APAC News

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New Perspectives for 2010

Welcome to the fourth issue of our Asia Pacific (APAC) regional newsletter.

In this issue, we review how our member firms are looking towards 2010 from a new perspective.

We have an article (*Melbourne*) on business succession from a different perspective where selling the business is not necessarily the best option.

Tax authorities around the world are also doing more to protect their tax revenue.

We review the thin capitalisation rules introduced in *South Korea* to target capital investments disguised as intercompany loans to claim deductions as well as to avoid withholding tax on dividends.

We have an article (*China*) explaining the measures being implemented to restrict the claims for treaty benefits.

In *Mauritius,* although the economy has remained resilient, a similar scrutiny on claims for treaty benefits under the India-Mauritius DTA will require closer attention.

We review the additional incentives and tax changes in *Malaysia* that were included in the 2010 Malaysian Budget.

We also have an update on *Indonesia* as it progress towards convergence to IFRS by 2012.

Finally, we review the benefits of establishing a holding company in *Hong Kong*.

New ways of doing business in 2010.

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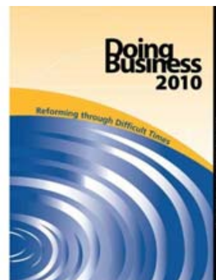
Russell Bedford contributes to World Bank Doing Business 2010

The World Bank has published its Doing Business 2010 report with participation by tax specialists from the Russell Bedford global accounting group.

The Doing Business project analyses regulations that apply to an economy's businesses during their life cycles. The data and analysis are used to help the World Bank to advise policy-makers in developing countries and by governments worldwide in identifying regulatory reforms to improve the ability of entrepreneurs to do business.



Special points of interest:

- Russell Bedford tax specialists participated in World Bank report
- More than 70% of the 183 economies covered by the report

MELBOURNE AUSTRALIA

SAWARD / DAWSON chartered accountants

"Selling the business is not the only succession strategy"

Business Succession – Another Perspective

As business owners get older and contemplate slowing down the question they often ask is "who is going to buy my business".

However, selling the business is not the only succession strategy that should be considered.

We often find that when we inform clients of the real value of their business they then realise that if they were to sell their business and invest the proceeds, they will see a substantial reduction in their disposable income.

With Australian small to medium businesses typically valued with EBIT multipliers in the range of 2 to 5, underlying pre-tax yields are therefore in the range of 20% to 50%.

The yields from traditional investments are unlikely to come anywhere near the yields generated by the business.

We are seeing more business owners setting themselves up to retain their businesses without having a significant active involvement in the business.

By ensuring that there are good systems, robust reporting and a sound management team in place, business owners can step aside and reap the high returns from their business without carrying the day-to-day responsibility.

We believe that this will become a common way of dealing with business succession.

Having good professional advisors is an important part of making this strategy work.

RBI firms are well equipped to help business owners withdraw from active involvement in their business and retain a sound investment interest by assisting with:

- Systems and procedure reviews
- Ensuring that management reporting is timely, accurate and relevant
- Working with the business management team in strategic planning and business review
- Coaching of the business management team
- Regularly reviewing the business performance

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SOUTH KOREA

CJAC 천지회계법인 CHEON JI ACCOUNTING CORPORATION

"…interest payable on the excess portion … are re-characterised as dividends"

Thin Capitalisation Rule in Korea

Thin Capitalisation Rule

A multinational enterprise (MNE) may adopt a tax avoidance mechanism under which the contribution of paid-in capital to its subsidiary in Korea is decreased, while increasing its loans to the subsidiary as much as possible.

This may reduce the taxable income of the subsidiary through the increase in interest expense deduction of the subsidiary.

Under such an arrangement, non-deductible dividend payments are replaced with deductible interest payments.

To cope with such an arrangement, the Law for the Coordination of International Tax Affairs (LCITA) and its enforcement decree contain thin capitalisation rules; whereby if a Korean company borrows from its controlling shareholders overseas (CSO), an amount greater than three times its equity (six times in the case of financial institutions) interest payable on the excess portion of the borrowing, computed as shown below, are re-characterised as dividends to which the article on dividends in tax treaty applies and therefore are treated as non-deductible in computing taxable income.

For the purpose of the thin capitalisation rules, money borrowed from a CSO includes amounts borrowed from an unrelated third party based upon a CSO's guarantee.

The non-deductible interest is computed as follow:

$$INT \times \frac{B}{A}$$

INT: Interest and discount payable to CSO;

A: Debt borrowed from the CSO or guaranteed by the CSO;

B: A - [Paid-in capital contributed by the CSO x 3*]

(6 for financial institutions)*

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SOUTH KOREA

Thin Capitalisation Rule in Korea (Continued)

(Continued)

Continued from page 2

Debt Under an Arm's Length Situation

Even if the ratio of debt owed to a CSO to equity exceeds 3:1, as long as the conditions and the amount of debt owed to a CSO are reasonable compared to the debt from an independent third party, such debt from the CSO will be excluded from the scope of the debt subject to thin capitalisation rules.

As a result, interest on such debt will be deductible.

