

# TEI Tax Summit 2016

Asia Pacific

Singapore  
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# Session 3: I Get No Credit

## The New Initiatives in the Context of Home Country Credit Regimes



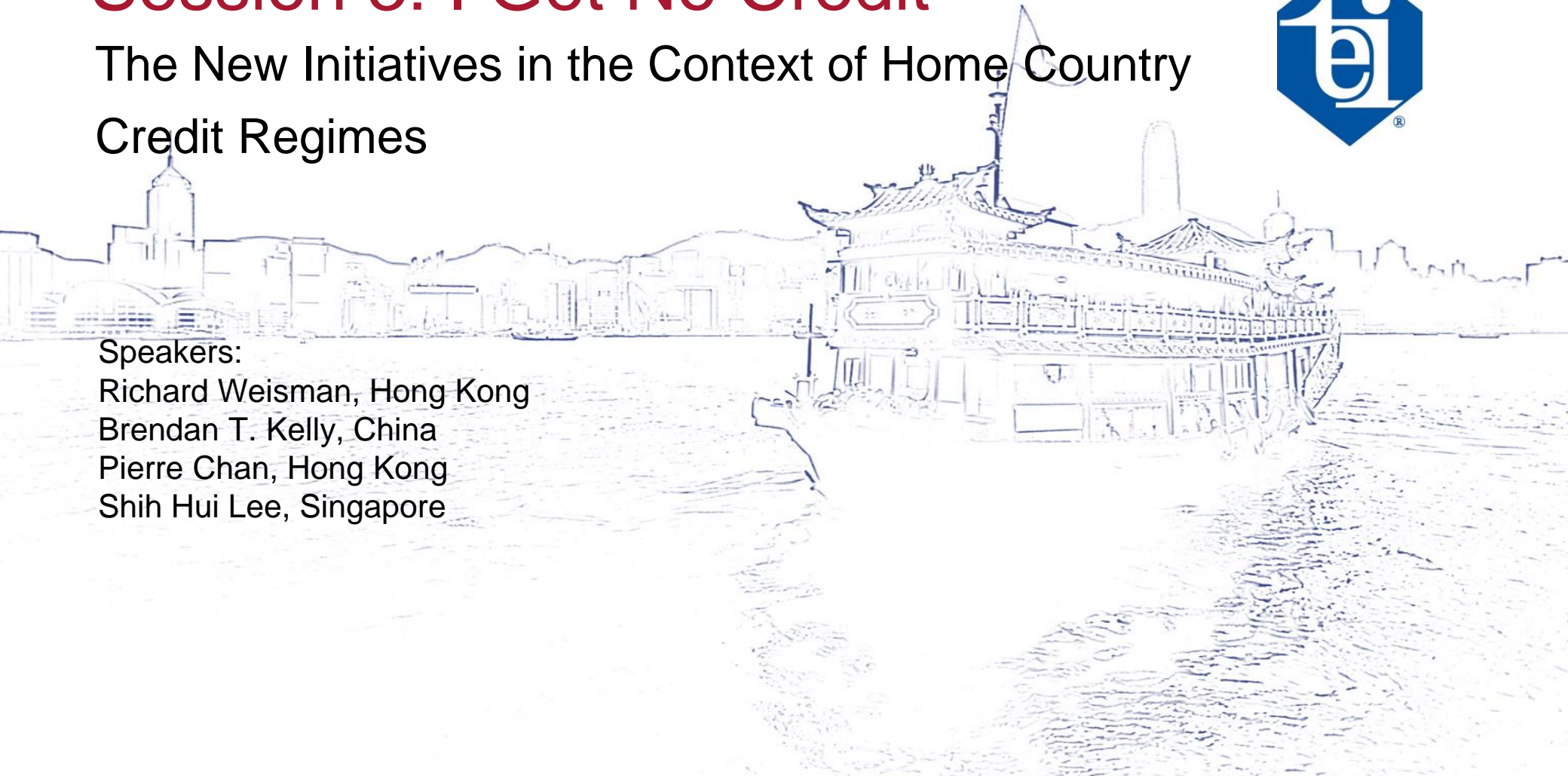
### Speakers:

