

# Asia Pacific Tax Adviser

Grant Thornton 

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

The second edition of the Asia Pacific Tax Adviser focuses on recent developments in tax laws within the Asia Pacific region that may impact your business. Grant Thornton International member firms throughout Asia-Pacific work closely to provide the best possible service for clients. If you require assistance concerning any of the issues raised, please contact your local member firm or [gary.james@gthk.com.hk](mailto:gary.james@gthk.com.hk).

## NEW DEVELOPMENTS

### Australia

On 12 May 2005 the Australian Treasurer delivered his budget outlining various changes to the Australian taxation system. These included significant personal tax cuts and changes to international tax arrangements. For details of the rates see [www.grantthornton.com.au](http://www.grantthornton.com.au). Some of the key changes are explained below:

### Abolition of the 3% tariff on business inputs

The Australian Government has abolished the 3 per cent tariff on business inputs with no domestic substitutes imported under the tariff concession scheme. This measure

came into effect on 11 May 2005 and is targeted at reducing costs in the mining sector.

### Capital Gains Tax (CGT) reduction for non-residents

Currently, Australia's CGT regime essentially applies to disposals of a range of Australian assets owned by a non-resident, including shares in Australian private companies. This deters non-residents from investing in Australia. Therefore, the Government has decided to limit the application of the CGT regime for non-residents to:

- Australian real property; and
- the business assets of Australian branches of a non-resident.

An anti-avoidance measure will protect the integrity of these rules by applying CGT to non-portfolio interests in interposed entities (including foreign entities), the value of which relates wholly or principally to Australian real property. This measure is to apply from the date the legislation is passed.

### Foreign source income exemption

This measure will apply to individuals who are temporary residents for up to four years. The changes will:

- exempt foreign source income;
- ensure that no capital gain or loss would arise on the disposal of foreign assets;

- remove interest withholding tax obligations; and
- extend the existing four-year exemption from the foreign investment fund ("FIF") rules.

### Removal of foreign loss and foreign tax credit quarantining

The Government will simplify the foreign source income rules by removing foreign loss and foreign tax credit quarantining. The measure will allow foreign losses to be deducted from domestic income and will eliminate the need for foreign tax credits and revenue losses to be quarantined into separate classes.



**John Ross**, Director, Taxation Services, Grant Thornton, Australia

## New Developments

### China

#### Regulations to fight against property speculation

In order to fight against property speculation in the PRC (especially in big cities like Beijing and Shanghai), the State Administration of Taxation (SAT) issued GuoShuiFa (2005) no.89 (the notice) on 27 May 2005.

According to the notice, effective 1 June 2005, if a taxpayer sells a property which was held for less than 2 years, the sales proceeds will be subject to 5% business tax (BT). Where the property was held for more than 2 years, and if it is classified as luxurious property, only the gain will be subject to BT. In Shanghai deed tax has increased to 3%.

#### Cancellation of export tariffs on 81 textile products

On 30 May 2005, the Chinese Government announced that it would no longer impose export tariffs on 81 categories of textile products effective 1 June 2005. This is in response to the European Union's (EU) imposition of quantitative restrictions on China-originated textile goods.

Upon negotiation between China and the EU on 11 June 2005, the EU has agreed to stop investigation on ten categories of textile products from China. It was also agreed that the annual export growth rates for the ten categories of Chinese textiles to the European market will be between 8 and 12.5% during the period from 11 June 2005 to the end of 2007.

### Hong Kong

As a part of measures to further strengthen Hong Kong's financial services industry and position as an international centre, the Financial Secretary announced in his 2005 Budget that he was "on balance" in favour of the abolition of Estate Duty. The relevant bill was introduced to the Legislative Council on 11 May 2005.

Estate Duty is currently levied on a sliding scale on the principal value of property situated in Hong Kong which passes or is deemed to pass on the death of an individual. An estate where the principal value does not exceed HK\$7.5 million is currently exempt from Estate Duty. For an estate where the principal value exceeds HK\$7.5 million, the rates of Estate Duty range from 5% to 15%.

### India

The Indian Government has recently entered into Double Taxation Avoidance Agreements with Armenia, Hungary, Malaysia, Sudan and Uganda. Existing agreements with Malta, Philippines and Uzbekistan have been amended.

Additionally, Fringe Benefit Tax (FBT) provisions were introduced in the 2005 Budget. The value of FBT is prescribed as a percentage of the expenses incurred by the employer with tax, at 33.66% being levied on this.

