



ASPAC
Tax News

March 2006

TAX

Contents

1	Australia	2
1.1	Regent Changes to ATO Executive	2
1.2	Loss Recoupment Rules for Companies	2
1.3	Taxation Reform – Taxation of Financial Arrangements (TOFA)	3
1.4	Compliance and Tax Risk Management Developments	4
1.5	Trade and Customs Compliance	5
1.6	Indirect Tax Developments	6
1.7	Other Developments	8
1.8	Contact	8
2	Hong Kong	9
2.1	Offshore Funds Exemption	9
2.2	Key features of the Bill	10
2.3	Status of the Bill	11
2.4	Contact	11
3	Japan	12
3.1	International Taxation	12
3.1.1	Scope of Non-Permanent Residents	12
3.1.2	Thin capitalization	12
3.2	Other Tax Updates	14
3.2.1	Amendments to the Japan-India Tax Treaty – Agreement Reached in Principle	14
3.2.2	Treatment of Special YK (Tokurei YK or TYK) Under the U.S. Check-the-Box Regulations	14
3.3	Contact	15

4	Korea	16
4.1	Revised Withholding Procedure With Regard to Korean Investment Income Earned by Foreign Investors Located in a Tax Haven	16
4.2	Interpretative Rulings and Judicial Cases	17
4.3	Transfer Pricing Issues	18
4.4	Contact	18
5	Malaysia	19
5.1	Budget 2006 – Tax Announcements	19
5.2	Contact	19
6	New Zealand	20
6.1	Coalition Government Agreement Tax Issues	20
6.2	Double Tax Agreements	21
6.3	Foreign Investment Fund Regime	22
6.4	Contact	23
7	Papua New Guinea	24
7.1	Contact	26
8	Philippines	27
8.1	New Tax Developments in the Philippines	27
8.1.1	Value Added Tax Rate Increased from 10 percent to 12 percent starting February 1, 2006	27
8.1.2	Transition Rules on the 12 percent VAT	27
8.1.3	Conditions/Procedures in Claiming Deductions of Payments to Third Parties	28
8.1.4	Mere Reimbursements of Expense Not Subject to Expanded Withholding Tax (EWT)	29
8.2	Contact	29

9	Singapore	30
9.1	Case Law Update	30
9.2	Contact	31
10	Sri Lanka	32
10.1	Recent Tax Developments in Sri Lanka	32
10.2	Contact	35
11	Taiwan	36
11.1	Scope of Transfer Pricing Information Disclosure for 2005 Tax Year	36
11.2	Safe Harbor Rules for Transfer Pricing Report Requirement	38
11.3	Contact	41
12	Thailand	42
12.1	Conversion of Foreign Currency Amounts into Thai Baht	42
12.2	Tax Exemption for Energy-Saving Equipment	44
12.3	Import Duty Exemption for Energy-Saving Machinery	45
12.4	Tax Exemption for Staff Training	45
12.5	Tax Exemption for Special Living Allowance	46
12.6	Seven Percent VAT Rate Extended to September 30, 2007	47
12.7	Contact	47

Introduction

Welcome to ASPAC Tax News, a quarterly tax bulletin. This publication highlights recent tax developments in the Asia Pacific region. Please contact your KPMG adviser or the authors for further information.



Australia

1.1 Recent Changes to ATO Executive

On November 10, 2005, the Commonwealth Treasurer, Mr Peter Costello, announced the appointment of Mr Michael D'Ascenzo as the Commissioner of Taxation with effect from January 1, 2006.

Mr D'Ascenzo was Chief Tax Counsel and has had extensive experience in revenue administrations. Prior to his appointment as the Commissioner of Taxation, Mr D'Ascenzo was a Second Commissioner of Taxation, having been first appointed to that role in May 1998.

1.2 Loss Recoupment Rules for Companies

The Tax Laws Amendment (Loss Recoupment Rules and Other Measures) Bill 2005 was passed by both Houses of Parliament on December 7, 2005. The Bill then received Royal Assent on December 14, 2005 becoming Act No. 147 of 2005. However, the passage of this legislation through Parliament was the subject of considerable public debate because of its dramatic impact on acquisition and divestment decisions for large business. (See below for further details).

The Act provides for a simplified continuity of ownership test (COT) to make it easier for large companies to pass the COT. The simplified COT applies for the year starting on or after July 1, 2002, or for certain eligible pre-2002 year losses.

However, the more contentious aspect of this legislation was the removal of the same business test (SBT) for companies or tax consolidated groups with total gross income of more than Australian Dollars (AUD) 100 million.

This measure applies for losses incurred in years starting on or after July 1, 2005.

This has two implications:

- Large companies can still access the SBT but only for losses made in years starting before July 1, 2005.
- If a company with tax losses fails the COT and has income greater than AUD 100 million in an income year, it will not be able to use the post July 1, 2005 losses. In theory, the tax losses are not lost forever. They are simply quarantined until such time when the company has total income of AUD 100 million or less to become eligible to apply the SBT to use the losses. It is noted, however, that if a company's total income falls from over AUD 100 million to less than AUD 100 million, a real question arises as to whether there has been a failure of the same business that triggered the fall in income such that the company would fail the SBT in any case.

Given the public debate over the imposition of an AUD 100 million ceiling for the SBT, the Australian Government has advised that it now intends to explore options for improving the operation of the SBT. It is anticipated that the outcome of this consultation process and any respective changes to the law will be announced in May 2006 as part of the 2006/07 Federal Budget announcements.

1.3 Taxation Reform - Taxation of Financial Arrangements (TOFA)

Following in the footsteps of a number of countries through the region, the Australian Government has released the much awaited Exposure Draft legislation containing the proposed rules on the tax-timing treatment of financial arrangements as well as proposed taxing rules for hedging arrangements (TOFA Stages 3 and 4).

These elements of the TOFA tax reform are attempting to achieve greater alignment between the tax-timing rules and the new accounting regime under Australian equivalents to International Financial Reporting Standards (AIFRS).

The release follows the implementation of the debt/equity rules (TOFA Stage 1) and the tax treatment of foreign currency gains and losses (TOFA Stage 2) over the past few years.

The new Exposure Draft legislation, Tax Laws Amendment (Taxation of Financial Arrangements) Bill 2006 (the Exposure Draft), also represents a fundamental shift in Australian tax law design and is one of the first pieces of Australian tax legislation to attempt a 'coherent principles' drafting framework. A coherent principles based approach to tax law design is intended to allow taxpayers a degree of flexibility in applying the proposed new tax regime to existing financial instruments and financial instruments that may evolve over time in the Australian and global capital markets.

The Exposure Draft modernizes the tax-timing treatment of financial arrangements by proposing to introduce methodologies in determining the tax recognition of the timing of gains and losses of financial instruments. Whilst, to the disappointment of some industry groups, full alignment with AIFRS, *AASB 132 Financial Instruments: Disclosure and Presentation* and *AASB 139 Financial Instruments: Recognition and Measurement* is not proposed in the current Exposure Draft, the proposed tax-timing rules do draw on financial accounting concepts from these accounting standards, which could potentially result in substantial compliance cost savings for some taxpayers.

Five tax-timing methodologies are proposed in the Exposure Draft. These include the compounding accruals method and realization method, which constitute the mandatory elements of the proposed regime whilst the elective elements of the regime comprise fair value accounting, retranslation method for foreign currency and hedging rules.

KPMG in Australia welcomes the release of the Exposure Draft containing the final stages of TOFA. It remains to be seen, however, how the process of providing further guidance on the proposed TOFA rules will 'unfold' for particular financial arrangements and whether the new rules will deliver certainty and compliance cost savings to taxpayers. The TOFA consultation process with Treasury and the Australian Taxation Office (ATO) is likely to be long and extensive. Final legislation is not expected in the short term.

1.4 Compliance and Tax Risk Management Developments

On October 13, 2005, the then Commissioner of Taxation, Mr Michael Carmody, addressed the International CFO Forum held in Sydney on Large Business and Tax Compliance.

In the address, Mr Carmody advised that the Australian Taxation Office (ATO) will not be reducing its scrutiny of compliance of the large corporate segment, however, the ATO does recognize that the quality and timeliness of the ATO's compliance activities needs to be improved. In discussing these areas for improvement, Mr Carmody highlighted the ATO's focus on:

- ATO compliance management approaches
- Compliance results and compliance risks currently in focus
- Improving the quality and timeliness of ATO compliance activities
- The review of goods and services tax (GST) in large business operation

As part of the presentation, Mr Carmody also released the much awaited Kevin Burges' report entitled *'Report on the concerns of a number of the largest companies in the Large Business Segment, with ATO audit, investigation and advice procedures'* (the Burges Report). In September 2004, Kevin Burges was engaged to conduct one-on-one interviews with large corporate representatives who had expressed concern about their audit experiences.

The Burges report raised concerns with:

- Obtaining meaningful binding advice from the ATO
- The conduct and outcomes of audit investigations
- Lack of commercial experience of the ATO
- General interest charge (GIC) composition and lack of remission
- ATO staff attitudes

Mr Carmody also released the report of the review of the ATO's management of GST compliance in the large business segment. This review was designed to take stock of the ATO's position, four years after the introduction of the GST, and to improve planning for the future.

The Australian Government has also released reports prepared by the Inspector General of Taxation, Mr David Vos, in respect of the review into the ATO's audit timeframes and the review into the ATO's administration of penalties and interest arising from active compliance activities.

In respect of the review into audit timeframes, the review found that there were examples of projects and isolated cases where the ATO had taken too long to finalize audits and a number of breaches of the Taxpayers' Charter. Overall, however, the review reflected well on the ATO noting that the ATO is a world leader in its approach to improving compliance levels.

It is expected that throughout 2006, the ATO will rollout a number of initiatives aimed at improving the relationship between large businesses and the ATO. Of particular interest will be the proposed large market symposium in mid 2006. It is anticipated that the 2006 symposium will launch the new version of the large business and tax compliance booklet as well as cover topics such as ATO directions and performance; developments in tax law; compliance processes and services.

1.5 Trade and Customs Compliance

The year 2006 will see increased Customs audits, both physical and documentary. Importers who are not cognizant of their responsibilities and their legal obligations under various legislation administered by the Australian Customs Service (ACS), are potentially at risk.

Whilst most companies have compliance manuals for taxation issues, experience suggests that very few have Customs Compliance Manuals. Consequently, there is no quality control over the procedures employed by companies in dealing with Customs issues.

Many companies are not aware that it is the entity holding itself out to be the owner of goods that takes the responsibility for inter alia:

- Declarations made to the ACS when clearing goods including statements made regarding customs value, tariff classification, origin, etc.
- Retention of commercial documents pertaining to imported/exported goods
- Any penalties in respect of incorrect statements made in declarations to the ACS
- Liability for any duty short paid for a period of up to four years

The appointment of sixty additional Customs' auditors together with the appointment of the former Commissioner of Taxation, Mr Michael Carmody, to the position of Chief Executive Officer of Customs heralds a new era in Customs compliance issues.

