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Asia-Pacific Banking & Capital Markets Tax Round-Up

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Asia-Pacific Banking & Capital Markets Tax Round-Up
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The Asia-Pacific Banking & Capital Markets Tax Round-Up is a quarterly series which highlights recent developments and current hot topics affecting banking and capital markets organisations operating in Australia, China, Hong Kong, India, Indonesia, Japan, Korea and Singapore.

This edition, with the recent announcements in relation to the Base Erosion and Profit Shifting (BEPS) Action Plan, we turn our attention to what this first raft of recommendations might mean for banking and capital market participants. We also look at other tax law developments across the key jurisdictions which could have a material impact to current tax issues for your organisation.

Foreword

Base Erosion and Profit Shifting (BEPS) – the latest developments

In our last edition, we touched on the some of the important priorities that have been developed by the Organisation for Economic Cooperation and Development (OECD) and G20 in the lead up to the BEPS announcements in July 2013, as well as the 15 action points that make up the BEPS Action Plan. Over the last several months the OECD has developed extensive detail to support its responses to the action points and on 16 September 2014, published its recommendations on seven of the 15 areas of the BEPS Action Plan.

What do the latest recommendations cover?

The actions are broad ranging and will touch all aspects of the global economy. In the banking and capital markets space, some will likely have more direct impact than others, particularly where the actions are addressing cross border operations and customer information. At a high level, the seven actions points covered include:

- *Digitisation of the economy* in the context of dealing with the tax challenges of fragmented business models and remedying other key BEPS work streams such as controlled foreign companies (CFC), avoidance of permanent establishment (PE) and transfer pricing measures.
- *Hybrid mismatches* to address the coherence of corporate income taxation at the international level with a set of proposed rules on repos, interactions with CFC rules, regulatory capital and collective investment vehicles.
- *Treaty abuse* by realigning taxation and substance to restore the intended benefits of international standards by adopting a "minimum level of protection" to prevent abuse through the key proposals of i) a limitation of benefits article to provide objectivity to determining nexus with resident country and ii) via a main purpose/anti-abuse rule within treaties generally.
- *Country-by-country reporting and transfer pricing documentation* to improve transparency for tax administrations and increasing certainty for taxpayers.
- *Transfer pricing and intangibles* in terms of aligning the transfer pricing outcomes with value creation and the consideration of alternative pricing methods.
- *Harmful tax practices* in the context of the actions and practices of States rather than taxpayers, through a focus on i) substantial activity requirements, ii) improved transparency via exchange of rulings related to preferential regimes, and iii) progress reporting on the review of member and associated regimes. In essence, aligning taxation with the substance of transactions and activities.
- *Use of a multi-lateral instrument* to rapidly implement the measures developed under the BEPS Action Plan, which will be critical to the effective and timely adoption of the BEPS initiatives.

Foreword

What does it mean for governments and businesses?

The volume of the recommendations released by the OECD will take time for governments and industry alike to properly digest and fully appreciate the impact. However, what is already clear is that, as expected, the OECD is advocating direct and extensive anti-BEPS reforms be embraced by the world's governments.

What is the relevance for banking and capital market participants?

The recommendations on the seven action points will have varying relevance to different segments of the economy. For banking and capital markets, the action points that are likely to require greater attention and therefore a strong advocacy from industry are:

- *Hybrid mismatches* and the likely impact on the forms of regulatory capital which developed in response to the financial crises (e.g., Additional Tier I Capital such as bail in capital), as well as potential implications for the stock loan and repo markets.
- *Treaty abuse* is likely to capture country access structures and structures which include a range of hedging transactions. Also, the recently finalized OECD changes to beneficial owner guidance could also impact a number of commonly (and long) used investment structures.
- *Country-by-country reporting and transfer pricing* due to use of multiple systems, structure of regional and global management of business and the concern with disclosing commercially sensitive information.

Interestingly, it's more likely the eight remaining action points will require greater attention, as from all indications, these have more relevance to banking specific practices. Primarily:

- *Permanent establishment*, more so in relation to centralised booking models used by banks, and an increased exposure to dependent agent rules given the likelihood of those rules being widened as a result of BEPS.
- *Interest and interest* equivalents and whether the nature of financial services will be explicitly considered in setting realistic leverage ratios workable for financial services as well as the broader economy.
- *CFC rules*, with the use of very large number of entities being typical in banking, there is likely a wider scope for impact then other sectors (e.g., SPVs, asset holding companies, and country access structures).
- *Risk and capital*, given the wide use of booking models, and global dealing/trading operations in terms of bifurcation of capital from origination functions. This topic is also relevant in the case of risk transfer transactions/arrangements (e.g., derivatives).

More broadly, participants in the banking and capital markets sector with their presence across multiple markets, will need to take action to both comply with new requirements in the context of their own business operations, but also in terms of the role that governments are increasingly asking financial institutions to play in relation to gathering and exchanging customer information.

What's next?

The banks are now beginning to recover from the implementation of FATCA, but of course face the next wave of global reporting in the form of the Common Reporting Standard (CRS). The sense of tax reform fatigue (and budget pressure) already should not be under estimated. The raft of BEPS changes (to be introduced in a very similar timeframe to CRS) means banks and the tax teams must be prepared for several more years of dealing with tax reform and uncertainty.

If the banking sector is seeking to influence the outcomes and have its voice heard, persistence in the face of the relentless change will be critical.

There are clearly implementation details to work on, as the OECD itself acknowledges. For taxpayers, in framing responses to the action point recommendations thus far, there is a real need to take account of the speed of these developments, including in relation to the work which remains in progress.

