TAX InSIGHTS

An Occasional Series 2/2010

MALAYSIAN DEVELOPMENTS

Gazette Orders 1
Administrative Matters 2
Public Rulings 2
Guidelines 3
Goods and Services Tax ("GST") 4
Double Tax Agreements (DTAs) 4
Tax Cases 5

INTERNATIONAL DEVELOPMENTS

Australia 7
Canada 7
China 8
Hong Kong 8
India 8
Japan 10
New Zealand 10
Pakistan 10
Taiwan 10
Thailand 10
United Kingdom 11
OECD 11

Best Transfer Pricing Firm in Malaysia
Award 2009 INTERNATIONAL TAX REVIEW

Malaysia is showing strong signs of economic recovery, with a growth rate of 10.1% in the first quarter, reflecting the fastest growth Malaysia has seen in the last decade. The Government expects the overall growth rate to be about 6% for 2010. However, concerns regarding the fiscal deficit remain, as the Government continues to grapple with ways to ease this. It was recently announced that the aim is to reduce the fiscal deficit from the current level of 5.3% of gross domestic product (GDP) to less than 3% of GDP by 2015. The most recent measure to reduce the deficit has seen the reduction in fuel and sugar subsidies, from which the Government hopes to save RM750 million. Undoubtedly, as the Government plans for the 2011 Budget which is expected to be announced on 15 October, 2010, this issue will be a matter of high priority.

From a Malaysian tax perspective, the last quarter has seen the introduction of various gazette orders, public rulings, double tax agreements, etc. From an international perspective, there are some interesting case law developments, the proposed introduction of Value Added Tax (VAT) in Pakistan, changes to the OECD model tax treaty, etc. We are pleased to provide an update on some of the key Malaysian and international tax developments below.

MALAYSIAN DEVELOPMENTS

Gazette Orders

Income Tax (Exemption) Order 2010

This order, which takes effect from the year of assessment (YA) 2010, exempts any person from the payment of income tax in respect of income derived from *Sukuk Ijarah* (other than convertible loan stock) issued in any currency by 1Malaysia Sukuk Global Berhad.

Further, the above-mentioned order also specifies that where such income from *Sukuk Ijarah* is derived by a non-resident person, withholding tax under Sections 109 and 109B of the Income Tax Act 1967 ("ITA") shall not be applicable.

Income Tax (Industrial Building Allowance) Rules 2010

Effective from YA 2009, a building shall be treated as an industrial building for the purposes of Schedule 3 of the ITA, if the building is constructed:-

- Under a privatisation project and private financing initiatives approved by the Privatisation/ PFI Committee of the Public Private Partnership Unit in the Prime Minister's Department; and
- Pursuant to an agreement entered into between a tax resident and the Government or a statutory body on a 'build-lease-maintain-transfer' basis, for which no consideration has been paid by the Government or statutory body.

It should be noted that these rules will only be applicable where the building is used for the purposes of the taxpayer's business. Where the criteria as set under these rules is met, the taxpayer would be entitled to an initial allowance of 10% and an annual allowance of 6%.

Stamp Duty (Exemption) Order 2010

A stamp duty exemption is given in respect of the purchase of flats under the "Program Perumahan Rakyat Majlis Tindakan Ekonomi Negara" and the "Perumahan Awam Dewan Bandaraya Kuala Lumpur" programme where the relevant agreements/instruments are executed between 1 January 2010 to 31 December 2011.

Administrative Matters

Penalty for unpaid CP204 tax instalments

The Inland Revenue Board (IRB) has recently clarified that penalties will not be imposed in respect of unpaid tax instalments (per Forms CP204) where the company's final tax liability is nil.

Extension of Time for Filing of all Tax Returns in 2011

The IRB has recently indicated that with effect from 1 January 2011, there will be no extension of time for the filing of all tax returns. However, a grace period of 3 days will be given for postal delays.

Please note that at present where the tax filing due dates fall within the calendar year 2010, a 7-day grace period is given for returns that are filed via post and by hand.

Filing of Real Property Gains Tax (RPGT) returns

It is understood that the IRB has previously rejected the submission of the Form CKHT 1A (i.e. the return form to be completed by the disposer upon the disposal of real property) where the acquirer's income tax reference number has not been furnished. The IRB has now clarified that they will not reject the form in such an event and further, taxpayers may appeal to the IRB to waive late payment penalties imposed, where the penalties have arisen due to the IRB's rejection of forms as a result of the absence of the acquirer's income tax reference number.

