Sovereign Wealth Funds

Investment trends and global tax risks

– Asia

PricewaterhouseCoopers Sovereign Wealth Funds Team

PricewaterhouseCoopers ("PwC") has a team dedicated to advising Sovereign Wealth Funds (SWFs) on various tax matters. We have extensive experience in advising SWFs and helping them address all aspects of international taxation for their funds, management companies, compensation structures and investments. The PwC SWF team comprises an unparalleled network of industry tax specialists in various jurisdictions and regions across the globe.

In the last quarter of 2009, the PwC SWF team began publishing a series of papers focussed specifically on tax and regulatory issues affecting SWF investments in various regions across the globe. The first paper in the series, which was published in October 2009, focussed largely on the U.S., Canada, the U.K. and Australia[1]. This paper focuses on the Asia region, and includes recent developments in Australia regarding the taxation of SWFs.

Authors:

Oscar Teunissen
oscar.teunissen@us.pwc.com
+1 646 471 3223

Puneet Arora
puneet.arora@us.pwc.com
+1 646 471 1691

Stuart Porter
stuart.porter@jp.pwc.com
+81 3 5251 2944

[1] See PwC, *Sovereign Wealth Funds: Investment Trends and Global Tax Risks (United States, Australia, Canada and the United Kingdom)*, published October 2009

Contents

Sovereign Wealth Funds: Investment trends and global tax risks – Asia 1

Asian jurisdictions that grant foreign SWFs exemption under domestic law... 3

Asian jurisdictions that do not grant foreign SWFs exemption under domestic law................................... 4

Summary 12

Appendix... 13

Contacts.. 14

Sovereign Wealth Funds: Investment trends and global tax risks – Asia

Sovereign Wealth Funds ("SWFs")[2] have become significant global investors especially in the wake of the global financial crisis. Generally defined as state-owned investment funds that invest in a wide range of financial instruments[3], SWFs have increased their global footprint, investing in a wide array of assets across all global regions.

Overview

Most countries across the globe have adopted either of two basic approaches to the taxation of SWFs with respect to income arising from within their borders: exemption of SWF income or taxation of such income. Countries that exempt SWF income from domestic taxation base such exemption on either (i) the principle of sovereign immunity, (ii) specific provisions under domestic tax law, (iii) administrative practice or (iv) reciprocal income tax treaty arrangements. In countries where SWF income is not exempt from taxation, such income is normally taxed the same way as any other type of income derived by nonresidents from the relevant jurisdiction.

In our prior publication in this series[4], we noted that the U.S. Internal Revenue Code section 892, which exempts from U.S. taxation certain categories of income derived by SWFs from U.S. sources, historically originated from the international law concept of a foreign government enjoying immunity from the laws of another jurisdiction[5]. Unlike the United States, countries like Canada, Australia and the United Kingdom rely on administrative practice in determining the scope of exemption to extend to SWFs.

As an alternative to the above approaches, some countries agree to give foreign governments immunity from taxation under their domestic laws on a reciprocal basis (i.e., only when a foreign government benefitting from the exemption grants identical treatment to the jurisdiction that has given the exemption). Generally, such concessional exemptions are incorporated in provisions of income tax treaties between the countries.

Some of the above approaches have also been adopted by a number of Asian jurisdictions, which are the focus of this paper. The paper analyzes the investment trends of foreign SWFs in Asia and the tax risks associated with foreign SWF investments in this region. We focus on the following jurisdictions: Australia, China, Hong Kong, India, Indonesia, Japan, South Korea, Malaysia, New Zealand, Pakistan, Philippines, Singapore, Sri Lanka, Taiwan, Thailand and Vietnam.

---

[2] For the definition of the term "Sovereign Wealth Fund", and other terms like "double tax treaty", "permanent establishment" and "withholding taxes", please see "*Glossary of Terms*" in the Appendix to this paper.

[3] JP Morgan Research, *Sovereign Wealth Funds: A Bottom-up Primer*, p.4, May 22, 2008 ("JP Morgan SWF Report").

[4] Supra footnote 1.

[5] In the United States, the doctrine of sovereign immunity is applied in a restrictive, rather than absolute, sense. See the Joint Committee on Taxation Report, "*Economic and U.S. Income Tax Issues Raised By Sovereign Wealth Fund Investment In The United States*, June 17, 2008, pp. 41-45.

Summary

Asian jurisdictions have different tax regimes with respect to the taxation of income derived by foreign SWFs from their activities in a particular jurisdiction. In most of these jurisdictions, foreign SWFs are taxed depending on the categories of income derived by a foreign SWF from its activities in a given jurisdiction.

