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A Guide to Selecting Holding or Financing Locations in Asia

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A Guide to Selecting Holding or Financing Locations in Asia

by Jack Sheehan

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In this article, Sheehan delves into a comparative analysis of tax and treaty rules in Singapore, Hong Kong, Malaysia, and Thailand and how those rules affect the process of selecting a holding or financing jurisdiction.

As we move into what many call "the Asian century," and economies in Asia continue to be the growth engine of the world, this article looks at some of the popular holding and financing jurisdictions for structuring investments into Asia. This article provides a comparative analysis of the attractiveness of structuring holding and financing activities in Singapore, Hong Kong, Malaysia, and Thailand, and a discussion on developments in domestic and treaty antiabuse rules.

Selecting a Jurisdiction in Asia

Several factors go into selecting a holding or financing location, including geographic preferences, regional headquarters location, treasury and shared services consolidation, and access to financial and capital markets. An important consideration when selecting a holding or financing jurisdiction is tax.

A wish list when selecting a jurisdiction may include the following attributes:

- exemption from tax on foreign income received at the holding company or financing company level, including for dividends and interest;
- no withholding taxes on dividends or interest paid from the company;
- access to a good tax treaty network;
- no taxes on capital gains;
- no controlled foreign corporation rules;
- no thin capitalization or interest deductibility rules;
- no antiavoidance rules;
- no substance requirements; and
- no foreign exchange controls.

Choosing a holding or financing jurisdiction in Asia with many of the above attributes is often challenging. In a post-base erosion and profit-shifting world, the structuring of holding and financing activities requires careful consideration of antiavoidance rules. These rules can be part of the domestic law of a jurisdiction in the form of a general antiavoidance rule or treaty-shopping rules, or antiabuse rules included in the articles of a tax treaty such as the principal purpose test or limitations of benefits test. Furthermore, companies must consider the implications of transfer pricing on structures involving related-party transactions, including interest on loans, management fees, and royalties.

Tax authorities in Asia are increasingly scrutinizing international holding and financing structures. They may deny treaty benefits or may not issue tax residency certificates to companies that lack the appropriate substance or if the income recipient is not the beneficial owner.[1]

[1] Tax authorities in Indonesia, Vietnam, Japan, India, China, and Korea all have rules for denying tax treaty benefits if a structure lacks substance or if the income recipient is not the beneficial owner.

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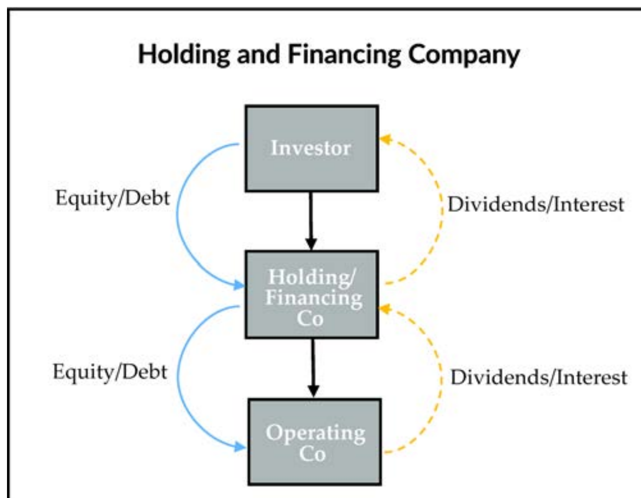

Comparative Analysis of Popular Jurisdictions

Singapore

Singapore is one of Asia's most popular locations for structuring holding and financing activities. It is a leading international finance hub with a business-friendly environment and a strong rule of law. It has a territorial tax system under which income that is not sourced or received in Singapore is generally not taxed in Singapore, subject to certain conditions. There are also some exemptions for foreign income received in Singapore.

Withholding Taxes

Singapore imposes withholding tax on certain payments to nonresidents. These include royalties, management fees, interest on loans, and rents. Dividends and capital gains are generally not taxable subject to certain conditions. Singapore has an extensive tax treaty network that may provide for reduced withholding tax rates.

Dividends and interest paid to a Singapore resident company are not subject to withholding tax. Interest paid to a nonresident is generally subject to a withholding tax of 15 percent. Dividends paid to a nonresident are not subject to withholding tax. Singapore has no branch remittance tax.

