

Asia Pacific
Tax Complexity
Forecast:
Where are your
challenges?



About Deloitte Asia Pacific International Core of Excellence

The Deloitte Asia Pacific International Core of Excellence (“AP ICE”) was established in June 2010 to provide international tax consulting services to Asia Pacific based companies investing abroad as well as multinational companies investing in Asia Pacific. AP ICE is based in Hong Kong and has a team of 21 senior tax professionals from 15 tax jurisdictions, including Australia, Canada, China, France, Germany, India, Ireland, Japan, Luxembourg, the Netherlands, Singapore, South Korea, Taiwan, United Kingdom and the United States.

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Preface

Dear Reader,

In celebration of the launch of the Deloitte Asia Pacific International Core of Excellence (AP ICE), we are pleased to present you with this inaugural Asia Pacific Tax Complexity Forecast.

The dynamics of globalisation brought both the founding of AP ICE and the necessity of this report. The challenges of effective tax planning and compliance are growing in three ways. Major multinational corporations are active across an increasing number of countries, and must operate under their tax rules and practices. Many of these jurisdictions are unfamiliar and present potential risks that need to be recognised and addressed. And, thirdly, the nature of highly integrated cross-border business activity gives rise to complicated issues which impact each area of taxation. In planning and launching ICE in Asia Pacific, we focused on providing a new level of integrated solutions to support clients in meeting these challenges.

The Asia Pacific region is leading the global recovery and has become the biggest beneficiary of global foreign direct investment. At the same time, Asia Pacific businesses are rapidly increasing their overseas investment and business activity. Achieving tax efficiency should be included as a fundamental in every company's business planning. It is an important element of maintaining competitiveness and profitability in the current dynamic period of global growth. Globalisation may be creating borderless markets but taxation, as expected, is still firmly regulated by geographical borders. Businesses expanding into other markets need to manage multiple and diverse tax environments. The potential for unnecessary tax impacts, on one hand, and attractive tax savings, on the other, is greater than ever before and a balancing act that all businesses need to consider.

This report presents the insights of 1,000 finance and tax professionals - around 700 tax executives from companies doing business in Asia Pacific, as well as the views and analyses of almost 300 Deloitte tax professionals. There are two key aims of this AP ICE Complexity Forecast. The first is to provide a benchmarking tool for businesses operating in Asia Pacific to help them compare their perceptions of and responses to the current and anticipated tax environments across the region. And the second is to provide some broad guidelines, drawing on the experience of the Deloitte tax practitioners, to help facilitate business decisions and tax management practice.

We hope you find this information useful, and invite you to contact our Asia Pacific International Core of Excellence team if you have any questions.



Alan Tsoi
AP ICE Co-Leader

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Lili Zheng
AP ICE Co-Leader

A handwritten signature in black ink, appearing to read 'Lili Zheng'.

1. Overview

Key findings

- Over 1,000 respondents took part in the survey, 700 tax executives across Asia Pacific and 300 Deloitte tax professionals drawn from around the region.
- The markets receiving the highest priority attention - China and India - are also expected to be the most complex tax environments over the next three years.
- Globalisation may be creating borderless markets, but not borderless tax environments.
- Perceived complexity of tax environments is often correlated with the fast pace of economic growth in that market.
- Complexity and predictability are of greater concern to companies than consistency.

Converging forces are driving changes in tax environments

Globalisation and the global financial crisis have profoundly altered the pace of change in tax, its breadth and its complexity. The pressure on government budgets everywhere is intense. To take one example only, China committed CNY4 trillion to a stimulus plan for 2008-10, and it is now rumoured that a CNY8 trillion plan will be announced for the next three years. Any level of incremental spending - particularly one this high - is likely to pass through the system as pressure to increase tax revenues dramatically. There are no countervailing pressures for tax reduction or moderation.

Converging with this pressure is the manifestation of new taxation opportunities, especially in emerging markets. Tax authorities are rapidly improving their technical skills, just as global systems for financial transactions become more precise and responsive. As global value chains become more refined and complicated, tax authorities are also becoming more focused on identifying and allocating precisely where value is added and at what price goods and services are bought and sold within these value chains.

In this changing environment, businesses with cross-border operations need to keep constantly up to date with respect to taxation matters, and the value of skilful planning is greater than ever.

In many countries the consequences of compliance lapses are rapidly becoming more significant to reputational standing and financially, and are increasingly material to the overall success

of management. Access to skilled international tax resources, whether in-house or outsourced, will be of even greater importance to company performance in the future. Management of businesses should carefully consider how these resource demands will be met and what combination of internal and external resources will be best for their particular situation.

Market potential rules, but does not diminish the challenges of tax complexity

What do you do when the highest potential growth markets in the world are also the most complex in terms of financial management? China and India, while deemed the top priority markets for the company executives completing the survey, are also deemed to have the most complex tax environments.

While our survey revealed that the tax environments in China and India have previously factored into some companies' decisions to exit or delay entry in these markets, with forecast 2010 GDP growth of 8.5 percent for India and 11 percent for China, it is now hard to argue against entry or expansion in these high growth markets. Our analysis shows that China, India and Japan (in that order) are deemed to be the most important markets, and also the tax jurisdictions where our survey respondents are devoting the most time and resources. The trend was particularly prevalent in the manufacturing industry, whereas for energy and resource companies, Australia and Indonesia were the priority tax jurisdictions.

With market potential outweighing concerns about complex tax environments, the challenge is now one of optimal tax planning. The high ranking of Singapore and Hong Kong for low complexity, and high consistency and predictability indicates, in our experience, that many continue to choose these as their regional business centres.

Globalisation may be creating borderless markets, but not borderless tax environments

As the 2008 global financial crisis, the eruption of Eyjafjallajökull in Iceland, and most recently the instability in the economy of Greece, have proven local economies may be defined by geographical borders but their impact is truly global. Jurisdictional and cross-border tax issues play an important part in attracting foreign direct investment, yet national tax rules and practices are truly national in nature, not global.

The areas of taxation most important to businesses were identified as corporate income tax, transfer pricing, and cross border international tax, in that order and across all industries.

Rapid economic development brings with it tax complexities

There is a clear correlation between an economy's perceived complexity of tax environment and its pace of economic development. China and India are seen by survey respondents as continuing to have the most complex tax systems three years from now, in 2013. Given the high pace of growth in those markets, should we be surprised?

Respondents' perception of the complexity of the Chinese tax system is likely attributable to the challenge of interpreting the tax law and related guidance issued by the government and tax authorities since the January 2008 adoption of the Enterprise Income Tax Law. The varying enforcement of tax laws and regulations by the local tax authorities was also noted as a significant factor.

For India the perception is probably rooted in the plethora of legislation in place. To address this, the Indian Government is exploring the possibility of enacting new legislation to provide much greater simplicity. For example, the Indian Income Tax Act and the Wealth Tax Act which have had more than 3,000 amendments to date are proposed to be replaced by the Direct Taxes Code - effective 1 April 2011. Similarly, there is a proposal to enact Goods and Services Tax legislation in place of the existing Value Added Tax and Service Tax legislations. It will be interesting to track in our next survey, the impact of such changes on the perceived complexity of India's tax environment.

While Japan and South Korea are not experiencing the same rapid pace of growth as China and India, they are nonetheless perceived as having complex tax environments - perhaps as a result of previous rapid modernisation and resultant tax effects which have not yet been simplified. For companies investing in Japan, there are complex issues to consider in the areas of group taxation, tax consolidation, M&A and transfer pricing. Japanese tax law is generally written in an opaque way, and there is a relatively small body of case law to provide precedent. Hence, it is often difficult to advise with certainty regarding the Japanese tax treatment of a proposed transaction. Japan however, has introduced significant changes to its tax system in recent years, notably the foreign dividend exemption system in 2009 and changes to the anti-tax haven rules in 2010.

Language, business culture and financial systems are also factors which add to the perceived complexity of the tax environments of the four tax jurisdictions ranked as complex by the most respondents - China, India Japan and South Korea. In emerging economies, recourse in the wake of decisions by designated local and central authorities tended to be very limited, creating interpretation and administration risks and inconsistencies which are not easily remedied.

As mentioned earlier, most respondents expected the more mature tax environments of Hong Kong and Singapore to be the least complex in the coming three years. For this reason, as well as their respective proximity to the strategic priority markets of China and India, it would appear many companies are spending greater time and resources on tax management in these markets. Their taxpayer-favourable policies continue to attract certain industries, such as financial services, and other more mobile business functions and resources.

