Tax

Asia Pacific
Newsletter

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Welcome to the fifth edition of Baker & McKenzie's Asia Pacific Tax Newsletter.

In this edition, we feature key tax developments and cases in Australia, China, Hong Kong, Indonesia, Malaysia, Singapore, Thailand and Vietnam.

To ensure these articles are relevant and interesting to you, we'd like to hear your views on future content and topics. Tell us what you think.

News

Baker & McKenzie Named Asia's Best Law Firm

Baker & McKenzie's Asia Pacific Tax and Wealth Management Practice was named "Legal Team Asia" at the inaugural WealthBriefingAsia Awards 2013, held in Singapore on 6 June. The Firm was also nominated as a finalist for "Best Tax Team," making Baker & McKenzie the only law firm that received two nominations at the event.

Commenting on the award, Michael Olesnicky, head of the Firm's Asia Pacific Tax and Wealth Management Practice, said, "We are honored to be recognized as the best legal advisor in the private banking and wealth management community. It is an affirmation of our efforts in providing comprehensive, first-class advice to our clients. It is also a confirmation of our reputation as one of the highly rated tax and wealth management advisers in the region."

Baker & McKenzie's Asia Pacific Wealth Management Practice provides the full suite of legal services to corporate groups, trust companies, high-net-worth families, private banks and other major financial institutions. For over 20 years, the Firm's multi-disciplined project teams have routinely handled high-value cross-border transactions, advising on the best course of action for structuring estates and trusts, business succession, litigation and dispute resolution, documentation or reporting obligations in relation to banking, securities and insurance laws, and design of investment products, among other matters that are central to institutions and wealth owners in wealth management. The practice was lauded by Asia Pacific Legal500 for its "in-depth specialist knowledge and ability to offer practical solutions." The Asia Pacific practice is part of the Firm's global Wealth Management Practice, with more than 150 wealth management lawyers globally who work seamlessly across borders to offer clients the resources they need to preserve, manage and transfer wealth anywhere in the world.

WealthBriefingAsia is the leading online publication for wealth managers and private bankers in Asia. The WealthBriefingAsia Awards are designed to recognize companies, teams and individuals in the global private banking, wealth management and trusted advisor communities which have "demonstrated innovation and excellence" in 2012. According to the publication, independence, integrity and genuine insight are the watchwords of the judging process, which involves specially convened expert panels across the region backed up by relevant expert third-party organizations.

New Partners, Promotions in Baker & McKenzie's Australia Tax and Employment Teams

Baker & McKenzie recently appointed two new partners and promoted four others in its Australian tax and employment teams.

Two new partners — Ellen Thomas and Sean Selleck — who joined the Firm in July are both from King & Wood Mallesons.

Sydney-based Thomas specializes in general corporate, property and banking tax advice across a range of sectors, including mining and financial services. She has acted for Westpac on its issue of Westpac Subordinated Notes and worked on a range of infrastructure projects including the M7 Motorway and the privatization of the Sydney desalination plant.

Melbourne-based Selleck advises on employment issues and disputes and industrial strategies and disputes. He has a special interest in non-standard labor practices such as labor hire, outsourcing, casual employment and independent contractors. On his appointment he said he was “thrilled to join one of the world's best labor law practices” with 24 lawyers in Australia and more than 500 worldwide.

The two appointments follow Baker & McKenzie's promotions of four new partners – Sebastian Busa (real estate); Jennifer Hughes (environmental markets); Kate Jefferson (corporate/M&A) and Anne Petterd (information technology and communications) – and the election of lateral partner and Life Sciences specialist, Amanda Turnill.

"Ellen and Sean will add a new dimension to our existing tax and employment teams, and the advice we provide our clients. On behalf of the Firm, I would like to welcome them to Baker & McKenzie. It's an exciting time to join one of the world's largest law firms," said Baker & McKenzie national managing partner Chris Freeland.

Freeland added that the Firm's recent appointments have increased Baker & McKenzie's female partner numbers by 3%.

"I am really pleased to see more of our female lawyers being promoted as leaders of the Firm. Whilst I acknowledge that we still have work to do in this area, these female promotions reflect well on our Firm's focus on this important issue, which will continue to remain front and center."

Baker & McKenzie Releases *Asia Pacific Tax Controversy Handbook*

Baker & McKenzie recently launched the *Asia Pacific Tax Controversy Handbook*, a publication that compares and contrasts the procedures and mechanisms in dealing with tax disputes in 11 jurisdictions across the region.

Written by Baker & McKenzie's tax dispute lawyers, the handbook is a comprehensive reference for taxpayers and in-house counsel of companies on a wide range of tax controversy matters. These include preparation and strategies for dealing with a tax audit, pros and cons of litigation, and litigation procedures specific to each of the 11 jurisdictions: Australia, China, Hong Kong, India, Indonesia, Japan, Malaysia, the Philippines, Singapore, Taiwan and Vietnam.
The Asia Pacific version is part of the *Tax Controversy Handbook* series, which covers the US, Latin America and Europe.

"Governments all over the world are under pressure to collect more revenue. More countries are entering into agreements to facilitate tax investigations and collect taxes for other countries. It's just a matter of time before cross-border tax audits become prevalent in Asia," said Michael Olesnicky, head of the Firm's Asia Pacific tax practice.

"The global tax environment is in a significant period of flux, and this poses many challenges for multinationals and their tax directors, particularly with the increase of public scrutiny of corporate tax affairs. This handbook will be a useful resource for companies in managing their tax risks and tax disputes."

The Firm's Asia Pacific tax practice is part of the highly rated global tax practice, which comprises more than 750 tax lawyers, economists and advisers in 46 countries. The group offers innovative advice to multinational corporations and helps businesses design, implement and defend tax strategies for international operations and transactions.

The highly experienced team has successfully handled large tax controversies at the audit, appeals and trial court levels in many countries.

Contact your local Baker & McKenzie office to request a copy of the Asia Pacific Tax Controversy Handbook.

Baker & McKenzie.Wong & Leow Tax Principal Receives Distinguished High Court Appointment

Baker & McKenzie.Wong & Leow, the member firm of Baker & McKenzie in Singapore, is pleased to announce that Tax Principal Edmund Leow has been appointed a judicial commissioner in the Supreme Court of the Republic of Singapore.

A judicial commissioner is appointed to the Supreme Court by the President of Singapore on the advice of the Prime Minister, and has the powers of a Judge. Leow will be leaving the Firm at the end of August 2013 to take up his position.

Eduardo Leite, Chairman of Baker & McKenzie's Executive Committee, commented on Edmund Leow's appointment, "We are very proud that one of our founding partners in Southeast Asia has been offered this distinguished position in the Singapore legal community. I thank Edmund both for his role in establishing and growing Baker & McKenzie.Wong & Leow, and for his personal friendship and commitment to the international reputation of Baker & McKenzie over many decades."

Wong Kien Keong, chairman of the Firm's activities in Singapore, Indonesia and Malaysia, also commented, "This appointment is a testament to Edmund's standing in the Singapore legal community. It is a significant position, received at the invitation of the Chief Justice and advice of the Prime Minister.

"Edmund is one of the founding partners of Baker & McKenzie in Singapore. He has been a valued colleague of mine for many decades. During his time in Singapore, Edmund was an integral part of growing Baker & McKenzie.Wong & Leow into one of the largest international firms in the Singapore market, with more than 100 lawyers. He is one of the finest legal minds around who has practiced law with the highest integrity.

"Edmund is also a highly respected and sought-after tax advisor and has played a key role in growing our Tax & Wealth Management practice to become one of the leading practices in Singapore. Edmund leaves the Firm in a strong position. We bid him farewell with great pride that he will continue to contribute to the development of law in Singapore with the judiciary, but with a sense of sadness as we will be losing a very fine practitioner in our midst."

"I am very honored to have been invited to take this position of judicial commissioner in the Supreme Court. The emergence of Singapore as a financial center has brought with it significant growth in the legal market. Singapore prides itself on an open, fair and impartial judicial system and I look forward to playing a part in facilitating the process of justice," Leow said.

"I have enjoyed my career at Baker & McKenzie and am proud of what this Firm has achieved in the three decades we have been operating in Singapore. I will miss many friends at the Firm."

Edmund Leow completed his Bachelor of Arts in Law (First Class Honors) at the University of Cambridge in 1986. Edmund joined Baker & McKenzie in London in 1987 and also practiced with the Firm in Hong Kong before returning to Singapore in 1992. Baker & McKenzie first opened in Singapore in 1981 and since that time the legal market has grown considerably. In 1996, Wong Kien Keong and Edmund Leow formed local firm Wong & Leow LLC that, through the joint law venture with Baker & McKenzie, allows the Firm to offer cross-border and domestic advice as one of the few full-service law firms in the country.

Baker & McKenzie Announces New Singapore Head of Tax & Wealth Management

Baker & McKenzie has recently appointed Eugene Lim as the new Head of the Tax & Wealth Management practice in Singapore.

Lim, who is a partner in the Firm's Hong Kong/China Tax Practice Group, will take on this new role beginning January 2014 and will be based in Singapore.

The move provides Lim the opportunity to expand the Firm's pan-Asia Pacific indirect tax and trade practice, which is a market leader in its field.

This new development follows the recent appointment of Edmund Leow, managing principal and present head of the Firm's Singapore Tax & Wealth Management Practice, as judicial commissioner at the Supreme Court of the Republic of Singapore.

A judicial commissioner is appointed to the Supreme Court by the President of Singapore on the advice of the Prime Minister, and has the powers of a judge.

Michael Olesnicky, head of Baker & McKenzie's Asia Pacific's Tax practice, commented, "We are very proud of Edmund's appointment as a Judicial Commissioner, and of his significant contribution to serving our clients in Singapore and globally. Edmund has been integral to building Baker & McKenzie's international reputation as the leading global legal tax advisory firm.

"We are delighted that we have strong leaders such as Eugene with an international skill set and reputation to ensure that we continue to deliver seamless service to our clients across the region. He will be joining a strong team in Singapore, including Dawn Quek and Allen Tan. This is a great opportunity to enhance our tax platform in the expanding Asian market. Eugene has built an impressive trade and related indirect tax practice in China and developed a great team, which will be led by Will Marshall after Eugene's relocation to Singapore. Will Marshall will continue to be supported by the tax and trade team spread across the Beijing, Shanghai and Hong Kong offices," Olesnicky added.

Lim, a Singaporean, joined Baker & McKenzie.Wong & Leow in Singapore in 2000 before relocating to Hong Kong. He graduated from the National University of Singapore with an LLB (Hons) and later McGill University with a LLM (international and comparative law). Qualified in Singapore and England and Wales, Lim co-Chairs Baker & McKenzie's Asia Pacific Regional Customs and International Trade Steering Committee and heads the China trade practice. He is experienced in tax and international trade matters (both contentious and non-contentious) and specializes in advising on global and regional supply chain structures.

"Eugene's move signals the growing importance of developing regional capabilities to cater to the needs of our Singapore-based clients. It also coincides with increasing economic integration across the 10 ASEAN nations. As ASEAN economic integration becomes a reality, holistic advice that covers tax and trade issues will be highly sought after with the expected increase in the movement of goods and services. With trade flows around and into this region also increasing, Eugene's skills complement our existing offerings and bolster our practice," said Andy Leck, who succeeds Edmund Leow as Managing Principal of Baker & McKenzie.Wong & Leow.

Lim said, "It is a privilege to return to the office where I started my career and to continue to work with my colleagues across Baker & McKenzie's international tax and trade practices, now including the high-caliber teams in Singapore and across Asia Pacific.