Royalties paid to a Singapore resident are not subject to withholding tax. However, royalty payments to a nonresident are subject to a 10 percent withholding tax and may be reduced under a tax treaty.

Foreign-Source Income

Foreign-source dividends, branch profits, and services income are exempt from Singapore income tax if resident taxpayers can meet the following conditions:

- subject to tax;
- foreign headline tax rate of at least 15 percent; and
- beneficial tax exemption.[2]

Capital gains are not taxable in Singapore unless the income is deemed to be trading income. Other types of foreign income are generally taxable when received in Singapore.

Tax Treaties

Singapore has signed tax treaties and information exchange agreements with around 100 jurisdictions.[3] Some of Singapore's tax treaties have been amended to reflect Singapore's multilateral instrument to implement BEPS positions. Several tax treaties have mandatory binding arbitration provisions. Singapore has tax treaties with most Asian jurisdictions, including China, India, Indonesia, Japan, Korea, Thailand, and Vietnam. It also has treaties with several European jurisdictions, including France, Germany, Ireland, Switzerland, and the United Kingdom. Singapore does not have a tax treaty with the United States, but does have an information exchange agreement and a limited treaty for shipping and aircraft income.

Thin Capitalization and Interest Deductibility

Singapore has no thin capitalization rules. Generally, interest expenses incurred on loans or borrowings taken to finance income-producing assets are tax deductible. Interest is usually deductible if the loan is obtained for revenue purposes.

Antiavoidance, CFC, and Transfer Pricing

Singapore has no CFC rules. Singapore's transfer pricing guidelines closely follow the

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[2] *See* Inland Revenue Authority of Singapore, "IRAS e-Tax Guide: Tax Exemption for Foreign-Sourced Income" (Jan. 23, 2019).

[3] Inland Revenue Authority of Singapore, "List of DTAs, Limited DTAs and EOI Arrangements" (last accessed Feb. 7, 2023).

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OECD guidelines.[4] Singapore has also introduced country-by-country reporting requirements. Singapore has no anti-treaty-shopping rules. However, it has a general antiavoidance or abuse rule and arrangements that are deemed to be made for tax avoidance can be subject to a penalty of 50 percent of tax due.[5]

Hong Kong

Hong Kong, long emerging from its British colonial past, was until recently the poster child for what a territorial tax system looked like. It is a leading international financial hub and a popular location for structuring inbound investments into China and Chinese outbound investments to other locations. Although part of China, Hong Kong is known as a special administrative region and has its own tax system and tax treaty network.

On January 1, Hong Kong introduced new foreign-source income exemption rules for Hong Kong companies that are part of multinational groups.[6] Under these new rules, covered taxpayers are entities that form part of a multinational group and carry on business in Hong Kong, and covered income encompasses foreign-source dividends, interest, intellectual property and royalties, and capital gains. Before the new rules, foreign-source income was exempt from tax in Hong Kong. Under the new rules, exemptions for foreign-source income will only apply if the Hong Kong entity has economic substance for dividends, interest, and capital gains, or a participation exemption applies for dividends and capital gains, and there is a nexus requirement for IP.[7]

Holding and Financing Regime

The EU views Hong Kong's territorial tax system as a preferential tax regime. From the EU perspective, for a taxpayer to benefit from such preferential tax treatment, it should have a substantial economic presence in the jurisdiction providing the foreign-sourced income exemption. The EU reviewed Hong Kong's territorial tax system as it applied to passive sources of income and concluded that under the existing rules, taxpayers did not need a sufficient economic presence in Hong Kong to benefit from the nontaxation of foreign-source income. As a result, the EU compelled Hong Kong to amend its tax laws under the threat of being labeled a noncooperative tax jurisdiction and being put on the EU's blacklist, which may have resulted in EU jurisdictions taking punitive measures against Hong Kong taxpayers.

To avoid this, the Hong Kong government agreed to consult with the EU and amend its tax laws, with the changes coming into effect in 2023.

Withholding Taxes

Hong Kong does not levy withholding tax on dividends and interest. However, royalty payments are subject to a withholding tax of up to 4.95 percent. Also, Hong Kong does not tax capital gains on share disposals.

Foreign-Source Income

Foreign-source income is generally not subject to Hong Kong tax provided the conditions under the income exemption rules can be met. However, under the new rules, the foreign-source income of entities that cannot meet the economic substance and participation exemption requirements will be subject to tax in Hong Kong.