As governments in the region start to formulate their responses to the OECD's guidance on the action points, we will continue to bring both OECD and country specific developments throughout this series.

Finally, the attitude and approach by local tax authorities in response to the BEPS agenda warrants a mention. We are finding a number of revenue authorities being emboldened by BEPS, and using it as justification for taking aggressive positions against multinationals in areas such as transfer pricing and statutory interpretation. Increasingly, we are seeing the need for tax teams to devote significant time and energy in dealing with issues that would be readily resolved before a court, but they are reluctant to take to court simply because of the time and effort involved.

Australia

Common Reporting Standard

Following the G20 Financial Ministers and Central Bank Governors meeting in Cairns in September, we have seen the first concrete steps by the Australian Government in response to the OECD's BEPS Action Plans.

The Treasurer has publicly committed to delivering a Common Reporting Standard (CRS), which is to be implemented in Australia by 2017. The CRS calls for a single reporting standard to deal with financial institutions' collection and reporting of financial account information on account holders who are residents in another jurisdiction. Like US FATCA, the CRS will require financial institutions around the globe to play a central role in providing tax authorities with greater access and insight into taxpayer financial account data including the income earned in these accounts.

The transparency created by the CRS is meant to be yet another deterrent to taxpayers' use of offshore financial accounts (held directly or indirectly) to avoid domestic tax liabilities.

The CRS may add an additional layer of compliance burdens to clients already affected by FATCA. Action that will be taken by the Australian and foreign governments to address other policy areas covered by specific Action Plans remains to be seen.

Want to know more? Media Release from ATO Deputy Commissioner Mark Konza is here: - *https://www.ato.gov.au/Media-centre/Speeches/Other/BEPS---a-progress-report-on-G20/OECD-action*

LIBOR Cap

The LIBOR capping rules operate to limit the amount of tax deductions which Australian branches of foreign banks may claim on interest paid or credited to their offshore parents to the LIBOR rate. The need for the LIBOR cap provisions has been challenged by industry over a number of years, and technical issues have arisen in respect of how the provisions apply when a LIBOR rate does not apply to a particular borrowing.

The Australian Taxation Office has recently agreed an administrative solution in respect of Australian dollar borrowings (for which there is no longer a quoted LIBOR) in order to determine a 'proxy' rate by which the rules can be applied.

Want to know more? - *https://www.ato.gov.au/Business/International-tax-for-businesses/In-detail/Making-payments-to-foreign-residents/Administative-solution-for-AUD-LIBOR*

Amendment to Foreign Dividend Exemption

Previously announced changes to Australian foreign dividend exemption rules have recently been passed by Parliament.

To date the law had applied a strict legal form analysis, meaning that dividends on 'shares' were potentially exempt from Australian taxation. The new provisions will focus principally on the substance of the investment to determine the availability of the exemption, the exemption determined by reference to Australia's tax debt and equity classifications.

This means that for pre-existing arrangements, there may be a change in the tax status of any subsequent return from the foreign investment, and perhaps the treatment of any gains and losses on the arrangement itself (for example, foreign currency movements).

This change will necessitate a review of existing arrangements, including consequential impacts on related funding and hedging activity. Any changes to the tax characteristics of investments in subsidiaries as a result of this amendment may also have material tax effect accounting implications.

Modification to thin capitalisation rules

Legislation has been passed which tightens Australian thin capitalisation rules for income years commencing on or after 1 July 2014 by:

- reducing the maximum debt limit from 3:1 to 1.5:1 (on a debt-to-equity basis) for general entities and from 20:1 to 15:1 (on a debt-to-equity basis) for non-bank financial entities;
- reducing the 'outbound' worldwide gearing ratio from 120 per cent to 100 per cent with an equivalent adjustment to worldwide capital ratio for ADIs; and
- increasing the safe harbour capital limit for ADIs from 4 per cent to 6 per cent of their risk weighted Australian assets.

In brief:

External Compliance Assurance Processes (ECAP) pilot program

The ATO has now commenced the first phase of the external compliance assurance processes (ECAP) pilot program, involving a small number of taxpayers with turnover between $100 million and $5 billion. The selected taxpayers have been offered a choice of having either their registered auditor or the ATO perform a factual review of specific matters in a tax return. If the pilot program is successful, a committee will be formed to advise on and guide the implementation of the ECAP program.

Tax transparency

Commencing with the 2014 income year, as a result of the tax transparency measures that were enacted last year by the former Government, the Commissioner of Taxation will publish certain aggregated tax information (total income, taxable income and tax payable) of large corporate taxpayers (those with reported total income of $100 million or more) on a named basis.

Bitcoin

The ATO has recently released its view of the taxation implications of transactions involving bitcoin. The ATO is of the view that businesses will need to record the value of bitcoin transactions as a part of their ordinary income, and must also charge GST when they supply bitcoin and may be subject to GST when receiving bitcoin in return for goods and services. In this way, transactions involving bitcoin will effectively be regarded as an ordinary barter transaction for Australian taxation purposes.