"I am delighted to be afforded this opportunity to develop our regional tax and trade specialties from Baker & McKenzie's Singapore office. Further developing the Firm's transfer pricing capabilities to ensure that we remain ahead of the curve in providing our clients with a full range of tax services is also a priority. Of course, we will continue to extend the sterling tax advisory and wealth management practices that have been serving our clients across Asia Pacific and the globe. Given Singapore's attractiveness as the location of choice for multinational regional headquarters, its position as one of the most significant global wealth management markets, and the considerable growth in pan-Asia Pacific trade, our Firm is well placed to continue to provide our clients with sophisticated global tax advice and to further consolidate our position as the leading legal tax practice," he added.

Baker & McKenzie's global tax and wealth management team comprises more than 750 lawyers, economists and advisers across the Firm's 74 offices. The Firm has always sought to achieve a high degree of mobility across our offices to ensure that we have experienced cross-border teams to provide them with the comprehensive globally informed advice that they increasingly demand. The Firm's Hong Kong/China offices retain an impressive tax practice headed by Michael Olesnicky and consists of more than 35 tax and wealth management professionals.

Baker & McKenzie Wins Four Awards at the 2013 ALB Hong Kong Law Awards

Baker & McKenzie is delighted to announce that it won four awards at the 2013 ALB Hong Kong Law Awards. The Firm took home the awards for "IT/Telecoms Law Firm of the Year," "Tax & Trusts Law Firm of the Year," "Wealth Management Law Firm of the Year" and "CSR Law Firm of the Year." This is the twelfth year that the Firm's Tax & Trusts practice has been lauded for its excellence.

Baker & McKenzie was among the list of firms that won the most number of awards -- four at the ALB Hong Kong Law Awards. The Firm had been shortlisted as a finalist in 18 categories out of a total of 27 categories -- the highest number of nominations among international law firms across all the deal and practice categories.

Baker & McKenzie had been selected as a finalist at the ALB Hong Kong Law Awards in the following 18 deal and firm categories:

Deal Categories

- M&A Deal of the Year: Bain Capital, Acquisition of Jupiter Shop Channel
- Debt Market Deal of the Year: Yuexiu Property MTN,The Link REIT MTN
- Equity Market Deal of the Year: Yuexiu Group Guangzhou IFC
- Korea Deal of the Year: KOWEPO Investment in Pioneer Gas
- Taiwan Deal Firm of the Year

Firm Categories

- Hong Kong Dealmaker of the Year: Dorothea Koo
- Construction Law Firm of the Year
- Corporate Citizen/CSR Law Firm of the Year
- Dispute Resolution Law Firm of the Year
- Employment Law Firm of the Year
- Insolvency & Restructuring Law Firm of the Year
- Insurance Law Firm of the Year
- Intellectual Property Law Firm of the Year

Investment Funds Law Firm of the Year
- IT/Telecoms Law Firm of the Year
- Real Estate Law Firm of the Year
- Tax Law Firm of the Year
- Wealth Management Law Firm of the Year

Upcoming Event

29th Annual Asia Pacific Tax Conference
29-30 October 2013
Marina Bay Sands Hotel and Sands Expo & Convention Center
This two-day conference brings together tax lawyers from around the region and around the world, who will provide anyone involved with tax and financial strategies with a comprehensive survey of topical tax developments.

Click here to register or get more information:

Special Webinar Feature

All You Need to Know About Moving Expat Employees to China

Numerous issues on immigration, employment and taxation come up when multinational corporations send employees to work in their China subsidiaries. In this webinar, Baker & McKenzie partners in Hong Kong, China and the US discuss the key issues involved in moving expat employees, updates and development on taxation rules, and comprehensive case studies.

Regional Round-up

Australia

New Australian Transfer Pricing Rules — Again

By Dixon Hearder, Amrit MacIntyre, Ellen Thomas and John Walker

Hot on the heels of the Australian transfer pricing law changes of 2012, the latest round of Australia's transfer pricing law amendments, contained in the Tax Laws Amendment (Countering Tax Avoidance and Multinational Profit Shifting) Act 2013, has recently received Royal Assent.

The new law represents a major shift in the way the transfer pricing law applies in Australia. For a multinational company with operations in Australia, it will need to ensure that its documentation processes meet the new technical and timing standards in Australia. Importantly, this includes higher thresholds for defending the commerciality of cross-border arrangements undertaken.

Background

The 2012 Amendments were intended as a "stop-gap" measure to address a perceived threat to the Australian tax revenue base. Controversially, those rules were backdated to 1 July 2004. The Australian Government explained this on the basis that the intended operation of the original transfer pricing rules was consistently made clear in public statements over many years, and these changes merely clarified that intention. This is despite Australian Courts having found the previous domestic law to have been deficient in adequately capturing that intention.

Complicating matters, going forward the 2013 Amendments replace the 2012 Amendments. The pre-existing domestic transfer pricing legislation contained in Division 13 of the Income Tax Assessment Act 1936 is repealed. The 2013 Amendments are intended as a modernisation of transfer pricing laws to better align with OECD developments and practice, as well as to re-tool the Commissioner to address perceived threats to the tax base as a result of modern business practice.

However, it is quite doubtful whether the rules establish positions wholly consistent with Organisation for Economic Co-operation and Development (OECD) guidance, which means at a minimum that multinationals will need to carefully consider whether existing documentation processes meet the new technical and timing standards in Australia for their related party dealings. Areas that will continue to be the focus of attention will include intra-group debt arrangements, historical loss positions, business restructures and previous and future tax and financial disclosures.

Application of New Law

New subdivisions 815-B to D modernise and relocate the transfer pricing rules into the Income Tax Assessment Act 1997 (ITAA 1997) to ensure that consistent rules apply to both tax treaty and non-tax treaty cases, and to relevant dealings between parties whether or not they are associated. In addition, subdivision 284-E of Schedule 1 to the Taxation Administration Act 1953 (TAA 1953) contains new rules related to transfer pricing documentation.

Basic Rule

Subdivision 815-B covers dealings between separate legal entities. It requires certain amounts (taxable income, a loss of a particular sort, tax offsets and withholding tax payable) to be worked out by applying the "internationally accepted arm’s length principle."

Broadly, this principle is proposed to be brought into the domestic law by requiring the commercial and financial conditions operating between entities, and which produce a transfer pricing benefit, to be replaced with the arm’s-length conditions. The identification of arm’s-length conditions involves hypothesising what independent entities dealing at arm's length would have done in the place of the actual entities in comparable circumstances. If that exercise results in a transfer pricing benefit to the taxpayer, a tax adjustment must be made accordingly.

Generally, the rules are intended to be self-executing, consistent with Australia's self-assessment system, but also provide for consequential adjustments, at the discretion of the Commissioner. The rules are to be applied as consistently as possible with relevant OECD guidance. There are also equivalent rules for partnerships and trusts.

Reconstruction Power

The "basic rule" must be applied taking account of the form and substance of the actual conditions between the parties. Broadly, this is intended to limit the Commissioner's ability to hypothesise conditions outside the actual commercial arrangements of the parties.

However, there are exceptions to this "basic rule." Where these exceptions apply, actual commercial or financial relations in connection to how the actual conditions operate are disregarded for the purposes of identifying arm’s-length conditions and making a tax adjustment (i.e. a reconstruction power). Broadly, these exceptions are where:

- the form and substance are not consistent; or
- parties dealing wholly independently with one another in comparable circumstances would not have dealt with each other in that way, or at all.

These exceptions will create new administrative burdens and uncertainties on multinationals which will need to carefully consider how far these hypothetical enquiries need to be pursued.

Permanent Establishments

Subdivision 815-C applies to entities with permanent establishments (PEs). The rules operate to ensure that the attribution of income and expenses of the entity between its parts is reflective of an allocation that could be expected if the parts of the entity were separate entities dealing wholly independently with each other. The decision of whether to adopt the more complex OECD-endorsed “separate entity approach” continues to be the subject of a separate domestic law review.

Documentation, Limitation Periods and Penalties

Subdivision 284-E of schedule 1 of the TAA 1953 explains the new documentation standards, which did not previously exist. Documentation continues not to be mandatory, however penalty risk will only be reduced by preparing and maintaining contemporaneous, supporting documentation that meets a "reasonably arguable position" standard. Bringing this within the self-assessment regime will mean extra responsibility on those charged with tax risk management, including directors and public officers.

A welcome development is there is now a limitation period on transfer pricing adjustments of seven years from the date of assessment. Previously there was no limitation period.

Australia

Case Commentary: Treatment of Fiscally Transparent Entities Under Tax Treaties

By Dixon Hearder, Amrit MacIntyre, Ellen Thomas and John Walker

In April 2013, the Federal Court handed down a landmark decision in relation to the taxation of fiscally transparent entities.

The case has implications for investors who are residents in treaty countries and invest in Australia through a fiscally transparent vehicle.

The *RCF* case also contains detailed analysis on how to prepare asset valuations in relation to the exemption from capital gains tax for non-residents.

The Case

In *Resource Capital Fund III LP v FC of T* [2013] FCA 363, the applicant (RCF) was a limited partnership that was formed in the Cayman Islands. RCF's manager and many of RCF's limited partners were residents of the United States.

The case arose because RCF sold AU$58 million worth of shares in an Australian mining company. The Commissioner of Taxation (Commissioner) issued an assessment to RCF in respect of the capital gain from this transaction. The Commissioner sought to assess RCF on the basis that RCF had a non-portfolio interest (ie >10%) in Australian shares that were "taxable Australian real property," that is, land rich.

The Federal Court found that the Commissioner could not issue a tax assessment to RCF in respect of the capital gain. The Commissioner was precluded from doing so by the Australia-US tax convention (Treaty). This was because the partners should be treated as deriving the capital gain from RCF's share sale, and the limited partners were entitled to the benefit of the Treaty. The Federal Court reached this conclusion even though:

- RCF was not a US tax resident;
- Australia treats limited partnerships as companies that are not fiscally transparent; and
- not all of the partners were residents of the US for tax purposes.

The Commissioner is appealing the case.

Broader Implications for Interpretation of Tax Treaties

The Federal Court endorsed the use of the OECD commentary in the interpretation of tax treaties.

The use of the OECD commentary had recently been the subject of uncertainty, following an immigration case considered by the High Court, *Minister for Home Affairs v Zentai* (2012) 289 ALR 644. In *Zentai*, the High Court rejected the examination of extrinsic materials to Australia's extradition treaty with Hungary and said that the meaning of the particular statute was to be ascertained by the application of ordinary principles of statutory interpretation.

The Federal Court in *RCF* said that the High Court in *Zentai* had not intended to override the established position on the interpretation of tax treaties. The Federal Court distinguished *Zentai* on the basis that the whole text of tax treaties are made part of our domestic law.

China

What the UN Manual Really Means for China

By Glenn DeSouza, Brendan Kelly, Jon Eichelberger and Jinghua Liu

The 34-member elite group of Organisation for Economic Cooperation and Development (OECD) nations has long set the gold standard for transfer pricing even in China. However, now the star of the UN, with its 193 members, is rising with the release of the *Practical Manual on Transfer Pricing* (UN Manual) in October 2012 with special chapters for China, India, Brazil and South Africa.

