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Recent developments in Southeast Asia with respect to tax treaty abuse

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Anti-abuse of tax treaties

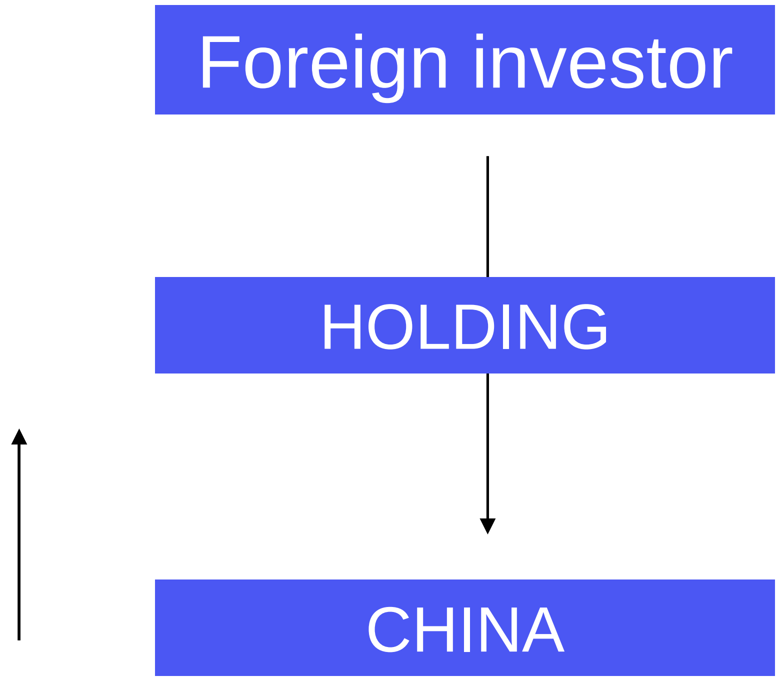
- Japan: substance required by NTA
- South Korea: International Tax Coordination Act (2006) substance over form rule will now be applied not only to domestic transactions, but also international transactions and tax treaty interpretations
- China: circulars 601 and 698 issued in 2009
- Indonesia: regulations 61 and 62 issued in 2009

CHINA (PRC)

China (PRC)

- Article 47 of the Enterprise Income Tax Law is the general anti-avoidance provision in the law
- Circular 601 (“Beneficial ownership circular”) of 27 Oct 2009
- Circular 698 (“Indirect sale circular”)
- Circulars 1 and 2 of 2009 (cover GAAR)

