

Controversy and litigation dominates tax forum

Following last month's Asia Tax Executives' Forum in Singapore, Ralph Cunningham and Jack Grocott discover what is really keeping Asia-Pacific taxpayers up at night. Increased scrutiny and dispute litigation rather than resolution really is the stuff of nightmares for the region's tax community.

The taxation of indirect transfers and a constant threat of audits and controversy are two of the biggest concerns facing Asian taxpayers.

Speaking at *International Tax Review's* Asia Tax Executives' Forum, tax directors from across the region produced a stream of stories about uncooperative officials and revenue-hungry tax departments.

Delegates also complained of a growing risk associated with permanent establishments and a lack of consistency in the way countries handle transfer pricing.

But with a degree of economic prosperity returning to the region, taxpayers explained that developing a relationship with various tax authorities is more important than ever as governments seek extra sources of revenue.

"Relationships are key," said one tax director. "We have come through the crisis but now we need to be aware that the authorities are going to be looking for tax at every possible opportunity."

"The greatest area that I am concerned about is the whole issue of the indirect transfer of shares," said David Sutherland, Asia-Pacific head of tax at Morgan Stanley. "That is the biggest concern for foreign investors."

Speakers commented there has been a serious knock-on effect from the Vodafone litigation in India, where the tax authorities argue that the UK mobile telecommunications company is responsible for a capital gains tax bill – some say \$2 billion – arising from its acquisition of a majority stake in Hutch Essar from Hutchison, the Hong Kong telecommunications company.

Vodafone maintains that as the transaction was between two offshore companies, there is no tax bill. However, the Indian authorities contend that the tax is due because the purchased assets were located in India. "This whole issue started with Vodafone," said Sutherland.

With such interest in the Vodafone case, one speaker claimed that other Asian countries have sparked into life and are now setting out agendas to target similar transfer of shares.

"Circular 698 in China is the latest attempt by the tax authorities to go after new sources of revenue," said Peter Ni, a tax partner at White & Case in Shanghai.

Released to the public at the end of January, circular 698 sets out the basis on which the State Administration of Taxation may tax a foreign company that indirectly transfers an equity interest in a subsidiary in China. An indirect transfer occurs when a foreign company transfers the shares of a subsidiary outside China that in turn holds a subsidiary in China.

The circular requires a non-resident seller to disclose an indirect transfer of a resident company to the tax authorities no more than 30 days after signing the share sale agreement if the tax burden in the intermediate holding company's jurisdiction is less than 12.5%, or if that jurisdiction exempts foreign-sourced income from tax.

However, panellists said the fact that the circular applies from the beginning of 2010 made it difficult to comply with.

Other speakers said that with the increased focus on indirect transfers and

more scrutiny on traditional tax planning methods, taxpayers are finding themselves dealing with officers who have adopted a different mindset.

Dispute resolution

Panellists also highlighted the contrast between the different attitudes to dispute resolution in the region.

"The overall approach is one of revenue generation and collection rather than resolution," was the panel's view.

"It is completely emotionless in Singapore," said Gurbachan Singh, senior partner, tax and trusts, at Khattar Wong – Taxand, a law firm in the city. "Emotions must give way at a certain level to principles," he added.

Singh said that though the Inland Revenue Authority of Singapore (IRAS) carries out case-specific ad hoc audits, but Singaporean tax policy was pro-economic development.

"Cooperation between IRAS and taxpayers is crucial because of the pressure Singapore comes under because of its low tax rate," Singh added. The corporate tax rate is 17%.

Trang Scott of Procter & Gamble said her company was involved in a tax case in Indonesia every year and that it had 300 cases under way in India. In Thailand, she said, the company had been speaking to the authorities about an advance pricing agreement for 10 years.

"Audit experiences are dependent on what country you are in," Scott said. "Each country is different."



Singh had a different story to tell about Singapore. "If five cases go to the High Court in Singapore in a year, that would be a record," he said.

The panel had a negative view about the effectiveness of mutual agreement procedures (MAP).

Mukesh Butani, partner of BMR Advisors – Taxand, who chaired the session, said a MAP had been applied for in 55 transfer pricing disputes in India in the last four years. None have been resolved.

"We try not to go through MAP if we can avoid it," said Scott. "We've had no MAPs in Asia and have successfully resolved issues through audit or APAs."

Speaking about India, Butani was not confident that new ways of settling disputes would find favour there.

Mandatory arbitration was included for the first time in the 2008 update to the OECD's model tax convention. This allows for a dispute to be submitted to arbitration if competent authorities cannot resolve the matter in two years.

"Mandatory arbitration is very far away for India," Butani said, "because officials won't give up their responsibility. ADR [alternative dispute resolution] will be in treaties only in name."

Documentation importance

With the theme of audits and litigation prevention dominating the two day event, panellists stressed the importance of documentation to any taxpayer's policy.

"Documentation is not a guarantee for a successful audit," said Gary Thomas, a partner of White & Case in Tokyo, who chaired the transfer pricing panel, "but it is essential to help you convince the authorities that your approach is appropriate."

Lim Lee Ching, Asia Pacific tax director of Sony, said her company had a two-part approach to documentation which was based on understanding the functions, risks and assets of the business, and profit-level indicators and benchmarking.

The panel, which also included Chai Sui Fun, assistant commissioner, tax policy & international tax division, of the Inland



Revenue Authority of Singapore (IRAS), and Peter Taylor, area tax manager for DuPont, also discussed topics such as controversy, enforcement, restructuring and advance pricing agreements before finishing up with a debate on the future of transfer pricing in Asia.

Chai encouraged any taxpayers thinking about restructuring their business in Singapore to come and talk to IRAS about the tax aspects of the arrangements.

"We are a friendly jurisdiction. You can involve us in the process," she said. "I encourage you to sit down with the beneficiary jurisdiction. It's free!"

Lim said the increase in audits now were being driven by tax collection.

"Audits in jurisdictions such as India are almost unavoidable," she said. "You probably don't have much choice but to litigate (if you're unhappy with the result of an audit). In Malaysia you get a long list of questions and interviews with key people."

Thomas urged taxpayers to take an interest in the progress of mutual agreement procedure (MAP) negotiations between the competent authorities of different jurisdictions.

"Sometimes MAP is left to competent authorities," he said. "Taxpayers should be proactive."