The State Administration of Taxation (SAT) states that China wants its "fair share" of global taxes in line with its contribution to global profits. The positions taken by the SAT in the China Chapter of the UN Manual directly contradict the long-standing approaches used by multinationals. For example, the SAT is taking the following views:

1. Location savings need to be reflected in the cost-plus markup for R&D;

2. If comparables used are from developed countries, such as Japan and Korea, there needs to be a step-up in the profit; and

3. Cost-plus should not be used in cases where the entity has high and new technology status.

Our Perspective on the China Chapter of the UN Manual

	Steps	Calculations
i	Calculate the arm's-length range of full-cost markups (FCMUs) based on foreign comparables, mostly in developed countries	Assume the median FCMU is 8%
ii	Calculate the difference between cost base of the Chinese taxpayer (e.g., 100) and average cost base of the foreign companies (e.g., 150)	150 – 100 = 50
iii	Multiply the arm's-length FCMU (e.g., 8%) with the difference in the cost bases (50)	8% x 50 = 4
iv	The resulting profit is the additional profit (i.e., 4) attributable to China for location savings	4
v	Determine the total arm's-length profit for the Chinese taxpayer	4 + 8% x 100 = 12
vi	Determine the adjusted arm's-length FCMU for the Chinese taxpayer	12 / 100 = 12%

Attack on Tax Havens

The SAT takes direct aim at R&D contracts in which the IP owner is in a tax haven, stating, "Sometimes it has been found that the principal entity that is claimed to be responsible for the R&D has neither the technical expertise nor the financial capacity to be responsible." Note also that in Article 94 of Circular 2, the SAT states, "The tax authority may, from the taxation perspective, deny the existence of enterprises without economic substance, particularly those which have been established in tax havens and enable their related parties or non-related parties to avoid taxation."

New Rules for Toll and Contract Manufacturing

The SAT has seriously tightened up the guidelines for contract manufacturing pricing. Conversion to toll manufacturing may no longer save taxes. The SAT states the following:

i. For toll manufacturing, the cost of materials should be added back to the cost base before any comparability analysis is made;
ii. Return on assets should not be used because it does not take into account the labor-intensive nature of Chinese manufacturing; and
iii. For both toll manufacturing and contract manufacturing, there is a tendency to understate the cost of material purchase from related parties so as to undermine the cost base.

Limited Risk Distributors & AMP

The so-called limited risk distributor (LRD) model, where the distributor is guaranteed a routine operating return, will no longer be acceptable in cases where the LRD engages in brand-building activities that are far more extensive than would be the case with an independent distributor. In particular, distributors who spend excessively on advertising, marketing and promotion (AMP) will find that they must either allocate extra profit to China or face potential disallowance of excessive expenditure.

No Cost-plus for HNTE

Multinationals often say one thing to the tax authorities and another to commercial authorities. In the future, greater consistency between the submissions will be necessary. Many multinationals provide overblown descriptions of their research activities to secure VAT exemptions, R&D deductions or high-technology preferences. But when it comes to transfer pricing, they only want to provide a routine return. The SAT has demonstrated that it will start to do more comprehensive document reviews to ensure that a Chinese entity which has obtained “high and new technology status” in Chinese law and enjoys tax incentives handed on the basis of ownership of valuable core technology does not claim elsewhere to have "no valuable intangibles."

Location Savings

Location savings is one of the most complex and significant new developments in transfer pricing. Multinationals generate enormous cost savings by offshoring. Often these savings
end up in a tax haven or back in the home country. Now the SAT has crafted an approach which involves possibly putting some of these savings back into China. The approach involves the following:

i. calculating the net location savings, taking into account the reduction in unit labor costs as well as disadvantages such as extra transport costs;
ii. adding in other "location-specific advantages" (LSA) such as the superior Chinese infrastructure and the well-developed network of suppliers;
iii. determining how much of the LSA will be captured in extra profits, known as "location rent," as opposed to being passed on to customers in lower prices; and
iv. allocating the location rent between China and the counter-parties based on relative bargaining power.

Add Profits for Market Premium

Companies who benefit from the China market boom must get ready to pay more in tax. At the SAT training previously cited, a question debated was whether additional profit enjoyed by the auto multinationals should be paid out as royalties (as the companies wanted) or locally taxed. In the China chapter, the SAT clearly suggests the latter. The SAT states that the Chinese auto industry is a good example of market factors creating "profits that are rightly earned by the Chinese taxpayers." These factors include (i) Chinese consumers’ general
preference to foreign brands and (ii) huge, inelastic demand for automotive vehicles in China.

No Permanent Royalties

MNEs also need to backstop their defense of their royalty policies. According to the SAT, “it may not be reasonable for the Chinese affiliate to continue paying the same royalty in 2012 (as in 2002) without revising whether the intangible has continued to provide the same value over time.”

China Should Receive Royalties

The SAT notes that the Chinese affiliate may have actually improved their foreign related party's technology; if so, the Chinese affiliate should instead be entitled to receive a return of the intangibles that it has developed and shared with the multinational group.

Change Comparables: Avoid Japanese Companies

One immediate impact on multinational enterprises that they should validate their set of comparable companies. The SAT states that when non-Chinese comparables are used, there should be some adjustment made for the fact that these comparables may come from developed countries like Japan, where risk and inflation rates are low, and therefore the overall profit rate is relatively low. The overuse of Japanese comparables is in fact a point we stressed in a training conducted for the SAT and over 150 local tax officials in October 2012 in Beijing.

Overuse of TNMM

The SAT criticizes the overuse of the transactional net margin method (TNMM) because it ignores or understates the contributions of the Chinese companies. It suggests that a more realistic and fact-based approach should be used, which would involve taking a look at the contributions of the Chinese company relative to those of the overseas companies in determining an appropriate share of profits. Since TNMM is effectively used in over 95% of the TP documentation prepared to date, this represents a potentially significant challenge for MNEs.

The Future of Transfer Pricing

China has changed very fast. Twelve years ago, it was the ninth-ranked economy in the world and hungry for foreign investment. It rolled out the red carpet for multinationals. TP enforcement was almost nonexistent. Now, China is the world's second-largest economy and fully confident of its taxing rights and surer of its technical capabilities. The SAT has informed us that one of their main international tax goals in the 12th five-year plan is to see that China gets "its fair share" of global taxes. Many multinationals fail to recognize that they are dealing with a new China and cling to outdated models.

China Expands VAT Pilot Program

By Jon Eichelberger, Jinghua Liu, Brendan Kelly, Glenn DeSouza, Eugene Lim and Shanwu Yuan

China's Ministry of Finance and the State Administration of Taxation (SAT) announced in May 2013 the expansion of the Value Added Tax (VAT) pilot program to cover the transportation industry and certain modern service industries (New VAT Pilot Program) on a nationwide basis starting 1 August 2013.

Cai Shui [2013] No. 37 (Circular 37) reorganizes and adjusts the existing tax rules under the New VAT Pilot Program regulations:

- Broadcasting, film and television services, including producing, publishing and broadcasting, are subject to VAT;
- The input VAT of cars, motorcycles and yacht subject to consumption tax can be credited if purchased for taxpayer's self-use; and
- Time charter, voyage charter and wet lease services provided to offshore entities can be exempted from VAT.

We expect that the VAT pilot program will soon be extended to cover express delivery services, construction and railway transportation.

SAT Clarifies IIT Treatment of Conversion of Reserves into Share Capital After Equity Acquisition

By Jon Eichelberger, Jinghua Liu, Brendan Kelly, Glenn DeSouza, Eugene Lim and Shanwu Yuan

China's State Administration of Taxation (SAT) recently clarified the individual income tax (IIT) treatment of an individual investor's share of the reserves (e.g., capital reserves, surplus reserves and undistributed profits) converted into share capital after a completed equity transfer through SAT Bulletin [2013] No. 23 (Bulletin 23).

According to Bulletin 23, where one or more individual investors acquire 100% of a company through an equity transfer, and the amount of reserves (e.g., capital reserves, surplus reserves and undistributed profits) of the company are not converted into share capital but are included as part of equity transfer price, the seller is subject to income tax on capital gain arising from the reserves. However, when the reserves are converted into share capital after the acquisition, the IIT treatment of the new individual investors differs in the following ways:

- If the equity transfer price paid by the new individual investor(s) was equal to or greater than the net assets value of the company (which means that the reserves amount was fully included in the equity transfer price), the new individual investor(s) need not pay IIT on reserves converted into share capital; and

- If the equity transfer price paid by the new individual investor(s) was less than the net assets value of the company (which means that the amount of reserves was not fully included in the equity transfer price), the new individual investor(s) need not pay IIT for the part of reserves already covered by the difference between the equity transfer price and the original share capital, but the new individual investor(s) need to pay IIT for the part of the reserves that exceed the difference between the equity transfer price and the original share capital (i.e., the IIT payment is the same as if the converted reserve amount were a dividend).

Published Tax Audit Case Interprets SOL Rules under Chinese Tax Laws

By Jon Eichelberger, Jinghua Liu, Brendan Kelly, Glenn DeSouza, Eugene Lim and Shanwu Yuan

A chief tax officer at a municipal tax audit department and his colleague recently published an article in C*hina Taxation News* to explain their views on the statute of limitation (SOL) rules under Chinese tax law. The article used an audit case conducted by the authors to discuss the SOL rules.

Facts and Application of Rules

In April 2013, the tax bureau where the authors of the article work conducted a routine tax audit on a company (Company) for the tax years 2009 to 2012. The tax bureau found that the Company underpaid enterprise income tax (EIT) by RMB260,000 in 2009 because of a mistake made by the tax bureau

The tax bureau decided that the SOL period on the underpaid EIT caused by their mistake should be three years. Moreover, no penalty was imposed on the Company.

- Underpaid business tax by RMB 80,000 in 2009 because of a reporting mistake made by the Company's finance staff (i.e., non-filing).

- The tax bureau exempted the Company from any tax liability since the three-year SOL period for underpayment due to taxpayer mistake had elapsed.

- Underpaid land use tax by RMB 350,000 from 2009 to 2012 mainly because the Company took improper deductions/exemptions after the tax rate was amended

The improper deductions/exemptions were deemed as tax evasion by the tax bureau. The Company was required to pay penalties and late payment surcharges in addition to the underpaid tax.

- Failed to withhold RMB 290,000 of IIT from 2010 to 2012 on dividends distributed to individual shareholders

The tax bureau only penalized the Company for not withholding IIT and did not impose late payment surcharges. It also required the Company to collect the unpaid IIT from individual taxpayers.

Observations

This case study provides a relatively comprehensive discussion of the SOL rules. It is one of very few sources confirming that non-filing due to taxpayer mistake cannot be treated as tax evasion. Instead, non-filing due to taxpayer mistake should be subject to the same SOL period as for underpayment due to taxpayer mistake.

LAO Releases Draft Amendment to Tax Administration Law

By Jon Eichelberger, Jinghua Liu, Brendan Kelly, Glenn DeSouza, Eugene Lim and Shanwu Yuan

In China, the Legislative Affairs Office (LAO) of the State Council released in June a draft of the amendments to the Tax Administration Law (TAL) for public comment (Draft).
Here are some of the Draft's highlights:

- Shortened tax registration – The tax bureau usually takes up to 30 days to complete the tax registration process.

The Draft cuts this down to one day. Tax bureaus will need to process and complete registration on the same day applications are received.

- Reporting obligations – The Draft provides a legal basis for tax authorities and other government bodies to share information on taxpayers. It will require banks to provide taxpayer bank account information, including total interest paid or calculated, investment income paid or calculated and account balances.

- Extension of SOL periods – For the SOL rules, Article 53 of the TAL allows very narrow application of the 3-year or 5-year statute of limitation (SOL) periods on cases involving taxpayers' "calculation errors." The Draft extends these SOL periods in cases of taxpayers "negligence," implying that the subjective intent of taxpayers will be a factor when deciding consequences for non-payment or under-payment of taxes. Article 64 of the Draft further reduces the penalty for non-payment or under-payment due to negligence to 20%.

- Tax evasion redefined – Article 63 of the Draft defines "tax evasion" as "fraudulent tax filing or non-filing by means of cheating and hiding." In contrast, the current TAL does not clearly refer to subjective intent when defining "tax evasion."

The Draft aims to improve the tax authorities' efficiency and facilitate and regulate their tax collection practices. Furthermore, the revisions to the SOL rules and "tax evasion" provisions may help reduce the overly severe penalties under the current TAL on taxpayers who unintentionally underpay taxes.

