

# Asia Pacific Tax News

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## FEATURE ARTICLE

**SALIENT FEATURES OF THE SRI LANKAN TAX SYSTEM****1. OVERVIEW OF DOMESTIC TAX SYSTEM**

A tax liability can arise in a country only if there is a connection between the tax jurisdictions and a taxpayer or a taxable event. These factors refer to connections, such as residence for tax purposes of the taxpayer, the source of income, the place where the income is earned or derived, or the location of the asset. The definition of residence and source are contained in the domestic law and often differ among countries.

**1.1 Residence**

Profits and income arising in or derived from Sri Lanka \* of every person, whether such person is resident or non-resident of Sri Lanka is taxed in Sri Lanka. A person resident in Sri Lanka is also liable to income tax on his world income. - Section 2 (1) of the Inland Revenue Act, No. 10 of 2006.

\* Profits and income arising in or derived from Sri Lanka, includes

- Profits and income derived from services rendered in Sri Lanka; or
- Profits and income from property in Sri Lanka; or
- Profits and income from business transacted in Sri Lanka, whether directly or through an agent; - Section 2 (2) of the Inland Revenue Act, No. 10 of 2006.
- Interest on certain loans payable to a non-resident deemed to be profits and income; - Section 93 of the Inland Revenue Act, No. 10 of 2006.
- Certain royalties deemed to be profits and income. - Section 94 of the Inland Revenue Act, No. 10 of 2006.

**1.1.1 Residence of a Company or a Body of Persons** is determined on the basis of –

- The location or the place where the registered or the principal office is situated; or
- The place where the control and management of its business is exercised. - Section 79 (1) of the Inland Revenue Act, No. 10 of 2006.

**1.1.2 Residence of an Individual** for tax purposes is determined on the basis of his physical presence in Sri Lanka. Where an individual is physically present in Sri Lanka for one hundred and eighty three

days or more during any year of assessment he deemed to be resident in Sri Lanka throughout that year of assessment. - Section 79 (2) of the Inland Revenue Act, No. 10 of 2006.

An individual who was deemed to be resident in Sri Lanka for two consecutive years shall be deemed to be non-resident, if he is continuously absent from Sri Lanka for an unbroken period of three hundred and sixty five days. Such person shall be deemed to be non-resident from the commencement of the year of assessment in which such absence commenced. - Section 79 (3) of the Inland Revenue Act, No. 10 of 2006.

**1.2 Sources of Income Chargeable with Income Tax: - Section 3 of the Inland Revenue Act, No. 10 of 2006.**

The charge to income tax extends to the following sources of “profits and income” or “profits” or “income”:

- Profits from any trade, business, profession or vocation;
- Profits from any employment;
- Net annual value of land and improvements;
- Dividends, Interest or Discounts;
- Charges or Annuities;
- Rents, Royalties or Premiums;
- Winnings from lottery, betting, or gambling;
- Any sum received by NGO ( Non Governmental Organization) by way of grant, donation or contribution or any other manner; and
- Income from any other source other than profits of a casual and non recurring nature.

The sources of profits and income described are mutually exclusive and the question whether a source will be treated as profits or income will depend on whether we are dealing with profits of a business or the income of a person.

**2. LIABILITY OF NON-RESIDENT INDIVIDUAL IN SRI LANKA**

**2.1** The provisions of Section 79 (7) of the Inland Revenue Act, No. 10 of 2006 are applicable only up to 31.3.2008. On or after 1.4.2008, no individual shall be deemed to be a non-resident under the provisions of this sub section 79(7). They are

subject to taxation as resident individuals.