Consistency causes less concern than complexity and predictability

While not unconcerned about consistency of enforcement, our survey indicates that respondents are most concerned about the complexity of the tax regulations and tax structures and the unpredictability of the future road map for tax regulatory developments.

In addition to high complexity, China and India are also perceived to have high levels of unpredictability whereas Singapore, Hong Kong and Australia are considered to have the least complex and most predictable tax policies. Although more respondents had experienced tax audits in China and India, (with the Chinese tax authorities perceived to be the most aggressive in conducting tax audits over the past 12 months), fewer respondents perceived consistency of

tax enforcement in these jurisdictions. Our observations are that tax authorities in many Asia Pacific locations have become more aggressive on cross border transactions, payments to non-residents and transfer pricing. However, China will probably remain the most challenging tax environment as the combined result of the fast pace of tax reform and the more aggressive program of tax audits - a trend which is likely to continue as part of China's stimulus plan - are unlikely to slow down.

We defined predictability as businesses' perceived ability to foresee tax law changes and compliance obligations. In terms of predictability, respondents perceived China, India and Indonesia to have the least predictable tax environments. On the other hand, Hong Kong and Singapore, which have one level of tax authority only, and hence relatively straightforward tax systems, are ranked by more respondents as having a high level of predictability. This view was borne across respondents from all industry sectors. The revenue pressures that governments are facing around the globe are likely to drive a faster pace of change and more dramatic, less predictable, and disruptive tax changes.

Respondents are most concerned about the complexity of the tax regulations and tax structures and the unpredictability of the future road map for tax regulatory developments

2. About the survey

About 700 finance and tax professionals based in Asia Pacific and representing companies across all industries took part in the survey. The companies, with annual revenues from over US\$20 billion to less than US\$500 million, include both multinational organisations and domestic businesses.

The size of the in-house tax departments closely reflects the size of the organisation itself. Eighteen percent of respondents work for organisations with annual revenue exceeding US\$20 billion while 33 percent of respondents are from companies with annual revenues of less than US\$500 million. Sixty eight percent of respondents' companies have established in-house tax departments in Asia Pacific. About 20 percent of the respondents' companies have more than 10 dedicated tax personnel. However, 32 percent have no tax department in Asia Pacific at all.

We also interviewed Deloitte tax professionals across the AP tax jurisdictions to see if their experience was in line with the external survey respondents. For this report, survey statistics provided refer only to the responses from external participants.

Figure 1: What is the revenue profile of respondents?

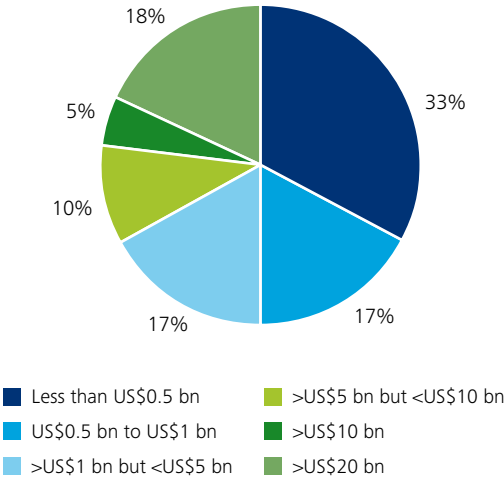


Figure 2: What is the size of the tax department?

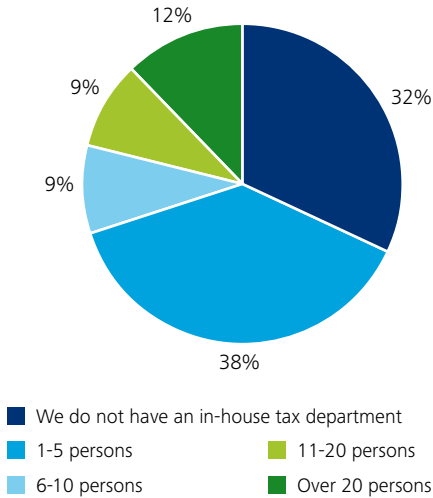
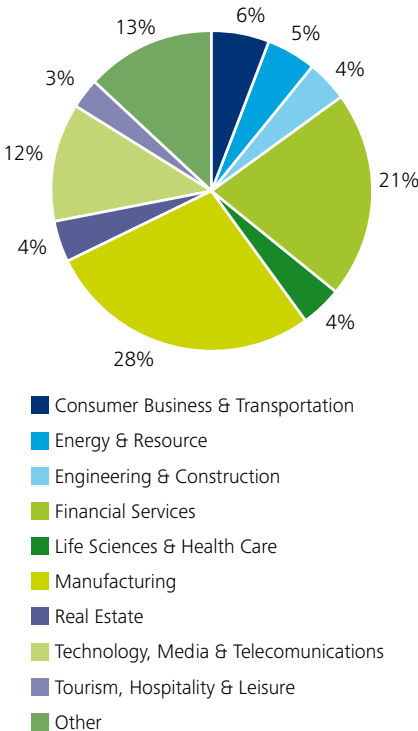


Figure 3: In which industries are respondents primarily engaged?



The manufacturing sector represents 28 percent of all respondents, followed by financial services at 21 percent; and the technology, media, and communication sector accounts for 12 percent.

3. Market potential outweighs tax complexity concerns

Key findings

- While China and India are ranked as the priority Asia Pacific business locations by most respondents, their tax environments are also expected to be more complex, less consistent and less predictable for the next three years to 2013. The trend is particularly prevalent in the manufacturing industry.
- Australia and Indonesia represent priority tax management areas for energy and resource companies.
- Hong Kong and Singapore continue to be popular locations for the financial services industry and for certain regional business functions.
- The taxation areas most important to respondents' businesses are corporate income tax, transfer pricing, and cross border international tax, in that order and across all industries.

Business opportunity outweighs tax complexity

To what extent is the tax complexity of a market a deterrent to businesses? One of the objectives of the survey was to explore the relationship between the locations companies deem to be the most important to their business and the time and resources they spend on managing tax issues in those locations.

The highest number of respondents indicated that their companies had in the past exited or postponed entry to China and India because of concerns about tax complexity and consistency.

Figure 4: Have tax concerns deterred entry or caused exit from markets?

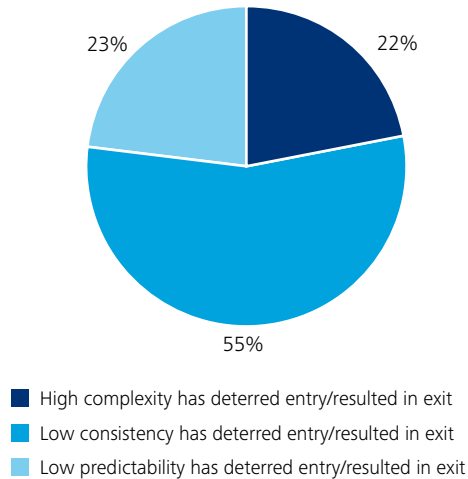
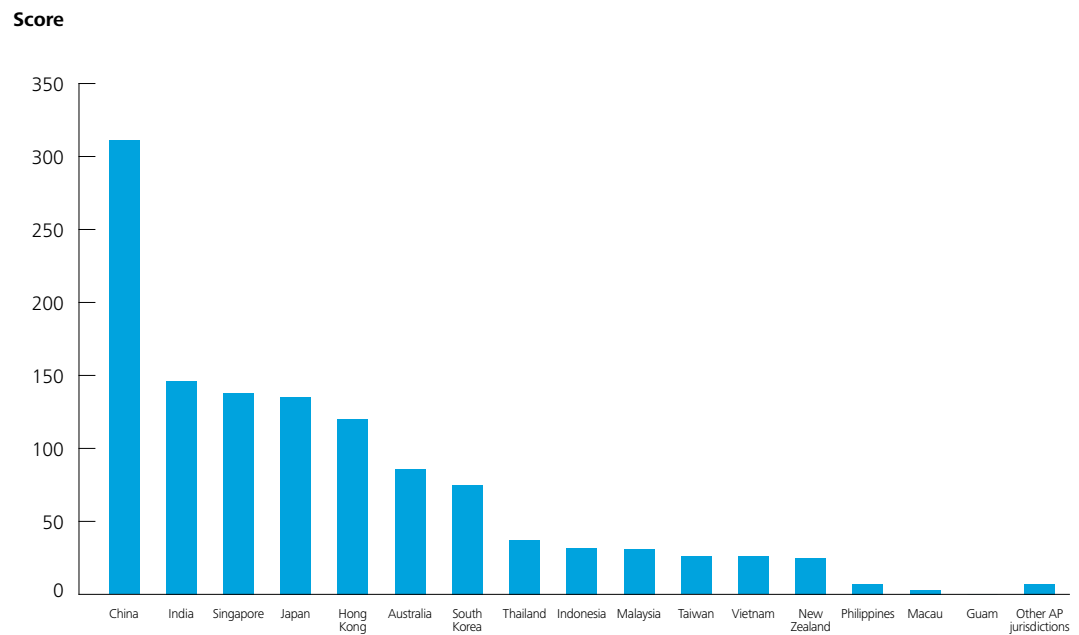


Figure 5: Where is your current focus?