China

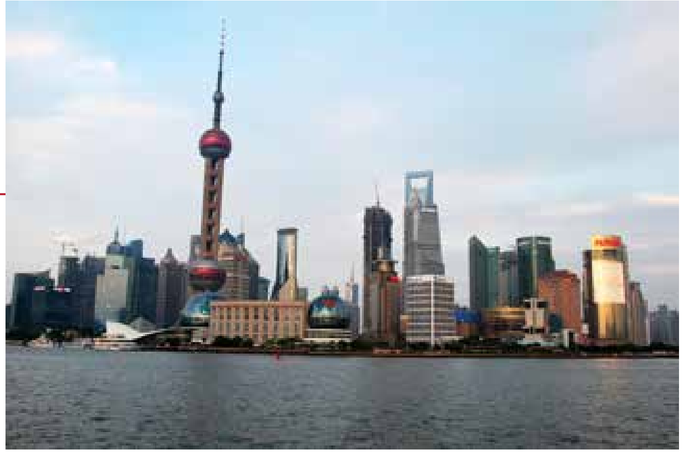
Cross border forex fund pool (cash pooling) now possible for multinational corporations in China

Early in September 2012, the State Administration of Foreign Exchange (SAFE) issued to its Shanghai and Beijing branches an internal circular which in principle, approved 13 qualified MNCs in China to centralise the forex management of their groups through bank accounts maintained with certain designated foreign or domestic banks. Since then, a total of over 70 MNCs have joined the above pilot program. The pilot program is welcomed by MNCs in China and the Chinese banking industry.

With the experience in the pilot program, the SAFE issued Notice Regarding the Administrative Measures on Centralised Forex Management for MNCs (Trial Version) ("Circular Huifa (2014) No 23") in April 2014 to expand the pilot program nationwide effective 1 June 2014. The Notice aims to facilitate trade and investment, to develop the real economy, to deepen the reform of marketisation of interest rates and forex rates and gradually to make it possible for the free conversion of RMB capital accounts which further promotes the internationalisation of RMB.

For pilot companies, the program helps to improve the flexibility of their fund management, control forex risk, reduce the financing cost, enhance their comprehensive income, and strengthen their global competitiveness. For Chinese banks which are seeking to become international, the program also improves their credentials in global fund management and enhances their competitiveness in the international banking area.

Considering that the forex fund pool is still a new arrangement in China, there is no specified tax policy at the moment. We believe as the program matures, the Chinese tax authorities may formulate relevant policies to clarify the tax treatments accordingly.



Notice of Anti-Avoidance Examination on Significant Outbound Payments

Recently, the State Administration of Taxation (SAT) released the Notice of Anti-Avoidance Examination on Significant Outbound Payments (Circular [2014] No. 146), (Circular 146). SAT requests the local-level tax bureaus to launch a comprehensive tax examination on significant outbound service fee and royalty fee payments to overseas related parties of a multinational company (MNC), with an aim to strengthen the tax administration on intra-group charges and prevent profit shifting. The SAT urges the local level tax bureau to launch a formal Special Tax Adjustment Investigation on the MNC subsidiary in China where the tax avoidance suspicion is obvious.

Earlier this year, in responses to the UN request for comments on intra-group service and management fees, the SAT reaffirmed its stance that service fees paid between related parties must be in compliance with the arm's length principle. In relation to management fees (seen as steward fees), the SAT stated that these expenses, in general, relate to shareholder activities and shall not be deductible for China corporate income tax purpose.

Some tests that could be applied to determine whether such charges warrant a Special Tax Adjustment, includes benefit test, necessity test, duplication test, value creation test, remuneration test and authenticity test.

However, industry continues to watch to see how this evolves and what approach will be taken by the SAT officials. There have been a number of instances already where the local tax authorities in China are initiating contact with taxpayers requesting the relevant information and commencing investigations.

Hong Kong

Guidance on taxation of Islamic bonds

Following the Legislative Council's enactment of the Inland Revenue and Stamp Duty Legislation (Alternative Bond Schemes) (Amendment) Ordinance 2013 in July 2013,the IRD issued Departmental Interpretation and Practice Notes No. 50 (DIPN No. 50) to set out its views and positions on the application of the relevant Inland Revenue Ordinance provisions to Islamic bonds.

The issuance of DIPN No. 50 is certainly welcomed in light of the concerns and questions raised by market players who are interested in the bond market in Hong Kong. In conjunction with DIPN No. 50, we also anticipate the issuance of the Stamp Office Interpretation and Practice Notes No.6 soon to cover the interpretation and practice of relevant provisions in the Stamp Duty Ordinance, which will provide further clarity and guidance.

Want to know more? - *http://www.pwchk.com/webmedia/doc/635412959453577310_fstax_news_jul2014_1.pdf*

HKSAR Government supports the automatic exchange of information

In a press release dated 15 September 2014, the Secretary for Financial Services and the Treasury announced that the HKSAR Government pledged to support the "Common Reporting Standard for Automatic Exchange of Financial Account Information in Tax Matters"(CRS).

In view of the possible adoption of the CRS in Hong Kong, financial institutions should assess whether their existing compliance and information systems are flexible enough to accommodate the additional reporting and due diligence obligations under the CRS. For taxpayers in general, the boosted international transparency under the CRS will serve as another deterrent to the use of offshore accounts, by both individuals and entities, to avoid domestic tax liabilities.

Want to know more?