- 2.2** As per section 13 (zz) of the Inland Revenue Act, No. 10 of 2006, on or after 1.4.2008, profits and income arising outside Sri Lanka to a non-citizen individual who is employed in any undertaking in Sri Lanka, during the period of such employment, is exempt from income tax.
- 2.3** The profits and income derived from outside Sri Lanka by any individual who has been a non resident of Sri Lanka and who arrives and stays in Sri Lanka, shall be exempt from income tax, if such individual is a citizen of both Sri Lanka and any other country, at the time of such arrival and during the whole of such stay. - Section 15 of the Inland Revenue Act No. 10 of 2006.
- 2.4** There is also the concept of residence guest status under the Resident Guest (Tax Exemption) Act No. 6 of 1979. The profits and income of any resident guest –
- (a) not being profits and income arising in or, derived from Sri Lanka; and
  - (b) accruing from moneys lying to his credit in any account opened by him in a Commercial Bank, for the deposit of sums remitted to him in foreign currency from any country outside Sri Lanka, shall be exempt from income tax. – Section 14 of the Inland Revenue Act, No. 10 of 2006.

### 3. LIABILITY OF ANY NON-RESIDENT COMPANY IN SRI LANKA

The income tax to which a Company which is non resident in Sri Lanka in any year of assessment, shall be liable for that year of assessment shall consist of –

- a sum equal to the amount calculated at the rate specified in the second schedule of the Inland Revenue Act, No. 10 of 2006.
- Where there are remittances of such Company in that year of assessment, a sum equal to 10% of the aggregate amount of such remittances by such Company. – Section 62(1) of the Inland Revenue Act, No. 10 of 2006.

### 4. ANTI-AVOIDANCE MEASURES

Tax authorities are concerned with the loss of their share of the global tax revenues through tax avoidance schemes and as such, some of the anti-avoidance measures adopted under the domestic law of Sri Lanka are given below:

#### 4.1 TRANSFER PRICING RULES

Transfer pricing is a critical issue, when related parties (domestic or cross-border) enter into business transactions. The prices used to record

such transactions are often subject to review mainly because one party may enjoy a greater share of revenue at the expense of the other, if prices are so arranged. The cardinal rule to follow is the arm's length price which is a price that would be used by unrelated persons, if engaged in the same transaction.

#### 4.1.1 Arm's Length Price

- Section 104 of the Inland Revenue Act, No. 10 of 2006, deals with profits and income or loss from transactions between associated undertakings to be determined having regard to the arm's length price.
- An Undertaking shall be deemed to be an Associated Undertaking of another undertaking, if the first-mentioned undertaking participates directly or indirectly or through one or more intermediaries, in the control of the second-mentioned undertaking in such manner or to such extent as may be prescribed.
- According to Section 104 (1) of the Inland Revenue Act, No. 10 of 2006, any profits and income arising, derived or accruing from or any loss incurred in any transaction entered into between two associated undertakings shall be ascertained having regard to the arm's length price.
- "Arm's length price" means a price which is applied in uncontrolled conditions in a transaction between persons, other than associated undertakings.
- The arm's length price referred to in section 104 (3) of the Inland Revenue Act, No. 10 of 2006 shall be determined by using the most appropriate method selected from the following methods prescribed in Gazette Notification No. 1546/10 of April 22, 2008:
  - Comparable Uncontrolled Price Method (CUPM);
  - Resale Price Method (RPM);
  - Cost Plus Method (CPM);
  - Profit Split Method (PSM) and
  - Transactional Net Margin Method (TNMM).

#### 4.1.2 Advance Pricing Agreements (APA) as prescribed

With a view to supplement the traditional administrative, judicial and treaty mechanism for resolving transfer pricing issues, arrangements have been made for entering into an advance pricing agreement in accordance with an appropriate set of criteria (e.g. method, appropriate adjustments thereto, and critical assumption as to the future events) for controlled transactions for the determination of the transfer pricing for those transactions over a fixed period of time. The arrangements can basically be divided into the following two categories:

- Unilateral Arrangement; and
- Bilateral Arrangement.

#### 4.1.3 Head Office Expenses

Section 27 of the Inland Revenue Act, No. 10 of 2006 deals with the deduction of head office expenses incurred by any non-resident company. Where any non-resident company carrying on in Sri Lanka, any trade or business, incurs any expenditure in the nature of head office expenditure, there shall be deducted from the profits and income of such company for such year of assessment from such trade or business, a sum equal to the lesser of –

- the amount of such expenditure; or
- the amount equal to ten per centum of such profits or income.