However, the most number of respondents indicated that China, India, Singapore, Japan and Hong Kong are now their priority focus. The trend is particularly prevalent in the manufacturing sector. It appears that market potential is now outweighing tax complexity concerns in the case of China and India, and that Singapore and Hong Kong continue to be used as regional business centres to complement operations directly located in these markets. The responses generally reflect an alignment between the priority tax locations and the underlying macroeconomic trends. For example, China received the most responses by a fairly large margin for both the location where businesses have operators and as a priority tax management location. In our experience, these top five priority jurisdictions reflect both a business

focus on market potential as well as operational organisation to optimise tax planning. While there is an anticipated increase in time and resources to be spent on tax management in China and India in 2013 relative to now, there is also an anticipated decrease on tax management time and resources in Hong Kong and Singapore over the same period. In our experience, this is probably directly related as businesses anticipate more of their operations and talent to be located on the ground in China and India as these markets mature.

In the manufacturing sector, markets such as Vietnam, Taiwan, and Thailand represented the next tier of locations where companies will be focusing their tax management efforts. For energy and resource companies, (which represented a smaller percentage of respondents), Australia and Indonesia are the priority tax jurisdictions. For most respondents, it seems that while a less complex tax system is preferable, the extent of business opportunities in the Asia Pacific region outweighs the perceived complexity of some of its tax jurisdictions.

The challenge at hand is therefore how to optimise tax efficiency in a complex tax jurisdiction to capture fully the growth opportunities the market presents

Priority focus on tax management related to international business expansion

The survey also explored the areas of tax deemed to be most important to businesses. Respondents across all industries consistently rank corporate income tax, transfer pricing, and cross border international tax as the most important areas of focus, generally in that order.

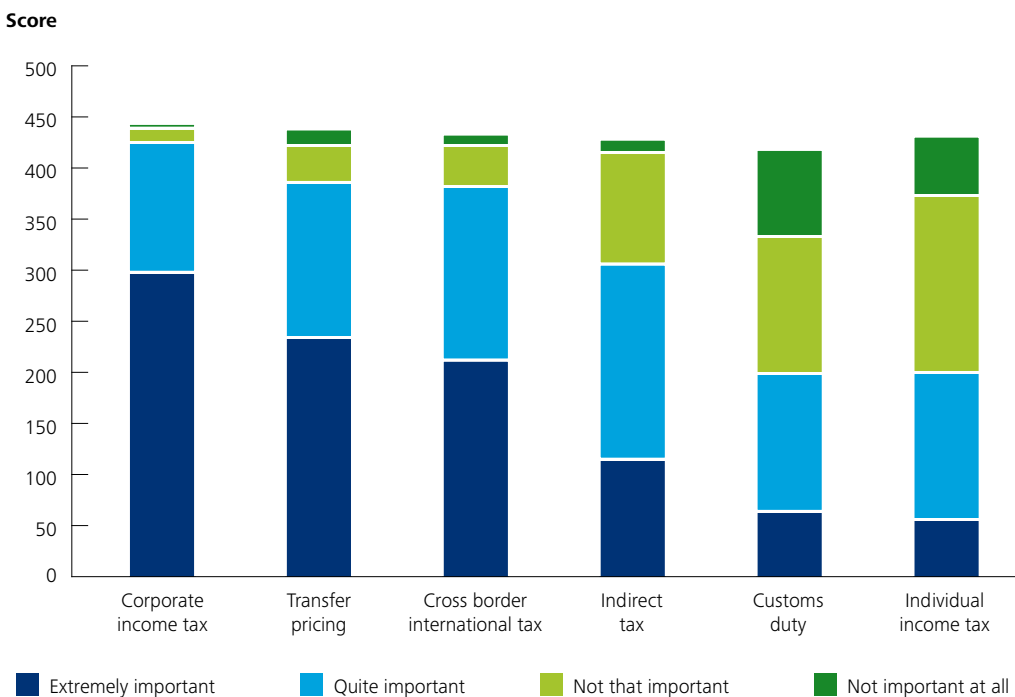
Comparing the relatively small geographic footprint of Hong Kong and Singapore to the large number of survey responses, the results appear to indicate that the favorable tax environment offered in Hong Kong and Singapore has been an important factor in companies' decisions on where to locate certain business functions.

Even though individual income tax is not voted as one of the most important taxation areas based on the survey, personal income tax costs

and tax equalisation schemes for company executives based in Asia Pacific are clearly significant considerations when it comes to business decisions such as locations of companies' headquarters in Asia Pacific. Hong Kong and Singapore become the logical choices as taxpayer-friendly locations.

Interestingly, customs duty is also an area that respondents deem to not be that important to their business. The large number of financial services industry participants appears to have contributed to this particular survey result, as one would have expected customs duties to have a significant impact on many organisations' above-the-line financial results. Another factor that could have affected the responses would be the individual respondent's role within an organisation, which, in many cases, may not include responsibilities in the individual income tax or customs duty areas.

Figure 6: Which taxation areas are most important to businesses?



Country and cross-border tax issues clearly are an important part of a multinational's business decisions and strategies. As companies design strategies for how to maximise financial results in what appears to be an economic recovery, tax policies in Asia Pacific will continue to attract the attention of businesses, given the economic growth potential in the region.

4. Complex tax economies require more investment in tax resources

Key findings

- China, India and Japan are expected to have the most complex tax environments in 2013, while Singapore and Hong Kong are expected to have the least complex.
- Companies are spending the most time and resources in China, followed by India, Japan, Singapore and Hong Kong.
- Between now and 2013, companies expect to increase the time and resources devoted to tax management in China and India, while for most of the other tax jurisdictions, companies expect to spend slightly less time and resources.

For the purpose of this survey, "complexity" refers to the perceived level of difficulty in interpreting and understanding the respective jurisdiction's tax laws and regulations

The "complexity" of a tax system is often rated as one of the primary factors when assessing whether the tax environment of a particular jurisdiction is "taxpayer-friendly".

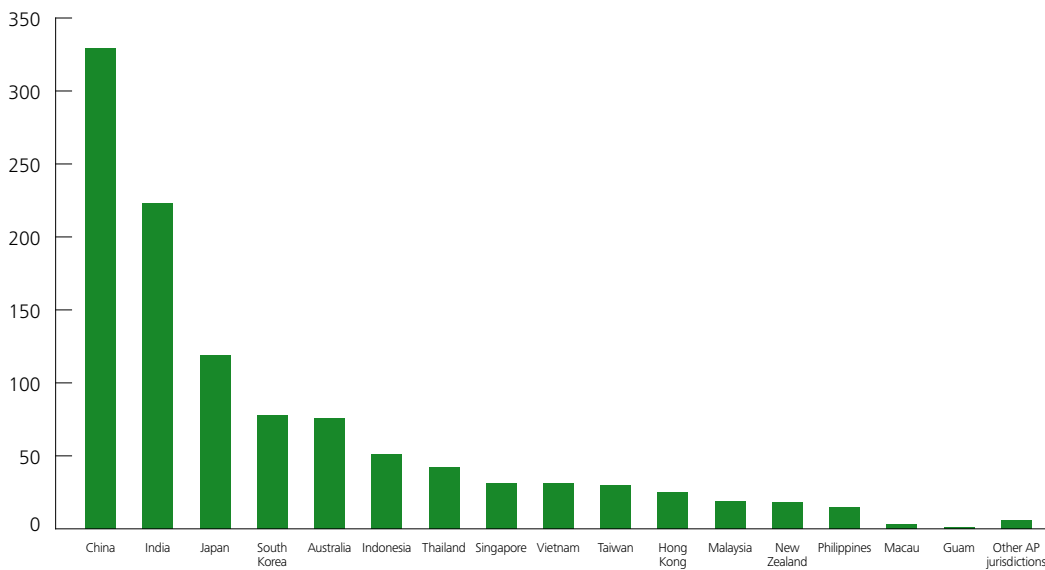
The perceived tax complexity of a number of Asia Pacific markets seems to be correlated with their pace of economic growth, as governments implement tax revenue measures in response to developments in the economy. Respondents were asked to identify the three tax jurisdictions in Asia Pacific that they expected to be the most complex in 2013.