Richard Weisman, Hong Kong

Brendan T. Kelly, China

Pierre Chan, Hong Kong

Shih Hui Lee, Singapore




# Home Country Foreign Tax Credit Considerations

# Foreign Tax Credit Regimes Typically Do Not Allow Foreign Tax Credits If the Foreign Tax Assessments Are Not Legitimate and Have Not Been Appropriately Contested By the Taxpayer

- Example: US Foreign Tax Credit Requirement that a Taxpayer “Exhaust All Remedies”

- A US taxpayer is required to “exhaust all remedies” against an assessment that would increase its foreign tax liabilities (the an “Exhaustion of Remedies Rule”). Treasury regulations are clear that to exhaust all remedies, a taxpayer must pursue all avenues of relief under the relevant foreign jurisdiction’s laws, including component authority where the jurisdiction’s laws are modified by treaty. See Treas. Reg. Sec. 1.901-2(a)(2); Treas. Reg. Sec. 1.901-2(e)(5). The taxpayer may take a credit for the assessed tax paid before the exhaustion of all remedies as long as the taxpayer is in pursuit of exhausting all remedies. See *International Business Machines Corporation v. United States*, 38 Fed. Cl. 661 (1997).



Additionally, a taxpayer is excused from pursuing remedies that would be unreasonable to pursue, taking into account the cost to pursue the remedy, the amount at issue and the likelihood of success. Treas. Reg. Sec. 1.901-2(e)(5). Therefore, when a taxpayer settles a dispute with a foreign tax authority, the taxpayer is treated as having exhausted all remedies, when it was more reasonable to agree to the settlement than it would have been to litigate the issue or take the issue to competent authority. Field Service Advice 1998-58 (July 15, 1993); c.f. Treas. Reg. Sec. 1.901-2(e)(5)(ii) Ex. 3

- A notable recent case with respect to the Exhaustion of Remedies Rule is *Procter & Gamble, Co. v United States*, 105 AFTR 2d 2010-330 (S.D. Ohio), where a taxpayer paid both Japanese and Korean withholding tax on the same income, but was only able to show that competent authority relief could not have been obtained with respect to the Korean tax. Foreign tax credits were allowed, but only up to the amount of the Korean tax.

- The Exhaustion of Remedies Rule is a major focus of the IRS on audits, as illustrated by the IRS’s publication of three International Practice Units (“IPUs”) on the Exhaustion of Remedies Rule at the end of 2014. Available at <https://www.irs.gov/businesses/corporations/international-practice-units>. The OPUs conform to the rules discussed above, with salient points being that:
  - A taxpayer should pursue administrative appeals and court challenges if a foreign tax authority’s position is unreasonable under local law, but a remedy is effective and practical only if its cost is reasonable in light of the amount at issue and its likelihood of success
  - A taxpayer is not required to pursue ineffective remedies



- If a taxpayer knew (or should have known) it could have pursued effective and practical remedies to reduce its taxes under foreign law, then the IRS will view any failure to preserve its remedies within the foreign statute of limitations as creating a voluntary payment
- If a taxpayer did not have actual or constructive notice that it overpaid foreign taxes before the statute expired, and no treaty applies, then it may have exhausted its remedies
- The taxpayer may demonstrate that remedies were ineffective based on an opinion letter from the relevant foreign jurisdiction or from competent foreign counsel (IRS counsel will however review the opinion letter)
- Lacking an opinion letter, the taxpayer must demonstrate that it (a) has requisite foreign tax expertise and (b) made a reasonable decision not to pursue the contest

- The OPUs also observe that that foreign audits of US-based taxpayers had become more frequent and, at times, more aggressive, already in 2014. New implementation of country-by-country reporting under Action 13 of the 2015 Final BEPs Report (implemented for US multinationals under Treas. Reg. 1.6038-4) can only serve to increase the frequency of foreign audits of US multinationals. Such audits invariably will lead to adjustments, leading to additional foreign taxes

# Big Picture FTC-Related Concerns Re BEPS - Inspired Changes/ CBC Reporting Under Action 13 of the 2016 Final BEPS Report