Foreign SWFs that have permanent establishments or otherwise engage in commercial activities in a given Asian jurisdiction are usually taxed the same way as domestic business entities. They have to file tax returns reporting their income and expenses as well as the tax due on the net gain. In contrast, foreign SWFs that do not have permanent establishments or otherwise conduct trading activities in a given Asian jurisdiction are ordinarily taxed on a gross basis with respect to passive income (dividends, interest, capital gains, royalties, etc) derived from investment activities in that jurisdiction. Tax liability on passive income, where applicable under domestic law, may be reduced under an income tax treaty, if any, between a foreign SWF's country of residence and the Asian jurisdiction in which the foreign SWF has invested.

In addition, some Asian countries' domestic tax regimes grant foreign SWFs exemption (partial or full) from domestic taxation on certain categories of passive income (e.g., dividends, interest and capital gains). These include the Philippines and Australia.

On the other hand, many Asian jurisdictions do not grant foreign SWFs any specific exemptions and tax foreign SWF investors the same way as ordinary non-resident persons (e.g., India, Indonesia, Pakistan, China, Hong Kong, etc.).

In our discussion below, we address these different taxation regimes for SWFs, beginning with countries that grant SWFs exemptions, followed by those which do not.

Asian jurisdictions that grant foreign SWFs exemption under domestic law

These include Australia and the Philippines.

Australia

It has been the long-standing practice of the Australian Taxation Office (ATO) to exempt a SWF from Australian income tax on its passive investments in Australia where, essentially, it can be established that:

- The person making the investment (and therefore deriving the income) is a foreign government or an agency of a foreign government performing government functions. This requires that the foreign investor is either the foreign government or an instrument of the foreign government;

- The moneys being invested are and will remain government moneys. In this regard, it must be evidenced that the foreign government entity is, and will remain, the beneficial owner of the assets and income derived from those assets; and

- The income is being derived from a non-commercial activity. Broadly, commercial activity is generally activity concerned with the trading in goods and services and includes carrying on a business. Owning an equity interest is considered non-commercial where it meets a certain threshold. Although it remains unclear precisely what that threshold is generally, based on experience, a 10% or less equity investment will be accepted as non-commercial.

Currently, SWFs must obtain a private binding ruling from the ATO in order for the exemption to apply.

However, the Australian Government recently announced that this long-standing administrative practice is to be codified into Australian domestic law. A consultation process has begun with the Australian Treasury, and draft legislation is expected to be released for further consultation later in 2010.

The Philippines

Generally, income derived from certain investments in the Philippines by foreign governments; financial institutions owned or controlled by foreign governments; and international or regional financial institutions established by foreign governments is exempt from income tax[6]. Thus, income derived by foreign SWFs, set up and controlled by a foreign government, from investments in the Philippines in loans, stocks, bonds or other domestic securities or from interest on deposits in banks in the Philippines is exempt from income tax. Income derived by any other foreign entity that does not fall under these exemptions is generally subject to income tax. However, foreign entities that do not qualify for any of these exemptions may qualify for income tax treaty relief in certain situations.

---

[6] Section 32(B)(7)(a) of the Tax Code.

Asian jurisdictions that do not grant foreign SWFs exemption under domestic law

These include China, Hong Kong, India, Indonesia, Japan, Malaysia, South Korea, New Zealand, Pakistan, Singapore, Sri Lanka, Taiwan, Thailand and Vietnam.

Malaysia

Malaysian domestic law does not specifically provide tax exemption to SWFs. However, certain exemptions may apply based on income tax treaties and tax exemption is normally granted on a case-by-case basis and extends to all income derived by a SWF from Malaysian sources. A foreign SWF has to file a tax return in order to determine whether it is entitled to the exemption or not.

Foreign SWFs which are not tax-exempt are subject to tax on income derived from Malaysian sources. If it is business income derived through a Permanent Establishment ("PE") or business presence in Malaysia, the corporate tax rate of 25% would apply to the income. If it is income from passive investments, such as dividends and interest, the tax liability would depend on the type of investments.

Based on existing domestic tax legislation in Malaysia, there are exemptions for most types of investments, including:

- dividends distributed by a Malaysian resident company to its shareholders regardless of the tax residence of a shareholder (due to the Single Tier Tax System);
- gains that are capital in nature (excluding gains on real property which are taxed at 5%) and
- interest on most bonds approved by the Securities Commission.

Generally, there is no withholding tax on dividends and a 15% withholding tax applies with respect to interest income. Certain interest income earned by non-residents (including SWFs that are not residents of Malaysia) is not subject to tax (e.g., interest in bonds and interest from Malaysian-licensed banks).

Taiwan

In Taiwan, foreign SWFs are taxed as ordinary non-resident persons under domestic law. If a SWF is a tax resident of a jurisdiction with which Taiwan has concluded an income tax treaty, it may qualify for the benefits of the applicable tax treaty.