The greatest number of respondents anticipate China, India, Japan and South Korea (in that order) to have complicated tax systems in the next three years, and recognise the need to devote more tax management resources relative to today, to China and India in particular. Australia is the jurisdiction with the fifth highest votes for complexity and the launch of the Henry Review may add to further perceptions of complexity. While Japan and South Korea are more mature markets, their perceived tax complexity is perhaps as a result of previous rapid modernisation and resultant tax effects which have not yet been simplified.



Figure 7: Where is the complexity in 2013?

Score



Markets may be borderless but businesses still need to manage across tax borders

While markets may be borderless in many respects, their tax borders are still clearly defined and each of the three tax jurisdictions ranked as most complex, is quite distinct. In the past few years, new transfer pricing regulations have been issued, and enforcement measures continue to be an emphasis in the three tax jurisdictions ranked as most complex - China, India and Japan.

• China

Respondents' perception of China as the most complex tax jurisdiction might be attributable to the Enterprise Income Tax (EIT) Law, which became effective on 1 January 2008. Interpretation of the EIT law and the tax guidance issued by the government and tax authorities thereafter has become a challenge for many companies, particularly non-resident companies deriving China-sourced income or engaged in business activities within China - whether those activities are cross-border services, exchanges of tangible goods, transfers of intangible property

rights or financial assets, sourcing activities, or investments in China enterprises that process goods or perform other business functions.

Tax issues are primarily enforced by local tax bureaus in China, and this tends to lead to more complexity for companies operating in multiple locations within China. While the EIT law itself is not very complex, the perception of survey respondents suggests that tax complexity is caused by varying enforcement and implementation of the tax laws and regulations.

China's new general anti-avoidance rules (GAAR) might have also influenced the perception of respondents that China has the most complex tax system in the region. In an effort to strengthen the enforcement of perceived abusive transactions, China introduced GAAR in its new EIT law. These provisions are written broadly and apply to many types of transactions, including non-residents' use of offshore holding companies to either avoid non-resident tax on equity transfers or to access

favourable tax treaties with China that would not otherwise apply. Prior to the EIT law, many of these practices were not relevant because the law did not impose withholding tax on passive income sourced in China.

- **India**

As mentioned in the Overview, in India the perceived complexity should lessen as the Indian Income Tax Act and the Wealth Tax Act are replaced by the Direct Taxes Code and proposed GST legislation.

India is currently considering including Advance Pricing Agreement legislation as part of the Direct Taxes Code. Many Asia Pacific locations, such as Thailand and China, have already introduced formal Advance Pricing Arrangement (APA) procedures. Given the expected growth in the region, this trend is expected to continue as more foreign investors enter or expand their business operations in the region.

- **Japan**

Japan, while not experiencing the high growth rates of China and India, is seen as being complex. A contributing factor could be the multiple levels of tax administration. Tax administration for companies with share capital of JPY100 million (US\$1 million) or more is handled by the Regional Tax Bureaus, while other companies' tax issues are enforced at the Local Tax Office level. The Japanese tax authorities audit the tax returns of companies in detail through on-site investigations, which can last for several months or more. The tax auditors have considerable discretion to negotiate adjustments, which adds to the uncertainty and complexity of the tax environment in Japan.

- **Singapore and Hong Kong**

Respondents perceive the tax laws in Singapore and Hong Kong to be the least complex which accounts for why these jurisdictions rank as the fourth and fifth behind the three most complex jurisdictions for companies' current spending on tax management time and resources. (See section 3, figure 5) . As we have noted, the taxpayer-favourable policies appear to be attracting companies in certain industries (e.g. financial services) and other more mobile business functions and assets to locate their business operations in these markets.



Figure 8: Where is the lowest complexity in 2013?

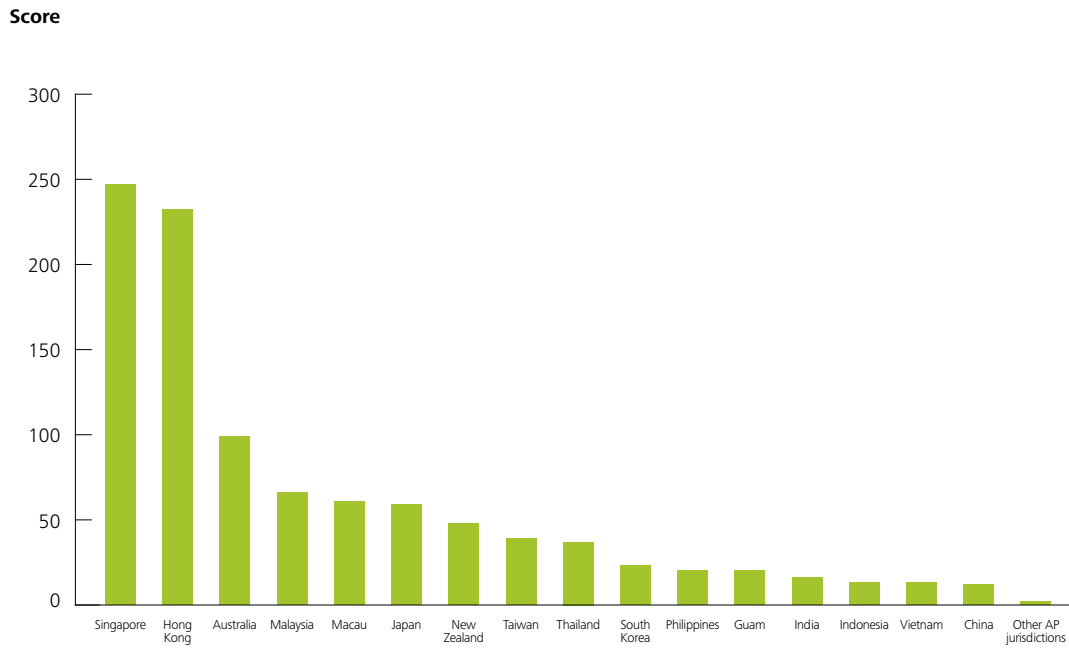


Figure 9: Which tax jurisdictions entail more time and resources - now and in 2013?

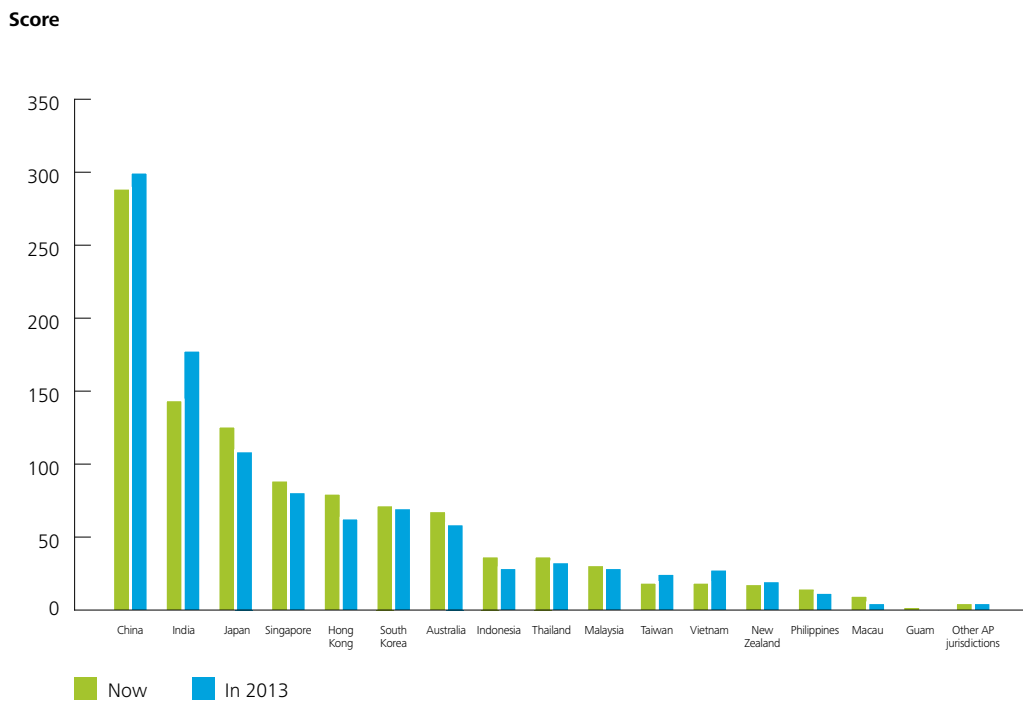


Figure 10: Plans to expand in-house tax departments?