Public Rulings

Public Ruling 1/2010 (PR1/2010) – Withholding Tax on Income under Paragraph 4(f)

This PR provides clarification on the IRB's interpretation as to when the above withholding tax would apply under Section 109F. Section 109F imposes a withholding tax of 10% on payments to non-residents which fall within Section 4(f) of the ITA. The PR indicates that the following criteria may be used in determining whether a payment (in cash or in-kind) to a non-resident falls under Paragraph 4(f) of the ITA:

- the payment is revenue and not capital in nature;
- the payment is not income that falls under Sections 4(*a*) to 4(*e*) and Section 4A of the ITA;
- the payment received by the non-resident person is in the nature of miscellaneous income, which is often casual in nature *(Casual income typically means occasional income, which is received outside the ordinary course of trade or vocation)*;
- the payment is for an isolated transaction; and
- there is an absence of repetition of transactions to indicate the commercial nature of the transaction.

The PR also provides numerous examples to illustrate the circumstances under which Section 109F would apply. Where the position is taken that Section 109F does not apply, the PR indicates that it is important that documentation be maintained to support this position, including a copy of the business contract or agreement, a copy of the audited accounts of the non-resident and a copy of an auditor's confirmation that the income derived by the non-resident has been earned in the ordinary course of the trade or profession of that person.

Public Ruling 2/2010 – Allowable Pre-operational and Pre-commencement of Business Expenses

This PR (which replaces PR 2/2002) provides guidance on the pre-operational and pre-commencement expenses that are deductible for tax purposes upon the commencement of business. The following are some of the salient points of the PR:-

- In general, expenses incurred by a company prior to the commencement of its business would be denied a tax deduction as such expenses would not be considered to be wholly and exclusively incurred in the production of the income.

Notwithstanding the above, Schedule 4B of the ITA and the following gazette orders allow for the deduction of certain expenses that are incurred prior to the commencement of business:-

- Income Tax (Deduction for Incorporation Expenses) Rules 2003 - amended by the Income Tax (Deduction for Incorporation Expenses) (Amendment) Rules 2005;
- Income Tax (Deduction for Approved Training) Rules 1992 - amended by the Income Tax (Deduction for Approved Training) (Amendment) Rules 1995;
- Income Tax (Deduction of Pre-commencement of Business Training Expenses) Rules 1996
- Income Tax (Deduction for Establishment Expenditure of Real Estate Investment Trust or Property Trust Fund) Rules 2006
- Income Tax (Deduction on Expenditure for Establishment of an Islamic Stock Broking Business) Rules 2007
- Income Tax (Deduction of Pre-Commencement of Business Expenses relating to Employee Recruitment) Rules 2008
- The PR also includes various examples to demonstrate the application of the provisions of Schedule 4B of the ITA and the rules stipulated in the aforesaid gazette orders

Fourth Addendum to the PR 2/2004 – Benefits-in-Kind

This addendum to the PR 2/2004 which is effective from YA 2008, stipulates that employees who are provided with free petrol by their employers can elect to be taxed at the prescribed values under Appendix 2 of the Public Ruling No. 2/2004, OR to claim an exemption of RM2,400 and RM6,000 respectively on petrol used from home to work and vice versa and for official travel.

However, the above-mentioned exemption of RM2,400 is only effective from YA 2008 to YA 2010. Further, if an employee receives free petrol exceeding RM6,000 for official duties, a claim for deduction can be made against his gross employment income provided appropriate records pertaining to the exempted amounts and the additional claim are maintained.

Finally, where the employer is not able to segregate between petrol used from home to work and for official travel, then only the RM6,000 exemption will be given.

Expected Public Rulings/Guidelines

It is understood that the IRB is expected to issue a new addendum (which will be the third addendum) to the PR2/2005 on the “Computation of Income Tax Payable by a Resident Individual” as well as a PR on Real Estate Investment Trusts and Property Trust Funds. Additionally, it is understood that guidelines may be issued on ‘E-commerce’ transactions.