1.6 Indirect Tax Developments

Application of subsection 38-190(3) to supplies made to non-residents that are GST-free

The Australian Taxation Office (ATO) has released a final Goods and Services Tax (GST) Ruling, GSTR 2005/6, which deals with the application of subsection 38-190(3) of the A New Tax System (Goods and Services Tax) Act 1999 to supplies, which would otherwise be GST-free under item 2 in the table in subsection 38-190(1) (item 2). Under item 2, supplies of things (other than goods or real property) made to non-residents are GST-free if the requirements of that item are met. Subsection 38-190(3) is a simple anti-avoidance measure in respect of supplies that satisfy item 2.

The avoidance it seeks to counter involves an Australian supplier making a GST-free supply to a non-resident, under an agreement with that non-resident, but in circumstances where that supply is provided, or required to be provided, to another entity in Australia. Subsection 38-190(3) operates to negate the GST-free status that would otherwise apply under item 2. In other words, it seeks to apply GST to the supply, based on what the Commissioner of Taxation calls the actual flow of the service or thing supplied, rather than the contractual flow.

Over 100 paragraphs provide further examples of how subsection 38-190(3) applies to various types of supplies, in particular, speaking services, legal and accounting services, advertising services, computer services, testing services and assembly services.

The critical element in the application of subsection 38-190(3) is the difference between the term “made” in item 2 and the term “provided” in subsection 38-190(3). The Ruling explains that subsection 38-190(3) applies where, in the performance of a service (or in the doing of some other thing which is supplied), the actual flow of that supply is in whole or in part to another entity that is not the non-resident entity with which the supplier made the agreement for the supply.

That is to say, the contractual flow of the supply is to one entity (the non-resident recipient) and the actual flow of the supply is to another entity. If that other entity is in Australia, subsection 38-190(3) will apply to negate the GST-free status that would otherwise apply to the supply. The Ruling also includes discussion of similar provisions (and case law) in other jurisdictions such as the United Kingdom (UK), New Zealand (NZ) and Canada.

Goods and Services Tax and multi-party arrangements

Draft Goods and Services Tax (GST) Ruling *GSTR 2005/D8 Goods and services tax: making supplies and analyzing multi-party arrangements* (the Draft Ruling), examines the meaning of the term “supply”; focuses on the characteristics of “supply” in a two-party transaction; and analyses “supply” in the context of a multi-party arrangement.

The Draft Ruling does not provide a specific definition of a “multi-party arrangement,” but simply characterizes it as a transaction involving more than two entities. In forming its views, the ATO has considered overseas guidance, particularly judicial consideration from the UK and NZ. Where appropriate, the ATO has sought to distinguish some of this overseas guidance due to differences between the respective value added tax (VAT) regimes.

The Draft Ruling, once finalized, will have wide significance for government and non-government entities alike given that any transaction involving more than two parties will be affected.

In this regard, the Draft Ruling identifies situations as varied as loyalty schemes, the provision of health, teaching and community care services, electricity and other government rebates and payment arrangements for legal services as common multi-party arrangements. The Draft Ruling also highlights the importance of ensuring that all contracts and other relevant documentation are properly drafted and reviewed prior to entering into any multi-party arrangement, as a failure to do so could jeopardize an entity's input tax credit entitlements.

GST treatment of Australian packaged tour holidays sold by non-resident tour operators

In a test case, *Saga Holidays Limited v Commissioner of Taxation* [2005] FCA 1892 (the Saga Holidays case), dealing with the goods and services tax (GST) treatment of Australian packaged tour holidays sold by non-resident tour operators, the Federal Court of Australia (FCA) has held that the provision of the accommodation component of a package tour holiday of Australia is a taxable supply under the *A New Tax System (Goods and Services Tax) Act 1999* (the GST Act).

The GST treatment of such supplies has been a source of contention since GST was first introduced. In 2005, the Government enacted specific provisions in the GST legislation to overcome the types of arguments made by the taxpayer in this case. Those amendments apply prospectively from October 1, 2005, whereas the Saga Holidays case dealt with the position prior to the amendments.

The specific issue in the case was whether the provision of the accommodation component of a packaged tour holiday by a UK resident company registered for Australian GST purposes is a taxable supply for Australian GST purposes.

The FCA held that the provision of the accommodation component of a package tour holiday of Australia is a taxable supply under the GST Act, being the supply of “real property” (which is defined broadly in the GST Act) that is connected with Australia. The FCA also endorsed a “substance and reality” approach to the interpretation of the GST Act, which emphasizes practical (rather than overly technical or artificial) considerations.

GST Emerging Issues - New client publication

KPMG's Indirect Tax Group in Australia has released a new publication series entitled *GST Emerging Issues*, a client newsletter which analyses and comments on emerging issues. The first issue explores situations where an overpayment has been received for a supply and whether there is still an obligation to remit GST.

1.7 Other Developments

Substantial Equipment and Permanent Establishments

The issue of whether a bareboat charter constitutes an Australian permanent establishment (PE) under the Australia-Singapore Double Taxation Agreement has been resolved with the High Court of Australia refusing the Commissioner of Taxation special leave to appeal against the decision of the Full Federal Court of Australia (FCAFC) in *McDermott Industries (Aust) Pty Ltd v Commissioner of Taxation [2005] FCAFC 67*.

The taxpayer was denied deductions for charter fees paid under a bareboat charter arrangement because the Commissioner of Taxation argued that the taxpayer had failed to deduct royalty withholding tax from the payments. The Commissioner of Taxation argued that the charter fees were royalty payments (and not attributable to a PE in Australia) and as such, the taxpayer was prevented from claiming a deduction for the payments as it had failed to deduct withholding tax. The taxpayer argued that withholding was not necessary as the Singapore company was deemed to have a PE in Australia and the charter fees were attributable to that PE.

The FCAFC held that a PE is deemed to arise because the barges, which constitute "substantial equipment," were being "used" in Australia, in accordance with Article 4(3)(b) of the Australia-Singapore Double Tax Agreement. In this regard, the FCAFC noted that the Australia-Singapore agreement should not be read down such that a PE can only exist if there is a "significant presence" in Australia. The High Court of Australia refused special leave to appeal the decision.

1.8 Contact

For further details or assistance please contact:

Matthew Hayes, Partner

KPMG in Australia
Tel: +61 2 9335 7503
mwhayes@kpmg.com.au

Janelle Swann, Manager - Knowledge Management

KPMG in Australia
Tel: +61 2 9335 7375
janelleswann@kpmg.com.au

Hong Kong

2.1 Offshore Funds Exemption

The funds industry in Hong Kong has been lobbying the Government for several years to broaden the existing tax exemptions that apply to only a limited segment of offshore funds managed from Hong Kong. Back in the 2003/04 Budget, the Government first announced that offshore funds would be exempt from profits tax to bring Hong Kong in line with other major international financial centers, where offshore funds are generally not subject to tax. This announcement was welcomed by the industry as a broad-based exemption from tax for offshore funds and is seen as vital to maintain Hong Kong as a vibrant international centre for the fund management industry.

After two rounds of public consultation on the issue of exempting offshore funds from profits tax, the Hong Kong Government published the *Revenue (Profits Tax Exemption for Offshore Funds) Bill 2005* (the Bill) on June 30, 2005. The publication of the Bill was followed by extensive consultative discussions with professional and industry bodies, including the Government's invitation for written submissions and meetings with the industry representatives. These consultations led to the proposal of a number of amendments to the Bill by the Bills Committee.

The purpose of the Bill is to give legal effect to the Government's proposal to exempt a broader range of offshore funds from profits tax, in a bid to bring Hong Kong in line with other international financial centers such as New York and London, and more closer to home, Singapore.

The proposed exemption will broadly exempt any offshore person from profits tax in Hong Kong, where the person is a non-resident (or not a "resident") and derives profits from certain qualifying transactions. The Bill, however, contains certain anti-avoidance provisions, which could have broader application than perhaps what was initially intended.

2.2 Key Features of the Bill

The Bill seeks to introduce several new sections and a new Schedule to the Inland Revenue Ordinance (IRO). In particular, it introduced a new set of Exemption and Deeming provisions into the existing Part IV of the IRO.

Exemption provisions

The exemption provisions will operate to exempt any non-resident person (defined to include an individual, corporation, trustee or partnership) in respect of profits derived from:

- Dealings in securities, futures contracts and leveraged foreign exchange trading (qualifying transactions); and/or
- Profits from transactions that are incidental to the carrying out of qualifying transactions (incidental transactions), where the receipts from such incidental transactions do not exceed five percent of the total trading receipts from carrying out qualifying and incidental transactions

The term “resident” will be central to the operation of the exemption provisions. Under the Bill, only a non-resident will qualify for the exemption. In the case of a corporation/partnership/trust estate, the proposed definition of “resident” looks at where the relevant entity’s central management and control is exercised. In this regard, we understand that the Inland Revenue Department proposes to interpret “central management and control” as meaning the highest level of control of the business of the person, and if the central management and control of an entity is exercised in board meetings, the relevant locality is where the board of directors, partners or trustees hold meetings.

For non-residents, the exemption will also only apply to dealings in securities, futures contracts and leveraged foreign exchange trading carried out through “specified persons” licensed or registered under the Securities and Futures Ordinance (SFO).

The exemption provisions will not apply where a non-resident person carries on any business in Hong Kong that involves any transaction other than qualifying and incidental transactions.

The exemption provisions, if enacted, will operate retrospectively and cover profits earned by a non-resident person in any year of assessment commencing on or after April 1, 1996.

Deeming provisions

The deeming provisions, if enacted, will introduce a new concept in Hong Kong whereby the profits of an offshore fund (or person) can be subject to tax in the hands

of a Hong Kong resident having a certain level of beneficial interest in the offshore fund (or person).

The deeming provisions would subject to tax a Hong Kong resident person holding a beneficial interest in an exempt non-resident person (e.g., an offshore fund that satisfies the proposed exemption provisions) on its share of the non-resident person's Hong Kong sourced profits under certain circumstances. The proposed rules will apply where:

- The resident person, together with his “associates,” holds directly or indirectly 30 percent or more beneficial interest in an exempt non-resident person; or
- The resident person, together with his “associates,” hold any (i.e., no minimum threshold) direct or indirect interest in an associated exempt non-resident person.

The deeming provisions are an anti-avoidance measure designed to counteract the possibility of “round tripping,” a term used to describe the kind of situation where a Hong Kong resident structures its activities and interests as a non-resident to take advantage of the proposed exemption.