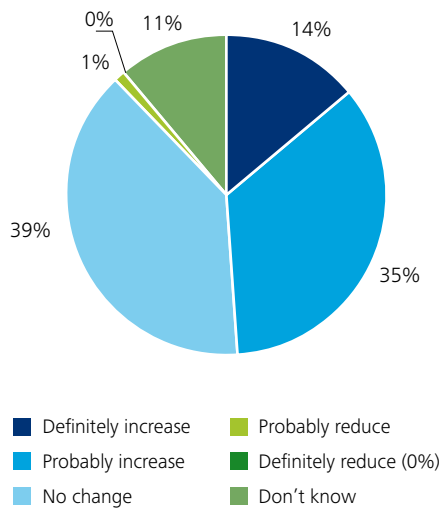
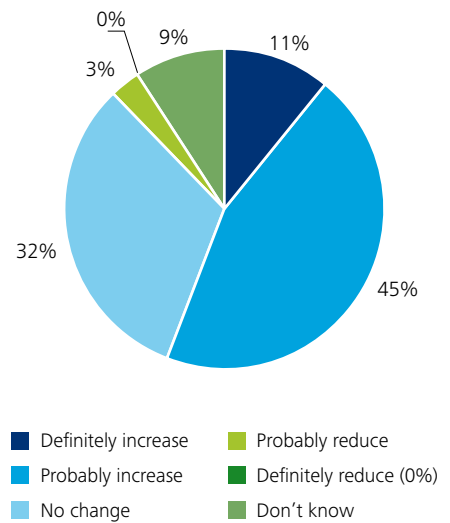


Figure 11: Plans to increase tax outsourcing?



Respondents sharing their tax management profiles indicated a strong prevalence (90 percent) to outsource some part of their tax compliance and planning, and a majority of 68 percent already have in-house tax departments covering their Asia Pacific. Increased expenditure on tax management in Asia Pacific jurisdictions in the coming three years is planned. Fifty six percent expect to increase their tax management outsourcing expenditure and 25 percent expect to increase the size of their in-house tax department in Asia Pacific.



5. Tax consistency and its challenges to businesses

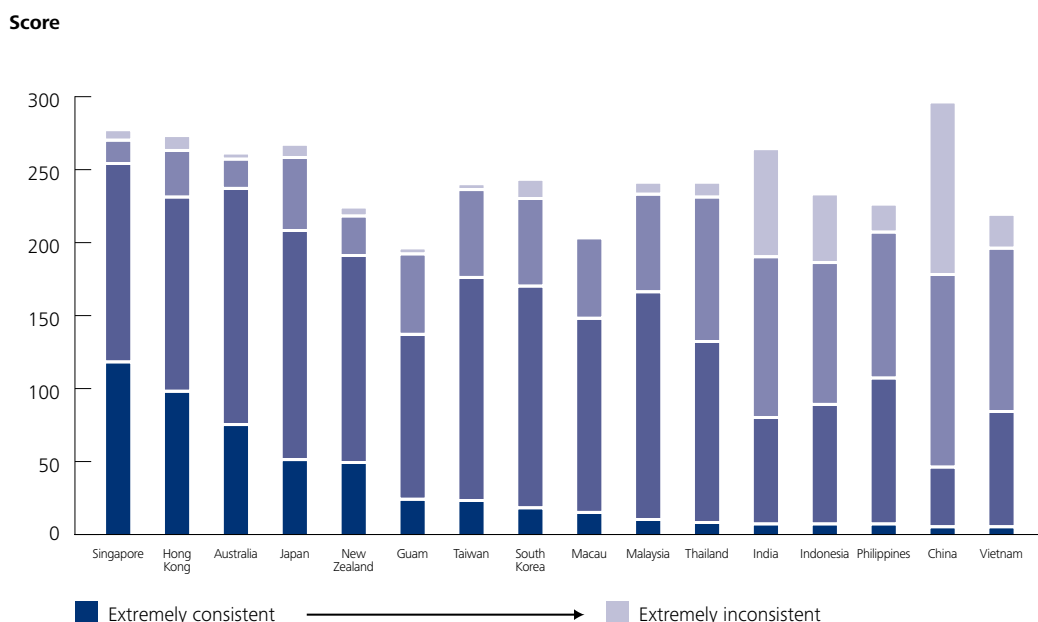
Key findings

- Respondents are relatively less concerned about consistency of tax law enforcement than about tax complexity and predictability.
- China and India are perceived as less consistent in enforcing tax law.
- Singapore, Hong Kong and Australia are perceived as more consistent in enforcing tax law.
- China, Japan, India and South Korea are where more respondents' companies have experienced tax audits.
- The Chinese tax authorities are perceived as the most aggressive in conducting tax audits in 2009.
- India's tax authorities have become more aggressive on cross border transaction, payments to non-residents, and transfer pricing.
- Consistency of tax law enforcement and frequency of tax audits are not correlated.

Our survey looked at perceived consistency of law enforcement including tax audits and concluded that there is no correlation between the level of consistency of tax law enforcement and the frequency or aggressiveness of tax audits. The most number of respondents perceived China and India as being extremely inconsistent in enforcing tax law while Singapore, Hong Kong and Australia attracted the highest number of responses for being extremely consistent in the enforcement of their tax policies.

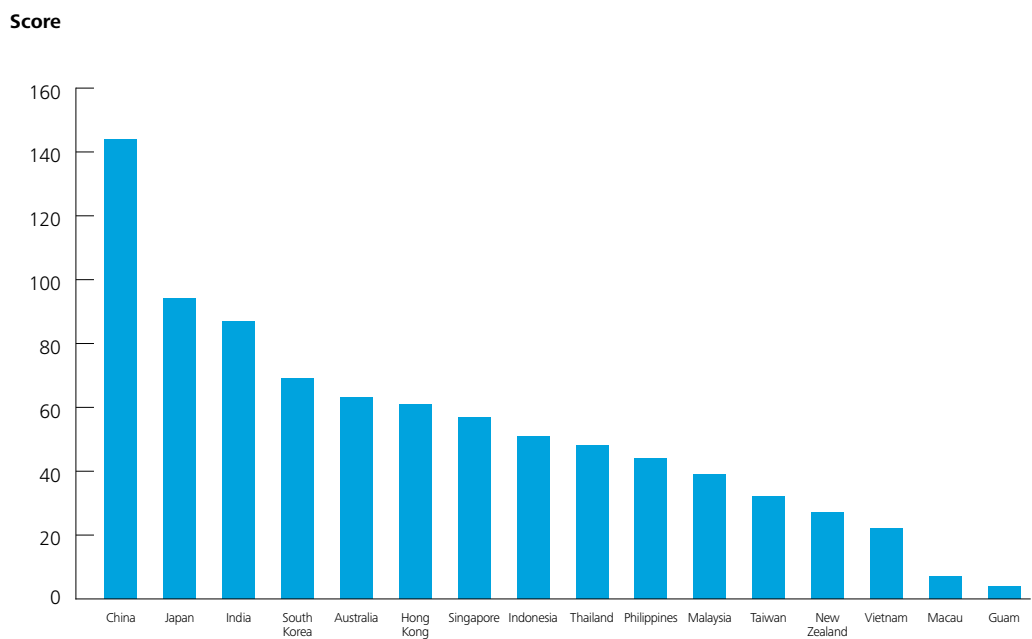
For the purpose of this survey, "consistency" means the perceived uniformity and transparency of enforcement of prevailing tax laws by the jurisdiction

Figure 12: How consistent are tax enforcement practices?