Guidelines

Petroleum Income Tax, 1967

Further to the changes made to the Petroleum (Income Tax) Act, 1967 (“PITA”) by the Finance Act 2010, the IRB has issued guidelines to clarify the manner in which the PITA will operate vis à vis the change from the preceding year basis to the current year basis of assessment and the application of the self-assessment system. Effective from the YA 2010, companies taxed under the PITA are subject to the current year basis of taxation, and will also be subject to the self-assessment system, rather than the formal assessment system. As a result, such companies will have two YAs for 2010, one based on income of the basis period ending in 2009 and the other based on income of the basis period ending in 2010. Unlike taxpayers who were taxable under the ITA in the year in which the assessment system was changed from the preceding year to the current year basis, a tax exemption will not be given for taxpayers who are taxable under the PITA. (A ‘waiver year’ was given to taxpayers under the ITA when the switch from the preceding year to the current year basis of assessment took place). Hence

such companies will be expected to pay taxes in respect of both years of assessment 2010. However, to ease the burden, the taxes for the YA 2010 (current year basis) may be paid in instalments over a period of five years from 2010 to 2014.

The guidelines offer a useful explanation of the following amendments to the PITA:-

- The change in the basis of taxation from the preceding year to the current year basis;
- The change from the formal assessment system to the self assessment system;
- The payment of taxes; and
- Transitional provisions

Companies taxable under the PITA should ensure that they are familiar with the guidelines.

Goods and Services Tax ("GST")

There have been no further announcements with respect to the introduction of GST, since the announcement earlier this year regarding the deferral of the second reading of the GST Bill in Parliament. However, on 13 July 2010 the Price Control and Anti-Profiteering Bill 2010 was tabled for the first reading at Parliament. The Bill is aimed at reforming the law on price control and enacting provisions to curb profiteering by businesses in Malaysia. The Bill is arguably a prelude to the introduction of GST, as this is seen as necessary in protecting the interests of consumers to prevent arbitrary price hikes in consumer goods. The Deputy Minister of Finance has previously stated that GST will not be introduced until the Price Control and Anti-Profiteering laws are enacted.

Double Tax Agreements (DTAs)

Malaysia – Brunei

Effective 17 June 2010, the DTA with Brunei has come into force, via the ratification of the Double Taxation Relief (The Government of His Majesty the Sultan and Yang Di-Pertuan of Brunei Darussalam) Order 2010.

Malaysia – Germany

Effective 8 June 2010, the DTA with Germany has come into force via ratification of the Double Taxation Relief (The Federal Republic of Germany) Order 2010. As reported in Vol.1/2010 of Tax Insights, the new DTA provides for the following rates of withholding tax:

- Dividends – 15%
- Royalties – 7%
- Interest – 10%
- Technical fees – 7%

Further, it should be noted that the provisions of the earlier DTA did not allow Malaysia to impose any withholding tax on technical fees. This relief is no longer available, but the new DTA allows for a lower withholding tax rate than the domestic rate of 10%. Likewise, the withholding tax rate for royalties is also reduced. The DTA also incorporates the internationally accepted OECD exchange of information provisions.

Malaysia - Senegal

The DTA with Senegal has also recently been gazetted via the Double Taxation Relief (The Government of the Republic of Senegal) Order 2010.

It is interesting to note the following with respect to the DTA:

- A building site, a construction, installation or assembly project will constitute a permanent establishment ("PE") if it exists for more than 8 months. Further a PE would also exist if supervisory activities are carried out for more than 8 months within any 12-month period in connection with a building site, a construction, installation or assembly project. (Most DTAs stipulate a period of 6 months before a PE comes into existence)
- Withholding tax rates under the DTA are as follows:-

- Dividends – 5% or 10%
- Interest – 10%
- Royalty – 10%
- Technical fees – 10%

The above DTA, pending ratification, is not in force yet.

Malaysia – Belgium

The details of the protocol amending the DTA between Malaysia and Belgium, gazetted via the Double Taxation Relief (The Government of Belgium) (Amendment) Order 2010, was reported in the first edition of the Tax Insights for 2010.

Protocol(s) to DTAs

Double Taxation Relief (The Government of Japan) (Amendment) Order 2010
Double Taxation Relief (The Government of the Republic of France) (Amendment) Order 2010
Double Taxation Relief (The Government of Ireland) (Amendment) Order 2010
Double Taxation Relief (The Government of Australia) (Amendment) Order 2010
Double Taxation Relief (The Government of the Kingdom of the Netherlands) (Amendment) Order 2010
Double Taxation Relief (The Government of the Republic of Turkey) (Amendment) Order 2010

Protocols to the DTAs with the above countries have been gazetted via the above-mentioned orders to incorporate the internationally accepted OECD exchange of information provisions.

