

Asia Newsletter

January 2009



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China

Debt to equity ratio introduced

- By circular (2008) no. 121 issued jointly by the Ministry of Finance (MOF) and the State Administration of Taxation (SAT), debt to equity ratios of 2:1 for non-financial enterprises and 5:1 for financial services enterprises were introduced in the New Enterprise Income Tax Law for qualifying related party situations, unless parties can demonstrate that their loans are at arm's length or that the tax rate of the borrowing company is lower than that of the lender company in China.

VAT

- On 15 December 2008 the MOF and SAT published detailed new implementation rules to clarify various changes to the amended VAT regulations. The new rules confirm that the newly added quarterly VAT filing cycle is applicable only to small VAT taxpayers, and that the input VAT paid on motorcycles, automobiles, and yachts is not creditable against the output VAT.

Business Tax

- The MOF and SAT also published detailed new implementation rules for the amended business tax regulations, stating that if a person who either performs or accepts the services is located in China, the services will be regarded as being provided inside China and hence subject to the Chinese Business Tax.
- This marks a shift in the business tax principle from the place of performance to a mixture of the place of destination (regarding services accepted in China) and the place of origin (regarding services performed in China). This change is reportedly believed to be a movement toward a unified VAT law that would ultimately abolish the business tax and impose VAT on both goods and services.

- Under the new Business Tax principle, services that are physically performed offshore by foreign service providers for Chinese residents will be subject to Business Tax. Meanwhile, China has not exempted services performed onshore by Chinese service providers for foreign residents from the business tax, or refunded the business tax on exportation of the services. Under the current rules, only technology development services or technology licenses for foreign residents are exempted from Business Tax. China has therefore maximized its taxing authority to impose business tax on both onshore and offshore services. However, it is generally felt that it remains to be seen how this new principle will be implemented.

Tax Administration

- The MOF and SAT have issued a Notice to reform the procedure for certain outbound payments with effect from 1 January 2009. According to the notice, the outbound remittance from China of all types of service trade income will require a tax certificate documenting the payment or exemption of the applicable Enterprise Income Tax (EIT) and Business Tax. This notice is considered a significant drawback from the trial measure, which simplified the outbound payment process, and it could again make outbound remittances a burdensome exercise. The change is believed to have been made partly because of the change in the Business Tax principle. The implementation of the new notice is still pending the issuance of detailed tax rules on how Chinese taxpayers may obtain the required certificates from the tax authority for outbound remittances.

Real property

- The Chinese government announced on 17 December that as a measure to stimulate the real property market, it will abolish Urban Real Estate Tax as well as cut the transaction tax for properties with ownership of two years or less. It added that it would encourage banks to extend credit lines to developments in the mass-market housing segment.

The information below is produced by Loyens & Loeff in Singapore and Tokyo. It is designed to alert those (interested in) doing business in the Asian region to recent developments in the region. Such developments are discussed in brief terms and are based on generally available information. The materials contained in this publication should not be regarded as a substitute for appropriate detailed professional advice. The information below was assembled based on information available as at 31 December 2008.

VAT Reform

- The State Council has approved the MOF/SAT proposal concerning the VAT Reform. It is expected that the text of the new VAT provisions will be published shortly. They are likely to apply as from 1 January 2009. The reform focuses on:
 - The input VAT credit on purchases of fixed assets by businesses will apply to all industries subject to VAT nationwide. The full amount of the input VAT on fixed assets would be recoverable. Fixed assets exclude personal cars, motorcycles, yachts and real estate for the VAT purposes;
 - The VAT exemption on certain imported equipment has been discontinued;
 - VAT refunds on domestically manufactured equipment purchased by foreign investment enterprises has been discontinued;
 - The VAT rate for small-scale taxpayers has been reduced to 3%; and
 - The VAT rate on mineral products has been increased to 17%.

