Asia Pacific tax

April 2012

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Welcome to the third edition of the Grant Thornton Asia Pacific tax newsletter. This newsletter provides summaries of the recent taxation changes and current hot topics within the Asia Pacific region.

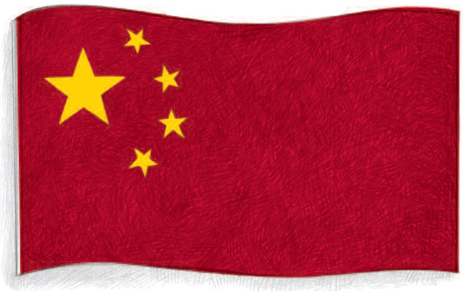
The Grant Thornton Asia Pacific tax team provides a complete range of services for organisations operating within the region.

We have a regional network of more than 440 partners and 6,300 staff, with access to over 31,000 people across 110 firms worldwide. The team consists of multilingual specialists from a variety of backgrounds, operating in services such as transfer pricing, corporate tax and accounting.

With a balance of local knowledge and a strong international capability, we are well positioned to help companies understand and manage the opportunities and threats of operating in the region.

To find out more about the topics featured in this newsletter, contact our Asia Pacific team. We have included contact details on the last page of this newsletter.

China



China introduces mandatory social insurance contributions for expatriate employees working in China

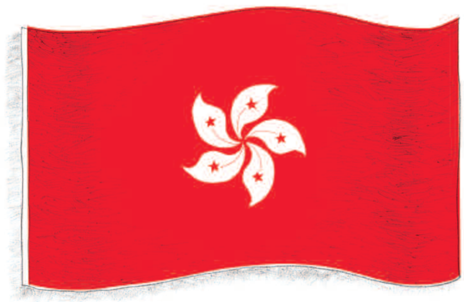
According to 'Social Insurance Law' (supplementary article No.3) of the People's Republic of China (PRC), expat employees and their employers are now required to make contributions to the Chinese social insurance system.

Effective from 15 October 2011, the main requirements of the interim measures for the participation of foreigners employed in China in social insurance (Order No.16) are outlined below:

- expats lawfully working in China must participate in the Chinese social insurance scheme. Expats whose home country has signed a bilateral or multilateral agreement for social insurance with China, shall follow that corresponding agreement
- the cap and percentage of contributions for expat employees will be the same as Chinese nationals
- the employer is required to register its expat employees in the social insurance scheme within 30 days of the employee receiving their work permit
- the expat employee may choose to maintain or terminate the pension account if they decide to leave China before the stipulated retirement age for pension payments. If terminated, the employee can apply for a lump sum withdrawal of the amount accumulated in their personal account. It is noted that the employer's portion cannot be withdrawn
- expats who retain their pension account but reside outside of China after the stipulated retirement age should provide a certificate to the social insurance administration agency annually in order to still benefit from the monthly pension payment.

Finally, although the Act is effective from 15 October 2011, each province's social insurance department is still to issue their own local policies.

Hong Kong



Latest budget plan and initiatives of the the Hong Kong SAR Government

In the 2012-13 Budget released on 1 February 2012, the financial secretary of the Hong Kong special administrative region government (the government) unveiled a raft of proposals to improve people's livelihoods and support Small and Medium Enterprises (SMEs) to weather the economic hurdles ahead.

The financial secretary took the opportunity to revise the government estimates for 2011-12 once again, forecasting that the consolidated account would show a surplus of 66.7 billion Hong Kong dollars for that year. Also, he expected that the fiscal reserve will increase to 662.1 billion Hong Kong dollars by 31 March 2012. At present, he believes there will be a deficit of 3.4 billion Hong Kong dollars in the consolidated accounts for 2012-13.

Inflation averaged at 5.3% during 2011, a marked rise on the 1.7% figure for 2010. It is expected to drop to 4% in 2012.

To reduce the burden on taxpayers, the financial secretary proposed a number of tax-relief measures, including:

- one-off reductions of profits tax, salaries tax and tax under personal assessment for 2011-12
- increases of various personal allowances and deduction limits for elderly residential care expenses and mandatory provident fund contributions
- an extension of the entitlement period for home-loan interest deductions
- a waiver of business registration fees and rates for 2012-13.

For SMEs, the financial secretary is proposing to enhance the existing SME financing guarantee scheme substantially by increasing the loan guarantee ratio to 80% and lowering the annual guarantee fee. More importantly, the Export Credit Insurance Corporation will extend the sales-by policy to cover the contracts of overseas and mainland subsidiaries of Hong Kong exporters.