New China-Denmark Treaty Now Effective; New China-Netherlands Treaty Signed

By Jon Eichelberger, Jinghua Liu, Brendan Kelly, Glenn DeSouza, Eugene Lim and Shanwu Yuan

China enters into two new preferential treaties with foreign countries to replace the old ones.

Taking effect this year is a new double tax treaty (New Denmark Treaty), signed between China and Denmark. This replaces the previous treaty that was concluded by both countries and applies to income obtained after 1 January 2013.

China and the Netherlands also signed a new double tax treaty (New Netherlands Treaty) in May this year, replacing the existing treaty of 13 May 1987. The ratification procedures are pending and no official entry date has been disclosed.

Here are the highlights of these two treaties:

- Both new treaties have reduced the applicable tax rate on dividends to 5%, provided the recipient of the dividend is a corporate shareholder who holds at least 25% of the shares in the distributing company. For all other shareholders, the applicable tax rate continues to be 10%.

- Like many other tax treaties negotiated by China, the old treaties allowed the source country to tax capital gains (arising from direct or indirect disposal of shares). The new treaties allow the source country to apply their domestic capital gains tax rules only when the resident of the other country owns (directly or indirectly) at least 25% of the shares in the disposed subsidiary. In addition, under the New Netherlands Treaty, the sale of shares in listed companies may be exempted from capital gains tax in the source state under certain circumstances.

- Both new treaties contain provisions to deny preferential withholding tax rates on dividends, royalties and interest if the main purpose test is not met. The main purpose test states that withholding tax reductions should not be granted if the main purpose for paying the dividend, interest or royalty payments to a recipient in the treaty partner state was to take advantage of the treaty benefits.

- The new treaties include additional provisions on information exchanges between the signatories' tax authorities and a Mutual Agreement Procedure based on the Organisation for Economic Cooperation and Development Model Tax Convention.

Furthermore, the New Denmark Treaty changes the period of time under which certain types of presences create a permanent establishment. Under the old Denmark treaty, a building site, construction, assembly or installation project constituted a permanent establishment if the activities continued for more than six months. Under the New Denmark Treaty, these types of presences create a permanent establishment only if their activities continue for more than 12 months.

We expect that the New Netherlands Treaty will further enhance the attractiveness of the Netherlands as a jurisdiction for bringing global investments into China and Chinese investments into Europe and other non-European countries.

Barbados Company Denied Treaty Tax Exemption for Capital Gains

By Jon Eichelberger, Jinghua Liu, Brendan Kelly, Glenn DeSouza, Eugene Lim and Shanwu Yuan

China Taxation News reported that the Xi'an Tax Bureau (XATB) denied an application by a US-held Barbados company (Barbados Co) for tax treaty benefits. Barbados Co sought tax exemption for capital gains arising from a direct equity transfer. As a result of this denied application, tax authorities collected RMB42.61 million in taxes on the equity transfer.

Facts

In September 2010, Barbados Co transferred its shares in a Xi'an real estate company to a third-party buyer and received a capital gain of approximately RMB400 million. The company applied in December 2010 for exemption of the capital gains under the original China-Barbados tax treaty, which provided a capital gain exemption on share transfers.

While reviewing the application, XATB questioned the company's resident status and commercial purpose. XATB discovered that: (i) Barbados Co never conducted business in Barbados; and (ii) the assets, staff and operations of Barbados Co did not match its income.

XATB also discovered during an information exchange with the Joint International Tax Shelter Information Centre that the US shareholder: (i) treated Barbados Co as its overseas branch under US tax rules; and (ii) paid income tax in the US on the capital gains derived from the equity transfer of the shares of the Barbados Co. XATB considered this information as one of the basis for rejecting the treaty benefit.

According to the *China Taxation News* report, Barbados Co eventually paid the capital gains tax to China, but the report did not say whether XATB also levied late payment surcharges against Barbados Co.

Observations

This newly published case indicates the heightened scrutiny the Chinese tax authorities are applying to treaty benefit applications from taxpayers from traditional "tax havens." In this case, although Barbados Co provided a Barbados tax resident certificate, the authorities still questioned the company's commercial purpose and asked for supporting documents to prove that it was not established for treaty shopping purposes.

However, as in some other previous cases, the tax bureau in this case again mistakenly applied the "beneficial ownership" analysis from the capital gains provision. Under the China-Barbados tax treaty, as well as China's other tax treaties, a taxpayer that claims treaty benefits for dividend, interest or royalty income must be the beneficial owner of the income. Under China's domestic laws used to interpret this treaty requirement, a company needs to have economic substance and to meet other requirements to qualify as a "beneficial owner." The relevant factors to determine economic substance include the scale of the company's assets, the number of its employees and the size of its operational activities. None of the capital gains provisions under the China-Barbados tax treaty or China's other tax treaties have this "beneficial ownership" requirement. Therefore, technically, as long as the applicant is a tax resident of the treaty jurisdiction, the applicant should qualify for the capital gains tax exemption.

It is interesting to note that the Chinese tax authorities referred to the company's tax status in the US (probably based on US check-the-box rules) when determining its tax residency. The US check-the-box rules allow US parent companies to treat foreign subsidiaries as branches, even if a foreign subsidiary is an actively operating company. Therefore, because actively operating companies can be treated as branches under these rules, being treated as a branch under these rules does not mean that the foreign subsidiary is not resident outside the US or that it is a shell company or does not have independent status.

Nevertheless, this case is another example of the Chinese tax authorities using different methods to deny a treaty benefit application. Multinational companies using traditional tax havens to invest in China may face heightened scrutiny when applying for treaty benefits.

SAT Clarifies Beneficial Ownership Determination Under the China-HK DTA

By Jon Eichelberger, Jinghua Liu, Brendan Kelly, Glenn DeSouza, Eugene Lim and Shanwu Yuan

The State Administration of Taxation (SAT) recently issued Shui Zong Han [2013] No. 165 (Notice 165), clarifying the beneficial ownership determination under the dividend provision of the China-Hong Kong double taxation agreement (DTA), in relation to Guo Shui Han [2009] No. 601 (Notice 601) and SAT Bulletin [2012] No. 30 (Bulletin 30).

Clarification of Notice 601

Notice 601 provides a list of negative factors for determining an applicant's beneficial owner status under tax treaties. The factors that Notice 165 clarifies are as follows:
Factor 1: The applicant is under an obligation to distribute all or the majority (e.g., more than 60%) of the China-sourced income to a resident of a third jurisdiction within a specified period (e.g., 12 months). According to the clarification under Notice 165, if the applicant has not distributed dividends to a non-Hong Kong resident company, it will not be considered a negative factor under the beneficial ownership determination.

Factor 2: The applicant conducts little or no business activities, other than holding the properties or rights that generate the income received. Notice 165 clarifies that "business activities" include investment activities. The tax authorities may not deny DTA relief solely because the applicant only holds a single investment. This clarification could mean that the applicant may obtain beneficial owner status even if holding only one investment, provided that the applicant does not fall within any other negative factor.

Factor 3: The entity (e.g., corporation) applicant's assets, size of operation and personnel are disproportionately small as compared to the income received. First, Notice 165 requires a comprehensive analysis to determine whether the applicant's assets are disproportionate to its income. This analysis should not equate "assets" with registered capital. If an applicant has disproportionately small registered capital, the source of its funding and the investment risks it bears should be analyzed to determine whether its assets are commensurate with the income received. Second, Notice 165 also adopts the substance-over-form principle to determine whether the applicant's staffing is commensurate with the income received. When conducting this analysis, the functions of the staff should be reviewed and analyzed.

Factor 4: The recipient does not, or usually does not, have the right to control or dispose of the income, or the properties or rights giving rise to the income, and bears little or no risk. In assessing this factor, Notice 165 requires the tax authorities to analyze: (1) whether relevant legal documents, such as the articles of association, have granted the applicant relevant rights to control or dispose of the income or properties; and (2) whether the applicant has exercised these rights at its own discretion. The tax authorities may not make a negative conclusion on this factor solely based on the fact that the recipient's shares are controlled by the recipient's holding company.
Factor 5: The applicant is exempt from tax or is not subject to tax in the resident jurisdiction with respect to income received from China, or the recipient pays tax in the resident jurisdiction but at an extremely low effective tax rate. Notice 165 clarifies that the Hong Kong rule which exempts income derived outside Hong Kong from being taxed in Hong Kong does not constitute a main negative factor when assessing beneficial ownership. The applicant should be assessed comprehensively based on the applicant's tax filing status under Hong Kong law.

Clarification of Bulletin 30

Bulletin 30 basically provides a safe harbor rule for a taxpayer who is either a listed company or 100% directly or indirectly owned by a listed company located in the same jurisdiction. Under either scenario, the taxpayer is automatically deemed to be the beneficial owner of the income. Notice 165 clarifies that this safe harbor rule may not be interpreted to deny an applicant's beneficial owner status when the applicant is: (1) 100% directly or indirectly owned by a non-listed Hong Kong resident company; or (2) ultimately owned by a Hong Kong company even though there are intermediate holding companies outside Hong Kong.

Observation

Notice 165 was issued in response to various inquires from lower-level tax bureaus about specific cases concerning Hong Kong companies applying for treaty benefits under the dividend provision of the China-Hong Kong DTA. The SAT consulted the Hong Kong Inland Revenue Department in drafting Notice 165 and obtained helpful guidance on the determination of beneficial ownership. Although Notice 165 was directly addressed only to certain provincial tax bureaus on how to interpret the dividend provision of the China-Hong Kong DTA, it is likely to receive wider application nationwide and beyond just the dividend provision of the China-Hong Kong DTA

Updates on the Shanghai Free Trade Pilot Zone

By Danian Zhang, Howard Wu, Harvey Lau, Brendan Kelly and William Marshall

On 22 August 2013, the State Council formally approved a plan to create a 28.78-square-kilometer Shanghai Free Trade Pilot Zone (FTPZ) within the existing Shanghai Integrated Bonded Zone. The Overall Plan for the China (Shanghai) Free Trade Pilot Zone (Plan), jointly developed by the Ministry of Commerce (MOFCOM) and Shanghai Municipal Government, has been submitted to the Standing Committee of the National People's Congress (NPC) for consideration, and should be published in the coming weeks after legal and legislative requirements are completed With some parts of the Plan projected to come into effect as early as the end of September, some senior officials are concerned that the FTPZ may lead to more smuggling, encourage capital flight from other parts of China, including Hong Kong, and increase regulatory complexity by making it necessary to address and resolve conflicts of laws between the FTPZ and the rest of China. Based upon available public information, the Plan represents a dramatic shift in several key regulatory areas impacting foreign investors. We highlight below the key proposals involving foreign investment administration, trade facilitation, tax policy and financial reform. Foreign Investment Administration The FTPZ is expected to simplify requirements for establishing and modifying foreign invested enterprises (FIEs). Instead of specific approvals to establish and modify FIEs, there would be a "negative list" of areas prohibited to foreign investors. FIEs in areas not on that list would not need specific approvals, but instead would likely be given national treatment, with filing and registration requirements the same as for domestic entities.

Since this would conflict with current PRC foreign investment law's requirements for FIE approvals, the National People's Congress 12th Standing Committee, 4th Session on 30 August 2013, passed a decision authorizing the State Council to "adjust" those approvals (i.e., replace them by filings) in the FTPZ for an interim period of three years starting on 1 October 2013. The Standing Committee can revise laws as long as their basic principles are not violated. Some question whether this authority covers suspending legal provisions in specified locales, but this decision at least reduces (if not totally eliminates) doubts about the legal effectiveness of the Plan's suspension of FIE approval requirements, and highlights the central government's support of the Plan.