Tax treatment of shipping and airline activities

- China's State Administration of Taxation has released a new tax notice, Guo Shui Han [2008] No. 952 (Notice 952), clarifying the enterprise income tax (EIT) treatment of non-resident enterprises that generate international transportation income from ships and aircraft. The notice was dated 24 November 2008, and has retroactive effect from 1 January 2008.
- As background, when foreign airlines or sea transportation companies ship passengers or goods that originate in China, the resulting transportation income is deemed to be sourced in China and therefore is subject to EIT. China adopted a deemed profit rate of 5% for China-source international transportation income. When the previous income tax rate was 33%, it resulted in an effective income tax rate of 1.65% on the gross revenue.
- Notice 952 confirms that the 5% deemed profit rate for international air or sea transportation income will remain as is.

However, because the new EIT law that took effect 1 January 2008, reduced the standard income tax rate from 33% to 25%, the effective income tax rate will become 1.25% of the gross revenue.

- China also imposes a 3% business tax on the gross revenue from international transportation. When taking into account the 3% business tax, Notice 952 confirms that the combined effective tax rate is 4.25% of the gross revenue, covering both EIT and business tax.
- However, China has entered into international transportation agreements with about 50 countries or jurisdictions that may exempt or reduce the business tax, EIT, and even individual income tax. Therefore, airlines and sea transportation companies should consider the relevant transportation agreements before paying the combined 4.25% Chinese taxes.

Regional Headquarters in Shanghai

- Based on a news report by law firm O'Melveny & Myers, we note that with effect from November 2008, qualifying investors may enjoy subsidies or tax benefits from the Shanghai municipal authorities if they satisfy pertinent conditions.
- In terms of financial incentives, multinational companies that choose to establish their regional headquarters in Shanghai in the form of a holding company (so-called "investment-type" company) will be entitled to a subsidy of RMB 5 million, to be disbursed over the course of three years. Multinational corporations that set up regional headquarters in Shanghai will also be entitled to a rent subsidy for a period of three years, with such subsidy equal to 30% of deemed rent calculated assuming an office space of 1,000 square meters and a daily rent of RMB 8 per square meter. Companies that purchase their premises will be entitled to a subsidy in the same amount to be paid in one lump sum. Furthermore, for multinational corporations recognized as being at the national level by the Ministry of Commerce, a one-time lump sum payment of RMB 10 million will be awarded to a holding company if it has generated revenues of over RMB 1 billion for the first time; a one-time lump sum payment of RMB 5 million will be awarded to a management-type company if it has generated revenues of over RMB 500 million for the first time.

- Holding companies are also encouraged to set up financial services companies to help manage the financial aspects of their daily operations. Commercial banks in Shanghai are encouraged to provide all financial services that the regional headquarters of the multinational corporations periodically require. In addition, personnel working for the regional headquarters of multinational corporations are entitled to preferential or simplified immigration requirements for living and working in Shanghai. Such benefits include simplified procedures for entry visas, long-term residency, permanent residency, and visas for Chinese employees going abroad.
- Certain qualified regional headquarters and their research and development centres may also receive preferential treatment when their goods are cleared through customs.

International Tax Developments

- France. The SAT has issued a technical explanation on how to implement article 1 of the protocol to the China-France income tax treaty. The protocol has been exempting the supervision of the assembly or installation of equipment or of an industrial or commercial plant from being regarded as a permanent establishment. However, by defining what are considered to be exempted supervision activities, the SAT appears to be limiting the application of the PE exemption.

Hong Kong

International Tax Developments

- Vietnam. Hong Kong signed a tax treaty with Vietnam on 16 December 2008. The treaty provides for a 10% withholding tax rate on dividends and interest payments (which in respect of dividends should have no consequences under the present domestic tax laws of the countries given their pertinent legislation in this regard which does not impose withholding tax). The treaty also provides for 7% withholding tax on royalty payments for the right to use any patent, design or model, plan, secret formula or process and 10% on all other royalties. The treaty contains a 180 days services-PE test as well as a LOB clause that treaty benefits may be denied if the predominant purpose is to enjoy the treaty benefits and no other business rationale can be provided why a Hong Kong company is being used.