A Comprehensive Cooperation Agreement (CECA) has been reached with Singapore. This is an integrated package comprising trade in goods and services, agreement on investments, mutual recognition agreements in conformity assessment of standards in goods, mutual recognition agreement in services, cooperation

agreements in customs, science and technology, education, e-commerce, intellectual property and media. The Double Taxation Avoidance Agreement (DTAA) has also been improved, tax residents will now enjoy capital gains tax exemption on investments in India.

Most Indian States agreed to introduce Value Added Tax (VAT) with effect from 1 April 2005 in place of existing State sales tax.

### Japan

#### Tax credit for staff training

In a move to increase staff training, the Japanese Government has introduced a new tax credit (capped at a maximum of 10% of the corporate tax liability) for corporations filing a blue tax return, against corporate tax liability for the following amounts:

- 25% of the excess of tax deductible staff training expenses over the average expenses for the past 2 years; or
- Small and medium-sized companies may choose a tax credit against their corporate tax liability for the following amounts:
  - If the staff training expense incremental rate is 40% or more, then 20% of total staff training expenses; or
  - If the staff training expense incremental rate is under 40%, then total staff training expenses x (staff training expenses incremental rate x 0.5).

This reform applies to fiscal years beginning on or after 1 April 2005. It will also be introduced for corporate inhabitant tax purposes for small and medium-sized companies as a three-year temporary measure.

### Revaluation gains/losses and utilisation of tax losses for companies

Where a company revitalisation plan is determined under the Civil Revitalisation Law, or an agreement for a company revitalisation plan is established (subject to conditions), the following measures will apply to the company whose debts are waived:

- the company can recognise revaluation losses/gains on its assets; and
- when the revaluation losses/gains are recognised, gains from the waiver of debts can be offset against expired tax losses before being offset against valid tax losses

Under the proposal, a company attempting to revitalise its business will be able to apply the above measures equally, regardless of whether the plan is under legal or non-legal proceedings.

### Capital Gains Tax from real estate interests

Gains made by non-resident individuals and foreign corporations on transfers of the following beneficial interests will be treated as Japanese sourced income and should be reported on Japanese tax returns:

- Shares in companies where 50% or more of the gross asset value represents real estate in Japan.
- Beneficial interests in specified trusts where 50% or more of the value of the trust's assets represent real estate in Japan.

The reforms will apply to non-resident individuals from 1 January 2006 and to foreign corporations for financial years commencing 1 April 2005.

This proposed change will affect Funds that invest in companies and trusts that predominantly own Japanese real estate. However, if the Fund itself or the investors in the Fund (provided the Fund is a pass through) are residents of a country that has a tax treaty with Japan, provided that the tax treaty provides capital gains tax protection on the sale of shares in Japanese companies, this change should not have an impact.

### Korea

From 2005, the Corporate Tax rate is reduced from 27% to 25% (from 15% to 13% where the tax base is not over one million Won). Individual global income tax rates, which range from 9% to 36% were reduced by one percentage point to 8% to 35% with respect to accrued income.

### Macau

On 13 June 2005, Macau changed the law on setting up Macau Offshore Companies (MOC). With effect from 14 June 2005, only the following businesses will be allowed to operate in Macau as MOCs:

- management and administration of ships and aircraft;
- hardware consultants;
- software consultants;
- data processing;
- database related activities;
- tests and technical analysis;
- back offices; and
- research and development.

Prior to the above change, there were 20 types of approved offshore services.

### Malaysia

The Malaysian Government proposes to implement GST on 1 January 2007. This

will replace the current two systems of sales tax (levied on goods at import or manufacture) and services tax.

### Philippines

A new tax law passed by Congress in January 2005 provides for a system of rewards and sanctions to encourage officials and employees of the Bureau of Internal Revenue to exceed their revenue targets. Rewards take the form of monetary benefits. Sanctions include termination from service or transfer to a different jurisdiction/office/function.

### Singapore

On 2 March 2005, the Inland Revenue Authority of Singapore clarified that the expanded scope of stamp duty relief, announced in the last budget statement, will apply as follows:

- Remission of stamp duties to be paid by prospective buyers on bona fide aborted property transactions, except for a charge of S\$50 to cover administrative costs.
- Extension of stamp duty relief to include the transfer of mortgages.
- Enhancement of stamp duty relief for the transfer of assets between associated companies as follows:
  - the transferee company can be a foreign company instead of a Singapore incorporated company or a Singapore tax resident;
  - if the transfer of assets is between wholly owned companies, the transferee company can acquire the assets based on net book value instead of open market value, and the consideration can be paid in the form of debt in addition to cash, or shares in the transferee company.

