Asia Financial Services Tax Quarterly Developments Report

October to December 2008

PRICEWATERHOUSECOOPERS

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Introduction

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

This PricewaterhouseCoopers Asia Financial Services Tax Quarterly Developments Report covers the period ended 31 December 2008. It very briefly lists tax developments in the Asia region that are relevant to financial services operations.

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

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

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Contents

Australia 5

China 8

Hong Kong 10

India 13

Indonesia 16

Japan 18

Korea 20

Malaysia 22

New Zealand 24

Pakistan and Afghanistan 26

Philippines 27

Singapore 34

Taiwan 35

Notes 36

Australia

Sector: All **Date:** Dec 2008 **Contact:** Sara Huda - Sydney

New capital investment allowance

As part of its second economic stimulus package, the Australian Government has announced a new temporary capital investment allowance in the form of:

- a bonus deduction of *30 per cent* for eligible depreciating assets costing $10,000 or more that are acquired, or start to be held, under a contract entered into between 13 December 2008 and the end of June 2009 (or where construction starts between those times), and which are installed ready for use by the end of June 2010.
- a bonus deduction of *10 per cent* for eligible depreciating assets costing $10,000 or more that are acquired, or start to be held, under a contract entered into between 1 July 2009 and the end of December 2009 (or where construction starts between those times), and which are installed ready for use by the end of December 2010.
- small businesses (ie businesses with a turnover of $2 million a year or less) will be eligible to claim these bonus deductions for eligible depreciating assets costing $1,000 or more.

What is an 'eligible asset'

The investment allowance will apply to new tangible assets used in carrying on a business in Australia, for which a deduction is already available under the Division 40 - Capital Allowances provision of the *Income Tax Assessment Act 1997*. Assets that are not deductible under the Capital Allowances provision will not qualify for the investment allowance. Land and trading stock are specifically excluded from the investment allowance.

Sector: Insurance **Date:** Dec 2008 **Contact:** Peter Kennedy - Sydney

Stamp duty refund to Qantas

A recent Supreme Court decision in New South Wales (NSW) ruled that a stamp duty refund of $5million was available to Qantas with regard to its global general insurance policy (*Qantas Airways Ltd v Chief Commissioner of State Revenue* [2008] NSWSC 1049).

The Court held that NSW insurance duty was not applicable to Qantas (as the insured) on its general insurance policy held with an offshore insurer, on the basis that the property or risk was in NSW and the offshore insurer is not a registered insurer under the *Insurance Act 1973* (*Cth*).

Sector: Banking and Capital Markets **Date:** Dec 2008 **Contact:** Tom Toryanik - Sydney

TOFA legislation introduced into Parliament

The Bill implementing the Taxation of Financial Arrangements (TOFA) Stages 3 and 4 rules was introduced into the Parliament on 4 December 2008.

The Bill will introduce new tax rules for accruals/realisation, fair value, retranslation, and reliance on financial reports and hedging.

The TOFA Stages 3 and 4 measures contain rules that cover tax treatments for certain financial arrangements which will achieve compliance cost savings by allowing eligible taxpayers to make use of particular aspects of the accounting standards to determine their taxable income from financial arrangements.

It is expected that the TOFA rules will become effective from 1 July 2010 with an elective application from 1 July 2009.

Sector: Banking and Capital Markets **Date:** Dec 2008 **Contact:** Tom Toryanik - Sydney

Taxation of emission permits

The Government released the White Paper on the proposed Carbon Pollution Reduction Scheme that is expected to commence on 1 July 2010.

The paper includes a note that legislative amendments dealing with taxation of permits will be drafted in line with the following broad principles:

- A deduction will be allowed for expenditure incurred on the purchase of a permit.
- Proceeds from a permit disposal will be included in assessable income.
- An amount will be included in a permit's holder assessable income or allowable deduction based on the movement of the value of permits held at the beginning and at the end of the income year (valued at the market value or cost, by election).

Sector: Banking and Capital Markets **Date:** Dec 2008 **Contact:** Tom Toryanik - Sydney

Expenses of holding company might not be deductible

The Australian Taxation Office released Interpretative Decision ATO ID 2008/163 expressing a view that capital expenditures of a holding company are deductible only where they relate to assessable income of the holding company.

For example, where capital expenditures in respect of investments in subsidiaries of a holding company and the holding company is unable, at the time the expenditure is made, to demonstrate that a policy for the repayment of dividends by the subsidiaries exists or to predict whether there would ever be a distribution of dividends from any of the subsidiaries, these expenditures would not be deductible either outright (as they are of a capital nature) nor over 5 years under s 40-880 of the *Income Tax Assessment Act 1997* (as they do not relate to assessable income of the holding company).

Sector: Banking and Capital Markets **Date:** Dec 2008 **Contact:** Tom Toryanik - Sydney

ATO rules on enhanced bond arrangement with a UK bank

The Australian Taxation Office (ATO) released for comment Draft Taxation Determination ATO TD 2008/D15 dealing with an enhanced bond arrangement between an Australian Taxpayer and a UK bank.

Arrangement

The arrangement involves an Australian taxpayer purchasing bonds from a UK bank (or another financial institution). The bonds are acquired through a Limited Liability Company (LLC) which is a subsidiary of the Australian taxpayer and a resident in a jurisdiction other than Australia or the UK.

The jurisdiction of the LLC is chosen so that the payment of interest to the LLC attracts UK interest withholding tax (either under the treaty between LLC country of incorporation and the UK or because there is no treaty with the UK).

The LLC acquires the bonds from a UK entity affiliated to the UK Bank, which holds the bonds under a securities lending arrangement with the Bank.

The UK Bank pays interest in respect of the bonds, while the affiliated entity claims a tax credit in the UK for a 'reverse charge' tax that is deemed to arise under the securities lending arrangement. That UK credit (claimed by the affiliated entity) is equal to the amount of the UK withholding tax liable to be paid under UK tax law.

For Australian tax purposes, the LLC is treated as a transparent foreign hybrid. This allows the Australian taxpayer to claim a foreign tax credit for the UK interest withholding tax. The amount of the foreign tax credit claimed by the Australian taxpayer exceeds the Australian income tax payable on the net interest income derived under the arrangement. The amount of the excess is then claimed to reduce Australian tax payable on other foreign source income of the taxpayer.

The arrangement produces an overall foreign tax credit benefit and therefore the UK bank is able to offer the bonds on the basis that they produce an enhanced return compared to those of a similar grade of issue without the foreign tax credit benefit.

ATO views

The ATO claims that no foreign tax credit will be given for the UK interest withholding tax for the following reasons:

- No foreign tax credit will be given for the UK interest withholding tax, as the UK has no right to impose such tax under Article 11.3(b) of the Double Tax Treaty between Australia and the UK. The ATO claims that this treaty, and not the treaty with the LLC country of incorporation, should be applied by the UK. This is because Paragraph 6.3 of the OECD Commentaries to Article 1 of the Model Tax Treaty requires the UK, as the state of source, to recognise that the LLC is transparent for Australian tax and therefore is not entitled to the benefits of the Treaty between the UK and the LLC's country of incorporation. The treaty with Australia should be applied instead. Under the Australian treaty, no withholding tax should be payable in the UK, as interest is paid by a bank or financial institution unrelated to the Australian taxpayer.
- Further, even where such UK tax were paid, it would not be paid in accordance with the provisions of treaty between Australia and the UK and therefore Article 22(1)(a) of this Treaty would not require Australia to provide a relief for this tax.
- In addition, the Australian taxpayer would not be able to rely on the Australian domestic foreign tax credit rules, as the rules require that a foreign tax be "imposed by law" other than Australian law. The ATO's view that "imposed by law" means "imposed in accordance with the laws" and that the laws of a foreign state must include the respective obligation under treaties entered into by that state. As he UK tax was not paid in accordance with the Treaty, it was not imposed in accordance with the UK laws and therefore was not imposed by law and, as such, no foreign tax credit would be available for it.
- Lastly, the ATO notes that it is likely that it would seek to negate any tax benefits (including foreign tax credits) by applying the General Anti-Avoidance Rule in Pt IVA of the *Income Tax Assessment Act 1936* to this arrangement on the basis that the scheme exhibits both a degree of contrivance, including the interposition of the LLC, and a lack of economic substance, as a credit is claimed without bearing an economic cost of it.

Sector: Real Estate/Property **Date:** Dec 2008 **Contact:** Sara Huda - Sydney

New Property transaction rules in Victoria

The Victorian Parliament recently introduced the *Duties Amendment Bill 2008*, which is set to have a significant impact on property transactions in Victoria from 21 November 2008.

