Asia Financial Services Tax Quarterly Developments Report

July to September 2008

PRICEWATERHOUSECOOPERS

PricewaterhouseCoopers (www.pwc.com) is the world's largest professional services organisation. Drawing on the knowledge and skills of more than 125,000 people in 142 countries, we build relationships by providing services based on quality and integrity.

This report aims to provide general guidance only and does not purport to deal with all possible questions and issues which may arise in any given situation. Should the reader encounter particular problems, he or she is advised to seek professional advice, which PricewaterhouseCoopers would be please to provide.

While all reasonable care has been taken in the preparation of this report, no responsibility or liability is accepted by the authors, PricewaterhouseCoopers, for any errors, omissions, or misstatements it may contain or for any loss or damage, howsoever occasioned, to any person acting or refraining from action as a result of any statement or omission in this report.

Copyright 2008 PricewaterhouseCoopers. All rights reserved. 'PricewaterhouseCoopers' refers to the network of member firms of PricewaterhouseCoopers International Limited, each of which is a separate and independent legal entity.

Introduction

For many years the PricewaterhouseCoopers Financial Services tax network in Asia has been sharing within the network a quarterly report on tax developments. We now share this knowledge with our valued clients.

This PricewaterhouseCoopers Asia Financial Services Tax Quarterly Developments Report covers the period ended 30 September 2008. It very briefly lists tax developments in the Asia region that are relevant to financial services operations.

The report is sorted by Asian territory. Please contact your local PricewaterhouseCoopers tax adviser if you wish to obtain further information on any development listed in this report.

We hope you find the report useful. I would be delighted to receive comments on the report.

John Masters

Asia Financial Services Tax Leader

Sydney

Ph: 61 2 8266 7265

Email: john.masters@au.pwc.com

Contents

Australia 5

China 8

Hong Kong 10

India 12

Indonesia 16

Japan 19

Korea 23

Malaysia 25

New Zealand 27

Pakistan 29

Philippines 30

Thailand 36

Notes 37

Australia

Sector:	Banking & Capital Markets	***Date:***	Sep 2008	***Contact:***	Tom Toryanik - Sydney

Interaction between transfer pricing and debt/equity rules

The ATO issued Taxation Determination TD 2008/20 dealing with the interaction between transfer pricing and debt equity provisions. The Determination was previously released as Draft Taxation Determination TD 2008/D3.

The Determination states that the classification of an arrangement under the debt/equity provisions will not be relevant in the determination of an arm's length consideration under the arrangement for the transfer pricing purposes. For example, where profit-participating loan is treated as "equity" under the debt/equity rules, return from the loan is treated as a dividend. However, this classification will not be relevant for the determination of the arm's length rate of interest from the loan under the transfer pricing provisions.

Sector:	Banking & Capital Markets	***Date:***	Sep 2008	***Contact:***	Tom Toryanik - Sydney

Interest on state bonds will be exempt from withholding tax

The Treasury released for comment Draft legislation which will exempt from interest withholding tax interest paid on bonds issued in Australia by State or Territory central borrowing authority.

The exemption will operate if the bond issue satisfies the public offer test.

Sector:	Banking & Capital Markets	***Date:***	Sep 2008	***Contact:***	Tom Toryanik - Sydney

ATO clarifies the scope of participation exemption

The ATO issued Taxation Determinations TD 2008/24 and TD 2008/25 which said that the participation exemption for non-portfolio dividends received from non-residents will not apply if the dividends are received by a company in the capacity of a partner in a partnership or as a trustee (unless the partnership is a member of a tax consolidated group).

In Taxation Determination TD 2008/23, the ATO considered the exemption from Australian capital gains tax of a gain from a disposal of shares in a foreign company carrying on an active business.

Generally, for the purposes of this exemption the active business is ascertained based on the company's assets used in active business, as defined. However, it is the ATO's view that no assets of a partnership, in which a foreign company is a partner, are active assets of the foreign company.

Sector:	Banking & Capital Markets	***Date:***	Sep 2008	***Contact:***	Tom Toryanik - Sydney

Mutual recognition of SEC registrants

Australian Securities and Investment Commission announced a mutual recognition agreement with SEC, which will allow US and Australian broker-dealers and stock exchanges, regulated in only one of the jurisdictions, to operate across both jurisdictions without additional regulation.

Sector:	Banking & Capital Markets	**Date:**	Sep 2008	**Contact:**	Tom Toryanik - Sydney

Compound interest deductible

The ATO, in draft Taxation Determination TD 2008/D12 announced that the deductibility of compound and ordinary interest is subject to the same rules.

Sector:	Banking & Capital Markets	**Date:**	Sep 2008	**Contact:**	Tom Toryanik - Sydney

Tax debts to be collected across the Tasman

The Article on Assistance in Collection of Taxes of the Double Tax Agreement between the Governments of Australia and New Zealand has entered into effect. The Australian Taxation Office and Inland Revenue Department will now assist to collect tax debts owing to the revenue office of the other country.

Also, the Governments of Australia and New Zealand has announced that rules will be drafted that will allow taxpayers in each country to use imputation credits earned in the other country.

Sector:	Banking & Capital Markets	**Date:**	Sep 2008	**Contact:**	Tom Toryanik - Sydney

Foreign hybrids qualification for limited partnership clarified

The ATO in Draft Taxation Determination TD 2008/D13 discussed the meaning of the requirement that “foreign tax be imposed on partners and not the partnership” in the context of the foreign hybrid rules. If this requirement is satisfied, a foreign partnership may be treated as a transparent entity for the Australian tax purposes.

The ATO noted that this requirement aims to test whether the limited partnership is a taxpayer in the foreign country on the assumption that there was income or profits. The Determination includes a number of examples dealing with a variety of situations, including where the foreign partnership is an exempt entity:

- where the foreign country imposes a tax on the partnership in relation to only some income or profits of the partnership (eg German KG)
- where foreign partners may have tax liability generally, but will not from the actual business of the partnership (eg UK LP)
- where certain elections are made by the partnership (eg US LP) or a change in activities happens resulting in a change in the tax status (eg German KG).

Sector:	Real Estate	**Date:**	Sep 2008	**Contact:**	Michael Cox - Sydney

Modification of the Public Trading Trust Rules

A Bill containing proposed changes to Division 6C (the public trading trust rules of the Australian income tax law) was recently released. The trading trust rules have particular application to Australian REITs, as well as to wider managed investment funds. The Division 6C rules limit the investment activity which a trust can undertake while retaining “flow through” status.

The four key changes proposed are:

1. Widen the definition of land.
2. Expand the permissible range of financial instrument investments.
3. Provide a 25% of gross revenue safe harbour for certain non-rental income from land.
4. Provide a 2% safe harbour for other incidental non-rental income from land.

Sector: Real Estate ***Date:*** Sep 2008 ***Contact:*** Michael Cox - Sydney

Review of Tax Arrangements applying to Managed Investment Trusts (MITs)

The Board of Taxation released its discussion paper on the Review of Tax Arrangements applying to MITs. The discussion paper contains much complex detail. In summary the following issues have been raised in the paper to which the Board would like submissions from the industry by 19 December 2008.

1. Options for determining tax liabilities.
2. International considerations.
3. Trusts as flow through vehicles.
4. Capital v revenue account treatment for assets.
5. Definition of a Fixed Trust.
6. Public Trading Trust rules.
7. Whether Division 6B (which taxes certain trusts as companies) should be retained or modified.
8. Defining the scope of an MIT.
9. Implications for other trusts and whether any changes be extended to non-MITs.

The discussion paper is conceptual in nature and raises several issues that the industry has to deal with in the context of the current Tax Laws. At this stage, potential options and various questions are raised for industry input. Should you require a copy of the paper, please contact Michael Cox.

Sector: Real Estate ***Date:*** Sep 2008 ***Contact:*** Colin Morrow - Sydney

GST margin scheme integrity measures

The GST margin scheme integrity measures announced in the 2008-09 Federal Budget were introduced into Parliament on 25 September 2008. The proposed amendments have potentially significant implications, particularly for property developers.

The proposed amendments are intended to ensure that the interaction between the margin scheme provisions and various other provisions in the GST legislation results in GST applying to the value added to real property after 1 July 2000.

- The amendments aim to ensure that a supply which would otherwise be ineligible for the margin scheme cannot become ‘re-eligible’ as a result of interposing certain GST-free or non-taxable supplies.
- Secondly, where real property is otherwise acquired GST-free as part of the supply of a going concern, or as GST-free farmland, or where it has been supplied to a registered associate for no consideration, the calculation of GST on any subsequent sale of that property under the margin scheme will have to include the value added by the previous owner.

China

Sector:	All	***Date:***	Sep 2008	***Contact:***	TAX Knowledge Management Centre - Beijing

The new China Corporate Income Tax

The new China Corporate Income Tax ("CIT") Law has introduced the concept of thin capitalisation. The ratio, however, was not stipulated in the CIT Law or its Detailed Implementation Regulations. In October, the Ministry of Finance and State Administration of Taxation have jointly released a circular setting out the prescribed debt/equity ratio and other relevant rules.