#### 4.2 THIN CAPITALIZATION

Section 26 (x) of the Inland Revenue Act, No. 10 of 2006 deals with an adjustment in respect of interest payable by a subsidiary company on loans obtained from the holding company or another subsidiary.

This means that borrowers which borrow excessively from related parties will not be allowed full deduction of the interest incurred.

Disallowable part of the interest is:

- If the subsidiary company is a manufacturer, Interest on {Loans – 3 (issued capital + reserves)}
- If the subsidiary company is not a manufacturer, Interest on {Loans – 4 (issued capital + reserves)}

This limitation has been extended to interest payable by a holding company on loans obtained from any subsidiary company as well.

#### 4.3 DEEMED DIVIDEND TAX

Tax law historically provided a discretion to the Assessors to deem dividends and charge tax thereon where they were of the view that a reasonable distribution of profits were not made but with due consideration to a company's development plans, capital commitments etc.

Sri Lankan legislation has enforced a new tax, effective from the year of assessment 2007/2008, on resident corporate, at 15% on "deemed dividends" where such company had "distributable profits" for the preceding year of assessment and if the sum of 25% of such profits were not distributed on or before 30<sup>th</sup> September of the current year.

With effect from 1.4.2009, the last date for payment of 15% tax on a specified part of the distributable profits of a company is now extended from September 30 to October 30.

#### 4.4 EXCHANGE OF INFORMATION

Most bilateral tax treaties also have clauses to exchange fiscal information regarding transactions outside its territory in order to help combat tax evasion. Such exchange of information is usually on a routine basis or on the request of the contracting state with reference to a specific transaction or a taxpayer. Such information is treated as confidential and disclosed only to the person or authorities concerned with the assessment and enforcement of taxes covered by the treaties. Sri Lanka has in a number of instances successfully invoked the provisions of its treaties to obtain information from foreign tax authorities.

#### CONCLUSION

Therefore, taxation of cross-border transactions is not only a significant source of revenue for a government, but is also an essential instrument that can be used by governments to stimulate and control their economic policies and promote economic development. Especially, in the present situations like global economic downturn, taxation of cross-border transactions plays a vital role.

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## AUSTRALIA

### REFORMING THE ATTRIBUTION RULES

#### Introduction

Australia's foreign source income anti-tax-deferral rules ("Attribution Rules") encompass four broad regimes designed to prevent Australian resident taxpayers deferring their tax exposure on foreign sourced passive income retained in interposed controlled foreign entities.

In May 2009, the Australian Government announced its intention to update and amend to the existing Attribution Rules, with the potential to significantly alter Australia's taxation of foreign source income.

To date, no draft legislation has been released, however, it is expected that the amendments will occur in the 2010 calendar year, with limited retrospectivity. This article outlines the key changes proposed by the Government and highlights the major implications for Australian taxpayers within multi-national structures.

#### Existing Law

Australia's Attribution Rules broadly comprises of four regimes:

- Controlled Foreign Company Rules (**CFC**)  
*Anti-deferral rules designed to attribute tainted foreign sourced income (passive flows, dividends, interest royalties etc.) of foreign entities to 'controlling' Australian taxpayers for Australian tax purposes.*
- Foreign Investment Fund Rules (**FIF**)  
*Anti-deferral rules designed to attribute tainted foreign sourced income (passive flows, dividends, interest royalties etc.) of foreign en-*

*tities to 'non-controlling' Australian taxpayers for Australian tax purposes.*

- Transferor Trust Rules and Deemed Present Entitlement Rules  
*Anti-deferral rules designed to attribute income accumulating in foreign trusts, not otherwise caught under the other anti-deferral regimes to Australian taxpayers for Australian tax purposes.*

Australia's Attribution Rules were introduced in the early 1990's with the objective of "prevent[ing] resident taxpayers benefiting unduly from deferring the payment of tax by accumulating income or assets in foreign companies or trusts."

However, whilst achieving this objective, the existing rules are considered relatively complex, creating unnecessary compliance and administrative costs for Australian businesses and thereby impacting Australia's international competitiveness in offshore structures and operations.