There will, however, be an exception to the application of the deeming provisions where the beneficial interests in the non-resident persons are regarded by the Commissioner of Inland Revenue as bona fide widely held.

The deeming provisions will not have retrospective application.

2.3 Status of the Bill

The first reading of the Bill was completed on July 6, 2005. A Bills Committee on the Bill was formed on July 8, 2005 to consider its implications before it is tabled for second reading debates at the Legislative Council meeting. The Bills Committee has invited interested parties to provide their written views on the technical aspects of the Committee Stage Amendments (CSAs) by December 31, 2005. It is expected that the Bills Committee will convene another meeting to consider the written submissions received before the second reading debate on the Bill resumes.

At the time of writing, there is no legislative timetable for the second reading and third reading of the Bill. However, it is understood that the Government would like to see the passage of the Bill as soon as possible.

2.4 Contact

For further details or assistance, please contact:

Darren Bowdern, Principal

KPMG in Hong Kong

Tel: +852 2826 7166

Fax: + 852 2845 2588 / 2524 5648

Email: darren.bowdern@kpmg.com.hk

Japan

3.1 International Taxation

3.1.1 Scope of Non-Permanent Residents

There are two categories of Japanese residents for individual income tax purposes: (i) permanent residents and (ii) non-permanent residents. While a permanent resident is taxed on his/her worldwide income, a non-permanent resident is taxed only on his/her Japanese source income and foreign source income paid in or remitted into Japan. Under the current tax law, a non-permanent resident is defined as a resident who has no intention to live in Japan permanently and has lived in Japan for less than five years. There have been some cases where taxpayers took advantage of such favorable treatment for non-permanent residents by leaving Japan for a short period of time and then re-entering Japan as a non-permanent resident.

The 2006 tax reform will include a rule to narrow the scope of non-permanent residents. Under the new rule, a non-permanent resident will be defined as a resident who does not have Japanese nationality and has lived in Japan for less than five years in the last ten years.

This amendment will be applied for determination of taxpayer's residency status on or after April 1, 2006.

3.1.2 Thin capitalization

The thin capitalization rule is an anti-avoidance measure to prevent a taxpayer from paying interest on a loan rather than distribute dividends on capital. Under the rule, broadly, interest expense is denied deduction to the extent that such interest relates to debts from overseas controlling shareholders in excess of three times the company's equity received from overseas controlling shareholders. An overseas controlling shareholder in this context means a non-resident or a foreign company, which controls the company in question by owning more than 50 percent of its capital stock or through some other special relationship with the company.

- **Bonds repurchase (saiken gensaki) arrangements**

Repurchase obligations under bonds repurchase (saiken gensaki or Japanese Repo) arrangements, etc., where funds borrowed can be traced to loans made by the borrower will be excluded from the definition of debt from overseas controlling shareholders. In this case, the safe-harbor debt-equity ratio will be reduced from 3:1 to 2:1.

This new rule will be applied to fiscal years ending on or after April 1, 2006. Thus, if a company's fiscal year ends on December 31, 2006, this new rule will be applicable for the year 2006.

- **Expansion of types of debts and interest subject to thin capitalization rule**

The types of debts and interest expenses subject to the thin capitalization rule will be expanded to include the following items: (Please note that if interest paid is includable in taxable income for Japanese corporation tax purposes in the hands of the recipient of interest, etc., such interest will be excluded from the interest expenses subject to thin capitalization rule.)

- (i) When a taxpayer borrows a loan from a third-party backed by a guarantee from its overseas controlling shareholder:

Debts: the loan borrowed from the third party

Expenses: the interest on the loan and guarantee fees paid to the overseas controlling shareholder

- (ii) When a taxpayer borrows a loan from a third-party by providing bonds borrowed from its overseas controlling shareholder as collateral:

Debts: the loan borrowed from the third party

Expenses: the interest on the loan and borrowing fees paid to the overseas controlling shareholder

- (iii) An arrangement with a combination of (i) and (ii):

Debts: the loan borrowed from the third party

Expenses: the interest on the loan, borrowing fees paid to the third-party and guarantee fees paid to the overseas controlling shareholder

This new rule will be applied to fiscal years beginning on or after April 1, 2006.

- **Information exchange for criminal investigation of cross-border tax evasion**

When a country having a tax treaty with Japan requests the Japanese government to provide them with information for a tax evasion investigation, even if there is no domestic tax interest for Japan, the Japanese tax authorities will have the right to make a voluntary investigation in Japan. Moreover, upon a judicial order, a compulsory investigation can also be carried out by the Japanese tax authorities. This amendment is in line with the global movements on transparency and information exchange discussed at the Organisation for Economic Co-operation and Development (OECD) Global Forum.

- **Transfer-pricing**

The Japanese tax authorities can use secret comparables when a taxpayer does not submit information that is necessary to calculate arm's length prices. In using secret comparables under the current law, the Resale Price Method, Cost Plus Method and methods similar to them are used. By virtue of the 2006 tax reform, the following two methods will be added to the methods that can be employed in using secret comparables:

- (i) Method based on net-margin ratio of companies carrying on similar business (method corresponding to Transactional Net Margin Method)
- (ii) Method to split total profits between overseas related companies and a taxpayer (method corresponding to Profit Split Method)

This amendment will be applied to corrections or determinations issued by the Japanese tax authorities on income for fiscal years beginning on or after April 1, 2006.

3.2 Other Tax Updates

3.2.1 Amendments to the Japan-India Tax Treaty - Agreement Reached in Principle

The Japanese Ministry of Finance made an announcement on October 31, 2005 that the Japanese government and the Indian government have reached an agreement in principle on the amendments to the Japan-India tax treaty. According to the announcement, withholding tax rates on dividends, interest, royalties and fees for technical services will be reduced to 10 percent and the provision for a tax sparing credit will be eliminated.

	Current tax treaty	After amendments
Dividends	15%	10%
Interest	10% (for banks) 15% (for others)	10%
Royalty Fees for technical services	20%	10%

3.2.2 Treatment of Special YK (Tokurei YK or TYK) Under the U.S. Check-the-Box Regulations

The U.S. IRS on December 19, 2005 released an advance copy of a Revenue ruling to address the U.S. federal tax classification of a Japanese Yugen Kaisha (YK) that becomes a Japanese Tokurei Yugen Kaisha (TYK or Special YK) under the new Japanese Company Law expected to become effective in May 2006.

The Revenue ruling concludes that a Japanese YK that becomes a Japanese TYK, pursuant to the changes in Japanese Company Law, will remain an eligible entity for purposes of the U.S. Check-the-Box regulations.

Background

Under the U.S. check-the-box regulations, certain business entities (including the Japanese Kabushiki Kaisha (KK) are always considered corporations (per se corporations) for U.S. federal tax purposes and are not eligible to elect to be treated as a pass through or disregarded entities (e.g., partnership, or entity disregarded as separate from its owner). However, under the U.S. regulations, a Japanese YK is eligible to elect to be treated as a partnership or disregarded entity for U.S. federal tax purposes.

Upon the new Company Law becoming effective, existing YKs will automatically become Kks in legal form. Such YKs will have two choices: (i) becoming an ordinary KK or (ii) continuously existing as a TYK keeping almost all of the characteristics of a YK. There was a concern that a TYK may be treated as a per se corporation for the U.S. check-the-box regulations purposes. However, the release of the Revenue ruling has eliminated the concern.

3.3 Contact

For further details or assistance, please contact:

James Dodds, Partner

KPMG in Tokyo

Tel: +81 (3) 6229 8230

Fax: +81 (3) 5575 3019

Email: james.dodds@jp.kpmg.com

Miyuki Murata, Senior Manager

KPMG in Tokyo

Tel: +81 (3) 6229 8044

Fax: +81 (3) 5575 3067

Email: miyuki.murata@jp.kpmg.com

Korea

4.1 Revised Withholding Procedure With Regard to Korean Investment Income Earned by Foreign Investors Located in a Tax Haven

On December 31, 2005, the National Assembly approved adoption of new provisions in the Corporate Income Tax Law (CITL) and Individual Income Tax Law (IITL), which had been proposed by Ministry of Finance & Economy (MOFE) with the aim to impose tax on Korean source income earned by a foreign investor in so-called tax havens. As of January 2006, the MOFE has not yet published what jurisdictions will be designated as tax havens.

The new CITL and IITL provisions dealing with special withholding procedures are summarized as follows:

- Investment income derived in Korea, such as interest, dividend, royalty, and capital gains from sale of shares, earned by foreign investors located in a tax haven jurisdiction specifically designated by the MOFE will be subject to Korean withholding taxes at the Korean domestic withholding tax rates (i.e., 27.5 percent for interest, dividend, royalty incomes and the lesser of 11 percent of the transfer price or 27.5 percent of the gains for capital gains from sale of shares), irrespective of any income tax treaty in force between Korea and the tax haven. Note: As of January 2006, the MOFE has not yet published which jurisdictions will be designated as tax havens.
- If the foreign investors affected by the new provisions provide documentary evidence proving that it qualifies for treaty benefits as the substantive owner of the income concerned to the Korean tax authorities within three years from the end of month tax is withheld, any difference between the amount withheld at the domestic tax rate and the tax amount based on the applicable tax treaty would be refunded within six months.
- The foreign investors affected by the new provisions may seek to apply the reduced rate under the applicable tax treaties at the outset by requesting for an advance approval to the Korean tax authorities, prior to receiving Korean source income, that they are eligible for the treaty benefits.

The above withholding procedures will come into effect from July 2006. The Presidential Decree related to these provisions has not been promulgated yet, however, the following specific items are expected to be included in the Presidential Decree:

- Conditions required in order for foreign investors to be regarded as beneficial owner of the profits received
- Documentary evidence required to be submitted to the Korean tax authorities in order for foreign investors to be regarded as beneficial owner of the profits

4.2 Interpretative Rulings and Judicial Cases

I. Interest incurred from a construction related loan, previously recorded as an asset, then treated as a current expense due to a revision in accounting principles, shall be excluded from the acquisition tax base, however, the tax authority may perform a comprehensive factual review to assess appropriateness of treatment (Sejong 2538, issued September 7, 2005).

Article 82-3(1) of the Local Tax Law Enforcement Decree provides that acquisition price of an asset (the tax base for acquisition tax purposes), shall be the price to acquire an asset at time of purchase. In addition, payments of all expenses (e.g., direct and indirect expenses to acquire asset, excluding value added tax (VAT), and which include finder's fees, design/planning costs, delinquency fees, interest on installment payments, and interest from construction reserves) that are made, or which shall be made, to a transaction party or third party to acquire the asset shall be included in determining acquisition price of an asset. Individuals, not corporations, acquiring an asset shall exclude interest from installment payments and delinquency fees from the asset's acquisition cost.