Under the new participation exemption, Hong Kong entities must have continuously held not less than 5 percent of the equity interests in the entities paying dividends or disposal gains for a period of not less than 12 months immediately before the foreign-source dividend or disposal gain accrues.

Tax Treaties

Hong Kong has entered into tax treaties with 46 jurisdictions, including India, Indonesia, Japan, Korea, Thailand, and Vietnam in Asia, and, France, Ireland, Italy, and the United Kingdom in Europe. However, there is no tax treaty between Hong Kong and the United States.

Thin Capitalization and Interest Deductibility

Hong Kong has no thin capitalization rules. Generally, interest expenses incurred on loans or

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[4] OECD, "Singapore: Transfer Pricing Country Profile" (Dec. 2021).

[5] Section 33 of the Singapore Income Tax Act.

[6] Hong Kong, Inland Revenue (Amendment) (Taxation on Specified Foreign-Sourced Income) Ordinance 2022, which amended the provisions in relation to the foreign-sourced income exemption (FSIE) regime under the Inland Revenue Ordinance 112.

[7] See full list of new rules at Inland Revenue Department, "Foreign-Sourced Income Exemption" (last accessed Feb. 7, 2023).

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borrowings taken to finance income-producing assets are tax deductible. Interest paid to a nonresident (other than a financial institution) is generally not deductible if the overseas recipient is not subject to Hong Kong profits tax on the interest income. Loans between related parties are subject to transfer pricing rules, and interest should be at an arm's-length rate.

Antiavoidance, CFC, and Transfer Pricing

Hong Kong has no CFC rules. Its transfer pricing rules are generally consistent with the OECD guidelines. Under the new rules, there is a main purpose test that can deny the participation exemption if the commissioner of inland revenue is satisfied that the main purpose, or one of the main purposes, of the taxpayer in entering an arrangement is to obtain a benefit relating to a liability to pay profits tax.

Malaysia

On September 29, 2022, the Inland Revenue Board of Malaysia (IRBM) issued technical guidelines on the tax treatment of foreign-source income. Under the new rules, taxable income includes all income derived from Malaysia and income derived from outside Malaysia and received in Malaysia. However, foreign-source dividends received in Malaysia are exempt from tax, subject to certain conditions.

Withholding Taxes

Malaysia does not levy withholding tax on dividends. Payments between Malaysian resident entities are generally not subject to withholding tax (except for some instances, such as agents). Interest paid to a nonresident is usually subject to a withholding tax of 15 percent (except for banks) and can be reduced under an applicable tax treaty. Royalties paid to a nonresident are generally subject to a withholding tax of 10 percent, which can be reduced under a treaty. Disposal gains on shares are generally not taxable in Malaysia unless they are for real property or shares in a real property company.

Foreign-Source Income

Malaysia does not have a participation exemption for foreign-source dividends. However, foreign-source dividends are exempt from tax if:

- the dividend income has been subjected to tax in the country paying the dividends; and
- the headline tax rate in the country paying the dividends is at least 15 percent.

On December 29, 2022, the IRBM issued amended guidelines requiring, in addition to the above conditions, that Malaysian tax resident entities meet the minimum economic substance requirements for foreign-source dividend income to be exempt from tax in Malaysia.[8]

A resident entity will meet the economic substance requirements if:

- it has employed an adequate number of employees with the necessary qualifications to carry out the specified economic activities in Malaysia; and
- it has incurred an adequate amount of operating expenditure to carry out the specified economic activities in Malaysia.

The IRBM said that because the mode of operation varies from industry to industry, it is neither feasible nor appropriate to specify any thresholds for the economic substance requirement and, therefore, would depend on the facts of each case. Factors that will be taken into consideration include:

- the number of employees according to the nature of the relevant activities; for instance, whether it is a capital- or labor-intensive industry;
- whether the employees are full-time or part-time; and
- whether the office premises have been used for undertaking the relevant activities and whether the premises are adequate for these activities.[9]

Other foreign-source income received in Malaysia will generally be subject to corporate income tax at 24 percent.

Special tax incentives exist for principal hubs that are established in Malaysia. A principal hub is a Malaysian entity that conducts regional and global businesses and operations through management, control, and support of key

[8] *See* IRBM, "Guidelines: Tax Treatment in Relation to Income Received From Abroad (Amendment)" (Dec. 29, 2022).

