



General tax update for financial institutions in Asia Pacific

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TAX

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Tax update

Australia



Changes in legislation

On 31 May 2006, the Tax Laws Amendment (Personal Tax Reduction and Improved Depreciation Arrangements) Bill 2006 was passed by the House of Representatives which proposed to:

- Increase deductions for the decline in value of a depreciating asset under the diminishing value method and project pools from 150% to 200%. A depreciating asset is defined as, broadly, an asset that has a limited effective life and can reasonably be expected to decline in value over the time it is used. Broadly, these amendments apply to assets that any taxpayer starts to hold on or after Wednesday 10 May 2006.
- Decrease personal income tax rates and thresholds, the Low Income Tax Offset, the Medicare levy phase-in rate and the fringe benefits tax rate.

These measures were announced on 9 May 2006 in the 2006-07 Australian Federal Budget.

On 25 May 2006, as part of the simplified imputation system, new share capital tainting rules were introduced into the House of Representatives within the Tax Laws Amendment (2006 Measures No. 3) Bill 2006 and New Business Tax System (Untainting Tax) Bill 2006. These amendments seek to ensure that companies cannot transfer profits to their share capital account and then distribute those profits to shareholders in the guise of preferentially taxed share capital. Accordingly, where a company transfers certain amounts to its share capital account, the account will become "tainted". Where the company taints its share capital account, a franking debit arises in the company's franking account. If the company chooses to untaint its share capital account, an additional franking debit may arise and untainting tax may be payable.

On 6 April 2006, the Tax Laws Amendment (2006 Measures No. 1) Bill 2006 received Royal Assent. Amongst other things, the Act provides that business capital expenditure that is not otherwise taken into account and is not specifically denied as a deduction by other provisions in the tax law can be deducted over 5 years starting in the year the expenditure is incurred. No relief was previously available for such expenditure.

The new rules apply to expenditure incurred on or after 1 July 2005.

Court cases

On 14 February 2006, the High Court of Australia in *Macquarie Finance Limited v Commissioner of Taxation* [2005] FCAFC 205 refused the taxpayer special leave to appeal against the decision of the Full Federal Court which had confirmed the Commissioner's objection decision to deny the taxpayer (a subsidiary of Macquarie Bank Limited) a deduction on 'interest' payable in respect of certain income securities. (For further details of this case, please refer to Issue 18 of this publication).

Other tax developments

On 24 May 2006, the Australian Taxation Office ("ATO") released Draft Taxation Ruling TR 2006/D8. Under the Ruling, foreign residents of many treaty partner countries which conduct enterprises as lessors or sub-lessors of substantial equipment that is used in Australia, may be deemed to have a permanent establishment in Australia. As a result, these foreign residents may not be liable to final royalty withholding tax on their lease rental payments, but instead may have an income tax liability in relation to the profits attributable to the permanent establishment. Where royalty withholding tax has been paid in relation to leasing arrangements for substantial equipment in previous years, a request for a refund can be made in writing to the ATO. The ATO is currently examining whether finance lessors and mortgagors of substantial equipment may also have a deemed permanent establishment in Australia.

On 13 April 2006, the ATO released Interpretative Decisions in relation to foreign exchange gains and losses. In one of the decisions, the ATO confirmed that where the head company of a tax consolidated group is an authorised deposit-taking institution, the entire consolidated group would be exempt from the operation of the foreign exchange realisation gains and losses provisions within Division 775 of the Income Tax Assessment Act 1997 (and instead be subject to different rules).

On 5 April 2006, the ATO released Draft Taxation Ruling TR 2006/D5 which concerns the taxation consequences of financing arrangements taking the form of sale and leaseback arrangements which involve depreciating assets subject to the capital allowance provisions within Division 40 of the Income Tax Assessment Act 1997 ("ITAA 1997"). The new Ruling revises and updates Taxation Ruling 1995/30, which it will replace when the new ruling is finalised, but it is substantially the same as its predecessor (albeit with more analysis of the potential application of the general anti-avoidance provisions).