The measures in the Bill are intended to close certain perceived loopholes in the Victorian Duties legislation. If passed, this Bill could impact a number of key areas including:

- Effectively re-introducing stamp duty on any lease arrangements for which any consideration (other than rent) is paid, either in respect of the lease itself or any other specified right.
- Imposing duty on leases on the market value of the underlying land. The duty applied is significantly higher than the previous Victorian "lease duty".
- Duty will be payable within 14 days instead of the current 3 months. This will significantly impact the cash flow requirements of entities entering into property transactions in Victoria.
- Potentially imposing a double duty on an agreement for the sale of land as well as on the transfer of land at settlement.
- Owners or vendors of the land may now be subject to stamp duty. This differs from current practice where initially on the grant of a lease, or on entering into a contract for sale of land, duty is imposed on the lessee/purchaser.
- Potentially imposing duty on dealings in a trust which holds Victorian land, even if the trust is not "land rich". Investors in property trusts could potentially have to pay stamp duty on their investments, no matter how small their relative holding is, at land transfer duty rates.

Most importantly, with the amendments applying retrospectively from 21 November 2008, some clients involved in transactions and dealings after 21 November 2008 could already be caught. The Bill will be further debated at the next sitting of Parliament in early February 2009.

China

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

Corporate Income Tax

China's new Corporate Income Tax (CIT) Law, together with its Detailed Implementation Regulations, introduced a set of anti-avoidance measures in Chapter 6 - Special Tax Adjustments. It may well be the most complex chapter of the CIT Law, encompassing not only exploratory new concepts such as cost sharing, controlled foreign corporations, thin capitalisation, general anti-avoidance, but also imposing mandatory contemporaneous transfer pricing documentation requirements, that could altogether cause significant impact to taxpayers.

In January 2009, the State Administration of Taxation (SAT) formally approved the final version of the "Implementation Measures of Special Tax Adjustments (Trial)" (the Measures), which lay out detailed rules on administering all aspects covered by special tax adjustments. The Measures contain 13 Chapters and 118 provisions and shall take retrospective effect from 1 January 2008.

Please refer to our China Tax / Business News Flash 2009 Issue 1 for a more detailed analysis of the special tax adjustment implementation measures. *http://www.pwccn.com/home/eng/chinatax_news_jan2009_1.html*

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

2008 Annual CIT Return Package

SAT published the 2008 Annual CIT Return Package on 30 October 2008 which has to be used for the annual CIT filing for year 2008. Among the package, there are different sets of schedules for the breakdown of income and expenses for financial institutions.

In addition, the SAT has also released the Related-Party Transaction Disclosure Forms (RPT forms), which should be attached to the annual CIT return package to be submitted to the tax authority. Taxpayers are required to disclose comprehensive information in relation to their related party transactions in the RPT forms.

Please refer to our China Tax / Business News Flash 2008 Issue 16 and Issue 18 respectively for more detailed analysis of the Annual CIT Return Package and RPT forms.
http://www.pwccn.com/home/eng/chinatax_news_nov2008_16.html
http://www.pwccn.com/home/eng/chinatax_news_dec2008_18.html

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

Changes to Withholding Tax

In November, the SAT issued a circular to confirm that the dividend paid by Chinese Tax Residence Enterprise (TRE) to their Non-TRE shareholders of H-Share from 2008 and onwards will be subject to Withholding Tax (WHT) at 10%. H-Shares refer to shares of Chinese companies listed on overseas stock exchanges.

This circular also clarifies that if the Non-TRE shareholders are eligible for a reduced treaty WHT rate they may apply to the in-charge tax authority to get refund of the overpaid WHT.

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

Prior to 1 January 2008, WHT was temporarily exempt for interest paid by foreign invested financial institutions in China to overseas institutions. The SAT has recently released a circular to clarify their position under the new CIT Law which was effective from 1 January 2008.

The circular stipulates that, effective from 1 January 2008 retrospectively, WHT should be withheld for interest payment on loans under the following scenarios:

1. interest payment from a domestic financial institution to an overseas foreign bank;
2. interest payment from a domestic foreign invested financial institution to an overseas entity; or
3. interest payment from a domestic institution to overseas branches of a domestic bank.

Sector:	Banking and Capital Markets	**Date:**	Dec 2008	**Contact:**	TAX Knowledge Management Centre - Beijing

Tax compliance – filing and payment

Under the CIT regime, companies with headquarters and branches across regions are subject to provisional CIT filings and payment at the location of the headquarters and branches. This tax filing mechanism also applies to branches of foreign invested banks with cross-regional business operations.

Foreign banks used to operate in China in the form of branches and were only allowed to incorporate foreign investment banks in China from 11 December 2006. For the newly established branches of these foreign invested banks, since the relevant information for the year 2006 which is required to calculate the provisional CIT liability for the first half of 2008 are not available, the SAT has recently issued a circular to clarify that these newly established branches of foreign invested banks are allowed not to file provisional CIT locally for the first half of 2008.

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

Urban Real Estate Tax

In December, the State Council issued an Order to abolish the Provisional Regulations on Urban Real Estate Tax which used to apply to Foreign Investment Enterprises (FIEs), foreign enterprises and foreign individuals.

Meanwhile, the Order also stipulates that FIEs, foreign enterprises and foreign individuals shall be subject to Real Estate Tax according to Provisional Regulations on Real Estate Tax effective from 1 January 2009.

Hong Kong

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

Reclassification of Financial Assets: Amendments to HKAS 39 and HKFRS 7

The recent financial turmoil and deterioration in market conditions has brought about a slash in the value of equity and debt securities investments. Under HKAS 39 “Financial Instruments: Recognition and measurement” Hong Kong companies holding these investments as trading assets have to account for these financial instruments under the classification of “Faire Value through Profit or Loss” (FVTPL) using the “fair value approach”. They also have to report the changes in the values of these investments in their income statements as gains or losses for financial reporting purposes.

Originally, trading financial assets classified as FVTPL were not allowed to be reclassified to other categories according to HKAS 39. As such, any further declines in the value of the trading financial assets in the recent financial turmoil would have further impact on the profitability of companies holding these assets.

In response to the concerns raised by the business community, on 13 October 2008, the International Accounting Standard Board (IASB) issued amendments to IAS 39 “Financial instruments: Recognition and measurement” and IFRS 7 “Financial instruments: Disclosures”, that permit reclassification of certain non-derivative financial assets if conditions specified in the amendments are met. On the following day, the Hong Kong Institute of Certified Accountants announced that it would adopt the IASB amendments for the equivalent Hong Kong Financial Reporting Standards (ie HKAS 39 and HKFRS 7).

Accounting-wise, permitting companies to reclassify certain financial assets will allow companies not to report the further decline in the value of these assets in their income statements.

Since capital gains (losses) are not taxable (deductible) under Hong Kong profits tax, the tax treatment of the gains or losses from change in fair value recognised upon reclassification will depend on the nature (ie revenue vs capital) of the assets immediately before the reclassification. Subsequent to the reclassification, in some situations, the tax treatment will very much depend on whether there is a change of the intention of holding the assets from trading to long-term investment purposes and if yes, the timing of such change. Both the change of the intention and its timing are a matter of fact. Depending on the facts of each case, the time of change of the intention may not be the time of accounting reclassification. Therefore, taxpayers have to maintain sufficient supporting documentation to substantiate a change of the intention, and its timing, should they wish to claim that the intention of holding the assets has changed from trading to long-term investment.

For further details on the Hong Kong profits tax implications of the reclassification please contact the Hong Kong tax team.

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

Ratification of the Hong Kong / Luxembourg Double Tax Agreement

Luxembourg and Hong Kong signed a comprehensive Double Tax Agreement (DTA) on 2 November 2007. On 2 May 2008, Hong Kong sent a notification of the completion of the ratification procedures to Luxembourg and received a notification dated 20 January 2009 from Luxembourg confirming the completion of its approval procedures. The DTA has therefore become effective on 20 January 2009 and shall have retrospective effect in Hong Kong for any year of assessment beginning on or after 1 April 2008.

The DTA provides a favourable framework for Asian companies to invest in Europe in a tax efficient manner via a Hong Kong-Luxembourg holding structure. In particular, additional tax planning opportunities are available for companies in mainland China wishing to invest in Europe as they may also enjoy the treaty benefits offered by the comprehensive DTA between mainland China and Hong Kong.