India

Works constituting a PE in India

- It was reported that the Delhi Income Tax Appellate Tribunal, in *Fugro Engineers B.V. v. ACIT*, held that geotechnical and geophysical work carried out by a foreign engineering company at client sites and on a moving vessel in India constituted a fixed place of business and therefore resulted in a permanent establishment in India.

The Vodafone case

- The Bombay High Court on December 3 dismissed Vodafone Essar's challenge of a \$2 billion capital gains tax claim stemming from Vodafone's 2007 merger with Indian telecom company Hutchison Essar.
- India's Income Tax Department claims that U.K.-based Vodafone should have withheld approximately \$2 billion in CGT at source when it acquired Hong Kong-based Hutchison Telecom International Ltd.'s (HTIL) 52% stake in Hutchison Essar, which at the time was India's fourth-largest mobile phone company. The tax authorities maintain that because most of the assets were in India, the deal was subject to Indian CGT. They also claim that under Indian law, the buyer is required to withhold CGT and pay it to the government.
- The tax department issued a show-cause notice to Vodafone Essar in September 2007, demanding that the company explain why it should not be treated as an agent (or representative assessee) of Vodafone under Indian tax law.
- Vodafone argued that it had no Indian tax liability on the transaction because the transfer of shares took place outside of India. The company says the shares were transferred from the original shareholder in Hong Kong (HTIL) to the Cayman Islands-based CGP Investment Holdings, then on to an entity in Mauritius. Vodafone further claims that Indian law at the time did not require it to withhold tax on the acquisition and that any tax liability lies with the seller of the shares -- that is, HTIL -- and not the buyer.
- Vodafone Essar had submitted an amended writ petition to the High Court in June challenging the constitutionality of a retroactive

amendment to India's tax laws in May 2008 that widens the scope of an "assessee in default" for withholding tax purposes, thereby enabling Indian tax authorities to take action against companies that do not withhold taxes when making a transaction.

Transfer pricing

- The High Court of Punjab and Haryana has issued its ruling in Coca Cola India Inc. v. Assistant Commissioner of Income Tax, holding that assessments for periods before the introduction of detailed transfer pricing provisions in Chapter X of India's Income Tax Act can be reopened on the basis of subsequent transfer pricing orders.

Liaison office not taxable

- India's Authority for Advance Rulings has held in Ikea Trading (Hong Kong) Ltd. that a liaison office set up in India to encourage the purchase of goods from India raises no income and lacks a business connection in India under section 9(1)(i) of the Income Tax Act, 1961.

External Commercial Borrowings (ECB)

- The RBI has issued a circular A.P. (DIR Series) Circular No.46 dated 2 January 2009 in which it has modified some aspects of the present ECB policy as indicated below:
 - All-in-cost ceilings: the all-in-cost ceilings for ECBs, in respect of both Automatic as well as Approval routes are as follows:
 - All-in-Cost ceilings over 6 Months LIBOR
 - Three years and up to five years 300 bps
 - More than five years 500 bps
 - RBI has now decided to dispense with the requirement of all-in-cost ceilings on ECB until 30 June 2009. Accordingly, eligible borrowers, proposing to avail of ECB beyond the permissible all-in-cost ceilings specified above may approach the Reserve Bank under the Approval Route.
 - In May 2007, RBI had withdrawn the exemption accorded to the 'development of integrated township' as a permissible end-use of ECB. It has now been decided to permit corporates,

engaged in the development of integrated township, as defined in Press Note 3 (2002 Series) dated 4 January 2002, issued by Department of Industrial Policy and Promotions, Ministry of Commerce & Industry, Government of India to avail of ECB under the Approval Route. The policy will be reviewed in June 2009.