Circular 601

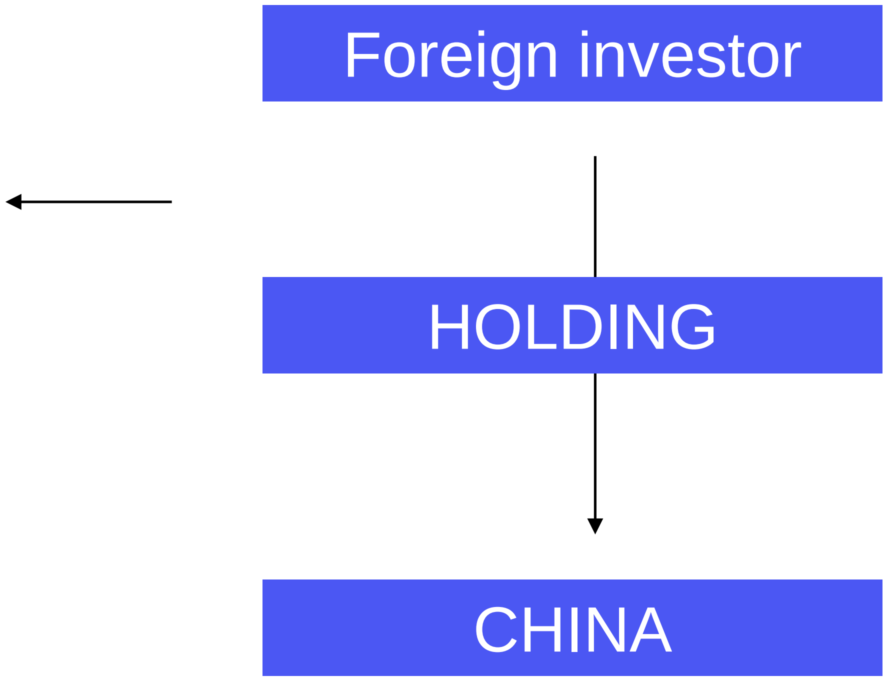


Dividends, interest or royalty payments: tax treaty benefits?

Beneficial ownership – Circular 601

- BO is any person who owns or has control and dominion over the income or the rights or assets giving rise to income
- BO must be engaged in substantive business activities
- Substance over form concept
- Negative factors according to circular 601 are:
  - Applicant has the obligation to pay or distribute all or a substantial part of the income (> 60%) to a third country resident within a prescribed time (eg 12 mths)
  - Applicant has no or hardly any business activities in that country
  - Assets, size and personnel not in line with the income received
  - No real rights of control nor business risks for applicant
  - Income not taxable or low tax rate
- Back-to-back loans or royalty flows
- Burden of proof on taxpayer that the above does not apply

Circular 698



Indirect sales

- The following occurrences may have an adverse effect on the application of BO:
  - The recipient is obliged to distribute or pay more than 60% to a resident of a third country within a prescribed time
  - The recipient does not have business operations
  - The recipient's assets, business volume and staff number are modest relative to the income concerned
  - The recipient has little or no controlling power or discretion over the income received and bears no or little risks
  - The recipient's country does not tax the income or at a very low rate
- Indirect sales must be disclosed by the transferor company < 30 days if the intermediary holding company is not taxed on its income or taxed at a very low rate – on disclosure: a number of items of information must be provided along the lines of the substance tests mentioned in the 5 blue bulletpoints above

INDONESIA

Foreign investor

HOLDING

INDONESIA

Sale of shares of a foreign holding company which owns shares of an Indonesian company

MoF Regulation No. 258/PMK.03/2008 d.d. 31 Dec 2008
Art. 18(3b) & 18(3c) Law 36, 2009

5% income tax of the gross sales proceeds if the foreign holding company is located in a tax haven jurisdiction and is a conduit company owning shares of an Indonesian company not listed on the JSE art.18(3c)

Or: if there is a 'special relationship' between the companies and the sales price was not at arm's length art.18(3b)

‘Tax haven’:

Country with a low tax rate (tax rate less than 50% of Indonesia’s rate)

Or

Country which either has banking secrecy or has no active exchange of information

Indonesia

- Regulations 61 and 62 (November 2009)
- Regulations 24 and 25 (April 2010)
- Tax form and questionnaire – DGT1

- Regulation 61 deals with the form procedure for claiming tax treaty protection
- Regulation 62 contains the substantive provisions dealing with avoiding abuse of Indonesia's tax treaties
- Updated Regs 24 and 25 – relaxation of certain provisions of Regs 61 and 62

