

Photo: The Pentecost River and Cockburn Ranges, Kimberley, Western Australia, Australia

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1. Introduction

In the admirably concise words of the International Monetary Fund, "Asia entered the global crisis on a strong footing and is continuing to lead the global recovery."

In brief, our reading of the economic data agrees with the IMF's positive assessment. Growth in the Asia Pacific region will be strong in 2011 and 2012, averaging almost 5 percent. The only likely drags on the region's growth will be subdued demand from heavily indebted Western economies and the threat of rising inflation. We foresee tax policies in the region following several key trends:

- ▶ **Fiscal consolidation.** Reversing course after two years of injecting fiscal stimulus to combat recession, nations in the Asia Pacific region will strive for fiscal consolidation – increasing tax collections and raising spending only slowly so that they can reduce the debt they accumulated during the global financial crisis.
- ▶ **Lowering of corporate tax rates.** Some Asia Pacific nations will continue lowering their statutory corporate and individual tax rates to compete for international investment. However, several nations, including China, have likely lowered their rates as far as they intend to.
- ▶ **Simultaneous broadening of the tax base.** While some headline rates will fall, corporate tax receipts are largely stable, indicating a simultaneous broadening of the corporate income tax base.
- ▶ **Tax breaks for favored industries.** Tax-writing legislators will continue creating and expanding tax breaks for selected industries, especially shared services centers, high-tech companies, financial services, and any industry whose activities are deemed to be “green” or that seem to leaders particularly valuable to their nations’ economic futures.
- ▶ **Aggressive tax enforcement to maintain revenue.** Nations will maintain corporate tax revenue despite lower rates and larger tax subsidies to green industries by enforcing new and existing economic substance rules, imposing stricter transfer pricing regimes, bringing pressure on low-tax nations, strictly auditing cross-border transactions, cooperating internationally to reduce tax avoidance or evasion, and generally acting to increase the percentage of corporate and individual income deemed taxable. This is the most challenging area for corporate taxpayers in the Asia Pacific region.
- ▶ **Increased taxation of immobile assets.** Nations will increase taxation of immobile assets such as land and minerals, because those taxes generate predictable revenue with minimal difficulty in administration.
- ▶ **Political tension over the shift to indirect taxes.** Nations will continue to try to raise indirect taxes when they want an infusion of tax revenue because leading global organizations like the Organisation for Economic Cooperation and Development (OECD) consider them to be the least economically damaging type of tax, but popular resistance may mean such increases are not as significant as desired or are thwarted altogether.

Here we review the recent economic performances and tax policies that have put the Asia Pacific region in the enviable position that the IMF describes. We do so to better understand the underlying trends so that we can predict what is to come in 2011 and 2012. The bulk of our report is the country-by-country summaries where we present important economic and governmental facts about 13 of the largest economies in the Asia Pacific region, but first we lay out the trends we have discerned and offer suggestions to companies on how to take advantage of them.

To avoid as many potential points of controversy as possible between corporate taxpayers and the world's increasingly aggressive tax authorities, companies must stay informed and

engaged. That means knowing what the legislature and the tax authority of each nation think of their current tax system: what's working and what's not. And it means studying the history of each country's tax policy and administration so that we can see what each government's leaders and tax administrators are likely to do next.

This educated approach to governments and their tax authorities can be thought of as “tax intelligence.” But there is no common pattern to follow for countries in the Asia Pacific region or any other region because countries conduct their business in vastly different ways.

The best approach, then, is a multi-faceted, strategic campaign to stay well informed about tax policy developments

and to reduce the risk of a major controversy between the company and the tax authorities. That task was made much more difficult over the past three years by the global financial crisis, as we will outline in the following pages.

We hope that this policy outlook will assist you in considering how to navigate your journey within the Asia Pacific region.

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2. The global financial crisis and the Asia Pacific region

Before globalization really took hold, a financial calamity could occur in one country without creating economic turmoil around the world. The global financial crisis illustrated just how interlinked our economies now are, as issues in the United States rippled across Europe and Asia.

The world's leaders responded to the crisis with a broadly similar set of policies. Many opted for fiscal stimulus, funneling funds into the economy via tax cuts and government spending programs to counteract a sudden dip in private earning and spending. In Western advanced economies, many governments used more funds to bail out financial institutions. Faced with massive revenue losses, governments the world over gave their tax administrators authority to enforce tax laws more aggressively.

The Asia Pacific region did not escape unscathed by any means, but the recession did hit with less force for several reasons. Most importantly, financial institutions and individuals in the Asia Pacific region had not invested heavily in mortgage-backed securities that were erroneously rated and sold as low-risk investments. Western economies are finally recovering from the crisis, but the ill effects are still with them: high unemployment levels, still-declining real estate values and alarming government indebtedness.

Secondly, economic growth in most of the Asia Pacific nations was at such a high level before the crisis that even though it dipped markedly, the recessionary tendencies bottomed out at a more bearable level than in Europe or North America. In fact, in the Asia Pacific region, six nations even managed to grow during 2009, and three of them – China, Indonesia and Vietnam – grew robustly (see Table 1).

Third, after bottoming out at a higher level, Asia Pacific economies recovered more quickly than advanced Western economies. Starting in late 2009 in most cases, Asia Pacific economies came back strong. They have continued along that growth path, and 10 of the 13 economies we examine here grew at a rate higher than 6% during 2010. The only three that didn't match that rapid pace are the advanced economies of the region, Japan, Australia and New Zealand, which all grew about 3%.

Table 1. Real economic growth projections 2009-2012 (% of GDP)

	2009	2010*	2011*	2012*
Australia	1.25	3.00	3.47	3.48
China	9.10	10.46	9.59	9.54
Hong Kong SAR	(2.76)	6.04	4.69	4.32
Indonesia*	4.55	6.00	6.20	6.50
Japan*	(5.22)	2.82	1.50	2.04
Korea	0.20	6.06	4.48	4.21
Malaysia	(1.71)	6.72	5.30	5.20
New Zealand	(1.59)	3.00	3.16	3.05
Philippines	1.06	7.04	4.46	4.50
Singapore	(1.28)	15.00	4.55	4.37
Taiwan	(1.91)	9.32	4.41	4.69
Thailand	(2.25)	7.52	4.00	4.25
Vietnam	5.32	6.47	6.82	7.04
Average	0.36	6.88	4.82	4.86

*Projections

Source: International Monetary Fund, World Economic Outlook database, October 2010



Photo: Champagne Pool, Wai-O-Tapu, Rotorua, New Zealand

Since an optimistic projection of economic growth is the most important metric to global business executives, there is every reason for Asia Pacific nations to expect the already strong flows of investment capital coming their way to strengthen even further.

The special role of China in the region's prosperity

The IMF draws particular attention to China, and in the Asia Pacific region, that is certainly justified. As Dr. Lawrence Kuhn, moderator of a recent Ernst & Young Strategic Growth Forum session on China, described the giant Chinese emerging market, "The world's second largest economy, China is on track to become the world's largest economy and a world leader in everything from economics and finance to sports and culture."

The global financial crisis seems to have marked the turning point in China's domestic demand. That is, China was long dependent on other nations' demand for its manufactured goods, but domestic demand has grown to the point that during the financial crisis and its aftermath, China's imports have been sufficient to buoy the economies of many other nations in the region, notably Australia, Indonesia and New Zealand. China's confidence in its economy is also reflected in a changing tax policy stance. Since its corporate rate cut in 2008, China has focused on higher taxes for previously tax-favored inbound investment, the goal being to equalize the tax treatment of foreign direct investment with domestic investment. One expression of this new policy is the recent conversion of local, inconsistently applied taxes to national, broadly applied taxes.

Throughout the 2011-2012 period, growth in China will be close to 10%, and in most of the other nations we examine here, rapid growth of 4% or more is predicted.

3. Tax trends in the Asia Pacific region

Fiscal consolidation replaces fiscal stimulus: tax policies during and after the crisis

With so much optimism about Asia Pacific economies, national leaders there might be expected to "take advantage" and experiment with higher levels of social spending or lower tax revenue. A few are doing so. Singapore is increasing funds to retirees and low-income people, Thailand is extending by two years the goods and services tax (GST) rate cut from 10% to 7% and in the Philippines the new president has vowed not to raise taxes.

But fiscal consolidation is the top priority in many Asian nations. Though they face much less dire budget deficits than do leaders of advanced Western economies, Asia Pacific leaders have pledged themselves to eliminating their budget deficits and reducing the debt they took on during the financial crisis (see Tables 2 and 3). Some nations, such as the Philippines and Thailand, have pledged to reduce deficits but have made countervailing commitments at the same time, so fiscal consolidation is less certain.

Table 2. Annual Deficit Projections 2009-2012 (% of GDP)

	2009	2010*	2011*	2012*
Australia	(4.11)	(4.57)	(2.48)	(0.60)
China	(2.98)	(2.89)	(1.93)	(1.28)
Hong Kong SAR	1.55	1.56	1.76	2.67
Indonesia*	(1.58)	(1.45)	(1.73)	(1.59)
Japan*	(10.23)	(9.60)	(8.89)	(8.12)
Korea	0.04	1.40	1.99	2.34
Malaysia	(5.53)	(4.57)	(5.54)	(5.23)
New Zealand	(2.77)	(4.14)	(3.37)	n/a
Philippines	(3.94)	(3.89)	(3.54)	(2.81)
Singapore	(0.82)	2.41	1.45	1.79
Taiwan	(5.79)	(3.76)	(2.48)	(2.27)
Thailand	(3.18)	(2.74)	(2.35)	(1.59)
Vietnam	(8.94)	(6.03)	(4.18)	(3.49)
Average	(3.71)	(2.94)	(2.41)	(1.68)

*Projections

Source: International Monetary Fund, World Economic Outlook database, October 2010

There is no doubt about the consensus on fiscal policy throughout the Asia Pacific region. Governments should enact prompt fiscal stimulus and lower interest rates as a recession hits, which they did, and governments should enact prompt fiscal consolidation when growth resumes and take measures to prevent inflation, which Asia Pacific leaders are declaring their intention to do. The IMF believes them, projecting lower budget deficits or higher surpluses in 2011 for every country in the group except Indonesia (deteriorating from -1.45% in 2010 to -1.73% in 2011) and Malaysia (from -4.57% in 2010 to -5.54% in 2011).

Table 3. Government Debt Projections 2009-2012 (% of GDP)

	2009	2010*	2011*	2012*
Australia	17.63	21.94	23.68	24.20
China	18.60	19.15	18.85	18.10
Hong Kong SAR	1.00	0.66	0.59	0.55
Indonesia*	28.60	26.71	26.34	25.41
Japan*	217.60	225.85	234.13	238.66
Korea	32.56	32.14	30.51	28.95
Malaysia	55.38	55.13	56.56	57.61
New Zealand	26.16	31.02	32.65	32.25
Philippines	48.89	46.35	45.57	45.39
Singapore	106.19	98.88	95.24	93.01
Taiwan	40.38	39.08	37.97	36.71
Thailand	45.23	45.52	45.48	45.30
Vietnam	9.04	52.65	52.17	51.80
Average	52.87	53.47	53.83	53.69

*Projections

Source: International Monetary Fund, World Economic Outlook database, October 2010



If these declarations are translated into fiscal policy, and many actions have been taken already to do so, Asia Pacific nations will have executed a textbook pivot from fiscal stimulus to fiscal consolidation. Many advanced Western economies proclaimed in late 2008 and 2009 that the fiscal stimulus measures they enacted were merely temporary measures against recession, and that they would reduce deficits and debt in the medium term. But many have resisted robust fiscal consolidation. Some advanced Western economies have acted to reduce their deficits, but many of those measures were undertaken only when sovereign debt crises prompted regional pressure.

Japan and Singapore are the only seriously indebted nations in the Asia Pacific region. At well over 200% of gross domestic product (GDP), Japan's debt is excessive and heading even higher. Singapore's is currently over 100%, but if the government pursues cautious fiscal policy, strong growth should reduce debt to 93% of GDP in 2012.

Most Asia Pacific leaders have every reason to believe they have the most promising economic prospects and the soundest budgets in the world. If they indeed reduce their indebtedness quickly, and seven of the 13 are predicted to do so, they will create an even greater contrast between themselves and debt-ridden advanced Western economies, making even more certain that strong capital flows will continue in their direction. The tax policies these nations choose will play a significant role in helping them fulfill hopes for economic growth.

Lowering statutory corporate tax rates to compete for investment

Though desiring to raise more tax revenue, Asia Pacific nations, alongside their peers around the world, have been competing vigorously for international investment by lowering statutory corporate tax rates. This is not a new development by any means. In fact, falling corporate tax rates is the longest-running continuous trend for tax rates worldwide.

Statutory corporate rates in the Asia Pacific nations covered in this publication currently range from 16.5% in Hong Kong to 41% in Japan, although this rate will fall by 5 percentage points in April 2011. Hong Kong's corporate tax rate was 16% until 2003 when sluggish revenue prompted a rate hike to 18.5%. In 2008, after Singapore cut its rate to 18%, Hong Kong reversed course and lowered its corporate rate to 16.5%. Singapore reacted in 2010 with another reduction to 17%, its sixth corporate rate

Going back 25 years to a major reduction by the United States, countries around the world have been lowering corporate tax rates. Recently, the strategy has been boosted by a study from the influential OECD, which ranked corporate income taxes as the most damaging type of tax, followed by personal income taxes, indirect taxes and property taxes.

Tax executives of global firms agree. A new Ernst & Young survey asked senior tax executives what factors were most important to them in choosing nations to invest in. A low corporate tax rate was the second most frequently cited factor; only the projected rate of economic growth was more important.¹

cut since 2000. Taiwan is the newest nation to compete in this cluster of ultra-low corporate tax rates, cutting its statutory rate from 25% to 17%, effective in 2010.