#### The Wave Of Reform

A review of Australia's Attribution Rules was first announced in 2006, with the aim of "examin[ing] ways to reduce the complexity and compliance costs associated with the regimes....and whether the regimes strike an appropriate balance between effectively countering tax deferral and unnecessarily inhibiting Australians from competing in the global economy."

Following the 2006 announcement, several consultation and position papers have been released, culminating with a final report by the Australian Board of Taxation in September 2008.

The Australia Government responded to the recommendations contained in the Board's 2008 review, announcing in May 2009 the following changes to be implemented:

- The CFC regime would be broadened to apply to a wider range of foreign enti-

ties (such as closely held fixed trusts and non-common law entities) and made the principal attribution rule for preventing the deferral of Australian tax on foreign passive income.

- Other key amendments to the CFC regime relate to simplifying the compliance burden for Australian taxpayers under the CFC regime, including allowing taxpayers to choose from a range of prescribed methods for calculating the amount of attributable income from a CFC (the branch equivalent calculation, market value, and deemed rate of return methods).
- The FIF regime would be repealed in full and replaced with a specific, more narrowly defined anti-avoidance rule.
- The deemed present entitlement regime would be repealed in full.
- The transferor trust regime would be retained, however subject to a more narrow application.
- Complying superannuation entities will now be excluded from the Attribution Rules.

#### Impact Of The Proposed Changes

By and large, the reform of the Attribution Rules will not only have a direct impact on the administration and compliance costs of Australian taxpayers with multi-national structures, but will also directly affect the Australian market and demand for foreign managed fund holdings.

As intended, the CFC regime applies where an Australian taxpayer has 'control' in relation a foreign company, and that company de-

rives certain types of income, being passive income which can be easily moved offshore (e.g. interest income) and accumulated without being subject to Australian tax.

Although the Government has indicated that the CFC regime will be retained, it is expected that the amendments will allow for greater certainty in applying the rules. What this means for Australian taxpayers with interests in foreign entities is that taxation under the CFC regime will still need to be assessed, however, the amendments and updated definitions (including the meaning of 'control' and 'passive income') are expected to better target areas at risk of inappropriate tax deferral, while substantially reducing compliance costs.

Historically, the FIF regime acted as a major deterrent for managers (Australian or foreign) in offering foreign funds into Australia as the FIF rules could apply to tax investors on an accruals basis on their investment in foreign entities.

Once these provisions are repealed, foreign funds should become more attractive to Australian investors, by removing the somewhat harsh tax exposure under the current FIF regime.

However, at this stage, in absence of any draft legislation having been released, it is unclear how broad the replacement anti-avoidance rule will be and whether its application will seriously affect the appeal of investing in foreign funds from Australia, outside of those low risk investments which are insulated from currency fluctuations, such as offshore accumulation or roll-up funds.

Going forward, the proposed reform of the Australian Attribution Rules will have a major impact on not only Australian taxpayers with multi-national structures or foreign investment holdings, but also for non-resident entities offering financial products in the Australian

market.

To date, the Australian Government has announced its intention to effect the proposed reforms in the 2010 calendar year and it is expected that such amendments would apply prospectively (typically from the date the laws enter into force).

The Attribution Rules remain a complex area of Australia's tax law and it is hoped that the proposed reforms go far enough to ensure improvements in Australia's taxation, by encouraging efficiency, equity and simplicity in line with globalisation.

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### **FOREIGN EMPLOYERS OF AUSTRALIAN RESIDENTS – BEWARE!**

Prior to 1 July 2009, the salaries of Australian employees continuously performing services overseas for 91 days or more were exempt. This exemption (Section 23AG) has now been removed for most Australian employees, except those who fall into certain specific categories. The removal of the s23AG exemption directly impacts most Australian expatriates, but will also have significant implications for their employers, even where such employers are not resident in Australia.

### **Determining Whether An Australian Tax Liability Exists**

A liability for Australian income tax on overseas employment income only applies to employees who are Australian tax resident. If the employee is not an Australian tax resident, overseas employment income will not be taxable in Australia.

