

Tax Excellence Decoded

Withstand the Test BEPS of Time
*Understand fundamentals of
cross-border structuring and "right-size" your total tax exposure*
5 February 2015, Thursday



Participants were all ears at a complex-made-comprehensible TED session facilitated by Loh Eng Kiat, Tax Partner, Baker Tilly TFW.

Businesses are increasingly venturing abroad. For some, it is to tap on emerging possibilities for growth; for others, it may be to counter existing market limitations. In operating across jurisdictions, businesses are likely to have to navigate difficult (and an increasingly diverse range of) disputes with the tax authorities. Some of these were discussed in a recent Tax Excellence Decoded session organised by the Singapore Institute of Accredited Tax Professionals (SIATP), and facilitated by accredited tax professional Loh Eng Kiat, Tax Partner, Baker Tilly TFW.

Substance over form

It is expected that “form or paper-based planning” will be on the decline as increasingly, more tax authorities focus on the business substance behind “tax structures”. In the Asia-Pacific region, countries like China, India and Indonesia are arguably the ones with highly aggressive focus on “substance” considerations in tax disputes. At the other end of the spectrum, the question of “form” is possibly still principally respected in countries such as Thailand, Vietnam and Papua New Guinea.

Legislation by announcements

Worryingly, some recent trends have suggested that tax authorities are becoming more adept at introducing legislation to support (what could otherwise be labelled as) aggressive tax enforcement. Notable examples include those in the area of “indirect equity transfers”, where there appears potential for newly-introduced legislation to apply retrospectively (as opposed to prospective application).

Other challenges, but opportunities exist

The level of disputes will also likely rise in “traditional” areas such as “source country versus residence country” taxation rules and transfer pricing.

Despite this, some opportunities remain available in the world of international taxation. Governments are likely to continue introducing and refining their tax incentives frameworks to anchor/support foreign investment. “Safe harbour” rules and tax rulings can also accord greater clarity and potentially enhance transparency. In some countries, it can be observed that there is greater engagement and consultation with the public prior to introducing new tax rules.

The above sets the scene for a more in-depth discussion on holding company structures and tax-efficient debt financing.

Holding company structures

- **Conventional basics: dividend withholding tax and exit planning**

Using an example of a US company investing in China operations, the discussions centered around the rate of Chinese dividend withholding tax (DWHT) expected. If the US company invests directly into China, the expected Chinese DWHT is 10%. However, if the US company uses, say, a Singapore company as intermediary to China, the DWHT is potentially reduced to 5% because of the tax treaty between Singapore and China.

The attractiveness of using a Singapore intermediary is enhanced when considering Chinese capital gains tax (CGT) on eventual exit. The “indirect” route may result in the absence of CGT when the US company sells the Singapore intermediary, while the “direct” route will result in CGT when the US company sells the Chinese operations.

From the above analysis, it may seem logical to conclude that US companies should consider investing in China via, say, a Singapore intermediary. However, the concept of “beneficial ownership” (and China’s Circular 601) could frustrate the tax benefits sought above; for example, if the Singapore intermediary is not the “beneficial owner” of Chinese dividends, the reduced 5% DWHT cannot apply.

- **Beneficial owner**

This concept is not only confined to dividend flow situations, it can also apply in debt financing situations, for example. Broadly, an income recipient who is not the “beneficial owner” of such income cannot be entitled to tax treaty benefits from the source country.

The level of business activity is one criterion in China for determining beneficial ownership. If the company is merely an asset-holding entity with minimal business activity, management, control rights and staff headcount, it may not be considered a beneficial owner by the tax authorities.

In addition, if the income of the intermediary is principally re-distributed to a third country fairly contemporaneously, the beneficial ownership position may be heavily contested. The situation is further complicated if the income is non-taxable or taxed at a low rate in the jurisdiction where the intermediary is based.