- In an effort to boost the cash-starved realty sector, this move will allow the developers of integrated townships to borrow funds from overseas.
- Non-Banking Financial Companies (NBFCs) are permitted to avail of ECB for a minimum average maturity period of five years to finance import of infrastructure equipments for leasing to infrastructure projects in India
- It has now been decided to allow NBFCs, which are exclusively involved in financing of the infrastructure sector, to avail of ECBs from multilateral / regional financial institutions and Government owned development financial institutions for on-lending to the borrowers in the infrastructure sector under the Approval route. While considering the applications, Reserve Bank will take into account the aggregate commitment of these lenders directly to infrastructure projects in India. The direct lending portfolio of the above lenders vis-à-vis their total ECB lending to NBFCs, at any point of time should not be less than 3:1. This facility will be reviewed in June 2009.
- At present, entities in the services sector viz. Hotels, Hospitals and Software sector are allowed to avail of ECB up to USD 100 million per financial year for import of capital goods, under the Approval route. It has now been decided to permit the corporates in the Hotels, Hospitals and Software sectors to avail of ECB up to USD 100 million per financial year, under the Automatic Route, for foreign currency and / or Rupee capital expenditure for permissible end-use. However, the proceeds of the ECBs should not be used for acquisition of land.
- The modifications to the ECB guidelines will come into force with immediate effect. All other aspects of ECB policy, such as USD 500 million limit per company per financial year under the Automatic Route, eligible borrower, recognized lender, end-use, all-in-cost ceiling, average maturity period, prepayment, refinancing of existing ECB and reporting arrangements remain unchanged.

Limited Liability Partnerships

- It was reported on 17 December that the Indian Parliament has adopted the Limited Liability Partnership Bill 2008 (LLP Bill).
- The current Indian Partnership Act 1932 will not apply to limited liability partnerships (LLPs), which means that unlike an ordinary partnership, LLPs may have an unlimited number of partners;
- A partner in a LLP can be an individual or a corporate body;
- The liability of the partners in a LLP would be limited to their agreed contribution;
- The use of a LLP can encompass several business activities and is not limited to professional services only;
- The LLP Bill includes procedures with regard to mergers, amalgamations, liquidation, etc., and on the conversion of ordinary partnership, private limited companies or unlisted public companies into LLPs; and
- The LLP Bill enables non-residents individuals or corporate bodies to be partners in an LLP formed in India. The LLP Bill also permits foreign LLPs to establish a presence in India although the rules governing this are yet to be issued.
- The Ministry of Corporate Affairs would be in charge of the LLP laws and LLPs would need to register themselves with the Registrar of Companies. The Ministry of Corporate Affairs is said to be drafting rules and regulation with regard to the formation, management and liquidation of LLPs.

Deemed dividend

- It was reported that the Special Bench of the Mumbai Income-tax Appellate Tribunal in the case of Bhaumik Colour Pvt. Ltd. held that deemed dividend under section 2(22)(e) of the Income-tax Act, 1961 would be taxable only in the hands of a person who was the shareholder of the lender company, and not in the hands of person who is not a shareholder. It was also held that the expression "such shareholder" referred to in section 2(22)(e) of the Act refers to both a registered shareholder **and** a beneficial shareholder.

Withholding tax on commissions

- The Chennai Income-tax Appellate Tribunal judgment in the case of Smt. Fathima Haris held that commission paid to an Indian agent of a non-resident for rendering services outside India, would be covered under the provisions of section 40(a)(i) of the Income-tax Act 1961, and accordingly, failure to withhold tax would result in disallowance of such payments.

Social security obligation for foreigners

- The Ministry of Labour and Employment announced on 1 October 2008 that foreigners working in India need to contribute to India's social security system unless they are required to contribute to a social security programme of a country which has a social security treaty with India. The contributions would amount to a total of some 12% of the base pay of the individuals concerned. This announcement marks a change with the past, when foreigners were not required to contribute.

Transfer of software is not subject to royalty withholding tax

- It was reported that the Delhi Income Tax Appellate Tribunal on 19 December issued its ruling in *Infrasoft Ltd. v. ADIT*, holding that income derived from the transfer of licensed software is business profit and not a royalty.

Technical services

- It was reported on 20 November that the Delhi High Court, in *CIT v. Bharti Cellular Limited, et al*, held that payments made by cellular telephone companies for interconnection, access charges, and port charges are not in the nature of fees for technical services because the concept of technical services does not include services provided by machines.