- Increased Assessments Such That Two or More Jurisdictions Claim the Right to Tax the Same Income
- Questionable Basis for Assessments
- Inadequate Dispute Resolution Procedure
- Inadequate Competent Authority Procedure Cost and Effort of Pursuing a Refund May Make it Unreasonable to Seek Recourse in Certain Situations, Placing FTCs at Risk

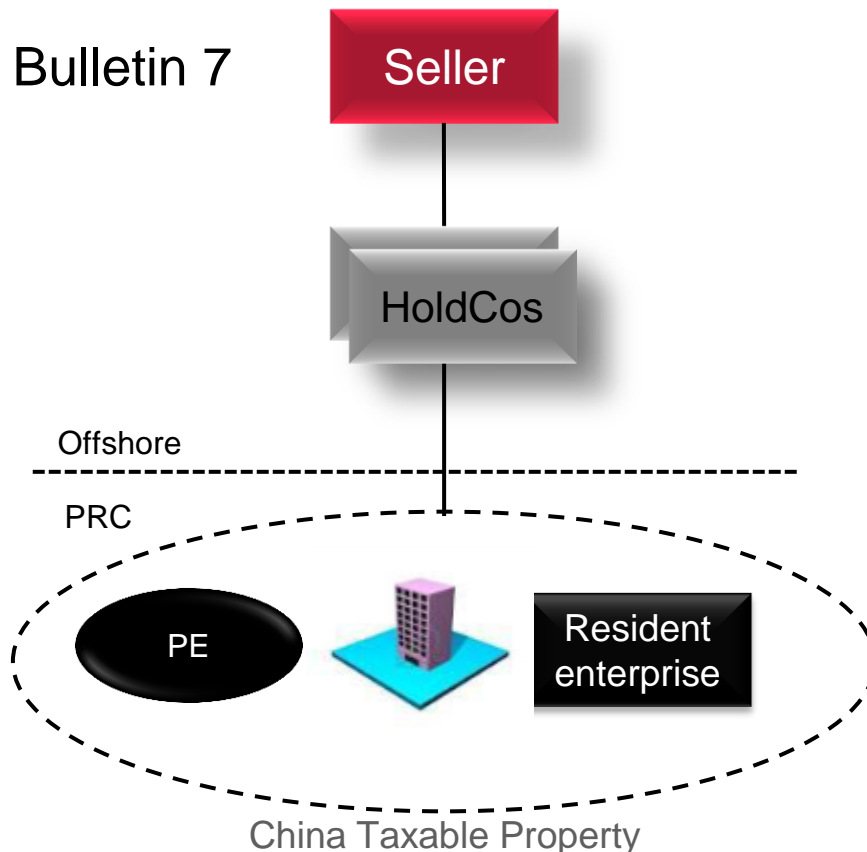
# Review of Audit/ Dispute Resolution Processes in Various Asian Jurisdictions in the Context of the Requirement to “Exhaust All Remedies”

- PRC
- Hong Kong
  - Desk audits / field audits and investigations
  - Additional tax assessments
  - Objection
  - Commissioner’s Determination
  - Appeal to Board of Review / Courts
- Singapore

Examples of Foreign Tax Where  
Entitlement to FTCs May be  
Challenged: PRC Taxation of Indirect  
Transfers, Challenges to Treaty  
Benefits, Service Fees, Royalties