On 26 April 2006, the ATO released Draft Taxation Determination TD 2006/D16 in relation to interbranch borrowings. Australia has specific rules dealing with Australian branches of foreign banks, and under these rules, there is a concessional 50% rate of withholding tax on notional interest paid on notional borrowings from head office/other branches. The Determination states that the concession will not be available, for example, where there is a borrowing from a third party that is booked through the accounts of another overseas branch (that has no real role in raising the funds), and which on-lends the funds to the Australian branch. In this example, the Australian branch would be taken to have borrowed directly from the third party, and interest would be subject to withholding tax at the full rate. The ATO is currently receiving submissions from professional bodies in relation to this draft Determination.

Hong Kong



Kim Eng Securities (Hong Kong) Limited v Commissioner of Inland Revenue

The Court of Appeal had unanimously dismissed the taxpayer's appeal in *Kim Eng Securities (Hong Kong) Limited v Commissioner of Inland Revenue* (Inland Revenue Appeal No. 7 of 2004) in its judgment handed down on 29 March 2006. The taxpayer is a company incorporated in Hong Kong and it is wholly owned by Kim Eng Holdings Ltd which is a company listed on the Singapore Stock Exchange. Under a scheme to get around the minimum commission rule in Singapore, overseas clients opened accounts with the taxpayer in Hong Kong to trade non-Hong Kong listed securities. The taxpayer derived commission income and claimed that the commission income was offshore sourced and therefore not subject to profits tax in Hong Kong.

The taxpayer argued that the profits arose offshore in Singapore or in the other countries where the securities were purchased or sold as the profits were generated from trades where the execution and conclusion was performed outside Hong Kong.

The Court of Appeal confirmed the Board of Review's decision and rejected the taxpayer's argument. The Court of Appeal held that the profits are Hong Kong sourced because the contractual arrangement between the taxpayer and the customer giving rise to the commission income is in Hong Kong. The Court also concluded what the taxpayer did to earn its share of the commission was bringing together the complementary needs of the customer (to pay less commission) and the overseas broker (to earn a portion of the commission from customers who were not prepared to pay the higher commission had they dealt directly with the local broker). The taxpayer did this by opening a trading account for a customer upon notification by the overseas office, taking note of settlement procedures/instructions, booking trades, matching confirmations, generating contract notes, following up on settlement of trades, making book entries of the transactions and reconciling statements and preparing/generating report on commission. All of these activities were performed by the taxpayer in Hong Kong.

The determination of the source of commission income was recently considered in two other cases, *ING Baring Securities (Hong Kong) Ltd v CIR* and *CIR v Indosuez W I Carr Securities Ltd*. In the Barings case, the Court of First Instance held that it was the execution of the trades that gave rise to the commission income and this was undertaken by the taxpayer's agents outside Hong Kong. As such, the commission income were held to be offshore sourced and non-taxable. The conclusions arrived at in Barings case differs from that in the case of *W.I. Carr*.

In the *W.I. Carr* case, the Court applied the operations test and considered the location of where the taxpayer undertakes all its business operations in determining the source of the commission income. Profits generated from orders placed by clients in Hong Kong on overseas markets were found to be sourced both onshore and offshore and therefore should be apportioned accordingly.

All three cases are currently under appeal. As a result, the source of commission income for Hong Kong tax purposes is unclear. At present, the conclusion of each case may vary depending on how the merit of each individual case is presented.

Insurance Companies Ordinance: Insurance Business Classes G and H

The Insurance Companies Ordinance ("ICO") was amended in 1993 to include retirement scheme management categories I and II as Classes G and H respectively under Long-term Business in Part 2, Schedule 1 of the ICO. It has been the Inland Revenue Department's ("IRD") practice to assess income arising from such a business as taxable under Section 23A of the Inland Revenue Ordinance ("IRO"), a specific section of the IRO governing insurance businesses.

Following a recent review of this matter by the Hong Kong Inland Revenue Department ("IRD"), the IRD has concluded that income arising from a business falling within Classes G and H should not be assessable under Section 23A of IRO. Rather, with effect from the year of assessment 2005/06, income arising from a business under Classes G and H will be assessable under the general assessing provision of the IRO (i.e. Section 14 of the IRO). This reflects the position that a contract for a retirement scheme is not a contract of insurance because it does not have as its principal object the provision of insurance.