Free Trade Agreements

The Free Trade Agreement (FTA) between Malaysia and New Zealand came into force on 1 August 2010. The FTA was signed in October 2009 (as reported in Tax Insights 4/2009) and provides a framework for closer economic cooperation and partnership between both countries and their respective business communities.

Tax Cases

Entertainment Expenses

In an appeal by the IRB against the decision in the case of ***ELM Sdn Bhd v. Ketua Pengarah Hasil Dalam Negeri*** *(which was reported in Tax Insights Vol 2/2009)*, it is learnt that the High Court has overturned the decision of the Special Commissioners and ruled in favour of the IRB.

Briefly, the taxpayer was a company involved in the pharmaceutical industry and in the course of its business, the taxpayer organised congresses to disseminate information and market new products. The taxpayer sponsored doctors and pharmacists, some to attend such congresses whilst others spoke at the same. The sponsorship costs included the cost of travel, meals, accommodation and the registration fees for the congress, for which the taxpayer claimed a deduction pursuant to Section 33(1). The IRB disallowed the claim for the years of assessment 2001 and 2002 on the basis that the expenses amounted to ‘entertainment’ costs.

The Special Commissioners of Income Tax (SCIT) held that where the dominant purpose of the expenditure is for the promotion of the business, then the expenditure would not amount to entertainment. It was also noted that the doctors gave up their time and the potential of earning income, in exchange for knowledge of latest products and developments in their fields. The time given and the opportunity costs arising from unearned fees (by the doctors) amounted to consideration for their attendance at the congress and the increased knowledge obtained. The doctors also obtained a practical advantage from their new and updated knowledge, which could also be viewed as consideration.

However, the High Court has overturned the decision of the SCIT ruling that the expenses amounted to ‘entertainment’ notwithstanding that the main purpose of the expense was to promote the taxpayer’s business. The taxpayer has appealed to the Court of Appeal.

The case of ***NVA Sdn Bhd v Ketua Pengarah Hasil Dalam Negeri*** *(which was also reported in Tax Insights Vol. 2/2009)* is another case involving entertainment expenses where the High Court has overturned the SCIT's decision in favour of the IRB. This case involved the issue of whether cash incentives paid to agents were deductible under Section 33(1) of the ITA.

The taxpayer was in the business of marketing of burial plots, urn compartments and funeral packages. The taxpayer appointed agents to perform the marketing functions for which it paid commissions pursuant to agency agreements. Apart from commissions, the taxpayer also rewarded the agents with cash incentives from time to time where certain targets were achieved. The IRB took the view that the cash incentives amounted to 'entertainment' within the meaning of Section 18, ITA and the costs were therefore disallowed under Section 39 of ITA. (It should be noted that the case involved claims for deduction in the years of assessment 2000 (current year of assessment), 2001 and 2002, i.e. prior to the changes to Section 39). The IRB argued that while the expenses prima facie met the Section 33(1) deductibility test, the cash incentives nevertheless comprised 'entertainment', and accordingly were expressly disallowed pursuant to Section 39.

The SCIT held that the expenses did not constitute 'entertainment' under Section 18 of the ITA on the basis that the expenses were incurred to motivate agents to increase the taxpayer's sales, and hence related to the "profit earning operations". The High Court however held that the payments were over and above the contractual amounts payable for achieving sales targets and were therefore gratuitous in nature and hence comprised disallowable entertainment expenditure.

The taxpayer has appealed to the Court of Appeal.

In a further case involving the question of entertainment, ***SFDC v. Ketua Pengarah Hasil Dalam Negeri***, the High Court overturned the SCIT's decision and ruled in favour of the taxpayer. Briefly, the taxpayer in the case was involved in the business of marketing dermatological products. As a business strategy, it introduced several marketing initiatives which involved providing incentives comprising overseas trips to sales persons upon achieving sales targets, etc. The SCIT held that the overseas trips, etc. in the absence of clear evidence to the contrary, was entertainment. The High Court reversed the SCIT's decision and the IRB is appealing to the Court of Appeal.