International Tax Developments

- Luxembourg. India signed a double tax treaty with Luxembourg on 2 June 2008. The maximum rates of withholding tax are 10% on dividends, royalty payments, technical service fees and most interest payments.

- Mauritius. The Foreign Investment Promotion Board (FIPB) has reportedly rejected the tax authorities' arguments and has said that "treaty shopping" is a tax issue that is separate from the regulatory approvals governing investment into India. The FIPB says that it will base its decisions on the foreign investment policy, and that tax issues would not affect such decisions which should instead be left to the tax authorities.

Indonesia

Income Tax Reform

- The new income tax law took effect on 1 January 2009. We refer to the previous edition of this newsletter for details. In brief, the new provisions contain sharpened anti-avoidance provisions with respect to foreign holding structures, and with regard to finance and royalty structures where tax treaties are used and applied for in order to obtain reduced Indonesian withholding tax rates (beneficial ownership requirements must be satisfied). The personal and corporate income tax rates have been reduced.
- We encourage our readers to critically examine their investment structure inbound Indonesia if it involves tax treaty benefits.

VAT Reform

- Parliament is still debating the proposed VAT change to abolish Indonesian VAT on exported services from Indonesia. If an Indonesian company provides services to an overseas party, these services are generally subject to 10% VAT. It is proposed that this will be abolished.

Japan

Proposal for exemption of foreign subsidiary earnings

- Additional details have been published on the proposed exemption on dividends from foreign subsidiaries. As included

in earlier Asia newsletters, it is proposed to exempt income from foreign subsidiaries provided that certain conditions are met (e.g. an interest of $\geq 25\%$ for at least 6 months). A credit for (withholding) taxes levied relating to such dividends would then no longer be available. Note that only 95% of the dividends received would be exempt. On the other hand, costs relating to the foreign subsidiaries will remain deductible.

- The exemption would apply to dividends received on or after 1 April 2009. Certain transitional measures would apply amongst others to prevent abuse.

Elimination of capital gains tax for foreign shareholders investing via a fund

- Currently, foreign investors that invest via a (non Japanese) fund into Japanese companies may be taxed with capital gains tax under the so-called 25/5 rule. In short, the 25/5 rule means that if someone sells $\geq 5\%$ of the shares of in a Japanese company and owns or has owned $\geq 25\%$ of the shares in that Japanese company for a certain period, capital gains tax may be due on such sale.
- The proposed amendment would eliminate the capital gains if investors invest into Japanese companies via a fund provided that certain conditions are met. This measure is also aimed at boosting foreign investments into Japan.

International Tax Developments

- General. One of the other attempts to boost the economy is that the domestic reduction on the capital gains tax rate will be extended until 2011. Also domestic tax relief for investors receiving dividends will be provided.
- Philippines. On 5 December 2008, the amended protocol to the income tax treaty between Japan and Philippines entered into force. Subject to satisfying the pertinent conditions, the withholding tax rates are reduced to 15% in case of dividends and 10% with on interest and royalties.
- Kazakhstan. Japan recently concluded an income tax treaty with Kazakhstan. Amongst others, the dividend withholding tax rate is reduced to 5% provided that certain conditions are met.

- The amended tax treaties with Australia and Pakistan recently entered into force.

Korea

New corporate income tax rates

- The new corporate income tax rates were approved by parliament and will as of 2009 be as follows:
 - The first KRW 200 million of taxable profit: tax rate: 11% (as of 2010: 10%)
 - Taxable profit exceeding KRW 200 million: 22% (as of 2010: 20%)

Advance rulings possible

- As of 1 October 2008 it is possible to apply for advance tax rulings, subject to a prescribed procedure being followed.

Domestic method of determining share costs also applies to foreign shareholders

- Until recently, it was unclear whether foreign corporate shareholders could apply the same method of calculating the costs allocable to shares owned in a Korean company. This is relevant for the tax on dividend income and/or capital gains realised in respect of such Korean companies. A recent publication clarified that foreign corporate shareholders can - upon election - apply the same method as domestic shareholders.

