taxpayer filed the aforesaid power of attorney.

The Tax Officer later issued an order under section 154 of the Act expressing his intention to withdraw the interest granted on refund from the date of filing of the return to the date of filing of the power of attorney. Rejecting the contention raised by the taxpayer that once the power of attorney was filed the defect was removed from the date of filing of the return, the Tax Officer withdrew the interest granted for the period from the date of filing of the return to the date of filing of the power of attorney.

The first appellate authority upheld the action of the Tax Officer withdrawing the interest on refund by observing that since the taxpayer had not filed the power of attorney along with the return of income, the return was to be treated as invalid and defective. Since the taxpayer rectified the defect later on, the delay from the date of filing of the return to the date of filing of the power of attorney was clearly attributable to the taxpayer.

On appeal, the Delhi Tribunal held that as per judicial pronouncements as discussed, non-filing of a power of attorney along with the return is a case of mere procedural irregularity and not of illegality. It is a curable irregularity. Hence, the procedural irregularity of non-filing of the power of attorney was rectified from the date of filing of the return of income and not from the date when the power of attorney was filed by the taxpayer on being called upon by the Tax Officer. It was therefore held that the authorities were not justified in their conclusion on the applicability of section 154 of the Act and treating the return non est during the currency of irregularity. Consequently the authorities have erred in holding

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that the taxpayer was not eligible for interest granted for this period.

Indonesia

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Tax update

Dividends from unlisted offshore company (CFC type provisions)

On 31 December 2008, the Minister of Finance (MoF) issued regulation 256/PMK.03/2008 to revoke a regulation from 1994 (the MoF Decree 650/KMK.04/1994) regarding deemed dividends from overseas entities controlled by Indonesian tax residents. The principle that dividends will be deemed to be received within a certain time is basically unchanged (i.e. four months after submission of a corporate tax return or seven months after the end of the financial year if submission of a corporate tax return is not required by the country's jurisdiction) but the new regulation expands the coverage from shareholders in specific listed countries (which were perceived as tax havens but which included a few jurisdictions not normally categorised as such) to all unlisted offshore shareholdings.

Income on derivative transactions

On 9 February 2009, the Government of Indonesia issued regulation number 17/2009. Under this regulation, futures contracts (derivative transactions) traded on the Indonesian Stock Exchange are subject to 2.5 percent final tax from the "initial margin". Initial Margin is defined as money or securities deposit that should be placed to secure a trade of a futures contract.

Income tax on bond interest & capital gain

On 9 February 2009, the Government of Indonesia issued regulation number 16/2009. Under this regulation, the final withholding tax rate on interest and discount from bonds is reduced from 20 percent final tax to 15 percent final tax. Interest and discount from bonds received by Banks and Pension Funds remain the same, i.e. not subject to withholding tax. Further, the final withholding tax rate for Mutual Funds is now as follows:

- 0 percent for the year 2009 and 2010;
- 5 percent final tax for the year 2011 up to 2013; and
- 15 percent final tax for the year 2014 onward.

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Japan

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Tax update

2009 tax reform

On 12 December 2008, an outline of the proposed 2009 tax reform was released. The draft bills amending the tax laws were passed by the Diet at the end of March.

Below are brief highlights of some of the key amendments:

- Relaxation of aggregation principle for a partner's share of Japanese corporation share sale gains

  A foreign investor deriving gains from sale of shares in a Japanese company is subject to tax if the so-called "25/5" threshold is met. Basically it applies to disposals where the foreign investor, together with its related persons,

  - owned 25 percent or more of the shares in a Japanese company at any time during the three year period up to and including the fiscal period of sale; and
  - has disposed of 5 percent or more of those shares in a single fiscal period.

  Under current law, if a foreign investor has an interest in certain types of partnership which hold shares in a Japanese company, each partner of the partnership is treated as a related person to the foreign investor for the purpose of the "25/5" threshold test.

  Under the tax reform, certain partners of a partnership will no longer be treated as related to all other partners for these purposes. Such partners cover broadly a non-resident limited partner of a partnership who is not involved in the management of the partnership business, who does not have more than a 25percent interest in the partnership and who, in the case where the partnership has a fixed place of business in Japan, does not have any special relationship with the general partner or have a permanent establishment in Japan.