Apart from the abolition of capital duty levied on local companies, the financial secretary has not proposed any significant new tax relief measures, nor changes to the rates of profits tax, salaries tax, property tax or stamp duty. To maintain the tax neutrality principle and a simple and low tax regime, the financial secretary did not introduce profits tax concessions for specific industry sectors or salaries tax deductions for various private expenses.

The proposals will be conducive to Hong Kong's economy but the initiatives and policies announced, though attractive in general, are positioned only to offer temporary relief to individuals and business.

Policies that target the six industries – cultural and creative, medical, education, innovation and technology, environmental and testing and certification services – are all one-off investment lump sums which will offer little sustainability for sector growth.

Setting aside an investment amount for capital works expenditure to support infrastructural development in Hong Kong, for example, is insufficient without complementary initiatives such as research and development.

The government has also made unrelenting efforts to preserve employment, yet having concrete initiatives to create employment opportunity is equally important to propel Hong Kong's economy forward.

For highlights of the Hong Kong Budget plan, please download Budget headlines from **Grant Thornton Hong Kong's tax centre**.

India

Analysis of the application of thin capitalisation rules in India under the present Income Tax Act, 1961

To take advantage of tax arbitrage, economies across the globe introduced concepts like transfer pricing, earnings stripping (thin capitalisation) and limitation of benefit clauses in tax treaties.

Thin capitalisation refers to excessive debt compared to equity and is a concern for tax authorities around the world on account of tax arbitrage opportunities in cross-border financing. To a considerable extent, the mechanism of thin capitalisation exists to minimise the overall tax payments for a group as a whole. A new entity would prefer equity to debt because interest cannot be postponed but payout on account of dividend would depend on the discretion of the management in the company.

Thin capitalisation across the globe

A look at economies across the world reveals that both developed, as well as developing, countries have been looking very closely at the mechanism of thin capitalisation. The fact that debt financing provides significant tax advantage to the group, and a consequent loss of revenue to the source country, has led tax authorities to formulate comprehensive anti-avoidance rules. One way to restrict the use of thin capitalisation is to impose the limit of debt-to-equity ratio for the subsidiary company.

A summary of existing thin capitalisation rules

Country	Whether thin capitalisation rules exist	Type of tests	Parameters in tests
Canada	Yes	Balance sheet	Debt equity ratio should not exceed 2:1
Cyprus	No	NA	NA
France	Yes	Balance sheet and income statement	Debt equity ratio to not exceed 1.5:1 and interest expense to not exceed 25% of pretax income
India	No	NA	NA
Ireland	No	NA	NA
Japan	Yes	Balance sheet	Debt equity ratio should not exceed 3:1
Luxembourg	Yes	Balance sheet	Debt equity ratio to not exceed 6:1
Malta	No	NA	NA
New Zealand	Yes	Balance sheet	Limit based on higher of 3:1 debt equity ratio or 110% of entity's global debt equity ratio

Thin capitalisation in India

India does not have specific provisions for checking the fiscal erosion through thin capitalisation under the Income Tax Act, 1961 (Act). In a scenario where the interest cost is established to have been incurred towards the business activities it is allowed as a business expenditure under the provisions of the Act.

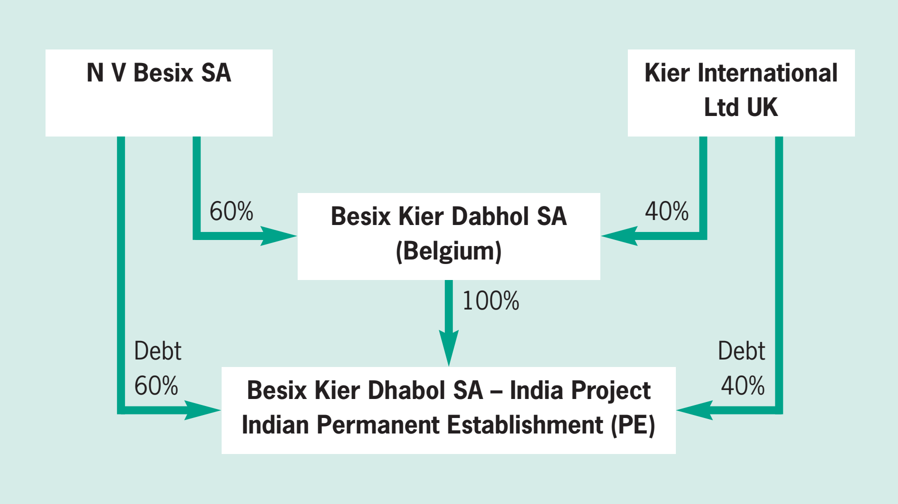
In a recent ruling, the Mumbai Bench of Income Tax Appellate Authority (ITAT) refused to apply anti-avoidance provision against thin capitalisation to deny the benefits available to a resident of Belgium under tax treaty for avoidance of double taxation between India and Belgium (Treaty). The ITAT held that the Act does not provide for any limitations on the benefits in the form of anti-thin capitalisation rules and therefore it was not permissible for the tax department to deny such benefits to the company.