In general, if a foreign SWF is subject to tax with respect to Taiwan-source income, the withholding tax rate for dividends and interest income is 20%. This rate may be reduced under an applicable tax treaty. Capital gain derived by a foreign SWF from trading in Taiwanese securities is exempt from Taiwanese tax provided that the SWF does not have a business agent or other activities which may create permanent establishment concerns in Taiwan.

SWFs would be liable to the Security Transaction Tax ("STT") when trading Taiwanese securities. There is no specific rule that exempts SWFs from the STT. The prevailing STT rates are 0.3% for equity securities and 0.1% for other approved securities.[7]

South Korea

Under South Korean domestic tax law, foreign SWFs are taxed like any other non-resident taxpayer. However, some income tax treaties to which South Korea is a signatory partly exempt income derived by a SWF from South Korean sources from domestic taxation. For example, under the U.S.-South Korea income tax treaty, interest income should be exempt from South Korean tax if it is beneficially derived by the U.S. Government, or any instrumentality wholly owned by the U.S. Government.

In the absence of tax treaty relief, a non-resident taxpayer without permanent establishment in Korea is subject to Korean income tax in the form of withholding tax. However, capital gains derived from the transfer of real estate or securities in a land-rich company would be taxed at domestic company rates[8].

In the absence of tax treaty relief, the main withholding tax rates are: 22% for dividends and interest (15.4% for interest on bonds), 2.2% for business income, the lesser of 11% of the gross proceeds and 22% of the net gain for capital gains derived from the transfer of securities; and 22% for other income.

Sri Lanka

Sri Lanka taxes foreign SWFs the same way as ordinary non-resident persons. Interest income paid to a non-resident person on the Government of Sri Lanka foreign currency-denominated bonds issued on or after October 21, 2008, is exempt from income tax. Interest payable to non-resident lenders on debt instruments other than sovereign bonds is subject to a 20% withholding tax.

Dividends distributed to non-resident persons are subject to a 10% withholding tax. Capital gains derived by non-resident persons from Sri Lankan sources are not subject to tax in Sri Lanka.

Japan

Japan has no tax exemption for foreign SWFs under its domestic law. SWFs are treated as foreign corporations under Japanese tax laws and should generally be subject to Japanese tax in the same manner as ordinary foreign corporations. However, income tax treaties to which Japan is a signatory may grant specific relief for a particular SWF; e.g., the Japan-Singapore tax treaty, which has an explicit provision exempting a particular SWF (the Government of Singapore Investment Corporation, etc.) from taxation on interest income earned in Japan.

In the absence of an income tax treaty exemption, a foreign SWF without a Japanese PE is subject to taxation on Japan-source income at various rates, depending on the nature of the income. Dividends paid to a foreign SWF by a Japanese corporation are generally subject to withholding tax at the rate of 20% under Japanese income tax law. However, provided the Japanese company paying the dividends to the foreign corporations is a listed company, this withholding tax rate is reduced to 7% until December 31, 2011 and 15% thereafter.

Under Japanese income tax law, interest on bonds issued by Japanese corporations paid to a foreign SWF without a PE is generally subject to withholding tax at the rate of 15%. Interest on Japanese government bonds and Euro-bonds paid to a foreign corporation is exempt from withholding tax under certain conditions. This exemption also applies to interest on certain corporate bonds[9]. Interest on loans to persons conducting businesses in Japan paid to a foreign corporation without a PE is generally subject to withholding tax at the rate of 20%.

With respect to capital gains, a foreign SWF without a PE in Japan should be subject to tax on the capital

---

[7] Trading in bonds is currently exempted from the STT up to the end of 2016.
[8] The rates applicable are: 12.1% for taxable income of up to KRW 200 million and 24.2% for taxable income above KRW 200 million.
[9] The exemption for interest on certain corporate bonds is part of the changes to the taxation of interest on bonds proposed under the 2010 tax reforms (scheduled to be effective from April 1, 2010).

gain derived from the sale of shares in Japanese corporations if the following conditions are met:

(i) 25-5% test - If a foreign SWF without a PE in Japan (a) owns or has owned, together with specially related shareholders, 25% or more of the shares in the Japanese corporation at any time during the business year of sale or the prior two business years, and (b) sells, together with specially related shareholders, 5% or more of the shares in the Japanese corporation in the business year of sale, such foreign corporation may be subject to Japanese corporation tax on the capital gain at 30%. Special qualifying exemption rules may apply in the application of the 25-5% test for investments by limited partnerships ("LPs") and these rules could extend to SWFs set up as LPs, to invest in Japanese and foreign private equity funds in Japan.