  The change should apply to disposals that take place on or after 1 April 2009.

- Inclusion of a TMK as an eligible lender to other TMKs

  A TMK is a securitisation vehicle which may take a tax deduction for dividend distributions made if certain conditions are met. Two of those conditions are broadly that (1) a TMK must undertake a bond placement solely with Qualified Institutional Investors (QII) and (2) where the TMK borrows it may only borrow from a QII. Under the current law, a TMK itself cannot be a QII, such that it is not possible for a TMK to lend to another TMK without the borrower TMK losing its special tax status.

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Under the tax reform, the scope of a QII will be extended such that a TMK will be treated as a QII for tax purposes if it acquires bonds or specified borrowings from another TMK for "securitisation" purposes. Details of this provision, including the specific nature of the "securitisation" required by the lender TMK are currently unclear.

- Amendment to the "90 percent test" for TMKs

  Another of the conditions for a TMK to achieve special tax status is that it must distribute more than 90 percent of its "distributable amount" for each relevant fiscal period. Under the current law, "distributable amount" is calculated by reference to a formula which utilises the TMK's taxable profit figure. However, a TMK's distributable profit, and so its ability to make a distribution, is determined based on its accounting profit. If the TMK's taxable profit is significantly higher than its accounting profit, for example as a result of recognition of an impairment loss for accounting purposes which cannot be deducted for tax purposes, the TMK may not be able to satisfy this "90 percent test" and hence may be disqualified for the preferential tax treatment.

  Under the tax reform, the condition will be revised such that the threshold for this "90 percent test" will be based on an accounting profit figure, rather than taxable profit. This should mitigate risk of failure of the "90 percent test" resulting in a loss of special tax status. However it should be noted that the occurrence of taxable income and accounting income mismatches will continue to be an adverse issue for TMKs because such mismatches can result in the TMK only being able to make a limited distribution relative to its taxable profit amount. This of course results in higher levels of net (post dividend deduction) taxable income at the TMK.

- Tax treatment of redemption income of Original Issued Discount (OID) Bonds

  The tax treatment of redemption income derived by a foreign company (bond holder) from an OID bond issued by another foreign company (bond issuer) is to be amended as follows:

  - If the OID bond proceeds are attributable to the bond issuer's business carried on in Japan, the redemption income will be treated as Japanese source income of the bond holder for corporation tax purposes;
  - If the bold holder does not have any permanent establishment (PE) in Japan, it will not be required to declare such income to tax or file any tax return in Japan.

  The change should apply for OID bonds issued on or after 1 April 2009.

- Relaxation of deemed PE treatment for partnership investors

  A foreign partner of a partnership is deemed to have a PE in Japan by virtue of having an interest in a partnership that has a fixed place of business in Japan. As such, its share of partnership profits is subject to full taxation in Japan.

  Under the tax reform, certain foreign partners will not be deemed to have a PE in Japan (and hence will no longer be subject to full taxation in Japan). Such partners cover, broadly, a non-resident limited partner who is not involved in the management of the partnership business, who does not hold 25 percent or more interest in the partnership and who does not have any relationship with the general partner of the partnership.

  The change should apply from 1 April 2009.

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- Introduction of a foreign dividend participation exemption

  Foreign dividends are taxable in Japan but direct and indirect foreign tax credits are available to domestic companies to mitigate the corresponding tax suffered overseas.

  Under the tax reform, a foreign dividend exclusion regime will replace the existing tax credit system. Under the new regime, 95 percent of foreign dividends derived by a Japanese company can be exempted from corporation tax provided that the Japanese company has owned at least 25 percent of the dividend paying company for a continuous period of at least six months up to the point of the dividend becoming fixed. Certain consequential changes to the Japanese Controlled Foreign Company tax rules will also occur pursuant to the introduction of this new regime.

  The new regime should apply to dividends received in fiscal years beginning on or after 1 April 2009.

Korea

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Tax update

Deemed Capital Rule (Corporate Income Tax Law, Presidential Decree Article 129 -3)

Subsequent to the repeal of the previous deemed capital rule, the new rule has been enacted under the Presidential Decree with several changes.