Other Asia Pacific nations have seemingly declined to compete with Hong Kong, Singapore and Taiwan but have nevertheless participated in the general trend toward lower statutory corporate tax rates. Like Hong Kong, the Philippines raised its corporate tax rate for a few years and then lowered it. Its rate had been 32% for many years. Effective in 2007, it raised the rate to 35%, but in 2009 it changed course and lowered the rate to 30%, effective on 1 January 2010.

¹ *Winning in a polycentric world: globalization and the changing world of business*
– Ernst & Young

Indonesia, New Zealand, Korea and Malaysia enacted phased reductions of their corporate tax rates. Indonesia cut its rate from 30% to 25% in two steps: first from 30% to 28% in 2009, then to 25% in 2010. New Zealand's company rate was 33% in 2008 when it put through a reduction to 30% effective for three years, 2009-2011. In 2012 and beyond the rate will fall to 28%. Korea lowered its corporate tax rate in 2009 from 27.5% to 24.2%, and it plans to lower it further in 2012 to 22%. Like China and the US, Korea is one of the few nations to apply its corporate tax to worldwide income. Malaysia has cut its rate in increments from 28% in 2006 to 25% in 2010.

Australia cut its corporate income tax rate twice in the late 1990s, from 36% to 34% and then to 30%, a rate still in effect today. In 2010, however, Australia scheduled in law a slight rate reduction to 29%, effective in 2013. A political backlash against the initial mining tax proposals thwarted efforts to cut the corporate rate more substantially. After maintaining the world's highest total corporate tax rate for many years, Japan decided in late 2010 to reduce its federal rate by an effective five percentage points. If approved, the total rate including local taxes on income and capital will be approximately 36% instead of a world's highest 41%.

Thailand and Vietnam have neither raised nor lowered their corporate tax rates in recent years; Thailand's rate is 30% and Vietnam's rate is 25%, although Thailand has enacted generous rates for resident firms, and for the past two years Vietnam has offered a 30% reduction to small- and medium-sized enterprises.

China, one of the few nations to retain

a worldwide taxation regime, cut its corporate tax rate from 33% to 25%, effective in 2008. This will almost certainly be China's last statutory corporate rate cut for many years. The main thrust of its tax policy since then has been to remove tax preferences from foreign direct investment, especially in the real estate sector, and to convert local, inconsistently applied taxes into broadly applied national taxes. China believes that the real estate sector is overheating and that targeted tax hikes could mitigate the damage.

Under Circulars 35 and 98, China has imposed a city construction tax (CCT), an education surcharge (ES) and a local education surcharge (LES) on the foreign investments of enterprises and individuals. In total, despite the corporate rate cut, China has been collecting more corporate tax revenue.

A trend toward lower personal income tax rates

The long-term, downward trend we have chronicled in corporate income tax rates applies to tax rates on personal income in the region also. New Zealand and Indonesia have made the most dramatic cuts, each taking five percentage points off its top personal tax rate. New Zealand cut its top rate from 38% to 33%, and Indonesia reduced its top rate from 35% to 30%.

Smaller changes were made in Australia and Taiwan. Australia has cut two percentage points off its top rate over three years, leaving its top rate at 46.5%. Taiwan last year shaved one percentage point off three of its lower-bracket tax rates: from 6% to 5%, from 13% to 12% and from 21% to 20%.

It's not just the rate: nations broaden the tax base to maintain revenue

We have chronicled the downward trend in statutory corporate tax rates across the Asia Pacific region, and indeed, it is a robust global trend. But in Asia Pacific and elsewhere, are national governments really collecting less corporate tax revenue as they cut their statutory rates? In some cases the answer is yes, and governments have enacted or raised other taxes to make up for the uncollected corporate tax revenue. But in most cases the answer is no. Along with the rate cut, they "broaden the base," i.e., they make legislative and administrative adjustments that make more income taxable. As in China, many nations have cut the headline rate but taken countervailing measures to maintain or even increase revenue.

After maintaining the world's highest total corporate tax rate for many years, Japan decided in late 2010 to reduce its federal rate by an effective five percentage points. If approved, the total rate including local taxes on income and capital will be approximately 36% instead of a world's highest 41%.

The trend among governments has been to implement stricter interpretations of existing law, enforce new and existing economic substance rules, impose new transfer pricing regimes, bring political pressure to bear on low-tax nations, initiate international exchanges of tax-related information and more strictly audit cross-border transactions.

Table 4. Government Revenue Projections 2009–2012 (% of GDP)

	2009	2010*	2011*	2012*
Australia	33.30	32.01	32.87	33.98
China	20.02	19.41	19.82	20.51
Hong Kong SAR	19.04	20.81	20.33	20.72
Indonesia*	15.63	15.85	15.85	16.01
Japan*	29.51	30.13	30.92	31.34
Korea	24.01	23.66	23.49	23.73
Malaysia	26.99	25.90	25.98	26.21
New Zealand	31.21	29.97	29.79	30.34
Philippines	14.61	15.00	15.74	16.63
Singapore	18.98	21.78	20.98	21.20
Taiwan	18.28	19.30	19.40	19.50
Thailand	20.83	20.94	21.14	21.53
Vietnam	24.40	25.00	25.56	25.82
Average	22.83	23.06	23.22	23.65

*Projections

Source: International Monetary Fund, World Economic Outlook database, October 2010

Most well known deductions, credits and exemptions in corporate tax codes – collectively known as tax expenditures – favor industries that employ many people or are otherwise culturally important. Reformers often urge that the tax base be broadened by repealing or reducing such tax expenditures, but that rarely happens, even in tax reforms with substantial base-broadening.

Instead, the trend among governments has been to implement stricter interpretations of existing law, enforce new and existing economic substance rules, impose new transfer pricing regimes, bring political pressure to bear on low-tax nations, initiate international exchanges of tax-related information, and more strictly audit cross-border transactions. These and other tactics can combine to dramatically increase the amount of corporate income that is defined as taxable, more than making up the revenue lost to a rate cut.

Sometimes, the promise to collect more revenue is stated with some specificity so that taxpayers can see what's coming. Often they are stated very generally, leaving tax administrators wide discretion to impose whatever regulatory solutions will bring in the desired revenue. Taxpayers need the best information and advice they can get to deal with these new collection strategies by governments across the Asia Pacific region, and indeed, around the world.

Tax incentives for selected industries: green and many more

Every nation in the world favors selected industries through the tax code. Often these are long-established industries with a strong political base. Farming, the housing sector, energy production, all are common candidates. Despite large budget deficits in the Asia Pacific region and worldwide, there has been no slowdown in the legislative process of granting such concessions.

Many of the newest concessions are to “green” industries; that is, industries that manufacture products or use manufacturing methods that boast environmental advantages. Most famously, firms that create energy sources that do not burn fossil fuels are receiving generous subsidies.

Of course, not all green policies involve lower taxes; many raise substantial revenue.

China will reinforce environmental protection by adjusting consumption tax (CT) rates, reforming resource taxes and initiating an environmental protection tax. Vietnam began this year with a new environmental protection tax. The broadest of all environmental taxes, the carbon tax, will be a major consideration in Australia starting in July 2011 when the Australian Greens Party takes the balance of power in the senate.

Special treatment has also been granted to high-technology firms, shared services centers and mobile industries, such as financial services and movie production. Sometimes a new industry can capture the imagination of the world's leaders who vie to make their countries into the new “mecca” for that industry in the same way Silicon Valley in California became a mecca for software developers. Worldwide, green technology firms are the hottest new contenders for tax generosity, and in one area that is arguably specific to the Asia Pacific region, nations are using tax policy to compete for global firms' call centers and other shared services centers.

China, determined to compete more vigorously with India for call center activity, issued Circular 64 in July 2010, which grants an exemption from the 5% Business Tax on gross receipts to offshore service outsourcing businesses located in 21 model cities, including Beijing, Shanghai, Guangzhou, Shenzhen, Chongqing and Dalian.

Competing for financial services centers

Recently, competition to become a major financial services hub has heated up in the Asia Pacific region. Hong Kong has had the paramount position for many years, and tax policy is arguably a major reason. Not only is its corporate tax rate the lowest in the region, but Hong Kong has continued reinforcing its standing in the financial services industry. In the current budget, several new initiatives are notable: exempting stamp duty on transactions of many exchange-traded funds (ETFs); extending the 50% reduction of profits tax to more debt instruments; increasing the certainty of profits tax exemption for non-resident funds and extending the application of tax exemption for offshore funds engaged in futures trading. For good measure, there is still no value-added tax (VAT), GST or sales tax.

Meanwhile, Singapore has always cast its tax policy as a competitive advantage for regional headquarters for many industries, not just financial services. But now it is granting allowance and stamp duty remission for qualifying mergers and acquisitions, and it is also refining its existing incentives for high value-added financial services, such as infrastructure finance and wealth management.

Other nations are weighing in, though. Shanghai has long been a contender in this area, and now Australia, New Zealand and Malaysia are customizing their tax policies to attract the financial services industry.

In February 2010, Malaysia enacted four new laws and amended four existing laws to re-position the city of Labuan as an international business and financial hub. In particular, Malaysia wants investment holding companies, trading companies, shipping companies, captive

insurance business, investment funds, and special purpose vehicles to consider Labuan a place where raising financing is comparatively easy.

Australia is demonstrating its commitment to the sector with several proposals. One would reassure foreign-managed funds that Australian tax authorities will not review their past uncertain tax positions. Another would grant a tax exemption for conduit income starting in the 2010-2011 tax year to reduce uncertainty arising from FIN 48 requirements. In yet another, financial institutions borrowing from offshore related parties and retail deposits in FY14 and FY15 would benefit from a phased-in reduction of interest withholding tax.

New Zealand has proposed gentler tax treatment of some non-resident investors, and the final stage of its new international tax regime will reform taxation of New Zealand companies' offshore branches.

Competing for green technology firms

In China, green technology firms can qualify for an exemption from the business tax (BT) and the VAT. A new program also offers the possibility of what the government is calling a "3+3 CIT holiday," which means that beginning with the firm's first income-generating year, it can claim a full corporate income tax exemption for three years, followed by three years of a 50% exemption.

Thailand last year enacted targeted tax breaks to encourage foreign investment in specific green and high-tech industries, and Japan has introduced an immediate deduction for investments that companies make in energy-saving facilities or in developing energy-saving appliances

Some environmental provisions apply more broadly to domestic firms and are not intended as a lure to high-tech

firms. In what it calls a green buildings tax credit, Australia will provide for three years starting 1 July 2011, a bonus tax deduction of up to 50% of the money that companies spend on improving their existing buildings' energy efficiency.

An eye on finance transformation: Asia competes for shared services centers

The principal new tax changes to favor shared services centers are in China, where the government is determined to compete more vigorously with India. Circular 64 in July 2010 granted an exemption from the 5% (BT) on gross receipts to offshore service outsourcing businesses located in 21 model cities, including Beijing, Shanghai, Guangzhou, Shenzhen, Chongqing and Dalian. Revenue generated by companies engaged in such qualified activities as information technology outsourcing, business process outsourcing and knowledge process outsourcing will receive the preferred treatment from July 2010 through December 2013. A retroactive approach allows taxpayers to take previous BT payments on such activities as an offset against future BT liabilities.

Competing for intellectual property

While intellectual property protection has improved to a certain degree across the Asia Pacific region, many companies would prefer that their intellectual property was protected to the same extent as in their home nations. As more research and development (R&D) occurs in this region, tax policies are increasingly favoring R&D and the intellectual property that R&D produces. This should increase the chances for a healthy intellectual property market.

Perhaps as the leading edge of a new trend, Hong Kong's Financial Secretary is promoting a wider application of intellectual property by enterprises and the development of creative industries by proposing to extend the tax deductions to cover registered trademarks, copyrights and registered designs.

Policing the tax base: the rise in tax enforcement

Stricter tax audits

Stricter auditing is a near universal feature of increasingly aggressive tax administration. Tax authorities in China will continue to tighten up the enforcement on non-resident taxpayers and cross-border transactions, intensifying the country's anti-avoidance campaign. Since 2009, China's tax authorities have issued a series of major tax circulars that instruct taxpayers on the procedures they must follow to benefit from tax treaties or to enjoy tax preferences for targeted industries.

One such circular asserts China's authority to ignore any legal entity that is set up, in the opinion of China's tax authorities, for tax-avoidance purposes. This is the "substance over form" doctrine. Henceforward, if the sale of an asset in China is made by a legal entity in a low- or no-tax jurisdiction, China will look to the residence of the owners when assessing taxes.

In the same circular, China imposed a new documentation filing requirement on gains that non-residents derive from transferring equity interest in Chinese resident companies if the gain is taxed in locations with a corporate income tax lower than 12.5%. This may serve as a floor below which Hong Kong, Singapore, Taiwan and other low-tax jurisdictions would not want to drop.

Malaysia plans more aggressive tax audits and investigations to increase compliance and increase revenue. The Korean tax service will engage with tax authorities in China and elsewhere to discuss strengthened tax audits of Korean companies. And in March 2010, the Philippines initiated the consolidated special tax audit on related companies and conglomerates covering taxable year 2009.

Joint audits conducted by two or more nations' tax administrations are the newest development. Australia has joint audits ongoing, and in September 2010, the OECD published a report that provides practical guidance for administrators on how to implement and manage joint audits. Corporate taxpayers should anticipate that this report will be taken seriously by tax administrations across the Asia Pacific region.

Rapid growth in taxpayer information exchange

Tax administrations in pursuit of information regarding global investors' international activity have found success with tax information exchange agreements (TIEAs). If an agreement is in place, two governments can request such information from each other as the status of individual or corporate bank accounts suspected of containing undeclared assets.

Hong Kong made big news in this area during 2010. Previously, it had refused to collect or supply information requested by other nations unless Hong Kong needed the information for its own tax collection purposes. A new law removes the "domestic tax interest" requirement. Hong Kong will now negotiate double-tax avoidance treaties that include effective agreements for exchange of tax information. Such an agreement is

already in force with China, and Hong Kong has signed 13 more in the past year that will take effect in future years or that await ratification. However, Hong Kong will not sign stand-alone TIEAs, and it will not agree to automatic or spontaneous exchanges.