International Tax Developments

- General. In case the tax authorities successfully challenge intercompany pricing, a 10% penalty applies unless a mutual agreement procedure indicates that the taxpayer was not to blame. The proposal is to also not impose a penalty if the taxpayer has sufficient transfer pricing documentation to substantiate the applied pricing.
- One of the prospective changes as of 2009 is that the loss carry forward term of 5 years would be extended to 10 years.

Malaysia

Tax losses and capital allowances

- In line with earlier announcements from Malaysia's Ministry of Finance, companies are now with retroactive effect from YA 2006 allowed to carry forward unabsorbed losses and capital allowances even if there is a significant change (i.e. more than 50%) in the direct shareholding of the company.
- However, if the company is a dormant company, the above does not apply and carry forward is prohibited. A company qualifies as dormant if it did not have any significant transactions in its account in the financial year prior to the substantial change in ownership.

Income from sales of Certified Emission Reductions (CERs)

- As of the year of assessment 2008, income received by a Malaysian incorporated resident company from the sales of Certified Emission Reductions (CERs) is exempt from income tax. This measure will apply until 2010.

International Tax Developments

- Myanmar. The income tax treaty between Malaysia and Myanmar entered into force on 21 July 2008. In Malaysia, the treaty generally applies from 1 January 2009 for withholding taxes and from 1 January 2010 for petroleum taxes. In Myanmar, the treaty applies from 1 April 2009 for withholding taxes and 1 April 2010 for other taxes.

Philippines

Service fees paid to non-residents

- The Bureau of Internal Revenue has ruled that service fees paid to non-resident entities for services rendered abroad are not subject to Philippine withholding tax, income tax or and/or VAT as the services are not Philippine sourced. If however, the services are directly connected to the business of the Philippine company, the payments are normally deductible as business expenses.

Buy back of own shares

- The buy back by a Philippine company of its own shares which are not listed or traded on the local stock exchange is regarded as a sale of shares from the stockholders to the Philippine company and are consequently subject to capital gains tax (5% on the first P100,000 and 10% on the excess over P100,000).

Conversion of preferred shares to common shares

- The Bureau of Internal Revenue has ruled that the conversion of redeemable preferred shares into common shares is not comparable to a redemption as a result whereof a conversion is not subject to capital gains tax. Furthermore, no stamp duty is due as the conversion does not involve the issuance of new shares.

No VAT on director's fees

- As of 24 November 2008, fees paid to a director who is not an employee of the company paying the fee are no longer subject to VAT. Reason for this being that it has been decided by the Bureau of Inland Revenue that the income does not relate to the provision of services in the course of a trade or business (as opposed to the opinion expressed in an earlier circular).

International Tax Developments

- Germany. In "Deutsche Bank AG Manila Branch vs Commissioner of Internal Revenue" a request filed in 2005 for a P22.56 million refund for taxes paid in 2003 was denied because Deutsche Bank failed to file an application for tax treaty relief at least 15 days prior to the transaction. The court held that before any benefit of a tax treaty may be applied by a non-resident, the provisions of the treaty should be invoked and it should be proved that the treaty provisions apply.
- New Zealand. A Protocol amending the income tax treaty of 29 April 1980 between New Zealand and the Philippines entered into force 2 October 2008. The protocol generally applies from 1 December 2008. The maximum rates of withholding tax are amended as follows: 15% on dividends, 10% on interest and 15% on royalties. Furthermore, the tax sparing credit has been removed.

- Japan. The protocol to the tax treaty between Japan and the Philippines has entered into force and applies as of 1 January 2008.

Singapore

Transfer pricing

- On 20 October 2008 the Inland Revenue Authority of Singapore (IRAS) published a supplementary circular which:
 - (a) provides further considerations and procedures which an APA applicant should observe to facilitate the acceptance by IRAS of an APA application and also the discussion and agreement by or among the competent authorities concerned;
 - (b) addresses the circumstances under which IRAS may consider to allow an APA applicant's request for the APA to apply to "roll back" years;
 - (c) sets out the circumstances which warrant IRAS discontinuing with the APA process initiated for a taxpayer's case.
- On 21 October 2008, a draft supplementary circular for public consultation was issued by the IRAS in relation to the application of the arm's-length principle to related party loan and service arrangements especially in cross-border situations. The circular confirms that because it is Singapore's obligation as a treaty partner, the IRAS will enforce the requirement to apply an arm's length interest rate to cross-border loan agreements.
- Furthermore, the circular confirms that a 5% mark up for the provision of related party services is acceptable if the services are "routine" in nature.