# PRC Taxation vs. Home Country FTC:

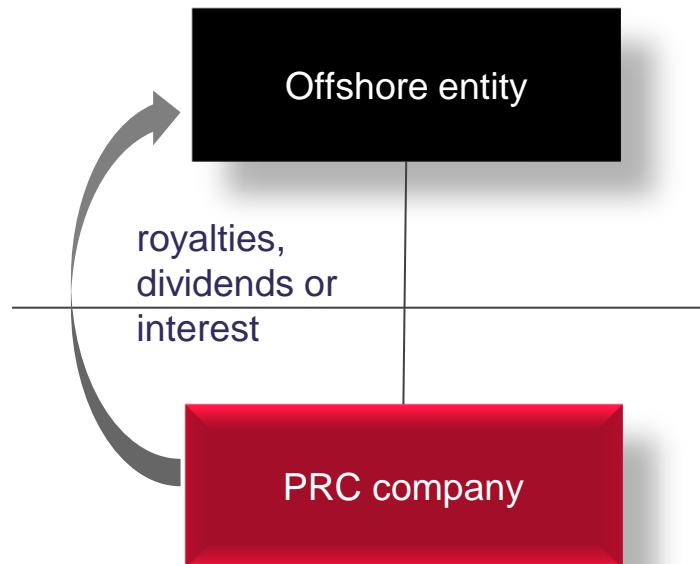
## Example I: Indirect Transfer



- Transfer of shares in the HoldCos
  - Recharacterized as direct transfer of China taxable property subject to tax in China
  - Voluntary tax payment?
  - Home country FTC?

# PRC Taxation vs. Home Country FTC:

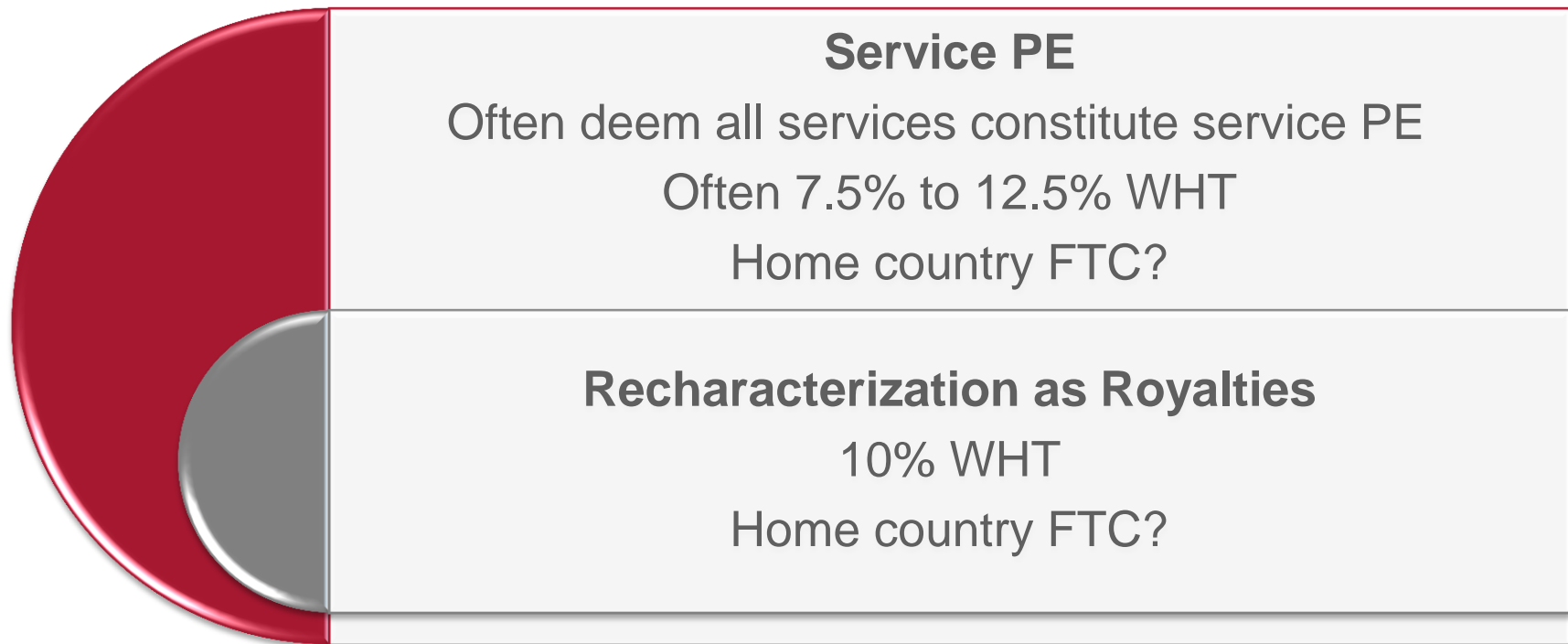
## Example II: Beneficial Ownership



- 10% domestic withholding tax (WHT) vs. reduced treaty WHT rate (e.g. 5% for dividends under China – HK treaty)
- Beneficial ownership (BO) test (Notice 601): rely heavily on economic substance
- Controversial application of BO test to treaty benefits for capital gains
- Treaty benefits denied based on BO test: home country FTC?