Facts of the case

Besix Kier Dhabol, SA (BKD) a company registered in Belgium was engaged in business in India. NV Besix SA, Belgium and Kier International Investments Ltd., United Kingdom held respectively 60% and 40% shares of the BKD (collectively referred to as shareholders). The Indian project office of BKD borrowed money from the shareholders in the same ratio as their shareholding in BKD. As of result of the borrowing the debt-equity ratio was 248:1. A diagram representation is shown opposite.

Assessment and proceedings before revenue authorities

BKD claimed deduction of the interest paid by its Indian project office to the shareholders against its income taxable in India. It was held by BKD that the borrowings were in fact from the shareholders and not the head office. It stated that the shareholders were separate and distinct from BKD. The assessing officer (AO) held that BKD had a high debt-to-equity ratio and that the ratio of borrowing was in the same ratio as the equity capital of shareholders in BKD and hence the interest paid by its Indian project office to the shareholders should not be treated as interest, but as equity.



Proceedings before the Appellate Authorities

On appeal before the Commission of Income Tax, Appeals (CIT (A)), the CIT (A) upheld the AO's decision. The second appellate authority i.e, ITAT allowed the appeal in favour of the tax payer on the following grounds:

- the ITAT held that while profits of BKD which are attributable to the Indian government establishment (PE) must be taxed, all expenses incurred for the business of the PE are allowed as deductions, subject to limitations placed under the treaty and the 'Act'
- the limitation placed under Article 7 of the treaty regarding allowance of intra-organisational loans was not applicable in its view, since the borrowings were accepted by the PE from the shareholders, and not from BKD itself
- the shareholders of BKD have a separate existence under law from BKD and the loan could not be treated as being taken from BKD itself
- the interest on the borrowings in this case would be covered under the specific provision of section 36(1)(iii) of the Act which permits deduction of interest paid in respect of capital borrowed for the purpose of business or profession. Therefore, it was not necessary to consider if the borrowing was in contravention of law, or not since the explanation of section 37 was not applicable to this case
- in relation to the thin capitalisation of BKD, the ITAT observed that since India has no anti-thin capitalisation rules in force, the tax department could not place any limitation on allowing interest as deductions
- referring to the landmark ruling of the supreme court of India in the case of Azadi Bachao Andolan 263 ITR 706 (SC), ITAT held that merely because suitable limitation provisions under the Act and the treaty are considered desirable, any effort to take advantage of the provisions of a treaty cannot be considered illegal, specifically in the absence of any law limiting such benefits
- relying on the supreme court of India in the case of UCO Bank v. CIT 237 ITR 889 (SC), ITAT held that in absence of specific legislation curtailing a benefit available under tax laws, it is not open to the tax department to limit benefits available to BKD by applying anti-abuse provisions
- there is no thin-capitalisation provision in the domestic tax laws and, therefore, it would be contradictory to the scheme of non-discrimination envisaged by Article 24(5) of the treaty to apply it in case of non-residents.

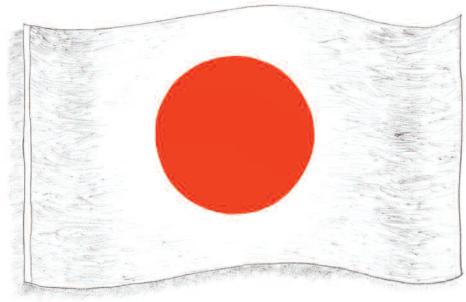
The future

In order to avoid this fiscal erosion the 'Direct tax code (DTC), Bill 2010' proposes to introduce various anti-avoidance provisions like a general anti-avoidance rule (or GAAR) which permits the revenue authorities to re-characterise the nature of the transaction, for instance treat the equity as debt and vice versa. Section 123(1)(f) of the proposed DTC as a part of the GAAR provides, 'any arrangement entered into by a person may be declared as an impermissible avoidance arrangement and the consequences, under this code, of the arrangement may be determined by re-characterising any equity into debt or vice versa'.