In the last two years, Japan has expanded its TIEAs by concluding tax treaties and agreements on exchange of information. In early 2010, the Philippines empowered its tax authorities to inquire into bank deposits and related information held by financial institutions in nations that have a treaty with the Philippines.

Transfer pricing

Always a contentious area, transfer pricing continues to be perceived as one of the most dominant challenges facing companies and tax administrators alike.

A longstanding trend in this area is stricter transfer pricing regimes in general, and a newer trend for Asia Pacific, at least, is the growth of advance pricing agreements (APAs), effectively a pseudo-audit before the company files its tax return in which the taxpayer and the government sign off on a set of transfer prices.

In December 2010, China published its first public document on APAs. It describes the regulations and forms associated with China's unilateral, bilateral and multilateral APAs. It plans to revise this document annually, and by doing so, promote systematic administration of transparent APAs.

As capital and labor become increasingly mobile, they become more difficult to tax. And while nations across the Asia Pacific region are working hard to tighten up their income tax enforcement, some are also starting to rely more heavily on the taxation of immobile assets, such as land and mineral extraction.

Indonesia has also published new guidelines both for transfer pricing in general and for filing for APAs. Korea has published rules that enable taxpayers to submit contemporaneous transfer pricing documentation and thereby avoid penalties during transfer pricing adjustments.

Taxing immobile assets: land can't cross borders

As capital and labor become increasingly mobile, they become more difficult to tax. And while nations across the Asia Pacific region are working hard to tighten up their income tax enforcement, some are also starting to rely more heavily on the taxation of immobile assets, such as land and mineral extraction.

China and Australia are key examples, China with new taxes on land and Australia with new mining taxes. No one can move the land out of China or threaten to relocate an Australian mine to another country. In both cases, these are immobile assets, and the taxes on them are easy to enforce. That said, there is still a prohibitive level of tax that could dissuade people from buying land in China or minerals in Australia. Immobility does not repeal all the rules that govern taxation in the market. But evidently the new taxes the two nations have been imposing don't reach that level because business in both is booming, to the point that both countries are contemplating how they might slow down those markets with taxes and regulation.

At the federal level, China has enacted several new land taxes recently, hoping to cool the real estate market. On 27 January 2011, Circular 12 announced that the 5% BT on gross receipts would apply to gains from transferring ordinary residential property held for less than five years, while a total exemption would

prevail if the property were held more than five years. This tax would be on top of the existing land VAT imposed on the appreciated value of property.

Although only in the pilot stage, local real estate taxes are coming to China. The national government has given the go-ahead for localities to levy property taxes. Circular 3 describes the terms of the new tax in Shanghai and Order 247 gives the terms for nine localities within Chongqing. Both were published at the same time as Circular 12 in late January 2011 to introduce the pilot programs.

Non-residents will pay on all residential property purchased in Shanghai after 27 January 2011. Shanghai residents will pay only on second homes purchased after that date. The rate will be either 0.4% or 0.6% depending on the size and value of the home. In Chongqing, the tax will apply only to stand-alone homes or high-end residences, and the rate will be 0.5%, 1.0% or 1.2% depending on the size and value of the home. As in Shanghai, the Chongqing real estate tax will apply only if the property was purchased after 27 January 2011, indicating that for at least the next few years, revenue is less important as a motive than slowing down the rate of transfers.

Australia's proposed new mining tax does promise significant revenue. A mining boom is well underway, largely caused by rapidly growing demand from China and other Asia Pacific nations. The new 30% minerals resource rent tax (MRRT) would take effect on 1 July 2012. After a 25% extraction allowance, the effective rate would be approximately 22.5% on iron ore and coal. The proposal would also extend the existing 40% petroleum resource rent tax (PRRT) from onshore oil and gas projects to offshore projects as well.

These two overheated sectors – China's real estate sector and Australia's mining sector – have created what some analysts call a dual-speed economy. This describes a situation where one or two major sectors in an economy are growing rapidly, driving up prices and diverting investment from all other sectors. If it threatens to create a bubble, the government would want to apply economy-wide corrective measures, such as tax or interest rate changes, but those are ineffective when a government is trying to selectively temper growth in one sector. In fact, they can be counterproductive because sectors already performing sluggishly are likely to be slowed further. China and Australia are hoping these targeted taxes will selectively calm down activity in these overheated industries without completely stifling them or inadvertently damaging other parts of the economy, not an easy task to achieve.

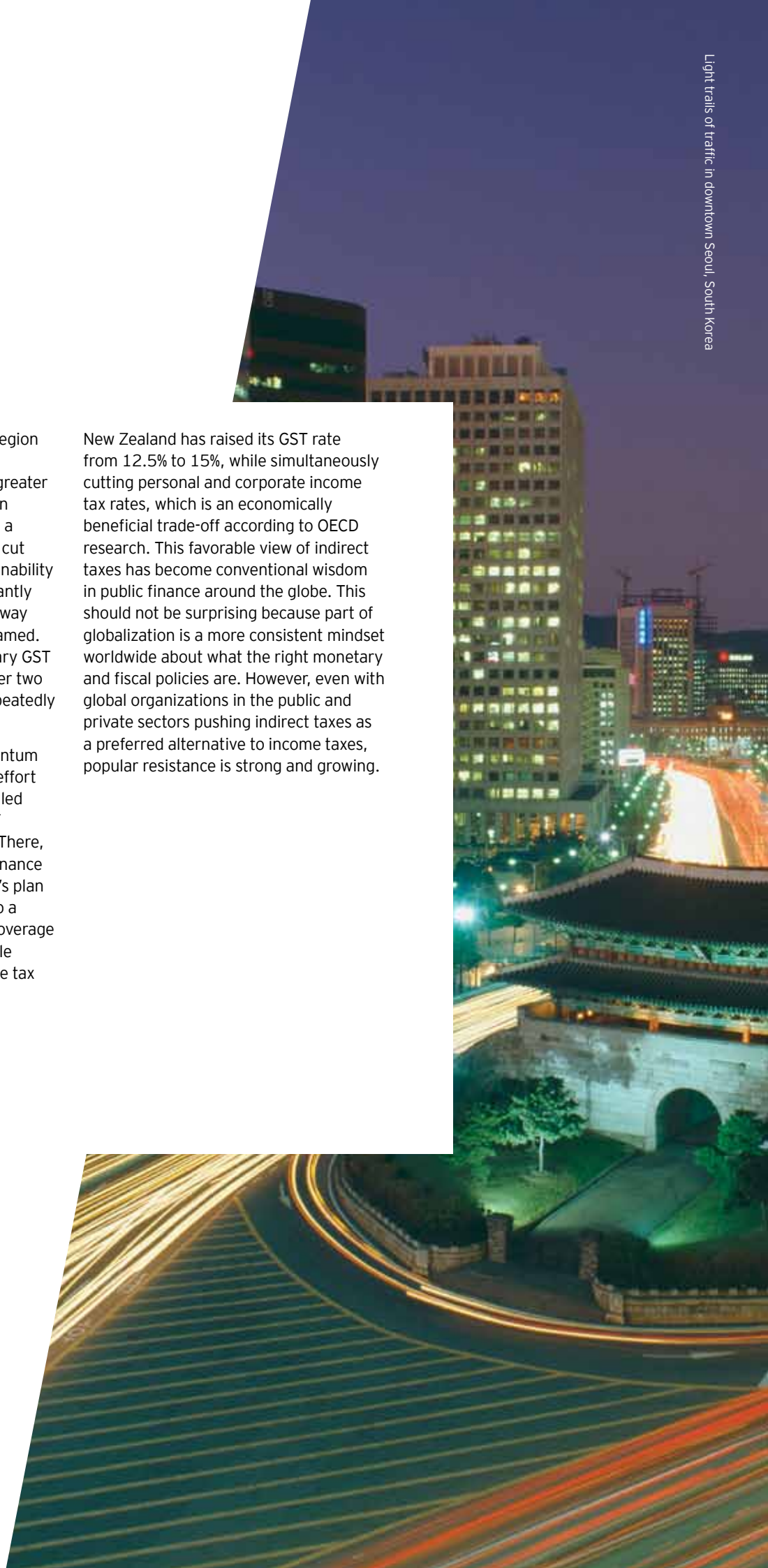
Political tension grows over indirect taxes

A long-term trend in Asia Pacific nations has been toward greater reliance on indirect taxes, especially VATs and GSTs. The European Union was an early supporter of VATs, requiring a minimum 15% VAT to join; and the OECD has ranked indirect taxes as less economically damaging than income taxes.

A newer trend in the Asia Pacific region threatens to slow down the strong movement toward indirect taxes: greater resistance among the electorate. In Japan, business actually expected a greater corporate income tax rate cut than was received, and it was the inability of the new government to significantly raise the local Shouhizei VAT as a way to pay for the cut that is widely blamed. Thailand has extended its temporary GST rate cut from 10% to 7% for another two years, and Malaysia has had to repeatedly postpone its effort to enact a GST.

However, there is still some momentum for indirect taxes. In Malaysia, an effort is underway to reinvigorate its stalled effort to introduce a GST, and VAT reform is a hot tax topic in China. There, a November 2010 article by the finance minister revealed the government's plan to convert the production VAT into a consumption VAT, expanding its coverage and reducing the number of taxable business purchases to avoid double tax collection.

New Zealand has raised its GST rate from 12.5% to 15%, while simultaneously cutting personal and corporate income tax rates, which is an economically beneficial trade-off according to OECD research. This favorable view of indirect taxes has become conventional wisdom in public finance around the globe. This should not be surprising because part of globalization is a more consistent mindset worldwide about what the right monetary and fiscal policies are. However, even with global organizations in the public and private sectors pushing indirect taxes as a preferred alternative to income taxes, popular resistance is strong and growing.





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Flinders Train Station, Australia



Sunda Kelapa Port of Jakarta, Indonesia



Shanghai skyline, China



Colorful Pantheon atop Sri Mariamman Hindu Temple, Singapore

2011 country tax policy outlooks

Bank of China Building in Hong Kong



View of Albert park and the harbor, Auckland, New Zealand



Golden Triangle Frontier, Golden Triangle, Thailand



Ho Chi Minh City Hall, Ho Chi Minh City, Vietnam



Tokyo Metropolitan Government Office, Tokyo, Japan

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Key drivers

- ▶ For the first time in 70 years, Australia has a national minority government, with support of rural independent members of Parliament and the Australian Greens Party, which presents unique political challenges.
- ▶ Environmental issues, including emissions trading and carbon pricing, will likely be at the forefront once the Australian Greens Party takes the balance of power in the Senate after 1 July 2011.
- ▶ The mining boom has generated a two-speed economy driven by demand for resources from China, which has made taxation of resources a contentious issue.
- ▶ Australia is seeking to establish itself as a financial services hub in the Asia Pacific region.
- ▶ The Australian dollar is trading at a historic high against most major currencies.
- ▶ The overall economic outlook is positive, driven by resource demand from Asia.
- ▶ Stimulus spending brought the Australian budget into deficit of approximately 2.9% of GDP.
- ▶ While overall debt is low by global standards, the government has committed to bringing down debt and returning to surplus by 2012-13.
- ▶ The government is committed to developing an approximately US\$40b national high-speed broadband network, which may act as a constraint over other budget measures.

Outlook

- ▶ Australia's Future Tax System Review (Henry Tax Review), released 2 May 2010, proposed a broad range of possible tax policy changes within its 138 recommendations.²
- ▶ Resource taxation is expected to be finalized in 2011, even as debate continues concerning resource tax levels. For example, the Australian Greens Party is committed to higher taxation than currently proposed by the government.
- ▶ Fundamental reform of the tax rules for managed investment trusts (MITs) and their distributions is currently under consideration to boost trade in Australian financial services.
- ▶ Proposed tax incentives for R&D activities in Australia are likely to alter existing concessions, but the timing and final form of the changes are unclear.
- ▶ Due to current budget deficits, corporate tax reduction and personal tax rate cuts in recent years, plus the composition of the Parliament (particularly as of 1 July 2011 when the Australian Greens Party has the balance of power in the Senate), any momentum for lower taxes is likely to be stalled.

Political landscape and recent elections

The Australian Labor Party has held the national government since 2007, with former Prime Minister Kevin Rudd replaced by Julia Gillard on 24 June 2010. In the 21 August 2010 federal election, neither of the two major parties won an absolute majority in the 150-seat House of Representatives. Subsequently, Labor achieved a 76-74 majority with the support of the Australian Greens Party and three independent members of Parliament (MPs).

Tax reform is on the government's agenda, and a tax summit will be held in October 2011. The tax summit will include comprehensive discussion of all of the recommendations in the Henry Tax Review alongside government recommendations.

From 1 July 2011, no party will be able to command a majority of the 76-seat Australian Senate without the support of the Australian Greens Party. The position of the Australian Greens Party and the proposed tax summit will have a strong

influence on tax policy formulation and passage of legislation during the life of this Parliament.

The next Australian federal election is due no later than 30 November 2013; however, due to the fragile nature of minority government, it is possible that the next election will be called earlier than that date.