A prior ruling (*Sejong* 1684, issued July 15, 2005) stated that if taxpayers were to treat interest from construction funds accumulated in a reserve as a current expense, rather than an asset for accounting purposes, the said interest can be excluded from the acquisition cost. However, the tax authority could review the facts regarding such treatment to determine whether the treatment is appropriate.

A more recent ruling (*Sejong* 2538, issued September 7, 2005) also provides a clear interpretation that interest expense incurred during construction shall not be included in acquisition price for acquisition tax purposes and further specifies that where a taxpayer records interest payment for an asset under construction as a current expense due to a change in accounting principles, the said interest should not be included in acquisition cost of the asset, however, the ruling further states that the tax authorities may perform comprehensive factual review (e.g., company books) to assess the appropriateness of the treatment.

II. Timing of salary income recognition when an officer of a foreign invested company receives shares of a foreign related company subject to share transfer restriction for a certain period (Seomyeon 1Team-1321, issued October 31, 2005)

An officer of a foreign invested company is granted shares from a non-resident company entitling him/her to voting rights, dividends, and title transfer, however, certain limitations are placed on the officer from transferring such shares (i.e., maximum of up to a third of the shares can be transferred at the end of each year).

The ruling request asks when the income should be recognized for individual income tax purposes, that is, is the receipt of shares recognized as income when the above mentioned restrictions expire, or at the time the shares are first granted?

The ruling states that income earned on account of the shares granted should be recognized when the aforementioned shares are granted. If an officer or employee returns shares whose transfer restriction is not lifted at the termination of his/her employment under the company policy, taxable income of the year when such shares were granted should be recalculated by subtracting the portion returned to the company. In addition, dividend earned from such shares should be classified as dividend income of the officer or the employee, not salary income.

4.3 Transfer Pricing Issues

Arm's Length Price in share transfer between unlisted foreign subsidiaries

In accordance with a tax ruling (*Kook-shim* 2005seo1406, July 4, 2005), where a foreign subsidiary transfers unlisted shares in a Korean company to another foreign subsidiary at Arm's length price calculated based on the supplementary valuation method under the Inheritance and Gift Tax Law (IGTL), the share price evaluated based on the IGTL is acceptable under the Law for the Coordination of International Tax Affairs (LCITA) and its Enforcement Decree (arm's length price). Therefore, the valuation under IGTL should be considered when applying transfer pricing regulations to capital transactions between unlisted foreign related parties (e.g., share transfer).

In addition, the ruling provides that the transfer pricing regulations under the LCITA shall also be applicable in a share transfer between unlisted foreign related parties, and that when the primary methods, such as comparable uncontrolled price method (the CUP method), resale price method (the RP method), and cost plus method (the CP method) are not applicable, the valuation method under the IGTL can be considered an "other reasonable method". Therefore, the valuation method under the IGTL can be considered as one of the transfer pricing method in determining the arm's length price of shares transferred between unlisted foreign related parties.

However, as mentioned above, since the Korean transfer pricing regulations LCITA states that the other reasonable method shall only be used if an arm's length price cannot be determined by applying one of the first three methods, the feasibility of the use of CUP, RP and CP method should be first considered before applying the valuation method under the IGTL when determining the arm's length price of share transfer between unlisted foreign subsidiaries.

4.4 Contact

For further details or assistance, please contact:

Hyun-Kyung Jo

KPMG in Seoul

Tel: +82 (2) 2112 7696

Fax: +82 (2) 2112 0902

Email: hyunkyungjo@kr.kpmg.com

Malaysia

5.1 Budget 2006 - Tax Announcements

Group Relief

Subsequent to the Budget 2006 speech delivered by the Prime Minister YAB Dato' Seri Abdullah Bin Haji Ahmad Badawi on September 30, 2005, the *Finance Act 2005* was gazetted on December 31, 2005.

A key measure is the extension of group relief for tax losses. Among others, the conditions proposed in the Budget 2006 speech require that both the claimant and surrendering companies must be resident and incorporated in Malaysia with a paid-up capital of ordinary shares exceeding 2.5 million Malaysian ringgit (MYR), have the same accounting period and at least 70 percent common ownership. It is now stated in the *Finance Act 2005* that where the companies are related directly or indirectly through other companies, these other companies must also be resident and incorporated in Malaysia.

5.2 Contact

For further details or assistance, please contact:

Nicholas Crist, Executive Director

KPMG in Kuala Lumpur

Tel: +603 2095 3388

Email: nac@kpmg.com.my

New Zealand

6.1 Coalition Government Agreement Tax Issues

Following the New Zealand election in September 2005, the Labour-Progressive Government has entered into confidence and supply agreements with United Future and New Zealand First. Under the agreement with United Future, Mr Peter Dunne became Minister of Revenue outside Cabinet. This means that at least one of the minor parties seems set to exert some influence on the Government's tax policy.

As a result of the agreements and the Ministerial appointment, there have been some changes to the tax measures discussed in the June 2005 edition of *ASPAC Tax News*.

- **Business tax review**

The Government is undertaking a business tax review, with proposals expected to be released for consultation by mid-June 2006. The Ministers of Finance and Revenue have stated they envisage some “bold measures emerging” from the Review and that it will not just involve “tinkering with the tax rules”.

The stated aim of the review is to provide incentives for productivity gains and improved competitiveness with Australia. At this stage, it is expected that any changes will be effective from April 2008.

- **Carbon tax**

The Government has also announced that it will not proceed with the proposed carbon tax, which was to have applied from April 1, 2007. A review of the carbon tax also formed part of the confidence and supply agreements entered into with United Future and New Zealand First.

The proposal as originally stated would have introduced a carbon tax of New Zealand Dollars (NZD) 15/tonne. The tax would have applied to New Zealand's emissions from fossil-fuel based energy supplies, including industrial process emissions and fugitive emissions.

The Government has stated that it will consider other ways to meet New Zealand's commitments to lower greenhouse gas emissions. It is still possible that a more narrowly-based carbon tax could be imposed on inefficient energy users and emitters. Such a measure is being considered, together with incentive-based programs to encourage investment in renewable energy, tree-planting and energy efficiency and conservation.

- ***Taxation (Depreciation, Payment Dates Alignment, FBT and Miscellaneous Provisions) Bill***

This Bill has not yet been enacted into law because of the September election. As a result, the Minister of Revenue has proposed the postponement of certain measures, some of which were to apply from April 1, 2006, to ensure that taxpayers have sufficient information and time to comply.

The following measures are to be postponed:

- The alignment of provisional tax dates with goods and services tax (GST) due dates
- The ability of small businesses to base provisional tax payments on a percentage of their GST turnover
- The subsidisation of the voluntary use of pay as you earn (PAYE) intermediaries by small businesses

The application date of other measures in the Bill is currently expected to remain the same, but this will not be confirmed until the Bill is reported back to Parliament and enacted later this year.

- **Other issues**

Other tax issues included in the confidence and supply agreements but not yet actioned include the following:

- An increase in the tax rebate available for donations made to charities
- A discussion document on income splitting
- The development of a new taxation regime for the racing industry

6.2 Double Tax Agreements

There has been some recent double tax agreement (DTA) activity.

- **Spain**

New Zealand has signed a DTA with Spain, which has yet to be ratified and is therefore not yet in force. The DTA generally follows the Organisation for Economic Co-operation and Development (OECD) model, although the definitions of “permanent establishment” and “royalties” are somewhat more restrictive than New Zealand's other DTAs.

The rights of New Zealand and Spain to levy withholding taxes on certain payments have been agreed at the same rates as generally apply in New Zealand's other DTAs, namely:

- Dividends - 15 percent
- Interest - 10 percent
- Royalties - 10 percent

However, there is a protocol to the Agreement which applies if New Zealand enters into a DTA with an OECD member state and such DTA provides a lower rate of withholding on any of the above three categories. In that case, New Zealand is obliged to immediately enter into negotiations with Spain with a view to providing that lower rate. As New Zealand is currently re-negotiating its DTA with Australia, and there is a possibility that this DTA will incorporate lower rates, the protocol is likely to be triggered.

- **Singapore**

New Zealand and Singapore have signed a protocol to their DTA. This also has yet to be ratified. The protocol ensures that a tax exemption is available in Singapore for the short-term supply of commercial consultancy services by New Zealand entities to Singapore, unless the services are provided in connection with a permanent establishment or a physical presence exceeding 183 days.

The protocol also provides that income derived by an individual resident in New Zealand from professional and other non-employment activities (including scientific, professional, literary, artistic, and educational/teaching activities) will only be taxed in Singapore (and vice versa) if:

- The individual has a fixed base regularly available in Singapore (or New Zealand, as the case may be) for the purpose of performing the services, or
- The individual's physical presence in the other state exceeds 183 days in any 12 month period.

The change generally aligns the Singapore-New Zealand DTA with other (but not all) New Zealand DTAs.

- **Australia**

New Zealand and Australia have signed a protocol updating their DTA. The protocol includes changes to the exchange of information and tax collection between the revenue authorities, which enables the extension of Australia's Wine Equalization Tax rebate to New Zealand wine producers. The amended DTA will come into effect once both countries have introduced the necessary domestic legislation.

At the time the Protocol was announced, New Zealand's Minister of Finance stated that the issue of whether a new DTA would be negotiated between the two countries was under review. One factor in the decision is whether New Zealand is willing to lower withholding rates included in the DTA. This requires a general review of New Zealand's position on withholding tax rates. The Government expects to make a decision on this early in 2006.

As discussed above, the decision to allow a lower withholding rate in the Australian DTA would have flow-on effects for New Zealand's other DTAs, such as the New Zealand-Spain DTA.

6.3 Foreign Investment Fund Regime

Related to the proposed changes to the taxation of domestic collective investment vehicles discussed in the June 2005 edition of *ASPAC Tax News*, changes are also proposed to the taxation of foreign investment funds (FIFs).

The proposed changes are controversial. Broadly, they propose the calculation of income on a comparative value basis for all foreign portfolio investments. The comparative value method would tax gains (and losses) on an unrealised basis. To mitigate against this, a capped method is proposed for individual investors.

The main issue centres on the view that the proposed regime introduces a capital gains tax on offshore portfolio investments. It is feared that this, combined with the proposed removal of the “grey list”, will create a distortion towards investment in New Zealand assets. It is argued by some that this disincentive against normal international diversification could reduce the value of New Zealand's savings due to the restrictive range of investment opportunities available to New Zealand investors.

Furthermore, the proposals are still considered to be too complex. A key driver for change was the complexity of the current regime, which was largely considered to be leading to non-compliance. The perception that the new rules also require a number of intricate calculations has caused concerns and given rise to calls for a further review of the proposals.