At the same time, China and India are also ranked as the jurisdictions where tax audits are most prevalent.

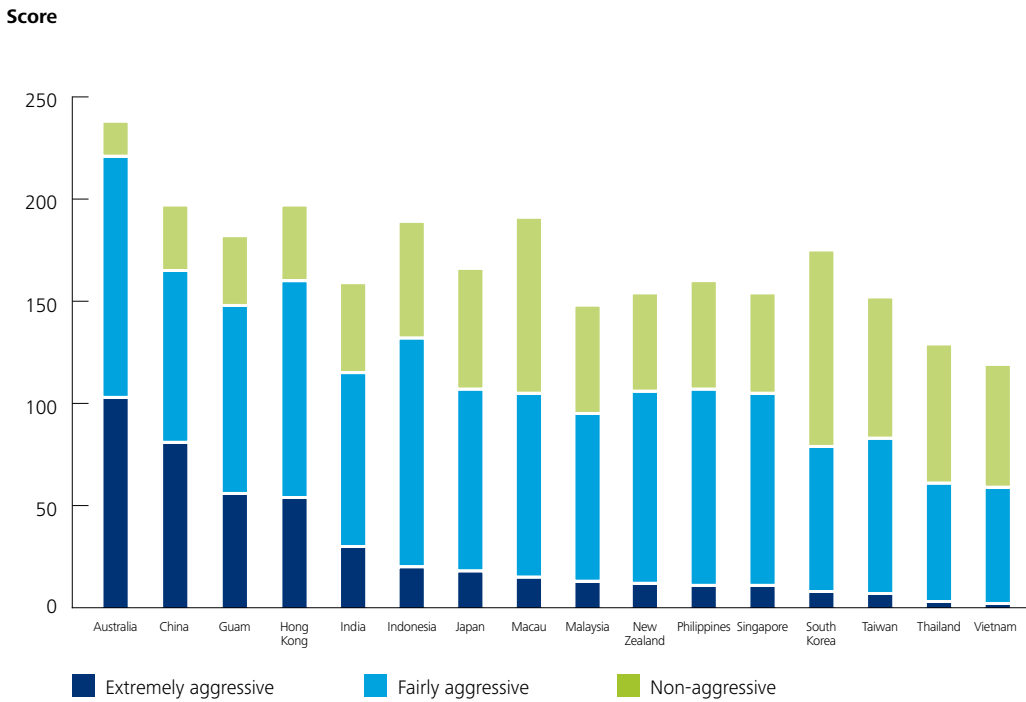
Figure 13: Where have companies experienced tax audits in the past three years?



While survey respondents are experiencing more aggressive tax audits in the more complex tax jurisdictions of China, India, Japan and South Korea, this is not correlated with consistency of tax law enforcement. In contrast to China and India being ranked as the least perceptibly consistent, Japan and South Korea were ranked as having relatively consistent tax enforcement practices.

Tax law changes in the four markets ranked as least predictable and the two ranked as most predictable illustrate the diverse challenges to businesses caused by the distinct tax structures, economic drivers and responses of each.

Figure 14: Which are most aggressive in tax audits?



• China

Respondents perceive that the Chinese government appears to have increased its tax enforcement measures. In the past 12 months, tax authorities have been more aggressive in conducting tax audits, particularly towards non-resident companies deriving income in China, and foreign invested enterprises. China's tax laws and regulations are expected to continue to develop, presenting ongoing challenges for taxpayers. As mentioned previously, China's tax laws are enforced by a myriad of local tax bureaus. While the national tax authority frequently dictates the expected interpretations of many different tax issues to the local tax bureaus, respondents clearly feel that the enforcement by the different tax bureaus is inconsistent.

• India

We also note that tax authorities in India have become more aggressive in relation to cross border transactions, in particular with holding company structures used for investments into India. Payments to non-residents are closely scrutinised as well. Transfer pricing is another area closely examined by the tax authorities. However, India's current tax system also provides incentives for foreign investors. For instance, foreign investors can seek an advance ruling on transactions undertaken/proposed to be undertaken, which could provide some level of certainty, and dividends paid by Indian companies are tax exempt in the hands of foreign investors. (Indian companies paying dividend have to pay Dividend Distribution Tax.) Sector and activity specific corporate tax incentives are also available.

- **South Korea**

Foreign investors often view that South Korea's tax laws do not prescribe clear and definite tax treatments and that the South Korean tax authorities are taking an aggressive position on earnings made from investment in South Korea. In actual fact, the South Korean tax authorities did not actively perform tax audits last year, considering the economic downturn. The tax authorities are trying to balance the promotion of foreign investment through providing tax incentives (for example, tax exemption on foreign direct investment in a South Korean company performing business involving highly advanced technology, or business or industry support service) and tax compliance. Its efforts to provide a more consistent and predictable investment environment include the introduction of measures such as the advance tax ruling request.

- **Japan**

Japanese tax authorities have been aggressive in conducting tax audits and the government has tightened transfer pricing reporting requirements. In addition, there has been significant tax law reform in the past 12 months in response to the global economic downturn, and these factors may have affected the survey results. We note that many of the changes benefit taxpayers. For instance, the new 95 percent foreign dividend exemption allows Japanese companies to repatriate foreign earnings with little tax cost. Also, there were changes to the controlled foreign companies (CFC) rules to help Japanese companies invest abroad.

- **Singapore**

Singapore continues to be a taxpayer-friendly jurisdiction for foreign investors. Historically, the government had not sought to raise revenue during economic downturns through tax increases. One of the measures it has taken in response to the latest global recession was to use budget surplus funds to provide incentives to companies in Singapore, including a tax-free cash grant to employers based on the number of employees.

- **Hong Kong**

As for Hong Kong, the low profits tax rate is certainly a big attraction to many foreign investors. In addition, the fact that Hong Kong does not tax dividends, capital gains and offshore income and the absence of GST/VAT are also attractive. Furthermore, Hong Kong is also expanding its tax treaty network to further promote foreign investments with more attractive withholding tax rates.

Tax enforcement consistency is a business challenge requiring careful attention

Although business opportunity seems to be outweighing concerns about tax consistency or, rather, any lack of it, the consistency of tax law enforcement should be an important factor that is considered and actively managed in business planning and decision-making, including where to locate resources and business functions.



6. Unpredictability can be managed with experience

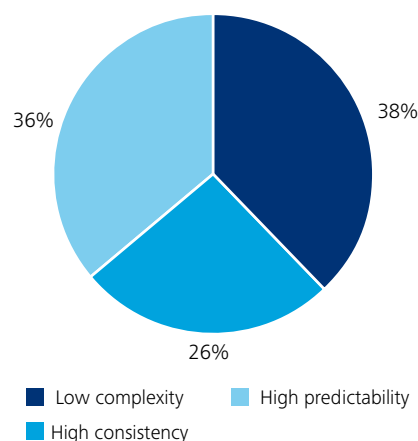
Key findings

- China, India and Indonesia are perceived to have the least predictable tax environments.
- The tax systems in Hong Kong and Singapore are perceived to be the most predictable; those of Japan, South Korea, Taiwan and Australia are also frequently selected as being fairly predictable.
- Respondents' industry sectors also show similar trends. For example, India receives the most selections for being extremely unpredictable among respondents from the financial services sector.
- Low predictability tends to be correlated with faster pace of economic development and with higher tax complexity.

For the purpose of the survey conducted, the term, "predictability", refers to the availability of information and resources from the tax authorities that allow taxpayers to foresee the direction and potential changes in tax law for the next three years. The predictability of a jurisdiction's tax system is an important factor that businesses should consider when making investments outside their home country.

Our survey indicates that while a low complexity tax environment is considered most important, businesses are concerned about predictability and being able to assess tax trends (such as an increase in compliance costs), and the impact to their business results and future plans.

Figure 15: Which is of greater importance?