Current tax policy leaders

- ▶ Julia Gillard, Prime Minister
- ▶ Wayne Swan, Treasurer
- ▶ Bill Shorten, Assistant Treasurer and Minister for Financial Services and Superannuation
- ▶ David Bradbury, Parliamentary Secretary to the Treasurer
- ▶ Dr. Ken Henry, Treasury Secretary (retiring March 2011)
- ▶ Dr. Martin Parkinson, Treasury Secretary (effective March 2011)

Current tax policy administrators

- ▶ Michael D'Ascenzo, Australian Taxation Office (ATO) Commissioner

² See Ernst & Young Tax Policy & Controversy Quarterly Briefing, October 2010: www.ey.com/tpc

- ▶ Bruce Quigley, ATO Second Commissioner (Law)
- ▶ Jennie Granger, ATO Second Commissioner (Corporate Services and Law Sub-plan)
- ▶ David Butler, ATO Second Commissioner (Enterprise Solutions, Technology and Operations)
- ▶ Mark Konza, ATO Deputy Commissioner
- ▶ Jim Killaly, ATO Deputy Commissioner (Large Business and International – Case Leadership)

Recent tax policy changes in 2009-2010

Although there have been no fundamental changes to the Australian tax base since the tax reform waves of 1999-2004, regular updates to the tax legislation have been made, including:

- ▶ Personal income tax reductions were phased in between FY2008 and FY2011, including lowering the top marginal tax rate from 48.5% to 46.5%.
- ▶ The Taxation of Financial Arrangements (TOFA 3&4) legislation introduced default and elective methods of taxation that are more closely linked to accounting standards. TOFA 3&4 became effective by election in FY2009 and mandatory in FY2010 for affected taxpayers.
- ▶ A suite of reforms to the 2002 income tax consolidation rules, introduced in 2010, has offered opportunities to amend prior year income tax returns and claim refunds for many groups.
- ▶ Reforms to limit tax exemptions for Australian expatriates working overseas (section 23AG) have an impact on foreign companies that employ Australian expatriates.
- ▶ Reforms to the taxation of MITs include the introduction of an irrevocable election to treat gains and losses on capital accounts (taxed more favorably than income), and withholding taxes have been reduced to a concessionary rate of 7.5% for MITs.
- ▶ Corporation law was amended during 2010 to allow dividends by solvent companies to replace the former profits requirement, with consequential amendments to income tax law.
- ▶ The foreign investment fund rules were abolished from 1 July 2010, to be replaced by the “anti-roll-up” rule, a new anti-avoidance measure.
- ▶ Rules to deem tax-free private use of company assets by employees, directors and owners as dividends were tightened. Affected company assets may include real estate, cars and boats.

Pending tax proposals

There is much unfinished business arising from the previous Parliament, 2010 federal election promises and recommendations from major tax reviews.

Operative from 2011 or earlier

- ▶ Proposed changes to the international tax rules, including the controlled foreign company (CFC) rules, are under development and are more favorable to taxpayers than the current rules.
- ▶ A “Green Buildings” tax credit is proposed for businesses that improve energy efficiency of their commercial buildings beginning 1 July 2011. A discussion paper was released in January 2011.
- ▶ Asset management and funds management reforms include a new tax system for MITs arising out of the Australian Financial Centre Forum report.
- ▶ Legislative protection from review of uncertain tax positions of certain foreign managed funds for 2010-2011 and earlier income years, and a tax exemption for conduit income for 2010-2011 and later years, will reduce uncertainty arising from FIN 48 requirements and is the first step in implementing a proposed investment manager regime, which demonstrates the government’s commitment to developing Australia’s financial services sector.
- ▶ The existing R&D tax concession is likely to change to a proposed tax credit. This has been introduced within Parliament but has not been passed by the Senate due to federal opposition to the proposed amendments.

Operative from later years

- ▶ A corporate tax rate reduction to 29% is proposed beginning 1 July 2013, and small business (turnover less than \$2m) tax rate reduction to 28% is proposed beginning 1 July 2012.
- ▶ The Australian tax base is expected to be broadened through increased taxation of natural resource extraction beginning 1 July 2012, with a proposed 30% MRRT rate after a 25% extraction allowance, which is (broadly) equivalent to 22.5% MRRT on iron ore and coal. The existing 40% PRRT will be extended to include both onshore and offshore oil and gas projects.
- ▶ There will be an increase in the mandatory rate of superannuation to be paid into employee pension funds by employers from 9% to 12% (incremental increases of 0.25% and 0.5% commencing 1 July 2013).

- ▶ There will be a 50% tax discount on the first \$1,000 of interest income, commencing 1 July 2012.
- ▶ There will be a phased reduction in the interest withholding tax (IWT) rate for financial institutions borrowing from offshore related parties and retail deposits in FY2014 and FY2015 (IWT reduction to 5% and exemption for certain specific circumstances).

Possible tax proposals that might emerge in 2011

- ▶ Reform of state indirect taxes
- ▶ Other measures arising from the Henry Tax Review

Tax policy and administration schedule: things to watch

8 February 2011	Federal Parliament commences autumn sittings
10 May 2011	Treasurer delivers FY2012 federal budget to Parliament
October 2011	Proposed tax summit
30 November 2011	Final day of Federal Parliament spring sittings

2011 headline tax rates (as of 1 January 2011)

Top federal (national) corporate tax rate	30%
Top federal (national) personal income tax rate	46.5%
Standard GST rate	10%

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Key drivers

- ▶ Although the People's Republic of China (PRC) recently encountered the most serious difficulties in its economic development since the turn of the century, they did not reverse the general trend of the PRC's long-term economic growth. In 2009, facing the unprecedented global financial crisis, the PRC contained the decline in growth, stabilized the national economy and witnessed an overall pickup again – all in a relatively short time. The PRC's GDP in 2009 was CNY33.54t (Yuan), an increase of 8.7% over 2008.
- ▶ The PRC is experiencing rapid industrialization and urbanization. Infrastructure construction, upgrades in industry and consumption structure, environmental protection and ecological improvement, as well as the development of other social programs, have great potential for demand and expansion to sustain the growth of China's economy at a relatively high speed over a relatively long period.
- ▶ On the other hand, the PRC's GDP per capita still ranks behind more than 100 countries. Calculated by the World Bank's poverty standard of US\$1.25 per person per day, the PRC still had some 150 million people living in poverty at the end of 2008. Although the country has made great achievements over the past 30 years in its reform, opening up and economic development, it is still a developing nation with a population of 1.3 billion.
- ▶ Facing the severe challenges posed by the global financial crisis, the PRC government has primarily relied on expanding effective domestic demand to maintain steady economic growth. It enacted a stimulus package reflecting both the short-term target of addressing the economic downturn and the long-term goal of promoting the transformation of the economic development pattern. The approaches adopted by the PRC government include:
 - ▶ Proactive fiscal policy
 - ▶ Moderately easy monetary policy
 - ▶ Advancing industrial restructuring
 - ▶ Increasing consumer demand

Outlook

- ▶ Following the 2007 reform of tax for use of land in urban areas and vehicle and vessel tax, and the 2008 introduction of the new corporate income tax and Interim Regulations on Tax for Farmland Occupation, which have been applied uniformly to both domestic and foreign-invested enterprises, the PRC government further unified the real estate tax and several local surcharges (the urban construction and maintenance tax and the education surcharge) for the PRC and foreign-invested enterprises and individuals. With this effort, the tax system for the PRC and foreign-invested enterprises and individuals has been unified.
- ▶ With the 2009 implementation of the amended Interim Regulations on VAT, Interim Regulations on BT and Interim Regulations on CT, VAT has been transformed, and the BT and CT systems have been further improved.
- ▶ 2011 will be the start of the PRC's 12th five-year plan, during which the Government will pursue further tax reform. Policymakers may consider changes to VAT, BT and individual income tax, as well as adopting a new property tax.
- ▶ Policymakers may increase pilot programs for property taxes in selected cities soon.
- ▶ Tax authorities will continue to tighten up the enforcement of existing taxes with focus on non-resident taxation and cross-border transactions.
- ▶ Anti-avoidance campaign will continue to be intensified.

Current tax policy leaders

Ministry of Finance (MOF) and the State Administration of Taxation (SAT)

Current tax administrators

The SAT at the central level and tax bureaus at local levels

Recent tax policy changes in 2009-2010

During the past two years, the SAT has intensified various tax collection and administration measures, focusing on non-resident taxation and cross-border transactions. A series of tax circulars were issued to provide guidance on certain fundamental principles with respect to the implementation of tax treaties:

- ▶ In February and September 2009, the SAT issued two tax circulars to detail how treaty clauses on dividends and royalties should be implemented. It also issued rules on how to determine beneficial ownership under tax treaties. In July 2010, a comprehensive

technical explanation of clauses of China's tax treaties was issued.

- ▶ In July 2009, the SAT issued a tax circular to provide samples of official tax resident certificates for 42 jurisdictions in order to facilitate the implementation of tax treaties and identification of tax residency by local tax authorities.
- ▶ In August 2009, the SAT issued a tax circular on treaty benefits claims. This circular clarifies the procedures and documentation requirements that should be followed and fulfilled when a non-resident seeks to enjoy treaty benefits.
- ▶ In late 2009, the SAT issued a tax circular to introduce an income tax administrative regime on gains derived from transferring equity interest in Chinese resident companies by non-residents. The income derived from Chinese resident companies' stocks bought and sold through public stock exchanges is not covered by the regime.

The “substance over form” doctrine is emphasized in this circular, and the SAT is empowered to disregard structures established for tax avoidance purposes. This circular imposes a PRC documentation filing requirement on non-resident sellers who have sold equity interest in Chinese resident companies indirectly when such gains are not subject to an effective tax rate of 12.5% or above in the sellers’ home countries.

Significant tax changes also included the imposition of CCT, ES and LES on enterprises with foreign investments, foreign enterprises and individuals, preferential tax treatments for technology advanced service enterprises (TASEs) and income tax rules for corporate restructuring:

- ▶ Under two circulars (Guofa [2010] No. 35 and Caizong [2010] No. 98), CCT, ES and LES are imposed on enterprises with foreign investments, foreign enterprises and individuals. LES local practices used to vary across different regions but now will be unified across the country.
- ▶ The PRC continues to offer new tax incentives to some industries and enterprises, including a 15% income tax rate and a business tax exemption for TASEs through 31 December 2013. Qualified R&D centers were also able to import R&D equipment free of customs duty and VAT through 31 December 2010.
- ▶ The MOF and the SAT issued income tax rules for corporate restructurings during 2009 and 2010. The rules classify corporate restructurings into regular restructurings that are taxable immediately and special restructurings that qualify for tax deferral. Tax deferral requires satisfaction of a number of criteria, including business purpose, continuity of business and continuity of interest. Additional criteria are imposed for cross-border transactions.
- ▶ In December 2010, the SAT published Chinese and English versions of the *China Advance Transfer Pricing Arrangement Annual Report (2009)*, marking the first time the PRC has published such a report on the APA program to external readership. The report, covering the statistical data and analyses from 2005 to 2009, mainly describes the rules and regulations, implementation procedures and practical development of China’s unilateral, bilateral and multilateral APAs. Conveniently attached to the report are standardized forms for APA application and communication purposes. Through its planned annual publication of the report going forward, the SAT hopes to achieve systematic administration of APAs, promote the use of APAs and increase the transparency of the APA process.

to watch

During the past year, the government has tried to cool the overheated real estate market but with little success. As a result, the China State Council is expected to approve property tax pilot programs in Shanghai and Chongqing in the near future. The MOF, the SAT and the Ministry of Housing and Urban-Rural Development have been involved in this new tax policy, and intensive statistics analysis and research have been completed. The government expects the property tax to help reduce speculator investment in the market and finally bring about robust, vigorous development of the property industry.

In addition to the property tax, the PRC is planning continued VAT reform. In November 2010, Chinese Finance Minister Xie Xuren published an article revealing that, following the steps to convert production VAT to consumption VAT, the government is also considering expanding the coverage of VAT and reducing business-taxable items to simplify the taxation system and avoid double tax collection. This will address the imbalance between commodity and service taxation policies and encourage further enhancement of the service industry, according to Xie.

Xie has also added that the PRC will reinforce environmental protection by adjusting consumption tax rates, reforming resource taxes and initiating an environmental protection tax.

At the same time, according to a circular issued in May 2010, the government will focus on improving its foreign individual profile management by intensifying a network among the taxation administration, banks and immigration office and targeting better access to salary information. As a result, foreign individuals’ taxable income is likely to be monitored more closely, and it is not impossible for PRC tax authorities to leverage the information to determine whether a permanent establishment assessment is appropriate.

2011 headline tax rates (as of 1 January 2011)

Top corporate income tax rate	25%
Individual income tax rate	Progressive rates ranging from 5% to 45% (may be changed)
Standard VAT rate	17%, 13% and 0%

Tax policy and administration schedule: things

Key drivers

- ▶ “Big market, small government” principles will continue to drive Hong Kong’s tax policy decisions.
- ▶ Promoting the financial services industry will continue to be a priority.

Outlook

- ▶ Hong Kong’s corporate income tax rate, while low at 16.5%, has seen its competitive advantage eroded as other countries reduce headline corporate income tax rates. The government will monitor this situation carefully, and external changes will likely be a future driver of tax policy decisions.

Political landscape and recent elections

The district council election will be held in November 2011. Legislative elections are held every four years, in years evenly divisible by four. The most recent legislative election was held on 7 September 2008, and the next election will presumably occur in September 2012. The Democratic Alliance for the Betterment of Hong Kong (DAB) is the largest single party in Council, with 13 seats, with the Democratic Party at 9 seats.

Current tax policy leaders

- ▶ John Tsang Chun-wah, Financial Secretary, GBM, JP
- ▶ K.C. Chan, Secretary for Financial Services and the Treasury, SBS, JP

Current tax administrators

- ▶ Chu Yam-yuen, JP
- ▶ Wong Kuen-fai, JP
- ▶ Chu Wong Lai-fun, JP

Recent tax policy changes in 2009-2010

Hong Kong’s 2010 year can be characterized as one of prudence on the part of Financial Secretary John Tsang. Although the 2010 budget contained a raft of measures designed to help both the middle and less advantaged classes, while sticking to the party line that the government’s role is not to lead the market but merely facilitate its efficient operation, there was little major shift that affected multinational business. The budget was used, however, to reinforce Hong Kong’s position as a premier financial asset management center, with

Tsang proposing the following:

- ▶ Exemption of stamp duty on transactions of exchange traded funds that track indices comprising not more than 40% of Hong Kong stocks
- ▶ Extension of the 50% concessionary profits tax rate to qualifying debt instruments with a maturity period of less than three years
- ▶ Clarification of the definition of “central management and control” in order to increase the certainty of profits tax exemption for non-resident funds
- ▶ Enlarging the lists of recognized stock exchanges and futures exchanges under the Inland Revenue Ordinance so as to extend the application of tax exemption for offshore funds engaged in futures trading

Hong Kong also shifted into an era of increased transparency and information exchange with other countries. New legislation was passed on 6 January 2010, that allows Hong Kong to start using the 2004 OECD Model Tax Treaty language in place of the 1995 Model Tax Treaty, in common with most other countries. According to the 1995 Model Tax Treaty, the Inland Revenue Department (IRD) may refuse to collect and supply the information requested by another contracting party if the IRD does not need such information for Hong Kong’s tax purposes (i.e., domestic tax interest). The new legislation removes the domestic tax interest requirement in Hong Kong’s domestic law. Exchange of information will occur upon request only, and Hong Kong will not agree to engage in automatic or spontaneous exchanges.