The previous deemed capital rule denied a tax deduction for a certain portion of interest payments made by a Korean branch of a foreign bank head office, if the branch's capital amount is lower than the deemed capital amount, i.e., the proportional amount to the head office and its branches' total capital to total assets ratio as at balance sheet date. Furthermore, if both the thin capitalisation rule of the International Tax Coordination Law and the deemed capital rule were applied, interest payments would be treated as being non-deductible for both provisions.

Under the revised Presidential Decree of CITL, in calculating the deemed capital amount, besides the previous method using the proportional amount to the head office's total capital to total assets ratio, the new rule allows a company to choose a method, which consider the Korean branch's functions, owned assets, assumed risk, etc. The new method will be specified in the Enforcement Rule. The relevant Enforcement Rule is yet to be promulgated as a result, the method for the computation of deemed capital is not currently determinable. In this regard, the pre-notification of the Enforcement Rule of the CITL specifies that the deemed capital calculation may be based on the ratio determined by the Bank for International Settlement (BIS) which incorporates risk weighted assets.

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In estimating the deemed capital amount under the deemed capital rule, if the accounting method used by a head office is different from that of a Korean branch, the accounting method adopted by the head office may be used. However, in such a case, the Korean branch should maintain accounting documents in the same manner as the head office.

Finally, in case both the thin capitalisation rule and the deemed capital rule are applicable at the same time, the tax treatment is as follows:

i. If the non-deductible interest amount under the deemed capital rule is less than the non-deductible interest amount under the thin capitalisation rule, the non-deductible interest amount under the deemed capital rule shall be regarded as nil; or

ii. If the non-deductible interest amount under the deemed capital rule is greater than the non-deductible interest amount under the thin capitalisation rule, the non-deductible amount under the deemed capitalisation rule will be the amount that exceeds the amount of the non-deductible amount under the thin capitalisation rule.

Under the pre-notification, this rule only applies to transactions between a foreign bank and its domestic branch.

Malaysia

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Tax update

Finance Act 2009

The Finance Act 2009 was gazetted on 8 January 2009 without any major changes from the Finance Bill 2008 which included the 2009 Budget proposals.

Double Taxation Agreement (DTA)

The Malaysian Government ratified the DTA with Qatar on 28 January 2009.

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New Zealand

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Tax update

Recent legislative changes

The New Zealand Government has recently passed legislation to increase the filing thresholds for PAYE (salary and wage withholding tax), GST (New Zealand's equivalent to VAT), and fringe benefit tax. The new legislation has also reduced the payments required under the provisional tax regime, which requires taxpayers to make interim tax payments based on their previous years' taxable income. This has been reduced because companies are not necessarily expected to increase earnings in the current economic climate.

The interest rates applied to underpayments and overpayments of tax were reduced from 1 March 2009. The rate for overpayments will now be 4.23 percent and underpayments will be 9.73 percent.

KiwiSaver is a voluntary, work-based savings initiative recently introduced by the New Zealand Government, designed to facilitate long-term saving for retirement. The member contributes either 2 percent or 4 percent of their salary annually. These rates have recently been reduced from 4 percent or 8 percent. Employer's contributions have been reduced to 2 percent, this rate was previously capped at 4 percent.

Philippines

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Tax update

Tax developments

- On 9 January 2009, the Bangko Sentral ng Pilipinas (BSP) issued Circular No. 638 providing that all financial institutions shall, prior to opening letters of credit, collect from the importer a deposit equivalent to the full amount of advance import duties due on the importation. The deposit shall be effected through an electronic Import Entry Declaration and cannot be withdrawable. It shall be utilised only by crediting the same to the import duties, taxes and other charges due on the importation. The Circular is applicable to

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importations cleared through the Customs offices operating the e2m Customs System.

- On 3 March 2009, the BSP issued Circular No. 647 amending Circular No. 619 on the 20 percent Final Withholding Tax (FWT) on Overnight Reverse Repurchase Transactions (RRPs).

  Circular No. 647 provides that banks/quasi-banks shall reimburse the BSP the amount equivalent to 40 percent of the 20 percent FWT due on its RRPs with the BSP from 1 January 2008 to 22 August 2008. Further, banks/quasi-banks which choose to pay the whole 20 percent FWT shall remit the amount equivalent to the 60 percent balance to the BIR through the BSP as withholding agent. In both cases, payment of the FWT to the BSP shall be made on or before 3 April 2009 either in full or in three instalments.