The determination of an individual's residence status is often very complex and employers will need to obtain significant information about both the employee and their spouse to determine the residence status of the employee. If there is any uncertainty, employers should obtain external advice

on this issue or the employee could apply for a Private Binding Ruling from the Australian Tax Office.

Where it turns out that the employee is an Australian tax resident, the employer will need to review the details of the international tax agreement with the host country (if there is one), to determine whether the wages paid to the employee are exempt from income tax under the agreement.

### **Additional Remuneration For Australian Residents?**

The determination of expatriates' salaries can be broadly divided into two categories, namely those that are remunerated on a specified net salary and those that are remunerated on an agreed gross salary.

If they are remunerated on a net salary basis, often the employer bears any additional tax costs as a result of the employee being seconded overseas compared with the employee's position if they had stayed in Australia. In this case the employer would bear the full cost of the removal of the s23AG exemption.

However, employers employing employees on an agreed gross salary are also likely to have an increase in salary costs, as these employees are likely to renegotiate their employment contracts because of the changes and shift some of the additional tax costs to the employer. Certainly, employees who are considering a short-term overseas assignment would be taking into account the total amount of tax payable on their income when they negotiate their contract and/or decide whether to take the opportunity.

There are some industries where these increased employment costs will be a significant issue. For example companies that supply Australian residents as contractors to offshore oil rigs throughout the world.

## PAYG Compliance

Employers are required to withhold Pay As You Go (PAYG) from payments made to Australian resident employees, where the employees' earnings are subject to tax in Australia. Thus PAYG will be required to be withheld where an employee is tax resident in Australia and the payments are not exempt under an international tax agreement.

The Deputy Commissioner of Taxation released a PAYG withholding variation legislative instrument on 10 July 2009. It applies where employees are in foreign service and their earnings are not exempt under the new s23AG. This variation allows employers to only withhold Australian tax to the extent that the Australian PAYG amount exceeds the foreign withholding. Without this variation an employer would have been required to withhold PAYG in the same way as for any other employee, as well as potentially withholding tax in the host country. This situation would clearly create a cash-flow issue for the employee.

The next challenge for employers is determining the amount of tax to withhold and setting up the payroll system to calculate withholding tax in two countries on the same payment amount. The payroll system would need to facilitate accurate and prompt reporting of the salary and tax withheld in both countries and produce data in a format that allows for the reporting amounts to be identified in both countries.

## Impact On Fringe Benefits

Fringe benefits tax (FBT) is payable by employers on benefits provided to employees. Previously an employee was not considered to be an employee for FBT purposes where s23AG applied and thus fringe benefits provided to the employee were not subject to FBT in Australia. With the removal of the s23AG exemption, benefits provided to expatriate employees by employers will generally be

subject to FBT in Australia.

As most foreign countries tax fringe benefits as income in the hands of the employee in the country in which they work, there may be double tax on these benefits. The current FBT legislation does not provide any mechanism to apply foreign tax offsets or to exclude any benefits from FBT where these same benefits have been taxed overseas. Relief from double taxation is, available in the international tax agreements Australia has concluded with New Zealand and the United Kingdom. To avoid double tax on FBT, multinational employers should consider terminating the employee's relationship with the Australian company where the expatriate employee is being seconded for an extensive period of time to any other jurisdiction.

Employment of Australian residents by non-Australian resident companies has become more complex with the effective removal of the s23AG exemption. The issues should be considered carefully by employers to ensure that they meet their Australian tax compliance obligations and that Australian employees are not adversely affected by these changes

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**Roger Penman**, Principal  
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## INDONESIA

### RECENT DEVELOPMENTS

Following to the issuance of the third amendment of the General Tax Provision and Procedure Law (Law No. 28 year 2007) and Income Tax Law (Law No. 36 year 2008) which have been effective since year 2008 and 2009 respectively and to complete the tax reform package, the Indonesian parliament has recently passed the third amendment of Value Added Tax Law (VAT Law). The new VAT Law will **become effective 1 April 2010**.