Trade facilitation

To streamline and liberalize customs administration within the FTPZ, goods shipped into the FTPZ may be allowed to remain within the FTPZ without having to clear customs immediately. The FTPZ will also establish an exhibition and trading platform for goods under customs bond, and take measures to enable the establishment of global repair and maintenance operations, cross-border e-commerce trade, international transit shipping and container consolidation, international vessel registration, and centralized management of foreign exchange funds.

Tax policy

It is still uncertain what specific tax incentives will be offered to enterprises within the FTPZ. Other special zones in China offer low preferential enterprise income tax rates and individual income tax rebates for certain qualified expatriate workers, the specific tax incentives to be offered in the FTPZ are the subject of ongoing discussion and debate. The Shanghai Municipal Government is reportedly pressing for low preferential enterprise income tax rates for enterprises within the FTPZ.

Financial reform

The reform and liberalization of the financial sector is a key part of the Plan with some of the more dramatic FTPZ reforms in that sector. Reports indicate that financial reforms may include:

- liberalizing interest rates;
- removing foreign exchange controls over RMB in capital accounts;
- allowing wholly foreign-owned as well as Sino-foreign JV banks within the FTPZ;
- enabling FIEs to engage in overseas portfolio investment;
- permitting offshore trading by qualified Chinese banks within the FTPZ;
- support (including tax incentives) for the finance lease industry within the FTPZ;
- permission for foreign companies to participate in futures trading; and
- incentives for the establishment of equity trading and integrated financial services platforms.

In addition, the Shanghai Government issued its Implementation Plan for the Guidance of the State Council General Office regarding Financial Support for Economic Restructuring, Transformation and Upgrading (Implementation Plan) on 9 August 2013, which includes 42 action items on financial reforms that are to be amongst the reforms piloted by the FTPZ. These items relate to RMB cross-border settlement; credit asset securitization; expansion of the role of RMB in international trade, investment and insurance; and outbound direct foreign investment by individual residents.

Additional reforms in cultural sectors

Public reports citing senior government officials state that the FTPZ will also make breakthroughs in the so-called modern services sector, including the cultural industry. FIEs are likely to be given access to certain specific sectors that were previously prohibited. Certain shareholding limits currently imposed on foreign investments in certain sectors will likely be removed.

The State Council has recently proposed to the NPC Standing Committee to suspend enforcement in the FTPZ of certain provisions of the Law on Cultural Relics Protection, to allow FIEs to engage in auctions of cultural relics, which is currently prohibited.

Conclusion

The reforms proposed for the FTPZ, once implemented, will create substantial tax, supply chain, and operational restructuring opportunities for FIEs in China. Financial institutions and auction houses, in particular, will want to closely monitor implementation of the Plan to anticipate the opening of new business opportunities in China.

Hong Kong

Hong Kong Liberalizes Exchange of Information Laws

By Michael Olesnicky, Steven Sieker, Richard Weisman, Pierre Chan, Travis Benjamin

Hong Kong's Legislative Council passed a new legislation in July that liberalizes the Exchange of Information (EOI) laws. This will enable the Hong Kong government to enter into stand-alone Tax Information Exchange Agreements (TIEAs) and Intergovernmental Agreements (IGA) related to the Foreign Account Tax Compliance Act (FATCA).

In discussions of the Inland Revenue (Amendment) Bill 2013 (the Bill) both the Hong Kong executive and its Legislative Council expressed their strong preference to continue to enter into full Comprehensive Avoidance of Double Taxation Agreements (CDTAs) rather than TIEAs. For Hong Kong, offering EOI as part of a CDTA has been a helpful negotiation point.

However, the Global Forum has recommended that Hong Kong put into place a legal framework for entering into TIEAs (independent of any CDTA), and the Hong Kong government pushed to have the Bill enacted before the Global Forum publishes its Phase 2 report on Hong Kong in September 2013.
It is also very significant that, under prior law, the Hong Kong government did not have the authority to enter into an IGA with the US with respect to FATCA. Now that the Bill has been enacted into law, it is anticipated that the Hong Kong government will wish to negotiate a Model 2 IGA with the US.

The Bill represents the second major step in recent years in the process of liberalizing Hong Kong's tax information exchange laws. Before 2010 the Hong Kong Inland Revenue Department (IRD) could exercise power to collect taxpayer information only in order to ascertain the taxpayer's liability under domestic tax law. This restriction limited the ability of Hong Kong to conclude CDTAs with other jurisdictions, as most had already adopted the 2004 version of the OECD's EOI article. In March 2010 Hong Kong's legislation was modified so the IRD also could collect and disclose a taxpayer's information in response to requests made by the CDTA partners even when the information was not otherwise required for domestic tax purposes.

Since making that change, Hong Kong has been very successful in negotiating CDTAs with its major trading and economic partners. Currently, Hong Kong has signed 30 CDTAs, including agreements with mainland China, Indonesia, Malaysia, Thailand, Vietnam, the UK, France, Italy, Spain, the Netherlands, Switzerland, Luxembourg, and Canada, among others.

One can anticipate the need for continuing reviews and updates to Hong Kong's EOI laws. Currently, Hong Kong uses the 2004 version of the EOI Article in the OECD Model Tax Convention as its CDTA, except for certain modifications to address local needs. Accordingly, under Hong Kong's current approach there is no automatic or spontaneous exchange of taxpayer information.

As international norms continue to develop, one can anticipate further liberalization of Hong Kong's EOI laws. Hong Kong tends to make only cautious, incremental changes to its tax system. In this case, pressure from the Global Forum and FATCA have led to this next step in liberalizing Hong Kong's exchange of tax information regime.

Indonesia

Indonesia Implements New Serial Numbering System for Tax Invoice Control

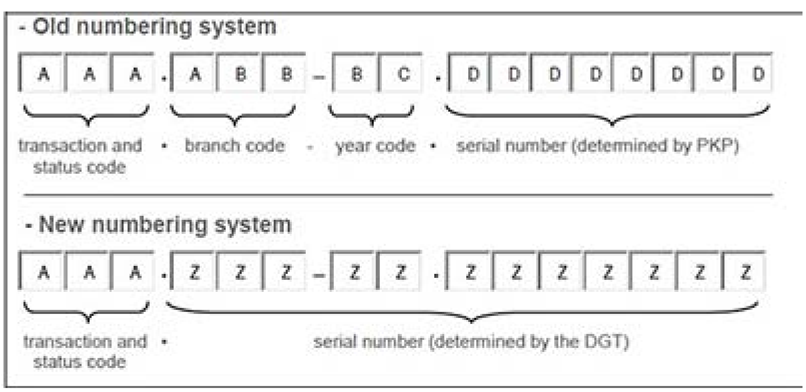
By [Wimbanu Widyatmoko](), [Ponti Partogi](), [Niken Kristalia]()

The rampant use of fictive or counterfeit tax invoices has caused Indonesian Government to look for more effective ways to deal with the issue. One of the measures that have been taken by the tax authority is requiring registered Taxable Entrepreneurs or *Pengusaha Kena Pajak* (PKP) to re-register, and introducing a new numbering system.

With the Input VAT crediting mechanism, tax invoice plays a very important role. Any misuse of tax invoices by an irresponsible PKP will lead to a tax underpayment and will negatively affect state revenue. The new numbering system is expected to provide better control over any misuse of tax invoices and prevent the use of counterfeit tax invoices. It is regulated by Director General of Tax (DGT) Regulation Number PER-24/PJ/2012 dated 22 November 2012 and amended by DGT Regulation Number PER-8/PJ/2013 dated 27 March 2013.

Previously, registered PKPs were allowed to determine their serial numbers for their tax invoices as long as the numbers were in sequence and based on the format that had been set out by the DGT. However, with the new numbering system, the registered PKPs must re-register themselves to obtain an activation code and a password from the tax office where each PKP is registered. The activation code and password are specific for each PKP and will be used as identification in the DGT system for the process of requesting the serial number itself. It is very important for the PKP to fill in and provide its correct address to the DGT because the activation code and password will be delivered by mail and will be sent to the PKP's registered address. After obtaining the activation code and password, the PKP must request the serial numbers that can be used in its tax invoices. Based on the new regulations, the serial numbers will be handed over the counter by the tax office where the PKP is registered, after the PKP provides the correct activation code and password to the tax office.

The comparison of the old numbering system and the new numbering system is as follows:



In the prevailing regulation, the DGT stipulates that the range of serial numbers that will be provided to the applying PKP will amount to 120% of the total number of transactions that PKP had during the three months before the application. For example, if based on the last three months of the reported VAT monthly returns a PKP had 500 transactions, the DGT will provide up to 600 serial numbers (120% of the total number of transactions).

The DGT has also stipulated that the DGT will provide up to 75 serial numbers for newly registered PKP. There is no limitation on the timing of serial number applications. Therefore, as soon as a PKP feels that the provided serial numbers are not enough, the PKP can apply for additional serial numbers.

The new numbering system came into effect on 1 April 2013. However, the prevailing regulation also stipulated a transition period up to 31 May 2013, during which the PKP can still use its old numbering system.

PKP that do not issue their tax invoices based on the prevailing regulations will be subject to significant administrative sanctions and also may face criminal sanctions as regulated in Law Number 28 of 2007 on General Tax Provisions and Procedures. In addition, incorrect tax invoices cannot be credited as valid input VAT. Similar to the issuance of a void VAT invoice, a PKP that credits a void tax invoice will also be subject to a large administrative sanction (100% of the VAT payable amount in addition to the VAT payable caused by the crediting of the void tax invoice).

The following tips may be useful for PKP:

1. Make sure to apply for the activation code and password as soon as possible.
2. Bring the activation code and password when applying for the serial number.
3. Manage your serial numbers carefully and ensure that one serial number is only used once.
4. Make sure all information stated in the tax invoices is correct and the signatories' identity and specimen signature have been informed to the tax authority before any of the signatories sign a tax invoice.
5. Apply for additional serial numbers on time.
6. Ensure your computerized tax invoice system (if any) has been updated based on the new serial numbering system.

With the issuance of the regulations, all PKPs are expected to make the necessary adjustments as soon as possible.

Malaysia

Guidelines on Taxation of E-Commerce Transactions

By Adeline Wong, Yvonne Beh, Chong Mun Yew, Krystal Ng, Istee Cheah, Lim Tien Sim, Tan Yi Lyn

The Malaysian Inland Revenue Board (IRB) released in March the Guidelines on Taxation of Electronic Commerce (Guidelines), which provide guidance on the tax treatment of e-commerce transactions. The Guidelines, which took effect 1 January 2013, adopt the principle of neutrality where both conventional businesses and online businesses are subject to the same tax treatment under Malaysian laws. As such, the provisions and the interpretation of the Income Tax Act 1967 (ITA) continue to apply to income arising from online businesses which are carried on in Malaysia. In addition, the Guidelines briefly consider the imposition of withholding taxes on royalty payments for software products.

Derivation of E-Commerce Income

The Guidelines note that at the outset, the determination of whether or not e-commerce income is deemed to be derived from Malaysia remains a question of fact and degree. Some of the business activities to be taken into account in determining the location of the business operations include the sourcing of content, sales, procurement of goods, advertisement and maintenance of the business' website. It is noteworthy that the location of the server for the online business is said to be irrelevant in this determination.

Having regard to these considerations, the Guidelines proceed to examine various permutations of online business models, the income of which can be considered to be derived from Malaysia, based on the concept of "substantial business activities" being conducted in Malaysia.

Characterization of Software Payments

Prior to the issuance of the Guidelines and in absence of any other guidance to the contrary, the Malaysian tax treatment of payments for software products (i.e., shrink-wrapped software, site licenses, and downloadable software, etc.) relied on a strict interpretation of the ITA, which would largely deem such payments to be royalties on the basis that they constituted a right to use a copyright. Accordingly, such payments would be subject to Malaysian withholding tax. Such approach paid no regard to the nature of the rights and extent of use which was conferred on the end-user licensee, such that payments for the sale of software to end users would also constitute royalties.