The most significant benefit under the DTA is the beneficial withholding tax rates for dividends received by a Hong Kong company from Luxembourg companies. Under the current domestic law in Luxembourg, dividends are generally subject to a withholding tax rate of 15% with certain exceptions. The DTA withholding tax rate is 0% if the Hong Kong company directly holds 10% or more of the capital of the Luxembourg company, or participation with an acquisition cost of EUR1.2 million or more. A withholding tax rate of 10% is applicable to all other cases.

Summary of treaty tax rates for Hong Kong company receiving income from Luxembourg:

	DTA Rates	Non-Treaty Rate
Dividends	0% if the Hong Kong company directly holds 10% or more of the capital of the Luxembourg company, or participation with an acquisition cost of EUR1.2 million. 10% in all other cases.	15%
Interest	0%	0%
Royalties	3%	0%

Under the DTA, a capital gain derived by a Hong Kong company from the disposal of shares in a Luxembourg company is tax exempt (regardless of the percentage of shareholding) unless the disposal is of shares in a real property holding company (ie more than 50% of the asset value of the Luxembourg company is derived from immovable property situated in Luxembourg).

The possible tax exemption for dividends and capital gains derived from disposal of shares under the DTA, together with the extensive tax treaty network of Luxembourg, present opportunities by using Hong Kong / Luxembourg companies as intermediate holding companies for investing into European Union.

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

Initiation of a Hong Kong/Kuwait Double Tax Agreement

The governments of Hong Kong and Kuwait initiated a Double Tax Agreement (DTA) on 11 December 2008 after the end of 3rd round of negotiation. The formal singing of the DTA is still pending. At the moment, information about the initiation of the DTA or its provisions is not yet available.

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

Signing of a comprehensive Hong Kong / Vietnam Double Tax Agreement

A comprehensive Double Tax Agreement (DTA) between Hong Kong and Vietnam has been signed on 16 December 2008. The DTA will apply with effect, in Vietnam from 1 January in the calendar year following that in which the DTA enters into force and, in Hong Kong, from 1 April in the calendar year following that in which the DTA enters in force. The DTA will enter into force after it has been ratified by both governments.

Some of the key features of the DTA are as follows:

The DTA provides benefits in withholding tax rates as following:

	Dividend	Interest	Royalty
Vietnam non-treaty rate	0	10%	10%
Hong Kong non-treaty rate	0	0	4.95%/4.5%[2]
Treaty rate	10%[1]	0%/10%[4]	7%/10%[3]

1. Currently, there is no withholding tax on dividends in Vietnam after tax is paid on the profits out of which the dividends are declared. The 10% treaty rate represents the maximum rate applicable to dividends received by a Hong Kong resident should a withholding tax on dividends be levied in Vietnam in the future.
2. The 4.95% rate applies to corporations whereas the 4.5% rate applies to unincorporated businesses/partnerships.
3. The 7% rate applies to royalties for the use, or the right to use, any patent, design or model, plan, secret formula or process. The 10% rate applies in all other cases.
4. The 0% rate applies to interest payments to the HKSAR Government and recognised institutions. The 10% rate applies in all other cases.
5. Where the non-treaty rate is more preferential than the treaty rate, the non-treaty rate would normally apply.

Currently, foreign companies performing business in Vietnam or having contracts with Vietnamese customers without establishing a legal entity in Vietnam are subject to “Foreign Contractor Withholding Tax” (CWT) at various rates depending on the business activities performed (eg 10% on service fees of which 5% represents corporate income tax and 5% represents value added tax). The corporate income tax component of such FCWT will be eliminated under the DTA provided that a Hong Kong company does not carry on business in Vietnam through a permanent establishment in Vietnam.

- The DTA does offer capital gain exemption in relation to gains derived by a Hong Kong resident from the alienation of less than 15% interest in a Vietnamese company that does not derive 50% or more of its asset value directly or indirectly from immovable property situated in Vietnam. Currently, a gain derived by a foreign investor on the transfer of interests in a foreign invested or Vietnamese company is generally subject to Vietnam tax.
- Under article 5 of the DTA, a PE is defined to include provision of services by an enterprise if the services continue (for the same or connected project) for a period or periods aggregating more than 180 days within any 12-month period.
- As far as employment income is concerned, Hong Kong employees will be exempt from Vietnamese personal income tax provided that: (1) they do not spend more than 183 days in Vietnam in any 12-month period commencing or ending in the fiscal year concerned; (2) their remuneration is not paid by, or on behalf of, an employer who is a resident of Vietnam; and (3) the remuneration is not borne by a PE in Vietnam.
- Similar to the other DTAs that Hong Kong has entered into so far, the Exchange of Information (EoI) article included in the DTA is the more restrictive 1995 version of the Organisation for Economic Cooperation and Development (OECD) model convention.
- The DTA also contains “Associated Enterprises” and “Mutual Agreement Procedure” articles similar to those in Hong Kong’s other DTAs, as well as provisions to eliminate double taxation that include relief for tax spared as a result of tax incentives granted under Vietnam’s provisions for encouraging foreign investment for development purposes.

India

Sector: Banking and Capital Markets **Date:** Dec 2008 **Contact:** Sunil Gidwani, Vikram Bohra - Mumbai

Ruling in the case of Standard Chartered Grindlays Bank Limited

In relation to commission received by offshore branches of the assessee bank on international credit cards where the transactions were completed in India by the card holders, the Tax Tribunal held that since the fees were received by the foreign branches for providing credit to card holders outside India, the debts were incurred outside India and therefore, fees earned by the foreign branches are not taxable in India.

On a separate issue on allowability of interest payment to Head Office, the Tax Tribunal has disallowed the same (referring to the Special Bench's decision in the case of ABN Amro Bank), being a payment to self.

Sector: Banking and Capital markets **Date:** Dec 2008 **Contact:** Sunil Gidwani, Vikram Bohra - Mumbai

Ruling in the case of B.S. Vasa

The Tax Tribunal held that that the assessee could claim bad debts only to the extent of the brokerage amount since the business turnover of the assessee is only the brokerage amount and not for the loss arising due to default of either the seller or the buyer when either of the parties defaults.

Sector: Banking and Capital Markets **Date:** Dec 2008 **Contact:** Sunil Gidwani, Vikram Bohra - Mumbai

Ruling in the case of Kotak Securities Limited - Depreciation on membership card of stock exchange, Tax withholding requirements on payment of transaction fees and facility fees to stock exchange

The Tax Tribunal has held that the stock exchange membership card is an intangible asset and it can diminish in value and therefore depreciation can be claimed

The Tax Tribunal further held that amounts paid to the stock exchanges as transaction fees and facility fees are not in the nature of 'fees for technical services' and hence should not be subjected to withholding tax provisions as contended by the Tax Officer.

Sector: Banking and Capital Markets **Date:** Dec 2008 **Contact:** Sunil Gidwani, Vikram Bohra - Mumbai

Ruling in the case of Gujarat Gas Financial Services Limited

The assessee company, engaged in the business of hire purchase, wrote off inter-corporate deposits (ICDs) as bad debts. The Tax Tribunal held that bad debts written off on account of ICDs is not in the ordinary course of its business and hence cannot be allowed as deduction.

Sector: Banking and Capital Markets **Date:** Dec 2008 **Contact:** Sunil Gidwani, Vikram Bohra - Mumbai

Instructions issued by Central Board of Direct Taxes ('CBDT') - Assessment of banks

Based on a review a of assessments of banks by the Comptroller and Auditor General, the CBDT has issued instructions to the Tax Officer prescribing guidelines to follow while conducting scrutiny assessment of banks. The guidelines are with respect to following key issues:

- For computing the deduction with respect to Non Performing Assets (NPA) write off, the opening balance of the provision made needs to be considered.

- The claims by Indian branches of foreign banks for Head Office expenses should be allowed in accordance with the arms length principle and the relevant tax treaty.
- Broken Period Interest (BPI) should be capitalised if the securities are purchased and held on capital account and as a corollary one can argue that BPI paid for securities purchased and held on revenue account should be allowed as a deduction (being in the nature of revenue expenditure).
- Reserve Bank of India ('RBI') guidelines should be considered along with the accounting treatment for claims for allowability of deduction for depreciation on investments.

Sector:	Banking and Capital Markets	**Date:**	Dec 2008	**Contact:**	Sunil Gidwani Vikram Bohra - Mumbai

RBI Circular on fund raising options for Systemically Important Non-Deposit taking Non Banking Financial Companies ('NBFCs')

In order to allow NBFCs as well as to garner funds for increasing business and meeting regulatory requirements, RBI has recently allowed all Systemically Importance Non Deposit taking NBFCs to augment their capital funds by issue of perpetual debt instruments (PDIs) in the form of bonds and debentures, in accordance with the prescribed guidelines.