Hong Kong maintains the policy of negotiating comprehensive double-tax avoidance treaties (CDTAs) and pursuing effective exchange of tax information only within the ambit of a CDTA. Hong Kong will not enter into standalone TIEAs with other jurisdictions as the existing statute does not cater for such TIEAs. Hong Kong’s policy on the exchange of information is restricted to exchange upon request and will not agree to engage in automatic or spontaneous exchanges. It has begun an aggressive campaign to sign double-tax avoidance treaties with exchange-of-information clauses written into them. An agreement with China is already in force, and Hong Kong has signed 13 more in the past year that will take effect in future years or that await ratification.

Pending tax proposals

The legislative bill extending the 50% concessionary tax rate to qualifying debt instruments with a maturity period of less than three years was announced in February 2011 and is expected to become law soon.

Currently, only costs incurred on acquiring patent and industry know-how rights are eligible for tax deductions. To promote a wider application of intellectual property by enterprises and the development of creative industries, the Financial Secretary proposed in his budget speech in February 2010 to extend the tax deductions to cover registered trademarks, copyrights and registered designs. The legislative bill for the proposed changes is expected very soon.

Hong Kong currently has no specific tax legislation catering to Islamic financial products, which in form may involve a sale and repurchase of assets but in substance is akin to a conventional loan arrangement. However, this type of Islamic financial product may entail more tax costs than a conventional loan arrangement. The Financial Secretary indicated in the 2009-2010 budget speech announced in February 2009 that in order to improve Hong Kong's regime as a platform for the growing area of Islamic finance, Hong Kong would introduce tax measures so as to create a level playing field for certain Islamic financial products. It is understood that the administration is actively working on the legislative proposal, but no definite time for the release of a legislative bill has been set.

Another legislative proposal relates to the modernization of the procedures for appeals against decisions of the tax tribunal, the Board of Review, to the courts. Under the proposal, taxpayers can appeal directly to the courts on any points of law arising from a decision of the Board of Review, instead of currently requiring the Board of Review to state a case on points of law for appeal to the courts. The Administration has now completed the consultation process for the proposal, and a legislative bill is expected soon.

Tax policy and administration schedule: things to watch

Budget speech 2011-2012

Legislative bill to extend the tax deductions to cover registered trademarks, copyrights and registered designs

2011 headline tax rates (as of 1 January 2011)

Top federal (national) corporate tax rate	16.5%
Top federal (national) personal income tax rate	17% (top marginal tax rate for those who claim personal allowances); standard rate for those who do not claim personal allowances is 15%
Standard VAT rate	Hong Kong does not levy VAT, GST or sales tax

Key drivers

- ▶ Promote investment
- ▶ Establish a favorable business climate

Political landscape and recent elections

The current President, Susilo Bambang Yudhoyono, was elected to his second term in 2009 and under the Constitution cannot be re-elected. The President's party won the election but failed to win a majority.

Current tax policy leaders

Agus Martowardojo, Minister of Finance

Current tax administrators

Fuad Rahmany, Director General of Taxes

Recent tax policy changes in 2009-2010

- ▶ The corporate income tax rate has been reduced from 30% to 28% for tax year 2009 and 25% for tax year 2010.
- ▶ The highest marginal individual income tax rate has been reduced from 35% to 30%, and the income threshold for each bracket has been elevated, thereby lowering the tax burden.
- ▶ The taxable income threshold for individuals has been increased significantly, from IDR2,880,000 to IDR15,840,000 for a single taxpayer.
- ▶ A VAT rate of 0% applies to the export of services.

Outlook

- ▶ The tax policy outlook is to put emphasis on encouraging investment by granting tax incentives.
- ▶ In the incentive area, it is expected that a tax holiday, which was abandoned in 1983, will be reintroduced for qualifying companies.
- ▶ The tax policy will focus on streamlining administrative procedures to ease taxpayers' administrative burden.

- ▶ The requirement to pay 50% of the tax assessed is delayed in the event that a taxpayer files an appeal.
- ▶ The obligation to pay the tax assessed is delayed in the event that a taxpayer files an objection.
- ▶ The application of pay-as-you-earn system is somewhat eased.
- ▶ A tax incentive in the form of a tax holiday is to be re-introduced, to be granted to new investment in qualified "pioneer industries," subject to further implementing regulation governed by a ministerial decree.
- ▶ Transfer pricing guidelines have been issued to deal with transactions between related parties.
- ▶ Regulation on APAs has been issued, giving an opportunity for companies to file an application for an APA.

Pending tax proposals

- ▶ The qualified industries eligible to enjoy the proposed tax holiday will be defined.
- ▶ There is an intention to establish five additional tax courts outside Jakarta. Currently all tax appeals must be handled by the Tax Court in Jakarta, which is the only tax court in the country.

Tax policy and administration schedule: things to watch

- ▶ There is no specific schedule in place, but the tax policy that is currently in the hands of the Director General of Taxes will be removed and assigned to a special unit within the Minister of Finance.
- ▶ The Minister of Finance is contemplating regulations that stipulate that a company audited by a public accountant and resulting in an unqualified opinion will not be subjected to a tax audit.

Key drivers

- ▶ Aging society
- ▶ Vast public debt
- ▶ Weak economy
- ▶ Improve tax compliance and enforcement

Political landscape

Last July, the Diet Upper House election delivered poor results for the ruling Democratic Party of Japan (DPJ). While the DPJ controls a solid majority in the Lower House, the ruling coalition with the People's New Party has fallen far short of a majority in the Upper House. By losing its narrow majority in the Upper House, the DPJ would be hard-pressed to pass any bills through the Diet called at the end of January 2011 unless it can recruit other coalition partners to reach a majority.

Current tax policy leaders

Ministry of Finance

- ▶ Yoshihiko Noda, Minister of Finance
- ▶ Kazuyuki Furuya, Director-General of the Tax Bureau

Current tax administrators

National Tax Agency

- ▶ Chikara Kawakita, Commissioner
- ▶ Kazuho Tanaka, First Deputy Commissioner
- ▶ Jun Sugie, Deputy Commissioner of International Affairs
- ▶ Seiichiro Tomita, Deputy Commissioner of Planning, Information System Management, Liquor Tax and Industry

Recent tax policy changes in 2009-2010

The main points of the 2009 tax reform were as follows:

- ▶ **Corporation tax.** Introduced two-year tax measures to allow immediate depreciation with regard to investment

Outlook

- ▶ The government is undertaking the largest review of the Act on General Rules for National Taxes since its enactment in 1962.
- ▶ To reform the National Tax Tribunal, the government is considering modification of the administrative appeal procedures, as well as the tribunal's organization and personnel system.
- ▶ With the aim of swiftly introducing a single taxpayer identification number system, the government is facilitating its study through the Panel on Identification Number System for Social Security and Tax.
- ▶ The government may soon propose how much the CT rate needs to be raised to cope with an aging society and reduce significant government debt.

in energy-saving and new-energy facilities and in production facilities for goods such as energy-saving home electric appliances.

- ▶ **International taxation.** Introduced a measure to treat the dividends received from overseas subsidiaries as non-taxable income in light of tax neutrality for a company's repatriation in place of indirect foreign tax credit.

The main points of the 2010 tax reform were as follows:

Individual income taxation

- ▶ Abolished deduction for dependents (up to 15 years old) (JPY380,000) while creating child allowances from the perspective of "the shift from income deduction to allowances"
- ▶ Abolished the additional part of deduction for the specified dependents (between 16 and 18 years) (JPY250,000) while providing high school education at virtually no charge

Corporation tax

- ▶ Streamlined the taxation on transaction of capital, including introduction of tax deferral for profits and losses derived from transfers of assets between 100%-owned group domestic corporations
- ▶ Abolished the taxation measure of "individually owned companies" (specially controlled family corporations) in the FY2010 tax reform

International taxation

- ▶ Reviewed the taxation rule for CFCs so that certain income of those corporations from asset management shall be effectively taxed and the "threshold tax rate" shall be reduced to "less than or equal to 20%," with a view toward preventing tax avoidance and invigorating corporate activities by responding to the change of business structures of Japanese corporations operating overseas
- ▶ Provided for necessary domestic legislation regarding information provision for foreign tax authorities in order to expand and reinforce the network of tax information exchange by concluding tax treaties and agreements on exchange of information for tax matters and implementing information exchange more effectively
- ▶ Provided non-resident investors with exemption for investments in certain corporate bonds

Pending tax proposals

Japan's government released the outline of its 2011 tax reform proposal on 16 December 2010. This should go on to form the basis of a finance bill to be introduced to the Diet called at the end of January 2011. If approved, most of the reform changes should be effective beginning 1 April 2011. The key provisions of the 2011 tax reform proposal are as follows:

- ▶ A reduction of the effective rate of tax for corporations by 5%
- ▶ Extension of the loss carry-forward period from seven years to nine years and a cap of 80% on taxable income that large enterprises may offset against net operating losses
- ▶ Reduction to the R&D tax credit and reform of accelerated depreciation rates

Tax policy and administration schedule: things to watch

1 April 2011	Likely effective date of reform changes if approved
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2011 headline tax rates (as of 1 January 2011)

Top federal (national) corporate tax rate	30% (Local income taxes, which consist of an income levy and a capital levy, are also imposed. The resulting effective tax rate is approximately 41%.)
Top federal (national) personal income tax rate	40% (plus local tax of 10%)
Standard VAT rate	4% (plus local tax of 1%)

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Key drivers

- ▶ The Korean economy's growth rate is forecast to decrease from 5.9% in 2010 to 3.8% in 2011. Export growth rate is likely to decrease to single digits, as is the growth rate of infrastructure investment. The construction industry especially is expected to experience slow growth due to the lagging real estate industry.
- ▶ Korea's low birth rate and aging population mean that economic vitality and productivity will decline. Furthermore, as many labor-intensive industries have been relocated out of Korea, unemployment will be a major concern. If economic growth without employment continues, societal polarization between the poor and the rich will intensify without a sufficient middle-class base. As such, the Korean government expects to increase spending on social welfare programs in the near future.
- ▶ With the gloomy economic forecast and the need for increased spending on social welfare programs, the Korean government is planning to achieve fiscal balance over the next several years by decreasing the national debt rate to 30% (33.8% as of 2009) and increasing taxation.

Political landscape

2011 is a critical year, as both presidential and general elections will be held in 2012 and a heated battle is expected. The congressmen in the Grand National Party closely cooperate with current President Lee Myung-Bak, but their alliance could weaken depending on the likelihood of winning seats in the elections.

This year's elections in other countries will also have a political impact on Korea. In particular, issues involving the Korea-US free trade agreement (FTA) ratification will be hotly debated; although

Outlook

- ▶ 2011 will be the start of a multi-year focus on tax reform designed to simplify the tax code and to broaden the tax base.
- ▶ The National Tax Service (NTS) is strengthening policies to prevent tax evasion via cross-border transactions with the following measures:
 - ▶ The NTS requires Korean residents or domestic corporations having more than KRW1,000m in a foreign bank account to report the balance.
 - ▶ The NTS joined the Joint International Tax Shelter Information Center and expanded their overseas network by entering into various agreements with other countries.
 - ▶ The NTS continues to track down and impose taxes on taxpayers who conducted international transactions through tax haven countries and failed to pay the taxes.
- ▶ In 2011, the NTS will share its database with the Korea Financial Intelligence Unit, collect data on the tax base and strengthen the analysis of such to select taxpayers with a high likelihood of tax evasion.
- ▶ Existing tax credits and incentives with sunset clauses will not be extended any longer. If extended, the incentives might be reduced.
- ▶ The NTS will actively support the transfer pricing issue on Korean companies having operations in foreign countries; the NTS will lead continuous discussion to effectively deal with strengthened tax audits on Korean companies operating overseas by countries such as China.

the Republican Party that supported the FTA won the midterm election, it will not rush ratification considering the 2012 US presidential election.

Conflict between South and North Korea will likely continue in 2011. However, the six-party nuclear talk participants – including the US, China and Russia – do not appear willing to aggressively advance another meeting because they will be undergoing political transition in 2012.

Current tax policy leaders

- ▶ Lee Myung-Bak, President
- ▶ Kim Sung-Jo, Commissioner, Strategy and Finance Committee, the National Assembly
- ▶ Yoon Jeung-Hyun, Minister, Ministry of Strategy and Finance
- ▶ Joo Yong-Sup, Tax and Customs Bureau, Ministry of Strategy and Finance
- ▶ Kim Na-Hoi, Tax Policy Division, Ministry of Strategy and Finance

Current tax administrators

- ▶ Lee Hyun Dong, Commissioner, National Tax Services
- ▶ Baik Wun-Chan, Head of National Tax Tribunal

Recent tax policy changes in 2009-2010

For the past two years, tax legislation has included a corporate tax rate cut, simplified taxation on corporate restructuring and introduction of the e-Tax Invoice system. All were intended to stimulate the economy and broaden the tax base.

- ▶ Corporate tax rate on income over KRW200m (approximately US\$180,000) was reduced to 24.2% from 27.5% in 2009 and will be 22% in 2012.