(ii) Real estate holding corporations - If a foreign SWF without a PE in Japan owned, together with specially related shareholders, as of the last day of the preceding business year, more than 5% of the shares in a real estate holding corporation (2% if the real estate holding corporation is privately held), such SWF may be subject to Japanese corporation tax on the capital gain at 30%. Real estate holding corporations are corporations whose gross assets consist of 50% or more real estate assets in Japan. In particular, Japanese Real Estate Investment Trusts ("REITs") would in general be real estate holding companies, and if a foreign SWF without a PE in Japan holds more than 5% of the shares of the Japanese listed REIT on the last day of the preceding business year, the capital gain would be subject to Japanese corporate tax at 30%.

(iii) If a foreign SWF without a PE in Japan sells shares in a Japanese corporation which the SWF has acquired for purposes of manipulating the market price of the shares, such foreign corporation may be subject to Japanese corporation tax on the capital gain at 30%.

The above tax treatment may be modified under any applicable tax treaties to which Japan is a signatory party.

China

There is no particular tax exemption granted to foreign SWFs on China-sourced income under the existing tax regime. Foreign SWFs are taxed like any other non-resident taxpayers under the China Corporate Income Tax ("CIT") law. The CIT law provides that non-resident enterprises which have no permanent establishment or place in China, or which have a permanent establishment or place in China but the income derived is not effectively connected to such permanent establishment or place, shall pay income tax on the income derived from China. The applicable PRC withholding tax rate for passive income like dividends, interest and capital gain sourced from China is 10%. Moreover, if a taxable presence is created in China, the business profit derived from this is subject to China CIT at 25%.

In addition to the above CIT law provisions, there are several specific circulars which have clarified that that the 10% withholding tax shall be levied on non-resident enterprises on dividends derived from investments in Chinese A shares (via qualified license), B shares and foreign shares (e.g. H shares and N shares). However, the position on the taxation of capital gains on disposal of these shares has not yet been clarified by specific circulars[10].

Foreign SWFs may qualify for treaty relief under China's income tax treaties. Claiming treaty benefits is subject to an "approval-application" procedure for passive income like dividends, interest, capital gains, or "record-filing" procedure for active income, such as business income of a permanent establishment. Under Circular 124, non-resident taxpayers should submit to the Chinese tax authorities the relevant tax residence certificate together with other necessary documents. The Chinese tax authorities should review all the information disclosed in the submitted documents before granting approval of the treaty benefits.

---

[10] The China State Administration of Taxation is expected to prepare a capital gain tax position paper for submission to Ministry of Finance / State Council before the end of 2009 to provide clarity on this issue.

Hong Kong

There are no exemptions for foreign SWFs under Hong Kong domestic tax law. SWFs are taxed like any other non-resident person.

A foreign SWF would generally be subject to profits tax in Hong Kong ("HK") if it carries on a trade or business in Hong Kong by itself or via an agent and a Hong Kong-sourced profit (that is not capital in nature) is derived from such trade or business. The prevailing corporate tax rate is 16.5%.

However, foreign governments may be exempt from HK profits tax under certain income tax treaties to which HK is a party. For instance, the income tax treaty between the Mainland of China and Hong Kong specifically exempts the Government of the Mainland of China from Hong Kong profits tax in respect of interest income arising in Hong Kong[11].

Foreign SWFs may also be liable to HK stamp duty. The Hong Kong Stamp Duty Ordinance (“SDO”) does not explicitly grant foreign governments or their related institutions any tax exemption / benefits. Thus, a foreign government would generally be liable to Hong Kong stamp duty if it carries out transactions involving instruments for (i) immovable property in Hong Kong, (ii) Hong Kong stock, (iii) Hong Kong bearer instruments or (iv) duplicates and counterparts of the above instruments. Stamp duty is levied on conveyance or sale of an immovable property in Hong Kong at a rate depending on the consideration paid for the relevant property. Stamp duty is imposed at 3.75% of the consideration for immovable exceeding HK$6 million for the year of assessment 2009/10 (i.e., for the year ending March 31, 2010). Pending enactment of the revised legislation, stamp duty will be imposed at 3.75% of the consideration for immovable property between HK$6,000,001 and HK 20 million and at 4.25% of the consideration for immovable property exceeding HK$20,000,000 for the year of assessment 2010/11 (i.e., for the year ending March 31, 2011)[12].

For a transaction involving Hong Kong stocks, each of the seller and buyer to the transaction is liable to 0.1% of the amount of the consideration or its market value on the date when the contract note is executed, whichever is higher.

Stamp duty exemption is available to intra-group transfers if certain conditions are satisfied. Stamp duty is also exempt if the Stamp Office is satisfied that there is no change of beneficial ownership. The SDO also provides that a taxpayer may apply to the Chief Executive of the Hong Kong Special Administrative Region to remit wholly or in part the stamp duty payable in respect of any instrument chargeable with stamp duty. In practice, this is rarely granted.