India



The Finance Bill 2006 enacted on 18 April 2006

The Finance Bill 2006 was passed by both the Houses of Parliament and received the assent of the President of India on 18 April 2006. The rate of tax for the financial year 2005/06 and the rates of tax for advance tax and tax withholding for the financial year 2006/07 is specified in the Finance Act 2006. The main change relevant to financial institutions is, the rate of service tax which increased from 10.2% to 12.24% from assent date.

Additionally, the Government of India had amended the service tax import rules and valuation rules. Certain amendments had also been made to the export rules. The above developments have brought about some significant changes in the scope of the levy of service tax and the manner in which the taxable value is calculated.

Guidelines issued by the Central Board of Direct Taxes

The Central Board of Direct Taxes (the "CBDT") recently issued two guidelines. The first is Notification No. 93/2006 on zero coupon bonds which provides guidelines for the computation of pro-rata discount on such bonds effective from 1 April 2006. This guideline is mentioned in Rules 8B and 8C of the Income-tax Rules 1962.

The CBDT had issued Instruction No. 1827 on the 31 August 1989 which laid down tests to distinguish between shares held as stock-in-trade and shares held as investment. The CBDT had recently issued a further draft Instruction to supplement Instruction No 1827 on 16 May 2006. This draft Instruction is currently in a consultation phase between the government and industry stakeholders. It was advised to the Assessing Officers that no single criteria listed in the draft Instruction is determinative. The total effect of all the criterion listed in the draft Instruction should be considered before the nature of the activity (i.e. whether the shares are held as stock-in-trade or investment) can be determined.

Depreciation on Membership Card of the Bombay Stock Exchange (“BSE”)

Depreciation on intangible assets is allowable post year of assessment 1999/2000. The Mumbai Tribunal had held in *Vymoit Shares, Stocks & Investments Pvt. Ltd. v D.C.I.T* that depreciation on BSE Membership Card is not an allowable deduction for a broking company for the year of assessment 1998/99 because the BSE membership is an intangible asset.

Subsequent to the *Vymoit Shares* case, the rule on depreciation of intangible assets was amended such that depreciation on intangible assets would be tax allowable if the depreciation was incurred subsequent to the years of assessment 1999/2000. This new rule was upheld in the decision of *Techno Shares & Stocks Ltd. v. ITO* where it was held that depreciation on BSE Membership Card (an intangible asset) was tax allowable for the years of assessment on or after 1999/2000.

A foreign company can avail itself of the benefits of the Act or the Treaty whichever is more beneficial

In *Morgan Stanley Asset Management Inc. v JCIT* ITA No. 4274/Mum/2002, the taxpayer is a US incorporated company, deriving income from capital gains, dividend and interest during the financial year ended 31 March 1998. In completing its tax return, the taxpayer claimed that interest income should be subject to a lower tax rate having regard to the Double Tax Avoidance Agreement (“DTAA”) between India and USA and offered to tax capital gains and dividend income as per the domestic tax law. The Assessing Officer (“AO”) calculated tax on interest at the rate of 20% rather than 15% as provided in Article 11 of the India-USA DTAA. The Commissioner of Income-tax (Appeals) [“CIT (A)”] upheld the order of the AO, arguing that the taxpayer company has to apply either the rates prescribed in the Income-tax Act or in the DTAA for all sources of income, whichever is higher. The company is not allowed to adopt a ‘pick and choose policy’ to paying the tax.

The Income-tax Appellate Tribunal (“ITAT”) held that the company has not adopted a “pick and choose policy” when applying the tax rate. The tax rates that should be applied should be determined by the combined reading of the Income-tax Act 1961 and the DTAA. Thus, the company should be liable to pay tax at the rate of 15% on interest income being the maximum rate provided in Article 11. Although the local tax rate as per section 115AD is 20%, the applicable tax rate cannot exceed 15%, i.e. the maximum tax rate as prescribed in the DTAA.