There are two prescribed debt/equity ratios - 5:1 for enterprises in the financial industry and 2:1 for non-financial enterprises. Related party interest expense pertaining to the portion of related party debt/equity ratio that exceeds the above prescribed debt/equity ratio will not be deductible in that year or any future years, except in situations where an enterprise can provide documentation to support that the inter-company financing arrangements comply with the arm's length principle; or where the effective tax rate of the borrowing enterprise is not higher than that of the domestic lending enterprise.

The circular confirms that the thin capitalisation rule in China is punitive by stipulating that the borrowing enterprise will be subject to CIT on the full amount of interest income (including the disallowed portion of the related party interest expense to the lending enterprise).

The new thin capitalisation rules should be effective retrospectively 1 January 2008. However, there are still much missing information, namely the documentation requirements of related-party financing, scope of related-party debts and equity for thin capitalisation purposes, etc, which we understand will be addressed in the upcoming Detailed Administrative Measures on Special Tax Adjustments.

(Note: Please refer to our China Tax / Business News Flash 2008 Issue 10 for more detailed analysis of the thin capitalisation rules.)

Sector:	All	***Date:***	Sep 2008	***Contact:***	TAX Knowledge Management Centre - Beijing

The rate of stamp duty on the transfer of shares

The rate of stamp duty on the transfer of shares (both A shares and B shares) listed on the Chinese Stock Exchanges is 0.1%, payable by both the transferor and transferee. Effective 19 September 2008, this stamp duty will only be payable by the transferor, and the transferee will not be subject to any stamp duty. This was believed to be a measure to stabilise the fragile stock markets in China.

Sector:	Banking and Capital Markets Insurance	***Date:***	Jul 2008	***Contact:***	Matthew Wong - Shanghai

New incentive program for companies/employees in the financial services sector

On 24 July 2008, Pudong New Area authorities (Shanghai) have promulgated a new incentive program for companies/employees in the financial services sector.

Financial services sector would basically include security houses, banks, and insurance companies. Qualified individuals include senior executives, individuals with managerial roles, and professionals with three years or more experience working for the financial institutions, which are registered in the Pudong New Area and approved by the China Securities Regulatory Commission, China Banking Regulatory Commission or China Insurance Regulatory Commission.

The incentives applicable to the qualified employees of the qualified financial institutions under the program are mainly taking the form of:

- Senior executives of newly set up financial institutions can apply for a housing subsidy of up to RMB200,000.
- Senior executives can apply for refund of up to 40% of his Individual Income Tax ("IIT") paid in a year.
- Managers and professionals can apply for refund of up to 20% of his IIT paid in a year.

The incentive program will expire on 31 December 2010.

Sector:	All	***Date:***	Sep 2008	***Contact:***	TAX Knowledge Management Centre - Beijing

Agreement between the Government of PRC and Tajikistan

In August, SAT issued a circular to announce that the Agreement between the Government of PRC and Tajikistan for the Avoidance of Double Taxation of Income and Prevention of Tax Evasion (“DTA”) has been officially signed by the two governments. The DTA will come into effect after both States complete their respective legal procedures.

Hong Kong

Sector: Financial Services ***Date:*** Sep 2008 ***Contact:*** Peter Yu
Florence Yip - Hong Kong

Revised Partnership Taxation Rules

The Hong Kong Inland Revenue Ordinance (the "IRO") has been amended in consequence of the change that a limited partnership can now consist of more than 20 partners pursuant to the Limited Partnership Ordinance.

Prior to 14 December 2007, partnerships consisting of more than 20 partners at any time in a year of assessment (other than registered partnerships of accountants or registered partnerships of solicitors, ie "large foreign partnerships") were not considered as a "partnership" for profits tax purposes. In this regard, the profits or losses of large foreign partnerships would be dealt with at the partnership level and would not be allocated to the individual partners of the partnerships. As a result, allowable losses of a large foreign partnership would be carried forward to set off against the future assessable profits of that partnership and would not be lost when a partner left the partnership.

With effect from 14 December 2007, large foreign partnerships are now taxed in the same way as an "ordinary partnership". Accordingly, the profits or losses of the partnership shall be allocated amongst the individual partners instead of being dealt with at the partnership level for profits tax purposes.

Sector: Financial Services ***Date:*** Sep 2008 ***Contact:*** Peter Yu
Florence Yip - Hong Kong

Hong Kong to Waive Some Taxes on First Islamic Bond

Hong Kong intends to waive some taxes on its first Islamic bond, according to a report issued on 15 July 2008 in the Standard, a Chinese business newspaper, which quotes K.C. Chan Ka-keung, Hong Kong's secretary for financial services and the treasury. The Islamic bond will probably be issued by the territory's Airport Authority and will precede any permanent changes to Hong Kong's tax regime. According to Chan there is still time to implement permanent tax changes regarding the issuance of Islamic bonds and for now Hong Kong will only exempt certain taxes on Islamic bonds on a case-by-case basis. There is no specific timetable for implementing permanent tax rules.

Hong Kong's decision to issue its first Islamic bond came after the signing of a memorandum of understanding between the Hong Kong Monetary Authority and the Dubai International Finance Centre Authority on 20 May 2008.

Sector: Financial Services ***Date:*** Sep 2008 ***Contact:*** Peter Yu
Florence Yip - Hong Kong

Revised DIPN No. 44 on China / Hong Kong Double Tax Agreement ("China / HK DTA")

The Second Protocol to the China / HK DTA ("2nd Protocol") and has taken effect on 11 June 2008.

On 15 August 2008 the Hong Kong Inland Revenue Department ("IRD") issued a revised Departmental Interpretation and Practice Notes ("DIPN") No. 44 in order to provide further clarification for the transitional treatments for the determination of service PE and guidance for the implementation of the other articles in the 2nd Protocol.

Permanent Establishment – transition from the “6 month” regime to the “183 days” regime

DIPN No. 44 (revised) now clarify that for the service projects which have already commenced in the Mainland before 11 June 2008, the old "6 months" rule should continue to apply to the whole project period to determine if a service Permanent Establishment is established; whereas for projects which have not commenced in the Mainland before 11 June 2008, the new "183 days" rule will apply.

DIPN No. 44 (revised) further clarifies that in counting the number of days spent by an enterprise in providing services, both parties will take the "day of presence" approach. That is to say, all days of presence, including both the day of arrival and the day of departure; the same-day trip will be counted as one day; and the reasons for the presence (working or leisure) not relevant.

Immovable Property

As mentioned previously, where a Hong Kong resident derives gains from the alienation of shares in a Mainland resident company and the Mainland company's assets are comprised, directly or indirectly, mainly of immovable property located in the Mainland, the gains may be taxed in the Mainland. As defined in the First Protocol, "mainly" means not less than 50 percent. However, the contracting parties had different views on the point of time that should be used to determine whether 50 percent or more of the assets is immovable property.

DIPN No. 44 (revised) clarify that, in determining whether the 50% threshold is exceeded, one has to look at the "year-end book value" of the assets. It is interpreted that the "year-end book value" is the net book value (ie historical cost reduced by the accumulated accounting depreciation and adjusted by other accounting adjustments such as revaluation) shown in the accounts that are prepared based on the prevailing accounting standards.

Sector:	Financial Services	***Date:***	Sep 2008	***Contact:***	Peter Yu Florence Yip - Hong Kong

ING Baring Case

The Inland Revenue Department (“IRD”) published a set of new Frequently Asked Questions (“FAQs”) on its website on 31 July 2008. The FAQs consists of 11 questions with respect to the ING Baring case in which the taxpayer succeeded in appealing to the Court Final Appeal on its offshore claim on brokerage commission income.

In the FAQs, the IRD confirmed that the Court of Final Appeal’s decision in the ING Baring case does not represent a change of law. The law remains that “one looks to see what the taxpayer has done to earn the profit in question and where he has done it” when determining the source of revenue.

The IRD is also of the view that the Court of Final Appeal has not rejected the “totality of facts” approach (introduced in the Magna Industrial case) and states that “it is perfectly proper to use the term “totality of facts” to describe the process of enquiry about source.

The IRD commented that it is reviewing the revised Departmental Interpretation and Practice Notes on “locality of profits” and will update the notes to reflect the decision in the ING Baring Case and other recent court decisions.