The most recent case on the issue of 'entertainment' is the case of ***MBMSB v. Ketua Pengarah Hasil Dalam Negeri (2010) MSTC 10-012*** wherein the SCIT ruled in favour of the IRB on several matters. The taxpayer in the case was the franchise holder and wholesaler of a luxury brand of cars. The case involved several matters, including the following:

- The deductibility of sponsorship costs, where the taxpayer sponsored a luxury fashion event in return for which it was given significant advertising space and advertising opportunities. The taxpayer contended that the sponsorship was incurred for business purposes, as the luxury fashion event was synonymous with its luxury car brand, etc. The SCIT however focused on the word 'sponsorship' and held that the sponsorship in this instance was 'entertainment' falling within the term "hospitality of any kind" as per Section 18 of the ITA. The SCIT's decision is interesting as this arguably contradicts the Court of Appeal decision in the case of *Aspac Lubricants* wherein it was held that where the sole purpose of incurring an expense was for business reasons and, or, where there is consideration for the purported 'entertainment', this could not be viewed as entertainment.
- The issue of whether the use of cars (which remained as stock-in-trade in the accounts) by the company for journalists to review the cars, and for other promotional reasons constituted withdrawal of stock for the company's own use notwithstanding that the cars were subsequently sold. The SCIT held that this was a withdrawal of stock for tax purposes
- The issue of whether various expenses incurred for product launches, dealer's incentives, etc. were deductible for tax purposes. The SCIT held that based on the facts, such amounts fell within the term 'entertainment' and were not deductible pursuant to Section 39 of the ITA. (It should be noted that the expenses were incurred in the years of assessment 2002/2003 prior to the changes to Section 39)

The decision appears to adopt a very narrow interpretation of the law and is being appealed by the taxpayer.

Reinvestment Allowance

The above question was addressed in the case of ***Syarikat KHCOM v. Ketua Pengarah Hasil Dalam Negeri***. The taxpayer in this case was a manufacturer and had been granted pioneer status in respect of its 'promoted product'. The taxpayer also manufactured a non-promoted product and claimed the reinvestment allowance (RA) in relation to the non-promoted product. The IRB argued that paragraph 7(a)(ii) of Schedule 7A of the ITA prohibited the taxpayer from claiming the RA during a period which the taxpayer was enjoying pioneer status in respect of the promoted product. It is learnt that the High Court has reversed the SCIT's decision and has ruled in favour of the taxpayer in a decision which is much welcomed by manufacturing companies. However, the IRB has appealed to the Court of Appeal. The outcome of the appeal will clearly be of interest to many taxpayers in the manufacturing sector.

Deductibility of Franchise Fees

In the case of ***SP(M) Sdn Bhd v Ketua Pengarah Hasil Dalam Negeri*** *(which was reported in Tax Insights 2/2009)*, the SCIT held that franchise fees paid to a company in the United States of America (U.S.A) for the exclusive right to use a multi-level marketing business system was deductible. Overturning the SCIT's decision, the High Court has held that the exclusive right to use the marketing system amounts to a capital asset, as this relates to the right to commence business, and as such the franchise fee payments were not expenses incurred in the production of income itself.

INTERNATIONAL DEVELOPMENTS

Australia

Islamic Finance

Australia has indicated that the tax laws will be reviewed to ensure that the tax treatment of Islamic financial transactions will be on an equal footing to that of conventional financing transactions. The intention is not to grant incentives or concessions for Islamic transactions, but rather to ensure that the tax laws do not hamper the development of such transactions.

Transfer Pricing

An interesting transfer pricing case was recently heard by the Federal Court. This case involved an Australian Company (SNF A) which was a subsidiary of foreign parent company based in France. SNF A was in the business of manufacturing and selling a particular product, Product X. Part of the raw materials for the manufacture of Product X were purchased from related companies in other parts of the world. SNF A had been in a tax loss position for several years, as a result of ineffective management and operations, poor productivity on the part of production and sales staff, etc. Steps were taken to improve the business performance including the hiring of a new manager, etc, but although the company started to show improved sales figures, it continued to operate at a loss.