The expression ‘Indian Concern’, for the purpose of Section 115A of the Act, includes Indian branch offices of foreign companies

In *Joint Official Liquidator of Bank of Credit and Commerce (Overseas) Ltd. v JCIT* ITA No. 4740/Mum/2001, the taxpayer is a non-resident company undergoing liquidation. During the year of assessment 1998/99, the company received interest on foreign currency non-resident (“FCNR”) deposits placed with Bank of Nova Scotia - Mumbai branch. The company paid tax at 20% under section 115A of the Income-tax Act 1961 (the “Act”). The AO was of the view that section 115A of the Act can only be applied when the interest is earned from an Indian Concern. The AO does not consider an Indian Branch of a foreign bank an Indian Concern. On this basis, the AO taxed the interest income at 48%. The CIT (A) upheld the order of the AO.

The Tribunal observed that the expression 'Indian Concern' used in Section 115A was not defined anywhere in the Act. A harmonious interpretation would suggest that the meaning of an Indian Concern should be taken as a business carried on in India including a business carried on in India by a non-resident.

The Tribunal relied on the CBDT Circular No. 740 dated 17 April 1996, 132 CTR (Statute) 5, which stated that the branch of a foreign company in India is considered to be an Indian Concern and a separate entity for the purpose of taxation. Accordingly, interest paid/payable by such a branch to its head office or any branches located abroad would be liable to tax in India, and should be governed by the provisions of section 115A of the Act. The Tribunal was of the view that this circular also covers the cases in which interest is payable by Indian branches of foreign banks.

As a result, the Tribunal held that the expression 'Indian Concern' should also include Indian branches of foreign companies. As such, the rate of tax applicable on the income earned by the company, (in this case, interest on foreign currency deposits) should be 20% instead of 48%.

The loss arising to a dealer from sale of shares acquired in the primary market is a loss in a speculation business.

In AMP SPG & WVG Mills Pvt Ltd. v ITO Ward 1(1) ITA No. 2358/AHd/2004, the Special Bench of the Ahmedabad Tribunal held that the loss suffered by the taxpayer company (which is a dealer in shares) on the sale of shares that were previously acquired by allotment, was a speculation loss for the purposes of Section 73 of the Act. Accordingly, any speculation loss suffered in the trading of shares acquired through public issues can only be offset against speculation gains of the taxpayer company.

Write off of Bad Debts is sufficient under the requirements of the amended provision of section 36(1)(vii) of the Act, for allowance as deduction

In DCIT v Oman International Bank SAOG and Spectrum Business Support Ltd v DCIT, the Special Bench of the Mumbai Tribunal held in the case of a bank, that it is the obligation of the bank to prove that the debt written off is indeed a bad debt for the purpose of obtaining a tax allowance under section 36(1)(vii)¹ of the Act. Previously, it was unclear whether the mere writing off of a debt is sufficient for claiming a tax deduction.

¹ Post the amendment to the section with effect from 1 April 1989.



Japan



Scope of non-permanent residents

The 2006 Tax Reform Bill was passed by the Diet on 27 March 2006 and subsequently the Cabinet orders and Ministerial orders have been made public. The scope of non-permanent residents has been changed due to the 2006 tax reform. The effect of the changes is to widen the definition of a permanent resident.

There are two categories of Japanese residents for individual income tax purposes:

- Permanent residents – which are taxed on their worldwide income; and
- Non-permanent residents – which are taxed on their Japanese source income and foreign source income paid in or remitted into Japan.

A non-permanent resident is a resident with no intention to live in Japan permanently and has lived in Japan for five years or less. Under the 2006 tax reform, the definition of non-permanent residents has been changed to a resident who does not have Japanese nationality and has lived in Japan for five years or less in the last ten years.

It should be noted that this amendment is applied to judgements of a taxpayer's residency status conducted on or after 1 April 2006. Thus, there will be people who become a permanent resident on 1 April 2006.