India

Sector: Investment Management
Real Estate

Date: Jul 2008

Contact: Tushar Sachade
Himanshu Mandavia - Mumbai

India's Position on recent update to OECD commentary

OECD has recently released "The 2008 Update to The OECD Model Convention". Various amendments to the Commentary made by OECD are incorporated in the 2008 Update. India is now an observer and has for the first time given its comments / reservations on the OECD Model and OECD Commentary. Some of the key provisions on India's position are summarised below:

- Tax Residency of tax transparent entities
  - The OECD commentary suggests that in a case wherein the partnership firm is treated as a transparent entity (which is not liable to tax in the home country) and is not eligible to avail Treaty benefits, the benefit of Treaty should be given to the partners in the country of which they are tax resident. However, India does not agree with this interpretation and believes that the same would be possible only if specific clauses to that effect are included in the Treaty.
  - OECD commentary suggests that the place of effective management is the place where key management and commercial decisions are in substance made, that are necessary for the conduct of the entity's business as a whole. India is of the view that the aforesaid concept of 'place of effective management' is quite narrow and that the place where the main and substantial activity of the entity is carried on should also be taken into account for determining the place of effective management.
- Permanent Establishment

  Fixed Place PE
  - India does not agree with the OECD requirement of geographical and commercial coherence as a necessary element for a Fixed Place PE. Accordingly, a person working in different places on unrelated contracts for short duration may be held to have a PE if the overall stay in India is for a substantial period of time.
  - As per India, bare letting of property itself, in certain circumstances, can create Fixed place PE exposure.
  - Under the OECD Commentary, place of management, branch, office, etc. referred in Article 5(2) constitute a PE only if it satisfies the basic tests laid down in Article 5(1) ie permanency test, etc. India disagrees with the said interpretation and is of the view that such examples provided under the deeming fiction would constitute a Fixed Place PE.
  - The OECD commentary provides that when a building site or a construction development project constitutes a permanent establishment in terms of the provisions of Article 5(3), then only profits which are resulting from the activities of such building site / project should be treated as attributable to such PE. If another part of the enterprise provides some goods or provides some services (such as planning, designing, drawing, blue prints, etc) outside the State in which the PE is created, then the profits arising from such supply of goods or services are not attributable to the PE. India does not agree with this interpretation. This Indian position seems to be contrary to the Supreme Court Judgement in the case of Ishikawajma-Harima heavy Industries Ltd.
  - India does not agree with the words "The 12 month test applies to each individual site or project." It considers a series of conservative short term sites or projects operated by a contractor would give rise to existence of a PE in the country concerned.

Service PE

- India is of the view that for furnishing services in a country, physical presence of an individual is not essential. Further, taxation principle applicable to the profit from sale of goods may not apply to income from furnishing of services and taxation rights may exist even when services are performed from outside the source country by a non-resident[1]
- India does not agree that only profits derived from the services should be subject to tax. It is also of the view, that gross amount of fees paid for the services could be an alternative to taxation of income from services.[2]
- India is of the view that a foreign enterprise outsourcing services to an enterprise resident of the source country, which are being performed by the employees of the later (under its directions and supervision) and which includes servicing clients of the foreign enterprise could be considered to be performed by foreign enterprise in the source country through its employees.

Agency PE

- According to OECD, mere attending or participating in negotiations, by itself, does not give rise to a presumption that such person has the authority to conclude contracts. India does not agree to this and considers, in certain circumstances, mere participation is sufficient itself to conclude that the person has exercised authority to conclude contracts. Even a person who is authorised to negotiate essential elements of the contract and not all elements and details, can be said to conclude contracts and thereby creating PE.

Others

- India does not agree to treat premium on debenture redemption as interest and such determination would be guided by its local laws.

Sector:	Investment Management Real Estate	***Date:***	Jul 2008	***Contact:***	Gautam Mehra Hemen Asher - Mumbai

M/S Cushman & Wakefield (S) Pte Ltd (AAR) (305 ITR 208)

The Singapore company (‘Applicant’) was engaged in the business of rendering full range of real estate services. In accordance with its global policy, its various offices were providing referral services to its other offices, for a ‘referral fee’ (30% of the amount charged) to be paid to the referring group company. In consonance with this policy, the applicant entered into an agreement with its Indian group company Cushman & Wakefield India Pvt Ltd (‘CWI’) whereby the applicant would refer / recommend potential customers, desirous of obtaining real estate consultancy and associated services in India, to CWI. The applicant was neither involved in persuading the customers to avail services of CWI, not in negotiating or, collecting fees by CWI from the customers referred. The ‘referral’ was made by the applicant either through e-mail or telephonically.

The AAR held that the :

- Referral fee was outside the scope of total income under the Act since it was received in Singapore. Accordingly, they cannot be said to be received / deemed to be received in India. Further, no activity except that of making a referral from Singapore to CWI India has been done in India. Accordingly, it cannot be said that the income accrues or arises in India
- Applicant was not having any activities in India except that of making a referral to CWI to Singapore. Besides, the AAR stated that it was the prerogative of the prospective customer & CWI to decide whether they wanted to enter into an agreement for services. Thus, there was no ‘business connection’ in India in the case of the applicant
- Receipt was not in the nature of royalty or fees for technical services.

---

[1] Section 9(1)(vii) of the Income tax Act, 1961 also provides this

[2] Several Tax Treaty signed by India as well the domestic law, section 115A contain similar provision

Sector:	Banking and Capital Markets	**Date:**	Aug 2008	**Contact:**	Sunil Gidwani - Mumbai

Ruling in the case of The Bank of Rajasthan

In the given case the Rajasthan High Court relying on the decision of the Apex court in the case of Vijaya Bank Ltd. V CIT [1991] 187 ITR 541 (SC) held that broken period interest on securities purchased by the Bank was in the nature of capital outlay and accordingly no part of it can be set off as expenditure against income accruing on those securities.

)Commissioner of Income Tax vs The Bank of Rajasthan Ltd. [2008] 218 CTR 417 (Raj))

Sector:	Banking and Capital Markets	**Date:**	Jul 2008	**Contact:**	Sunil Gidwani - Mumbai

Ruling in the case of Bright Star Investments Pvt Ltd

Bright Star Investments Pvt. Ltd. (the assessee) had converted stock-in-trade into investments at their book value and later sold them and offered to tax the difference between the indexed book value and the sale proceeds as capital gains. The assessing officer took the view that the difference between the book value and the FMV on the date of conversion had to be assessed as business income. The Tribunal held that in absence of the statutory provision, a rational basis has to be evolved to determine taxable profits ie the formula adopted by the assessee of taking the difference between the indexed book value on the date of conversion and the sale proceeds as long-term capital gains, being beneficial to the assessee, should be adopted. No part of the gains can be assessed as business income.

(ACIT V Bright Star Investments Pvt. Ltd.2008-TIOL-392-ITAT-MUM)

Sector:	Banking and Capital Markets	**Date:**	Aug 2008	**Contact:**	Sunil Gidwani - Mumbai

SET Satellite Judgement:

Bombay High Court held that if correct arm's length price is applied and paid to its dependent agent then nothing further would be left to be taxed in the hands of the Foreign Enterprise.

Considering the provisions of Circular No. 233, Circular No. 7424, Article 7 of the Tax

Treaty and the order of the Supreme Court in the case of Morgan Stanley & Co. Inc.,

the High Court held as under:

- If the correct arm's length price is applied and paid, then nothing further would be left to be taxed in the hands of the Foreign Enterprise.
- Having regard to the CBDT Circular No. 7424, it would be fair and reasonable that the taxable income of the foreign telecasting company is computed at 10% of the gross profits. In the instant case, so far as marketing services are concerned, by the arm's length principle, what has been paid is more than 10%.
- The CBDT Circular No. 23 read with Article 7(1) would result in holding that the advertisement revenues received by the assessee are not taxable in India as long as the Treaty and the Circular stands.
- Merely because tax on income was paid for some assessment years, it would not stop the assessee from contending that its income is not liable to tax.

After the decision of the Supreme Court in the case of Morgan Stanley, this is a welcome decision of the High Court accepting the principle that payment of arm’s length remuneration to dependent agent in India would extinguish the tax liability of the foreign enterprise in India.

This judgment will have far reaching implications vis-à-vis foreign enterprises carrying on business in India through agents or associated enterprises constituting PE and would provide much needed certainty and relief to the tax payers.

Sector:	Banking and Capital Markets	***Date:***	Jul 2008	***Contact:***	Sunil Gidwani - Mumbai

RBI has issued a directive that resident and non-resident investors cannot hold more than 10 percent of the equity capital in any credit information company.

The RBI has issued a directive that resident and non-resident investors cannot hold more than 10 percent of the equity capital in any credit information company. This limit would apply to funds routed through the foreign direct investment channel as well. The RBI issued this directive to ensure that ownership of banks and other financial sector entities is well diversified.

(RBI Press Release 2008-2009/91 dated 22 July 2008)

Sector:	Banking & Capital Markets	***Date:***	Oct 2008	***Contact:***	Sunil Gidwani - Mumbai

Liaison office of foreign enterprise liable to pay FBT in India : AAR

In case of Singapore Tourism Board, a company incorporated in Singapore, AAR ruled that Liaison office of foreign enterprise liable to pay FBT in India. The Singapore company had no business activities in India but it had employees working in India. The

The Department relied upon a ruling of the Authority in the case of Population Council Inc (2 Population Council Inc., In re (2006) 286 ITR 243 (AAR))

The AAR also referred to Question No 26 of the CBDT Circular No 8 / `2005 dated 29 August 2005 which clarified that FBT will apply to liaison offices of foreign companies in India if the liaison offices have employees based in India.

Indonesia

Sector: General | ***Date:*** Jul 2008 | ***Contact:*** Margie Margaret, Jim McMillan, Hendra Lie - Jakarta

Tax concession under sunset policy – an update

The Director General of Tax (DGT) recently issued guidelines on the application of its tax concession policy (referred to as the "Sunset Policy").

The policy provides to certain taxpayers an opportunity to revise or submit annual income tax returns (AITRs) and disclose a tax underpayment. Under the policy, the taxpayer obtains an exemption from interest penalty otherwise payable on underpaid tax (otherwise the penalty amount be calculated at the rate of 2% per month overdue, for up to 2 years). The Sunset Policy only applies up to 31 December 2008 for existing registered taxpayers, or to 31 March 2009 for newly registered taxpayers.