This is in accordance to the arm's length principle from Article 9(1) of the OECD Model Tax Convention.

Thus, if given requirements are satisfied, the debt-equity ratio prevailing in the industry (rather than a 3:1 or 6:1 ratio) will be applied.

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"the debt-equity ratio prevailing in the industry … will be applied."

INDONESIA

ED PSAK No.1 (revised 2009) Financial Statement Presentation

Syarief Basir & Rekan

Registered Public Accountants

The Financial Accounting Standard Board (DSAK) IAI has approved the Exposure Draft (ED) PSAK 1 (revised 2009) of Presentation of Financial Statements on April 21, 2009.

This is part of the adoption process to converge the Indonesian accounting standards with the IFRS by 2012.

There are some significant differences between the ED PSAK 1 (Revised 2009) with the previous version which was revised in 1998. The main changes are highlighted as follow:

General Presentation

In addition to the change of the names of the financial statements, the new standard requires the comprehensive income statement to presenting profit and loss from operation and other comprehensive income.

3rd Statement of Financial Position

For retrospective restatement or reclassification, a third Statement of Financial Position is required to report the financial position at the beginning of the comparative period.

Statement of Compliance

Entities are required to expressly state whether it has complied with the PSAK.

Short-Term Liabilities

Financial liabilities refinanced and due within 12 months after the reporting date are classified as short term liabilities.

In addition, for debt covenant violations that result in the creditor calling for repayment are presented as short-term liabilities, even if the creditor has agreed after the reporting date to postpone payment to 12 months after reporting date.

Management Disclosure

Management will be required to provide additional disclosure on the accounting policies used, the sources of estimation uncertainty, and also how it is managing the company's capital.

With the date for full convergence drawing closer, management should assess the impact of the new IFRS at the exposure draft stage to ensure that they are well prepared for 2012.

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"management should assess the impact of the new IFRS at the exposure draft stage to ensure that they are well prepared for 2012."

MALAYSIA

2010 Malaysian Budget Highlights

RUSSELL BEDFORD MALAYSIA

"… the 2010 Budget proposed spending of RM191.5 billion"

"Real Property Gains Tax … is reinstated with effect from 1 January 2010."

The 2010 Budget was released on 23 October 2009 by the Honourable Prime Minster and Minister of Finance, YAB Dato' Sri Mohd Najib Tun Abdul Razak. With the theme "1MALAYSIA, TOGETHER WE PROSPER" the 2010 Budget proposed spending of RM191.5 billion which focuses on three main strategies namely:

i) Driving the nation towards a high-income economy,

ii) Ensuring holistic and sustainable development and

iii) Focusing on well-being of the Rakyat ("people").

Some of the proposed tax measures include:

- ***Reduction in income tax rate for individual taxpayers***

  Individual's and cooperative's highest tax rate is reduced from 27% to 26%.

  Similarly, non-resident individual will be taxed at the flat rate of 26% effective YA2010.

  Further, personal relief for an individual will increase from RM8,000 to RM9,000.

- ***Reinstatement of Real Property Gains Tax ("RPGT")***

  RPGT, a capital gains tax imposed on gains from disposal of real property ("RP") and shares in a real property company ("RPC") which was exempt since 1 April 2007 is reinstated with effect from 1 January 2010.

  A flat rate of 5% RPGT will be imposed on the gains arising from disposal of RP or RPC shares regardless of the holding period.

  A new requirement has also been introduced for the acquirer of RP or RPC shares to withhold 2% of the purchase consideration and remit the same to the Malaysian Inland Revenue Board within 60 days from the transaction date pending RPGT assessment.

Other tax incentives are for specific areas or industries or type of companies, with the Islamic financial services sector enjoys a lion share.

As expected, there are less tax incentives proposed in the Budget 2010 announcement as certain incentives have already been granted in the Mini Budget announced in March 2009 in response to the economic condition.

Comprehensive Deregulation of FIC Guidelines

In June 2009, the Malaysian Government announced a deregulation of the investment guidelines administered by the Foreign Investment Committee ("FIC").

The FIC guideline on the acquisition of interest, mergers and takeovers is repealed. FIC will no longer process such share transactions nor impose equity conditions on such transactions.

The equity condition imposed earlier by FIC on the existing companies will be waived automatically other than for strategic sectors such as water, telecommunications, ports and energy, the equity policies of which are being determined by the respective sector regulators.

With the deregulation, FIC approval is now required only on transactions involving the dilution of Bumiputera and / or Government interests in properties valued at RM20 million and above, acquired directly or indirectly.

Restrictions on foreign interests in commercial and residential properties valued at less than RM500,000 and RM250,000 (increased to RM500,000 with effect from 1 January 2010) respectively are still in force.

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Treaty Benefits Scrutinised

CHINA

Serving Hong Kong Since 1994

The State Administration of Taxation ("SAT") has issued a series of circulars in relation to the claiming of treaty benefits on passive income such as dividends, interest, royalty and capital gains.

Guoshuifa (2009) No.124 was issued on 24 August 2009, providing guidance and clarifying the procedures and documentation requirements for non-residents seeking to claim treaty benefits.