The objectives of the new VAT Law, among others, include minimizing VAT administration hassles, providing more certainty, and implementing equal treatments for all taxpayers in addition to the budgeter purposes. The major changes to the newly amended VAT Law are summarized below.

#### Export Services

The current VAT Law only recognizes export of goods which is subject to 0% VAT. To stimulate services sectors, the imposition of 0% VAT is now also applicable for export services and utilization of intangible goods from Indonesia in outside Indonesian custom area.

#### Non Taxable Transactions - Restructuring

To minimize administration burden and to safe cash flow of taxpayers, transfer of taxable goods in the event of merger, consolidation and acquisition is no longer considered taxable transactions for VAT purposes. In other words, VAT is now exempt for transfer of taxable relating to such events.

The exemption facility is only applicable if both transferor and transferee are taxable firm for VAT purposes. If one of or both parties involved are not taxable firm for VAT purposes, the transactions would be considered tax-

able transaction, and as a consequence 10% VAT on the gross value of the transaction would be applicable

### Financial Services

The newly amended VAT Law provides equal treatments for all taxpayers engaging in financial services. It is clearly regulated that financial services is now excluded from taxable services regardless the status of the service providers, whilst previously only banking services and leasing with option right which are not considered as non taxable services.

### VAT Refund

#### General

While currently all taxpayers may claim VAT refund in a monthly basis, starting 1 April 2010 only certain taxpayers would be able to claim VAT refund in a monthly basis, which are:

- Taxable firm conducting export of goods
- Taxable firm conducting export of intangible goods
- Taxable firm conducting export of services
- Taxable firm conducting delivery of goods and/or services to VAT collector
- Taxable firm conducting delivery of goods and/or services of which the related VAT is not collected under the applicable Law and regulations.
- Taxable firm in the pre-production stage.

Other than the above could only claim VAT refund in a annual basis which is at the end of a book year. This means that any VAT overpayment balance at the end of a month or period should be carried forward into subsequent months or period, and only the

balance available at the end of a book year that can be claimed for refund.

#### Foreign Individual

The newly amended VAT Law, similar to the one available in other countries, provides VAT refund facility for individual holding foreign passport relating to purchase on goods which would be consumed outside Indonesian custom area. The refund facility would only be applicable for VAT value minimum of IDR 500,000.

### Preproduction Stage

A taxpayer who is still in the pre-production stage is still able to claim VAT charged by its suppliers. However, only VAT related to purchase of capital goods which are creditable in nature, others should be treated as expenses.

Apart from the above, if the taxpayer fails to reach production stage, any VAT that have been credited and refunded should be paid back to the State Treasury.

### Cancellation of Delivery of Taxable Services

The current VAT Law only recognizes return of goods. In the newly amended VAT Law, a provision of return of services (cancellation of delivery of services) is introduced. With the introduction of this provision, taxpayer can now compensate VAT on delivery of services which are partly or wholly cancelled. In other words, the VAT on services which are partly or wholly cancelled can be credited against current VAT obligations.

### Deemed Input VAT

Certain taxpayers, such as retailer or small enterprises, may face difficulties in following the normal VAT mechanism i.e. Output and Input VAT Mechanism, and in fact it creates administration burden.

To cope with the above, the new VAT Law provides facility for taxpayers engaging in certain sectors and having certain level of reve-

nue to adopt "deemed" input VAT mechanism. Under this mechanism, normally the amount of VAT to be paid to the State Treasury would be based on certain percentage of total revenue. Therefore, taxpayers who are qualified to adopt "deemed" input mechanism are no longer required to calculate VAT payable by considering total Output VAT and Input VAT.

### VAT Centralization

The current VAT Law regulates that for taxpayers having several points for delivering taxable goods and/or services or having branches located under different district tax offices' jurisdictions may request to the Directorate General of Taxes for VAT centralization. If the approval is given, the taxpayers can centralize all of its VAT obligations into one tax office as per taxpayer request.

To simplify the above, now under the new VAT Law, the taxpayers are no longer required to firstly obtain approval from the Directorate General of Taxes to implement VAT centralization, instead they are only required to submit notification to the Directorate General of Taxes.