The policy also gives taxpayers an opportunity to stop on-going tax audits, but there is no guarantee that future tax audits will not occur, particularly if the revised tax return does not reflect the correct tax position.

Sector: General | ***Date:*** Aug 2008 | ***Contact:*** Margie Margaret, Jim McMillan, Hendra Lie - Jakarta

Status of beneficial owner in double tax agreements

The DGT issued a circular letter regarding the meaning of "beneficial ownership" in applying Double Tax Agreements (DTA) between Indonesia and its partner countries. The concept is relevant to identifying who is the "owner" of income and therefore potentially entitled to treaty protection, that is to prevent withholding taxes of up to 20% from applying to dividends, interest and/or royalty income.

The circular letter provides a very general definition of "beneficial owner", that is the beneficial owner is the party who *actually receives the benefits* of the income, such as dividends, interest and /or royalty. However, there is no guidance from the DGT about how to evidence beneficial ownership.

Under the amended Income Tax Law, in addition to the availability of a Certificate of Residence, the DGT will apply the beneficial ownership rules based on corporate domicile, that is by identifying the country in which the major shareholders (individually or collectively more than 50%) of the corporate taxpayers reside or hold "effective management". The meaning of this article is potentially confusing, as it is unclear whether this is a reference to the "effective management" of the shareholders, or of the company itself.

Sector: Merger | ***Date:*** Aug 2008 | ***Contact:*** Margie Margaret, Jim McMillan, Hendra Lie - Jakarta

A further update on the implementing regulation on a tax-neutral merger, consolidation, or expansion

The DGT issued a circular letter on requirements and procedures for a tax-neutral merger, consolidation, or expansion. This circular letter will affect both dissolving and surviving entities involved in the merger, consolidation, or expansion.

The letter confirms that:

- There will be tax audits of both surviving and dissolving entities.
- If there is an offset of inter-company loans between the surviving and dissolving entities, for debtors, the loan offset is not taxable income while for creditors, the receivable offset is not tax deductible.

- After obtaining approval for the use of book value, within 5 years, the DGT could revoke the approval if there is evidence that:
  a. The business purpose test has not been met.
  b. The taxpayer disposes of assets which were owned by a previous company, and has not informed the DGT (in writing).
  c. There were outstanding tax liabilities as of the date of DGT's approval for the use of book value.

Unfortunately the circular letter did not address the tax implications of the merger, consolidation, or expansion at the shareholder level.

Under the draft amended VAT Law, there may no longer be 10% VAT on the transfer of fixed assets from a dissolving company to a surviving company. However, the new law has not yet been passed by the Parliament. If the proposed change is approved by Parliament, the amended VAT Law is likely to be effective from 1 January 2009.

Sector:	General	***Date:***	Sep 2008	***Contact:***	Margie Margaret Jim McMillan Hendra Lie - Jakarta

Parliament finally passed the long awaited draft new Income Tax Bill

The new income tax law has been passed and will be effective from 1 January 2009.

Some of the relevant changes in the new Income Tax Law are:

1. A flat corporate income tax rate of 28% will apply starting in 2009 and will be further reduced to 25% in 2010. Public companies, subject to a minimum listing of 40% and other conditions, may have a further tax cut of 5% from the top rate. This will give them an effective tax rate of 23% in 2009 and 20% in 2010.
2. More lenient bad debt rules. A bad debt can be claimed as a deductible expense if:
   a. It has been expensed commercially
   b. The relevant list of account receivables is delivered to the DGT
   c. *One* of the following conditions can be satisfied:
      i. Debt recovery action has been taken in a state court or state receivables and auction directorate (DJPLN); or
      ii. There is a written agreement between debtor and creditor releasing the debt; or
      iii. Debt release has been published in general or special publication; or
      iv. There is acknowledgement of the debt write off by the debtor.

Under the existing Law, to claim a bad debt tax deduction, the taxpayer must announce the bad debt write off in a general or special publication and take debt recovery action through a state court or DJPLN.

3. Dividends paid out from retained earnings and received by a Perseroan Terbatas (Limited Company – (PT)) from another PT company will be exempt from income tax, subject only to a minimum share ownership of the dividend recipient in the company paying dividends of 25%. The existing "active business" requirement has been removed.
4. Interest on bonds received by mutual funds will be subject to tax in the hands of mutual funds. This ends the era of tax incentives to mutual funds in the first five years. At this stage, the tax rate on such income has not yet been determined.
5. Currently only listed shares and bonds are subject to final tax. Under the amended Income Tax Law all exchange-traded securities will become subject to final tax. Included in the definition of exchange-traded securities are derivative transactions, although detailed rules about how the derivative transaction will be taxed have not yet been finalised.
6. Under the amended Income Tax Law, the definition of "Permanent Establishments" has been expanded to include warehouse, computers, electronic agent, or automatic equipment used by a transaction organiser to carry out business activities through the internet.

7. Swap premiums and other hedging transactions paid to non-residents (other than a PE in Indonesia) will be subject to domestic tax (or lower tax if tax treaty protection applies). Again precise details of how the taxing arrangements will work are not yet available.
8. Islamic Finance (Syariah) activities will be subject to income tax. Businesses that are Syariah compliant will be governed under separate government regulations. However, the VAT issues that are currently a barrier to effective Syariah financing arrangements in Indonesia have not yet been resolved. In the draft amended VAT law (currently before Parliament), Syariah activities will be exempt from VAT as financing activities. This will resolve the VAT problems under the current law, and should facilitate future Syariah financing transactions in Indonesia.

Sector: General ***Date:*** ***Contact:*** Margie Margaret
Jim McMillan
Hendra Lie - Jakarta

Statement of Financial Accounting Standard (PSAK) 50 and 55 will be effective in 2009

PSAK 50, on Presentation and Disclosure of Financial Instruments, and PSAK 55, on Recognition and Measurement of Financial Instruments, are based on International Accounting Standards (IAS) 32 and 39, and will be effective from 1 January 2009 (Earlier adoption is also available). These two accounting standards will have a significant impact on almost all organisations.

Currently there is no guidance from the DGT on whether or not the tax treatment should follow the accounting treatment. Potential tax issues could arise in the area of provisions generally, and also marketable securities.

Japan

Sector:	Banking & Capital Markets Insurance Investment Management Real Estate	***Date:***	Aug 2008	***Contact:***	Sachihiko Fujimoto Katsuyo Oishi Yuka Matsuda Tetsuo Iimura Akemi Kitou Hiroshi Takagi - Tokyo

New Independent Agent Exemption for Discretionary Investment Managers: Background, Release of Reference Cases, Q&A and Joint Presentation by the FSA, NTA and MOF

We summarise the guidance issued following the Financial Services Agency's ("FSA") press release on 27 June 2008 outlining a collection of "Reference Cases" and a "Q&A" on practical applications (together, the "Guidance"), and a subsequent joint presentation titled "Minimizing the 'PE Risk' of Fund Managers" by the FSA, National Tax Agency ("NTA") and the Ministry of Finance ("MOF") held on 4 July 2008.

Background

On 21 December 2007, the FSA announced the basic concepts of a plan for strengthening the competitiveness of Japan's financial and capital markets. Part of the plan called for encouraging foreign fund managers to participate in Japanese markets by removing taxation risk of the fund in carrying out business through independent agents in Japan.

Under Japanese law, a non-Japanese resident may cause a permanent establishment ("PE") to arise where it conducted business through an agent in Japan who acted in a discretionary capacity on its behalf regarding the conclusion or negotiation of contracts ("Agent PE"). For Japanese fund managers, unlike many other jurisdictions and the Organisation for Economic Co-operation and Development ("OECD") Model Tax Convention on Income and on Capital ("Model Tax Convention"), Japan had neither a general independent agent exemption nor the equivalent of a safe harbour trading rule or investment management exemption for the management of foreign registered and domiciled funds ("foreign funds") by Japanese based advisors. Since many foreign funds were not themselves eligible under a double tax treaty with Japan or were not considered qualified for tax exempt status pursuant to Japanese tax principles, this lack of an OECD-standard independent agent exemption under Japanese law created a PE exposure for funds and their investors where the Japanese based investment advisors acted formally or in practice as decision makers.

The NTA had previously advised that discretionary trading in Japan on behalf of a foreign investor under Japanese tax law in the absence of any relief under a double tax treaty creates an Agent PE because there is no independent agent exemption for trading activity. Moreover, analysing and reporting this risk to investors in foreign funds became acute with the adoption of FIN 48 "Accounting for uncertainty in income taxes" for US GAAP reporting, which required the accrual of tax liabilities on an assumed full disclosure basis to the relevant tax authorities.

In practice, this risk contributed to the restriction of investment management activities in Japan, and often the location of regional investment managers in Hong Kong and Singapore, with the Japan team acting as nondiscretionary advisors/researchers. By comparison, other major fund management centres have safe harbour rules (in particular, the UK) that allowed investment managers to invest and trade in securities on behalf of foreign funds without subjecting them to the risk of Agent PE taxation.

Change to Japanese tax law

Following policy recognition of the detrimental effect the absence of an exemption was having on the Japanese fund management industry and with active support by the FSA, an independent agent exemption was included in

Japanese law in the 2008 Japanese tax reforms, which was passed into law on 30 April 2008 and became retroactively effective from 1 April 2008.