This is the first step taken by India's tax administration in the direction of having formal thin capitalisation rules in India. India has woken up to neutralise this kind of fiscal erosion and the DTC seeks to provide a legislative framework for remedial measures for thin capitalisation.

India has acted on this issue and several other economies may follow suit. It will be worth observing how economies, which do not have any such rules in place as of today, make provision over a period of time and how the economies which have it in place already modify it to keep up with the changing global pace and scenario the world over.

Japan



Tax reforms: reduction in corporation tax rates

As a result of the earthquake in March 2011, the introduction of some tax reforms were postponed for further discussion. These have since been introduced and the main corporate tax changes are discussed below.

Corporation tax rate changes

The 2011 tax reform proposals announced a reduction in the headline corporation tax rate. The government has now passed the reductions and they will apply to fiscal years beginning on or after 1 April 2012. However in response to the need for additional funds to deal with the aftermath of the earthquake, a surcharge of 10% of the national corporation tax liability (special reconstruction corporation tax) has been added to the national corporation tax rate for three years. A summary of the new rates is shown opposite.

Corporation tax rates on or after 1 April 2012

Type of company	Tax rate to 31 March 2012	Revised tax rate from 1 April 2012	Total tax rate including surcharge
Large company	30%	25.5%	28.05%
Small or medium-sized enterprise Taxable income up to eight million Japanese Yen	18%	15%	16.5%
Small or medium-sized enterprise Taxable income over eight million Japanese Yen	30%	25.5%	28.05%

Carried forward losses

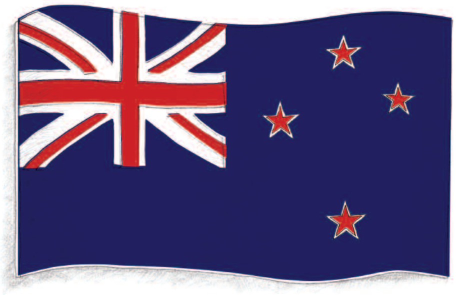
Also proposed for 2011 was a measure to mitigate the impact of the corporation tax rate reduction. The rules relating to 'carried forward losses' will change for periods commencing on or after 1 April 2012. The carry forward period for tax losses generated after 1 April 2008 has been extended from seven years to nine years. For companies that are not small or medium sized enterprises, Tokutei Mokutei Kaishas or Toushi Kaishas, the use of the losses are restricted to 80% of the taxable income for each year. Before the change, carried forward tax losses could be used against 100% of taxable income.

Effective tax rate and deferred tax

As a result of the above changes to the corporation tax rate and loss carry forward rules, companies will need to recalculate any deferred tax assets or liabilities that are recognised in their financial statements to take into account the new rates.

The effective tax rate (including local taxes) for timing differences to be reversed in fiscal years starting between 1 April 2012 and 31 March 2015 will be 38.01%. The rate for timing differences reversed in fiscal years starting after 1 April 2015 is 35.64%.

New Zealand



New Zealand transfer pricing requirements

The Inland Revenue's transfer pricing rules generally follow the OECD's guidelines for multinational enterprises. The Inland Revenue's view is that the onus is on the taxpayer to establish appropriate transfer prices for tax purposes, which will require judgement and depend on the taxpayer's specific circumstances. The onus of proof to show this approach is wrong rests with the Inland Revenue.

Provided taxpayers establish transfer prices that comply with the arm's length principle and prepare adequate documentation to support their actions, the Inland Revenue is less likely to conduct an audit. Consequently, it is in the taxpayer's interest to maintain appropriate transfer pricing documentation, even though legislation does not require it.

And if no documentation is prepared? Then the onus of proof shifts to the taxpayer and, should any shortfall in tax result from an enquiry, penalties will be applied.

Importantly for multinational enterprises, the documentation must accord with New Zealand requirements. This generally means taking group documentation, and making any necessary adjustments to comply with New Zealand requirements.