- *http://www.pwchk.com/webmedia/doc/635470745437040723_hktax_news_sep2014_10.pdf*

- *http://www.pwchk.com/webmedia/doc/635385333488672342_hktax_news_jun2014_8.pdf*

Updates on Tax Information Exchange Agreement (TIEA) and Inter-governmental agreement (IGA)

The TIEA between Hong Kong and the US signed on 25 March 2014 came into force on 20 June 2014. The TIEA with the US provides the necessary basis for Hong Kong to exchange information upon requests made in relation to the information that needs to be reported by financial institutions in Hong Kong to the US under the US Foreign Account Tax Compliance Act (FATCA). In addition, as of 9 May 2014, Hong Kong and the US have substantially concluded discussions and agreed in substance on a Model 2 inter-governmental agreement (IGA) to facilitate compliance with the US FATCA by financial institutions in Hong Kong. A Model 2 IGA (which essentially requires financial institutions to report the relevant account information of US taxpayers to the US IRS directly, supplemented by group requests made by the US IRS, on a need basis, for exchange of information on relevant US taxpayers at a government level) is expected to be signed between Hong Kong and the US later in 2014.

Subsequent to the signing of the HK-US TIEA in March 2014, Hong Kong has signed six other TIEAs on 22 August 2014 with the Nordic jurisdictions (i.e. Denmark, the Faroes, Greenland, Iceland, Norway and Sweden). The provisions of all these TIEAs are substantially the same as all of them substantially follow the OECD Model TIEA. The above TIEAs will enter into force and take effect after the completion of the ratification/ notification procedures by each of the contracting parties.

Multinational corporations with cross-border transactions/ operations should stay tuned for the development in this area and be prepared to assess the possible impact of the changing EoI landscape on them.

Updates on comprehensive double tax agreement (CDTA)

Hong Kong signed a comprehensive double tax agreement with Korea on 8 July 2014. Potential benefits for Hong Kong investors under the HK/Korea CDTA include the reduced withholding tax (WHT) rates on dividends, interest and royalties, possible elimination of the WHT on equipment rental and permanent establishment protection for active business income. However, the HK/Korea CDTA does not offer any tax exemption for gains derived from disposal of shares in a Korean company or a Korean property holding company.

With the signing of the HK/Korea CDTA, Hong Kong companies currently investing into Korea through an intermediary established in a jurisdiction having a tax treaty with Korea should revisit their existing holding structures and assess whether the benefits remain from the retention of such intermediaries.

Want to know more? - *http://www.pwchk.com/webmedia/doc/635422457872677631_hktax_news_jul2014_9.pdf*

Shanghai-Hong Kong Stock Connect at a glance from a tax perspective

Shanghai-Hong Kong Stock Connect is a pilot programme for securities trading and clearing links to enable the Mainland and Hong Kong investors to trade eligible securities listed in each other's stock market. The programme is planned to be launched in around October 2014. Whilst the mutual connectivity is established between the Shanghai and Hong Kong stock markets through this programme, investors need to understand the complex taxation issues arising from the programme in order to harvest the potential opportunities from this ground breaking initiative.

Want to know more? - *http://www.pwchk.com/webmedia/doc/635374786093328590_hktax_news_jun2014_6.pdf*

Stamp Duty (Amendment) (No.2) Ordinance 2014 was gazetted on 25 July 2014

The Ordinance gives effect to the following two measures previously proposed by the Government to further address the overheated property market in Hong Kong:

- Introduce a set of special (higher) ad valorem stamp duty (AVD) rates (referred to as Scale 1 rates in the Ordinance) on transfer of immovable property (both residential and non-residential) in Hong Kong; and
- Advance the charging of AVD on non-residential property transactions from conveyance on sale to the agreement for sale (i.e. to make agreements for sale of non-residential property chargeable with stamp duty).

The substantial part of the Ordinance is deemed to have come into operation on 23 February 2013 - i.e. the above two measures will be applied retrospectively to immovable property transactions executed on or after 23 February 2013.

India

Key policy proposals of the Finance Act (No. 2), 2014

The Finance Act (No. 2), 2014 has raised a number of key policy developments for the banking and capital markets sector which will usher in substantial reform in India. Of particular interest, developments include:

- Indian Depository Receipt framework to be revamped and a much more liberal and ambitious Bharat Depository to be introduced. Additionally, the American Depository Receipt/Global Depository Receipt regime is to be liberalised, allowing issuance of depository receipts on all permissible securities;
- International settlement of Indian debt to be permitted;
- Introduction of one single operating demat account;
- Measures to be taken for the introduction of uniform know your client (KYC) norms and inter-usability of the KYC records across the entire financial sector; and
- Based on advice from Government, financial sector regulator will take steps to develop a vibrant, deep and liquid corporate debt market and deepen currency derivative market by eliminating restrictions.

Key tax proposals of the Finance Act (No. 2), 2014

The Finance Act (No. 2), 2014 has raised a number of key tax proposals of note, including:

Direct tax

- Company's principal business of which is trading in shares excluded from the purview of Explanation to section 73 of the Income-tax Act, 1961, and hence loss incurred on trading in shares will not be considered as deemed speculative loss and therefore restriction on set-off would not apply;
- Period of holding to qualify as a long-term capital asset, for unlisted security and units of a mutual fund (other than an equity oriented fund) increased from 12 months to 36 months;
- An eligible transaction in respect of trading in commodity derivatives carried out in recognised association, which is chargeable to Commodities Transaction Tax, shall not be deemed to be speculative transaction;
- Withholding rate reduced to 5% for all long term bonds (instead of only long-term infrastructure bonds) issued by Indian corporates. The reduced withholding would be applicable till 30 June 2017;
- To remove uncertainty on characterisation of income of Foreign Institutional Investors (FIIs)/Foreign Portfolio Investors (FPIs), all income arising to FIIs/FPIs from transaction in securities (including derivatives) be treated as 'capital gains'. This may also encourage fund managers of foreign funds to be based out of India;
- Transfer of G-Sec (carrying periodic payment of interest) by non-resident to non-resident through an intermediary dealing in settlement of securities – not regarded as taxable transfer;
- Indian broking houses having transactions with unrelated party may be subject to transfer pricing provisions under certain circumstances; and
- No deferral of the General Anti-Avoidance Rules ('GAAR'). GAAR effective from the financial year beginning 1 April 2015.