### Payment and Reporting

The deadline for submitting the VAT monthly return has been changed and become the following:

The monthly return has to be submitted at the latest at the end of the following month.

The payment has to be made at the latest at the end of the following month before the monthly return is submitted.

### Sales Tax on Luxury Goods (SLTG)

To provide flexibility for the Government especially relating to budgeter purposes, the maximum rate of SLTG has been increased from 75% to 200%.

**KOREA**

We summarize below some of proposed tax law changes which were submitted to the National Assembly. Most of the tax law changes below are proposed to be effective from January 1, 2010 unless indicated otherwise after the National Assembly passes the proposed tax laws.

**1. Abolition of 30% Non-taxation Treatment for Foreign Employee**

Under the Special Tax Treatment Control Law ("STTCL"), foreign employees have been eligible for special tax benefits of either non-taxation treatment on 30% of their earned income ("30% non-taxation") or application of the flat tax rate of 16.5% (including resident surtax).

According to the proposed STTCL, 30% non-taxation will be abolished and accordingly, only the flat tax rate of 16.5% will be applicable from 2010, which is to reduce unequal tax treatment between foreign employees and local employees.

**2. Reduction in Income Tax Exemption for Foreign Engineer**

Under the STTCL, the qualified foreign engineers (defined) have been eligible for 100% income tax exemption benefits on their earned income for a period not exceeding 5 years. Under the proposed STTCL, the rate and period of tax exemption benefits will be reduced to 50% and to 2 years, respectively.

**3. Abolition of Non-taxation Benefits on Royalty Income of Foreign Company related to High-end Technology**

Under the STTCL, a foreign (non-Korean) company has

enjoyed a tax exemption benefit on its royalty income for 5 years that is related to high-end technology (defined) introduced to a domestic company in Korea.

However, under the proposed STTCL, such benefits will no longer be applicable to resolve the issue of unequal tax treatments between royalty payment for the technology from a domestic company and that from a foreign company.

**4. Corporate Tax Return Filing Due Extension for Corporations subject to External Audit**

According to the proposed Corporate Tax Law of Korea ("CTL"), an external audit required company may request extension of corporate tax return filing due date and upon application, up to one month extension from the original filing due date will be automatically granted.

However, a penalty for the late payment of the corporate tax (which is in nature of interest) will be imposed at 10.95% p.a. for the period from the original filing due date to the date when tax payment is made under the extension.

**5. Increase of Minimum Tax on Large sized Companies**

Under the STTCL, minimum tax on small/medium companies (defined) are scheduled to be reduced to 7% for 2010 whereas minimum tax on other companies are scheduled to be reduced to 13% (10% up to the taxable income of W100 billion).

Under the proposed STTCL, the minimum tax on the large companies (defined) on taxable income between W10 billion and W100 billion, and taxable income over W100 billion will be increased to

13% and 15%, respectively.

The minimum tax rates for 2009 and 2010 (proposed) are summarized as below:

Classification	2009	2010 (Proposed)
Small/medium companies	8%	7%
Large companies:		
Taxable income of W10b or less	11%	10%
Taxable income of W10b to W100b		13%
Taxable income over W100b	14%	15%

(Note) 10% of corporate income tax shall be imposed as resident surtax additionally.

**Revised Notice on Electronic VAT Invoices**

Under the revised VAT Law of Korea, a corporate taxpayer should issue VAT invoices only electronically starting from January 1, 2010.

On August 31, 2009, the National Tax Service ("NTS") of Korea announced a revised notice (NTS Notice 2009-80) as to how a corporate taxpayer should issue electronic VAT invoices and store them, which includes the following:

- Storing VAT invoices issued and received electronically will suffice the taxpayer's obligation of VAT invoice-keeping
- When issuing VAT invoices electronically, a corporate taxpayer should send the electronic VAT invoices using an electronic certification from public electronic certification institutions or similar secured certification system.