New Zealand

There is no foreign SWF exemption under New Zealand domestic tax law. As a result, foreign SWFs are generally taxed like any other non-resident taxpayer under New Zealand domestic law (but may be eligible for relief under an applicable treaty like any other non-resident taxpayer). New Zealand domestic law imposes a withholding tax of 15% on interest and 30% on dividends derived from New Zealand.

New Zealand has a tax treaty network of 35 income tax treaties. Generally, these treaties lower the withholding rates to 10% for interest and 15% for dividends[13].

Certain recent NZ treaties contain specific exemptions granting tax relief to SWFs on interest and dividends. In June 2009, New Zealand and Australia signed a new tax treaty which, among other things, will generally lower withholding taxes when it comes into force (expected to be in 2010). The new treaty

---

[11] The term “Government” is not clearly defined in the China-HK income tax treaty. However, in other income tax treaties between Hong Kong and other countries, e.g., Vietnam, the definition of "Government" generally includes a list of named institutions.

[12] These changes are contained in the 2010/11 Budget Proposal delivered by the Financial Secretary on February 24, 2010.

[13] New Zealand has begun renegotiating its income tax treaties in order to reduce the withholding tax rates on such items of income as dividends, interest and royalties. For instance, in December 2008, a protocol updating the existing U.S. - New Zealand income tax treaty was signed (it is expected to enter into force in 2010). The protocol reduces the withholding rates on dividends from 15% to a maximum of 5% for an investor who holds 80% or more of the shares in the company distributing the dividends and meets other criteria. The withholding rate for royalties is reduced from 10% to 5%. The rate for interest generally remains at 10%, although it may drop to 0% for interest paid to lending or financing businesses that satisfy other requirements.

also contains specific rules for SWFs in relation to interest and dividends. Under the new treaty, while the general rate of source country tax on interest will continue to be limited to 10%, no tax will be chargeable in the source country on interest derived by government bodies, including government investment funds such as Australia's Future Fund, and central banks. A zero rate limit will also apply to dividends paid in respect of portfolio (under 10%) investment by a government body, including government investment funds such as Australia's Future Fund.

Furthermore, in August 2009, New Zealand and Singapore signed a new income tax treaty to replace their 1973 treaty. This treaty retains a general interest withholding tax rate of 10% but provides for an exemption from tax on interest for each Government. In relation to New Zealand, the treaty specifically exempts the New Zealand Superannuation Fund (New Zealand's SWF). In relation to Singapore the treaty includes the Government of Singapore, the Government of Singapore Investment Corporation Pte Ltd, and any institution wholly or mainly owned by the Government of Singapore, as may be agreed from time to time between the competent authorities of Singapore and New Zealand.

Singapore

Unlike the United States, there is no specific provision under the Singapore's domestic tax regime that provides for income tax exemption on certain passive income derived by foreign SWFs from Singapore.

A foreign SWF would generally be subject to tax in Singapore if it carries on a trade or business in Singapore by itself or through an agent. It may also be taxable by way of withholding tax on certain other income (for example interest, royalties, management and technical service fees) sourced or deemed sourced in Singapore that is not capital in nature. The prevailing corporate tax rate is 17%. However, under a number of Singapore's tax treaties with other jurisdictions, certain foreign SWFs may fall within the definition of "Government" or may be regarded as "State-owned" enterprises. These SWFs would enjoy exemption from Singapore income tax on certain income, including interest and business profits, derived from Singapore.

Singapore does not have a capital gains tax regime. Therefore, if a transaction is capital in nature, the resultant gain or loss will not be taxable or deductible for Singapore tax purposes.

Under Singapore tax law, dividends distributed by a Singapore resident company to its shareholders (regardless of the tax residence of the shareholder) are not subject to tax in Singapore.

Interest sourced or deemed sourced in Singapore and payable by a Singapore resident to a non-resident is generally subject to Singapore tax in the form of withholding tax at the domestic rate of 15%. However, the rate of withholding may be reduced under an income tax treaty to which Singapore is a signatory. Income tax treaties concluded between Singapore and certain jurisdictions, e.g., China, UAE, provide for tax exemption on certain income, such as interest, derived by foreign SWFs from Singaporean sources.

Thailand

In Thailand, foreign SWFs are taxed the same way as any other non-resident persons. However, SWFs may benefit from tax exemptions applicable to governments if foreign SWFs qualify under the definition of 'Government' in a relevant income tax treaty between Thailand and the foreign SWF's country of residence.

In the absence of income tax treaty relief, dividends derived from Thai sources by a foreign SWF are subject to a withholding tax rate of 10% under domestic laws. The withholding tax rate for interest income is 15%; and, where capital gains tax is applicable, the withholding tax rate is 15%[14].