There is no clarity from a tax perspective, in terms of, taxability of income on such PDIs in the hands of the investor and deductibility of expense in the hands of the issuer as well as characterisation of such income / expense (whether interest or dividend).

Sector:	Investment Management Real Estate	**Date:**	Dec 2008	**Contact:**	Tushar Sachade Nehal D Sampat - Mumbai

Ruling in the case of Vodafone International Holdings

In this landmark decision, the Mumbai High Court has made significant observations on the taxability of transfer of shares in offshore companies which result in a change in controlling interest of Indian companies and withholding obligations on non-resident transferee entities in such transactions.

While disposing the writ, the Mumbai High Court, in a much awaited judgement, held that the transaction of transfer of shares was prima facie taxable in India since it amounts to a transfer of a capital asset (controlling interest) in India and was not merely a transfer simplicitor of a stake in an offshore corporate entity. The dominant purpose of the transaction was to acquire a controlling interest held by the Hutchison Group in the Indian joint venture company.

The said decision is likely to have a significant impact on MNCs contemplating entry into India or Private Equity Funds as well as existing MNCs operating through subsidiaries in India. It is pertinent to note here that this decision is not the final law on the subject, as Vodafone proposes to challenge it in the Supreme Court.

Sector:	Investment Management Real Estate	**Date:**	Dec 2008	**Contact:**	Tushar Sachade Nehal D Sampat - Mumbai

Ruling in the case of Clifford Chance

The assessee was an international firm of solicitors resident in the United Kingdom. It did not have any office or fixed base in India. The assessee was appointed as English Law Legal Advisors for certain projects in India. The assessee offered to tax in India, the income that was attributable to its operations in India and contended that the income that is attributable to work performed outside India should not be taxable in India. The tax authorities were of the opinion that the entire fee received by the assessee in relation to the Indian projects should be taxable in India. On appeal, the Bombay High Court held that for a non-resident to be taxed on income for services in India, the services should be rendered in India as well as utilised in India. Both of these conditions have to be satisfied simultaneously. Accordingly, the Court ruled that only the income which is charged on hourly basis for services rendered in India and utilised in India shall be assessable in India.

This ruling is relevant in the context of taxability of non-residents rendering services from outside India, which are utilised in India.

Sector: Investment Management, Real Estate **Date:** Dec 2008 **Contact:** Tushar Sachade, Nehal D Sampat - Mumbai

Ruling in the case of Jyotindrasinhji

The assessee was a beneficiary in the offshore trust settled by his father. The assessee did not offer income from the offshore trust as the trusts were discretionary and no remittances were received. The tax authorities contended that income of the offshore trusts should be taxable in India as the trusts were specific trusts and not discretionary trusts.

On appeal, the Gujarat High Court observed that the trusts have exercised their discretion in retaining net income. So long as the trustees decide not to exercise the discretion to distribute the income, no income arose to any of the beneficiaries. Until the trustees take a decision to distribute the income, the beneficiaries have no right to income nor can it be said that income accrues to them. Further, tax has been levied upon the respective trust incomes under the laws of US and UK. Levying tax over again in India on the very same income would amount to double taxation. Accordingly, the Court ruled that no tax is leviable on the income of the offshore trusts in India.

Sector: Investment Management, Real Estate **Date:** Dec 2008 **Contact:** Tushar Sachade, Nehal D Sampat - Mumbai

Advance Ruling in the case of LMN India Limited

The Authority for Advance Rulings ('AAR') in this case held that payment in the form of interest on convertible bonds up to the date of conversion of bonds into equity would be characterised as interest and thus subject to withholding tax. The ruling affirms that interest paid on a convertible instrument does not lose its character as 'interest'.

Sector: Investment Management, Real Estate **Date:** Dec 2008 **Contact:** Tushar Sachade, Nehal D Sampat - Mumbai

Limited Liability Partnership

The Government introduced the Limited Liability Partnership (LLP) Bill, 2008 which has been passed by both the Houses of Parliament of India and has received the President's assent on 7 January 2009.

The Act provides for formation and regulation of LLP, a new form of entity in the Indian context. The LLP will be a separate legal entity different from its partners. Except for the designated partners, partners of the LLP have a limited liability with respect to their stake in it. Designated partners are liable to all penalties imposed on the LLP for contravention of the provisions of LLP. The LLP is a kind of a hybrid entity combining the advantages of a partnership firm and a limited company. Such distinct advantages may drive the entrepreneurs to structure their ventures as an LLP against other structures. The Government is expected to clarify the tax treatment of an LLP later during the year.

Indonesia

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

Sunset Policy - another update

The Government of Indonesia has extended the deadline for taxpayers to utilise the sunset policy from 31 December 2008 to 28 February 2009. By extending the deadline, the Government of Indonesia expects that more taxpayers will register for tax purposes and more revenue generated for the country.

In response to many questions around the type of income taxes which is under the scope of the sunset policy, the Indonesian tax authority has confirmed in writing that the sunset policy is applicable only for the corporate income tax category. Included in the corporate income tax category are final tax (eg, applicable for building rental companies) and deemed profit tax (eg, applicable for shipping and airline companies).

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

Income tax cut for public companies

The Minister of Finance has issued an implementing regulation on an income tax cut for public companies listed on the Indonesia Stock Exchange (IDX). The public companies entitled to the income tax cut of 5% must qualify for the following conditions:

- The total shares held by the public are a minimum of 40% of the total paid in capital.
- The total shares are held by at least 300 parties where each party has stock less than 5% of total paid in capital.
- The above conditions must prevail for at least 6 months or 183 calendar days within 1 fiscal year.

However, the implementing regulation does not yet address whether the income tax cut also applies for listed companies in other specific situations. For example: a company having dual listing shares (eg, 39% of shares listed on the IDX and another 25% listed on an overseas exchange) and satisfies other conditions.

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

Withholding tax article 26; income from the sale or diversion of shares.

The Minister of Finance has issued an implementing regulation on the application of Article 18(3c) of Income Tax Law. Article 18(3c) of Income Tax Law discusses the tax implications of the transfer of shares of a special purpose company in a tax haven country having a special relationship with a company in Indonesia. In this situation, the Indonesia tax authority can deem the share transaction as the transfer of shares of the Indonesian company.

The implementing regulation provides that the transfer of shares is subject to 5% income tax on the share selling price, subject to a tax treaty rate. If the buyer of the shares is an Indonesian tax resident, the latter is obliged to collect the tax. However, if the buyer is a non-Indonesian resident, the obligation to collect the 5% income tax rests with the Indonesian company whose shares are transferred.

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

Treatment of Income Tax after deducted by Permanent Establishment Tax

In relation to the application of branch profit tax for permanent establishments (PEs), the Minister of Finance has issued guidance for PEs to be exempt from branch profit tax. PEs whose net income after corporate income tax are reinvested in Indonesia and satisfy the following conditions are exempt from branch profit tax:

- The reinvestment of net income after corporate income tax is made fully in the form of shares in a newly established company in Indonesia.
- The newly established company must have business activities actively based on its establishment deed no later than 1 year after the company is established.
- The reinvestment is made in the current year or no later than the following year after the income is received.
- The reinvestment is not transferred within 2 years after the investee company has operated commercially.

Unfortunately, the guidance is silent on the definition of 'operating commercially'. It is expected that the Indonesian tax authority will issue an implementing regulation to address this matter.

Japan

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

Proposed 2009 Japanese Tax Reforms – Changes to investment into certain partnerships and the 25/5 Rule

On 12 December 2008, the Liberal Democratic Party released its proposed 2009 Tax Reform package (2009 Tax Reform Proposal). Following the release of this proposal, it is anticipated that the Ministry of Finance will further summarise the proposal for the Cabinet's approval, with such summary subsequently being modified into draft legislation for the Diet's approval to amend existing Japanese tax laws.

As one part of the 2009 Tax Reform Proposal, certain amendments have been proposed that may significantly affect taxation of foreign private equity and other investment funds investing in Japan. These reforms in general follow similar reform efforts proposed by the Financial Service Agency and the Ministry of Economy, Trade and Industry as a joint effort to bring Japan's taxation of foreign investment into domestic venture companies in line with international standards, revitalise domestic industries, and facilitate further foreign direct investment in Japan to stimulate the economy.

It should be noted that the proposal is not law and may change upon further review and discussion.