A number of submissions have been made on the proposals and a Government announcement is expected shortly regarding their future.

6.4 Contact

For further details or assistance, please contact:

John F Cantin, Partner

KPMG in Wellington
Tel: +64 4 802 1262
Fax: +64 4 802 1224
Email: jfcantin@kpmg.co.nz

Donna Huggard, National Tax Director

KPMG in Wellington
Tel: +64 4 381 8041
Fax: +64 4 802 1224
Email: dhuggard@kpmg.co.nz

Papua New Guinea

The Papua New Guinea (PNG) Government brought down its 2006 Budget on November 15, 2005. The following is a summary of the major legislative changes.

Tax rates

Personal income tax rates have been reduced and the threshold at which the top marginal rate takes effect has been increased. The new rates with effect from January 1, 2006 and January 1, 2007 are as follows:

2005 rates		2006 rates		2007 rates	
Income over (PGK)	Rates	Income over (PGK)	Rates	Income over (PGK)	Rates
6,000	25%	6,300	25%	6,600	25%
16,000	35%	18,000	30%	18,000	30%
-	-	33,000	35%	33,000	35%
70,000	40%	70,000	40%	70,000	40%
95,000	47%	150,000	45%	250,000	42%

The tax rates for non-residents are the same as for residents in the table above except that non-residents do not benefit from the tax free threshold.

The tax rate for non-resident mining companies has been reduced from 48 percent to 40 percent.

Dividend withholding tax

Income that is distributed as dividends by a company is currently taxable both at the company level and as income for the shareholders. The Income Tax Act has been amended to make the dividend withholding tax the final tax in respect of dividends paid to individual resident and non-resident shareholders. This applies to all dividends paid after January 1, 2006 irrespective of when they were declared.

Infrastructure tax credit

The infrastructure tax credit for agricultural activities has been increased from 1 percent to 1.5 percent of assessable income.

New agricultural projects

The 20 percent concessional tax rate for new agricultural projects has been extended for a further five years to December 31, 2011. In addition, the minimum investment has been reduced from Papua New Guinea Kina (PGK) five million to PGD one million.

Company amalgamations

The amalgamation provisions of the Income Tax Act have been amended to allow a company to carry forward losses following an amalgamation, providing that either the continuity of ownership test is satisfied, or failing that, the amalgamated company is carrying on the same business it was engaged in when the losses were incurred.

Research and development (R&D) costs

Taxpayers are now permitted to lodge an appeal where the Research and Development Expenses Approval Committee denies a taxpayer's application for a 150 percent R&D income tax deduction.

Double deduction

A double deduction is now available for certain expenses incurred for the development of tourism in PNG. The expenditure for which a double deduction is available will include:

- Market research
- Participation in trade fairs
- Public relations work
- Overseas advertisements
- Maintenance of overseas sales offices
- Bringing travel agents to PNG for the purpose of promoting PNG tourism

Accelerated depreciation

New plant or articles acquired for the purpose of tourism within PNG will qualify for accelerated depreciation of 20 percent in the initial year.

Customs and import duties

Changes have been implemented to permit Customs to carry out audits after goods have been cleared and to make provision for the eventual change to the issuance of customs clearances by computer.

Import duties have been removed from a range of goods as a means of assisting the private sector, specifically canneries and fish processing plants, the tourism industry, the fishing and aquaculture industries and local manufacturers. In addition, fish imported for local processing will also be exempt from import duty provided the fish is imported by a licensed processor.

The final phase of the tariff reform program will continue with the duty on a range of goods falling by five percentage points on January 1, 2006. The Minister stated that a more comprehensive review of the tariff structures will be carried out in 2006.

Goods and services tax (GST)

The local sale of crude oil by a resource company will now be GST zero-rated if it is sold to a refiner for refining in PNG. The oil must not be resold within the country in an unrefined form and it must be entered into a licensed warehouse or bond store.

Mining levy

The mining levy will continue to be phased out as planned.

Capacity strengthening at the Internal Revenue Commission (IRC)

The IRC will be implementing changes aimed at improving compliance and targeting priority areas for revenue collection. Initiatives to be implemented in 2006, some of which have already commenced, include:

- Preparation of a corporate plan
- Implementation of an audit program for major corporate taxpayers
- Development of an audit training program for IRC staff
- Commencement of a prosecution program for non-compliance
- Creation of an intelligence system which will provide information that enables a better understanding of industries and taxpayers and assists in identifying areas of non-compliance
- Establishment of a cash economy task force to target both audits and taxpayer education programs
- Commencement of a taxpayer education program, including newspaper articles and tax agent seminars

7.1 Contact

For further details or assistance, please contact:

Lynette Morris, Partner

KPMG in Port Moresby

Tel: +675 321 2022

Fax: +675 321 2780

Email: lynette_morris@kpmg.com.pg

Philippines

8.1 New Tax Developments in the Philippines

8.1.1 Value Added Tax Rate Increased from 10 percent to 12 percent starting February 1, 2006

Pursuant to the recommendation of the Secretary of Finance contained in a Memorandum submitted to the President dated January 30, 2006, the Executive Secretary by authority of the President has issued a Memorandum on January 31, 2006 addressed to the Department of Finance (DOF), the Bureau of Internal Revenue (BIR) and Bureau of Customs (BOC) informing the said agencies of the approval of the President of the increase of value added tax rate from 10 percent to 12 percent effective February 1, 2006 pursuant to Republic Act No. 9337. The BIR through Commissioner, Mr Jose Mario C. Bunag, on the other hand has issued Revenue Memorandum Circular (RMC) No. 7-2006 on January 31, 2006 instructing all internal revenue officers, employees and others concerned of the said increase in the rate of value added tax (VAT).

8.1.2 Transition Rules on the 12 percent VAT

The following clarifications have been issued on the applicable VAT rate on billed but uncollected sale of services and on the issuance of invoices/receipts from cash register/point of sale (CRM/POS) machines.

- **Billed but uncollected sale of services** - The 10 percent VAT shall continue to apply on amounts due for services rendered before February 1, 2006 but collectible only after February 1, subject to the following conditions:
 - Taxpayer files an information return on or before February 28, 2006 showing the names of the clients and the contract price earned and outstanding as of January 31, and a declaration of the obligation to pay the applicable VAT
 - The seller billed the unpaid amount before January 31, 2006, and a copy of such billing is attached to the information return
 - The seller has recorded in his/her books of accounts the amount receivable as of January 31
- **Reconfiguration of CRM/POS machines** - Taxpayers using cash register machines and point of sale machines should reconfigure the program to reflect and show separately the 12 percent VAT. Until the reconfiguration is completed, manual invoices/official receipts (ORs) should be issued indicating the amount of the 12 percent VAT. If the taxpayer continues to issue invoices/ORs indicating the 10 percent VAT from the CRM/POS machines, the taxpayer/issuer shall be liable to the 12 percent VAT even if only a 10 percent VAT was collected from the buyer.

The BIR also issued a circular clarifying the amount subject to VAT and Expanded Withholding Tax (EWT) (Income Tax) of Brokers and others similarly situated and the other parties with whom they transact business. This memorandum circular provides for the following reimbursable expenses and/or advanced payments that shall not be subject to VAT on the part of the broker:

- The reimbursable expenses and/or advanced payments, except those incurred for the benefit of the brokers, are receipted separately using *non-VAT* official acknowledgement receipts to be issued by the brokers to customers upon collection of the reimbursements or advances previously recorded as *receivable for cash advances on behalf of customers*, which recording was done upon payment, on behalf of customers, of the advances to the third party service providers who issued official receipts in the name of the customers and not of the brokers.
- The third party service providers to whom the advanced payments or reimbursable expenses of the customers have been paid by the brokers shall issue receipts in the name of the customers.
- The brokers shall record the reimbursable expenses of or the advanced payments on behalf of customers under the account *receivable for cash advances on behalf of customers*.
- For liquidation purposes, the brokers shall attach the original copy of all said official receipts issued by the third party service providers in the name of the customers to the *non-VAT* official acknowledgment receipt of the brokers issued to their customers upon payment by the latter of the reimbursable expenses.

8.1.3 Conditions/Procedures in Claiming Deductions of Payments to Third Parties

To ensure that the proper taxes are deducted and withheld from such payments to third party service providers, the following conditions/procedures must be complied with:

- It shall be the responsibility of the brokers to instruct the third party service providers to issue the official receipts directly in the name of customers of the brokers.
- Upon making the payments to the third party service providers, the brokers shall compute and deduct the EWT due on the said payments. Likewise, the broker shall issue the Certificate of Tax Withheld for the deducted amount of EWT, which certificate shall reflect the name of the third party service provider as the payee of the income payment, the name of the Customer as the real payer of the income payment with parenthetical mention of the name of the broker as agent of the customer, the amount of income payment, the amount of EWT, the nature and description of income payment, the covered period and such other information as required under existing rules and regulations.
- In the subsequent claim for reimbursement of the said payments, the broker shall demand from the Customers only the amount actually paid to the third party service providers (which is already net of EWT) with instructions to said customers to remit to the BIR the amount of EWT on the said payments.
- The brokers shall attach to their *non-VAT* Official Acknowledgment Receipts (reflecting the amounts being reimbursed) the original copy of the official receipts issued by the third party service providers in the name of the customers of the brokers.

- The time for withholding of the taxes due on said payments to third party service providers shall be governed by the provisions of the prevailing law and regulations on the withholding of the tax on income payments reckoned from the time the reimbursement is claimed from the customers by the brokers.

8.1.4 Mere Reimbursements of Expense Not Subject to Expanded Withholding Tax (EWT)

With respect to the reimbursement to the brokers by their customers of the reimbursable expenses and/or advanced payments of the former in favor of the latter following the prescribed procedures, the same shall no longer be subject to EWT since these payments do not form part of the gross receipts of the brokers. They merely collect what they have advanced on behalf of their customers and hence do not derive any income from collecting such advances. However, for reimbursable expenses and/or advanced payments of expenses accruing to the benefit of the brokers, the same shall, upon reimbursement by the customers, form part of the broker's gross receipts and shall therefore be subject to EWT notwithstanding that such reimbursements are for payments of reimbursable expenses and/or advanced payments made by the brokers on behalf of their customers.

