

# Asia Pacific Tax Adviser

Grant Thornton 

A quarterly round up of recent tax developments in the Asia Pacific region

In this issue we compare tax rates around the region and their role in the decision making process for structuring a business. We also look at the importance of control over tax compliance and good tax planning advice in reducing business risk.

## Expanding in the Asia Pacific region – tax rates and trends

Although tax issues should not dictate business strategy, tax planning is part of the decision making process in the structuring of businesses.

Of interest to businesses are the trends in relation to taxes generally and of particular interest is the age-old question, “how do I get my money out?” The table below sets out the key corporate direct and indirect taxes affecting companies looking to establish a presence in the Asia Pacific region, and the withholding taxes that apply on profit repatriation.

	Corporate tax rate(s) % (Note 1)	VAT/GST rate(s) %	Dividends (Note 7) %	Interest (Note 7) %	Royalties (Note 7) %	Technical Services (Note 7) %
<b>Australia</b>	30	10	30	10	30	30
<b>Mainland China</b>	33 (Note 2)	Exempt/0/13/17	0	10	10	10
<b>Hong Kong</b>	17.5	N/A	Nil	0	5.25 / 17	0
<b>India</b>	33.66 (domestic cos.) 41.82 (foreign cos.)	Exempt/0/1/4/12.5/20	Nil (Note 8)	20	10 (Note 9)	10 (Note 9)
<b>Japan</b>	41.28/42.79 (Note 3)	0/5	20	20	20	20
<b>Korea</b>	14.3/27.5 (Note 11)	Exempt/0/10	27.5	27.5	27.5	22
<b>Malaysia</b>	28 (Note 4)	N/A (Note 5)	Nil	15	10	10
<b>New Zealand</b>	33	Exempt/0/12.5	30	15	15	15
<b>Philippines</b>	35	Exempt/0/12	35	35	35	35
<b>Singapore</b>	20 (Note 4)	5	Nil	15	10	20
<b>Taiwan</b>	25	Exempt/0/5	20/25/35	20	20	20 (Note 10)
<b>Thailand</b>	15/25/30 (Note 4)	7	10	10/15	15	0/15
<b>Vietnam</b>	28	Exempt/0/5/10	Nil	10	15	10

### Notes:

- Reduced rates given to small businesses as investment incentives or to qualifying corporations have not been included in this table.
- Rate applicable to foreign invested enterprises. There are also 15% and 24% rates for certain locations.
- This effective tax rate includes inhabitant taxes and enterprise taxes.
- There are reduced rates if the paid-up capital is below a certain amount.
- GST will be implemented on a date yet to be announced to replace the current sales and services tax.
- Rate was increased from 10% to 12% on 1 February 2006.
- Rate imposed when there is no tax treaty in force. Lower rates may be available under certain tax treaties.
- There is no withholding tax on dividend payments. However, the company paying the dividend is required to pay Dividend Distribution Tax at an effective rate of 14.03%.
- Under Indian domestic tax laws, withholding tax rate of 10% applicable in respect of agreements entered into on or after 1 June 2005.
- This rate can be reduced to 3.75% through an advance ruling application to the Ministry of Finance.
- The effective tax rate includes inhabitant surtax.

The corporate tax rates given are the standard rates. Some of these tax jurisdictions offer a progressive tax rate system depending on the amount of taxable income. In some tax jurisdictions reduced rates are offered as investment incentives to qualifying corporations.

In Asia Pacific the typical jurisdictions that are usually considered as holding location regimes are Hong Kong, Singapore, Malaysia and Australia. Both Hong Kong and Singapore have the lowest corporate tax rates in the region. Singapore also offers an extensive range of investment incentives that are designed to encourage foreign investment in certain sectors. Australia has recently enhanced its tax laws to allow for the flow through of foreign income without withholding taxes.

For comparative purposes, the standard corporate tax rates in some European countries are: United Kingdom 30%, Denmark 28%, Sweden 28%, Netherlands 29.6%, Cyprus 10% and in the US, 15% – 35%.

Value-added tax (VAT) or Goods and Services Tax (GST) is a consumption tax charged on the supply of goods and services. The only tax jurisdictions that have yet to introduce this tax are Hong

Kong and Malaysia, although this is set to change in the near future. In most of the Asia Pacific tax jurisdictions the rate depends on the type of goods. The general trend has been for the rates to remain unchanged. In some tax jurisdictions such as New Zealand, there was a trade-off by the Government on the implementation of this tax and personal tax rates were reduced.

### **Look out for our next issue for more in depth coverage on VAT /GST.**

So finally, the age-old question, “How do I get my money out?” The method of profit repatriation depends on the structure of the local entity that has been set up, for example whether it is a branch, subsidiary, etc. After-tax profits may be repatriated directly by branches.

More commonly used methods are dividend, interest or royalty payments. In most of the tax jurisdictions mentioned, where profits have already been subject to local taxes, after-tax profits may be repatriated directly without being subject to further withholding tax.

The withholding tax rates are the rates when there are no treaties in force. Generally, except for Hong Kong, which

only has withholding tax on royalty payments, all the other Asia Pacific tax jurisdictions impose withholding tax of between 10% and 35% on payments of interest and royalties.