1. Taxation in relation to foreign investment in certain Japanese partnerships (Determination of Direct PE)

Under existing Japanese tax rules, foreign investors investing in Japanese investment business limited partnerships (*toushi jigyou yugen sekinin kumiai*, or "IBLP) may have a risk of a permanent establishment in Japan. Under the proposed changes, a foreign individual or corporate partner (Foreign Partner) may invest in IBLPs without risk of a direct permanent establishment (PE) in Japan on account of such investment provided certain requirements are met. These conditions include:

  a. The Foreign Partner has limited liability with respect to the IBLP.
  b. The Foreign Partner is not involved in the management or operation of the IBLP.
  c. The Foreign Partner's investment ratio in the IBLP is less than 25%.
  d. The Foreign Partner is not specially related to the general partner of the IBLP.
  e. The Foreign Partner does not otherwise have a permanent establishment in Japan.

The above proposal will apply to determinations on or after 1 April 2009 in connection with whether a Foreign Partner will have a Direct PE in Japan in relation to an investment in such IBLP.

2. Application of the 25/5 Rule to certain foreign partners

Under existing rules, gain from the sale of shares of a Japanese corporation is subject to tax, even where the Foreign Partner does not have a PE in Japan, if the Foreign Partner (together with specially related persons) sells 5% or more of the shares of such corporation during a fiscal year and such Foreign Partner (together with specially related persons) owns or has owned 25% or more of the shares in such company for a specified holding period. (25/5 Rule).

The 2009 Tax Reform Proposal liberalises the 25/5 Rule for certain transactions where the sale is by a IBLP or other foreign partnership fund similar to an IBLP, assuming certain criteria are met. This reform proposes to cover transactions where (1) a 1-year holding period criteria is met; and (2) the transaction does not involve a shareholding in certain distressed financial institutions.

If a transaction is a covered transaction, the 25% ownership threshold may be tested at the Foreign Partner level where the following conditions are met:

a. The Foreign Partner meets the criteria provided in (1) above; or

b. The Foreign Partner is in a partnership similar to an IBLP where (A) the Foreign Partner does not have a PE in Japan; (B) the Foreign Partner is a limited partner in the partnership; (C) the Foreign Partner does not own 25% or more of the shares of the corporation sold; and (D) the Foreign Partner is not involved in the management or operation of the partnership.

The above amendment is proposed to apply to the sale of shares on or after April 1, 2009.

It should be noted that the 2009 Tax Reform Proposal is silent with regard to the interplay of the above proposal and the existing rules on taxation of real estate holding companies.

Korea

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

Withholding tax rate

Under the amendment to the Corporate Income Tax Act, the withholding tax rate on the Korean sourced interest, dividend income and capital gain paid to a non resident is reduced from 27.5% to 22%, effective 1 January 2009.

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

Reduction in corporate income tax rate

Under the amendment to the Corporate Income Tax Act, corporate income tax rates will be reduced as follows:

Taxable Income	Tax year commencing on or after 1 January 2008	Tax year commencing on or after 1 January 2009	Tax year commencing on or after 1 January 2010
Up to KRW 200,000	11%	11%	10%
Over KRW 200,000	25%	22%	20%

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

Net operating loss

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

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

Stock option expense

Under the proposed amendment to the Presidential Decree of the Corporate Income Tax Act, stock option expense reimbursed by a Korean subsidiary for the option granted by the foreign listed parent company to the employees of the Korean subsidiary is deductible to the Korean subsidiary.

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

Education tax on financial service companies

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

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

Relief in transfer pricing penalty

Under the amendment to the Law for Coordination of International Tax Affairs, under reporting penalty may be waived provided there is contemporaneous transfer pricing documentation and the basis for the selection of the transfer pricing method used is reasonable.

Malaysia

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

Income Tax (Exemption) (No. 9) Order 2008

The income of a Malaysian resident licensed under the Capital Markets and Services Act 2007 (CMSA) derived from the regulated activity of dealing in securities under the CMSA relating to the business of dealing in Sukuk is exempted from income tax.

This Order shall apply to non-Ringgit Sukuk that originate from Malaysia and are issued or guaranteed by the Government of Malaysia or approved by the Securities Commission under the CMSA. Separate accounts for income derived from the above business activities are to be maintained and shall treated as a separate and distinct source of business and activity of that person.

This Order shall have effect from the Year of Assessment (YA) 2009 until YA2011.

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

Income Tax (Exemption) (No. 10) Order 2008

The income of a Malaysian resident licensed under the CMSA derived from the regulated activity of dealing in securities and advising on corporate finance under the CMSA relating to the arranging, underwriting and distributing of Sukuk is exempted from income tax

This Order shall apply to non-Ringgit Sukuk that originates from Malaysia and issued or guaranteed by the Government of Malaysia or approved by the Securities Commission under the CMSA. Separate accounts for income derived from the above business activities are to be maintained and shall treated as a separate and distinct source of business and activity of that person.

This Order shall have effect from YA2009 until YA2011.

Sector:	Banking Investment Management	**Date:**	Dec 2008	**Contact:**	Khoo Chuan Keat Frances Po Jennifer Chang Lim Phaik Hoon Lorraine Yeoh Azura Othman - Kuala Lumpur

Income Tax (Exemption) (No. 11) Order 2008

Income tax exemption is given to on advisory fees in relation to the structuring and listing of a foreign corporation or listing of a foreign investment product on a stock exchange under the CMSA.

This Order shall have effect from YA2009 until YA2013.

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

Finance Act 2009

The Finance Act 2009 gazetted on 8 January 2009 has taken into account the proposals in the 2009 Budget as follows:

- Withholding tax on income received by foreign institutional investors and non-corporate investors from Real Estate Investment Trusts (REIT) listed on Bursa Malaysia is reduced to 10%.
- Non-residents will be subject to a 10% withholding tax rate on gross income derived from Malaysia for payments falling under Section 4(f) of the Income Tax Act (ITA).

New Zealand

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

Relocation expenditure

The IRD has released a draft determination setting out a list of relocation expenses likely to be eligible for treatment as non-taxable income in the hands of employees for the 2002/2003 and subsequent years. The Tax Bill introduced in July and expected to be enacted next year will change the law to ensure that relocation payments that meet certain criteria are tax-free in employees' hands. The draft determination will not be finalised until the Bill is enacted.

The list is relatively comprehensive and expands the list of eligible relocation expenditure included in the consultation document released in November 2007.

Submissions on the draft determination are due by 31 March 2009

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

Tax Bill enacted

The Taxation (Urgent Measures and Annual Rates) Bill received the royal assent on 15 December 2008 introducing a number of tax reforms, including:

- a three-year program of personal tax rate cuts and threshold changes;
- there will be no immediate changes to the tax rate structures that apply to portfolio investment entities to reflect the new personal rates structure. Changes will not occur until consultation with the managed funds industry has taken place
- changes to resident withholding tax rates will not be fully implemented until there has been consultation with banks and other financial institutions. Changes to the resident withholding tax rate structure are likely to apply from 1 April 2010. However, banks and other financial institutions will be able to apply a new optional 38% RWT rate from 1 April 2009
- the repeal of the research and development (R&D) tax credit, however businesses will still be able to lodge R&D tax credit claims for the 2008/2009 income year
- changes to KiwiSaver from 1 April 2009 for example the minimum employee contribution rate will reduce from 4% to 2% of gross salary or wages, the $40 annual fee subsidy will cease, the employer tax credit will be removed, and the exemption from employer superannuation contribution tax (ESCT) will be limited to the 2% compulsory employer contribution.

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

Tax avoidance

The Supreme Court of New Zealand has delivered its first two decisions on tax avoidance since the abolition of the right of appeal to the Privy Council. In both cases the Supreme Court upheld the Court of Appeal's decisions in favour of the Commissioner – ruling that the arrangements in question constituted tax avoidance.

In Accent Management Limited and Others v Commissioner of Inland Revenue the Supreme Court essentially confirmed that compliance with a specific provision in the Act (eg compliance with the 'black letter law' authorising a deduction for a certain type of expenditure) is insufficient to preclude the application of the Act's general anti-avoidance provision. The judgement provides that taxpayers are also required by the general anti-avoidance

provision to show that the specific provisions they relied on had been used in a manner which was within Parliament's purpose and contemplation when Parliament enacted the legislation.

In Glenharrow Holdings Ltd v Commissioner of Inland Revenue the Supreme Court confirmed that the Commissioner was correct in invoking the general anti-avoidance provision in the GST Act 1985, and treating the arrangement in question as a tax avoidance arrangement. The Court focused on what it perceived to be the lack of commerciality of the arrangement.