The Inland Revenue considers that when assessing the risk of a potential transfer pricing adjustment, a taxpayer must have explicitly considered whether its transfer prices are at least broadly consistent with the arm's length principle. As a minimum, it would expect to see the following documentation:

- identification of the related party cross-border transactions
- a broad functional analysis of the facts surrounding the business
- an estimation of the risk of not preparing more detailed transfer pricing analysis
- an estimation of the costs of complying with the transfer pricing rules.

Process for determining transfer prices

A taxpayer should generally prepare a functional analysis and gather data on relevant comparables. The Inland Revenue should expect documentation to include:

- a form of functional analysis
- a review of potential comparables
- an explanation of the process used to determine the relevant transfer pricing method
- details of any special circumstances influencing the prices set by the taxpayer.

Inland Revenue audits

Current focus

The Inland Revenue publishes its perceived major transfer pricing risks each year, together with guidance on the perceived risks.

Management service fees

The Inland Revenue has set a minimum threshold for service charges (services that are not the core business of the enterprise) of 600,000 New Zealand dollars (100,000 New Zealand dollars before 1 July 2010), below which entities are entitled to use a mark-up of 7.5% for administrative simplicity, rather than benchmarking what an appropriate rate should be.

Despite this, care is still required to identify costs that should be on-charged, and to ensure prohibited charges are not included (such as shareholder costs).

Financing and related party loans

Cross-border financing is a substantial part of the total associated party dealings by New Zealand members of multinational groups. Key issues include the pricing of interest and guarantee fees at market rates, and structuring within New Zealand's thin capitalisation rules.

Current risks

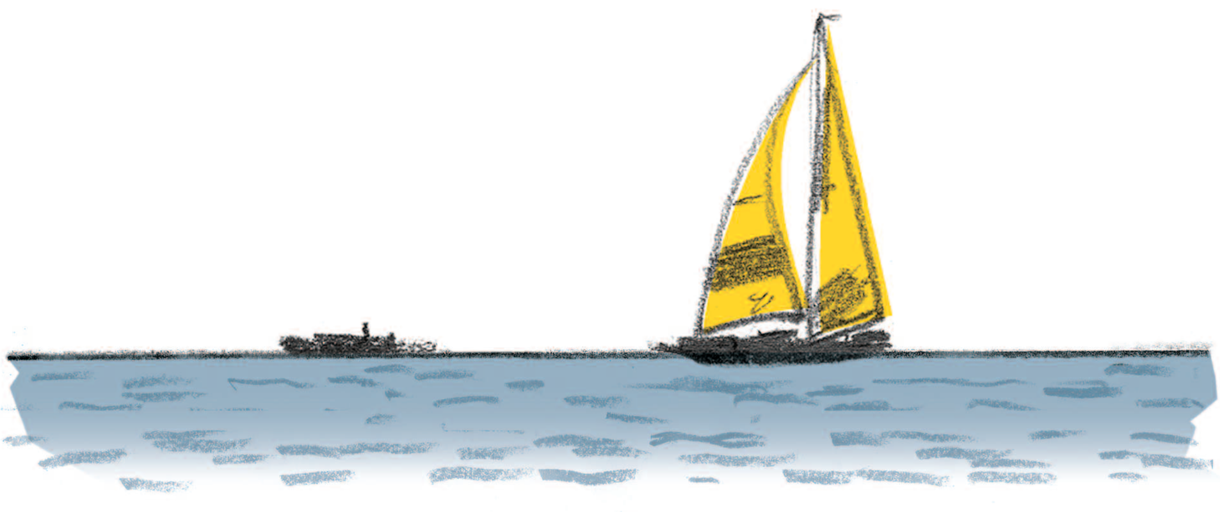
Inland Revenue is currently paying close attention to:

- inbound loans over 10 million New Zealand dollars
- outbound loans of all sizes
- the appropriateness of non-investment grade credit ratings.

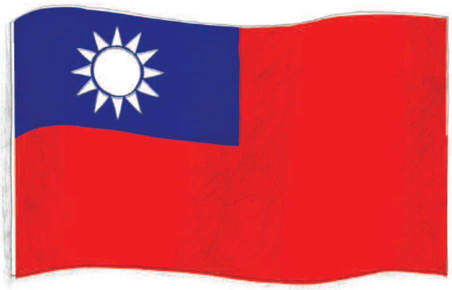
Additional risks

In addition to management fees and cross border financing (including guarantee fees and thin capitalisation effects), Inland Revenue is also focussing on:

- related party royalties where there are insufficient local profits to justify them
- loss making enterprises of any description.