Also, under the new rules, a form including the following items is required to be attached to individual tax returns of non-permanent residents:

- The dates of entry into Japan (the date of having domicile or residence) and the dates of leaving from Japan (the dates of losing domicile or residence in Japan) during the last ten years
- Japanese source income for the year
- Foreign source income for the year and foreign source income paid in or remitted into Japan for the year
- Other related items.

When the form is published by the tax authorities, more details of what is required will be confirmed.

The possible results of these changes include:

- Some individuals who are non-permanent residents under the old law become permanent residents from 1 April 2006 and therefore are taxed on worldwide income;
- Some individuals who have returned to work in Japan after a break in Japanese residence could become permanent residents within five years of returning or even immediately on their return in some cases.

Korea



Taxation Ruling: Seomyun Team 2-596, issued 4 May 2006

Taxation Ruling Seomyun Team 2-596 was issued on 4 May 2006. In this ruling, it was held that in respect of borrowing and lending transactions between related parties (which includes companies which are no longer related or affiliated) where (i) the loan repayment period has been fixed, and (ii) the overdraft interest rate as prescribed under Article 89(3) of the Corporate Income Tax Law ("CITL") Enforcement Decree (i.e. the market rate) has been agreed by both parties, the timing of recognising interest income and interest expenses from the said transaction will be subject to Article 45(9)-2 of the CITL Enforcement Decree.

In Article 45(9)-2, companies paying interest on borrowings can claim deduction on interest payments in the year the payment is made. However, if the interest payments are made subsequent to the year-end closing date, and the interest payments are recorded in the companies' current year's accounts, based on the accrual method of accounting, the expense will be deductible in the year the expense is recorded in the companies' accounts.

However, if the loan repayment period in these borrowing and lending transactions is not in line with the repayment periods that are commonly adopted by independent non-related parties, the regulations denying unfair transactions under Article 52 of the CITL apply.

Revision to Corporate Income Tax Law

(Announced on 9 February 2006):

Currently under Article 73 and 76 of the Enforcement Decree in the CITL, only a special purpose company ("SPC") who enters into currency swap contracts to hedge against currency exchange risks associated with assets and liabilities denominated in foreign currencies is allowed to recognise the gains or losses from the valuation of such currency swap contracts in its accounts.

In this regard, companies other than SPCs are not allowed to offset gains or losses on assets and liabilities denominated in foreign currencies with the valuation gains or losses on currency swap contracts. As such, any gains on assets and liabilities denominated in foreign currencies by companies other than SPCs would be subject to corporate income taxes under the existing Article 73 and 76 of the Enforcement Decree.

However, this rule has been revised recently to allow all companies other and not just SPCs to recognise the valuation gains or losses from currency swap contracts in their accounts. Therefore, all companies are now allowed to utilise any valuation losses from currency swap contracts to offset against gains derived from assets and liabilities denominated in foreign currencies.

This amendment is applicable to currency swap contracts entered into on or after 9 February 2006.

Malaysia



Recent tax deduction order gazetted

Effective from the year of assessment 2006, a Real Estate Investment Trust ("REIT") or Property Trust Fund ("PTF") which is approved by the Securities Commission is now eligible for a deduction for the consultancy, legal and valuation fees incurred in the course of establishing the unit trust.

New Malaysia – Singapore Double Tax Avoidance Agreement ("DTAA")

The new DTAA between Malaysia and Singapore was ratified on 13 February 2006 and the DTAA is effective from 1 January 2007.

The salient features of the new agreement are as follows:

Category of income	Tax rate as per existing Treaty	Rates in the new Agreement
Dividends*	0%	0%
Interest	15%	10%
Royalties	10%	8%
Fees for Technical Services	10%	5%

* An underlying foreign tax credit on dividends received from Singapore is available if the beneficial owner is a company, which owns at least 10% of the voting shares in the company paying the dividend. A foreign tax credit on dividends received from Malaysia is available if dividends are paid out of profits.

It was further provided by way of a protocol that for the purposes of Article 10 (Dividends) of the Malaysia-Singapore DTAA, a company that is resident in Malaysia or Singapore may, when paying a dividend, declare itself to be a resident of the other Contracting State. This provision would however cease to have effect for dividends paid on or after 1 January 2008.