Sector:	Banking and Capital Markets	**Date:**	Dec 2008	**Contact:**	Ian Fay Paul Mersi - Wellington

Tax law change for finance company workouts

The New Zealand Government has announced that they intend to introduce legislation preventing unanticipated tax liabilities arising for troubled finance companies and certain other debtors who enter into workout agreements with their creditors.

Changes to the tax legislation in 2007 in relation to returning income and expenditure from financial arrangements caused an unanticipated technical consequence. Companies entering into workout arrangements with creditors can become liable to pay an immediate one-off tax liability.

The new legislation will allow affected debtors to use yield-to-maturity calculations based on actual and expected cash flows on those liabilities amended by the workout.

The Government intends to incorporate the changes into tax legislation as soon as possible with the changes being effective from the 2008/2009 income year.

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

Philippines / New Zealand DTA

The DTA between New Zealand and the Philippines has been updated with effect from 1 December 2008. The key changes to the 25 year old treaty include:

- The withholding tax rates on dividends and royalties have been lowered from a split rate of 15% and 25% to a flat rate of 15%.
- The withholding tax rate on interest has been reduced from 15% to 10%.
- The provision allowing 'tax sparing' has been removed.

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

United States / NZ Double Tax Agreement (DTA)

A Protocol to update the DTA between the United States and New Zealand was signed on 1 December 2008. The key changes to the protocol include:

- For dividend income a withholding tax rate of 15% will remain where the shareholding is less than 10%, a withholding tax rate of 5% will apply where the shareholding is 10% or more and a withholding tax rate of 0% will apply where the shareholding is 80% or more and meets other criteria.
- The withholding tax rate payable on interest income to eligible institutions is reduced to 0%. For all other interest payments the rate will remain at 10%.
- The withholding tax rate payable on royalties is reduced from 10% to 5%,
- the Limitation on Benefits Article is amended to limit the application of the double tax agreement. The amended article is similar to the Limitation on Benefits Articles included in the United States' DTA with Australia and the United Kingdom.

The Protocol will not become effective until it is ratified in accordance with the applicable procedures in both the United States and New Zealand.

Pakistan and Afghanistan

Sector: Banking and Capital Markets
Investment Management | **Date:** February 2009 | **Contact:** Soli R. Parakh - Karachi

Revised Pakistan/Switzerland tax treaty

The revised Pakistan / Switzerland tax treaty will come into force from July 2009.

Sector: Banking and Capital Markets
Investment Management | **Date:** Dec 2008 | **Contact:** Soli R. Parakh - Karachi

New tax treaty for Pakistan/Ukraine

A new tax treaty has been signed between Pakistan and Ukraine, although it has yet to be notified.

Sector: Banking and Capital Markets
Investment Management | **Date:** Dec 2008 | **Contact:** Soli R. Parakh - Karachi

New rules on buy-back of listed shares

Companies have been allowed to buy-back their listed shares and hold as treasury shares.

Sector: Banking and Capital Markets
Investment Management | **Date:** Dec 2008 | **Contact:** Soli R. Parakh - Karachi

New Government injection of capital

The Government with a view to boosting the stock exchange, has by way of an injection through NIT's State Enterprise Fund of a capital of Rs 20 Billion, devised a scheme for buying 8 eligible scrips in the Karachi stock exchange.

Sector: Banking and Capital Markets | **Date:** Dec 2008 | **Contact:** Soli R. Parakh
Syed Shabbar Zaidi - Karachi

New exposure drafts

The Islamic Financial Services Board has approved two exposure drafts, namely 'Capital Adequacy requirements for Sukuk Securitisations and Real Estate Investments' and 'Guiding Principles on governance of Islamic Collective Investment Schemes'.

Sector: Banking and Capital Markets
Investment Management | **Date:** Dec 2008 | **Contact:** Rashid Ibrahim - Islamabad

Update on amendment of Tax Law 2005

The existing Income Tax Law 2005 is in the process of being revised, and the new Income Tax Law is likely to be promulgated in mid 2009.

Philippines

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

Rules on the registration of manual books of accounts

The Bureau of Internal Revenue (BIR) issued new and uniform rules and procedure with respect to the registration of the manual books of accounts to help the taxpayer to conveniently comply with the requirements.

The following are the rules with respect to the registration of manual books of accounts:

1. Unused portion of the previously registered book of account can still be reused in the succeeding year without the need of re-registering or re-stamping.
2. The registration of new set of manual books of accounts shall only be registered at the time when the pages of previously registered books have all been already exhausted.
3. The registration deadline of “January 30 of the following year” mentioned in RMO 29-2002 applies only to computerised books of accounts while the “15 days after the end of the calendar year” under RMC 13-82 refers to loose-leaf bound books of accounts.
4. Newly registered taxpayers shall present the manual books of accounts before use to the Revenue District Offices (RDOs) where the place of business is located or concerned office under the Large Taxpayer Service (LTS) for approval and registration.
5. Subsidiary manual books of accounts to be used by taxpayers should be registered before use, following the same rule as that of manual books of accounts.
6. Taxpayer Service Section (TSS) of the RDO or concerned office under Large Taxpayer Service has no authority to examine the completeness of the previously registered book prior to approval of registration.

(Revenue Memorandum Circular 82-08 dated 13 November 2008)

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

Director’s fees are no longer subject to business tax

This Circular repealed, in part, RMC No. 34-2008 which previously imposed business tax (12% Value Added Tax (VAT) or 3% percentage tax) on director’s fees, including per diems, honoraria and allowances, received by directors who are not employees of the company.

In resolving the issue of whether or not directors of corporations of which they are not employees are considered as persons liable to VAT, the BIR determined first whether the functions discharged by these individuals as directors fall within the purview of those transactions pursued “in the course of trade or business” upon which the VAT or percentage tax is imposed.

Based on the VAT provisions, VAT is generally imposed to persons whose undertakings are intended to be pursued on a going-concern basis where the end view is to realise unrestricted amounts of pecuniary gains/profits from those who may avail of the goods they sell or the services they render.

A director who is not an employee of the corporation does not fall under the category. First, the director does not freely offer his services to just any corporation. To be a director, the laws require him to own one share of capital stock of the corporation. Second, the term of the director is limited only for one year, which is contrary to the nature of a "going-concern" basis. Third, the remuneration of a director is subject to the ceiling provided by the Corporation Code, compared to the remuneration/gains or profits that a seller of goods/services may realise in his commercial transactions. Lastly, the director is generally restricted from having business dealings directly with the corporation of which he is a director.

Based on the above, it is apparent that the fees, per diems, honoraria or allowances being given to a director of a corporation as such cannot be considered as derived from an economic or commercial activity that have been pursued "in the course of trade or business". Rather said fees are remunerations paid in the exercise of a right of an owner in the management of a corporation.

(Revenue Memorandum Circular No. 77-2008 dated 24 November 2008)

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

Guidelines and procedures in the issuance of Taxpayer Identification Number (TIN) to Securities and Exchange Commission (SEC) registrants

This Circular clarified the following guidelines and procedures in the issuance of TIN to SEC registrants pursuant to the Memorandum of Agreement between the BIR and the SEC on the implementation of the electronic exchange of information among government agencies:

Salient guidelines are as follows:

- All newly formed corporations, partnerships, associations and other organisations shall be issued pre-generated TINs by SEC Head Office.
- Where a business address or trade name is different from those indicated in the SEC Registration Certificate, the taxpayer shall be required to immediately update its registered address or trade name for proper updating in the Registration System.
- Where the RDO issues another TIN to a corporation with pre-generated TIN issued by the SEC, the pre-generated TIN issued by the SEC shall be retained if both TINs have no transactions yet. If both TINs have transactions, the TIN with more transactions shall be retained.
- The RDO, particularly the TSS personnel, shall be sanctioned/penalised for the issuance of multiple TINs to taxpayers.

(Revenue Memorandum Circular 72-2008 dated 3 November 2008)

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

Increasing the coverage of withholding tax agents from the top 10,000 private corporations to top 20,000

These regulations were issued amending Section 2.57.2(M) of RR No. 2-98 (Consolidated Withholding Tax Regulations) by increasing the coverage of the top 10,000 private corporations to top 20,000 private corporations. Effectively, the amendment would result in a substantial increase in the number of withholding agents required to withhold the 1% (for regular sale of goods) and 2% (for regular sale of services) creditable withholding tax. Corporations which are presently required to withhold pursuant to RR Nos. 12-94 and 17-03, as amended, shall continue to do so unless (a) the Commissioner of Internal revenue shall communicate to them in writing that they have ceased to qualify as taxpayers includible in the list of top 20,000 private corporations; (b) upon closure of the business; or (c) undergone business combinations wherein by operation of law the taxpayer ceased to exist.