8.2 Contact

For further details or assistance, please contact:

Frank Tagao, Principal

KPMG in Manila
Tel: +63 (2) 894 1833
Fax: +63 (2) 894 1985
Email: fgtagao@kpmg.com

Maria Georgina J Soberano, Principal

KPMG in Manila
Tel: +63 (2) 893 8507
Fax: +63 (2) 894 1985
Email: gjsoberano@kpmg.com

Singapore

9.1 Case Law Update

IA v Comptroller of Income Tax [2005] SGHC 229

Under the Singapore tax system, income is subject to tax on a territorial basis whilst capital gains fall out of the tax net. Thus, only expenses incurred in producing those income that is subject to tax, are admissible deductions. Although section 14 of the *Income Tax Act (ITA)* provides the general deduction rule and makes specific reference to certain categories of expenses which are tax deductible, it does not provide an exhaustive list of deductible expenses. Section 15 of the ITA sets out expenses that are statutorily not deductible for tax purposes but is not comprehensive. Hence, like other tax jurisdictions round the world, taxpayers in Singapore do get into disputes with the Revenue on the deductibility of certain expenses. Recently, a number of such cases were heard before the courts of Singapore.

In this article, we discuss the recent case of *IA v Comptroller of Income Tax [2005] SGHC 229* where the High Court ruled in favor of the taxpayer and found the borrowing expenses, prepayment penalty and guarantee expenses to be deductible under section 14 of the ITA.

Background

The taxpayer carries on the business of a property developer and obtained a syndicated loan to finance the purchase of a parcel of land for the development of a condominium project and incurred borrowing expenses. Subsequently, when the taxpayer received revenue receipts from progress payments made by purchasers of the apartments in the Condo Project, it decided to repay Singapore Dollars (SGD) 100 million of the Syndicated Loan. In this regard, the taxpayer was required to obtain bank guarantees for the amount of withdrawal from the project account with respect to the revenue receipts under the Housing Developers Rules. The taxpayer incurred guarantee expenses and the repayment of the syndicated loan also resulted in a prepayment penalty.

The taxpayer claimed deduction for the borrowing expenses, prepayment penalty and guarantee expenses but the Comptroller of Income Tax (CIT) disallowed them on the grounds that they are capital expenditure. The taxpayer appealed to the Income Tax Board of Review (ITBR) and its appeal was dismissed. The taxpayer then appealed to the High Court.

Findings

The High Court allowed the appeal in respect of borrowing expenses, prepayment penalty and guarantee expenses as deductible expenses within section 14(1) of the ITA based on the following findings:

- As the syndicated loan was obtained solely to purchase the land and finance the development costs that formed its trading stock, the loan is revenue in nature. The borrowing expenses arising from the loan were accordingly also held as being revenue in nature.
- The prepayment penalty was incurred to avoid paying further interest arising from the syndicated loan (i.e., to commute or extinguish a contractual obligation to make recurring revenue payments) and hence it is revenue in nature.
- The guarantee expenses were not incurred to enlarge the capital of the taxpayer but to facilitate the release of the funds in the project account to pay off the syndicated loan which was for the purpose of acquiring trading stock.

Comments

In arriving at its decision, the High Court preferred to focus on the purpose for which the loan was obtained and used as opposed to the nature of the loan itself, that is, whether the loan was of a temporary and fluctuating nature, in determining the revenue or capital nature of the borrowing and other associated costs. The decision of the High Court provides much needed guidance to taxpayers in the light of the perennial revenue versus capital controversy. It is not presently known if the CIT is appealing against the decision.

9.2 Contact

If you have any enquiries on the case or need assistance in reviewing the deductibility of similar expenses, please contact the following persons:

Tay Hong Beng, Director

KPMG in Singapore
Telephone: +65 6213 2565
Email: hongbengtay@kpmg.com.sg

Agnes Schlesinger, Manager

KPMG in Singapore
Telephone: +65 6213 2642
Email: aschlesinger@kpmg.com.sg

Sri Lanka

10.1 Recent Tax Developments in Sri Lanka

In keeping with the proposals in the budget speech of the United People's Alliance Government for the year 2006 presented in parliament on November 8, 2005, a new budget was presented on December 8, 2005 by the recently appointed President Mahinda Rajapakse in line with his election manifesto (Mahinda Chinthana) to implement policies towards building a new Sri Lanka with rapid socio-economic development.

The following is a summary of the fiscal proposals presented in the new budget:

- **Rate changes**

- **Personal tax rates**

Personal tax rates pertaining to resident and non-resident individuals have been altered slightly in the new budget proposal. A new slab for taxable income between Sri Lanka Rupees (LKR) 1,100,000 - 1,600,000 has been introduced at the rate of 30 percent and taxable income of LKR 1,600,000 and upwards will be taxed at 35 percent. The prevailing tax rate for non-citizens employed in flagship companies from the sixth year to the end of the tax holiday of the company or for a further five years whichever is earlier will be increased from 15 percent to 20 percent. Whereas for non-citizens who are not employed in flagship companies the tax rate after the first three years of employment but before the sixth year of employment will be increased to 20 percent as opposed to the existing rate of 15 percent.

- **Corporate tax rates**

Resident companies that have a taxable income of less than 5 million will be entitled to a lower tax rate of 15 percent as opposed to the prevailing rate of 20 percent. In instances where the taxable income of the Company is over LKR 5 million, if the company is listed, within first five years after quotation it will be taxed at a rate of 33 1/3 percent. Thereafter, it will be taxed at a blanket rate of 35 percent. This differs from the present situation of listed companies being taxed at a blanket rate of 30 percent. Companies not listed having taxable income of more than LKR 5 million will be taxed at a rate of 35 percent as opposed to the prevailing tax rate of 32.5 percent. Non-resident companies which have a taxable income of less than LKR 5 million will be taxed at a rate of 15 percent as opposed to the present rate of 20 percent and companies that have a taxable income over LKR 5 million will be taxed at a rate of 35 percent as opposed to the prevailing rate of 32.5 percent.

Corporate Tax Rates

Resident/Non-resident companies - rates¹

	<i>Proposed Y/A 2006/2007</i>	<i>Prevailing Y/A 2005/2006</i>
Resident Companies		
Taxable income < LKR 5 million	15 %	20 %
Taxable income > LKR 5 million		
Listed - First five years after quotation	33 1/3 %	30 %
- Others	35 %	30 %
Others	35 % (<i>note 1</i>)	32.5 %
Dividends	10 %	10 %
Non-resident Companies		
Taxable income < LKR 5 million	15 %	20 %
Taxable income > LKR 5 million	35 %	32.5 %
Remittance of profit (chargeable to tax)	10 %	10 %

Note 1 - Rate applicable on profits and income from business of gaming and auto lotteries will be at 40 percent

• Co-operative Societies

The co-operative societies will be taxed at a rate of 15 percent as opposed to the current rate of 20 percent.

• Social Responsibility Levy (SRL)

SRL is to increase from the prevailing 0.25 percent to 1 percent.

• Ports and Airport Development Levy (PAL)

PAL on the importation of an article for processing and re-export has been abolished for the purpose of encouraging exports. Presently the PAL for same is 0.25 percent. PAL on other imports will be increased from the present rate of 1.5 percent to 2.5 percent.

• Economic Service Charge (ESC)

Proposed changes to ESC include the change of the basis of calculation from preceding year to current year. Reduction of minimum threshold for chargeability from LKR 50 million to LKR 40 million per annum and the increase of the limitation on charge for maximum per year of assessment from LKR 50 million to LKR 60 million.

• Taxation of Group Companies

• Transfer Pricing

It has been proposed to introduce regulations within the ambit of the tax statute to enforce the arm's length principle in transactions between related parties.

• Thin Capitalization

It was intimated that thin capitalization rules be introduced in the future. Further, deductibility of interest payments between members of a group of companies is proposed to be restricted to the a debt to equity ratio of 2:1 in the case of manufacturing companies and a ratio of 3:1 in the case of other companies.

• Concessions

• Agriculture

The budget proposal gives special prominence to the agricultural sector by introducing income tax concessions to processed primary agricultural products in addition to that already prevailing in respect of agriculture and the export of agricultural products such as fruits, vegetables, rice, cut flowers, foliage plants and organic agricultural produce. New incentives have been offered to encourage the cultivation of cashew.

• Development of Provinces

The budget proposals highlighted the importance placed by the new Government on the development of infrastructure at provincial and rural level to create pro-rural development programs with the introduction of income tax concessions for a period of five to ten years (depending on the nature of investment) for new industries that have a minimum capital investment of LKR 30 million and provide direct employment to a minimum of 200 persons in any district other than Colombo or Gampaha. A further duty and value added tax (VAT) exemption has been proposed on the importation of plant and machinery to be used in such projects.

• Industries

Industries in the nature of advanced technology, textile processing, domestically sourced export industry have been ear marked for income tax concessions. It has been proposed to extend the currently prevailing Board of Investment (BOI) incentives available to the textile industry to Thulhiriya and Horana textile processing zones. The health care, printing, gem cutting & polishing, packaging and rice milling industries have been granted an increased rate of tax depreciation on plant and machinery to 33 1/3 percent per annum from the existing rate of 12.5 percent per annum. Further, incentives have been offered to these industries in connection with the importation of machinery such as granting an import duty exemption on such machinery. It has been proposed that if an enterprise within the domestically sourced export industry receives an income in the form of convertible foreign currency from the company exporting the final product it will be eligible to a concessionary income tax rate of 15 percent.

- **Professionals**

In view of the growing number of Sri Lankan professionals providing professional services from or outside Sri Lanka for payment in foreign currency it has been proposed that such services be exempt from income tax. In the case of a company it will be entitled to a concessionary rate of tax of 15 percent. Further, foreign currency earnings on investment in foreign currency denominated treasury bonds with a maturity period of three to five years for professionals and Sri Lankans living overseas has been exempt from income tax.

- **International sports events, shipping and annuities**

Income tax concessions have been extended to international sports events such as “under 19 World Cup 2006” and shipping agents approved by the Director of Merchant Shipping will be entitled to a concessionary income tax rate of 15 percent on profits attributable to transshipment agency fees received in foreign currency. In view of encouraging savings and facilitating pension schemes it has been proposed by the budget to exempt from income tax the totality of any purchased annuity.

- **Administration**

Returns are proposed to be filed on or before September 30, immediately succeeding the end of that year of assessment. Presently the returns should be filed on or before November 30, immediately succeeding the end of that year of assessment. The time bar provision for raising assessments has been reduced considerably.

- **Stamp duty**

Stamp duty is to be re-introduced in respect of instruments and documents other than those which are subject to PAL, debit tax and share market transactions.

10.2 Contact

For further details or assistance, please contact:

Suresh Perera, Director

KPMG in Colombo

Tel: +94 (0) 11 2426 502

Fax: +94 (0) 11 2445 872

Email: sperera@kpmg.lk

Taiwan

11.1 Scope of Transfer Pricing Information Disclosure for 2005 Tax Year

The Ministry of Finance (MOF) of Taiwan recently issued the final rules governing the scope of transfer pricing information disclosure applicable to the 2005 tax year.