- **Indirect transfer**

This is an emerging risk area. Broadly (and using the above US-Singapore-China example), this contemplates that even if eventual exit happens at the intermediary’s level (that is, US company selling Singapore company, with no direct sale of shares in the Chinese underlying investment), there can still be a China CGT risk.

- **US-treaty style LOB clause**

There is a call for future tax treaties to include US-treaty style limitation of benefits (LOB) clauses. Such clauses, if incorporated, could result in less benign tax treaties. For instance, it could require the income recipient seeking treaty benefit to be a publicly-traded entity, have significant operations, etc. If the inability to satisfy such LOB clauses results in non-availability of treaty benefits, it could have a huge impact on Singapore companies.

Tax efficient debt financing

Some parameters that can result in tax benefits in various debt (or hybrid) financing situations were also discussed at the session.

- **Use of hybrid instruments**

For example, an Australian subsidiary issuing redeemable preference shares (RPS) to its Singapore holding company may be accorded debt treatment for such RPS in Australia and obtain interest deductions. The Singapore recipient, on the other hand, may not be taxed on such RPS receipts (with appropriate planning), which can make the overall financing structure highly tax desirable.

- **“No income pick-up” due to tax consolidation regime**

Subject to certain conditions, a Singapore branch of an Australian company (AusCo1) may obtain tax-efficient interest deduction in Singapore when it pays interest to another Australian company (AusCo2). With AusCo2 being the shareholder of AusCo1, and both companies forming part of an Australian consolidated group, it is possible that intra-group payments between the two are disregarded for Australian tax purposes and therefore the arrangement does not result in Australian tax but nevertheless yields a Singapore tax deduction on interest. The overall tax benefit can be reduced by Singapore interest withholding tax which could apply, but with careful planning, there can still be an overall benefit.

- **Hybrid entity**

There is also the concept of a hybrid entity (as opposed to hybrid financial instruments) classification. For instance, a US limited liability corporation (LLC) may be regarded as tax transparent by the US but tax opaque in a counterparty country, for example, Canada. Such a “mismatch” in tax classification can potentially result in tax deduction in the source country with no corresponding “tax pick-up” in another location.

Moving forward

It is increasingly clear that the wheels of change are turning in relation to cross-border tax planning. The intense undercurrents brought about by the Organisation for Economic Co-operation and Development (OECD), via its Base Erosion and Profit Shifting (BEPS) initiative, will strongly shape global tax developments. This will also be the case in the domain surrounding holding company structures’ planning and tax-efficient debt financing.

For holding structures, anti-avoidance rules are set to strengthen and substance will probably become even more paramount. Increasingly, tax treaty benefits cannot be taken for granted.

In the space of debt financing, the use of preferential regimes and hybrids look likely to be heavily curtailed. A more robust transfer pricing approach can also be expected in relation to many future financing arrangements.

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About SIATP’s Technical Discussions

SIATP’s technical discussions have continually been very well received by accredited tax professionals. Unlike the run-of-mill Continuing Professional Educational courses which typically cover tax fundamentals, SIATP’s interactive technical discussions are designed to cover tax issues that do not have clear-cut solutions or situations that may have different interpretations. Over time, these discussions contribute in boosting the overall tax standards in Singapore.

About Mr Loh Eng Kiat



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In the profession for more than a decade, clients and fellow professionals have regularly endorsed Eng Kiat's versatility within the taxation field. He has delivered on projects of diverse technical nature including large scale compliance-based engagements, due diligence (largely for private equity houses), post-deal restructuring, supply chain modelling, incentive negotiation, transfer pricing, alternative investments and debt offerings.

Prior to joining Baker Tilly TFW in 2014, Eng Kiat has acquired significant experience with an international public accounting firm, where he advised clients across a broad spectrum of industries on their international and regional tax structuring needs.

This technical event commentary is written by SIATP's Assistant Director, Joanna Wong and Tax Manager, Felix Wong.