Indirect tax – Services tax

- In a recent ruling, the Mumbai bench of the Income Tax Appellate Tribunal (the Reverse charge mechanism extended to include recovery agent services provided to banks, NBFC's and other financial institutions;
- Concept of intermediary which hitherto was restricted to services is extended to goods. Intermediaries cover brokers, agents or any other person who arranges or facilitates a transaction;
- Interest rate for non-payment of Service tax extended up to 30% depending upon the period of delay; and
- Government empowered to prescribe rules for determining the rate of exchange for calculation of taxable value for certain services.

Case roundup

In a welcomed ruling, the Bombay High Court (the HC) recently dismissed an appeal filed by Income-tax authorities against the favourable order by the Mumbai Tribunal (the Tribunal) on a number of issues relevant to the banking industry.

Disallowance under section 14A

The assessee, HDFC Bank Limited, during the period AY 2001-02 to 2005-06 had made investments in tax free securities. The assessee had paid interest on borrowed funds and the assessee's own funds were not separately identified.

The revenue argued that in the absence of direct nexus between its own funds and investments, the investments ought to be treated as being from a common pool and a proportionate disallowance of interest was justified.

The HC relied on the undisputed finding of the Tribunal that the assessee's own funds and other non-interest bearing funds were more than the investments in the tax free securities. The HC followed the judgement in the case of Reliance Utilities and Power Limited [2009] 313 ITR 340 (Bom). The principle in this judgement being that, if there were funds available (both interest free and interest bearing loans taken), then a presumption would arise that the investments would be out of interest free funds if the they were sufficient to cover the investments.

In view of the factual position and principle stated above, the HC ruled that it would have to be presumed that the investments made by the assessee were done so out of the interest free funds. The decision has been rendered for the period prior to insertion of Rule 8D, however, in our view the same should hold true in similar current scenarios as well.

Broken period interest

The HC upheld the Tribunal's order allowing deduction for broken period interest on investments held as stock in trade, by following the judgement in the case of American Express International Banking Corporation v. CIT [2002] 258 ITR 601.

Diminution/amortisation expenses on investments held to maturity

The HC upheld the Tribunal's order allowing deduction for diminution in the value of investments and amortisation of premiums on investments held to maturity as per RBI guidelines. This follows the judgement in the case CIT-2 v. Lord Krishna Bank Ltd ITA No. 1079 of 2012 (now merged with the assessee).

Interest on NPA not assessable on accrual basis

In another recent ruling by the HC, it dismissed an appeal filed by Income-tax authorities against the Tribunal's favourable ruling on the issue of taxability of interest on non-performing assets (NPAs). The assessee, KEC Holdings Limited, is a non-banking finance company (NBFC) engaged in the business of investing activities. For AY 2003-04, the assessee did not offer to tax accrued interest from its NPA portfolio. However, the assessing officer (the AO) did accrue for interest on NPAs. The Tribunal, relying on the Delhi HC ruling in CIT vs. Vasisth Chay Vyapar Ltd [2011] 330 ITR 440, ruled in favour of the assessee.

The tax authorities had challenged the decision of the Tribunal. The argument put forward by the tax authorities was that the assessee should have showed accrued interest as it was following mercantile system of accounting. Hence, the additional accrual of interest by the AO on NPAs was justified.

The HC concluded that the view taken by the Tribunal accords with the RBI guidelines, which are not in any way in conflict with the Income-tax Act, 1961. Similarly, the Supreme Court has held in the case of UCO Bank that the interest income would have been brought to the profit and loss Account provided it was actually realised. Therefore, it is permissible to disclose or to show them as income in the assessment year in which either the interest amount or part of it is recovered.

Accordingly, the HC dismissed the appeal filed by the tax authorities, upholding the order of the Tribunal.

Pre-approval of the RBI in cases of acquisition/ transfer of control of NBFCs

Formerly, prior approval of the RBI was required only in cases of acquisition/ transfer of control of deposit taking NBFCs. The RBI, per Notification No. DNBS. (PD) 275/GM(AM)-2014 issued dated 26 May 2014, has made it necessary to obtain prior approval in case of acquisition/ transfer of control for all NBFCs (i.e. deposit taking as well as non-deposit taking). This is to enable the RBI to ensure the 'fit and proper' character of the management of NBFCs, both deposit taking and non-deposit taking, is continuously maintained.

Indonesia

Exchange of Information (EOI)

In Indonesian taxation law, provisions concerning EOI have been regulated in Article 32A of the Income Tax Law No.36/2008 and Article 59 of Government Regulation No.74/2011 with reference to General Tax Provisions (Ketentuan Umum dan Tata Cara Perpajakan/KUP) Law No. 16/2009.

On 1 April 2014, the Minister of Finance (MoF) issued Regulation No.60/PMK.03/2014 (PMK-60) which further regulates the Exchange of Information procedure. PMK-60 has been effective since 1 April 2014 and is applicable for the above international tax agreements in place prior or after the effective date of PMK-60.