Carrying Forward of Unutilised Losses and Capital Allowances

The Ministry of Finance has recently issued guidelines on the carrying forward of accumulated tax losses and unabsorbed capital allowances by companies. These guidelines seek to clarify the continuity of ownership test which was introduced in the Finance Act 2005.

Effective from the year of assessment 2006, a company will not be allowed to carry forward unabsorbed tax losses and capital allowances to set off its future income if there is a substantial change i.e. more than 50% change in its ultimate shareholder.

Group Tax Loss Relief For Companies – New Section 44A of the Income Tax Act 1967

Following the gazette of the Finance Act 2005 on 31 December 2005, it has been clarified that it is not a requirement for the surrendering company and the claimant company to be incorporated in the basis year in which a claim for group tax loss relief is made.

In addition, to qualify for group tax loss relief, any indirect ownership must be through a medium of companies that are residents or incorporated in Malaysia. If the surrendering company and the claimant company are directly or indirectly held by another company, the last mentioned company must be a resident and incorporated in Malaysia. Previously the language in the Bill was silent on the status of the last mentioned company.

New Zealand



Taxation of investments

The New Zealand Government has now introduced draft legislation into Parliament regarding major amendments to the taxation of investments. There are two main areas being amended, being the taxation of collective investment vehicles (e.g. superannuation funds, unit trusts) and the taxation of overseas portfolio investment in shares.

Taxation of collective investment vehicles

The key feature of the new regime for taxation of collective investment vehicles (to be known as portfolio investment entities or "PIEs") is to align the taxation treatment of investment income from PIEs with that of direct investments by individuals. This removes the long-standing disadvantage of investing through intermediaries like managed funds that pay tax on capital gains.

Important aspects of the collective investment regime include the following:

- To qualify to be a PIE, an investment vehicle must:
 - have the provision of investment and savings services as its principal activity;
 - have at least 20 investors, with no single investor holding more than 10% of the PIE (some exceptions exist such as investing into another PIE);
 - not own more than 25% of any underlying entity (subject to exceptions);
 - not issue separate classes of interests that stream proceeds from the same asset to different interest holders;
 - be a New Zealand tax resident; and
 - elect to be a PIE
- A PIE must perform a notional wind-up on entering or leaving the new regime, under which a deemed disposition and acquisition occurs at market value.
- Individual investors into the PIEs will be able to elect a 19.5% tax rate if their income from all sources (including PIEs) in the previous year was NZ\$48,000 or less. All other individuals will be taxed at 33%.
- The individual investors will not pay the income tax themselves. Rather, the PIE will be required to calculate a hybrid rate based on the tax rates advised by its investors.

Taxation of offshore portfolio investment in shares

The existing foreign investment fund ("FIF") rules are being substantially amended for investors holding interest of less than 10% in overseas companies. Key features of the new regime include:

- The existing "grey list", which consists of countries where New Zealand portfolio investors receive more favourable tax treatment, is being abolished for New Zealand investors holding interests of less than 10% in a foreign company.
- Generally, investors will be taxed on 85% of the increase in value of their overseas share portfolio, and on dividends received or other proceeds received on realisation of investments. However, the FIF income taxable in any one year will be capped at the higher of 5% of the investment's opening market value or the net cash flow received from that investment (e.g. dividends).
- Any amounts not taxed in a given year due to the 5% cap will be carried forward to the next year and included in the FIF income calculation for the next year.

- The above rules would be applicable in general circumstances. However, in certain circumstances as prescribed by the legislation, the FIF income would be calculated using either one of the following methods:
 - a cost method under which FIF income is the higher of the amount of dividends received or 5% of opening cost;
 - a market value method under which FIF income will be 85% of the change in share value (plus dividends), i.e. no 5% cap applies
- Investments into Australian resident ASX listed companies will be exempt from the new rules, meaning only dividends from these companies are taxed, unless the investor is holding the shares on revenue account.