---

[14] Thai capital gains tax is applicable if the sale is to a buyer in Thailand, or if any part of the disposal proceeds is paid in, or from, Thailand. However, if the disposal route is a sale to an offshore buyer (i.e., non-Thai), any gain on such sale would not be subject to Thai tax provided no part of the gain is paid in, or from, Thailand.

Vietnam

There is no general tax exemption for foreign SWFs under the Vietnamese tax regulations. Foreign SWFs are taxed the same way as other non-resident persons. SWFs deriving income from Vietnam are taxed via a withholding tax mechanism (the so-called Foreign Contractor Withholding Tax (FCWT)). FCWT consists of a Corporate Income Tax (CIT) element and VAT element.

The withholding tax rate depends on the nature of the income derived from Vietnamese sources. Some examples of tax rates which may be relevant to a SWF include: interest income (10% CIT, no VAT), dividends (0%), royalties (10% CIT, no VAT), service fees (10% - 5% CIT and 5% VAT), gain from the sale of securities (e.g., shares and bonds) (0.1% of the sale proceeds) and gain from the sale of interests in limited liability companies (25% of the net gain).

Foreign SWFs may qualify for relief with respect to the above rates under income tax treaties to which Vietnam is a party[15].

Pakistan

In Pakistan, there is no specific exemption for foreign SWFs under the current domestic tax law. Foreign SWFs are taxed like any other non-resident person under domestic tax law unless specific concessions have been granted under an applicable income tax treaty to which Pakistan is a signatory.

Under domestic tax law, the taxation of non-residents with respect to Pakistan source income depends on the nature of the income. Dividends are subject to Withholding Tax (WHT) at 10% of the gross amount. The final tax cannot exceed 10%. WHT on dividends declared or distributed by companies engaged in power generation or purchasers of power projects privatized by the Water and Power Development Authority is 7.5% and the final tax cannot to exceed 7.5%.

Interest income is subject to WHT at the following rates: 0% on interest paid to foreign corporations, if the security, arrangement, loan is approved by the Federal Government depending on the nature of exemption sought (see below); and 10%, in all other cases if the lender has no PE in Pakistan.

The following interest payments are tax exempt:

- Interest received by a non-resident person on security approved by the Federal Board of Revenue and issued by a resident person, if both persons (resident and non-resident) are not associates; the security was widely issued outside Pakistan by the resident person for use in business carried on by the resident person in Pakistan; and profit is paid outside Pakistan.
- Interest on Government securities is exempt from tax under certain income tax treaties.
- Interest payable to a non-resident on a private loan utilized on a project in Pakistan. The approval of the Federal Government is required in this case as regards the loan amount, nature of loan, rate of profit, terms of repayment and nature of the project.
- Interest on moneys borrowed under a loan agreement or in respect of foreign currency instrument approved by Federal Government.
- Any profit on debt derived from foreign currency accounts held with authorized banks or certificate of investment issued by investment banks in accordance with the Foreign Currency Accounts Scheme introduced by the State Bank of Pakistan, by a foreign association of persons, companies registered and operating abroad and foreign nationals residing in Pakistan.

Foreign SWFs may also be exempt from Pakistan taxation on interest income under some income tax

---

[15] Note: there is no DTA between Vietnam and the US.

treaties to which Pakistan is a party, e.g., tax treaties with Singapore, Germany, and Oman.

Capital gains are assessed to income tax at the normal corporate tax rate of 35%. For assets disposed of after a holding period of more than 1 year, tax is imposed on only 75% of the capital gains. Gains from the alienation of any shares in a Pakistani company, the assets of which consist wholly or principally, directly or indirectly, of immovable property, or rights to explore for or exploit natural resources in Pakistan, are taxable. Otherwise, capital gains from the alienation of immovable property (not being an adventure in the nature of trade) are exempt from tax.

The shares of listed or public companies, listed instruments of redeemable capital, etc., are exempt from tax up to the income years ending on or before June 30, 2010. Foreign institutional investors approved by the Federal Government enjoy exemption from tax on capital gains derived from the sale of public company shares.

With effect from July 1, 2010[16], the Federal Government, based on news reports, intends to levy capital gains tax at rates which will vary depending on the period the taxpayer held the security: 10% for securities held for less than 6 months and 7.5% for securities held for more than 6 months but less than 12 months prior to disposal. Gain from the disposal of securities held for more than 12 months will be exempt from taxation. These rates will remain unchanged for two years (i.e., up to June 30, 2012)[17].