Japanese law was amended upon the issue of Cabinet Orders to the existing Corporate Tax Law Enforcement Order 186, Individual Income Tax Law Enforcement Order 290 and Local Tax Law Enforcement Order 7-3-5, which defined an Agent PE for Japanese tax law purposes. The amendments made by these Cabinet Orders *exclude* from the definition of an agent:

> "…a person who conducts business activities associated with the business of the foreign corporation independently of the foreign corporation….and in the ordinary course of his business"

This exemption is broadly in line with Article 5 of the OECD's Model Tax Convention, and is consistent with many other taxation regimes of OECD member countries. However, the amendment did not contain any language specifically defining the scope of the exception, nor did the change provide a safe harbour for certain activities conducted by an agent in Japan. Rather, a case-by-case analysis as to the independence of each agent is required. Further commentary and the equivalent of a safe harbour rule for foreign funds came with the issuance of the Guidance.

The Guidance: independent agent and the four tests

Independent agent

The Guidance starts with the OECD standard in the Model Tax Convention: for an agent to be considered an independent agent, such agent must be *legally* and *economically independent* and must be acting in the *ordinary course of its business* when providing services as an agent.

Whether an agent is independent is a question of facts and circumstances; however, the Guidance provides the following indications of what facts would be relevant in making this determination:

Legal independence

- The agent must have sufficient discretion to act as an agent, relying on its own special skill and knowledge in carrying out the role of agent, and not be subject to detailed instructions or to comprehensive control by the principal.
- An agent who is a subsidiary of the principal does not, of itself, preclude the agent from being independent of its parent company.

Economical independence

- An element of entrepreneurial risk must be borne by the agent.
- While not determinative, the number of principals represented by the agent is relevant, as is the dependency on a single principal for the agent's income.

Ordinary course of Business

- This is to be considered by examining the business activities that the agent customarily carries out when acting as an agent.

The four tests for a discretionary investment manager

The Reference Cases then clarify the meaning of an independent agent in the context of an investment management business, ie, restricted to where a foreign general partner ("FGP") or foreign investment manager ("FIM") of a foreign fund enters into a discretionary investment agreement with a Japanese discretionary investment manager ("DIM") registered under the Financial Instruments and Exchange Law, and the DIM conducts certain investment activities.

These four tests are more of a safe harbour rule where the circumstances apply, since meeting the four tests is taken as satisfying the meaning of an independent agent in the context of a discretionary fund management business.

Where applicable, the DIM will be treated as an independent agent of the foreign fund if it satisfies all of the following *four* tests:

1. *Detailed instruction* test: the FIM may provide broad discretion to the DIM but not detailed instructions; and the DIM must have enough discretion to make decisions when acting as an agent in order to be considered

legally independent. The Guidance then states that the DIM should be fully or partly entrusted to make decisions on: the kinds, issues, amounts or process of securities to be invested, including the contents and timing of any derivative transactions to be conducted, as well as whether the securities shall be purchased or sold and by what method and at what timing. The Guidance also provides examples of the application of this test in the areas of risk management, asset allocation, investment restrictions (eg, negative limits), investment policy, investment approvals, exchange of information and oversight.

2. *Shared officers* test: one half or more officers of the DIM should not concurrently serve as officers or employees of the FGP or the FIM.
3. *Remuneration* test: the DIM receives remuneration that reflects its contributions made; and a DIM will fail this test if it does not receive remuneration which corresponds to the amount of the total assets to be invested under the discretion of the DIM or its investment income.
4. *Diversification capacity* test: the DIM should have capacity to diversify its business or to acquire other clients, without fundamentally altering the way the DIM conducts its business or losing economic rationality for its business where the DIM exclusively or almost exclusively deals with the foreign fund or the FIM (with exceptions for a start up period).

Comments

Scope

The Guidance is prima facie limited to foreign funds that are established as foreign partnerships or foreign corporations without access to any double tax treaty with Japan. This is somewhat intentional as the Guidance is designed to deal with the interpretation of a change in Japanese domestic law. However, the approach to an independent agent in the Guidance will generally assist in the application of the equivalent OECD/treaty based test from the Japanese perspective.

The Guidance only applies to specific investment activities, by which is meant activities of portfolio investment, and these do not extend to the advisory or management of investments particularly of note covering private equity, real estate and non-performing loans, where by comparison with portfolio investment, income is generated through control of the investment.

Flexibility

There are favourable comments and indication that the approach by the NTA as to what is an independent agent and the application of the four tests if applicable will be applied with some degree of flexibility and openness, where for certain reasons a foreign fund or fund manger’s circumstances may not strictly meet all of the four tests enumerated. This extends to the NTA willing to respond on a disclosure basis to individual enquiries by fund managers, either in the form of advance confirmation (written responses) or confirmation with a relevant tax office (oral response).

Policy changes and final remarks

Overall, the introduction of an independent agent exemption represents a positive step forward for the financial services sector in Japan and in particular the global and local fund management industry. The changes do not eliminate the taxation risks or the need to manage these risks; however, they do generally align Japan’s taxation policy in this respect with the OECD and international fund management centres.

The change was also notable for the active involvement of the FSA in framing Japanese tax policy in consultation with MOF and the NTA, and also for the collaborative consultation process that involved discussions amongst government agencies, industry bodies, advisors, asset managers and other interested parties.

Sector:	Banking & Capital Markets Insurance Investment Management Real Estate	**Date:**	Sep 2008	**Contact:**	Sachihiko Fujimoto Katsuyo Oishi Yuka Matsuda Tetsuo Iimura Akemi Kitou Hiroshi Takagi - Tokyo

Proposed Introduction of Foreign Dividend Exemption System

As a major item of the Tax Reform Request for FY 2009, it has been proposed that a new exemption rule for dividends received by Japanese corporations from foreign subsidiaries should be enacted.

The following is proposed in the 2009 tax reform proposal of the Ministry of Economy, Trade, and Industry. The direct foreign tax credit system would also be changed under this proposal.

Taxes to be covered	Corporate income tax (National and Local corporate income tax)
Income to be covered	Dividends from foreign subsidiaries (not including profits from foreign branches, foreign investment income such as interest, royalties or capital gains from the transfer of shares in foreign subsidiaries)
Foreign subsidiaries to be covered	Ownership of 25 percent or more for at least six months
Amount to be excluded	"Certain percent of dividend received from foreign subsidiaries (eg 95 percent of dividends)" or "Dividend received from foreign subsidiaries less actual expenses (eg interest expense) incurred to hold shares"
Withholding tax	Neither subject to direct foreign tax credit nor tax deduction for foreign withholding tax imposed on dividends
Corresponding changes in anti-tax avoidance rules	To be appropriate and minimum if reinforcement of the anti
Others	(i) Provisional measure including the treatment of excess and unused foreign tax credit limitation carried forward under the existing foreign tax credit rules (ii) The indirect foreign tax credit rules may be abolished.

Korea

Sector:	Banking & Capital Markets Investment Management Insurance Real Estate	***Date:***	Sep 2008	***Contact:***	J.Y. Lee - Seoul

Withholding tax rate

Under the proposed amendment to the Corporate Income Tax Act, the withholding tax rate on Korean sourced interest, dividend income and capital gains paid to a non resident is reduced to 22%, effective for payments made on or after 1 January 2009.

Sector:	Banking & Capital Markets Investment Management Insurance Real Estate	***Date:***	Sep 2008	***Contact:***	J.Y. Lee - Seoul

Net operating loss

Under the proposed amendment to the Corporate Income Tax Act, the net operating loss carryforward period is extended from 5 years to 10 years for losses incurred in the tax year beginning on or after 1 January 2009.

Sector:	Investment Management	***Date:***	Sep 2008	***Contact:***	J.Y. Lee - Seoul

Timing of taxation on valuation gains derived by investment trust

Dividends, interest, capital gains and valuation gains derived by an investment trust are taxed in the hands of the investor upon capitalisation at the end of the trust accounting period. Effective from 1 April 2009, taxpayers will have the option of deferring any valuation gains until the date of redemption.

Sector:	Capital Markets	***Date:***	Sep 2008	***Contact:***	J.Y. Lee - Seoul

Education tax on financial service companies

Under the proposed amendment to the Education Tax Act, securities companies, futures traders, credit card companies, leasing companies and instalment sales financing businesses will be newly subject to education tax from 1 January 2009.

Sector:	Banking & Capital Markets Investment Management Insurance	***Date:***	Sep 2008	***Contact:***	J.Y. Lee - Seoul

Expansion of VAT taxable activities

Under the proposed amendment to the Value Added Tax Act, financial service commission income will be subject to VAT from 1 July 2009.

Sector:	Investment Management	***Date:***	Sep 2008	***Contact:***	J.Y. Lee - Seoul

Partnership taxation of PEF

Under the proposed amendment to the Special Tax Treatment Control Act, a private equity fund may elect to apply the partnership taxation. However, income distributed to a passive shareholder is treated as a dividend. This provision applies to income arising on or after 1 January 2009.