# Incentives

## China

### Changing the tax calculation on bonuses

On 21 January 2005, the State Administration of Taxation (SAT) issued GuoShuiFa (2005) no.9 addressing the tax calculation on bonus income paid to employees.

- Bonus income used to be taxed as separate income at progressive rates ranging from 5% to 45%.
- The notice introduces a new method that will reduce the individual income tax (IIT) liability on annual bonus income. The tax on annual bonus income will still be calculated separately from salary. However, the bonus will be spread over 12 months to determine the applicable tax rate. As the applicable tax rate calculated in this manner is usually lower, the IIT liability will be reduced.
- For other bonuses, e.g. quarterly, semi-annually etc, these are added to monthly salary and tax is calculated on the aggregate amount. However, for non-PRC residents, these bonuses are still taxed separately from monthly salary.

### Individual Income Tax (“IIT”) issues for Stock Option Gain

On 28 March 2005, the Ministry of Finance and the SAT jointly issued Cai Shui (2005) no.35 (the Notice) clarifying the IIT issues regarding stock option gains.

- The Notice provides definitions of the following: stock options, grant date, exercise date etc. These are generally in line with international practice.
- When stock options are granted to an employee, the employee is not

generally regarded as receiving taxable income.

- When the option is exercised, the difference between the exercise price and the market price (i.e. the option gain) is regarded as income to the employee.
- Capital gains on subsequent sales of stock obtained from the exercise of the stock option is regarded as “income from asset transfer” and will be taxed accordingly.
- If the employee subsequently receives profit sharing from the stock, the gain will be regarded as “dividend, interest and bonus” and will be taxed accordingly.
- The Notice confirms that the source of the stock option income can be determined by reference to the number of months the employee has worked inside and outside China.

## Hong Kong

A new DIPN no. 38 has been issued, in relation to Salaries Tax and the taxation of employee share option benefits.

The revised DIPN clarifies the following:

- A distinction is drawn between “a share certificate” and “a share” pursuant to a Board of Review decision. Shares will be treated as acquired when the taxpayer’s name is entered in the Register of Shareholders and becomes entitled to dividend and voting rights despite non-availability of the share certificate.
- Restriction on sale will now be taken into account in determining the open market value. In a Board of Review decision, a 25% discount was allowed to reflect a five year restriction period.

- If there is a change from Hong Kong employment to non-Hong Kong employment (or vice versa) during the vesting period, the share option gain will first be apportioned between the two employments on a time apportionment basis. Chargeability of such gains will then be considered based on the usual principles.
- For taxpayers leaving Hong Kong and electing notional exercise of the share option, the gain will be ascertained by reference to any open market value within 7 days (instead of the immediate day) before submission of the individual’s tax return for the final year. If the gain in respect of the actual exercise is less than the amount assessed in respect of the notional exercise, the IRD will favourably consider any application for appropriate amendment and re-assessment.



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**Korea**

Improving tax incentives available to foreign investors.

The tax incentive law has been amended to reduce the tax exemption or reduction period, but eligibility requirements have also been relaxed (effective 1 January 2005) allowing more foreign invested companies to become entitled to these incentives.

With regard to foreign investment in high tech projects authorised for tax benefits and investment in a foreign investment zone, corporate or individual income tax exemptions are amended as below:

- the tax exemption period has been reduced from the first seven years to the first five years; and
- the tax reduction period has been reduced from the subsequent three years to the subsequent two years.

In addition, the 50% reduction period of local taxes (acquisition, property, aggregated land, registration taxes) for the industries listed above has been reduced from three years to two years.

The following qualified foreign invested companies are eligible for full exemption of

corporate tax for the first three years and 50% reduction for the subsequent two years:

- operators of master-planned city developments and companies to be located in master-planned cities (applies to manufacturing, logistics and R&D businesses); and
- foreign investment in foreign exclusive industrial complexes (applies to manufacturing and logistics businesses)

**Australia**

The Australian Government has introduced legislation making the taxation of employee shares and rights consistent with the OECD model whereby:

- Income assessed under the employee share scheme provisions, like other employment income, is generally able to qualify for existing exemptions for offshore employment; and
- Amounts are not assessable under the employee share scheme provisions to the extent that the share or right acquired relates to the relevant employment offshore while the employee was not an Australian resident.

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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