# PRC Taxation vs. Home Country FTC:

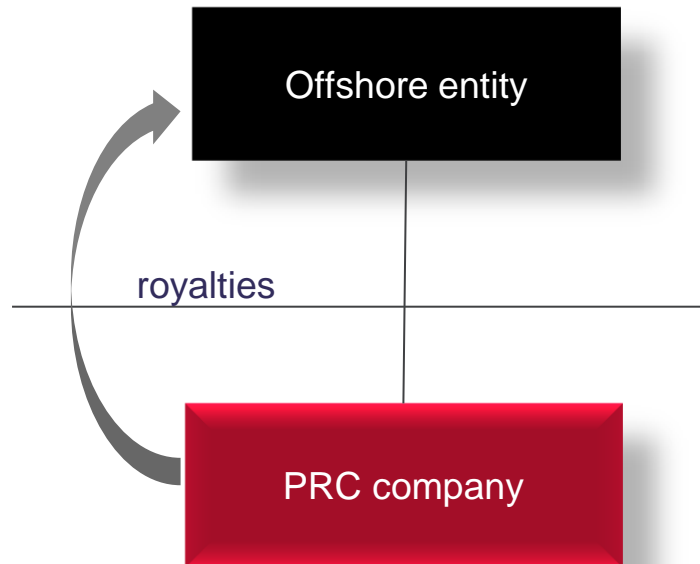
## Example III: Service Fees





# PRC Taxation vs. Home Country FTC:

## Example IV: Royalties



- Bulletin 16 denies deduction of
  - Royalties to offshore affiliates with no economic ownership (value creation requirement)
- No refund of 10% WHT that has been paid?
- Home country FTC?

Singapore Perspective

# Singapore Income Tax

- Territorial tax regime where tax is imposed on Singapore sourced income and foreign sourced income that is received or deemed to be received in Singapore
- Recognises that foreign sourced income may be subject to tax in the foreign jurisdiction. To mitigate double taxation, foreign tax credit may be claimed by taxpayers in Singapore.
  - Reliefs under the avoidance of double taxation arrangement. Singapore has concluded 80 comprehensive tax treaties
  - Unilateral tax credits may be allowed for taxes suffered by taxpayers in a non-treaty jurisdiction

# Tax credits

- Conditions:
  - Available to Singapore tax residents;
  - Income is received and subject to tax in Singapore; and
  - Tax has been paid or is payable on the same income in the foreign country.

# Tax credits (cont'd)

## – Limitations:

- The amount of tax credits available is capped on the lower of the foreign tax paid and the Singapore tax payable on that income.
- Unutilised amount cannot be carried forward
- Source-by-source basis (and country-by-country basis)
- Claims to be made within 2 years
- No credits shall be allowed on income accruing in or derived from Singapore (i.e., Singapore sourced income)

# Tax credits pooling

- Liberalised tax credits claim with effect from year of assessment 2012
- The amount of foreign tax credit available will be the lower of the total Singapore tax payable on the elected foreign income and pooled foreign taxes paid on those income.
- Benefits:
  - Increase the amount of tax credits by eliminating leakage under source-by-source basis.

# Tax credits pooling (cont'd)

## — Conditions:

- Foreign income tax has been paid on the elected foreign income in the foreign country;
- Headline tax rate of the foreign country from which the elected foreign income is derived is at least 15% at the time the elected income is received in Singapore; and
- The elected foreign income is subject to tax in Singapore.