R&D tax incentive

- The IRAS has issued a circular on 31 October 2008 on research and development tax measures which were introduced in the 2008 budget, as follows:
 - (i) Liberalized R&D Tax Deductions. A taxpayer that undertakes qualifying R&D activities in Singapore is now able to claim:
 - (a) tax deduction for expenditure incurred for undertaking

R&D in any area; and (b) a further tax deduction equal to 50% of qualifying R&D expenditure (i.e. total tax deduction of 150% of such R&D expenditure);

(ii) **New R&D Tax Allowance Scheme.** The RDA scheme is a new incentive scheme targeted at encouraging the Small and Medium-Sized Enterprises that enjoy profitability to engage in qualifying R&D activities in Singapore. The scheme allows a taxpayer to earn a tax allowance equal to 50% of its chargeable income up to \$300,000 in a Year of Assessment ("YA"). The taxpayer can deduct the tax allowance earned from its assessable income in any subsequent YA up to YA2016, if certain conditions are met; and

(iii) **New R&D Incentive for Start-up Enterprises.** The scheme allows loss-making start-ups which expend at least \$150,000 in a year on qualifying R&D activities in Singapore to convert their adjusted tax losses of up to \$225,000 (i.e. based on 150% of \$150,000) into a cash grant at the rate of 9%. Accordingly, the maximum cash grant a start-up may obtain under the scheme is \$20,250 (i.e. \$225,000 X 9%). The scheme is available to a start-up company in its first 3 YAs of incorporation.

- The new measures will apply only to R&D expenditure incurred by a taxpayer who is the beneficiary of the R&D activities. It will not apply to R&D expenditure incurred by a taxpayer who is in the trade or business of providing R&D services.
- To qualify for any of the new R&D measures, a taxpayer must incur expenditure on undertaking R&D activities in Singapore which meet certain conditions and also do not fall within the list of specified excluded activities.

International Tax Developments

- **Belgium.** On 27 November the tax treaty between Singapore and Belgium entered into force which is applicable as of January 2009. Compared to the old tax treaty amendments have been made in the definition of service and construction permanent establishments. The withholding tax rate on interest is reduced from 10% to 5% as well as the withholding tax rates on lease payments for industrial, commercial or scientific equipment which is effectively reduced to 3%. Dividends distributed to a corporate shareholder holding at least 25% of the share capital for at least 12 months are exempt.

- **PRC.** On 23 October 2008, Singapore and China (People's Rep.) signed a free trade agreement (FTA) which has entered into force on 1 January 2009.
- **Gulf Cooperation Council.** On 15 December 2008, a free trade agreement was signed between Singapore and Gulf Cooperation Council (GCC) which aims to allow tariff free access for goods between Singapore and the GCC as well as other measures stimulating the trade between these countries.

Taiwan

Securities transaction tax reduced

- On 9 October the Taiwanese parliament completed a proposal which cuts the securities transaction tax to 0.15%, for a six-month period. This measure is aimed at revitalizing Taiwan's weakening stock exchange.
- Furthermore, it has been announced that new tax rules for foreign IPO's are considered where i) the security transaction tax will be 0.1% for IPOs carried out in the form of depository receipts ii) gains on the sale of the foreign company's shares will be tax exempt iii) dividends derived from the foreign companies qualify as foreign sourced and will be tax exempt for individuals until 31 December 2009, iv) foreign companies will not be subject to corporate income tax if they only engage in share agent related activities, and finally v) the foreign company's shares listed in Taiwan will not be subject to inheritance and gift taxes.