Capital gains may also be exempt from Pakistan taxation under certain tax treaties to which Pakistan is a party, e.g., tax treaties with the Netherlands, Malaysia and the U.A.E.[18]

Indonesia

Under Indonesian domestic tax law, foreign SWFs are taxed the same way as ordinary non-resident persons. Investment income, such as interest and dividends, is generally subject to a 20% withholding tax. However, this rate may be reduced under an income tax treaty to which Indonesia is a party provided the recipient is beneficial owner of the income and can provide an original Certificate Of Domicile ("COD") using the format determined by the Indonesian Tax Authority (Form DGT-1 and DGT-2). The information required to be stated in the new COD format is aimed at establishing whether the income recipient is the beneficial owner. This new COD format is effective starting January 1, 2010.

Capital gains may be taxed differently depending on the type of assets involved. Certain capital gains, such as capital gains from bonds, are treated as interest. Capital gains from the disposal of Indonesian non-listed and listed shares are taxed at 5% and 0.1% of the transaction value, respectively. Capital gains may be exempt from Indonesian tax under an applicable income tax treaty.

India

India does not provide foreign SWFs specific exemption from taxation. SWFs are taxed the same way as any other non-resident taxpayers under domestic law.

However, many of the SWFs invest in Indian listed securities through the stock exchange. Capital gains derived from the disposal of such listed stocks are exempt from taxation if the stocks are held for a period of more than one year prior to the date of disposal. This exemption is available to all categories of

[16] Although it appears from news reports that capital gains tax will only be applicable on shares acquired on or after July 1, 2010, this is not confirmed. Thus, shares held on or before July 1, 2010, which are disposed of within a period of 12 months from the date of acquisition, may attract capital gains tax liability.

[17] From July 1, 2012 the rates are scheduled to increase by 2.5% per annum for three years (up to a maximum of 17.5%) for securities held for less than 6 months and by 0.5% per annum for five years (up to 10%) for securities held for more than 6 months but less than 12 months. Securities held for more than 12 months will remain exempt from taxation. Based on this gradual increase in rates, the tax rate on gain from the sale of securities held for 6-12 months will be 10% in 2017, and gains on securities held for less than 6 months will be capped at 17.5% in 2015.

[18] The Pakistan tax authorities are likely to become more aggressive on the issue of "beneficial ownership" in the determination of eligibility for treaty benefits from July 1, 2010, should the proposed tax on capital gains (for holding periods below 12 months) come into force.

investors; not just SWFs.

Some of the tax treaties entered into by India with other countries do provide for exemption from tax on interest income paid to the government of the other country or of its political sub-division or a local authority or certain specified financial institutions. However, the treaties do not provide for any special treatment for SWFs for any category of income. SWFs are treated the same way as any other foreign corporations resident in the other country and would be eligible for any concessional tax treatment ordinarily available to the residents of that country.

Summary

Tax authorities around the world are becoming more sophisticated, and the risk that foreign SWFs may be subject to close scrutiny with respect to taxation matters is increasing.

Many of the emerging markets within Asia in which foreign SWFs are investing, or might be looking to invest, have relatively undeveloped, and sometimes unpredictable taxation systems which require careful consideration and monitoring. It is imperative therefore for foreign SWFs to manage tax compliance in order to mitigate exposure to reputational risk and increased political sensitivity in the jurisdictions in which foreign SWFs invest or contemplate investing.

Appendix

Glossary Of Terms

Double Tax Treaty ("DTT") - A DTT is an agreement between two (bilateral) or more (multilateral) states defining the taxing rights of each signatory state with respect to cross-border income. When an investor who is a tax resident of a country (Country A) invests in another country (Country B), both countries A and B may have legitimate claims to the right to tax income arising out of this investment. Without a DTT, the investor could be subject to taxation in both countries (i.e., double taxation). A DTT alleviates this problem by laying down guidelines by which either country A or B may tax the investor's income (depending on such factors as the nature of the investment, category of income, etc).

Most DTTs countries have signed are modeled after the Model Tax Convention drafted by the Organization for Economic Co-operation and Development ("OECD"). This Model Convention is revised regularly; the latest revision was done in 2008.

Permanent Establishment - A permanent establishment ("PE") is a DTT concept that describes the level of taxable presence an investor must have in a country in which the investor has invested (i.e., "source country") in order for that country to have the right to tax income arising from that investment. Generally, the level of taxable presence that creates a PE for the investor includes having a fixed place of business in the source country (e.g., an office, a branch, workshop, factory, etc) and excludes conducting peripheral or auxiliary activities (e.g., mere storage or display of goods) in the source country.

Sovereign Wealth Fund ("SWF") - There is no conventional definition of the term "Sovereign Wealth Fund" in international taxation. Generally, SWFs are state-owned investment funds that invest in a wide range of financial instruments. SWFs usually have a broader mandate than central banks in a sense that, unlike the latter which focus more on liquidity and safe-keeping of foreign reserves, they (SWFs) can invest in riskier asset classes, including equity and alternative assets and commodities[19].