Singapore

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Tax update

Singapore Budget 2009

In the Budget 2009 speech, the Minister for Finance proposed various changes to the existing tax rules and incentives in Singapore in response to the global economic crisis. To attract foreign investments, the changes proposed were:

- Reduction in corporate income tax rate

  Reduction of corporate income tax rate to 17 percent with effect from the Year of Assessment 2010.

- Tax framework for facilitating corporate amalgamations

  A new tax framework for qualifying amalgamations would be introduced to alleviate the overall tax impact arising from corporate amalgamations. It is intended that the new framework would apply to qualifying corporate amalgamations where the amalgamated company takes over all the assets and liabilities of the amalgamating companies and the amalgamating companies cease to exist (commonly referred to as an absorption merger).

  The Inland Revenue Authority of Singapore (IRAS) has released a public consultation paper on 20 February 2009 to gather feedback from the public on the proposed tax framework.

- Enhancement to the tax incentives for fund management

  It is proposed that a new Enhanced Tier fund management incentive be introduced to exempt funds, with a minimum fund size of S$50 million at the point of application, from income tax. Under the new scheme, the tax

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exemption incentive would be enhanced as follows:

a) Imposing no restriction on the residence status of the fund vehicles and investors;
b) Extending the tax incentive to fund vehicles setup in the form of limited partnerships; and
c) Lifting of the investment limits imposed on resident non-individual investors.

An application is required to be submitted to the Monetary Authority of Singapore (MAS) for approval under this scheme.

The MAS is expected to provide further details on the above proposal by April 2009.

- Enhancement of Financial Sector Incentive – Headquarter (FSI-HQ) Services scheme

  It is proposed that the FSI-HQ scheme be enhanced in the following manner:
  a) to include services to an approved office or person in Singapore;
  b) to extend the scheme to admit a company that:
     i. is wholly-owned directly or indirectly by or wholly owns directly or indirectly, a company that is licensed or approved by the MAS or by the MAS-equivalent in the company's home country; and
     ii. provides treasury, investment or financial services in Singapore to any of its offices or its associated companies.
  c) to grant withholding tax exemption on interest payable on qualifying loans taken up by a FSI-HQ company during the period from 22 January 2009 to 31 December 2013 to perform qualifying activities;
     to subsume the Qualifying Processing Services Company (QPC) scheme under the FSI-HQ scheme such that income derived by a FSI-HQ company from the provision of prescribed processing services in Singapore to any financial institution or another QPC would enjoy the concessionary tax rate of 10 percent. Companies which are currently enjoying the concessionary tax rate of 5 percent under the QPC scheme would continue to do so until the end of their respective awards.

  The MAS is expected to provide further details on the proposed changes by April 2009.

- Extension and enhancement of Commodity Derivatives Trader (CDT) scheme

  The CDT scheme which expired on 26 February 2009 grants a concessionary tax rate of 5 percent on income derived by an approved standard/enhanced commodity derivatives trading company from:

  a) Trading in over-the-counter/exchange-traded commodity derivatives or freight derivatives;
  b) Services as an intermediary in connection with transactions relating to over-the-counter/exchange-traded commodity derivatives or freight derivatives.

  It is proposed that the CDT scheme be:

  a) Subsumed under the Financial Sector Incentive-Derivatives Market scheme;
  b) Enhanced with the lifting of counter-party restrictions for trades carried out on exchanges; and
  c) Extended to include emission derivatives.

  Further details pertaining to the proposed changes are expected to be released by the MAS by April 2009.

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- Enhancements of Specified Income and Designated Investments lists

  It was announced that the lists of specified income and designated investments applicable to certain tax incentives provided under the Singapore Income Tax Act would be expanded.

  The list of specified income would be expanded to include the following:

  a) Income realised (other than through sale) on or after 22 January 2009 from designated investments in other forms (held to maturity, redemption, or where the realisation leads to a transfer of both economic and legal ownership).
  b) Income derived from debt securities under the Qualifying Debt Securities ("QDS") scheme. This includes:

     i. Prescribed income directly attributable to QDS issued on or after such date as may be prescribed by regulations; and

     ii. Amount payable on any Islamic debt securities which are QDS issued on or after 22 January 2009.