(Revenue Regulation No. 14-2008 dated 26 November 2008)

Sector: Banking and Capital Markets
Insurance
Investment Management
Real Estate

Date: Dec 2008

Contact: Malou Lim - Manila

Implementing the optional standard deduction (OSD) of individuals and corporations in computing their taxable income

The following are the salient features of the RR:

Persons covered

The following may be allowed to claim OSD in lieu of itemised deductions:

- Individuals:
  1. Resident citizens;
  2. Non-resident citizens;
  3. Resident aliens; and
  4. Taxable estates and trusts.
- Corporations:
  1. Domestic corporations; and
  2. Resident foreign corporations

Determination of the amount of OSD for Corporations

The OSD amount allowed to corporations shall be maximum of 40% of their gross income. The OSD shall be based on gross income; "cost of goods sold" and "cost of services" will be allowed to be deducted from gross sales.

In case of sellers of services, the term "gross income" means the "gross receipts" less sales returns, allowances, discounts and cost of services. "Cost of services" means all direct costs and expenses necessarily incurred to provide the services required by the customers and clients including (a) salaries of personnel directly rendering the services, and (b) cost of facilities directly utilised in providing services (eg, depreciation or rental). Interest shall only be allowed as cost of service for banks and other financial institution.

A taxpayer who elected to avail of OSD shall signify in its/his return such intention, otherwise he/it shall be considered as having availed himself of the itemised deductions under Section 34 of the Tax Code.

Transitory provisions

- For taxable period 2008, the maximum 40% deduction shall only cover the period beginning 6 July 2008. However 1 July 2008 shall be considered as the start of the period when the 40% OSD may be allowed.
- In the case of an individual taxpayer, he is given the option to use either the itemised method of deduction or the 40% OSD in the filing of his quarterly income tax return covering the third quarter ending 30 September 2008. However, if in the filing of his annual income tax return he chooses OSD to be his method of deduction, the rate of OSD to be applied for the period covering January 2008 to 30 June 2008 shall only be 10% of gross income, while the rate for the OSD for the period covering 1 July 2008 to 31 December 2008 shall be 40% of gross sales/gross receipts.

(Revenue Regulation No. 16-2008 dated 26 November 2008)

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

Revisions to RP-Japan Tax Treaty

The Protocol enhanced the preferential income tax treatments under the 1980 RP-Japan Tax Treaty. Its salient features include the following:

- Amendment of the period within which to count the 6 months threshold in determining the existence of a permanent establishment in a Contracting State in the case of services rendered in said Contracting State, eg, consultancy, supervisory services, from "a period or periods aggregating more than six months *within any taxable year*" to "a period or periods aggregating more than six months within any twelve-month period".
- Reduction of the general withholding tax rate on dividends from 25% to 15% per Article 10(2)(b) Modified RP-Japan Tax Treaty.
- Decrease in the shareholding requirement from 25% to 10% in order to qualify for the 10% preferential dividend tax rate per Article 10(2)(a) Modified RP-Japan Tax Treaty.
- Reduction of the general withholding tax rate on royalties (except those paid for the use or the right to use cinematographic films and films or tapes for radio or television broadcasting which remains to be taxed at a maximum rate of 15%) from 25% to 10% per Article 12(2)(b) Modified RP-Japan Tax Treaty.
- Imposition of a fixed 10% withholding tax rate on interest arising in a Contracting State and paid to a resident of the other Contracting State without qualification as to the nature of the transaction from which the interest is paid or the status of the payor per Article 11(2) Modified RP-Japan Tax Treaty.
- Tax exempt interest includes interest on debt claims guaranteed, insured or indirectly financed by the Governments of Japan and the Philippines, including their respective political subdivisions and local authorities; Central Bank or wholly owned financial institutions. Moreover, for this purpose, the term "financial institution wholly owned by the Government" was amended to refer to, in the case of Japan, the Japan Bank for International Cooperation and the Nippon Export and Investment Insurance replacing the Export-Import Bank of Japan, the Overseas Economic Cooperation Fund and the Japan International Cooperation Agency; and in the case of the Philippines, to include the Land Bank of the Philippines in addition to the Development Bank of the Philippines (refer Article 11(3) Modified RP-Japan Tax Treaty).

The Protocol will enter into force on December 5, 2008 or 30 days after the date of exchange of diplomatic notes indicating its approval last November 5, 2008. The new treaty rates on the other hand, shall be effective on 1 January 2009.

(Modified RP-Japan Tax Treaty)

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

Credit Information System Act (CISA)

CISA was enacted to establish a comprehensive and centralised credit information system for the collection and dissemination of fair and accurate information relevant to, or arising from, credit and credit-related activities of all entities participating in the financial system.

Under the CISA, banks, quasi-banks, their subsidiaries and affiliates, life insurance companies, credit card companies and other entities that provide credit facilities (submitting entities), are required to submit basic credit data and updates thereon on a regular basis to the Credit Information Corporation (Corporations).

Confidentiality of Information

The Corporation, the submitting entities, the accessing entities, the outsource entities, the special accessing entities and the duly authorised non-accessing entities shall hold the credit information under strict confidentiality and shall use the same only for the declared purpose of establishing the creditworthiness of the borrower.

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

Sale, Discounting, Assignment or Negotiation by Banks and Quasi-Banks of their Credit Rights in Special Deposit Account (SDA) Placements and Reverse Repurchase Agreements (RR/P) with the Bangko Sentral ng Pilipinas (BSP)

The credit rights in SDA placements and RR/P Agreements with the BSP of banks and quasi-banks, shall not be the subject of sale, discounting, assignment or negotiation on a "with or without recourse" basis.

Sale agreements executed by banks and quasi-banks with clients before the effectivity of the issuance shall be allowed to remain in force and subsisting until the pre-termination or maturity of the underlying SDA placement or RR/P, whichever comes earlier.

(BSP Circular No. 636 dated 17 December 2008)

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

Treatment of Net Unrealised Losses in the FCDU/EFCDU Book for Purposes of Determining Compliance with the FCDU/EFCDU Asset Cover Requirement

The MB approved the following treatment of net unrealised losses arising from mark-to-market of financial assets/liabilities and revaluation of third currencies to US dollar in the FCDU/EFCDU book for purposes of determining compliance with the FCDU/EFCDU asset cover requirement:

Whenever the total of the following FCDU/EFCDU book accounts:

1. Retained Earnings – Free – FCDU/EFCDU, representing cumulative unrealised gains/(losses) from operations from prior years;
2. Items comprising the 'Net Unrealised Gains/(Losses) from Operations' credited/debited to 'Undivided Profits/(Losses)', as well as those not yet credited/debited to 'Undivided Profits/(Losses)';
3. Net Unrealised Gains/(Losses) on AFS Financial Assets' recognised directly in equity; and
4. Gains/(Losses) on Fair Value Adjustments of Hedging Instruments' recognised directly in equity.

results to a net "debit balance", banks may for the period beginning the effectivity of the Circular until 31 March 2009, add back the "net debit amount" to total assets in the FCDU/EFCDU book for purposes of determining compliance with the 100% asset cover requirement instead of transferring eligible foreign currency assets from the RBU book to FCDU/EFCDU book.

(Bangko Sentral ng Pilipinas Circular No. 629)

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

US Dollar Denominated Repurchase (R/P) Agreements with the BSP

- US dollar denominated R/P facility may likewise be effected with the BSP, subject to the following terms and conditions, and as may be provided under the R/P facility:
  a. The US dollar denominated R/P facility shall only be available to banks with legitimate foreign currency denominated funding needs as may be provided under the R/P facility: Provided, that the borrowing shall be for the account of the applicant bank and shall not be used to fund liquidity requirements of foreign branches, affiliates, or subsidiaries.
  b. Only US dollar denominated obligations of the National Government of the Republic of the Philippines (ROP) shall be eligible as collateral.
  c. The availing banks shall comply with all the pertinent requirements of the BSP.
- FCDUs/EFCDUs are authorised to engage in US dollar denominated R/P agreements with the BSP.
- Depository banks under the foreign currency deposit and expanded foreign currency deposit systems shall maintain at all times a 100% cover for their foreign currency liabilities, except US dollar denominated repurchase agreements with the BSP. Provided: That, violation of the terms and conditions of the US dollar denominated R/P facility shall subject the borrowings of the bank to the FCDU/EFCDU asset and liquid asset cover requirements.