Under the Guidelines, payments for the use of, or the right to use, copyrights would constitute royalties while payments for the purchase of a product would not generate royalty income.
Whilst this may be an attempt to align the Malaysian tax treatment of software payments with the rights-based approach advocated by the Organization for Economic Co-operation and Development (OECD) and most recently adopted by the Inland Revenue Authority of Singapore, no further distinction or explanation was provided in the Guidelines as to what constitutes the purchase of products and what constitutes the use of a copyright (i.e., whether the former would include sales to end users and a license to use a copyright for the intended functional purposes of the software and whether the latter would include rights to copy, adapt, modify or reverse-engineer a copyright).

As such, it appears that the IRB has yet to take a committed, definitive stance on the Malaysian tax treatment of software payments.

Servers as Permanent Establishments

As online transactions typically transverse various jurisdictions, the Guidelines have also addressed the availability of tax relief where e-commerce income may be subject to tax in Malaysia and another country. In the context where Malaysia has a tax treaty with the other country, such relief would be determined by the provisions of such treaty. In the absence of a tax treaty, a unilateral tax credit may be granted under the ITA.

Further, the Guidelines confirm that where a server constitutes a permanent establishment under applicable tax treaties which Malaysia is a party to, the income arising from electronic transactions through the said server is considered sourced from Malaysia and subject to Malaysian tax, provided that the activities conducted by the server represent a significant and essential part of the online business and are not merely preparatory or auxiliary.

Implications of the Guidelines

Whilst the Guidelines seek to provide guidance and clarity in an area where prevailing laws are not yet adapted to suit changing and complex commercial landscapes, the Guidelines arguably do not provide sufficient certainty for taxpayers and indeed expressly state that they are not intended to be exhaustive.

Taxpayers should exercise caution and refrain from relying on the Guidelines in totality. Specific advice should be sought on the application of the Guidelines and the tax treatment under the ITA for specific structures or business model. Nevertheless, the Guidelines still offer some insight as to the position and interpretation which would be adopted by the IRB in the event of an audit and the factors which it views to be important when determining the tax implications of transactions involving electronic commerce.

The Implementation of GST in Malaysia: Inevitable and Imminent?

By Tien Sim Lim, Yvonne Beh

From as far back as 2005, the idea of introducing a Goods and Services Tax (GST) regime in Malaysia has been bandied around, its merits and drawbacks mentioned, discussed, and heatedly debated. The government, after first introducing it in the 2005 Budget speech, has since deferred the implementation of the GST several times with the stated intention to engage in further public consultation and to accord businesses more time to prepare for its introduction. Since the GST Bill was tabled in the Malaysian Parliament for its first reading in 2009, there has been no further progress in Parliament to date, with the second and third reading of the bill having been repeatedly postponed.

When the prime minister alluded to the implementation of a new tax structure which will ensure that the federal government's finances remain sustainable for the future in the 2013 Budget speech, there was a flurry of anticipation that the government will finally proceed with the implementation of a GST regime. Given that the 13th general election had recently just been completed, it is anticipated that the GST will be implemented very soon. This was exacerbated by recent comments by a minister in the Prime Minister's Department who commented that if the GST was implemented at the same rate of 7% as that of neighboring country Singapore, this can guarantee additional revenue of MYR20 billion to MYR27 billion.

Nevertheless, as recent as May 2013, Finance Minister II Datuk Seri Ahmad Husni Hanadzlah made it a point to stress that no time frame has been set for the GST's implementation and that the government would be re-examining earlier studies before effecting the regime. This was in response to the outcry by the public that the 7% rate is too high. Whilst he affirmed that the rate for the GST has not been determined, he further added that a GST rate of 4% would be a normal starting position.

Malaysia remains one of only three countries in Southeast Asia that does not yet operate under a GST regime, the other two being Brunei and Myanmar. Currently, sales tax of 5% to 20% and service tax of 6% are imposed on the domestic consumption of certain prescribed goods and services, respectively, on an *ad valorem* basis. When implemented, the GST will replace the existing sales and service taxes. In contrast to both single-stage taxes above, the GST will be a multi-stage value-added consumption tax payable by all intermediaries in the production and distribution chain, though the tax burden will still be ultimately borne by the consumer. In contrast to the current sales and service tax regimes, the proposed GST regime allows input tax credits to be claimed, similar to the GST regime in Singapore and Australia.

Critics of the GST regime voice concerns on the exorbitant cost of implementing and regulating a GST system, as well as on the resulting burden on consumers whose incomes have arguably remained stagnant. Their argument centers around the contention that the GST is only viable if the income gap is first addressed and if the country's per capita income is higher than it currently is.

Nevertheless, the government has recognized the issue and the proposed GST model contains similar concepts adopted by other regimes, such as standard-rated, zero-rated and exempt supplies. It has been proposed that certain basic goods and services which are deemed necessities will be zero-rated or exempted from the GST, including basic foodstuff, residential accommodation, education, health services, public transportation, and domestic water and electricity supply to a certain limit. Fears that businesses will increase the prices of goods in light of the GST should be allayed by the Price Control and Anti-Profiteering Act 2010 which came into effect on 1 April 2011. In addition, all exports of goods and services will be zero-rated to ensure that Malaysian products and services remain internationally competitive.

While the GST regime's implementation in Malaysia remains uncertain in terms of a concrete timeline, it is likely to be an inevitable outcome. Even detractors concede that the introduction of a GST regime would result in a more efficient taxation system overall as it would reduce the opportunity for tax evasion while simultaneously generating additional revenue for the country. It has further been acknowledged by all parties that personal income and corporate tax rates should be reduced accordingly in tandem with the adoption of a GST system.

It would appear that the move to introduce GST is in line with Malaysia's vision of being a high-income nation by 2020. Although the introduction of a GST regime would initially impact businesses and individuals across the board, a focused and well-driven implementation should prove to be beneficial for the country as a whole in the long run.

Comparison of the Operational Headquarters Regime in Malaysia, Singapore and Thailand

By Adeline Wong, Yvonne Beh, Chong Mun Yew, Krystal Ng, Istee Cheah, Lim Tien Sim, Tan Yi Lyn

Introduction

As competition for foreign direct investment continues to grow in Asia, with China and India taking the lead as popular destinations for investments in Asia Pacific, Malaysia, Singapore and Thailand have each put in place incentive packages to encourage multinational corporations (MNCs) to use their countries as a base for conducting headquarters management activities as well as for coordinating their regional and global operations.
In Malaysia, the incentives are commonly referred to as the operational headquarters (OHQ) incentives. However, they are generally referred to as regional headquarters and regional operating headquarters incentives, respectively, in Singapore and Thailand. For the purposes of this article, the incentives offered by the three countries will be referred to collectively as OHQ incentives.
This article explores the OHQ incentives available in Malaysia, Singapore and Thailand, respectively, and seeks to provide an objective assessment of the packages offered. In brief, an OHQ would generally be a locally incorporated company that provides support services to its subsidiaries or related companies. An OHQ functions as a management centre in the region, and generally provides managerial, administrative and technical services as well as other supporting services to its related enterprises.

Qualifying Criteria

A company intending to enjoy OHQ incentives is required to meet specific criteria and conditions, which usually include, amongst others, a minimum paid-up capital, minimum operating and investment expenditure, and a minimum number of overseas entities receiving the provided services.

i) Minimum Paid-up Capital

In Malaysia, the minimum paid-up capital of an OHQ entity is RM 500,000 (USD 160,000), whereas in Singapore, an OHQ entity is required to have paid-up capital of SGD 500,000 (USD 400,000) by the end of the third year of the incentive period. Thailand currently has two OHQ incentive schemes running concurrently, i.e., the original scheme introduced in 2002 ("Original Scheme") and the new enhanced scheme introduced in 2010 ("Enhanced Scheme"). The Enhanced Scheme is a temporary incentive which is only open to application for the period of 5 years from 15 November 2010 (i.e. no later than 15 November 2015). The current minimum paid-up capital requirement under both schemes is THB 10 million (USD 330,000).

ii) Qualifying Activities

The forms of prescribed activities to be provided by an OHQ entity are largely similar for the three counties, and generally include administration and business planning, sourcing and procurement, technical support, and marketing and sales promotion services. Malaysia, Singapore and Thailand (Original Scheme) requires that the services must be rendered to at least 3 entities outside the country, whereas Thailand's Enhanced Scheme allows for an incremental progression in the number of service countries, with the requirement to provide services to at least 3 countries by the fifth year of the incentive period.

iii) Minimum Operating Expenditure

In terms of minimum operating expenditure, Malaysia requires an OHQ to have a minimum local business spending of RM 1.5 million (USD 470,000) per annum, in comparison to Singapore's requirement that the OHQ should have an incremental annual local business expenditure of SGD 2 million (USD 1,580,000) by the third year.
Comparatively, Thailand's Enhanced Scheme requires business spending to be at least THB 15 million (USD 490,000) a year, or alternatively for investment spending to be at least THB 30 million (USD 970,000) per annum.

iv) Skilled Workforce

Each country also has its own requirements for the OHQ's workforce to comprise of a minimum number of skilled or management-level personnel, with Malaysia requiring at least 3 senior management-level personnel whereas Singapore requires at least 75% of the workforce to be skilled workers. In Thailand, the Old Scheme does not have a specific requirement for skilled workforce; whereas the Enhanced Scheme requires the OHQ to maintain a percentage of 75% of skilled staff by the third year of the incentive period.

Incentives

i) Income Tax Incentives

For Malaysia, business income, interest and royalty payments arising from services rendered to an OHQ's related company or office located overseas ("Qualifying Income") are 100% exempt from tax for a period of 10 years. Business income in respect of the services provided to the OHQ's related companies in Malaysia are also exempted, subject to the condition that the 'local' income does not exceed 20% of the total Qualifying Income. Dividends paid from the exempt Qualifying Income are also tax-exempt in the hands of the shareholder.

In Thailand, the net profits for income derived from services provided to foreign associated enterprises are subject to a concessionary rate of 10% for an indefinite period under the Original Scheme, whereas the said income is exempted from corporate tax under the Enhanced Scheme for a period of 10 years.

Comparatively, Singapore currently offers a 15% concessionary corporate tax rate for 5 years on incremental qualifying income. Additionally, companies that commit to exceed the minimum requirements of an OHQ may be offered customised incentive packages with lower concessionary tax rates on their Qualifying Income.

From the perspective of the applicable concessionary tax rates, Malaysia currently has the most favourable tax rate, although Thailand's Enhanced Scheme is closing the gap. Whilst Singapore does on occasion customise special incentive packages for companies that exceed the minimum criteria, Malaysia appears to have an edge over its neighbours by offering a 100% exemption for 10 years from corporate tax for Qualifying Income.

ii) Tax breaks for Expatriate Posts

Additionally, in Malaysia, expatriate posts will be approved based on the requirement of the OHQ and the expatriates will be subject to income tax only on the portion of income attributable to the number of days that they are in Malaysia i.e. on a days-in-days-out basis. In Singapore, companies may explore the possibility of seeking for expatriate posts to be subject to income tax only on the portion of income received during their stay in Singapore. Under Thailand's Enhanced Scheme, expatriates working for an OHQ in Thailand may opt to be subject to a flat tax rate of 15% instead of the normal progressive tax rates for a maximum period of 8 years, provided that the entity generates more than 50% of the annual income from qualifying services charged to overseas affiliates.

iii) Foreign Exchange Controls

With regard to exchange controls, Singapore does not have any restrictions in place. Although Thailand has foreign exchange regulations in place, its regulations and restrictions have been generally relaxed since 1990.