Individuals will be exempt from the new FIF rules if the original cost of their investment totals NZ\$50,000 or less.

Sri Lanka



Income tax

The following legislative changes were introduced with effect from 1 April 2006:

- **Thin capitalisation rules** were introduced to limit deductibility of interest on debts between related parties that exceed the prescribed gearing ratio. The prescribed gearing ratio is 3:1 for Manufacturers (manufactured products exceeding 50% of turnover) and 4:1 for all other types of industries.
- **Transfer Pricing rules** were introduced to enforce the arm's length principle in transactions between associated parties. Pricing methodologies to determine arm's length prices are still to be gazetted and are expected to follow the OECD methodologies.
- **Reintroduction of 10% withholding tax** on interest/ discount on corporate debts. This will lead to consistent taxation treatment of interest, irrespective of whether the interest arose from bank deposits, Government Securities or corporate debts.
Where tax has been withheld, it would generally be a final tax in the hands of individuals. Corporations would be entitled to a tax credit.
- **Purchased annuities** from banks or insurance companies received by senior citizens (60 years or above) are exempt from income tax.
- **The general corporate rate of tax** increased to 35% (from 32.5% prior to the amendments) where taxable income exceeds LKR\$5 million.

Stamp duty ("SD")

SD was introduced from 4 April 2006 and is payable to the Central Government on 'specified instruments' on an ad valorem basis or fixed charge. SD is chargeable when the instrument is executed, drawn or presented in Sri Lanka. Specified instruments include inter alia, affidavits, insurance policies, license to carry on trade, business, profession or vocation, credit card transaction claims, share certificates, bonds or mortgages affecting any property, promissory notes, lease or hire of any property, receipt or discharge given for any money or other property, and any other instrument gazetted.

Value Added Tax ("VAT")

The rate of VAT on financial services was increased from 15% to 20% effective from 1 January 2006.

Social Responsibility Levy ("SRL")

SRL is payable on income tax, excise duty and customs duty and the rate was increased from 0.25% to 1% with details as follows:

- Effective from 1 April 2006 for SRL payable on income tax; and
- Effective from 1 January 2006 for SRL payable on customs/ excise duty.

Economic Service Charge ("ESC")

This is a levy payable at a percentage of turnover of a trade, business, profession or vocation. The following changes have been introduced effective from 1 April 2006:

- Threshold for liability (turnover) reduced to LKR\$10 million per quarter, from the previous LKR\$50 million per annum (or LKR\$12.5 million per quarter).
- Maximum charge increased to LKR\$15 million per quarter, from the previous LKR\$50 million per annum (or LKR\$12.5 million per quarter).
- The calculation base (i.e. the turnover of the business) changed to 'current year quarterly basis' from the 'preceding year basis'.
- Deductible against income tax from any source, whereas previously, restricted to liability from the same source.

Taiwan



Major Amendments to Taiwan Income Tax Law

With the objective of developing a fairer tax environment, the Ministry of Finance (MOF) had proposed various amendments to the Taiwan Income Tax Law. The Legislative Yuan has recently passed the amendments which are effective from 2 June 2006. The amendments are applicable to the 2006 income tax return and the major changes which may affect financial institutions are summarised below:

1. Article 24 Calculation of income for profit-seeking enterprises

Allocation of costs/expenses between taxable and tax exempt income

According to the amended Article 24 of the Taiwan Income Tax Law, when calculating taxable income, companies, regardless of which industries the companies are engaged in, are required to allocate costs/expenses between taxable and tax exempt income. Except for those costs/expenses which can be specifically identified and are directly linked to either taxable income or tax exempt income, companies should use reasonable basis to allocate general costs/expenses between taxable and tax exempt income. The allocation rules shall be determined by the MOF.

At the time when this tax update is prepared, the MOF has not announced any allocation rules. However, in order to be prepared for the filing of 2006 income tax return, companies are encouraged to correctly identify their costs/expenses to taxable or tax exempt income and for general costs/expenses which cannot be separately identified, determine a reasonable basis of allocation.