In September 2014, there were a number of ratification of agreements between the Government of the Republic of Indonesia and governments of several other jurisdictions including with the Government of Jersey, States of Guernsey, Government of Isle of Man and Government of Bermuda (as authorized by the Government of the United Kingdom of Great Britain and Northern Ireland) on the exchange of information relating to tax matters. It is expected that more ratification of agreements will be issued by the Government of Republic Indonesia.

2014 Tax Audit Target

The Director General of Taxation (DGT)has set the 2014 tax audit revenue target to be IDR 24 trillion (approximately US$2.2 billion), increased by 30% from 2013 target of IDR 18.5 trillion. This target, along with the tax audit strategy and plan, is stipulated in the DGT Circular Letter No. SE – 15/PJ/2014 (SE-15) dated 21 March 2014.

The corporate taxpayers targeted for 2014 audits are those in the property and financial services. On the other hand, the targeted individual taxpayers are entrepreneurs, shareholders and notaries.

The tax audit strategy is based on certain types of industry sectors, certain professions for individual and certain other criteria set out in SE 15. On top of the strategy, there is also a tax audit plan in relation to the statute of limitation for the fiscal years that will expire by the end of 2014 and 2015.

The factors considered to determine industry sectors for the tax audit target mostly remain the same as in previous years:

- Industries where compliance levels in previous years were low;
- Industries that make a significant contribution to the economy and tax revenue;
- Industries that are expected to be booming in 2014; and
- Industries with high growth rate.

Tax Audit Instruction Letters based on manual risk analysis at the DGT level may be issued on taxpayers:

- That have transactions with domestic related parties, including individuals related to the transactions.
- In the oil and gas sectors.
- That have transactions with related parties (transfer pricing audit apart from tax audit due to tax overpayment).

That are subject to a joint audit between the DGT and external parties.

It is recommended that bank and securities companies to substantiate the tax positions and to prepare complete supporting documentations such as invoices, agreements, list of fixed asset to support the tax calculations.

Confirmation of Income Tax Borne by Government for Interest and Third Party Brokerage Service over Government Bond Exchanged Overseas

The Minister of Finance (MoF) has issued regulation No. 149/PMK.011/2014 (PMK -149) on 15 July 2014 regarding government borne income tax for the payment of interest from government bonds exchanged in overseas market in foreign currency and its related brokerage service rendered by third party to the Indonesian government.

The subsidy threshold was based on Law No.23/2013 regarding the State Budget for Financial Year 2014, along with its amendment. This regulation is effective from 1 January 2014 to 31 December 2014.

Based on this regulation, it is confirmed that investors who invest in such bond could enjoy the full coupon or interest payment without any Indonesia withholding tax deduction.

Implementation of Electronic Value Added Tax Invoice

On 20 June 2014, the Director General of Tax (DGT) issued Regulation No. PER-16/PJ/2014 (PER-16) as an implementing regulation of the Minister of Finance (MoF) Regulation No.151/PMK.03/2013 (PMK-151) concerning electronic format of Value Added Tax (VAT) Invoices (Faktur Pajak/FP).

The use of electronic based FP (e-FP) is mandatory starting 1 July 2014 for certain VAT-able Entrepreneurs (Pengusaha Kena Pajak / PKP) which appointed by DGT.

Based on DGT Regulation No. KEP-136/PJ/2014 (KEP – 136), the mandatory requirement to adopt e-FP will be conducted gradually as follows:

- 1 July 2014 for 45 PKPs listed in the attachment I of KEP – 136.
- 1 July 2015 for other PKPs under certain DGT Regional Offices.
- 1 July 2016 for the remaining PKPs and new PKPs.
- The DGT may also issue a special decision to appoint certain PKPs to use e-FP apart from the above list.

The obligation to issue e-FPs is not applicable for the following conditions:

- Delivery of taxable goods and services by retail traders as referred to in article 20 of Government Regulation No.1/2012;
- Delivery of taxable goods and services by retail stores to individual holders of foreign passports as referred to in Article 16 E of the VAT Law No.42/2009; and
- Delivery of taxable goods and services which in place of tax invoices are using certain documents that are considered equal to tax invoice as referred to in Article 13 (6) of the VAT Law No.42/2009.

The requirement on the timing of the issuance and the description that must be stated in an e-FP remain the same as the normal tax invoice. The signature used in e-FP adopts electronic signature. PER-16 stipulates that the e-FP reporting is carried-out by uploading the e-FP to the electronic system or application provided by the DGT and obtaining approval by the DGT for each e-FP.

On the same date, the DGT also issued Regulation No.PER-17/PJ/2014 (PER-17) as the second amendment of PER-24 regarding tax invoice procedures. PER-17 stipulates several main changes as follows:

- The serial number of tax invoices can be obtained through a website governed by the DGT.
- PKP can use DGT – governed application or electronic system to prepare e-FP.

To be able to use the above functions, PKPs must apply for an electronic certificate from DGT. This certificate functions as an authentication for the PKP to use electronic services provided by the DGT. The procedure for requesting and the granting of an electronic certificate through the website will follow the user manual provided by the DGT.

It is recommended for the bank and securities companies to be ready and to review their IT system at the earliest to be able to implement the electronic VAT invoice by 1 July 2016 at the latest.

Japan

Corporate tax reform has been a major focus for Japan in 2014 and is set to remain so in 2015. The past few months have seen a number of pronouncements, together with the release of key discussion papers and guidance on a number of key proposals.