- ▶ The e-Tax Invoice system was introduced to reduce taxpayers' compliance costs and enhance transparency of business-to-business transactions. The e-Tax Invoice is an online tax invoice system that enables online issuance and distribution of a tax invoice and transmission to the NTS.
- ▶ By submitting the contemporaneous transfer pricing documentation, a taxpayer could relieve the penalties on tax assessment in transfer pricing adjustment.
- ▶ A consolidated tax return is available for a group containing a parent company and its 100%-owned subsidiaries. After the parent company elects tax consolidation, it must maintain the consolidation for the subsequent five years and apply the consolidation to all 100%-owned subsidiaries.
- ▶ To promote corporate restructuring, most of the taxes could be deferred if such restructuring is contemplated in certain ways designated in the tax law.
- ▶ Non-financial corporations can recognize translation gains and losses on monetary foreign currency assets and liabilities and translation gains and losses on hedge-purpose currency swaps and forwards as their taxable income or losses for the concerned fiscal year in question.
- ▶ To encourage employers to shift from a retirement allowance system to a retirement pension system, the deduction for the in-house reserve for employee retirement will be gradually phased out until 2016.
- ▶ Various changes in tax laws were legislated with the introduction of Korean International Financial Reporting Standards (IFRS).

Pending tax proposals

No pending tax proposals

Tax policy and administration schedule: things to watch

April-July 2011	Draft 2011 tax reform bill (Ministry of Strategy and Finance)
August 2011	Approval of Tax Committee in the Ministry of Strategy and Finance
August or September 2011	Presidential sanction on the 2011 tax reform bill
September 2011	Submission to National Assembly
September or December 2011	Debate and analysis on 2011 tax reform bill (Strategy and Finance Committee, the National Assembly)
December 2011	Ratification in National Assembly

2011 headline tax rates (as of 1 January 2011)

Top federal (national) corporate tax rate*	24.2%
Top federal (national) personal income tax rate*	38.5%
Standard VAT rate	VAT is levied at a rate of 10% on sales and transfers of most goods and services except exports and some other prescribed transactions

*Resident surtax, 10% of tax payables, is included.

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Key drivers

- ▶ Malaysia is currently at a crucial development phase in its efforts to transform the nation into a developed and high-income economy by 2020.
- ▶ To accelerate economic expansion, the Malaysian government will give development priority to the following 12 national key economic areas (NKEAs) with high-growth potential:
 - ▶ Wholesale and retail
 - ▶ Tourism
 - ▶ Oil and gas
 - ▶ Education
 - ▶ Electrical and electronics
 - ▶ Private health care
 - ▶ Palm oil and related products
 - ▶ Information and communications technology
 - ▶ Agriculture
 - ▶ Business services
 - ▶ Greater Kuala Lumpur
 - ▶ Financial services
- ▶ Malaysia is currently facing stiff competition for foreign direct investment from emerging economies, particularly China, India and Vietnam. In this regard, the Malaysian government will continue to encourage private investment as the engine of growth.
- ▶ The Malaysian government recognizes the need to broaden the tax base in order to reduce the budget deficit. The government is aiming to reduce the 2011 budget deficit to 5.4% of GDP from 5.6% in 2010.

Outlook

- ▶ The government is expected to focus more on indirect taxes as a source for tax revenue. The implementation of a GST as a new source for tax revenue is expected in the near future. The GST will operate similar to VAT and GST systems around the world.
- ▶ Increased tax enforcement efforts through tax audits and tax investigations are expected to continue and intensify to increase the level of compliance with tax legislation and prevent tax revenue loss to the Malaysian government.

Political landscape

Prime Minister Dato' Sri Mohd Najib Bin Tun Abdul Razak, who leads the ruling Barisan Nasional coalition, has implemented a number of initiatives since assuming the top post, such as 1Malaysia, the Government Transformation Program, Economic Transformation Program and NKEAs. These initiatives aim to transform Malaysia into a developed and high-income economy by 2020 as well as mend ties between the country's various ethnic groups.

Although the next general election is not until 2013, it is speculated that one could be held as early as 2011.

Current tax policy leaders

- ▶ Dato' Sri Mohd Najib Bin Tun Abdul Razak, Prime Minister and Minister of Finance
- ▶ Dato' Seri Hj. Ahmad Husni Bin Mohamad Hanadzlah, Minister of Finance II
- ▶ Senator Datuk Ir Donald Lim Siang Chai, Deputy Minister of Finance
- ▶ Senator Datuk Dr. Awang Adek Bin Hussin, Deputy Minister of Finance
- ▶ Tan Sri Dr. Wan Abdul Aziz Bin Wan Abdullah, Secretary General of Treasury
- ▶ Dato' Siti Halimah Bt Ismail, Secretary of Tax Analysis Division of Ministry of Finance

Current tax administrators

- ▶ Dato' Dr. Mohd Shukor Hj. Mahfar, Director General of Inland Revenue Board
- ▶ Dato' Sri Hj. Mohamed Khalid Bin Hj. Yusuf, Director General of Royal Malaysian Customs Department

Recent tax policy changes in 2009-2010

On 11 February 2010, four new laws were introduced and comprehensive amendments were made to four existing laws with the view to reposition Labuan as an international business and financial center (IBFC). As a result, Labuan's IBFC is now governed by the following legislations:

- ▶ Labuan Companies Act 1990
- ▶ Labuan Financial Services Authority Act 1996
- ▶ Labuan Business Activity Tax Act 1990
- ▶ Labuan Trusts Act 1996
- ▶ Labuan Financial Services and Securities Act 2010
- ▶ Labuan Limited Partnerships and Limited Liability Partnerships Act 2010
- ▶ Labuan Foundations Act 2010
- ▶ Labuan Islamic Financial Services and Securities Act 2010

The new legislation is designed to reposition Labuan as an attractive location to set up investment holding companies, trading companies, shipping companies, captive insurance businesses, investment funds and special purpose vehicles to raise financing through Labuan and for purposes of private wealth management.

- ▶ Effective as of 2010 the year of assessment, upstream petroleum companies subject to tax under the Petroleum (Income Tax) Act 1967 are placed under the self-assessment system of taxation and assessed to tax on a current-year basis to be consistent with companies subject to tax under the Income Tax Act 1967. This is a change from the previous official assessment system and preceding-year basis of assessment.
- ▶ In order to boost the tourism industry and promote Malaysia as a shopping haven, the import duty on tourism-related products, such as handbags, apparel, footwear and jewelry, has been abolished effective 15 October 2010.
- ▶ Effective as of 1 January 2011, the Malaysian government has increased the service tax rate from 5% to 6% as a temporary measure to increase tax revenue prior to the implementation of a GST.

Pending tax proposals

The GST bill was tabled for the first reading in Parliament on 16 December 2009. However, it was subsequently announced that the implementation of a GST, originally scheduled in the second half of 2011, will be delayed to beyond 2011, as the government would like to gather more feedback from the public. The GST, when introduced, will replace the existing sales tax and service tax. It has been proposed that the GST will be levied at a rate of 4%.

Tax policy and administration schedule: things to watch

May 2011	Budget 2012 consultative meetings between the Ministry of Finance and industry associations and professional bodies
October 2011	Budget 2012 announcement

2011 headline tax rates (as of 1 January 2011)

Top corporate income tax rate	25%
Top personal income tax rate	26%
Service tax rate	6%
Sales tax	5% to 10%

Key drivers

- ▶ New Zealand's short-term aim is to return to fiscal surplus as soon as possible. Prior to the earthquake in Christchurch on 22 February 2011, this was forecast to occur in 2015-2016.
- ▶ The broader fiscal plan focuses on improving growth through increased saving and investment and reduced consumption and borrowing.
- ▶ There is longer-term concern over the sustainability of the New Zealand tax system. New Zealand has one of the most internationally mobile labor forces in the OECD and depends on international investment in the economy. This creates risks due to the reliance on personal taxation and company profit taxation.

Political landscape and recent elections

New Zealand has a unicameral parliamentary system. A general election, in which all members of Parliament will face re-election, will be held on 26 November 2011. It is unlikely that any legislation introduced after April or May 2011 could be passed prior to the election, so tax reform is not expected this year except in areas where policy officials and the government are already well-advanced in their thinking and design work.

Although the election is still some time away, the current center-right government is expected (based on current opinion polls) to be re-elected, and it would likely continue currently announced policies. The center-left opposition party has not yet released its tax policy, although the party has indicated that if elected, it would raise the top personal tax rate and introduce exceptions for certain foods from the current comprehensive GST.

Outlook

- ▶ The government remains committed to lowering tax on businesses and saving once the fiscal position allows. The short-term focus on the fiscal deficit is on reducing government spending and improving the performance of state-owned assets.
- ▶ Recent years have seen significant changes in tax rates and reform of the taxation of savings and the international tax regime. Changes over the short to medium term will likely be marginal, including the treatment of cross-border hybrid funding instruments, improving the interaction between social assistance and the tax system and the treatment of certain closely held entities.
- ▶ Following the report of the Tax Working Group, consideration was given to shifting the tax base to less mobile factors (particularly increasing the taxation of land), but this was rejected by the government.

Current tax policy leaders

- ▶ John Key, Prime Minister
- ▶ Bill English, Minister of Finance
- ▶ Peter Dunne, Minister of Revenue
- ▶ John Whitehead, Secretary to the Treasury
- ▶ Robin Oliver, Deputy Commissioner Policy, Inland Revenue

Current tax administrators

- ▶ Robert Russell, Commissioner of Inland Revenue
- ▶ Carolyn Tremain, Deputy Commissioner, Service Delivery, Inland Revenue

Recent tax policy changes in 2009-2010

Significant tax reform has been undertaken over the last year, including:

- ▶ Cutting the top personal tax rate from 38% to 33% and the company tax rate from 33% to 30% (with further reduction to 28% from the 2012 fiscal year onward)
- ▶ Increasing the rate of GST from 12.5% to 15% (effective 1 October 2010)
- ▶ Reforming the international tax regime from a full attribution of income earned through offshore companies to an "active-passive" regime, where only passive income earned offshore will be attributed back to New Zealand shareholders
- ▶ Removing depreciation and amortization allowance on buildings with an expected life of 50 years or more

- ▶ Reducing thin-capitalization limits (permitted debt to total asset ratios) from 75% to 60% and extending the thin-capitalization regime to New Zealand-owned businesses with interests in controlled foreign companies
- ▶ Abolishing gift duty (effective 1 October 2011)

Pending tax proposals

The Prime Minister has announced a desire for New Zealand to become a regional financial services hub, and work is under way to remove regulatory and tax impediments to this goal. It is expected that changes will be proposed to the taxation of collective investment vehicles by non-resident investors. The final stage of reforming New Zealand's international tax regime – namely the treatment of offshore branches of New Zealand companies – is also on the agenda for 2011.

The government has formed a Savings Working Group to address the perceived lack of private sector savings in New Zealand, as evidenced by a persistent current account deficit. Although the group has a wide scope, initial comments by the group suggest it is likely to suggest changes to the taxation of savings in New Zealand, possibly including a move to a Nordic tax system with differential rates of tax between capital and labor income. The government is not likely to be open to such radical tax reform.

The New Zealand government is focused on expanding and updating its tax treaty network, which currently covers 35 countries, with a focus on reducing withholding taxes on a bilateral basis.

Tax policy and administration schedule: things to watch

19 May 2011	2011 budget
9 May 2011	Taxation (International Investment and Remedial Matters) Bill reported back from Select Committee
7 June 2011	Taxation (Tax Administration and Remedial Matters) Bill reported back from Select Committee
Late 2011	General election

2011 headline tax rates (as of 1 January 2011)

Top federal (national) corporate tax rate	30% (although 28% for companies with 31 December year-end)
Top federal (national) personal income tax rate	33%
Standard VAT rate	15% (no state or local income taxes or VAT)

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Key drivers

- ▶ The President's campaign promise to not raise taxes constrains government efforts to generate more revenue to fund spending and reduce the country's budget deficit.
- ▶ The administration's intensified program against corruption should improve investors' perception of the country and attract more foreign direct and domestic investments in the long term.
- ▶ Sustained growth in remittance inflows from overseas Filipino workers will continue to fuel consumer spending.
- ▶ The President's flagship initiative for public-private partnerships (PPPs) will help fund strategic public works and public services projects and play an important role in stimulating the economy.
- ▶ The business process outsourcing industry in the Philippines continues to grow. Second only to India in outsourcing worldwide, the rapid growth of this multibillion-dollar industry in recent years is fueled by continuing demand for offshore contact centers and knowledge process outsourcing.

Political landscape and recent elections

The Philippines will hold the next national and local elections in May 2013 when half of the Senate, all of the House of Representatives and all local officials will be elected into office.

The political landscape significantly changed after the May 2010 elections when, after nine years, the country elected a new chief executive. President Benigno Aquino III, the only son of a popular former president and a martyred senator, won by a landslide margin primarily on a campaign based on change and anticorruption.

Outlook

- ▶ Government spending will likely decrease from the prior year in an effort to curb budget deficit.
- ▶ The Bureau of Internal Revenue (BIR) and the Bureau of Customs (BOC) are expected to introduce and enforce strict tax administration measures to plug tax leakages that erode revenues and to significantly improve tax effort.
- ▶ The government's campaign against tax cheats, smugglers and corrupt revenue officials should, in the long run, broaden the tax base and increase tax collection.
- ▶ Legislative proposals to raise taxes will not likely prosper in 2011 in view of the President's repeated declaration that new taxes would be a last priority.
- ▶ The BIR's and BOC's continued computerization project will not only boost tax collection but also improve taxpayer service.

In his first few months in office, however, President Aquino had to face multiple challenges before the Supreme Court for several executive actions, including the revocation of "midnight" appointments and formation of a commission to investigate alleged corruption scandals of the past administration.

The President's fiscal policy was clearly laid down in his first State of the Nation address: no new taxes, a tighter rein on government spending, rationalizing fiscal incentives, strict implementation of existing laws and a crackdown on corrupt government officials and erring taxpayers. The legislative agenda's priorities are influenced by the President, as both the Senate and the House of Representative are controlled by political allies.