(Bangko Sentral ng Pilipinas Circular No. 627, as amended by Bangko Sentral ng Pilipinas Circular No. 631)

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

Guidelines on the Availment of US Dollar Denominated Repurchase Agreement Facility with the BSP

RBUs or FCDU/EFCDUs of banks with FCDU/EFCDU authority who can demonstrate legitimate funding needs can avail of the US Dollar denominated repurchase agreement facility.

The qualifying purposes are as follows:

1. Proceeds from the borrowings shall be used for legitimate liquidity requirements of FCDU/EFCDU or RBU for local operations as follows:
   a. Compliance with FCDU/EFCDU cover requirements;
   b. Servicing of withdrawals of FCDU/EFCDU; and
   c. Servicing trade-related requirements.
2. The borrowing shall be for the account of the applicant bank and shall not be used to fund liquidity requirements of foreign head office, foreign branches, affiliates, or subsidiaries.

(Bangko Sentral ng Pilipinas Memorandum M-2008-034 dated 12 November 2008)

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

Outsourcing of other banking functions without approval from the Monetary Board (MB)

Bank are allowed to outsource Automated Teller Machine (ATM) incident management service without approval from the MB; Provided, that the messages transmitted by the ATM machines to the service provider's monitoring system are purely ATM statuses. Client or transaction information should not be sent.

(Bangko Sentral ng Pilipinas Circular No. 623 dated 9 October 2008)

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

Guidelines on the Registration of All Outstanding Shares Prior to Listing in the Philippine Stock Exchange

The following are guidelines on the registration of shares that will be offered to the public by way of primary or secondary offering, or both, and all unregistered outstanding shares of listed companies that plan to list at the Philippine Stock Exchange (PSE).

The registration of all outstanding shares with SEC is required in the following circumstances:

- Companies that will make an Initial Public Offering (IPO);
- Companies applying for Listing By Way of Introduction;
- Public companies that will make an IPO or Listing By Way of Introduction.

Under the following circumstances, disclosure on the total number of shares that will be issued and offered to the public and NOT registration of all outstanding shares is required:

- Shares already registered with SEC but were not listed by their company at the PSE and are applying for listing PSE for the first time;
- Registered shares of companies, or shares of companies covered by Sections 10.1 and 10.2 (Exempt Transactions) of the Securities Regulation Code(SRC) that are applying for PSE listing; and
- Shares already listed at the PSE that were not registered with the SEC pursuant to Section 9(e) of the SRC.

All companies that want to apply for listing at the PSE shall, prior to listing, accomplish and submit SEC Form 10-1 to the Commission.

(Securities and Exchange and Commission Memorandum Circular No. 9, Series of 2008)

Sector: Banking and Capital Markets
Insurance
Investment Management
Real Estate

Date: Dec 2008

Contact: Malou Lim - Manila

Amendments to Philippine Accounting Standard (PAS) 39 and Philippine Financial Reporting Standard (PFRS) 7

The Commission en banc resolved to adopt amendments to PAS 39 and PFRS 7 to permit the reclassification of securities out of the trading category in rare circumstances and reclassification to loan category (cost basis) if there is an intention and ability to hold the financial instruments for the foreseeable future (in the case of loans) or until maturity (for debt securities).

All companies that intend to make the reclassification shall strictly comply with the conditions for the exercise of such option. Furthermore, the effective date of the amended standard shall be July 1, 2008; hence, no reclassification before such date should be permitted.

In addition, the reclassification of financial assets under this Circular should be supported by a resolution of the company's Audit Committee, as certified by the corporate secretary, and documents showing the change of intention on the financial assets proposed to be reclassified.

In instances where the company is required to submit quarterly reports, it shall reflect in their quarter report as September 30, 2008 any reclassification made in accordance with this Circular and comply with the requirements.

For pre-need companies, reclassification of Held to Trading or Available for Sale investments to Held to Maturity shall be allowed only upon showing to the Commission that their liquid assets will be sufficient to service maturing loans within the term of the instruments proposed to be reclassified.

In contradiction to above mention, mutual funds or investment companies cannot avail the reclassification option provided in this Circular on account of nature of their business.

(Securities and Exchange and Commission Memorandum Circular No. 10, Series of 2008)

Sector: Banking and Capital Markets
Insurance
Investment Management
Real Estate

Date: Dec 2008

Contact: Malou Lim - Manila

Guidelines on the Determination of Retained Earnings Available for Dividend Declaration

Dividends, whether cash, property or stock, shall be declared out of unrestricted retained earnings of the Corporation. Accordingly, a corporation cannot declare dividends when it has zero or negative retained earnings otherwise known as Retained Earnings deficit. For such purpose, the surplus profits or income must be bona fide income founded upon actual earnings or profits.

The "actual earnings or profits" as mention above shall be the net income for the year based on the audited financial statements, adjusted for unrealised items discussed below, which are not available for dividend declaration

- share/equity in net income of the associate or joint venture accounted for equity method as the same is not yet actually earned or realised.
- unrealised foreign exchange gains, except those attributable to cash and cash equivalents.
- unrealised actuarial gains which is the result when the company chooses the option of recognising actuarial gains or losses directly to profit or loss statement.
- fair value adjustment.
- deferred tax asset.
- adjustment due to deviation from PFRS/ GAAP.
- other unrealised gains or adjustments.
- other adjustments that the Commission.

(Securities and Exchange Commission Memorandum Circular No. 11, Series of 2008)

Singapore

Sector:	All	**Date:**	Dec 2008	**Contact:**	Paul Lau Lynn Tay - Singapore

Transfer Pricing

On 20 October 2008, the Inland Revenue Authority of Singapore (IRAS) issued a circular, *Supplementary Administrative Guidance on Advance Pricing Arrangements*. Very broadly, the circular builds on the guidance provided in an earlier circular on the procedures for seeking advance pricing agreements and spells out certain important time limits which taxpayers should observe.

The IRAS also issued a public consultation paper on related party loans and services. The draft circular on related party loans and services provides much needed guidance for taxpayers, given that these transactions are commonly undertaken among related parties. It reiterates the need to comply with the arm's length standard, but provides certain safe harbour and transitional provisions to assist taxpayers' with implementation.

It should be noted that in relation to lending, the guidance covers both loans transactions as well as inter-company credit balances arising from normal trading activities. There are, however, certain exclusions that should be welcomed by taxpayers: the IRAS will not insist on the charging of arm's length interest for loans between two Singapore companies and where the lender is not in the business of providing finance. Further, taxpayers who have extended cross border loans on an interest free basis are given a two-year period (starting from 1 January 2009) to restructure the loans to reflect commercial, arm's length conditions.

Sector:	All	**Date:**	Dec 2008	**Contact:**	Lennon Lee Lim Maan Huey - Singapore

Tax treaty with Belgium

Tax treaty with Belgium was ratified and entered into force on 27 November 2008. It will come into effect on 1 January 2009.

Sector:	All	**Date:**	Dec 2008	**Contact:**	Lennon Lee Lim Maan Huey - Singapore

Tax treaty with Uzbekistan

Tax treaty with Uzbekistan was ratified and entered into force on 28 November 2008. It will come into effect on 1 January 2009.

Taiwan

Sector: All **Date:** Dec 2008 **Contact:** Richard Watanabe - Taiwan

Extension of carry forward period for losses

An income tax amendment regarding an extension of the loss carry forward period passed the third hearing. The carry forward period has now been extended from five to ten years.

The amendment only applies to losses carried forward that have not yet expired in tax filing year 2008. For instance, losses incurred in year 2003 that were due for expiry in 2008 but not yet been fully utilised can now be further extended to year 2013. The amendment will therefore not be applicable to losses incurred before year 2003, for instance, losses incurred in year 2002 were expired in year 2007, and utilisation of those losses in the tax filing of 2008 will not be permissible.

Note that the amendment should be subject to official announcement by the President. Thus, should there be any discrepancies between the amendment passed by Legislative Yuan and that later announced by the President; the amendment announced by the president shall prevail.

Sector: Banking and Capital Markets
Investment Management **Date:** Dec 2008 **Contact:** Richard Watanabe - Taiwan

Reduction in securities transaction tax

Taiwan’s Cabinet proposed a temporary bill to reduce the securities transaction tax (STT) by half from the current 0.3% to 0.15% on the gross proceeds of securities sold for a period of six months. The proposal is aimed at boosting the liquidity of Taiwan's stock exchange and increase trading volume. The Executive Yuan has prepared a revision of the Securities Transaction Tax Act for the approval of legislators in upcoming months.

Notes

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