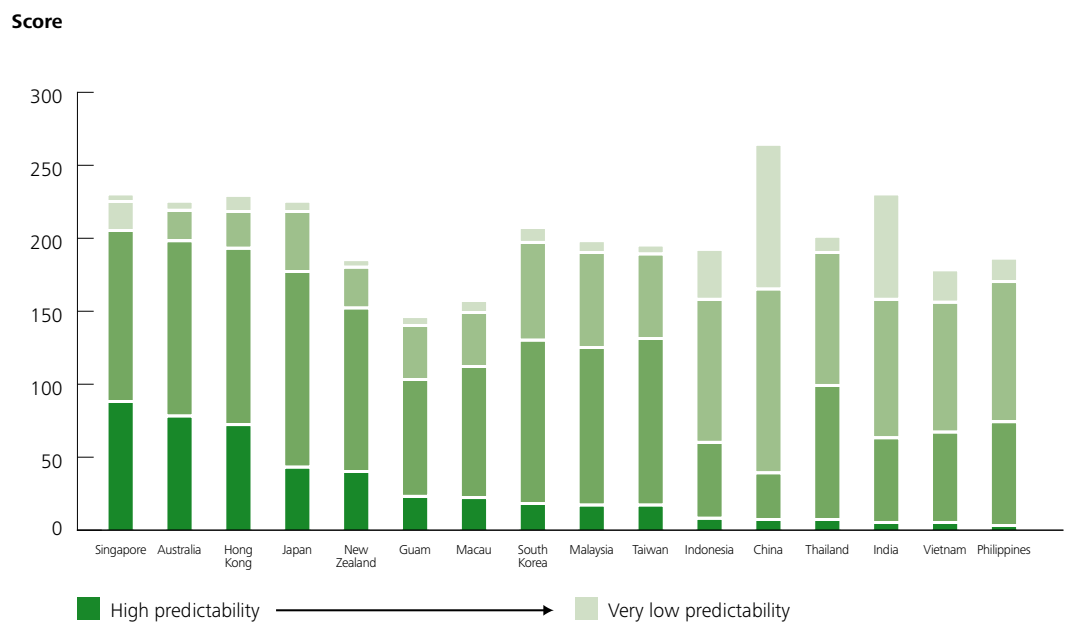
It is not always possible to know the details and exact timing of future tax law or enforcement practice changes before they occur. However, we have observed that experience gained over time in the jurisdiction does help in the interpretation of even unclear signals. For businesses that have not yet had sufficient time to build up their own experience in new markets with complex tax systems and less perceptible future tax developments, the most practical solution may be to deploy external advisors. This may account for the 56 percent of survey respondents who



indicated that they would probably or definitely increase their outsourcing of tax management in the coming three years. (See figure 11 in section 4.)

There appears to be a close link between respondents' perception of predictability and complexity. Jurisdictions perceived to have complex tax systems, such as China and India, are also ranked as the least predictable. Moreover, tax jurisdictions rated as less consistent in their enforcement of tax law are also ranked as the less predictable tax jurisdictions. There could be cumulative reasons for such high correlations: lack of a mature, structured tax system; different levels of tax authorities; and inconsistent and insufficient guidance from tax authorities.

Figure 16: How predictable is the tax environment?



- **China**

There is no substitute for China tax experience when managing the tax situation of your business in China. A clear illustration is the circular released by China's State Administration of Taxation in December 2009 on the transfer of shares by non-resident companies. While it indicated that the government intended to tax certain indirect equity transfers, many uncertainties have yet to be clarified, including how the tax authorities would enforce and monitor offshore transfers. Further, the requirement to disclose all of the information about the transactions may pose a significant administrative challenge to businesses. The lack of detailed guidance and the quantity of information that the circular requires businesses to disclose illustrate not only the complexity but the unpredictability of the tax environment in China. The pace of economic development is necessitating similarly rapid changes to the tax system, raising complexity and lowering predictability.

- **India**

Changes being implemented by India may enhance the predictability of its tax system. Tax authorities, which have traditionally used a manual system to handle tax filings, recently launched an automated system to expedite tax audits and assessments. They have also developed a formal procedure for the application of advance tax rulings for uncertain tax positions. Another recent initiative is the proposed Direct Taxes Code.

- **Singapore and Hong Kong**

Respondents rate the tax jurisdictions of Singapore and Hong Kong as highly predictable. Both Singapore and Hong Kong operate under a single-tier tax system, with only one level of tax authority, and their tax systems also are relatively straight-forward and, hence, easier for businesses to comply with. As a result, businesses may find it easier to foresee and prepare for recurring tax compliance obligations

as well as potential tax law changes. In addition, Hong Kong and Singapore serve as a platform for many foreign investors to enter other Asia Pacific markets such as China and India; while the tax systems may not be the predominant factor in companies' strategies, these might still have an impact on their business plans.

Businesses in or entering Asia Pacific markets should expect and prepare for increasing scrutiny over transfer pricing and cross-border transactions, as the region's tax jurisdictions strive to implement tax measures to capture revenue from economic growth and minimise tax avoidance



7. Conclusion

From all of the findings of our survey, here are the key conclusions that we wish to share with businesses in or considering entering Asia Pacific markets.

Market potential should be your top business priority

The rapid pace of economic development in the Asia Pacific region presents both business opportunities and rapid change to tax systems in the region's fastest growing markets. Managing your tax position will often be a challenge but as respondents to our survey have shown, the short to medium term challenges are outweighed by the long term strategic significance of participating in these markets. The goal should be to ensure that tax management is a fundamental component of your business planning and receives sufficient attention.

Complexity requires more investment

In the experience of our survey respondents, the fastest growing markets in Asia Pacific are the most complex - and our respondents are in these markets already. You will need to have access to skilled tax resources who, furthermore, are experienced in your priority markets. Unless you already have an in-house tax department with sufficient requisite skills and experience, you should research for and out-source to expert resources to give you time to establish or expand one. The appropriate combination for your business of in-house and out-sourced resources and the choice of location of certain business functions should be carefully considered.

Tax consistency poses challenges to businesses

Consistency of tax law enforcement is lower in the fastest growing markets and while survey respondents are relatively less concerned about consistency when compared to complexity and predictability, businesses are still strongly advised to factor aggressive tax law enforcement in their business scenario planning as there could be significant cost implications. In light of respondents' experience of aggressiveness in tax audits in the fastest growing markets, businesses are recommended to pay close attention and devote more resources in these areas to mitigate future tax exposures.

Unpredictability can be managed with experience

The fast pace of economic development and consequent tax law changes in China and India significantly increase their perceived complexity and unpredictability. Even tax professionals who have long experience in these markets cannot fully predict the detail, timing and enforcement of the changes. However, those who have been deeply involved in tax management long enough in these markets are usually better able to read the signals and the likely path of change and enforcement in these tax jurisdictions.

Appendices

Appendix I: Highlights on recent and upcoming tax changes



What are some of the tax law changes in Asia Pacific markets that are relevant to most businesses? The following is a snapshot based on the observations of our team of AP ICE Tax professionals. Please note that it is not intended to be a comprehensive list of all tax law changes in Asia Pacific.

Australia

Corporate income tax

- On 2 May 2010, the Australian government announced the proposed introduction of a 40 percent resource rent tax that will apply to resource entities earning "super profits" from the exploitation of non-renewable resources. The proposed changes are intended to apply to all existing and future projects with effect from 1 July 2012.
- In the Henry Review released by the Australian government in May 2010, broad changes are expected in their corporate tax system including changes in consolidated return filings, controlled foreign company tax rules and research & development (R&D) tax incentives.
- The 2010-2011 budget proposals indicated that the corporate tax rates will be reduced for both large and small businesses (from 30 percent to 28 percent by 2014-2015 for large businesses and reduction to 28 percent in 2012-2013 for small businesses).

China

Corporate income tax

- China has introduced a number of circulars in the past year to address tax issues with respect to non-residents. The circulars cover guidelines on determining the beneficial owner of income for tax treaty purposes, guidelines on income from non-resident enterprises' equity transfers and guidelines on taxation of representative offices as well as calculation of EIT by non-resident enterprises with establishments in China.

- It is anticipated that there will be further guidance released related to the M&A tax rules and the foreign tax credit rules.

Individual income tax

- It is anticipated that there will be further guidance released related to taxation with respect to seconded employees.

Hong Kong

Corporate income tax

- It is expected that there will be more tax disputes over source of profits when companies determine their Hong Kong profits tax liability, if any.
- Recently, Hong Kong has signed double tax agreements with Brunei, Indonesia and the Netherlands. More double tax agreements will likely be signed between Hong Kong and other jurisdictions (for example, Japan), which will further enhance tax planning for multinational companies using Hong Kong as an investment platform.

Transfer pricing

- There is also increasing scrutiny over transfer pricing by the tax authorities.