Tax treatment on Taiwan dividends received by foreign companies

Under Article 42 of the Taiwan Income Tax Law, dividends received by Taiwan companies for the investment in Taiwan companies are exempt from tax in Taiwan. In order to avoid foreign companies to apply the above tax exemption, Article 24 was recently amended to deny foreign companies with Taiwan

branches entitlement to this tax exemption. A foreign company that receives dividends from its investments in Taiwan companies will be subject to 20% withholding tax as the final tax.

2. Article 66-9 : Calculation base for the 10% Surtax on undistributed retained earnings

Under the Taiwan imputation tax system which is effective for tax years beginning on or after 1 January 1998, an additional 10% surtax is imposed on retained earnings generated from post-1997 tax years that remain undistributed as of the end of the following tax year. The time frame for reporting and paying the surtax is from 1 May to 31 May of the second year after year end.

Prior to the amendment to Article 66-9, the term "undistributed retained earnings" refers to the amount of taxable income as assessed by the tax authority, or the amount of taxable income reported on the tax return as certified by a CPA, after making certain adjustments allowable for surtax calculation purposes. The calculation of undistributed retained earnings was based on the tax income rather than accounting income. However economically, it is the accounting income that will determine the ability of a company to make dividend distribution. Thus, the difference between accounting and tax income may result in unfair tax treatment (i.e. a company might be in a loss position for financial reporting purpose but in a profit position for tax reporting purpose and thus is subject to 10% surtax and vice versa).

The MOF had recently revised the surtax calculation. Under the amended Article 66-9 which is applicable from the 2005 surtax return (which will be filed together with the 2006 income tax return), "undistributed retained earnings" will be calculated in accordance with the Commercial Accounting Law after making certain adjustments allowable for surtax calculation purposes. The amendment is expected to ease the adverse surtax impacts arising from the gap between the financial and tax positions.

Thailand



Reduction of rates and exemption of taxes for commercial banks

With effect from 18 April 2006, Royal Decree No 454 ("RD 454") was issued to repeal the existing laws and introduce tax exemptions and reduced tax rates for commercial banks.

Repeal of Laws

Pursuant to RD 454, the previous laws which provide tax concessions (i.e. reduced tax rates and tax exemptions) to an International Business Facilities operator ("IBF operator") were repealed.

Reduction of rates and exemption of taxes on income from deposits or borrowed funds from sources outside Thailand for offshore lending

Where a commercial bank under the law governing commercial banking in Thailand undertakes the business of accepting deposits or borrowing funds from sources outside Thailand for offshore lending purposes, the RD 454 provides for reduced tax rates and certain tax exemptions to such commercial banks.

Details of the new rules are as follows:

- Reduction of income tax rate to 10% of net profits derived by the commercial bank.
- Exemption of withholding tax on interest payments by the commercial bank to non-residents of Thailand.
- Exemption of withholding tax on profits paid by the commercial bank out of Thailand.
- Fees received by a commercial bank for acting as a manager in circumstances of joint lending, will be exempt from tax.
- Exemption of Specific Business Tax on the following income:
 - (a) interest, discounts, fees, consideration for services, or gross profits from purchase or sale of, or obtained from, negotiable instruments or any document of indebtedness; and
 - (b) gross profits from exchange or purchase or sale of currencies, issuance of negotiable instruments or any document of indebtedness, or remittance of currencies to a foreign country.
- Where a commercial bank was liable to stamp duty as a result of accepting deposits or borrowing funds from sources outside Thailand for performing offshore lending activities, the commercial bank will now be exempt from stamp duty under the new rules.

Transitional

With the introduction of RD 454, IBF operators are allowed certain concessions during a transition period:

- Interest payments paid by an IBF operator to non-residents will be exempt from withholding tax for 3 years provided the deposits or borrowed funds are from sources outside Thailand for offshore lending purposes.
- Reduction of withholding tax rate to 10% on interest payments to non-resident individuals by an IBF operator for domestic lending purposes.
- Exemption of withholding tax on interest payments to non-residents by an IBF operator for domestic lending purposes, where the IBF operator has lent monies to a state enterprise.

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