Applicants of treaty benefits will now have to prove that the recipient of the dividend, interest, royalty or capital gains is the beneficial owner, and not merely a conduit company which was set up solely to utilise the benefit under the relevant DTA and to re-route the income back to the true beneficial owner.

A special purpose vehicle ("SPV") that was set up in a treaty country with little or no business substance would likely be challenged by the SAT.

It is unclear how much is considered sufficient substance for the purpose of claiming treaty benefits. However, it is likely that the status of those SPVs with little substance (eg. no office or staff) will be scrutinised and determined on a case-by-case basis.

A similar circular, *Guoshuifa* (2009) No.81 was issued on 20 February 2009 specifically on claims to reduce the dividend withholding tax under a tax treaty.

Recently, *Guoshuifa* (2009) No.601 ("Circular 601") was issued on 27 October 2009, which provides further details of the SAT's interpretation of a beneficial owner. According to Circular 601, the application for treaty benefits would be disadvantaged if the recipient:

- is under an obligation to remit 60% or more of the income received to another jurisdiction
- has a back-to-back financing or licensing arrangements
- has minimal assets or business substance
- is exempt from tax or taxed at an extremely low rate

It is now a global trend by tax authorities around the world to scrutinise holding company structures, financing arrangements and intellectual property structures to ensure that there is no loss of tax revenue.

As such, clients are advised to review their existing and proposed arrangements in light of the recent developments on granting of tax treaty benefits.

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" … global trend by tax authorities … to scrutinise holding company structures … to ensure that there is no loss of tax revenue.. "

Testing Times

MAURITIUS

A year after the collapse of Lehman Brothers unleashed the deepest global financial and economic crisis since the 1930's, there are signs that leading economies, supported by government stimulus measures, are coming out of recession.

Japan, Germany and France posted modest growth in the second quarter while the US and the UK are likely to follow suit in the third quarter. Nonetheless, the renewed stability is fragile and the path to recovery is still ill-defined.

In spite of a drastic fall in cross-border investments, the Global Business sector in Mauritius has proven resilient in the crisis.

Statistics from the Financial Services Commission indicate a slight increase in the number of global business companies from 31,806 as at end June 2008 to 32,895 as at end June 2009, although the regulatory body delivered 50% fewer new global business licences for the first semester of 2009, compared to the same period last year.

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"the renewed stability is fragile and the path to recovery is still ill-defined."

MAURITIUS

(Continued)

"… Mauritian entities will be wise to ensure commercial substance in order to have a good claim to tax benefits…."

Testing Times (Continued)

Continued from page 5

Testing times lie ahead. The World Investment Report 2009, released on 17 September 2009 by the UNCTD, forecasts a 30% annual contraction in global FDI inflows to USD 1.2 trillion for this year. The volume of crossborder investments is expected to recover as from next year, albeit the pre-crisis level will not be attained before 2011.

Of specific relevance to the Mauritian Global Business industry, India is taking a more aggressive stance in the collection of taxes, with a closer scrutiny of cross-border transactions.

Last August, the Indian Finance Minister unveiled the draft legislation for a revised income tax system that may become effective as from April 2011. The inclusion in the proposed domestic tax law of a clause to override treaty benefits and a wide-ranging General Anti-Avoidance Rule raises serious concern that the unique advantage of the India-Mauritius DTA will be nullified.

It is suggested however, that a more positive reading of the draft legislation be taken and that Mauritian entities will be wise to ensure commercial substance in order to have a good claim to tax benefits under the treaty with India.

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HONG KONG

Serving Hong Kong Since 1994

"Hong Kong continues to be the location of choice to manage and control investments in the region …"

Hong Kong Holding Company

With the growing focus by tax authorities on offshore holding companies incorporated in "tax haven" jurisdictions, many investors are considering the use of a Hong Kong incorporated company to hold their investment in the Mainland China.

Not only would this reduce the stigma often associated with companies incorporated in a "tax haven" jurisdiction, there are also additional benefits due to the preferential withholding tax rates that are available under the double taxation arrangement between Mainland China and Hong Kong.

At a glance, the withholding tax rates on the following payments to a Hong Kong company are as follow:

- Dividends 5%*
- Interest 7%
- Royalties 7%

* *10% if shareholding is less than 25%*

As can be seen, the above withholding tax rates are lower than most countries, including those with tax treaties with Mainland China.

Despite the new requirements on treaty benefits (refer to China article on page 5 for details), payments to a Hong Kong holding company should continue to enjoy the above preferential withholding tax rates if it can be demonstrated that the company has legitimate commercial purpose and business substance in Hong Kong.

Often referred to as the "Gateway to China", Hong Kong continues to be the location of choice to manage and control investments in the region due to its established legal and financial system, professional workforce and efficient logistic network.

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Disclaimer

The information contained herein is of a general nature and is not intended to address the circumstances of any particular individual or entity. Although we endeavour to provide accurate and timely information, there can be no guarantee that such information is accurate as of the date it is received or that it will continue to be accurate in the future. No one should act upon such information without appropriate professional advice after a thorough examination of the particular situation.

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