India

Corporate income tax

- The current domestic tax law is expected to be replaced by a new set of tax rules - the Direct Taxes Code. The Direct Taxes Code is likely to be effective commencing 1 April 2011. Amongst the various changes, the new tax rules may introduce the concept of GAAR and new tax laws governing indirect equity transfers of Indian companies.
- In March 2010, India's Authority of Advanced Rulings has issued an advanced tax ruling, confirming that the capital gains tax exemption under the India-Mauritius Tax Treaty will continue to apply to Mauritius-based companies.

Indirect tax

- A new Goods and Services Tax (GST) legislation will likely replace the existing Value-Added Tax (VAT) effective 1 April 2011.

Indonesia

Corporate income tax

- Indonesia's Directorate General of Taxation has issued a regulation earlier in the year that standardises the procedure for exchanges of information under Indonesia's tax treaties. The regulation is also in line with its objective of preventing tax treaty abuse and its current focus on transfer pricing issues.
- Indonesia's Director General of Taxation has issued a regulation on the government's policy for conducting tax audits for other purposes, broadening the scope of such "other purpose" audits. The regulation applies as of 21 December 2009.
- The Indonesian Ministry of Finance issued a regulation in January 2010 that grants various tax and customs benefits for activities relating to renewable energy resource utilisation.

Indirect tax

- The latest amendments to the VAT Act in Indonesia became effective as of April 1 2010 and amongst the changes, financial services (including Shar'iah compliant businesses) are not subject to VAT.

Japan

Corporate income tax

- The 2009 and 2010 Tax Reforms introduced significant changes, including a 95 percent foreign dividend exemption for Japanese companies; changes to the anti-tax haven rules, and the introduction of a group taxation system to facilitate tax-free transfers of assets between 100 percent owned Japanese companies.

Indirect tax

- The current rate of consumption tax is 5 percent. There is a continuing debate regarding when, and by how much, this rate should be increased, in order to fund Japan's growing deficit.

Malaysia

Corporate income tax

- The Malaysian government continues to promote Labuan as an International Business and Financial Centre for the development of offshore activities such as banking, insurance, investment holdings and trusts.
- More environmental-based tax incentives are expected to be introduced.

Indirect tax

- The Malaysian government has decided to postpone the implementation of GST until 2012. It is expected that there will be a subsequent decrease of the direct tax rates after the GST implementation.

New Zealand

Corporate income tax

- An active income exemption for controlled foreign companies has been enacted.
- The company tax rate will fall from 30 percent to 28 percent from the 2011/12 income year. There will be a two year transitional period for imputing dividends at the existing 30 percent rate.
- Loss attributing qualifying companies and qualifying companies will become flow-through entities for tax purposes for income years starting on or after 1 April 2011.
- The thin capitalisation threshold for non-resident investors will be reduced from 75 percent to 60 percent from the 2011/12 income year.

Indirect tax

- GST will increase from 12.5 percent to 15 percent, from 1 October 2010. This increase in GST will raise an additional \$2.46 billion in government revenue by 2013/14, without factoring in increasing spending arising from income tax relief. Benefits will be increased by 2.02 percent on 1 October to compensate for the GST rise.

Individual income tax

- Personal tax cuts effective from 1 October 2010 for all taxpayers, but most notably a decrease in the top personal income tax rate from 38 percent to 33 percent.

Philippines

Corporate income tax and transfer pricing

- There is an increasing significance placed on corporate income tax and transfer pricing by the tax authorities of the Philippines.

Indirect tax

- There is a proposal to increase the current VAT rate from 12 percent to 15 percent.

Singapore

General

- No significant tax changes were proposed in the budget released in February 2010. Specifically, no changes have been proposed to the corporate or personal income tax rates.
- Major tax changes are not expected in the near future.

South Korea

Corporate income tax

- Introduction of consolidated tax returns: a parent company and its directly and indirectly owned subsidiaries can file a consolidated tax return starting from financial year 2010.
- The government has approved a tax bill to revise the current M&A tax rules. The new rules will be effective from 1 July 2010. Under the new

rules, companies can undergo tax-free mergers if certain conditions are met.

Transfer pricing

- Transfer pricing has become increasingly important as the South Korean tax authorities appear to be trying to raise tax revenue from this area.

Taiwan

Corporate income tax

- The corporate tax rate is expected to be reduced from 20 percent to 17 percent.
- In January 2010, the Taiwan Ministry of Finance has issued guidance on the applicability of Taiwan's tax treaties, which enables the tax authorities and taxpayers to better interpret treaty provisions. The new rules are based on the 2008 OECD Model Treaty and Commentary.
- The Taiwan Ministry of Finance has proposed new thin capitalisation rules with a 3 to 1 debt to equity ratio, which they are planning on enacting in 2011.
- New rules were enacted under the Industry Innovation Act in April 2010, providing income tax credit for innovation-related R&D expenses incurred by Taiwan-based enterprises at their facilities located in Taiwan.

Thailand

Corporate income tax

- A potential reduction of corporate income tax rate to 28 percent has been proposed.
- Tax exemption periods will potentially be available for green-technology activities promoted by the Thailand Board of Investment.

Indirect tax

- A potential extension of the reduced rate of VAT at 7 percent from the normal rate of 10 percent has been proposed.

Transfer pricing

- Introduction of formal APA procedures recently has increased the focus of the tax authorities on related party transactions.

Appendix II: Asia Pacific tax rates at a glance

	Corporate Tax Rate ¹	Individual Tax Rate ¹	GST/VAT	Withholding Tax Rates ²			
				Branch profits	Dividends	Interest	Royalties
Australia	30%	45%	GST - 10%	0%	0%/30%	10%	30%
China	25%	45%	VAT - 17%	0%	10%	10%	10%
Guam	35%	35%	4%	30% ⁴	30% ⁴	30% ⁴	30% ⁴
Hong Kong	16.5%	17%	0%	0%	0%	0%	4.95%
India	30%/40% ⁵	30%	VAT - 12.5%	0%	0%	20%	10%
Indonesia	25%	30%	VAT - 10%	20%	20%	20%	20%
Japan	30% ⁶	50%	Consumption Tax - 5%	0%	20%	20%	20%
Malaysia	25%	26%	GST - 4% ³	0%	0%	15%	10%
New Zealand	30%	38%	GST - 12.5%	0%	15%/30%	15%	15%
Pakistan	35%	25%	GST - 16%	10%	10%	10%	15%
Philippines	30%	32%	GST - 1% to 7% VAT - 12%	15%	30%	20%	30%
Singapore	17%	20%	GST - 7%	0%	0%	15%	10%
South Korea	24.2%	38.5	VAT - 10	0%	22%	22%	22%
Taiwan	20%	40%	GST - 5%	0%	20	15%/20%	20%
Thailand	30%	37%	VAT - 7%	10%	10%	15%	15%
Vietnam	25%	35%	VAT - 10%	0%	0%	10%	10%

1. Highest statutory rates.

2. Assuming no treaty relief.

3. The effective date of GST has yet to be announced and law is not yet in place.

4. Guam statutory withholding tax rates subject to the reductions accorded in US double tax treaties.

5. The rate is 30% for domestic companies and 40% for foreign companies and branches of foreign companies. Also, a 10% surcharge applies to domestic companies (2.5% for foreign companies) if income exceeds INR 10 million. An additional 3% cess is payable in all cases.

6. The effective corporate tax rate is approximately 41%, and is comprised of the national corporate income tax of 30%, the local inhabitants tax of approximately 6.2% and the local enterprise tax of approximately 7.56%.

Appendix III: Additional reference sources

Deloitte International Tax Source

The Deloitte International Tax Source (DITS) is a comprehensive one-stop site for international tax rates, information and analysis key to doing business in a cross-border environment. DITS currently covers more than 60 jurisdictions worldwide.

Asia Pacific Dbriefs

These are live webcasts featuring our tax professionals offering insights on important developments affecting businesses in Asia Pacific

Asia Pacific merger and acquisition tax and structuring guide

The report provides advice on structuring deals and managing risk throughout the Asia Pacific Region.

Global Tax Alerts

Prepared by Deloitte professionals around the world, these provide timely commentary and analysis on tax developments affecting cross-border transactions.

International Tax and Business Guides and Highlights

Business Guides provide an overview of the investment climate, taxation and operating conditions for more than 50 jurisdictions, while the Highlights series offer major tax rates and investment information for over 120 jurisdictions

Please visit <http://www.deloitte.com/internationaltax/ice/apice> or contact the AP ICE office.

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