The tax authorities argued that this was due to the fact that the company paid excessive prices for the purchase of materials from its related parties overseas, notwithstanding the fact that the company was able to show that independent parties would actually have been transacting at the same or even higher prices. However, the tax authorities rejected the company's comparables for several reasons including the fact that the comparables were foreign, were not functionally comparable, that the price included costs to assist the related parties to penetrate the Australian markets, etc. The tax authorities also rejected the company's transfer pricing methodology, arguing that the transactional net margin method (TNMM) should be used.

Having heard the arguments, the Federal Court held as follows based on the facts of the case:

- For Australian transfer pricing purposes, the TNMM method was not an appropriate method to arrive at the arm's length consideration in this case

- It was clear that there was an international market for materials purchased from the related entities, and the market price was generally higher than the price paid by the company
- The actual reason for the losses was substantively due to the poor management and non-productive sales team, market competition, etc. rather than for transfer pricing reasons.
- Strategically, the parent company allowed SNF A to continue in Australia, notwithstanding the recurring loss position, as it required a market presence there and this was part of its overall long term business plan.

The decision is interesting as this focuses not merely on the transfer pricing methodology and its validity, but rather the bigger picture of the manner in which the business was actually operated. The case is expected to be appealed by the tax authorities.

Canada

Tax Avoidance Structures

In Vol.1/2010 of Tax Insights, we reported that Ireland, the United Kingdom (U.K) and the U.S.A have either introduced provisions or increased the requirements in respect of reporting of uncertain or aggressive tax positions. Canada has now proposed that tax transactions that have certain tax avoidance features which are viewed as aggressive will need to be reported to the Canadian tax authorities.

China

New High Technology Enterprises (NHTEs)

A ruling was issued in April to clarify the tax incentives available for NHTEs during the transitional period during which the rules were changed. NHTEs are entitled to tax incentives involving 2-year or 5-year tax exemptions with reduced exemptions in the ensuing 3rd and 5th years respectively, depending on the types of incentives granted. Malaysian companies with NHTEs in China should familiarise themselves with the ruling *(Guo Shui Han [2010] no. 157)*.

Property Tax

It is understood that China intends to introduce a new tax on the holding of real estate by an individual where such property is not the individual's private residence. It is anticipated that the tax will be imposed at the rate of 0.8% of the market value of the property.

Hong Kong

Tax Treaties

Hong Kong has recently signed new tax treaties with Brunei, the Netherlands and Indonesia. In addition, Hong Kong has agreed tax treaties with several countries, and it is understood that negotiations for tax treaties are planned or under way with several countries including Malaysia (for which the first round of treaty negotiations took place in June). Hong Kong is undertaking these steps to implement compliance with the OECD's internationally agreed tax standards on transparency and the exchange of information.

India

Tax Treatment of Support Fees

The question for which a ruling was sought involved the issue of whether the provision of support services by a company in the U.K to its member entities constituted fees for technical services under the domestic legislation and under the Indian tax treaty with the U.K. The U.K company was Ernst & Young EMEIA Services Ltd (E&Y U.K) which provided support services to Ernst & Young member entities. Ernst & Young (P) Ltd, the Indian firm, paid fees to E&Y U.K for these services. The services essentially involved developing and formulating strategies for the member firms, providing global programs and protocols to be followed by member entities, developing and monitoring training programs, procurement, technology support, and a host of other support services. The U.K entity did not derive any income from these services and merely recovered the costs involved in the provision of these services based on an agreed method.

The Authority for Advanced Rulings ('AAR') ruled that the services did not amount to technical services and hence were not taxable in India. Primarily, it was found that for the purposes of the tax treaty, technical knowledge, experience and skills must be made available for the services to amount to 'technical and consultancy services'. The mere dissemination of information, guidelines, strategies, policies, etc. did not amount to 'making available' technical knowledge or experience. Hence it was decided that the payments were not taxable in India.

Transfer Pricing

Briefly, the case of *DCIT v. M/s. 3 Global Services Pvt. Ltd (2010-TII-15-ITAT-MUM)* involved a transfer pricing adjustment on a company, 3 Global Services Private Limited, which provided Information Technology ('IT') enabled services. It is interesting to note that the Mumbai Income Tax Appellate Tribunal held that in determining an appropriate comparable uncontrolled price (CUP), it was acceptable to use hourly rates published by the National Association of Software Companies (NASSCOM) as these represented an average of comparable uncontrolled rates in the industry. The taxpayer in this case had demonstrated sufficiently that the NASSCOM rates better reflected the arm's length price than the comparables used by the tax authorities, as the NASSCOM rates were in relation to services in the same sector as the taxpayer's.