Foreign investor

HOLDING

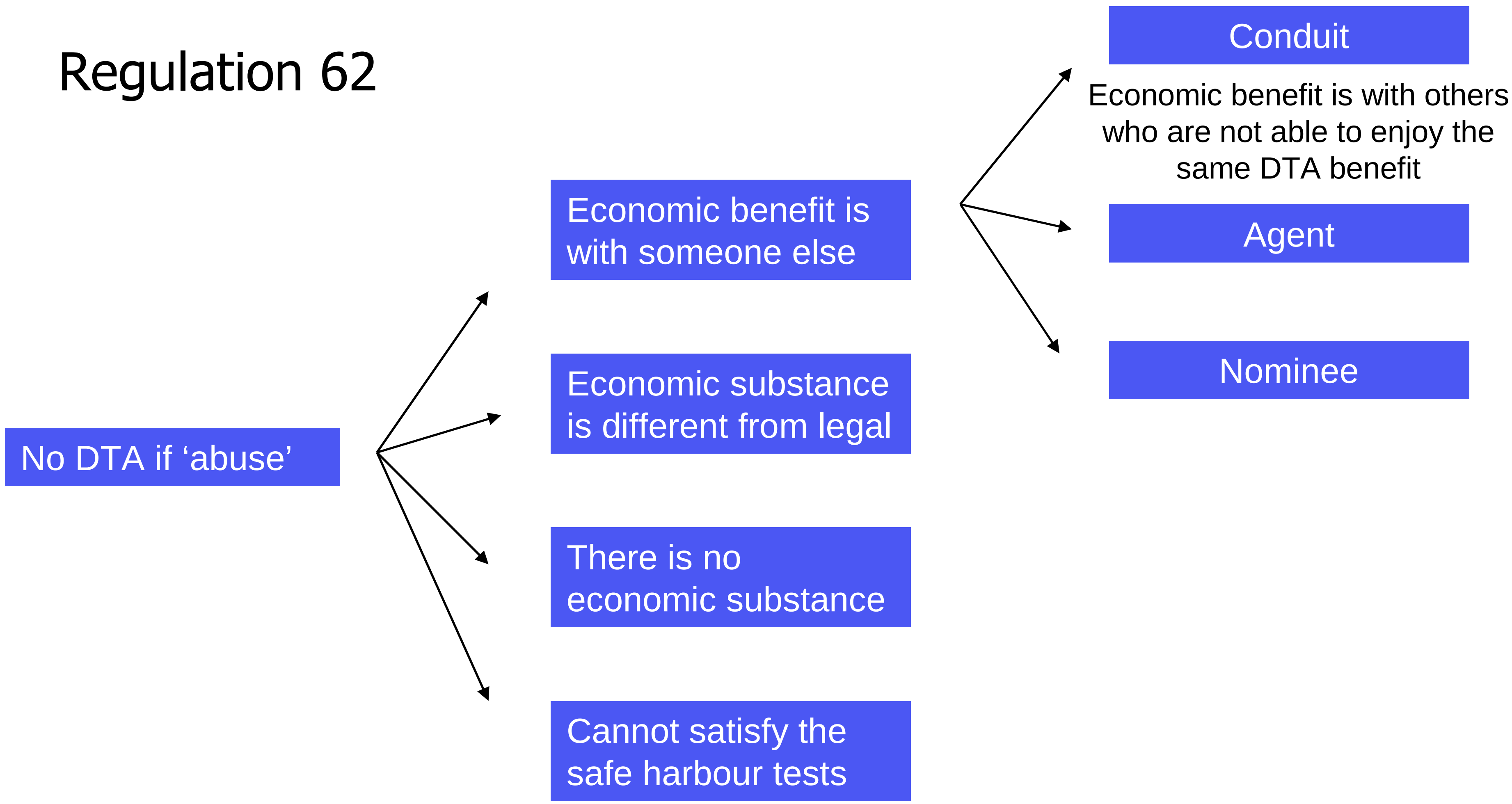
INDONESIA

Tax treaty benefits under Indonesia’s tax treaties?

Scope of Regs 61 and 62:

- Payments requiring Beneficial Owner under the tax treaty
- Not: Business Profits article
- Not: capital gains article
- Dividends
- Interest
- Royalty payments
- Service fees
- Rental fees

Regulation 62



Indonesia – safe harbour situations

- Listed companies whose shares are traded regularly
- Banks/financial institutions
- Companies which satisfy all of the following conditions:
  - Not established merely to obtain tax savings
  - Management: adequate authority to make transactions
  - Employees
  - Active business
  - Income is 'subject to tax' in the country of the recipient
  - Not more than 50% of the Indonesian income will be paid to someone else under an obligation