**Cho Yong Hae**  
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## MALAYSIA

### RECENT TAX DEVELOPMENTS

#### Economic Slowdown

Spared the stifling recession in many other countries, Malaysia has not come through unscathed although it did not suffer the debilitating effects as those in the hard hit countries. The country recorded positive growth of 0.1% in Q4 2008 during the height of the Lehman Brothers collapse, negative growth in Q1 2009 (-6.2%) and Q2 2009 (-3.9%). The Q3 2009 growth rate is expected to be in negative territory with a turnaround in Q4 2009. None of the banks faced difficulties and no major company has gone into bankruptcy. Nevertheless, the feeling on the ground is that the economy is sluggish. Certainly, there is no blood on the streets and neither is there a lot of pain but many companies are merely maintaining their operations and looking forward to a better 2010.

#### Stimulus Packages

Meanwhile, the Malaysian Government has introduced 2 stimulus packages. The first package unveiled in November 2008 provided for a spending of RM7 billion (amounting to less than 1% of the GDP of the country), most of which was designated for infrastructure works. Seeing the ineffectual amount of stimulus, the Government unveiled a Second Stimulus Package on 10 March 2009 for RM60 billion which was primarily made up of RM15 billion for fiscal injection, RM25 billion for Guarantee Funds and RM10 billion for equity investments. The amount allocated for tax incentives was RM3 billion. Recently, the Government has announced that within 10 months since the first stimulus package was unveiled, 90 per cent of projects identified had been awarded or in various stages of implementation.

#### Tax Changes

The amount allocated for tax incentives was comparatively low and the tax changes were nil in the First Stimulus Package and minimal in the Second Stimulus Package. Nevertheless, some of the significant changes were as follows:

##### Accelerated Capital Allowances (ACA)

ACA will be allowed within 2 years on plant and machinery purchased between 10 March 2009 and 31 December 2010. This is applicable to all businesses and companies. However, SMEs are presently already allowed 100% ACA in the year of purchase and therefore will not benefit from the incentive.

ACA will be allowed within 2 years on renovation and refurbishment expenditure of up to RM100,000 incurred between 10 March 2009 and 31 December 2010. This expenditure would normally not be eligible for capital allowances unless it forms part of an industrial building in which case, the taxpayer can claim for industrial building allowance. With this change, renovation and refurbishment expenditure incurred on non-industrial buildings can now be eligible for ACA of up to RM100,000.

##### Carry Back of Current Year Tax Losses

Current year losses of up to RM100,000 will be allowed to be carried back for setoff against the previous years' profits. Notably, the carry back is limited to the immediately preceding year for assessment year 2009 and 2010 and restricted to an amount of RM100,000. At the present corporate tax rate of 25%, the potential tax savings is RM25,000.

##### Incentive for Employing Locally Retrenched Workers

Double deduction of the remuneration incurred on employees

will be allowed to an employer subject to certain conditions. For example, the employee must be a Malaysian citizen and resident retrenched from 1 July 2008 and the remuneration should not exceed RM10,000 for each worker and limited to a maximum period of 12 consecutive months commencing from the first month the employee is employed. The double deduction is only allowed for workers employed between 10 March 2009 and 31 December 2010. In addition, it is not applicable to persons employed to replace former employees.

##### Financial Guarantee Incentives

Whilst tax measures are beneficial, the Stimulus Packages have made use principally of government spending and Government Guarantees Schemes as drivers for economic recovery. In such economic times where financial institutions are reluctant to lend even though the Malaysian banking system is flush with funds, the Government has ingeniously provided financial guarantees to taxpayers to enable them to borrow more easily from banks or raise capital for their business activities. The financial guarantee schemes are either financial guarantee insurance provided by Danajamin (the Government Financial Guarantee company) to issuers of private debt and Islamic securities or financial guarantees provided by the Government but administered and managed by Prokhas Sdn Bhd (a special purpose vehicle wholly owned by the Minister of Finance Inc, to administer and manage the two guarantee schemes announced in the Second Stimulus Package). With these stimulus measures, the economy is slowly but surely being revived.

The full effects of the Stimulus Packages are yet to be fully felt but it is hoped that 2010 will bring a strong economic recovery and welcomed respite from the fretful recession.

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