Software Licence Fees

In the case of *Velankani Mauritius Ltd v. DDIT (2010 TII 64) (Banglore)*, the Indian courts have once again ruled that the consideration for a licence to use software would not amount to a royalty. The facts of the case and the relevant agreements clearly showed that the licensee was only allowed to use the software and was not given any rights to the copyright itself. The income from the license to use the software therefore amounted to business profits of the licensor (an Israeli tax resident). In the absence of the licensor having a permanent establishment in India, such profits were not taxable in India.

Existence of a PE

The case of *Airlines Rotables Limited, U.K v. Joint Director of Income Tax (ITA No. 3254/Mum/06F)* involved the question of whether a PE would be deemed to exist in a situation where a stock of goods was maintained for sale at a warehouse in India. The taxpayer in the case, Airlines Rotables Limited was a U.K company in the business of servicing and providing spare parts for aircrafts. The taxpayer entered into an agreement with an Indian customer to provide spare parts and services in respect of its customers' aircraft. To ensure that it was able to provide seamless services, the taxpayer maintained a stock of spare parts at its customers' warehouse in India. The customer had possession of the spare parts, but only as a bailee. The spare parts were intended for use by the customer as replacement parts while the taxpayer actually carried out the repairs and services on the original parts.

The tax authorities contended that this arrangement created a PE for the taxpayer in India. It was held that the arrangement did not give rise to a 'fixed place of business' PE. This would only arise where there was a clear physical location, combined with a right to use the location and the fact that business must actually be carried out at that location. In the present case, the storage space belonged to the customer and the taxpayer did not carry out any business at this place. Accordingly, it was held that the taxpayer would not have a PE in India.

Direct Taxes Code

The Indian Government has released a Revised Discussion Paper on the Direct Taxes Code ("DTC") on June 15. The new DTC is expected to be introduced with effect from April 2011. The Revised Discussion Paper introduces several modifications to the original draft. Some of these include the proposal to include general anti-avoidance rules (GAAR) into the Indian tax laws. Under the proposed GAAR rules, a transaction would be treated as a tax avoidance transaction where the main purpose of the transaction is to obtain a 'tax benefit' and where there is no bona fide business purpose, or where the transaction lacks economic substance or is not at arm's length. In addition, controlled foreign company rules are being proposed as another anti-avoidance measure.

Japan

Transfer Pricing

With effect from 1 April 2010, Japan has enacted transfer pricing documentation requirements which stipulate the type of documentation required for related party transactions as well as the documents required to show that such transactions have taken place on an arm's length basis. In addition, in June 2010, the Administrative Guidelines for transfer pricing have been changed, the key changes relating to the price negotiation process and presumptive taxation. (Presumptive taxation would arise where taxpayers fail to submit requisite transfer documentation within a reasonable time-frame)

New Zealand

Tax Rates

The New Zealand Budget for 2010/2011 was announced in May 2010. The Budget proposals include a reduction in both corporate and personal tax rates. The corporate tax rate is expected to be reduced to 28% from the current 30%. The marginal personal tax rates will also be reduced with the highest rate lowered from 33% to 30%.

Anti-Avoidance

In the case of *CIR v. Penny and Hooper CA201/2009 [4 June 2010] NZCA 231*, the Court of Appeal ruled in favour of the tax authorities in relation to an anti-avoidance issue. The case involved two individuals in the medical profession, who had each established companies and trust structures to take advantage of tax benefits arising from a reduction in the corporate tax rate, as compared with personal tax rates. Essentially, corporate structures were established, to which the businesses were transferred, (the consideration for which involved a significant amount of 'goodwill') and the two individuals became employees of their companies drawing salaries which were considerably lower than what they previously earned in their individual capacities. Their salaries were effectively 18% and 33% of their previous net taxable income. A combination of interest-free loans from the company, a flow of dividends to the holding trust entities, and thence to the individuals' families allowed the individuals the benefit of the income, but at lower tax rates.