Reduction in the effective corporate tax rate

On 24 June 2014, the Corporate Tax Discussion Group (CTDG) of the Government Tax Commission released a discussion paper outlining its views on future corporate tax reform. The discussion paper proposed that as a reduction in the corporate tax rate is a permanent measure, it should be implemented with corresponding measures to increase the taxable base, together with expanding the scope of taxable entities. The key proposed tax reforms include:

- Abolition or curtailment of tax incentives.
- Focus on an incremental based R&D tax incentive rather than expenditure based.
- Slowing down of the recoupment of losses (NOLs).
- Dividend exclusion regime based on a purpose test.
- Remove of declining balance depreciation method.

Want to know more? - *http://www.pwc.com/jp/en/taxnews/pdf/jtu102-jul-2014-e.pdf*

Aligning Japanese tax principles of international taxation with authorised OECD approach

On 15 July 2014, Japan's National Tax Agency (the NTA) issued amended Corporate Tax Basic Circulars (Basic Circulars) to align the Japanese international tax principles with those of the OECD. In particular, the revisions to the Basic Circulars provide new guidance on the application of intra-entity dealing and cost allocation. These will have particular implications for financial institutions (especially banks) with single entity and foreign branches globally.

Want to know more? - *http://www.pwc.com/jp/en/taxnews-financial-services/assets/fs-aug-2014-e.pdf*

Impact of J-REIT taxation based on investment scope and the asset test for dividend deductibility

On 3 September 2014, an amended Cabinet Order of the Law concerning Investment Trust and Investment Companies (ITIC Law Cabinet Order) was issued and, in conjunction, the Special Taxation Measures Law Enforcement Orders were also amended.

In particular, the revisions to the ITIC Law Cabinet Order allow investment trusts and J-REITs to invest in specified assets such as renewable energy facilities and concessions for public facilities. On the other hand, J-REITs must meet the "assets tests", in order to claim deductibility of dividends, and where additional assets are not to be treated as qualified assets.

Want to know more? - *http://www.pwc.com/jp/en/taxnews-financial-services/assets/fs-sep-2014-e.pdf*

Korea

The Ministry of Strategy and Finance (MOSF) has announced the government's bill to amend tax laws on 7 August 2014. These proposals have not been legislated yet. Some of the relevant proposals introduced are:

Proposed amendments to VAT Law

The scope of VAT-exempt financial services will be reduced with expectations to apply VAT on certain 'non-traditional' financial services that do not constitute essential financial services such as bank deposits, loans, electronic transfers, insurance, stock brokerage, etc. Details on the scope of non-traditional financial services subject to VAT will be set forth by the to-be-amended enforcement decree of the VAT Law.

The VAT Law currently exempts the supplies of financial services including an investment advisory business and discretionary investment business under the Capital Market and Financial investment Business Act (CMFIBA). There has been a discussion on the inclusion of investment advisory services and discretionary investment services in applying VAT. However, it is still under the discussion and details will be set forth by the to-be-amended enforcement decree of the VAT Law, which will be expected to be finalised on beginning of 2015.

If these changes will be reflected on the amended VAT Law, supplies of the investment advisory services and discretionary investment services provided after 1 July 2015 will be subject to VAT.

Extension of the statutory period for the application of a tax refund request

The statutory period for the application of a tax refund request will be extended by two additional years to five years, to be consistent with the period for statutory limitation on the assessment of national taxes. This proposed change should fulfill a long-cherished wish of all taxpayers and give taxpayers more changes to reassess tax issues and tax refund opportunities.

Singapore

Income tax treatment of Hybrid Instruments

The Inland Revenue Authority of Singapore (IRAS) issued a circular on 19 May 2014 which provides guidance on the income tax treatment for financial instruments that possess features of both debt and equity for example convertible bonds, perpetual notes and profit participating loans.

The IRAS clarified that the accounting classification of the instrument as debt or equity, which is largely governed by the Singapore Financial Reporting Standards, will not be determinative for tax purposes.

Instead, it will consider various factors in determining the characterisation of these instruments, such as their legal form, the nature of interest acquired, investor's right to participate in the issuer's business, voting rights, the obligation to repay the principal amount as well as periodic distributions, classification by other regulatory authority and ranking for repayment in the event of liquidation or dissolution.

A combination of factors and the facts and circumstances of the case will be taken into account to determine the characterisation of hybrid instrument.

A Singapore-based issuer may seek an advance ruling from the IRAS on the tax treatment of the hybrid instrument.

While the above circular provides some clarity in how the IRAS will view these instruments, challenges arise from mismatches in domestic laws of investor's and issuer's jurisdictions which also is one of BEPS concern. Achieving symmetry on a cross-border basis is a big goal.

Want to know more? - *http://www.pwc.com/sg/en/tax-bulletin/assets/taxbulletin201406.pdf*

Draft amendments to the Income Tax Act

The Ministry of Finance (MOF) issued the draft Income Tax (Amendment) Bill 2014 (the draft Bill) for public consultation on 4 July 2014. The draft Bill mainly contains tax changes proposed at the 2014 Budget. In addition, a number of non-Budget changes to existing tax policies and administration have also been proposed.

PwC Singapore has provided feedback to the MOF and on 24 September 2014, the MOF provided a summary of the feedback received and its responses.

Want to know more? - *http://app.mof.gov.sg/newsroom_details.aspx?type=press&cmpar_year=2014&news_sid=20140924749835533066*

Tax treatment of borrowing costs - BFC v Comptroller of Income Tax

In a recent judgment in *BFC v Comptroller of Income Tax [2014] SGCA 39*, the Court of Appeal held that discounts and redemption premiums in relation to two bond issues were not deductible on the grounds that they were capital in nature. The characterisation of the borrowing costs followed the underlying purpose for which the bonds were issued. In this case, the bonds were meant to raise funds to be employed as capital and hence the related borrowing costs were of a capital nature.