Major concern has been raised regarding the government's ability to manage the country's budget deficit, presently at 3.9% of GDP, as the President's policy of not raising taxes clearly poses a big challenge to revenue efforts. The crackdown on corrupt revenue officials, tax cheats and smugglers is not expected to result in immediate substantial revenue gains. In addition to stressing prudence in spending, the government plans to privatize assets to generate much needed funds. President Aquino also has initiated a program for PPPs to fund key government infrastructure projects.

Current tax policy leaders

- ▶ Benigno Aquino III, President of the Republic of the Philippines
- ▶ Cesar Purisima, Secretary of Finance
- ▶ Juan Ponce Enrile, Senate President
- ▶ Feliciano Belmonte, Jr., Speaker of the House of Representatives
- ▶ Ralph Recto, Chairperson, House Ways and Means Committee
- ▶ Hermilando Mandanas, Chairperson, Senate Ways and Means Committee

Current tax administrators

- ▶ Kim Jacinto-Henares, Commissioner of Internal Revenue
- ▶ Angelito Alvarez, Commissioner of Customs

Recent tax policy changes in 2009-2010

Significant tax legislation over the past two years includes the reduction in corporate income tax, measures to enforce tax compliance and encourage transparency by taxpayers, as well as new BIR audit rules:

- ▶ Effective 1 January 2009, the regular corporate income tax was lowered to 30% from 32%.
- ▶ In June 2009, Congress passed a law exempting from stamp taxes the sale, barter or exchange of shares of stock listed and traded through the stock exchange.

- ▶ In February 2010, a new law was passed reducing the tax on life insurance premiums from 5% to 2% and significantly reducing the stamp tax on life insurance policies.
- ▶ In March 2010, legislation was enacted authorizing the Philippine tax authorities to exchange information on tax matters with treaty partners. The Commissioner is now empowered to inquire into the bank deposits and other related information held by financial institutions on taxpayers who are the subject of a request for information.
- ▶ In March 2010, the BIR initiated the consolidated special tax audit on related companies and conglomerates covering tax year 2009.
- ▶ In August 2010, the BIR revised the rules covering the exemption or preferential treatment of income payments to non-resident foreign corporations pursuant to a tax treaty. To enjoy such exemption or preferential treatment, an application for tax treaty relief must be filed with the BIR before the transaction.
- ▶ In December 2010, the BIR prescribed a new requirement for corporations to disclose specified information in the audited financial statements accompanying the tax returns, such as taxes and duties paid for the year, as well as tax assessments issued by the national and local tax authorities.

To improve collection, the Department of Finance (DOF) has intensified the implementation of programs such as the Revenue Integrity Protection Service (RIPS), Run After Tax Evaders (RATE) and Run After the Smugglers (RATS). In the past six months, the BIR and BOC have been alternately filing criminal cases at the Department of Justice on a weekly basis against suspected corrupt revenue officials, tax evaders and smugglers.

Pending tax proposals

The 2011 national budget, signed into law on 27 December 2010, is PHP1.645t, 77% of which – or some PHP1.27t – is to be financed through tax collection. Consistent with the President's election pledge, the current administration does not rely on new taxes to raise revenues but focuses on improved tax collection efficiency. The BIR and BOC are expected to enhance and tighten tax administration to increase revenue collection.

The DOF recently submitted to Congress its proposal to rationalize fiscal incentives granted to business enterprises. The proposed bill seeks to strike a balance between the country's need to attract new investments while minimizing revenue losses. The government is expected to review existing legislation granting tax incentives to businesses as well as tighten the implementation of these incentives and privileges.

While new tax bills are not a priority of the Aquino administration, a number of tax proposals are pending in the House of Representatives, including:

- ▶ Restructuring of the excise tax on tobacco products
- ▶ Amendment of the present VAT law by replacing it with a value simplified tax (VAST) system, which proposes to reduce the tax rate from 12% to 6% while removing the input tax credit mechanism

The above proposals have a low probability of enactment into law in 2011, as they contradict the current policy against new taxes. In particular, the DOF expressly opposes the VAST bill as it is effectively a turnover tax that can inflate the prices of goods and services.

Tax policy and administration schedule: things to watch

Mid-January 2011	Congress resumes session
Late January 2011	Legislative-Executive Development Advisory Council meeting
July 2011	Cabinet deliberation of the 2012 budget and submission to Congress
25 July 2011	President's State of the Nation address

2011 headline tax rates (as of 1 January 2011)

Top corporate tax rate	30%
Top personal income tax rate	32%
Standard VAT rate	12%

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Key drivers

- ▶ Widening income gaps and rising inflation
- ▶ Healthy budget surplus unveiled in the budget announcement for FY2011
- ▶ Strong regional growth

Political landscape and recent elections

Singapore's general election is expected to be held in the second quarter of 2011. There is little doubt that the ruling party, which has been in power since Singapore became an independent nation in 1965, will be returned to power. The key focus will be whether the opposition parties can garner more votes and win more seats in Parliament.

Current tax policy leaders

- ▶ BG Lee Hsien Loong, Prime Minister
- ▶ Tharman Shanmugaratnam, Minister for Finance
- ▶ Peter Ong, Permanent Secretary (Finance)

Current tax administrators

- ▶ Moses Lee, Commissioner of Inland Revenue

Recent tax policy changes in 2009-2010

In 2009, the focus was on measures to cushion the impact of the financial crisis and to save jobs. The emphasis was shifted in 2010 to measures that would build up the capabilities needed to grow the Singapore economy over the next decade through quality, productivity and innovation. Changes included:

- ▶ Reduction in the corporate income tax rate from 18% to 17% as of tax year 2010

Outlook

- ▶ Short-term measures to buffer impact of inflation and to strengthen social safety nets for low-income and retiree households.
- ▶ Focus on longer-term strategies to grow Singaporeans' real income through productivity-driven growth.
- ▶ Broad-based reduction in tax rates not anticipated or likely.
- ▶ Continued focus on assisting small and medium enterprises to leverage on strong regional growth.
- ▶ Refinements to existing tax incentive schemes to further promote hubbing of high value-added financial services such as infrastructure finance and wealth management to further anchor Singapore as a regional or international headquarters base and to attract high value-added activities such as pharmaceuticals.
- ▶ Increased focus on enforcement with less tolerance for mistakes and frivolous tax positions.

- ▶ One-year temporary tax exemption on remittance of all foreign-sourced income
- ▶ Enhancement of loss carry-back relief to increase the amount of losses that can be carried back and the number of back years that such losses can be used
- ▶ Accelerated capital allowance for capital expenditure relating to tax years 2010 and 2011
- ▶ Introduction of a new broad-based tax incentive, known as the Productivity and Innovation Credit, which grants enhanced tax deductions and allowances on qualifying expenditure for investments in six specified activities centering around productivity and innovations, this tax incentive has been further enhanced in the 2011 Budget
- ▶ Granting of allowance and stamp duty remission for qualifying M&A deals

Tax policy and administration schedule: things to watch

March 2011	Budget debate
May or June 2011	Release of Draft Income Tax Amendment Bill for public consultation

2011 headline tax rates (as of 1 January 2011)

Top federal (national) corporate tax rate	17%
Top federal (national) personal income tax rate	20%
Standard VAT rate	7%

Pending tax proposals

All tax proposals will be announced in the 2011 Budget

Key drivers

- ▶ To promote economic development
- ▶ To pursue social justice
- ▶ To improve international competitiveness
- ▶ To maintain a sustainable environment

Political landscape and recent elections

The recent special municipality elections marked the first time that the Democratic Progressive Party (DPP) received a greater share of the overall vote than the Chinese Nationalist Party (KMT) in a local election.

The elections also signaled a significant change in the structure of the KMT's support at both the national and local level. Although the KMT has always held an overall lead over the DPP, that lead tended to be greater the more local the elections were.

In addition to the two parties' relatively even strength in the direct municipality mayoral elections, they also drew even in the county and city councilor elections, where they received a third each of the vote and 130 seats each. As for the most local of all elections, the borough and village chief elections, the KMT has in the past won 80% of the seats, but on this occasion failed to secure one-third of the available votes.

The result of the special municipality elections indicates a trend toward a two-party system, which, although it may be perceived as positive, also makes it difficult for a diversity of new progressive issues to make their way into the public focus. It also gives an indication of the national standing of KMT and DPP in terms of the 2012 president election outcome.

Outlook

- ▶ Tax reform policies underway in Taiwan have four main dimensions: personal income tax reform, corporate income tax reform, green taxation system and increasing the deduction on estate and gift tax.
- ▶ The government has established a Tax Reform Commission and an advisory council to promote tax reform, in order to resolve current taxation problems regarding adequacy, efficiency, tax administration and equity.
- ▶ For income tax, issues such as income tax credits, implementation of tonnage tax and the anti-avoidance system have been carefully reviewed.
- ▶ The estate and gift tax system and exemptions or reductions of land and house tax have also been studied.
- ▶ The government is researching the introduction of a green tax and necessary modification of the business tax in order to provide a sustainable environment.
- ▶ There are also studies on tax problems associated with special economic zones and capital gains with the objective of increasing the country's taxation competitiveness.
- ▶ The tax administration is being streamlined in order to reduce the overall tax compliance burden.

Current tax policy leaders

Sush-Der Lee, Minister, Ministry of Finance

Current tax administrators

- ▶ Yu-Jer Sheu, Director-General, Taxation Agency, Ministry of Finance
- ▶ Chin-Chien Chen, Director-General, Taipei National Tax Administration, Ministry of Finance,
- ▶ Jui Tang Ho, Director-General, Kaohsiung National Tax Administration, Ministry of Finance
- ▶ Tzu-Hsin Wu, Director-General, National Tax Administration of Northern Taiwan Province, Ministry of Finance
- ▶ Yi-Ho Cheng, Director-General, National Tax Administration of Central Taiwan Province, Ministry of Finance
- ▶ Chun-An Sheu, Director-General, National Tax Administration of South Taiwan Province, Ministry of Finance

Recent tax policy changes in 2009-2010

In order to promote economic development, pursue social justice, improve international competitiveness and maintain a sustainable environment, the Ministry of Finance has been working on tax law amendments and tax reform implementation, continuing to revise tax laws and regulations, working on tax treaties to facilitate international taxation exchange and promoting the conclusion of tax conventions with other countries.

The following represent the main tax amendments, tax reform implementation issues and treaties for the past two years:

Individual taxation

- ▶ Rates of individual income tax have been reduced from 6%, 13% and 21% to 5%, 12% and 20%, respectively, since 2010.

Corporate taxation

- ▶ The corporate profit tax rate was lowered to 17% from 25% (17% for 2010 and 25% for 2009) in order to enhance international competitiveness.
- ▶ The Statute for Upgrading Industries (SUI) was succeeded by the Statute for Industry Innovation (SII). Under this new incentive legislation, industry-specific grants were replaced by functionality-based subsidies that provided tax breaks, subsidies and other incentives to encourage business innovation and hiring. Moreover, under SII, companies engaged in R&D activities may claim 15% of their eligible R&D expenditures as a credit against their income tax payable. The tax credit is capped at 30% of the taxpayer's current year income tax payable.
- ▶ The thin-capitalization provision was introduced. Where business enterprises' related-party debt to equity ratio exceeds a certain prescribed threshold, the interest on the excessive debt would not be deductible for income tax purposes. Furthermore, business enterprises are required to disclose related-party debt to equity ratios and other relevant information in their annual corporate income tax return.
- ▶ The Regulation on the Mutual Exemption from Tax in Accordance with Cross-Strait Sea Transport Agreement and Cross-Strait Air Transport Supplementary Agreement were published, which enable Mainland China companies engaged in a transportation business in Taiwan to claim business tax and income tax relief for revenues derived within Taiwan.

VAT

- ▶ 3% VAT rate for purchase of services sold by foreign enterprises, institutions, organizations or associations engaged in banking, insurance, investment trust, securities, futures, commercial paper and pawnshops and having no fixed place of business within the territory of Taiwan.

Estate and gift taxation

- ▶ The estate tax rate has been reduced and simplified to a flat tax rate of 10% from a multiple tax rate schedule under which the highest tax rate was 50% in 2009.

International taxation

- ▶ Taiwan-Hungary tax treaty signed: Hungary is the only country in Eastern Europe that has concluded a treaty with Taiwan. Therefore, the treaty may have the potential to become the gateway for investment in Taiwan from other countries in Eastern Europe and vice versa.
- ▶ Taiwan-France tax treaty signed: Tax rates on dividends will be matched at 10% as opposed to 20% and 25% in Taiwan and France, respectively.
- ▶ The tonnage tax provision was introduced, which allows profit-seeking enterprises headquartered in Taiwan engaging in international marine transportation (Taiwanese shipping companies) to be taxed at a deemed lump sum amount based on the tonnage of their fleet.

Tax policy and administration schedule: things to watch

Detailed regulations on the thin-capitalization rules will be announced in the near future.

2011 headline tax rates (as of 1 January 2011)

Top federal (national) corporate tax rate	17%
Top federal (national) personal income tax rate	40%
Standard VAT rate	5%

Key drivers

- ▶ The Thai economy is forecast to grow from 3% to 5% in 2011. Inflation is expected to increase from 2% to 4%, and unemployment is likely to improve to 1.1%. However, consecutive expansionary budgets to stimulate economic growth and widen the social net will increase the deficit, which will continue to grow in the short term. Thailand's public debt, at 42% of GDP, is unlikely to exceed 50% in the near future, but the Democrat-led government has announced that it wants to achieve a balanced budget by 2016.
- ▶ The result of the next election, which is required to be held this year, could have a significant impact on Thailand's tax system and the likelihood of reducing the corporate tax rate from 30% to 20%. If this government is returned to power, changes to the tax system are likely.
- ▶ The 10-member Association of Southeast Asian Nations (ASEAN) has set 2015 as the target for implementing a single regional economic market. Major features will include tariff reductions on key goods traded between member countries as well as free flow of goods, services, capital and labor. This will provide both challenges and opportunities for Thai enterprises.