[9] *Id.*

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functions, such as risk management, strategic decision-making, finance, and human resources. A principal hub will enjoy a corporate income tax rate of 0 percent, 5 percent, or 10 percent.

Tax Treaties

Malaysia has tax treaties with 76 countries, including many of the major economies, such as Canada, China, France, Italy, Japan, and the United Kingdom. Malaysia has no tax treaty with the United States.

Thin Capitalization and Interest Deductibility

Following the recommendations under the OECD's BEPS action 4, Malaysia has interest deduction rules. Interest on loans between related-party companies is capped at 20 percent of earnings before interest, taxes, depreciation, and amortization.

Antiavoidance, CFC, and Transfer Pricing

Malaysia has no CFC rules. It has a GAAR that allows the IRBM to disregard tax avoidance schemes that are entered into with a primary or dominant purpose of obtaining a tax benefit. Malaysia has transfer pricing rules that are largely based on and refer to the OECD guidelines.[10] It has an advanced pricing agreement program.

CbC reporting has been introduced. A Malaysian parent entity with total revenue of MYR 3 billion or more in a financial year must file a CbC report no later than 12 months from the close of the entity's financial year.

Thailand

Thailand is the second-largest economy in Southeast Asia and is a manufacturing powerhouse. While less well-known than Singapore and Hong Kong, Thailand can offer specific benefits as a holding jurisdiction.

Unlike Singapore and Hong Kong, Thailand does not have a territorial tax system and resident entities are subject to tax on a worldwide income basis. Thailand has a dividend participation exemption and an international headquarters scheme.

Withholding Taxes

Dividends paid to a nonresident entity are subject to a withholding tax of 10 percent. Interest or royalty payments made to a foreign company with no business operations in Thailand are subject to a withholding tax of 15 percent. However, these rates may be reduced by a tax treaty. Currently, no mechanism exists under Thai law to tax disposal gains derived by a foreign entity that sells shares in a Thai entity to another foreign entity outside Thailand (that is, the transaction is entirely offshore).

Foreign-Source Income

Foreign-source dividends received in Thailand are exempt from tax if the following conditions are met:

- if a Thai-registered company holds at least 25 percent of the voting shares of a foreign (non-Thai-registered) company for a six-month period before and after the date of the dividend distribution; and
- dividends are paid out of profits already subject to a headline tax rate of at least 15 percent in the foreign country where the company is deemed resident.[11]

Dividends paid to resident Thai companies are not subject to tax. Other foreign-source income received in Thailand is subject to corporate income tax at the current rate of 20 percent unless the Thai entity is provided with tax incentives such as an international business center (IBC) scheme.

Disposal gains received by Thai entities from the sale of shares in entities outside Thailand are deemed taxable and subject to corporate income tax at 20 percent. This is one of the major disadvantages of Thailand as a holding jurisdiction in comparison with Singapore and Hong Kong, which do not generally tax disposal gains. However, disposal gains from the sale of shares in a Thai entity by a foreign holding company to a Thai purchaser are subject to withholding tax of 15 percent, unless exempted under a tax treaty.

Thailand has special incentives for companies that can meet the requirements of an IBC. Entities

[10] *See* OECD, "Malaysia: Transfer Pricing Country Profile" (Dec. 2021).

[11] Royal Decree 442, B.E. 2548 (2005).

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that qualify as IBCs benefit from lower corporate income tax rates of 3 percent, 5 percent, or 8 percent for providing administrative and technical support services or treasury support services. In addition, there is no withholding tax on dividends paid by an IBC to foreign entities. IBC entities can be granted tax incentives for up to 15 years if they meet certain conditions.[12]

Tax Treaties

Thailand has entered tax treaties with 60 countries. These treaties tend to be a mix of the OECD and U.N. model conventions. Thailand has treaties with many of the major Asian, European, and North American economies, including China, France, Japan, the United Kingdom, and the United States. Most of Thailand's tax treaties do not provide for a lower rate of withholding tax on dividends than the domestic rate, which is 10 percent. There are a few exceptions, notably the double tax agreement between Taiwan and Thailand, which provides a 5 percent rate if dividends are paid to a beneficial owner holding at least a 25 percent participation, and the treaty with Mauritius, which provides for withholding tax of 5 percent.[13]

Thin Capitalization and Interest Deductibility

Thailand has no thin capitalization rules. However, a minimum debt-to-equity ratio may apply for companies registered under the Board of Investment schemes (3-1 ratio) and the Foreign Business Act (7-1 ratio). Interest is generally deductible, provided the loan is used for business operations. The interest must be at a market rate.