Most of the Asia Pacific tax jurisdictions have now entered into tax treaties with many tax jurisdictions. The treaties provide for a reduction or exemption of withholding tax on certain types of income. Treaties also aim to avoid double taxation i.e. credit is given in most tax jurisdictions for the lesser of the actual tax paid on foreign income and the local tax applicable to such income.



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# Tax risk management

Whether due to a lack of control over tax compliance or poorly implemented tax planning advice, the cost to a business of not having sufficient control over the tax compliance and planning process can be disastrous. The risks can come in many forms and include:

- wasted time and resources dealing with tax authority queries and investigations;
- adjustments to tax returns submitted, which usually carry interest and penalties;
- a loss of reputation.

## Current tax environment

The key factors that influence and shape the current tax environment are transparency and measures to combat tax leakage. This includes the introduction of reporting requirements in relation to tax schemes and offshore transactions, the exchange of information agreements and the introduction of anti-avoidance legislation.

These initiatives have intensified over the last 12 months. A very good example is transfer pricing. Transfer pricing laws generally prescribe that international related party transactions be undertaken on a commercially justifiable “arm’s length” basis in order not to shift profits from one jurisdiction to another. Within the Asia Pacific region a number of countries, including China, India, Malaysia, Australia and Japan have either introduced or enhanced the legislation governing transfer pricing, increased the number of audits and investigations into transfer pricing, or clarified aspects of

their transfer pricing legislation thereby indicating that transfer pricing is a target area.

In respect of corporate governance, the US Sarbanes-Oxley Act of 2002 has had a profound impact in this area. The Act requires the management of a company to report on the effectiveness of the company’s internal control over financial reporting. This has led to similar legislation being introduced in other countries around the world. In 2004 public companies and their auditors in the US identified accounting for taxes as one of the primary areas of weakness in internal controls over financial reporting.

## The Australian Promoter Penalty regime

Over recent years the Australian Courts have heard an increased number of cases addressing issues of tax avoidance as a direct result of the Australian Taxation Office’s (ATO) focus on mass marketed tax schemes since the late 1990s. The schemes have been marketed to the public for their tax benefits and, in some cases, would not make commercial sense but for their taxation consequences.

The Promoter Penalty regime has been introduced to deter the mass marketing of tax schemes. At present, where a taxpayer has been found to be involved in tax avoidance activities, the taxpayer is faced with various additional taxes and penalties, whereas the promoter suffers no consequence. Under these new rules, persons who promote, or assist with the implementations of, tax schemes face injunction on the scheme as well as

penalties of up to over \$2.5 million.

However the legislation has wide application and doing business in Australia may become more difficult as advisors will need to seek ATO rulings on business transactions to ensure they are not caught out by these penalties.

## Managing risk

Every company should review their own internal control systems for taxation. This would include evaluating compliance, considering how key estimates are developed and recorded, reviewing how tax positions and planning strategies are developed, evaluated and approved, and evaluating how key conclusions and decisions are documented.

## Tax compliance

Companies should ensure that their tax compliance function has adequate internal controls at an operational and group level. In the past, all too often management in each country has been left to deal with compliance, often with little or no resources. Even if this function is outsourced to a professional firm at an operational level, there is still a need for internal controls locally, and for someone to have overall responsibility at a group level.

One possible approach that has been successful in helping deal with the compliance process on a multinational level has been to use a professional firm who controls the compliance process on a multinational level. This enables management at a group level to monitor

and review the compliance process on a multinational basis. In addition this can help in identifying planning opportunities and save on professional fees.

**Planning**

Many corporate structures and tax planning strategies have evolved over time, with little or no regard for the current tax environment, with the result that:

- the corporate structure or planning strategy is no longer tax efficient because of changes in tax legislation;
- the planning strategies in place are aggressive and open to attack;
- no one in the organisation understands the planning and as a consequence the planning is not being properly implemented;
- there is no group wide tax planning strategy;
- the tax strategy no longer fits the business needs.

What is needed is a complete review of the structure and current planning strategies in order to identify areas of weakness. Of course, this can also help identify opportunities.

**Transfer pricing**

Companies should consider their transfer pricing practices and policies as part of any risk review analysis given that adjustments, when coupled with penalties and interest, can be material.

An alternative approach and one which has been successfully implemented is to look more strategically at the business from a supply chain management perspective. As well as leading to savings from a business perspective, this approach can also lead to the identification of tax planning opportunities.

**Internal controls**

Companies should be implementing and documenting internal controls over the tax function, including:

- implementing internal controls on tax compliance
- setting approval processes and controls on future tax planning arrangements
- establishing a system that regularly updates and tracks the transfer pricing system used

**Conclusion**

Tax risks are inherent; what is essential is to understand and manage those risks. The starting point is to take a step back and assess your current practices and procedures and strategically look at your tax arrangements in the context of the business as a whole.

If you would like to find out more about how Grant Thornton member firms can assist you, please contact one of the divisional offices, or visit [www.gti.org](http://www.gti.org)

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