# Considerations

- No tax credit if foreign sourced income is not subject to tax in Singapore:
  - Income kept offshore and not received / deemed to be received in Singapore
  - Application of foreign sourced income tax exemption (FSIE)



# Risks of Double Taxation involving Singapore

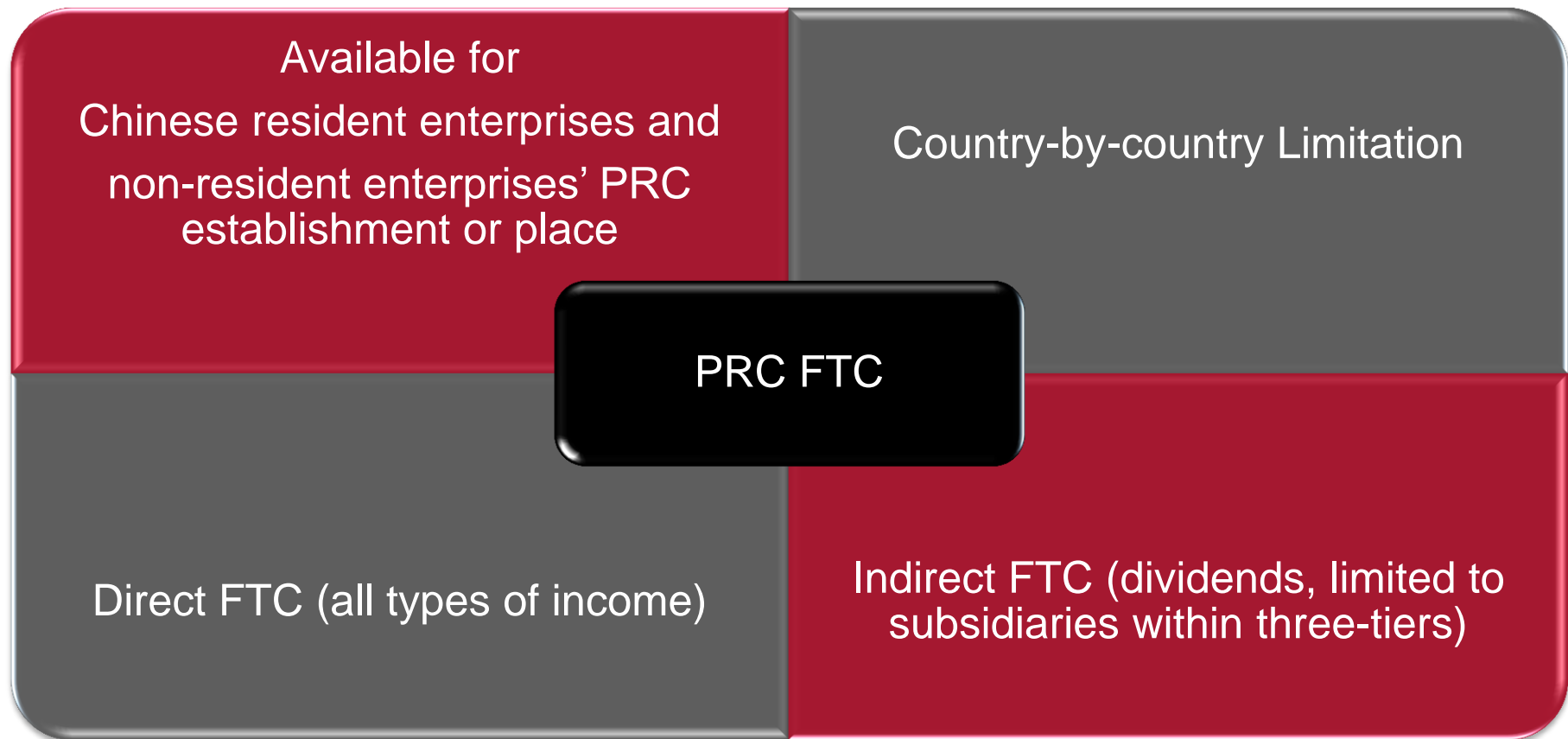
- Tax credits claim on foreign sourced income only
  - Where the income is sourced will be scrutinised
- Tax imposed under local law and not in accordance with tax treaties will not be creditable
  - Consider source rules under tax treaties
- Claim for credit within two years after the end of the year of assessment