Sector:	Banking & Capital Markets Investment Management Insurance Real Estate	***Date:***	Sep 2008	***Contact:***	J.Y. Lee - Seoul

Consolidated income tax return

Under the proposed amendment to the Corporate Income Tax Act, a consolidated income tax regime is introduced for a domestic parent and its 100% owned domestic subsidiaries. This provision applies effective 1 January 2010.

Malaysia

Sector: All **Date:** Aug 2008 **Contact:** Khoo Chuan Keat
Frances Po
Jennifer Chang
Lim Phaik Hoon
Lorraine Yeoh
Azura Othman - Kuala Lumpur

Malaysian 2009 Budget announcement

The Malaysian 2009 Budget was announced by the Ministry of Finance on the 29 August 2008. Summarised below are the important updates affecting the Malaysian financial services sector.

Incentive for Listing of Foreign Companies and Foreign Products in Bursa Malaysia

Subject to listing conditions approved by the Securities Commission Malaysia, income tax exemption is to be given on fees received by corporate advisors for primary listing, dual listing or cross listings of:

1. corporations with predominantly foreign based operations;
2. Exchange Traded Funds and Real Estate Investment Trusts with foreign based assets;
3. foreign listed securities; and
4. foreign financial instruments.

This proposal is effective from the Year of Assessment (“YA”) 2009 until YA 2013.

Income Tax Exemption on Income of Corporate Advisors on the Issuance and Trading of Sukuk

Income tax exemption to be given on:

1. fees earned by qualified institutions in undertaking activities related to the arranging, underwriting and distributing of non-ringgit sukuk issued in Malaysia and distributed outside Malaysia; and
2. profits from the trading of non-ringgit sukuk issued in Malaysia, received by qualified institutions.

Such sukuk and institutions must be approved by the Securities Commission.

This proposal is effective YA 2009 until YA 2011.

Income Tax Exemption on Interest from Deposits

Currently, certain interest income received from moneys deposited in all institutions approved to take deposits is taxed at 5%.

It is proposed that tax on interest income received by individuals from moneys deposited in all institutions approved to take deposits will be fully exempted.

This proposal is effective 30 August 2008.

Venture Capital Industry

Currently, income tax exemption for 10 years at statutory income level is given to Venture Capital Companies (“VCC”) subject to the VCC meeting the following conditions:

1. at least 50% of its funds invested in venture companies must be in seed capital; or
2. at least 70% of its funds invested in venture companies must be in start-up or early stage financing.

To stimulate and further promote the funding of venture companies, it is proposed that a 5 year income tax exemption be given to VCC investing at least 30% of its funds in seed capital or early stage financing in venture companies.

Applications are to be made to the Securities Commission from 30 August 2008 until 31 December 2013.

Reduction in Withholding Tax Rates for Real Investment Trust (“REIT”) Investors

Currently, income received from REITs listed on Bursa Malaysia by:

1. foreign institutional investors are subject to a final withholding tax rate of 20%; and
2. non-corporate investors including resident and non-resident individuals are subject to a final withholding tax rate of 15%.

from 1 January 2007 until 31 December 2011.

To further promote the development of REITs in Malaysia and to attract foreign investment, it is proposed that both these rates would be reduced to 10%.

This proposal is effective 1 January 2009 until 31 December 2011.

Enlarging the Scope of Withholding Tax

Currently, there are no clear provisions to determine and collect tax on other incomes of non-residents falling under Section 4(f) of the Income Tax Act; eg commissions, guarantee fees and introducer’s fees.

It is proposed that withholding tax at the rate of 10% of the gross income is to be deducted from payments falling under Section 4(f) to non-residents, provided the income is derived from Malaysia.

This proposal is effective 1 January 2009.

Withholding Tax on Technical Fees

Currently, technical fees paid to non-residents are subject to withholding tax of 10% on the gross income. The gross income includes reimbursements such as travelling cost, hotel accommodation and telephone bills.

It is proposed that reimbursements relating to hotel accommodation in Malaysia are not to be included as gross technical fees for withholding tax purposes.

This proposal is effective 1 January 2009.

Sector:	Banking & Capital Markets	***Date:***	Sep 2008	***Contact:***	Khoo Chuan Keat Frances Po Jennifer Chang Lim Phaik Hoon Lorraine Yeoh Azura Othman - Kuala Lumpur

Income Tax (Deduction For Promotion of Malaysia International Islamic Financial Centre) Rules 2008

Certain expenses incurred in promoting Malaysia as an international Islamic finance centre such as expenses incurred in respect of market research, feasibility studies, etc have been allowed as tax deductions.

This Rule is effective from YA 2008 until YA 2010.

New Zealand

Sector: All / Insurance ***Date:*** Jul 2008 ***Contact:*** Ian Fay
Paul Mersi - Wellington

Tax bill introduced

The Taxation (International Taxation, Life Insurance, and Remedial Matters) Bill has been tabled and introduces a number of major business tax reforms, including:

- reform of the taxation of the life insurance business – the bill brings in a coherent framework of changes that taxes risk business on actual profits, in a manner similar to the way other businesses are taxed. It also extends the tax benefits of the portfolio investment entity rules to all savers in life products, ensuring savings through life insurance are taxed, as much as possible, in a manner that is consistent with the taxation of savings through other vehicles;
- reform of New Zealand's international tax rules – the present system of taxing offshore income of controlled foreign companies as it is earned will be replaced by one that exempts the active income of these companies;
- raising tax thresholds to reduce compliance costs for smaller businesses;
- clarifying the law to ensure employer payments for relocation and overtime meal allowance are tax-free if certain criteria are met;
- introduction of a voluntary payroll giving system for charitable donations – employees will be able to have their charitable donations deducted from their pay by their employers, and will receive the tax benefit of their donations each payday (without the need to present donation receipts);
- updating the petroleum mining rules to remove possible disincentives to further investment in oil and gas exploration and development in New Zealand; and
- changes to strengthen the definitions of "associated persons" in income tax law.

Sector: All / Investment Management ***Date:*** Jul 2008 ***Contact:*** Ian Fay
Paul Mersi - Wellington

Mutual recognition of imputation credits

The Australian and New Zealand Governments have agreed to consider proposals for mutual recognition of imputation and franking credits between companies that invest in the other country. This would allow a New Zealand resident to claim a tax credit for franking credits attached to dividends received from Australian companies. Similarly, Australian residents would receive a tax credit in Australia for imputation credits attached to dividends paid by New Zealand companies. The New Zealand treasury has been invited to make a formal submission on mutual recognition to the Australia's Future Tax System review which was recently established by the Federal Labor Government and is anticipated to issue its final review by the end of 2009.

Sector: All ***Date:*** Aug 2008 ***Contact:*** Ian Fay
Paul Mersi - Wellington

Imputation credit review

A Government Discussion Document was issued in August inviting views on two key aspects of the imputation rules; whether, and in what circumstances, the streaming of imputation credits should be allowed; and whether imputation credits should be refundable to charities and other tax-exempt entities.

In relation to streaming, the current rules do not permit companies to stream imputation credits, ie companies cannot direct imputation credits toward those shareholders who can best use them (generally resident tax-paying shareholders) and away from those shareholders who cannot use them. Australia's anti-streaming rules are

different to New Zealand's rules and the Discussion Document asks whether New Zealand should adopt some of the Australian rules.

In relation to imputation credits, currently they are not refundable. This means that shareholders whose income is exempt from tax (eg charities) lose the benefit of the credits completely.

Submissions on the Discussion Document closed on 10 October 2008.

Sector:	All	***Date:***	Sep 2008	***Contact:***	Ian Fay Paul Mersi - Wellington

Stapled securities

The Government has introduced amendments, in a Supplementary Order Paper to the Taxation (International Taxation, Life Insurance and Remedial Matters) Bill, to the law on stapled stock instruments that give effect to its February announcement that the law would be changed to prevent a potential loss to New Zealand's tax base arising from the use of such instruments.

The new rules will be limited to arrangements involving "ordinary shares" or shares that are not "fixed rate shares".

The company issuing the debt must be a party to the legal stapling arrangements and the debt component of the arrangement must be such that it would normally give rise to tax deductible interest.

Sector:	Investment Management	***Date:***	Sep 2008	***Contact:***	Paul Mersi Ian Fay - Wellington

KiwiSaver – mortgage diversion

An Order in Council signed on 15 September 2008 allows more types of mortgages to qualify for the mortgage diversion facility. The mortgage diversion facility allows members to divert up to half of their contributions to repaying the mortgage on their home, so long as the mortgagee and the scheme provider agree.

Current regulations mean this facility is limited largely to table mortgages and the like. This restriction was put in because of concern that people with flexible mortgages would use the diverted contributions to repay part of their mortgage but then automatically borrow these contributions up to their credit limit.

The majority of mortgages will qualify provided the diverted contributions reduce the home loan.

Sector:	All	***Date:***	Sep 2008	***Contact:***	Ian Fay Rachel Wards - Wellington

Tax treaty updates

A Protocol amending New Zealand's Double Tax Agreement (DTA) with the United Kingdom entered into force on 28 August 2008. The Protocol allows the two tax authorities to exchange information on taxes other than income tax and to request assistance from each other in the recovery of tax debt.

New Zealand's DTA with the Czech Republic has come into force. It will apply for withholding taxes in both countries from 1 January 2009. For other taxes, it will apply generally from 1 April 2009 in New Zealand and from 1 January 2009 in the Czech Republic.