The Court of Appeal did not hold that the corporate and trust structures in themselves were unacceptable, but this combined with the significantly reduced salary levels which were neither realistic nor commercially justifiable tainted the structures with artificiality. Further, the level of goodwill involved was viewed as being artificially high. Although the individuals contended that the structures were implemented to protect their assets in the event of litigation, etc. the Court found that the structures were tax driven and amounted to anti-avoidance.

Simplification

The New Zealand Government is exploring ways to simplify the tax system to improve efficiency and reduce the costs involved in tax compliance for both the tax authorities and taxpayers. To this end, the Government has recently issued a discussion paper covering various proposals to simplify the tax system.

Pakistan

Value Added Tax (VAT)

As part of the Pakistani Budget proposals for 2010-2011, plans have been unveiled for the introduction of VAT. It is expected that this will be introduced in 2011 at the rate of 15%.

Taiwan

Corporate Tax Rate

Taiwan has reduced its corporate tax rate from 20% to 17% retrospectively from 1 January 2010, in an aim to increase its competitiveness in Asia, bringing its tax rate on par with Singapore's corporate tax rate of 17% and Hong Kong's corporate tax rate of 16.5%.

Thailand

Regional Headquarters

With effect from 1 June 2010, Thailand has enhanced its tax incentives for regional headquarters companies (RHQs). RHQs will enjoy a 15-year tax exemption on income derived from the provision of qualifying services to affiliate companies outside

of Thailand (as compared with the previous 10% rate of tax). RHQs will also be exempt from tax on dividend income received from affiliate companies overseas and the payment of dividends from an RHQ to its foreign shareholders will be exempt from withholding tax. Where services are provided to Thai affiliate companies, the income from such services will be subject to a reduced 10% corporate tax rate. Clearly, this enhanced incentive gives Thai RHQs a competitive edge over Malaysia and Singapore's equivalent incentives.

United Kingdom

Emergency Budget

With the recent change in the U.K Government, an Emergency Budget was delivered by the new Chancellor of the Exchequer on 22 June 2010, which announced several measures including the following:

- a reduction in the main rate of corporate tax rate from 28% to 27% (for the financial year 2011), with the commitment to reduce the rate by 1% each year for the next 4 years to hit a rate of 24% for the financial year 2014
- an increase in the current 17.5% VAT rate to a rate of 20% from January 2011
- the introduction of a bank levy from January 2011 for banks and building societies

It is also interesting to note that the U.K is looking into means of simplifying its tax system and has set up an 'Office of Tax Simplification' to review taxes affecting individuals and companies.

OECD

Model Tax Convention

The model convention is in the process of being updated and the draft contents have been released. The update will include the following:

- Updates to the Business Profits Article (Article 7)
- Treaty relief in relation to the income of Collective Investment Vehicles
- Updates to the Commentary to take account of issues that are relevant to the telecommunications industry, including the question of how payments to satellite operators should be classified for treaty purposes, the question of the treatment of payments for roaming facilities and for the use of sub-sea cables etc.

Following approval of the proposed updates by the OECD Council, a revised model convention is anticipated to be released in September this year.

UPCOMING EVENT:

Taxand Malaysia will hold its Annual Tax Seminar entitled "Avoiding Pitfalls" on 27 October, 2010 at Hotel Maya, Jalan Ampang, Kuala Lumpur. The seminar will cover the following:

- **Utilising the 2011 Budget Tax Changes**
- **Recent Developments in Case Law and Tax Administration**
- **Transfer Pricing Audits—Defensive Positions and Preventive Action**
- **International Tax Developments— Being Prepared!**

To register, please refer to the Taxand website at www.taxand.com.my

DISCLAIMER:

The information contained in this newsletter is intended only to be a guide. It must not be relied on in, or applied to, specific situations without previously seeking proper professional advice. Even if all reasonable care has been taken in its preparation, Taxand Malaysia Sdn Bhd and all the members of the Taxand Network do not accept any liability for any errors or omissions that it may contain before being issued, whether caused by negligence or otherwise, or for any losses, however caused, or sustained by any person or entity. Descriptions of, or references or access to, other publications within this publication do not imply endorsement of them.

TAXAND MALAYSIA SDN BHD (745982-X)
Suite 13A.05, Level 13A, Wisma Goldhill, 67 Jalan Raja Chulan, 50200 Kuala Lumpur, Malaysia
T | 603 2032 2799 F | 603 2032 3799 E | info@taxand.com.my