Whilst Malaysia has exchange controls, the Central Bank of Malaysia ("Bank") has granted various exemptions to an approved OHQ to facilitate the prescribed activities such as the conduct of treasury and fund management services undertaken by the OHQ. The OHQ has flexibilities as regards the following facilities, including:

a) Obtaining any amount of credit facilities in foreign currency from any licensed commercial banks and merchant banks in Malaysia (including the licensed offshore banks in Labuan);

b) Borrowing freely in Ringgit Malaysia from licensed onshore banks and other resident companies;

c) Investing in any amount in foreign currency assets funded with own foreign currency funds or foreign currency borrowing;

d) Opening of foreign currency account with designated banks in Malaysia, licensed banks in Labuan or overseas banks; and

e) Paying freely to other resident companies in ringgit, or if in foreign currency, for the settlement of goods and services sourced from its foreign currency account if the OHQ has export earnings.

As a method of liberalising and simplifying the exchange control regulations in Malaysia, the Bank has increased the overnight limit account further for approved OHQ to USD100 million from USD70 million effective 1 April 2004, but with effect from 2005 this restriction has been abolished. With the various exemptions put in place, a company seeking to establish its OHQ in Malaysia is, in effect, able to conduct its activities almost as though no exchange control regulations are in place.
Which country offers the most attractive scheme?

The incentive packages offered by Malaysia, Singapore and Thailand may appear somewhat similar at first glance, however there are some subtle differences in the criteria and tax incentives available which may tip the balance in favour of one country over the others. For instance, Singapore and Thailand evidently place a strong emphasis on the employment of skilled workers in the OHQ, whilst Malaysia is more open to the employment of expatriates to encourage more MNCs to consider establishing its OHQ in the country.

Whilst the quality of the tax incentives offered is a crucial factor considered by MNCs in deciding on the optimum location for its OHQ in this region, there are also other factors demand due consideration. Some key considerations would include, amongst others, the standard of skilled workforce, political and economic stability, developed financial system, the transparency and accessibility of the legal and regulatory framework, education and standard of living as well as infrastructural and information technology support.

Singapore has over the years established itself as one of the preferred regional management hubs in South East Asia. In its efforts to continue as the most competitive location for OHQ and the preferred hub for international companies, corporate and individual taxes have been lowered, as have the costs of infrastructure services and other factors of production.

However, as Singapore struggles to cope with rising inflation, soaring property prices, scarce school places and cost of living issues, MNCs may slowly be turning to alternative locations such as Malaysia or Thailand. To further promote itself as an attractive regional hub for MNCs, Malaysia has stepped up its efforts to improve on the IT facilities and infrastructure offered, as well as poured in considerable investments to develop a skilled workforce to cater to the needs of MNCs looking to set up regional headquarters in Malaysia.

Thailand is also growing in popularity for MNCs who wish to consider establishing its OHQs in the country, with its ideal geographic location and considerably cheaper workforce. In keeping up with its neighbours, Thailand has introduced its Enhanced Scheme which offers more competitive tax incentives, although the improved incentives are somewhat hampered by stricter qualification requirements.

At a glance, it must be noted that Malaysia appears to have a slight edge in comparison to Thailand and Singapore as a preferred regional hub centre, with its favourable tax incentives for OHQs, relative ease of doing business and growing supply of skilled workforce, as well as the enhanced global connectivity as a result of the Malaysian Government's continued emphasis on English language proficiency. Furthermore, the Government's Economic Transformation Programme which seeks to establish the country as the centre for regional education has brought about a proliferation of international schools which adopt an international syllabus to cater to the demand of both expatriates and locals alike. Nevertheless, with steep competition coming from neighbouring ASEAN countries, Malaysia needs to continue to work on making itself a premier destination for MNCs looking to set up regional offices in South East Asia.

*Note: The quantifications used are in approximate USD, based on the current exchange rate at time of writing.

Singapore

Singapore Steps Up International Cooperation Efforts on Tax Matters

By Edmund Leow, Dawn Quek, Esme Wei and Danny Quah

The Singapore Government has announced that it is taking further steps to strengthen its framework for international cooperation to combat cross-border tax offenses. It will introduce legislative amendments to implement these steps by the end of 2013.

We discuss the Singapore Government's announcement below.

Improving Exchange of Information Assistance

Since 2009, Singapore has been negotiating with its tax treaty partners to incorporate the standard for exchange of information (EOI) endorsed by the Organization for Economic Cooperation and Development (OECD).

Singapore will now apply the OECD standard for EOI to all of its existing bilateral tax treaties without the need for renegotiation, subject to reciprocity by the tax treaty partner. It will also sign the Convention on Mutual Administrative Assistance in Tax Matters (the Convention). In addition to an EOI, Singapore will be able to extend administrative assistance on tax matters to all of the Convention's signatories. This will apply even to signatories that Singapore has not concluded tax treaties with.

With these steps, Singapore will significantly increase the total number of its EOI partners from 41 to 83 jurisdictions, including the United States.

Accessing Bank and Trust Information without a Court Order

With respect to EOI requests, the Inland Revenue Authority of Singapore (IRAS) will no longer need a court order to obtain information protected by the Banking Act and Trustees Act from financial institutions.

While a court order will no longer be required, basic safeguards to taxpayers’ interests remain. IRAS is still required to apply the OECD standard for EOI when assessing EOI requests, and has to be satisfied that the information requested is “foreseeably relevant” to the enforcement of the foreign jurisdiction’s tax laws. In addition, taxpayers continue to have a right of appeal.

Concluding an Inter-Governmental Agreement with the United States

The Singapore Government will conclude a Model 1 Inter-Governmental Agreement (IGA) with the US to help financial institutions in Singapore (FIs) achieve compliance with the US Foreign Account Tax Compliance Act (FATCA). Under the Model 1 IGA, FIs will have to provide FATCA related information to IRAS on a regular basis. IRAS will in turn provide such information to the US Inland Revenue Service (IRS).

Commentary

The IGA with the US is expected to ease the burden faced by Singapore financial institutions in complying with FATCA.

Singapore's decision to sign the Convention and to automatically include EOI in its tax treaties is a significant step, particularly as some of the provisions in the Convention extend beyond the OECD EOI standard in tax treaties. In some cases, this may include the spontaneous exchange of information.

Along with the impending criminalization of the laundering of proceeds from serious tax offenses after 1 July 2013, these developments present a clear message that Singapore does not want and will not tolerate inflows of illicit funds and will be proactive in safeguarding the integrity and reputation of Singapore as a clean financial center. Financial institutions should embrace this change as we believe that this will be crucial for Singapore in maintaining its growth as a global financial center.

By Allen Tan and Dawn Quek

The Monetary Authority of Singapore (MAS) has recently released further details of the changes to the Financial Sector Incentive (FSI) scheme announced by the Minister of Finance in his 2013 Budget speech earlier this year.

The FSI scheme is an umbrella incentive scheme that awards concessionary tax rates of 5%, 10%, and 12% on certain income derived from qualifying financial service activities conducted in Singapore.

Some noteworthy changes include the following:

- The application period for the FSI scheme will be extended to 31 December 2018. This is except for the FSI-Islamic Finance (FSI-IF) scheme that expired on 31 March 2013. Several of the FSI sub-schemes will merge from 1 January 2014, and the FSI sub-schemes going forward are as follows:

Scheme	Concessionary tax rate (%)
FSI-Standard Tier (FSI-ST)	12
FSI-Headquarter Services (FSI-HQ)	10
FSI-Fund Management (FSI-FM)	10
FSI-Capital Market (FSI-CM)	5
FSI-Credit Facilities Syndication (FSI-CFS)	5
FSI-Derivative Market (FSI-DM)	5

In particular, the FSI-Bond Market (FSI-BM) and FSI-Equity Market (FSI-EM) schemes will merge to form a new FSI-CM scheme from 1 January 2014. The five separate FSI-Derivatives Market (FSI-DM) sub-schemes will also merge into a single FSI-DM scheme. These changes will not affect existing award holders.

- The list of qualifying activities incentivised under the FSI scheme will be expanded from 1 January 2014. For example, the qualifying income under the FSI-ST will be expanded to include qualifying Islamic Finance Activities, amongst others. This is following the expiry of the FSI-IF scheme.

- Withholding tax exemption will be granted automatically on interest payments made by FSI-HQ award holders on qualifying loans, effective 25 February 2013.
- New applicants for the FSI-FM award will need to satisfy, in addition to the existing conditions, an Asset under Management (AUM) requirement of at least S$250 million. This condition will not apply to existing FSI-FM award holders.

MAS releases further details of changes to the FSI scheme

By Allen Tan and Dawn Quek

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Companies with FSI awards due to expire on or after 31 December 2013 who plan to renew their awards, as well as new applicants, should take note of the above.

Thailand

New Rule for Tax Invoice and VAT Documentation Effective 1 January 2014

By Aek Tantisattamo, Chanida Leelanuntakul, Sirirasi Gobpradit

To prevent VAT fraud and false tax invoices, the Revenue Department recently announced Director-General Notification No. 194-196 (the DG Notifications) prescribing the additional mandatory description/items that must be specified in a tax invoice, debit note and credit note.

A major change is an inclusion of Thai tax ID number for Thai resident and non-resident income taxpayers (both individuals and companies). In general, Thai tax ID of the taxpayers who are Thai citizens will be as same as their Thai ID numbers. Similarly, Thai tax ID of Thai companies or registered foreign branches are the same as their corporate registration numbers. Such Thai tax ID requirement is not applicable to other individual or juristic customers who are not subject to domestic tax and are not required to have Thai tax IDs for tax purposes.

Under the DG Notifications, all tax invoices, debit notes and credit notes must contain the additional mandatory description/items. By 1 January 2014, all tax invoices, debit notes and credit notes issued by VAT-registered operators must conform to this new requirement, the details of which are described below.

VAT Documents	New Mandatory Description/Item
Tax invoice (issued under section 86/4 of the Revenue Code)	• Thai Tax ID number of the recipient • The office of the seller/service provider (i.e., head office or branch no.) • The statement of the "head office" of the recipient (in the case where a tax invoice is issued to a VAT-registered recipient and the recipient's head office address is specified in such tax invoice) • The statement of the "branch no." of the VAT-registered recipient (in case the recipient's branch office address is specified in such tax invoice)
Credit note	• Thai Tax ID number of the recipient • The statement of the "head office" of the issuer (in case the credit note is issued with reference to the tax invoice issued by the head office of the issuer) • The statement of the "branch no" of the issuer (in case the credit note is issued with reference to the tax invoice issued by the branch office of the issuer); • The statement of the "head office" of the recipient (in case the credit note is issued with reference to the tax invoice issued to the head office of the recipient) • The statement of the "branch no" of the recipient (in case the credit note is issued with reference to the tax invoice issued to the branch office of the recipient)
Debit note	• Thai Tax ID number of the recipient • The statement of the "head office" of the issuer (in case the debit note is issued with reference to the tax invoice issued by the head office of the issuer) • The statement of the "branch no" of the issuer (in case the debit note is issued with reference to the tax invoice issued by the branch office of the issuer) • The statement of the "head office" of the recipient (in case the debit note is issued with reference to the tax invoice issued to the head office of the recipient)

	• The statement of the "branch no" of the recipient (in case the debit note is issued with reference to the tax invoice issued to the branch office of the recipient)
Output Tax Report	• The fields for Thai Tax ID number and the office of the customer • Thai Tax ID number (if any) of the customer • The office (i.e., head office or branch no.) of the customer (in the case where the customer is a VAT-registered operator
Input Tax Report	• The fields for Thai Tax ID number and the office of the seller/service provider • Thai Tax ID number (if any) of the supplier • The office (i.e., head office or branch no.) of the supplier who is a VAT-registered operator

The VAT-registered operators should be prepared ahead of time as the business and supporting departments must be ready by 1 January 2014. Non-compliance of this new rule will expose the VAT-registered operators to a fine. The regulations do not prohibit the implementation of these changes before the specified date, so it is recommended that VAT-registered operators begin as soon as possible in order to familiarize themselves and systemize its accounting and database system in order to prevent any unexpected problems before legal implications are enforced.