Political landscape and recent elections

The Thai Prime Minister has confirmed plans to call an early general election in 2011, once the constitution drafting process has been concluded. The election is expected to be a runoff between the incumbent Democrat-led coalition and the opposition Peua Thai Party, although numerous parties will be fielding candidates and could play a role in forming a government. Parties in

Outlook

- ▶ There will be ongoing evaluation of major reforms to the tax system, likely focused on reducing income taxes and boosting revenue from other taxes, especially on luxury and "sin" goods.
- ▶ With government spending reductions unlikely in the midterm, tax collection will need to be boosted.
- ▶ With an election expected soon, political considerations will continue to constrain any efforts to significantly increase tax collection through legislation.
- ▶ Increased enforcement of existing taxes can be expected in the short to medium term.
- ▶ With increased government spending, especially on welfare programs, there is a building consensus that tax reforms are likely to be needed to raise state revenues and avoid a fiscal crisis in the future, especially as some taxes may need to come down to address Thailand's competitiveness as the prospect of a single ASEAN market looms closer. The Finance Ministry is currently looking at the possibility of wide-ranging tax reform, including significant cuts in corporate and/or personal income tax rates, introduction of nation-wide taxes on immobile property and an inheritance tax.
- ▶ Loss of revenue from any cuts in income tax rates would need to be compensated, and VAT could be a likely target because even a small increase would compensate significantly for a corporate income tax cut. Reform of investment privileges is another area to be considered, and it is likely to be more in line with the changing economic environment. Sin taxes are also likely to be targeted. There may be an introduction of a thin-capitalization law rule.

both coalitions are expected to go to the voters with a range of populist measures to attract support. The issue of funding these and existing welfare programs in the medium term will be one of the challenges for the next government.

While new elections could ease political tensions in the country somewhat by providing greater legitimacy to the winning side, it is unlikely that the elections will resolve Thailand's five-year political turmoil. However, they may result in a new political playing field.

Parliament is expected to soon debate and vote on proposed constitutional changes; in fact, the government has tied the passage of these amendments to the timing of the election. The proposed changes mainly concern electoral matters such as the number and distribution of constituency members of Parliament and the makeup of the Senate.

Current tax policy leaders

- ▶ Korn Chatikavanij, Finance Minister
- ▶ Pradit Pataraprasit, Deputy Minister of Finance
- ▶ Naris Chaisutr, Director of Fiscal Policy Office

Current tax administrators

- ▶ Satit Rungkasiri, Director General of Revenue Department
- ▶ Sompong Tanthapat, Director of Bureau of Large Business Tax Administration
- ▶ Atchaka Sibunruang, Secretary General of the Board of Investment
- ▶ Prasong Poonthanet, Director General of Customs Department
- ▶ Pongpanu Sawetrun, Director of Excise Department

Recent tax policy changes in 2009–2010

- ▶ Stimulus legislation passed over the past two years has included only minor tax measures, such as changes in personal income tax deductions.
- ▶ Legislation passed in 2010 provides a tax incentive package for regional operating headquarters to stimulate investment. Incentives include a 10-year, extendable tax holiday for qualified overseas income and reduced taxes on domestic income.
- ▶ The previous reduction of the VAT rate from 10% to 7% was extended for another two years, until 2012.
- ▶ As a measure to help control rapid depreciation of the baht, the government ended a tax exemption on capital gains on bonds for overseas investors.
- ▶ Targeted tax breaks have been instituted to encourage foreign investment in specific green and high-tech industries.

Pending tax proposals

- ▶ Implementation of measures proposed to reform the land and building tax system for efficiency is definitely on the agenda if the Democrat-led government is returned to power. The introduction of an inheritance tax could follow.
- ▶ Existing temporary tax breaks to encourage business transfers and mergers and acquisitions and new breaks to ease tax burdens on business reorganizations are likely to be extended or codified permanently.
- ▶ The Finance Ministry is considering whether to extend privileges allowing companies listed on the Market for Alternative Investment (MAI) to pay tax at reduced rates for the first five years of their listing.
- ▶ Active examination of transfer pricing issues among multinational companies is expected in light of the authorities' greater knowledge.

Tax policy and administration schedule: things to watch

March 2011	A subcommittee of the Capital Market Development Committee is expected to make recommendations to the government on whether the privilege granting reduced corporate income tax rates for small and medium enterprises listed on the MAI should be continued on expiration, either permanently or for a certain period.
Mid- to late 2011	General election

2011 headline tax rates (as of 1 January 2011)

Top corporate tax rate	30%
Top personal income tax rate	37%
Standard VAT rate	7%

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Key drivers

- ▶ High inflation rates may force the National Assembly to reduce personal income taxes by either raising the self-relief horizon or widening the tax band.

Political landscape and recent elections

The country's political system is dominated by the Vietnamese Communist Party, which has had a monopoly on power since the end of the Vietnam War in 1975. Anti-corruption efforts in recent years have improved government transparency. Economically, the country has undergone rapid growth since embracing economic liberalization in the 1990s and acceding to the World Trade Organization in 2007.

The industrial mix has focused on light manufacturing and assembly operations, but has also begun to include more capital-intensive sectors. With sizable oil reserves, the country is one of Southeast Asia's largest producers of crude oil. In 2009, the country opened its first refinery premises in Dung Quat.

Despite its favorable growth trajectory, the Vietnamese economy continues to face serious macroeconomic imbalances. The clearest symptoms of these imbalances, caused by the government's pro-growth policy bias, are rapid inflation and acute downward pressure on the currency. In November 2010, the consumer price index rose by 1.9% month-on-month and by 11.1% year-on-year, the fastest point-to-point rise in 20 months. The final inflation rate for 2010 of 11.75% is well above the government's target of 8.0% and almost double the 2009 figure of 6.88%. While food price increases (up 20.5% year-on-year) have helped to drive this recent bout of inflation, so too have unrestrained domestic demand and earlier devaluations. In early November 2010, in an effort to try and contain price pressures and ease foreign exchange shortages, the central bank raised benchmark interest rates, put in place gold import quotas and pledged to supply the market with its own foreign exchange reserves.

Outlook

- ▶ Tax administrative procedures may be further simplified under a program of administrative procedure reform launched by the government.

In 2011, policymakers will need to restore price stability and market confidence. Higher interest rates and lower credit growth targets will both be necessary to stem recurring price pressures and downward pressure on the currency. Fortunately, with the political leadership decided in January 2011, the new development policies are likely to be introduced.

Economic experts believe that with the high inflation rate in 2010 and the devaluation of VND compared with gold and other hard foreign currencies, the current self-relief for personal income tax of VND4m per month (around US\$200), also known as the tax-free horizon, is no longer relevant. As such, the Ministry of Finance may ask the National Assembly to reduce the personal income tax rate, either by raising the relief or expanding the tax band.

Current tax policy leaders

- ▶ Nguyen Phu Trong, Chairman of National Assembly and Communist Party General Secretary
- ▶ Phung Quoc Hien, Head of the Budget and Finance Committee of the National Assembly

Current tax administrators

- ▶ Vu Van Ninh, Finance Minister
- ▶ Do Hoang Anh Tuan, Vice Finance Minister-cum-General Director of the General Department of Taxation

Recent tax policy changes in 2009-2010

During the past two years, the following tax changes were introduced:

- ▶ Personal income tax exemption for January through June 2010
- ▶ 30% reduction of corporate income tax for small and medium enterprises for fourth quarter of 2008 and 2009

- ▶ Extension of payment of 2009 tax for small and medium enterprises and enterprises operating in certain industries
- ▶ 50% VAT reduction for certain goods and services for February through December 2009
- ▶ New natural resource tax rates applicable as of 1 July 2010
- ▶ Law on environmental protection tax effective as of 1 January 2011 (Law No. 57/2010/QH12)
- ▶ New import-export tariff applicable as of 1 January 2011 (Circular 184/2010/TT-BTC)

Pending tax proposals

Some tax amendment proposals still being considered include:

- ▶ Amendment of corporate income tax
- ▶ Amendment of VAT
- ▶ Amendment of stamp duty with respect to cars

Tax policy and administration schedule: things to watch

No specific schedule in place.

2011 headline tax rates (as of 1 January 2011)

Top corporate tax rate	25% (tax rates of 32% to 50% apply to oil and gas and other rare, precious natural resources)
Top personal income tax rate	35%
Standard VAT rate	0%, 5%, 10%

Conclusion and lea

Global companies have been flocking to the Asia Pacific region, looking to expand where future economic growth is likely to be strongest. National leaders in the region are committed to deficit reduction, which means they are keeping the pressure on tax administrators to raise the maximum available revenue. Making this task even harder is the rapid change exhibited by tax policymakers: cutting statutory corporate tax rates, broadening the tax base and granting concessions to selected industries.

Policymakers may try to recoup lost revenue by raising indirect taxes, but currently, political opposition to those is growing. They may instead levy new or higher taxes on immobile assets such as land or minerals.

In China and many other nations in the region, tax legislators and tax administrators have been under tremendous pressure. For companies to operate effectively in these countries, they must understand the difficulties administrators face. Only then will they be in position to take full advantage of the complex profit opportunities that every company doing business in the Asia Pacific region is looking for.

Increasingly companies are recognizing that a key way to reduce potential tax controversy within a country is to ensure that the direction of tax policy in the country is closely monitored and assessed.

To stay truly current, a company must engage with government officials often. New tax laws sometimes impede commercial decisions in ways unintended by policymakers. Companies faced with this issue can either adapt their business plans accordingly or work collaboratively with the government to explain the impediment, model the potential outcomes and develop alternative policy choices.

Although globalization has made some nations' policies and administrations more similar than in decades past, there are still important idiosyncrasies in every nation. In an important sense, then, a global company has to be local. If a company cannot cover every important nation, it is best to join forces in an industry or trade group.

If companies observe a potential change that would clearly be damaging, they should not assume policymakers have this information. Create an impact assessment that includes economic modeling, and put it into their hands. Comparative tax studies and insightful analysis of tax policy proposals' effects on competitiveness can be persuasive.

Just as companies need to stay connected with tax legislators, they need to know their tax administrators. By developing "tax administration intelligence," companies can better understand administrators' actions and motives. Companies should understand which tax compliance tools and techniques can lower the risk of serious controversy between the company and the tax authority. Risk ratings models, risk assessments, advance pricing agreements, rulings and new dispute resolution tools are all useful and evolving tools for these purposes.

ding practices to consider

Managing the risks of global tax controversy

Adopt a global approach to tax controversy and risk

Companies should develop and assess their tax controversy and risk management strategies and actions from a global perspective, because that is how tax administrations are increasingly viewing them. Companies should establish a global vision and strategy for tax controversy and risk management. The strategy should consider how to establish good working relationships with tax administrators in key jurisdictions, weave in all available tax administration intelligence, use available methods to achieve a lower risk rating, and encompass – where culture permits – a more transparent, collaborative and responsive relationship with tax authorities.

Managing future controversy requires an understanding of both the scope and direction of a likely tax audit or examination. Companies need to ensure the right processes are in place to manage the risk of potential tax controversy. Global tax risk management systems should have processes to identify, assess, measure, mitigate and monitor actions and strategies. While many tax functions may have designated “tax risk manager” and “tax controller” positions to monitor and manage tax risks on an ongoing and proactive basis, controls and procedures should be integrated into the various tax and business processes as far upstream as possible – and not be treated as separate activities within the tax function.

Manage any controversies at a strategic level

For issues that advance to the controversy stage, it is necessary to assess the relative merits and weights of each issue and analyze the nature of disputes with tax authorities. For cross-border issues, it is important to evaluate how a settlement or adjustment in one jurisdiction will affect other jurisdictions. In addition, businesses should consider:

- ▶ Establish criteria to identify business transactions that should be managed proactively to avoid or mitigate controversy (e.g., documentation, pre-filing agreements).

- ▶ Track current controversies, as well as business transactions and decisions that may result in controversy.
- ▶ Establish priorities and focus for jurisdictions that have significant or potentially significant issues. Analyze countries that may have shared interests in these issues
- ▶ Understand key tax jurisdiction’s legislative and regulatory environment, information exchange policies and strategic direction.
- ▶ Conduct, for each key jurisdiction, a technical risk assessment of tax return positions in light of existing documentation and enforcement activity.
- ▶ Use resolution tools and processes to facilitate closure of disputes and issue resolution.
- ▶ Understand the potential multiyear and multijurisdictional impact of the issues and the means by which they are resolved.

Include global tax risk as a corporate governance issue

Tax administrations are working diligently to elevate tax strategy to the boardroom agenda. Policymakers and tax administrators expect corporate boards to understand their responsibilities with regard to their business tax strategies and outcomes. Some tax administrators are engaging CEOs and CFOs, as well as corporate boards, in dialog regarding tax risk. In response, companies should consider ways to:

- ▶ Educate the board about the tax implications of business decisions as well as the structure, processes and policies related to tax controversy and risk management within the company.
- ▶ Prepare for board-level inquiries related to tax risk management strategies.
- ▶ Actively engage the C-suite and board in discussions related to tax risk management.

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Ernst & Young's Tax Policy and Controversy services

The economic downturn and its impact on profits is increasing the pressure on tax directors. Rapid globalization has brought increasing interconnectivity among businesses, and permanent shifts in the flow of capital. Tax departments are bearing the responsibility of more corporate risk than ever. Tax now has a higher profile, not only with company management but also with shareholders, regulators, the media and other industry observers.

Developing a tax policy that resolves impediments to business needs a team that can work with government to explain issues, clarify objectives and achieve a successful outcome for everyone. Ernst & Young's global tax policy network has extensive experience of helping develop and implement policy initiatives, both as external advisers to governments and companies, and as advisers inside government. Our dedicated teams of tax policy professionals and business modelers help address your specific business environment and improve the chance of a successful outcome.

In addition, our global tax controversy network works with you to address your global tax controversy, enforcement and disclosure needs. We focus on pre-filing controversy management to help you properly and consistently file your returns and prepare the relevant back-up documentation. Our controversy professionals leverage the network's collective knowledge of how tax authorities operate, and increasingly work together, to help resolve difficult or sensitive tax disputes. It's how Ernst & Young makes a difference.

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