Withholding Taxes ("WHT") - In international taxation, the term "withholding taxes" is used to categorize taxes that are collected at source (i.e., at the time of payment to or receipt of taxable income by a taxpayer). Generally, statutory obligations impose the obligation to withhold tax on a given taxable income on persons ("withholding agents") that have temporary custody of the taxable income (e.g., payors, prime brokers, etc) and the recipient of the income becomes obligated to pay the tax due only when a withholding agent did not meet the statutory withholding obligation.

Withholding taxes are to be contrasted with, and distinguished from, taxes that are collected via the mechanism of assessment (i.e., a taxpayer files a tax return and is assessed on the tax due by the tax authorities).

[19] JP Morgan Research, *Sovereign Wealth Funds: A Bottom-Up Primer*, May 22, 2008, p.4.

Contacts

If you would like to discuss any of the issues raised in this paper, please speak with your usual contact at PricewaterhouseCoopers, or one of the following:

Australia	Canada	China	Germany
Liam Collins liam.collins@au.pwc.com +61 3 8603 3119	**Michael S. Bondy** michael.s.bondy@ca.pwc.com +1 416 365 2724	**Matthew Wong** matthew.mf.wong@cn.pwc.com +86 21 2323 3052 **Edwin Wong** Edwin.wong@cn.pwc.com +86 (10) 6533 2100	**Hans Ulrich Lauermann** hansulrich.lauermann@de.pwc.com +49 69 9585 6174
Hong Kong	**Japan**	**Korea**	**India**
Florence Yip florence.kf.yip@hk.pwc.com +852 2289 1833	**Stuart Porter** Stuart.porter@jp.pwc.com +81 3 5251 2944	**Taejin Park** taejin.park@kr.pwc.com +82 2 709 8832 **Han Chon** hjchon@samil.com + 82-2-3781-3489	**Gautam Mehra** gautam.mehra@in.pwc.com +91 22 6689 1155
Indonesia	**Malaysia**	**Middle East**	**New Zealand**
Margie Margaret margie.margaret@id.pwc.com +62 21 528 90862	**Jennifer Chang** jennifer.chang@my.pwc.com +603 2173 1828	**Dean Rolfe** Dean.rolfe@ae.pwc.com +971 4 304 3351 **Lars Lawall** lars.c.lawall@ae.pwc.com +971 2 69 46 918	**Stewart McCulloch** stewart.j.mcculloch@nz.pwc.com +64 9 355 8751 **Alice Candy** alice.m.candy@nz.pwc.com +64 9 355 8122
Norway	**Pakistan**	**Philippines**	**Singapore**
Dag Saltnes dag.saltnes@no.pwc.com +47 9526 0632	**Soli Parakh** soli.r.parakh@pk.pwc.om +92 21 241 6434	**Lim Malou** malou.p.lim@ph.pwc.com +632 845 2728	**Lee Lennon** lennon.kl.lee@sg.pwc.com +65 6236 3688
Sri Lanka	**Taiwan**	**Thailand**	**United Kingdom**
Hiranthi Ratnayake hiranthi.c.ratnayake@lk.pwc.com +94 11 471 9838	**Elaine Hsieh** elaine.hsieh@tw.pwc.com +886 2 2729 5809	**Paul Stitt** paul.stitt@th.pwc.com +66 2 344 1119	**David Newton** David.newton@uk.pwc.com +44 (0) 20 7804 7595
United States	**Vietnam**		
Oscar Teunissen oscar.teunissen@us.pwc.com +1 646 471 3223 **Puneet Arora** puneet.arora@us.pwc.com +1 646 471 1691	**Dinh Thi Quynh Van** dinh.quynh.van@vn.pwc.com +84 4 3946 2246 1500		

pwc.com

In the event that, pursuant to a request which you have received under the Freedom of Information Act 2000 (as the same may be amended or re-enacted from time to time) or any subordinate legislation made thereunder (collectively, the “Legislation”), you are required to disclose any information contained in this report, we ask that you notify us promptly and consult with us prior to disclosing such information. You agree to pay due regard to any representations which we may make in connection with such disclosure and to apply any relevant exemptions which may exist under the Legislation to such information. If, following consultation with us, you disclose any such information, please ensure that any disclaimer which we have included or may subsequently wish to include in the information is reproduced in full in any copies disclosed.

© 2010 PricewaterhouseCoopers LLP. All rights reserved. 'PricewaterhouseCoopers' refers to PricewaterhouseCoopers LLP (a limited liability partnership in the United Kingdom) or, as the context requires, the PricewaterhouseCoopers global network or other member firms of the network, each of which is a separate and independent legal entity. Design: 1000301_strategy design