Mergers

- In a ruling of the Ministry of Finance of 17 October 2008, it has been declared that the share consideration paid to the shareholder of a target company as a result of a merger, which is attributable to the stepped-up portion of fixed assets, insofar as it relates to goodwill and retained earning will be treated as a taxable dividend. The shareholders are allowed to claim the actual costs of their shares as the basis for determining how much dividend income they earned. The dividend will be subject to 20% withholding tax unless reduced by a favourable tax treaty.

Acquired corporations of mergers and acquisitions are exempt from paying final business income tax.

- The Ministry of Finance clarified on 8 December that non-resident shareholders may also request to deduct the actual cost by electing either an R.O.C.-resident individual or a corporation with a permanent establishment in the R.O.C. to act as their agent.

Deferral of introduction minimum tax on overseas income

- On 25 September it has been approved that the scheduled 2009 introduction of a 20% alternative minimum tax on overseas income will be deferred until 2010.

Estate and gift tax

- The Taiwan government proposes a reduced estate and gift tax rate. Currently, a progressive system applies where the maximum rate is 50%. It is proposed to introduce a uniform rate of 10%.

Thailand

Corporate income tax rate

- It has been reported that the Thai cabinet is proposing to reduce its corporate tax rate to 25% - the current income tax rate for corporates is 30%. The reduced income tax rate, if approved by parliament, may take effect in the course of 2009.

Variance payments in swap agreements subject to withholding tax

- On 15 August and 29 September 2008, department instructions were issued in which it is determined that the "variance payment" in relation to interest swaps is subject to withholding tax.
- Firstly, variance payments in relation to an interest rate swap contract in which a party to the contract is not a lender are not subject to withholding tax but if a party to the contract is also a lender, the payment of variance from the interest swap will be treated as interest.

- Secondly, if both parties intend to enter into a loan agreement but agree to make an interest swap to transfer the income from loan interest to be a variance from the interest swap, the variance payments will be subject to withholding tax.

Vietnam

Corporate income tax

- To stimulate the Vietnamese economy, the corporate income tax rate of 28% is lowered to 25% as of 1 January 2009.

Personal income tax

- On 30 September 2008 the circular on Personal Income Tax ("PIT") was issued governing the new Law on Personal Income Tax (reference is also made to the autumn Asia Newsletter). The circular provides for further guidance on the PIT law. Despite various call for postponement of the new PIT law because of the current economic crisis, the PIT law has entered into force per 1 January 2009.
- Non-residents are taxed on all Vietnamese-sourced income, at various flat rates from 1% to 20%.
- The government announced that the new tax regime under the personal income tax law for stock market investors, which has entered into force as per 1 January 2009, will continue to apply. Before January 2009, no tax was levied on any gains or income from stock market transactions. As of 2009 the taxpayer may opt for an annual capital gains tax of 20% or a transaction tax of 0.1% of the transaction value per sale (thus also when the sale results in a loss).

VAT

- On 23 June 2008 a new law on Value-Added Tax was introduced has taken effect from 1 January 2009. A draft Decree has been released in which the following rates are applicable:
 - 0%: International transportation will be added to the list of goods and services subject to a VAT rate of 0%;

- The 5% rate shall mostly apply to goods and services which are “inputs” for agricultural production and to goods and services related to cultural, exhibition and sports activities as well as artistic performances and film production;
- 10%: applies to all goods and services which are not subject to VAT at either the 0% or 5% rate and which are not exempted from VAT.
- In addition, new rules for claiming input VAT are introduced.

International Tax Developments

- Hong Kong. On December 2008 the income tax treaty between Vietnam and Hong Kong was signed. The tax treaty provides for a 10% withholding tax rate on dividends, interest (except for payments to certain specified governmental institutions) and royalties (except for royalties made for the right to use any patent, design or model, plan, secret formula or process for which a 7% rate applies). Given that the domestic withholding tax rates in both countries insofar as they actually have a withholding tax are lower or equal to the tax treaty rates, the treaty will have limited effect on withholding tax but may have a positive effect in reducing income tax liabilities in either country.

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