Background

The MOF imposed the requirement to disclose certain information on related parties and controlled transactions starting from the 2004 tax year pursuant to the Assessment Rules Governing Non-Arm's Length Transfer Pricing for Profit-seeking Enterprises Income Tax (TP Assessment Rules) that was introduced at the end of 2004. To alleviate the impact of this new compliance burden, the MOF later announced the disclosure standards to limit the application scope of this requirement for the 2004 tax year. Enterprises whose situations meet or exceed the standards must comply with the disclosure requirement.

Based on the filing statistics of the 2004 tax returns, the MOF announced a new set of disclosure standards for 2005 in a ruling dated December 30, 2005.

Enterprises Subject to Disclosure Requirements for 2005

- Profit-seeking enterprises whose annual combined total of net operating revenue and non-operating revenue (collectively referred to as "turnover") is greater than Taiwan New Dollars (TWD) 30 million, and who satisfy one of the following conditions are subject to the disclosure requirements:
 - Profit-seeking enterprises that have related parties (including head offices and branch offices) outside of Taiwan
 - Profit-seeking enterprises that enjoy tax incentives pursuant to tax concession laws or report deductions for losses carried forward from previous five years. However, this condition does not apply if the enterprises report tax credits for a combined total of no more than TWD 500,000 against income tax payable for the current year and surtax payable for undistributed earnings from previous year, or if the enterprises report deductions for losses carried forward from previous five years for no more than TWD two million.
 - Profit-seeking enterprises that do not meet the preceding two conditions and have annual turnover of TWD 300 million or more

Related Parties and Controlled Transactions Subject to Disclosure Requirement for 2005

- **Related Enterprises**

Profit-seeking enterprises subject to the disclosure requirement pursuant to the foregoing rules shall disclose relevant information on its related enterprises and controlled transactions therewith in prescribed forms of the income tax returns, if one of the following conditions is met:

- The annual aggregate amount of transactions with the same related person is TWD 12 million or more
- The annual aggregated amount of transactions with all related persons is TWD 50 million or more

- **Related Persons**

In respect of related parties other than related enterprises ("related persons"), profit-seeking enterprises subject to the disclosure requirement pursuant to the foregoing rules shall disclose relevant information on its related persons and controlled transactions therewith in prescribed forms of the income tax returns, if one of the following conditions is met:

- The annual aggregate amount of transactions with the same related person is TWD 6 million or more
- The annual aggregated amount of transactions with all related persons is TWD 25 million or more

Other Rules

- In determining whether indirect holding of issued and outstanding voting shares or capital stock in another profit-seeking enterprise is 20 percent or more, one shall refer to the Statement of Financial Accounting Standard No. 5. (Basically, this means that the holdings by affiliated companies shall be considered.)
- The "annual aggregate amount of transactions" is the sum of the absolute amounts of all transactions for the whole year, regardless of the transaction types and the classification of income or expense.
- Concerning the use of fund, the transaction amount shall be computed by multiplying the fund amount by the highest interest rate applicable to borrowing from non-financial institutions as announced by the MOF for the current year.

KPMG Observation

Overall, the 2005 disclosure standards are lower than 2004 standards. This reflects the intention of the MOF to see more enterprises disclose related party and controlled transaction information in 2005 tax returns. According to the statistics provided by the MOF, the number of enterprises affected by this new rule is estimated to be around 10,000, as compared to 4,500 in 2004.

11.2 Safe Harbor Rules for Transfer Pricing Report Requirement

The Ministry of Finance (MOF) of Taiwan recently issued the final safe harbor rules in respect of the transfer pricing report requirement.

Background

Starting from the 2005 tax year, enterprises with controlled transactions must prepare a transfer pricing report (TPR) to support the arm's length nature of the transfer prices pursuant to the Assessment Rules Governing Non-Arm's Length Transfer Pricing for Profit-seeking Enterprises Income Tax (TP Assessment Rules) announced at the end of 2004. The deadline for completing the TPR is when the return is filed. This is in addition to the information disclosure requirement that was implemented since the 2004 tax year.

However, if the controlled transaction amounts are below certain safe harbor standards, this requirement would be waived and enterprises can substitute the TPR with other documents that are sufficient to prove the arm's length nature of the controlled transaction. The MOF announced the safe harbor standards in a ruling dated December 30, 2005.

Enterprises Falling into the Safe Harbor

Profit-seeking enterprises are allowed to prepare documentations other than the TPR that can sufficiently establish the arm's length nature of controlled transactions if one of the following conditions is met:

- The annual combined total of net operating revenue and non-operating revenue (collectively referred to as "turnover") is less than TWD 100 million.
- The annual turnover is TWD 100 million or more, but less than TWD 300 million, and all of the following conditions are met:
 - The enterprises do not enjoy any tax incentives and did not report deductions for losses carried forward from previous five years. However, this condition does not apply if the enterprises report tax credits for a combined total of no more than TWD 1 million against income tax payable for the current year and surtax payable for undistributed earnings from previous year, or if the enterprises report deductions for losses carried forward from previous five years for no more than TWD 4 million.
 - The enterprises do not have any related enterprises (including head offices and branch offices) outside of Taiwan. (For a financial holding company, or company or its subsidiary governed by the Enterprise Merger and Acquisition Act, this applies to related parties other than related enterprises as well.)
- Profit-seeking enterprises that do not meet the preceding two conditions and have annual turnover of less than TWD 100 million.

Controlled Transactions Falling into the Safe Harbor

Profit-seeking enterprises that do not meet the above conditions shall prepare the TPR to evaluate the arm's length nature of its controlled transactions in accordance with the TP Assessment Rules when filing the income tax return. However, analysis for individual controlled transactions can be waived provided that:

- Other documentations than TPR that can sufficiently establish the arm's length nature of controlled transactions is prepared
- The applicable rules and reasons why the other documentations are sufficient are stated in the TPR
- The individual transactions meet one of the following conditions:
 - One of the participants to the controlled transaction is a government agency or a state-owned enterprise
 - All of the participants to the controlled transaction are profit-seeking enterprises within Taiwan, do not enjoy any tax incentive, and do not report any deduction for loss carried forward from the previous five years
 - For controlled transaction relating to operating income or cost items, the annual aggregate amount of controlled transactions of the same type is TWD 10 million or less. For controlled transaction relating to other items, the annual aggregate amount of controlled transactions of the same type is TWD 5 million or less.
 - For profit-seeking enterprises within Taiwan that do not enjoy tax incentives nor report deductions for losses carried forward from the previous five years, and:
 - For controlled transaction relating to operating income or cost items, the reported gross margin is above the standard profit margin of the same industry and the annual aggregate amount of controlled transactions of the same type is TWD 20 million or less
 - For controlled transaction relating to other items, the reported net margin is above the standard profit margin of the same industry profit, and the annual aggregate amount of controlled transactions of the same type is TWD 10 million or less
 - For controlled transaction relating to use of funds, the amount of funds is TWD 300 million or less, and:
 - The fund providers report revenue more than the amount of interest calculated by multiplying the fund amount by the basic lending rate of the Bank of Taiwan as of 1 January of the current year, or
 - The fund users report costs or expenses less than the amount of interest calculated by foregoing way.

Other Rules

- The "annual aggregate amount of controlled transactions" is the sum of the absolute amounts of all transactions for the whole year, regardless of the transaction types and the classification of income or expense.
- The "annual aggregate amount of transactions of the same type" is the sum of the absolute amounts of all transactions of the same type for the whole year, regardless of the classification of income or expense.
- Concerning the use of fund, the transaction amount shall be computed by multiplying the fund amount by the highest interest rate applicable to borrowing from non-financial institutions as announced by the MOF for the current year.

Substitute Documentations

Other documentations than TPR that can sufficiently establish the arm's length nature of controlled transactions include the following:

- The public tender documents and information, if one of the participants to the controlled transaction is a government agency or a state-owned enterprise.
- For other situations, information in relation to the internal comparable uncontrolled transactions between the enterprise and unrelated parties. If such information is not available, the following documents shall be prepared:
 - The public tender documents and information of comparable uncontrolled transactions
 - The market price information prescribed under Article 22 of Income Tax Assessment Rules, which refers to the following:
 - The market prices stated in newspaper or magazines
 - The weighted average product sales prices of the same month as recorded in the accounts of competitors in the same industry located in each county or city
 - The average market price of the same month, if there are several types of market prices available at the same time
 - The market price converted based on the duty paid price declared to the customs for imported goods
 - Valuation report issued by independent real estate appraisers or certification organizations.
 - The transfer pricing report prepared in accordance with local regulations by foreign related enterprise that is one of the participants to the controlled transaction. However, such report shall be modified, if the content clearly does not comply with the TP Assessment Rules.
- Other documents that fulfill the comparability principle under Paragraph 1, Article 7 of the TP Assessment Rules, and provide sufficient evidence that the transfer prices of the controlled transactions produce arm's length results.

KPMG Observation

The safe harbor standards are more complex and lower than what have been discussed and expected. The MOF estimates that around 1,300 enterprises will need to prepare a transfer pricing report based on such standards. It is anticipated that only small and medium sized companies are likely to benefit from this rule. Large companies are advised to review the scope of controlled transactions to be covered by the transfer pricing report and to ensure that adequate resources are available for timely completion of the report.

11.3 Contact

This information is intended to serve as a brief update on the recent development of new tax legislation or practice and is not intended to address many issues that may arise when the new legislation and practice is in effect. We will be pleased to further discuss this matter with you.

For further details or assistance, please contact:

Stephen Hsu, Partner

KPMG in Taipei

Tel: +886 (2) 2715 9817

Email: stephenhsu@kpmg.com.tw

Lorene Chen, Director

KPMG in Taipei

Tel: +886 (2) 2715 9823

Email: lchen2@kpmg.com.tw

Ninie Liu, Manager

KPMG in Taipei

Tel: +886 (2) 2715 9999

Email: nliu@kpmg.com.tw

Thailand

12.1 Conversion of Foreign Currency Amounts into Thai Baht

Departmental Instruction No. Paw. 132/2548 (DI No. Paw 132) came into effect on March 1, 2005 and provides a guideline for the conversion of foreign currencies into Thai Baht. It is included within Section 9, Section 65 bis (5) and (8) and Section 79/4 of the Revenue Code.

(I) Calculating withholding taxes and value added taxes

Clause 4 of DI No. Paw 132 provides direction on which rates should be used for the translation of foreign amounts. This is in accordance with Section 9 of the Revenue Code and the Ministerial Notification on Exchange Rate dated February 8, 2005. Accordingly, the following rates must be used:

- (1) Daily exchange rates (selling rates) announced by commercial banks which were established under the *Commercial Banks Act*, or
- (2) Daily reference rates (average selling rates) as prescribed by the Bank of Thailand.