  The list of designated investments would also be enhanced to cover the following:

  a) Investments in structured products;
  b) Units in business trusts;
  c) Qualifying Islamic investments involving the Murabaha, Mudaraba, Ijara wa Igtina, Musharaka, Istisna and Salam concepts;
  d) Emissions derivatives;
  e) Stocks and shares of unlisted companies (whether resident or non–resident in Singapore) denominated in any currency; and
  f) Adjudicated and non-adjudicated liquidation claims.

  The MAS is expected to provide further details on the above proposal by April 2009.

- Recovery of input Goods and Services Tax (GST) for Qualifying Funds

  Generally, funds based in Singapore are unable to register for GST if they only make exempt financial supplies or receive dividend income. Therefore, such funds would incur irrecoverable GST on their expenses, such as fund management fees charged by Singapore fund managers. Even if such funds make some taxable supplies to enable GST registration, they would only be entitled to claim the input GST incurred in their businesses to the extent that the input GST relates to the making of taxable supplies, which would typically be minimal. Therefore, such funds may incur substantial irrecoverable GST on their expenses.

  It is proposed that Qualifying Funds that are managed by a prescribed Singapore fund manager would be allowed to claim a substantial portion of their input GST on prescribed expenses.

  The MAS is expected to release details of the proposed change by April 2009.

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Sri Lanka

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Tax update

Nation Building Tax

A new tax similar to turnover tax was introduced effective from 1 February 2009. The tax is levied at 1 percent on turnover on imports, service providers and manufacturers, with an input credit mechanism limited to manufacturers. The business of banking and finance, leasing of immoveable property and life insurance are exempted from this tax. However, general insurance business will be subjected to this tax.

Taiwan

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Tax update

Legislative amendments

The Statute for Upgrading Industry which offers a variety of tax incentives and exemptions to certain selected industries is scheduled to be repealed on 31 December 2009. However, in order to maintain tax competitiveness, the Ministry of Finance has decided to retain a portion of the incentives and exemptions offered under the said Statute.

As a result, amendments to the Income Tax Act have recently been proposed by the Executive Yuan to promote fairness across all corporations as well as individuals earning low to middle incomes.

Major changes proposed in this amendment include the following:

a) Reduction of the corporate income tax rate from 25 percent to 20 percent

b) Reduction of tax rates for certain personal income tax brackets. The tax rate for the three lower income brackets has been lowered from the current 6 percent, 13 percent, and 21 percent to 5 percent, 12 percent and 20 percent

The draft amendment has been submitted to the Legislative Yuan for approval

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and revision if it deems necessary.

Assuming it has passed all three readings by the Legislative Yuan, the amendments will be subject to further review by the President, before being signed into law.

Should the amendments become effective, the reduced income tax rates will be applicable from 2010.

Thailand

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Tax update

Economic Stimulus Package

On 20 January 2009, a number of tax incentives aimed at enhancing the economy were announced by the Government. Aimed principally at the property sector, small and medium enterprises (SMEs), the tourism sector, debt restructuring and partial business transfers, the Government hopes to stimulate consumer spending and investments in the private sector to boost Thailand's economic growth.

Highlights of the new measures announced include:

Personal income tax

- A new deduction for payments of up to THB 300,000 for newly constructed houses acquired during 2009.

Corporate income tax

- A double deduction for certain expenses incurred by companies that organize seminars and workshops in hotel facilities in Thailand for 2009.
- An extension of the tax incentives received by venture capital companies which invest in SMEs by 31 December 2011. In addition, the initial requirement to invest 20 percent of the registered capital in the first year of operation has been removed.
- An exemption from income tax, VAT, stamp duty and specific business tax and a reduction of fees on rights registration with the Department of Land in relation to asset transfers, asset disposals and other transactions stemming from debt restructuring for 2009.
- An exemption from VAT, specific business tax, stamp duty, as well as a reduction of fees on rights' registration of transfers with Department of Land in relation to transferring parts of businesses among public companies or limited companies. The transfer must be completed by 31 December 2009.

Details of the laws will be promulgated soon.

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