A new Order in Council includes Mexico and Austria in New Zealand's list of treaty partners that have access to the income tax exemption for gains made on the sale of shares in unlisted New Zealand companies by certain non-resident investors.

A second Order in Council incorporates into New Zealand law a tax information exchange agreement with the Netherlands on behalf of the Netherlands Antilles. We expect the agreement to come into force in October.

Sector:	Investment Management	***Date:***	Jul 2008	***Contact:***	Ian Fay Rachel Wards - Wellington

Deemed rate of return set

The deemed rate of return for taxing foreign investment fund interests has been set at 10.87% for the 2007-08 income year, up from 10.27% for 2006-07.

Pakistan

Sector:	Banking & Capital Markets	**_Date:_**	Jul 2008	**_Contact:_**	Soli R. Parakh Syed Shabbar Zaidi - Karachi

The Securities & Exchange Commission of Pakistan has allowed associated companies of fund managers to invest in mutual funds.

Sector:	Investment Management	**_Date:_**	Aug 2008	**_Contact:_**	Soli R. Parakh - Karachi

The Government has allowed legalization of undisclosed foreign currencies on payment of 2% tax, under the Investment Tax Scheme, 2008, providing an opportunity to disclose unexplained currencies.

Sector:	Banking & Capital Markets	**_Date:_**	Aug 2008	**_Contact:_**	Soli R. Parakh - Karachi

Malaysia's Maybank now holds 20% interest in MCB Bank.

Sector:	Banking & Capital Markets	**_Date:_**	Sep 2008	**_Contact:_**	Soli R. Parakh - Karachi

The Asian Development Bank has been exempted from payment of all taxes including withholding taxes.

Sector:	Banking & Capital Markets Investment Management	**_Date:_**	Oct 2008	**_Contact:_**	Soli R. Parakh - Karachi

The revised Double Tax Treaty between Pakistan and Japan now takes effect from 9 November 2008.

Philippines

Sector:	Banking and Capital Markets	**Date:**	Aug 2008	**Contact:**	Malou Lim - Manila

Non-imposition of Gross Receipts Tax (GRT) on transactions of Bangko Sentral ng Pilipinas (BSP)

The Bureau of Internal Revenue (BIR) ruled that the transactions undertaken by the BSP in connection to its primary and ancillary functions as the central monetary authority are outside the coverage of the GRT. The activities engaged in and transactions undertaken by the BSP are geared towards the attainment of its constitutional and statutory mandates, and not in pursuit of commercial or business activities. Hence, the BSP cannot fall under the definition of a bank or non-bank financial intermediaries performing quasi-banking functions nor other non-bank financial intermediaries.

Further, taking into consideration the indispensable functions BSP performs for the government, the imposition of GRT on its transactions might impact its abilities to implement monetary policies and to discharge its mandated functions efficiently and effectively.

(Revenue Regulations No. 8-2008)

Sector:	Banking and Capital Markets Insurance Investment Management Real Estate	**Date:**	Jul 2008/ Sep 2008	**Contact:**	Malou Lim - Manila

Increase in personal and additional exemption for individual taxpayers; increase in optional standard deduction; and exemption from income tax and withholding of income tax on compensation for minimum wage earners

The Philippine Congress passed Republic Act No. 9504 which amended certain provisions of the Tax Code. The law became effective 6 July 2008. To implement the amendments, the BIR issued Revenue Regulation No. 10-2008 in September 2008.

Increase in Personal and Additional Exemption for Individual Taxpayers

Starting 6 July 2008, the personal exemption for individuals is increased to Php50,000 per individual taxpayer, while the additional exemption is increased to Php25,000 for each dependent not exceeding more than four. In connection with this, Revised Withholding Tax Tables were issued by the BIR which shall be used starting January 2009.

From 6 July 2008 (effectivity of the law) to 31 December 2008, a transitory withholding tax table shall be used. The withholding tax rates in the transitory withholding tax table were determined by pro-rating the annual personal and additional exemption under new law over a period of six months.

Increase in Optional Standard Deduction

Under the Tax Code, certain individual taxpayers are allowed to elect the standard deduction instead of the itemised deduction. Under the new law, the rate for optional standard deduction was increased from 10% to 40% of gross sales or gross receipts. In addition, domestic and resident foreign corporations may now avail of the optional standard deduction by signifying in the return its election of the optional standard deduction. Corporations are entitled to the optional standard deduction of 40% of gross income.

Exemption of Minimum Wage Earners (MWE) from Withholding Tax on Compensation

MWE are now exempt from income tax. Thus, every employer employing MWEs, need not withhold tax from the standard minimum wage, including holiday pay, overtime pay, night shift differential and hazard pay of MWEs.

(Republic Act No. 9504 and Revenue Regulation No. 10-2008)

Sector:	Banking and Capital Markets Insurance Investment Management Real Estate	***Date:***	Aug 2008	***Contact:***	Malou Lim - Manila

Consolidated revenue regulations on primary registration, its updates and cancellation

The BIR consolidated and updated all existing regulations relative to primary registration. Among the provisions of the consolidated regulations are the following rules:

- In the application and issuance of the Tax Identification Number (TIN), only one TIN shall be assigned to the taxpayer. Multiple TIN acquisitions shall be subject to a fine of Php 1,000 for every TIN acquired in excess of one (1), in addition to criminal liability, except for banks with Regular Banking Units (RBU) and Foreign Currency Denominated Units (FCDU) which are assigned different TINs for each unit.
- The application to open bank accounts and application for loans with banks, financial institutions and other financial intermediaries, are among the documents enumerated in the regulation in which the taxpayer must indicate his/her TIN. For this purpose, such person is required or may secure a TIN.

(Revenue Regulation No. 11-2008)

Sector:	Banking and Capital Markets Insurance Investment Management Real Estate	***Date:***	Jul 2008	***Contact:***	Malou Lim - Manila

Clarification on the compromise power of the BIR

The BIR clarified the inconsistency between two revenue issuances covering the procedures for payment of tax under the exercise of its compromise power. Under Revenue Regulation (RR) No. 30-2002, as amended by RR No. 8-2004, the compromise offer may be paid before or after the offer of compromise is approved by the Board; while Revenue Memorandum Order 20-2007 provides for a stricter implementation in the payment of tax under the exercise of the compromise power of the BIR. The aforesaid inconsistency is resolved in accordance with the rules that an RR is higher in category than an RMO. Accordingly, the RR shall prevail over the RMO, in case of conflicts in the provisions. Thus, the compromise offer may be paid before or after its approval by the Board, at the option of the taxpayer.

(Revenue Memorandum Order No. 27-2008)

Sector:	Banking and Capital Markets Insurance Investment Management Real Estate	***Date:***	Aug 2008	***Contact:***	Malou Lim - Manila

Clarification on the reckoning point of the redemption period on foreclosed assets by banks, quasi-banks and trust companies and period for payment of applicable taxes

The BIR clarified that the reckoning point of the one-year redemption period, in the case of individual mortgagors, or the three-month redemption period for juridical persons/mortgagors, shall be from the date of the confirmation of the auction sale which is the date when the certificate of sale is issued.

In case of non-redemption, the applicable taxes on the foreclosed capital asset of the mortgagor shall be due and paid as follows:

1. Capital Gains Tax shall become due within thirty (30) days following the expiration of the redemption period;
2. If the property is an ordinary asset, the creditable expanded withholding tax shall be due and paid within ten (10) days following the end of the month in which the redemption expires;
3. The VAT, if warranted under the circumstances, must be paid by the mortgagor on or before the 20th day or 25th day, whichever is applicable, of the month following the month when the right of redemption prescribes; and

4. The filing of the return and payment of documentary stamp tax shall be made within five (5) days from the end of the month when the redemption period expires.

Under the foregoing circumstances, the mortgagee banks, quasi-banks, and trust companies, are considered the statutory sellers in the foreclosure sales of these foreclosed real properties, and are thus, expected to pay the aforesaid taxes within the periods provided without need to further wait for another or subsequent buyer.

(Revenue Memorandum Circular No. 58-2008)

Sector: Insurance ***Date:*** Aug 2008 ***Contact:*** Malou Lim - Manila

Minimum Corporate Income Tax (MCIT), Business Tax and Documentary Stamp Tax (DST) for Insurance Companies

The BIR amended and clarified previous issuances on the computation of MCIT for life and non-life insurance companies and business and documentary tax implication of various business activities of life insurance companies.

MCIT Computation for Life and Non-life Insurance Companies

For the purpose of computing MCIT, the costs of services or direct cost and identifiable direct revenue-related deductions shall refer to those incurred costs which are exclusively related or otherwise considered indispensable to the creation of the revenue from their business activity as an insurance company, including the generation of investment income not subject to final taxes, and shall be limited to the following:

1. Salaries, wages and other employee benefits of personnel directly engaged in the following activities:
   a. underwriting
   b. claims and benefits
   c. actuary
   d. policy owner services, such as but limited to the following:
      i. policy changes and amendments
      ii. policy endorsements/assignments
      iii. policy benefits and features
      iv. changes in forfeiture options
      v. policy reinstatements
2. Commissions on direct writings/reinsurance
3. Cost of facilities directly utilised in providing the service such as depreciation or rental of equipment used and cost of supplies
4. Inspection and medical fees
5. Claims, losses, maturities and benefits net of reinsurance recoveries
6. Additions required by law to reserve funds
7. Reinsurance ceded.