(II) Calculating market value of foreign currencies, assets and liabilities

Clause 2 states that on the last day of the accounting period, a company or partnership, must convert its foreign currency, assets or liabilities using the Bank of Thailand rate only, as follows:

- Foreign currency and assets must be converted at the average buying rates of commercial banks, calculated by the Bank of Thailand
- Foreign liabilities must be converted at the average selling rates of commercial banks, calculated by the Bank of Thailand

This is in accordance with Section 65 bis (5) (a) of the Revenue Code.

Clause 3 states that foreign currency transactions *during the period* should be converted to Thai currency at the market price rate prevailing at the date of payment or receipt. A transaction could consist of buying or selling foreign currency, assets or liabilities. This is in accordance with Section 65 bis (5) paragraph two of the Revenue Code.

The market price rate referred to above is calculated as:

- (1) The daily exchange rates announced by commercial banks, established under the *Commercial Banks Act* (buying rate or selling rate), or
- (2) The daily reference exchange rates prescribed by the Bank of Thailand (average buying rate or average selling rate).

KPMG Comment

(I) The rate for conversion of foreign amounts during the period - an option

The new Ministerial Notification (MN) states that the exchange rate used for conversion must be the daily Bank of Thailand reference rate on “*the day that the transaction was incurred*”. This changed the previous ruling where amounts of foreign withholding and value added taxes were converted at the previous day rate.

Therefore under the new MN, if a company pays a royalty fee to a foreign company, say on Thursday November 3, 2005, the amount is converted at the daily Bank of Thailand reference rate of that day. The daily Bank of Thailand reference rate on November 3, however, represents the average exchange rates at the close of the previous day, Wednesday, November 2.

The new MN amendment is welcomed, as under the previous MN if a royalty was paid on November 3, the amount was converted at the previous day's daily Bank of Thailand reference rate. This meant it represented the average exchange rates two days previous to the date of the transaction, on Tuesday, November 1. The new MN therefore aligns closer the transaction and the exchange rate used for its conversion to Thai Baht.

The new MN also provides an option whereby the daily exchange rate of any other commercial bank which is established under the *Commercial Bank Act* may be used. In other words, the daily exchange rate announced by a commercial bank on Thursday, November 3, 2005 could be used in preference to the daily Bank of Thailand reference rate.

Although the Bank of Thailand announces a daily reference exchange rate like other commercial banks, as previously mentioned this represents the closing exchange rates of the commercial banks of the previous business day, that is, the average exchange rate of yesterday. For a rate announced on Monday this is the average exchange rate of three days ago. Hence, the option to use another commercial bank's rate other than that of the Bank of Thailand is also another welcomed change.

It should be borne in mind however that once the choice is made to either use the reference exchange rate of the Bank of Thailand or the daily exchange rate announced by a commercial bank, then a change cannot be made to any other as the same bank's rate must always be used in the future. For a change to an alternative Bank's rate, a company must obtain the permission of the Director-General of the Revenue Department. In practice, if the daily exchange rate of a commercial bank is used for converting foreign currency for withholding taxes or value added taxes, then care should be exercised to not revert back to using the daily reference rate of the Bank of Thailand. If that should happen it may result in a tax shortfall and this would have consequences.

(II) The Bank of Thailand rate for year end conversions

The daily rate of a commercial bank can be used to calculate foreign transactions during the year. The amounts remaining at the end of the year, however, can only be translated using the exchange rate of the Bank of Thailand. Section 65 bis (5) and (8) of the Revenue Code and the instruction under DI No. Paw 132 sets this out. Therefore, conversion of the remaining foreign currencies, assets and liabilities on *“the last day of the accounting period”* can only be at the Bank of Thailand rate.

Importantly, the option to use the rate of another commercial bank other than that of the Bank of Thailand for transactions during the accounting period should not be confused with the specific requirement to translate the year end foreign exchange balances at the Bank of Thailand rate only.

DI No. Paw 132 only provided a choice for converting assets, liabilities and cost of goods denominated in foreign currencies *“during the accounting period”* into Thai Baht, between the daily reference exchange rate prescribed by the Bank of Thailand or that rate announced by commercial banks.

12.2 Tax Exemption for Energy-Saving Equipment

Royal Decree No. 436 of the Revenue Code was issued to encourage replacement of equipment for energy-saving purposes. This Royal Decree will be effective up to December 31, 2006. A 25 percent exemption from personal and corporate income taxes has been provided for expenses associated with acquiring energy-saving equipment to replace existing equipment, not exceeding Thailand Baht (THB) 50 million.

The Royal Decree grants such tax exemption to the individuals, companies and juristic partnerships under the Revenue Code.

For individuals, the tax exemption is granted for income assessed only under Section 40 (5)-(8) of the Revenue Code. Used energy-saving equipment is not eligible for the exemption.

The tax exemption is granted according to an average measure of the exempted tax. The average is taken over a period of either:

- Five tax years, starting with the first tax year in which the equipment was acquired and ready to use, or
- Five accounting periods, starting with the first accounting period in which the equipment was acquired and ready to use.

KPMG Comment

The Director-General of the Revenue Department issued further guidance on the operation of Royal Decree No. 436 in a Notification No. 145, which sets out the rules, procedures and conditions of the tax exemption.

One notable condition, stated by the Notification, requires an applicant to file a separate application with the Department of Alternative Energy Development and Efficiency, Ministry of Science. The energy-saving equipment will then be inspected and, if approved, the Department will issue a certificate.

12.3 Import Duty Exemption for Energy-Saving Machinery

The Board of Investment issued a Notification No. 5/2548 for “promoted persons”. This provides them with an exemption from import duty on energy-saving machinery that has been approved by the Department of Alternative Energy Development.

In order to qualify for the exemption however, the energy-saving machinery must be imported within two years of the date of approval of the investment promotion. In order for an application to be considered for the exemption of import duty on energy-saving machinery, it must be submitted by or before December 30, 2009.

12.4 Tax Exemption for Staff Training

Royal Decree No. 437, issued under the Revenue Code, repeals former related legislation (Royal Decree Nos. 284, 288 and 298) to provide companies and limited partnerships with a tax deduction for staff training expenses as follows:

- 100 percent of the costs paid by the organization for any employee to study or train at educational institutions or labor skill development places, either set up by the government agency or announced in the governmental gazette by the Minister of Finance
- 100 percent of the costs paid by the organization for training employees under the rules, procedures and conditions set out by the Director-General of the Revenue Department

The Royal Decree also provides a tax deduction for certain expenses under the labour skill development law for trainers. The decree applies to personal and corporate income taxes, as follows:

- 50 percent of expenses paid for pre-work training that are beneficial to the business of the trainer during the period from January 29, 2003 to October 18, 2005
- 100 percent of expenses paid for pre-work training beneficial to the business of the trainer, from October 19, 2005

Please note however, that Royal Decree No. 437 does not repeal the provisions of Royal Decree Nos. 284 and 288 where income tax collections are still outstanding that should have been paid before October 19, 2005. In addition, the provisions of Royal Decree No. 298 are still effective if income tax collections are still outstanding that should have been paid before January 29, 2003.

12.5 Tax Exemption for Special Living Allowance

Royal Decree No. 438, issued under the Revenue Code, provides a tax deduction for 50 percent of certain employee special living expenses incurred by companies and juristic partnerships. It applies to expenses (employee living allowances) paid to employees from August 1, 2005 to December 31, 2007. In order to qualify, however, the special living allowance payments must commence by December 31, 2005.

The Director-General has issued a notification which provides the rules, procedures and conditions for the 50 percent deduction for tax purposes to apply. In order for 50 percent of the living allowance deduction to be accepted, the following conditions must be met:

- The qualifying amount is the amount actually paid in respect of an employee who receives a monthly salary not exceeding THB 7,000 per month. In addition, the monthly salary *plus* the special living allowance must not exceed THB 7,000 per month in total.
- The qualifying amount cannot exceed THB 1,000 per month in respect of an employee who receives a monthly salary between THB 7,000 to THB 10,000. In addition, the monthly salary plus the special living allowance must not exceed THB 10,000 per month in total.
- Payments of the special living allowance must be made on a monthly consecutive basis and have commenced before August 2005. The payments must also be in addition to the employee's normal salary and other income derived by virtue of employment.
- In the month of a special living allowance payment, employees' monthly salaries shall not be lower than those received in July 2005 for the employees who commenced working before August 2005. For those who commenced working after August 2005 it is the amount received in August 2005 for the employees.

The term "monthly salary" is defined under the Royal Decree as "money that an employer pays to an employee according to a written employment contract which shall be calculated on a monthly basis regardless of whether the payment period is fixed on a monthly basis".

KPMG Comment

Under the labor law, an employment contract is not required to be in writing. However, in order for the 50 percent tax deduction to apply, the Royal Decree requires that each "monthly salary" paid is in accordance with a written employment contract. Therefore, an employee without a written employment contract is required to have one in order for their living allowance to be allowable as a tax deduction (50 percent) for the company or juristic partnership.

12.6 Seven Percent VAT Rate Extended to September 30, 2007

Royal Decree No. 440, issued under the Revenue Code, extends the current value added tax (VAT) rate of 7 percent to September 30, 2007. From October 1, 2007, however, the Royal Decree increases the VAT rate to 9 percent, which combined with the municipal tax charge, will mean an effective VAT rate of 10 percent.

The VAT rate generally applies to the sale of goods, provision of services and the importation of goods.

12.7 Contact

For further details or assistance, please contact:

Sara Mattsson, Assistant Manager

KPMG in Bangkok

Tel: +66 (2) 677 2574

Fax: +66 (2) 677 2441-3

Email: smattsson@kpmg.co.th

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.

The views and opinions expressed herein are those of the authors and do not necessarily represent the views and opinions of KPMG International or any other member firm.

KPMG International is a Swiss cooperative that serves as a coordinating entity for a network of independent firms operating under the KPMG name. KPMG International provides no audit or other client services. Such services are provided solely by member firms of KPMG International (including sublicensees and subsidiaries) in their respective geographic areas. KPMG International and its member firms are legally distinct and separate entities. They are not and nothing contained herein shall be construed to place these entities in the relationship of parents, subsidiaries, agents, partners, or joint venturers. No member firm has any authority (actual, apparent, implied or otherwise) to obligate or bind KPMG International or any other member firm, nor does KPMG International have any such authority to obligate or bind any member firm, in any manner whatsoever.

© 2006 KPMG International. KPMG International is a Swiss cooperative that serves as a coordinating entity for a network of independent firms operating under the KPMG name. KPMG International provides no services to clients. Each member firm of KPMG International is a legally distinct and separate entity and each describes itself as such. All rights reserved. KPMG and the KPMG logo are registered trademarks of KPMG International. March 2006. NSW9543TAX.