It is also important to note that failure to include these additional mandatory items will result in the non-deductibility of input tax in their VAT computation by the recipient who receives non-conformed tax invoices. Again, VAT-registered operators must also ensure that tax invoices and VAT documents which they receive contain the requisite information.

Save Time and Money with e-Invoices

By Aek Tantisattamo and Chanida Leelanuntakul,

Until 2012, tax invoices, receipts, debt notes and credit notes were issued through paper-based processes and delivered to the recipients in hard copy.

In compliance with the Electronic Transaction Act, the Revenue Department has recently permitted VAT operators to issue electronic invoices and tax invoices (e-tax invoices) instead of paper tax invoices, which have to be delivered to the customers physically. This encourages entrepreneurs to use e-tax invoices and helps VAT operators reduce business operation costs.

To regulate the issuance of e-tax invoices systematically, the Revenue Department issued a tax regulation in 2012 regarding "the preparation, delivery and storage of e-tax invoice and e-receipt." Under the regulation, in order to issue e-tax invoices, VAT operators must satisfy the following criteria:

a. The VAT operator must be a limited company or public limited company with paid-up registered capital of at least THB10 million;

b. The VAT operator must have stability and credibility within the business operations. For examples, the operator must have a good tax payment history, must not have any tax avoidance behavior, must not use counterfeit tax invoices in the past, or must have more net assets than net liabilities;

c. The VAT operator must have proper accounting systems and security system necessary to accommodate and implement a secured e-invoicing system; and

d. The VAT operator must have a good internal control system which is able to prove that the e-tax invoices and receipts prepared and sent to recipients are complete and accurate.

To implement the e-invoicing system, the VAT operator must have its first digital signature (which is to be created by the software of the Revenue Department) and the second digital signature certified by an authorized certification authority. A submission of e-invoicing application to the Revenue Department and an approval of the Director-General of the Revenue Department are to be proceeded before the VAT operator can issue e-tax invoices.

The e-tax invoices must be delivered to the customers through an electronic data interchange or EDI, which is a method for transferring data between different computer systems or computer networks. It is important to ensure that the adopted delivery method is an acceptable method.

An implementation of the e-invoicing system requires good understanding of various technical issues, system flows and VAT regulatory/compliance. Having said that, e-invoicing substantially helps you cut down on operation costs and reduce time spent on issuing and delivering the paper-based invoice documents typically used in the old days.

No More VAT Exemption for Locally Produced Cigarettes

By Panya Sittisakonsin and Chanida Leelanuntakul

Manufacturing cigarettes in Thailand is a business monopoly. Cigarettes sold in Thailand are manufactured by the Tobacco Factory, which is a government-owned business. Resellers or distributors selling locally produced cigarettes and imported cigarettes also hold different licenses. Before 15 October 2012, the supplies or sales of locally produced cigarettes were exempted from VAT, while VAT was imposed on the supplies or sales of imported tobacco. In other words, locally produced cigarettes received preferential VAT treatment over imported cigarettes until a recent World Trade Organization (WTO) judgment concerning the Thai government's violation of the 1994 General Agreement on Tariffs and Trade.

On 17 June 2011, WTO through its Appellate Body upheld the Panel's opinion that Thailand acts inconsistently with Article III: 2 and 4 of the GATT 1994 by subjecting imported cigarettes to internal taxes in excess of those applied to like domestic cigarettes and granting exemption from VAT for resellers of locally produced cigarettes together with the imposition of VAT on resellers of imported cigarettes when they do not satisfy prescribed conditions obtaining input tax credits necessary to achieve nil VAT liability.

After the Thai government expressed its intent to implement the rulings of WTO on 11 August 2011, with effect from 15 October 2012 onward, Thailand implemented the WTO rulings/obligations by issuing Royal Decree No. 533 to revoke the VAT exemption on the supplies of locally produced cigarettes.

Now, VAT is chargeable on domestic supplies of all imported and locally manufactured cigarettes.

Vietnam

Amended Circular Improves Some Value Added Tax Rules

By Frederick Burke, Nguyen Thanh Vinh

Vietnam's Ministry of Finance recently issued Circular No. 65/2013/TT-BTC on 17 May 2013 (Circular No. 65) amending Circular No. 06/2012/TT-BTC on value added tax (VAT). The amended Circular will take effect on 1 July 2013 and contains several welcomed changes.

Shareholder Loans and Credit Services

Circular No. 65 abolishes the previous controversial rule that VAT-exempt credit services must be provided by credit institutions. Accordingly, financial services provided by either credit institutions or non-credit institutions are VAT-exempt from 1 July 2013. If non-credit institutions have already charged VAT on loan interest from 1 March 2012, lenders and borrowers are allowed to (i) issue a new adjusted invoice or (ii) borrowers can claim credit for such input VAT if borrowers use loans for business activities subject to VAT.

Leasing, Export of Digitalization Service

Leasing of factories to organizations or individuals in duty-free zones is now eligible for 0% VAT, instead of 10% VAT as with the previous rule. In addition, digitalization services provided in Vietnam to offshore entities are subject to 0% VAT from 1 July 2013.

Installment Sale and Claim of Input VAT

According to the current rule, payment for purchases with the value of 20 million VND or more must be made via bank so that the relevant input VAT can be credited. The rule also applies to installment sales. Circular No. 65 further provides that when a payment is overdue and a taxpayer does not make an adjustment to reduce the input VAT credit claimed previously before there is a tax audit, the input VAT credit will be disallowed based on the tax authority's decision upon the tax audit. Taxpayer may claim back this input VAT credit when they have documents for payment via bank within six months from the tax authority's decision.

Calculation of VAT Refund Related to Export Sales

Additionally, according to the current rule, if taxpayers have both domestic sales and export sales in a month, and the input VAT that is not yet credited in the month amounts to 200 million VND or more, they are eligible for a tax refund. However, under Circular No. 65, the tax amount eligible for a refund must correspond with the percentage of export sales revenues over total revenues.

Welcome Amendments to Enterprise Income Tax Law and Value Added Tax Law

By Frederick Burke, Nguyen Thanh Vinh

The National Assembly recently passed Law No. 32/2013/QH13 Amended Enterprise Income Tax Law (Amended EIT Law) and Law No. 31/2013/QH13 Amended Value Added Tax Law (Amended VAT Law), which introduce certain favorable changes that will take effect 1 January 2014.

Amended EIT Law

Tax rates and tax incentives

One of the most welcome changes is the tax rate cut from the current rate of 25% to 22% and 20% from 1 January 2014 and 1 January 2016, respectively. However, enterprises with a total annual revenue of no more than VND20 billion can apply the tax rate of 20% from 1 July 1 2013.
A new category of "new investment projects" has been created to replace "newly established enterprises." Instead of only new companies getting tax incentives, the amendment allows companies with more than one investment project to seek tax incentives for each one.

Under the amended law, tax incentives are granted to large-scale manufacturing projects at a 10% tax rate for 15 years, 4-year tax exemption and 9-year 50% tax reduction if they meet one of several conditions. Manufacturing projects related to the production of goods subject to special consumption tax and exploitation of mineral resources) are not eligible.

Companies who meet these conditions are eligible for the tax exemption:

- Investment capital is at least VND6,000 billion and the investment capital will be contributed within 3 years from the issuance date of the investment certificate and the annual revenue is at least VND10,000 billion after 3 years at the latest from the year generating revenue; or

- Investment capital is at least VND6,000 billion and the investment capital will be contributed within 3 years from the issuance date of the investment certificate and the project has more than 3,000 employees.

Enterprises engaged in development of social policy housing for sale, lease, lease-purchase according to Article 53 of the Housing Law can enjoy the 10% tax rate from 1 July 2013.

The tax rate of 20% (reduced to 17% from 2016) for 10 years, 2-year tax exemption and 4-year 50% tax reduction will be granted to new projects engaged in production of high-quality steel, energy-saving products, machines or equipment used in agriculture, forestry, fishery, salt production, irrigation equipment, foods for livestock, poultry and aqua animals, and development of traditional careers.

An expansion investment to a current project is not eligible for tax incentives. The Amended EIT will bring back tax incentives to an expansion investment if certain conditions are met.

Deductibility and Cap on Advertising and Promotion Expenses

Payment via bank with respect to purchases amounting to VND20 million or more is necessary for claiming input value added tax credit. Under the Amended EIT Law, this is also the condition for expense deductibility.

Expenses for advertising, marketing, promotion, brokerage commission, receptions, conferences, marketing support (referred to as "Advertising and Promotion Expenses") are still subject to a cap on deductibility. However, the deductibility cap at 15% of other deductible expenses will be applied throughout the operation of companies, not only the first three years from the establishment as in the current law. Furthermore, payment discount will not be included in the group of expenses subject to the deductibility cap.

Loss carry forward

To relieve difficulties for real estate business, the Amended EIT Law allows carrying forward loss incurred from transfer of immovable properties to offset it against income from main business during the tax period.

Amended VAT Law

Under the Amended VAT Law, the following services are VAT exempt:

- Loan financing by non-credit institutions (in addition to credit institutions)

- Export of goods and services – To qualify for 0% VAT exported service, foreign customers must have no permanent establishment in Vietnam. Exported goods and services must be consumed outside Vietnam or in duty-free zones. It is not clear yet if the requirement for no permanent establishment will remain in the implementing decree and circular.

VAT has been reduced for the following services:

- Sale, lease or lease-purchase of social policy houses are subject to 5% VAT (previously 10%) effective 1 July 2013.

- Sale, lease and lease-purchase of commercial residential houses, with an area of less than 70 square meters and a selling price of less than VND15 million, are eligible for 5% VAT (previously 10%), effective 1 July 2013 to 30 June 2014.

Other changes of the Amended VAT Law include the following:

- Longer period for claiming incurred input VAT – At present taxpayers can claim a VAT refund if they incur input VAT not yet credited for three consecutive months. Under the Amended VAT Law, this waiting period will be extended to 12 months; however, this raises cash flow issues.

- Threshold for VAT refund – The threshold for a company during the pre-operating period to claim a VAT refund has been increased from VND200 million to VND300 million.

New Decree Implementing the Amended Personal Income Tax Law

By Frederick Burke, Nguyen Thanh Vinh

With the Amended Personal Income Tax Law taking effect 1 July 2013, the Government has issued Decree No. 65/2013/ND-CP on 27 June 2013. The Decree also comes into effect on the same day as the Amended Personal Income Tax Law. We summarize major changes introduced in the Decree.

- Definition of a tax resident – Under the old regulations, either a presence in Vietnam for 183 days or more or a lease of 90 days or more in a tax year would qualify one for a resident status. The Decree now solves this inconsistency by using the 183-day threshold of either presence or lease term to determine the residence status. However, if a person has a lease contract with the term from 183 days or more but is actually present in Vietnam for less than 183 days in a tax year, he/she will still be treated as a resident if he/she cannot provide proof of residence in another country.

- Tax-exempt one-time relocation allowance – This tax-exempt allowance is now extended to Vietnamese people who go abroad to work.

- Tax on non-compulsory insurance premium and pension fund contributed by employers – Insurance companies and pension fund management companies are required to withhold 10% personal income tax on the amount of non-compulsory insurance premium and pension fund contributed by employers from 1 July 2013 when they pay insurance compensation or pension to individuals.

Increase of the monthly deduction for taxpayers – Monthly deduction for taxpayers will be increased from VND4 million to VND9 million and for dependents from VND1.6 million to VND3.6 million. Taxpayers will also be allowed to deduct contributions to voluntary pension fund capped at VND1 million per month. However, this contribution to voluntary pension fund will be subject to further detailed guidance from the Ministry of Finance.