The Court of Appeal also held that the discounts and redemption premiums were not "interest" under section 14(1)(a) of the Income Tax Act (ITA) and hence were not deductible under the provisions governing deductibility of interest.

Want to know more? - http://www.pwc.com/sg/en/tax-bulletin/assets/taxbulletin201409.pdf

Singapore FATCA compliance – open for consultation

On 22 September 2014, the Ministry of Finance (MOF), Monetary Authority of Singapore (MAS) and the Inland Revenue Authority of Singapore (IRAS) released draft proposed regulations and an e-Tax Guide, to help financial institutions in Singapore comply with the US Foreign Account Tax Compliance Act (FATCA).

Broadly, FATCA requires financial institutions to gather and report certain information on financial accounts held by US persons to the US Internal Revenue Service (IRS).

To manage the compliance burden created by FATCA, Singapore has substantially concluded a Model 1 Intergovernmental Agreement (IGA) with the US. The IGA was initialled on 5 May 2014 and is expected to be formally signed in the fourth quarter of 2014.

Whilst the full text of the IGA will only be released after it is signed, the draft regulations and e-Tax Guide provide the details Singaporean financial institutions have been waiting for to assess the impact of FATCA on their organizations. In particular, the e-Tax Guide sets out the reporting regime, covering:

- The financial institutions that must report;
- The account holders and financial accounts that will be subject to reporting;
- Exempt financial institutions, account holders and financial accounts;
- The due diligence procedures required to identify reportable accounts;
- The information to be reported; and
- The timelines for reporting the information to IRAS.

The draft regulations and e-Tax Guide are open for public consultation from 22 September to 17 October 2014. Singaporean financial institutions have an opportunity to shape the compliance landscape where persons, products and accounts that are specific to Singapore are not covered in the Model IGA. Thus, the MOF, MAS and IRAS are strongly encouraging financial institutions to take the opportunity to draft feedback on the Regulations and Guidance.

For more information, see

draft regulations - http://app.mof.gov.sg/data/cmsresource/public%20consultation/2014/2014_FATCA/ITEM%20A_FATCA%20Reg_19%20September%202014_For%20PC.pdf

e-Tax guide - http://app.mof.gov.sg/data/cmsresource/public%20consultation/2014/2014_FATCA/e-Tax%20Guide_SG%20US%20FATCA.pdf

and the MOF consultation announcement - http://app.mof.gov.sg/pc_fatca_2014.aspx

Asia-Pacific Banking & Capital Markets Team

Leaders

Ernie Chang	+61 2 8266 0557	ernest.chang@au.pwc.com
Liam Collins	+65 6236 7248	liam.collins@sg.pwc.com

Australia

Matt Osmond	+65 2 6803 5883	matt.osmond@au.pwc.com
Bill Testa	+65 2 8266 7239	bill.testa@au.pwc.com
Gavin Marjoram	+61 2 8266 0576	gavin@marjoram@au.pwc.com
Grant Harrison	+61 2 8266 0590	grant.harrison@au.pwc.com

China

Danny Yiu	+86 10 6533 2787	danny.yiu@cn.pwc.com
Matthew Wong	+86 21 2323 3052	matthew.mf.wong@cn.pwc.com
Jessie Huang	+86 10 6533 3155	jessie.huang@cn.pwc.com

Hong Kong

Florence Yip	+852 2289 1833	florence.kf.yip@hk.pwc.com
Rex Ho	+852 2289 3026	rex.ho@hk.pwc.com
Philip Mak	+852 2289 3503	phillip.mak@hk.pwc.com
David Kan	+852 2289 3502	david.kh.kan@hk.pwc.com
David McDonald	+852 2289 3526	david.mcdonald@hk.pwc.com
Sandy Lau	+852 2289 3526	sandy.wh.lau@hk.pwc.com

India

Suni Gidwani	+91 22 6689 1177	sunil.gidwani@in.pwc.com
Vikram Bohra	+91 22 6689 1160	vikram.bohram@in.pwc.com
Jignesh Desai	+91 22 6689 1158	jignesh.desai@in.pwc.com

Indonesia

Margie Margaret	+62 21 5289 0862	margie.margaret@id.pwc.com
Ivan Budiarnawan	+62 21 5289 0862	ivan.budiarnawan@id.pwc.com

Japan

Hiroshi Takagi	+813 5251 2788	hiroshi.takagi@jp.pwc.com
Stuart Porter	+813 5251 2944	stuart.porter@jp.pwc.com

Korea

Han Jun Chon	+82 23781 3489	hjchon@samil.com
Hyeong-Tae Cho	+82 23781 2596	htcho@samil.com
Jenny Haein Lee	+82 2709 0467	jenny.haein.lee@kr.pwc.com

Singapore

Paul Lau	+65 6236 3733	paul.lau@sg.pwc.com
Tan Hui Cheng	+65 6236 7557	hui.cheng.tan@sg.pwc.com
Lim Maan Huey	+65 6236 3702	maan.huey.lim@sg.pwc.com
Carrie Lim	+65 6236 3650	carrie.cl.lim@sg.pwc.com
Michael Muncaster	+65 6236 3749	michael.muncaster@sg.pwc.com
Lynn Tan	+65 6236 3645	lynn.tan@sg.pwc.com