Taiwan



Taiwan and Switzerland tax treaty

The Taiwan and Switzerland bilateral DTA was effective from 13 December 2011. Under the DTA, preferential withholding tax rates will apply for dividend, royalty and interest payments. These can be summarised as:

- interest and royalty: 10%
- dividend: 15% in general (10% for shareholders of companies with at least 20% direct shareholding).

Income Tax Act amended to extend the annual withholding tax statement filing deadline

On 4 January 2012, the Presidential Office promulgated amendments to the Income Tax Act to allow for an extension of withholding tax statement filing deadlines, if there are national holidays on at least three consecutive days in January of the same year.

The withholding tax statement filing deadline can be extended from 31 December to 5 February. For issuance of withholding tax certificates to beneficiaries, the deadline can be extended from 10 February to 15 February.

Thailand

Enhancing Thailand's competitiveness: Various tax changes

As part of Thailand's strategy to enhance its competitiveness in the region, the following changes have been implemented:

Reduction of the corporate income tax rate (CIT) for the next three years

The Thai government has issued Royal Decree No. 530 to reduce the regular CIT rate of 30% as follows:

1. **Corporate and Juristic partnerships**
   The general CIT rate of 30% will be reduced to:
   - 23% for the first accounting period starting on or from 1 January 2012
   - 20% for the succeeding two tax years starting 1 January 2013.

2. **Small, Medium Enterprises (SMEs)**
   SMEs with paid up capital at the end of its accounting period not exceeding five million Baht and revenue not exceeding 30 million Baht, the following reduction is available:
   - first 150,000 Baht of taxable profits – exempt
   - taxable profits over 150,000 Baht but not exceeding one million Baht – 15% CIT rate for accounting period starting 1 January 2012 and thereafter
   - taxable profits over 1 million Baht – 23% CIT rate for the first accounting period starting on or from 1 January 2012 and 20% for the accounting period starting 1 January 2013 and thereafter.

3. **Companies listed on the Thailand stock exchange before 31 December 2009 (current rate is 25%)**
   The CIT rate is also reduced in accordance with the rates in item one.

Double tax agreement (DTA) update

The Thai cabinet has already approved the following proposed DTAs:

- Brunei
- Estonia
- Ireland
- Kenya
- Lithuania
- Morocco
- Papua New Guinea
- Philippines (amended)
- Tajikistan
- Zimbabwe.

The Thai parliament will have to ratify the same before they go into effect. The Thai-Myanmar DTA took effect starting 1 January 2012.

The Board of Investment (BOI) of Thailand measures to mitigate the effects of the recent flood

In order to help the investors that were affected by the recent floods in Thailand, the BOI has granted the following enhanced fiscal benefits:

Existing BOI projects receiving CIT exemption with a cap (of up to the amount of investment capital less value of land and working capital) will receive:

Eight years of CIT exemption and will be treated as a new project. If the investment is in the same province affected by the flood, the project shall receive a CIT exemption of 150% of investment capital (less the value of land and working capital).

If the investment is in another province, the project will receive a CIT exemption of up to 100% of the investment capital (less value of the land and working capital).

Existing BOI projects receiving an unlimited CIT exemption will receive:

Three years of CIT exemption in addition to the remaining privileges but not exceeding eight years in total. If the remaining period of CIT exemption is more than five years, an additional 50% reduction in the regular CIT rate (as reduced above) will be granted as follows:

- 5-6 years will receive 2 years
- 6-7 years will receive 4 years
- 7-8 years will receive 5 years.

The following conditions must be met:

- the company must be an existing BOI promoted business
- the company must have machinery or factory that was damaged by the flood
- the business activity must be eligible for promotion under existing BOI rules.

Changes in Thailand's tax identification (ID) system

The Thai Revenue Department (TRD) has issued a mandate stating that from 1 February 2012 individual and corporate taxpayers should stop using their 10-digit tax ID numbers issued by the TRD. Instead, Thai individual taxpayers should use their 13-digit citizen identity number issued by the Ministry of Interior. However, corporate taxpayers should use their company registration numbers issued by the Ministry of Commerce.

Due to very short notice being given by the TRD, widespread complaints were received by the government. Following these complaints, for those taxpayers concerned who could not implement the new tax ID system, the TRD is giving a grace period until 31 January 2013 to comply.

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