In addition, investment expenses should not form part of the direct cost nor a deductible expense in the determination of the net taxable income. However, investment expenses relating to investment income that has not been subjected to final tax, although do not form part of the direct cost, shall be allowed as deduction to arrive at the taxable income.

Business Tax and DST Implications of Various Business Activities of Life Insurance Companies

Business Tax

- Premium on Health and Accident Insurance, whether received by a life or non-life insurance company is subject to the 5 % Premium Tax and not Value-added Tax (VAT).
- Re-issuance fees, reinstatement fees, renewal fees as well as penalties paid to the life insurance company are considered as income of the life insurance company for services rendered to customers and therefore subject to VAT or Percentage Tax, whichever is applicable.

- Income earned from investments (marketable securities, instruments, other financial products and in real estate) are considered income earned from performing quasi banking activities or similar banking activities; thus, subject to the Gross Receipts Tax. The funds used for such investments must be solicited and pooled from policyholders for investments and is recognised as liabilities by the insurance company.

DST

- The imposition of DST on the issuance of individual certificates to individual employees covered by a group insurance policy is strictly enjoined by the BIR. It is the group insurance policy issued that is subject to DST on life insurance policy of P0.50 on each P200, or fractional part thereof (effectively 0.25%) of the amount of premium collected.
- Health and accident insurance policies are considered life insurance policies, and are subject to DST on life insurance policy of P0.50 on each P200, or fractional part thereof (effectively 0.25%) of the amount of premium collected.
- The certificates issued to the policyholder evidencing his contribution to the Variable Unit Link (VUL) fund partakes the nature of deeds of trust and are not subject to DST. The premiums on variable contracts have already been subjected to DST.

Business Tax and DST Implications of Various Business Activities of Non-life Insurance Companies

Business Tax

Premiums received on health and accident insurance contracts underwritten by the non-life insurance companies, in as much as the same partakes the nature of a life insurance policy, is subject to the 5% premium tax.

DST

Health and accident insurance policies are considered life insurance policies, and are subject to DST on life insurance policy of P0.50 on each P200, or fractional part thereof (effectively 0.25%) of the amount of premium collected.

(Revenue Memorandum Circular No. 59-2008)

Sector:	Banking and Capital Markets	***Date:***	Sep 2008	***Contact:***	Malou Lim - Manila

Clarification of the Tax Implications of the Activities undertaken by the BSP

The performance by the BSP of the proprietary functions will not warrant the imposition of Gross Receipts Tax (GRT) as it is not included in the enumeration of taxpayers subject to GRT. However, it becomes subject to VAT, if in the course of trade or business, it sells, barters, exchanges, leases goods or properties, renders services, and imports goods.

(Revenue Memorandum Circular No. 65-2008)

Sector:	Banking and Capital Markets	***Date:***	Sep 2008	***Contact:***	Malou Lim - Manila

Guidelines on filing and payment of tax returns of newly transferred taxpayers

The filing of a tax return and payment of taxes of newly transferred taxpayers shall be done at Authorized Agent Banks (AAB) under the jurisdiction of the new RDO even if the application for transfer of registration is still in process. However, the old RDO code shall still be indicated in the return.

No penalty shall be imposed to taxpayers for the wrong-venue in filing the return/s. Likewise, no procedural penalty shall be imposed to AABs in these circumstances.

(Revenue Memorandum Circular No. 66-2008)

Sector:	Banking and Capital Markets Insurance Investment Management Real Estate	**Date:**	Sep 2008	**Contact:**	Malou Lim - Manila

Clarification on the date of collection of all accepted tax returns and payments by Authorized Agents Banks (AABs)

Tax returns and payments received and accepted shall be validated and reported by the AABs on the day of acceptance or transaction. The date of collection in the Batch Control System (BCS) report should be the actual day when the return was filed and the payment was made, including payment through checks received by the AABs after clearing cut-off time. Transactions reported in the BCS dated the following day shall be considered late and subjected to appropriate penalty.

(Revenue Memorandum Circular No. 67-2008)

Sector:	Banking and Capital Markets	**Date:**	Aug 2008	**Contact:**	Malou Lim - Manila

Final Withholding Tax on Overnight Reverse Repurchase Transactions (RRP) with Bangko Sentral ng Pilipinas (BSP)

Under the National Internal Revenue Code, the term “deposit substitutes” includes Reverse Repurchase Agreements (RRPs) entered into by the BSP with any authorized agent bank. Thus, pursuant to Monetary Board Resolution No. 041.A.1 dated 14 August 2008, the BSP shall withhold 20% final withholding tax (FWT) on its overnight RRPs starting 1 January 2008, under the following guidelines:

- All overnight RRPs shall be subject to the 20% FWT in the same manner as term RRPs, which tax is deducted on each maturity date and remitted to the Bureau of Internal Revenue;
- The total 20% FWT on the overnight RRPs due starting 1 January 2008 until the effective date of this Circular shall be divided equally in the remaining months of taxable year 2008. The instalments due will be deducted every end of the month from the regular demand deposit account (RDDA) of concerned banks; and
- Concerned banks shall issue the corresponding debit authority to the BSP to cover the 20% FWT on their overnight RRPs.

(BSP Circular No. 619)

Sector:	Banking and Capital Markets Insurance Real Estate Investment Management	**Date:**	Jul 2008	**Contact:**	Malou Lim - Manila

Guidelines on On-site verification of financial records relative to certain applications filed with the Commission

The SEC issued guidelines and procedures governing the on-site verification of financial records required for the following applications:

1. Applications for Increase in Capital Stock where the cash payment for subscriptions and/or conversion of advances/liabilities to payments for subscription to increase are to be verified;
2. Applications for a Certificate of Authority to operate as a Financing or Lending Company to verify that the entity has accepted or solicited investments, other than loans, from more than 19 persons without complying with the requirements of the Security Regulations Code and its implementing rules; and
3. Other applications that the Commission may require an on-site evaluation of certain financial records to ensure the accuracy and completeness of the information submitted to the Commission.

Corporations with pending applications prior to the issuance of the Circular that cannot meet the previous requirements on on-site verification procedures may request the Commission to be allowed instead to comply with the Circular.

(SEC Circular No. 6, Series of 2008)

Sector:	Banking and Capital Markets	***Date:***	Aug 2008	***Contact:***	Malou Lim - Manila

Availment of Tax Treaty Relief must be preceded by an Application for Tax Treaty Relief

The Court of Tax Appeals ruled that before a Philippine branch can avail of the preferential tax treaty rate on branch profit remittance, it must apply for tax treaty relief with the Bureau of Internal Revenue-International Affairs Division (BIR-ITAD) fifteen (15) days before the date of the transaction. If the Philippine branch failed to file the necessary application within the time prescribed by the BIR, it can no longer claim a tax refund on the difference between the tax paid based on the normal tax rate and treaty rate.

(Deutsche Bank AG Manila vs. Commissioner of Internal Revenue, CTA Case No. 7344, 28 August 2008)

Thailand

Sector: Banking ***Date:*** Jul – Sep 08 ***Contact:*** Ornjira Tangwongyodying - Bangkok

New guideline on withholding tax implications for payments under interest rate swap contracts and cross currency swap contracts

Departmental Instruction No. Paw. 136/2551 dated 29 September 2008 was issued to change the withholding tax implications for payments under interest rate swap contracts and cross currency swap contracts of which the swapper is also a lender, which had been previously provided for in Departmental Instruction No. Paw 114/2545 dated 15 August 2002.

The Revenue Department formerly provided its guidelines in Paw 114/2545 whereby the payment for the difference under interest rate swap, cross currency swap, or cross currency interest rate swap contracts of which the swapper is also a lender is an income item under Section 40(4) (a) of the Revenue Code.

However, the Revenue Department has recently changed its interpretation and issued Departmental Instruction No. Paw. 136/2551 on 29 September 2008. The change in the interpretation is a result of Supreme Court Judgement No. 736/2550.

Paw. 136/2551 provides that starting from 29 September 2008 onwards, in the case where a company has entered into interest rate swap, cross currency swap, or cross currency interest rate swap contracts of which the swapper is also a lender, the payment for the differences derived from the currency and interest rate swap will be regarded as income under Section 40(4)(a) of the Revenue Code only if there is a circumstance showing that the counterparties have an intention to enter into a loan agreement and intentionally execute an additional swap contract to change the remuneration stipulated under the loan agreement to be a remuneration item under the swap contracts, ie the swap contract is created without an intention to hedge against the fluctuation in the interest rate and foreign currency.

Accordingly, if the swap transaction is truly for a hedging purpose, the payment for the differences under the swap transaction will be regarded as income under Section 40(8) of the Revenue Code and the payer will not be required to withhold tax when making such payment. Conversely, a withholding tax liability may be incurred if the payment for the difference under the swap contract is regarded as income under Section 40(4) (a) of the Revenue Code.

In conclusion, the interpretation under Paw 136 will give rise to a burden of proof that the swap transaction is purely for a hedging purpose. Hence, evidence to prove such intention is required to be maintained.

Notes

www.pwc.com.au