Antiavoidance, CFC, and Transfer Pricing

Thailand has no CFC, general antiavoidance, or treaty-shopping rules. Thailand has yet to introduce tax avoidance rules in its domestic law, making it unlike many of its neighbors. China, Indonesia, Korea, Singapore, and Vietnam have adopted rules such as substance requirements for granting benefits under tax treaties, look-through provisions for lower-tier share sales, and other provisions intended to address abusive uses of tax treaties. On September 30, 2021, the Thai Revenue Department published a list of information that must be included in transfer pricing documentation when requested.[14]

Generally, the Thai transfer pricing rules follow the OECD guidelines. Taxpayers must provide transfer pricing documentation to the Revenue Department within 120 days of receiving a request (or 180 days if it is a first-time request).

Comments on Antiabuse Rules in Asia

Many Asian jurisdictions are taking stricter stances on tax avoidance and treaty abuse. For example, China, India, Indonesia, Japan, Korea, and Vietnam have domestic antiabuse or anti-treaty-shopping rules for dealing with structures that lack economic substance or in which the income receiver is not the *beneficial owner*. Four major developments in antiabuse rules are:

- Most jurisdictions in Asia have opted to implement the minimum standards as part of the OECD's BEPS action plan. Hong Kong, Malaysia, Singapore, and Thailand have all deposited their instruments of ratification for the OECD's Multilateral Convention to Implement Tax Treaty Related Measures to Prevent Base Erosion and Profit Shifting. BEPS action 6 introduces the principal purpose test under which tax treaty benefits can be denied if, considering all relevant facts and circumstances, it is reasonable to conclude that obtaining the treaty benefit was one of the principal purposes of an arrangement or transaction.[15]
- For financing structures, hybrid instruments have been mostly eliminated since the introduction of the OECD BEPS action plan.
- Substance has become a priority in structuring holding and financing activities in Asia. Accessing lower tax rates or exemptions under tax treaties is becoming more difficult because of domestic and treaty antiavoidance rules. Moreover, several jurisdictions, including Singapore

[12] *See* DFDL, "Thailand Tax Alert: Thai Government Announces New International Business Center ('IBC') Tax Incentive" (Jan. 8, 2019).

[13] Clause (d) of the 1997 protocol to the Mauritius-Thailand tax treaty provides that the withholding tax rates under the treaty must on par with the lowest rate provided for in any other tax treaty entered by Thailand.

[14] Thai Revenue Department, Notification of Director-General of Revenue Department (No. 407).

[15] OECD, "Action 6 on the Prevention of Tax Treaty Abuse" (last accessed Feb. 8, 2023).

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and Hong Kong, require evidence of a minimum level of substance before issuing a certificate of tax residency, which is required for claiming tax treaty benefits. Holding and financing structures that lack the appropriate substance will find it difficult to satisfy the various antiavoidance rules and tax residency requirements to access tax treaty benefits.

- The implementation of the OECD pillar 1 and 2 tax reform proposals will likely see commercial factors as the main drivers for structuring of holding and financing activities. As countries introduce minimum tax rates, multinational companies may shift to start managing tax risks on a CbC basis rather than entity-by-entity.

Concluding Remarks

While Singapore and Hong Kong have historically been two of Asia's most popular jurisdictions for holding and financing activities, Thailand and Malaysia are increasingly being seen as alternative locations that can offer benefits for multinational companies with operational substance in the country. These benefits include investment incentives, such as those around the establishment of regional headquarters schemes (Thailand's IBCs and Malaysia's principal hubs).

Many Asian jurisdictions are already taking stricter stances regarding tax avoidance and treaty benefits. China, India, Indonesia, Japan, Korea, and Vietnam, all have domestic antiabuse rules that can deny tax treaty benefits if holding or financing structures lack appropriate substance, or the income recipient is not the *beneficial owner*. It is not yet clear how Asian jurisdictions will apply these antiabuse rules or the principal purpose test to holding and financing structures.

As we move through the Asian century, commercial factors are expected to play an important role when structuring holding and financing activities. Given the proliferation of domestic and treaty antiabuse rules, the challenge for companies doing business in Asia will be weighing the most beneficial holding and financing jurisdiction when setting up a structure against developments and future trends that may provide greater long-term benefits. ■

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