Hong Kong Perspective

# Risks of Double Taxation involving Hong Kong

- No credit for tax paid in a non-DTA jurisdiction
- Tax imposed not in accordance with DTA
- General two-year time limit for claiming tax credits in a DTA jurisdiction

# Overview of China's FTC System



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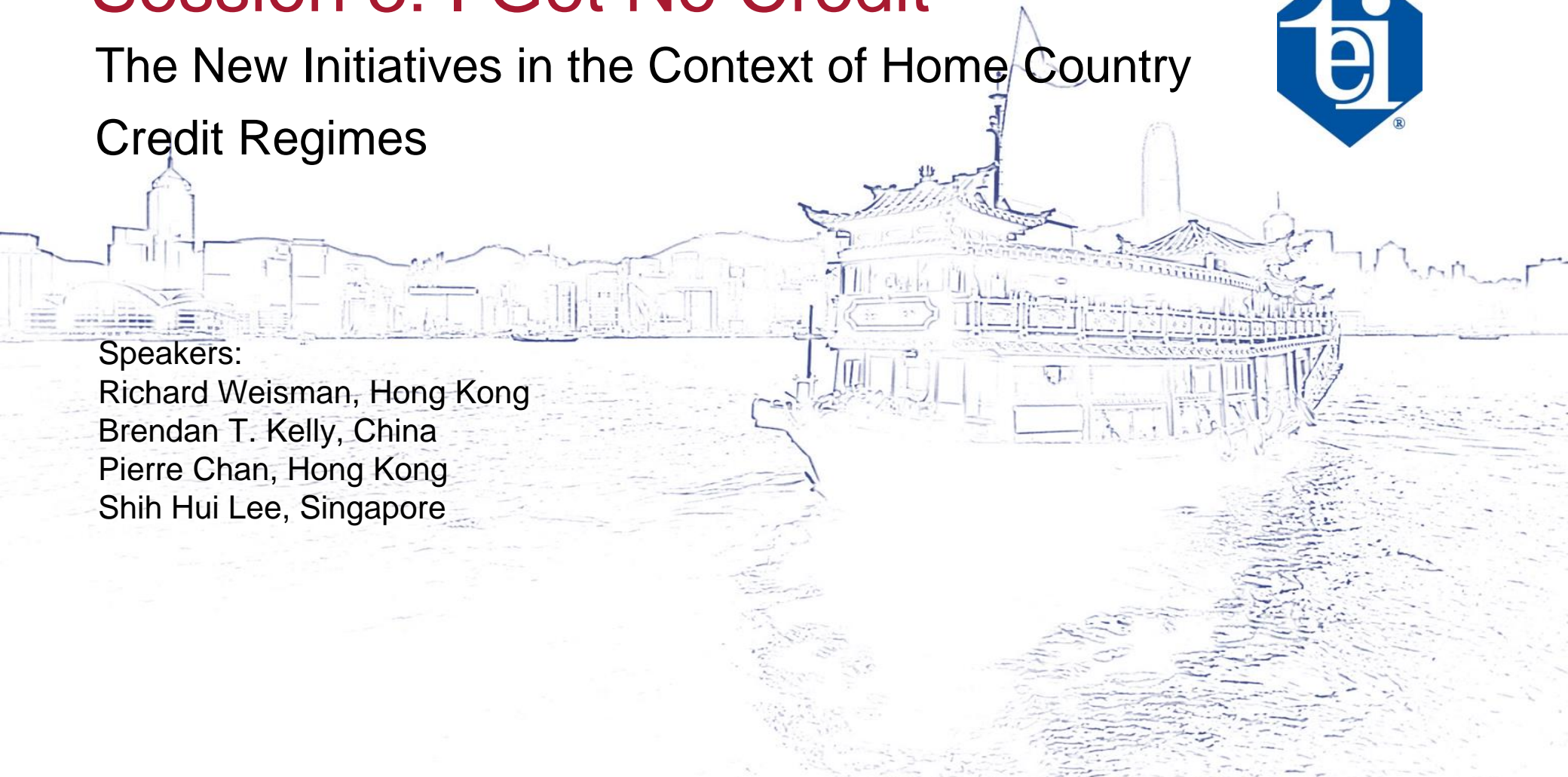
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