PRACTITIONERS' CORNER

Tax-Savvy Investing in ASEAN Nations

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This discussion is not intended as legal advice and cannot be relied upon for any purpose without the services of a qualified professional.

Taxes are always important to investment mechanics, especially in the international realm. This article examines tax planning for U.S. investors in emerging ASEAN economies.

Investors may venture into foreign lands to explore acquisitions or investments hoping for stellar returns. The legal and cultural difficulties may make structuring a deal daunting. In general, everything will be far less established and regulated than Americans are accustomed to seeing. For some investors, the tax impact may be an afterthought.

The Association of Southeastern Asian Nations (ASEAN) is comprised of Brunei, Cambodia, Indonesia, Laos, Malaysia, Myanmar, the Philippines, Singapore, Thailand, and Vietnam. To avoid unpleasant tax surprises, investors should plan structures carefully. The tax regimes in these emerging economies are changing. There can also be vast local differences between different parts of a single country.

Even administratively, there may be marked inconsistencies by the tax authorities across borders and within the borders of a single country. For all of these reasons, investors should understand the tax environment they will face. They should also understand how the overall tax picture may change over time, and its impact on their investments.

Tax Treaty Considerations

Tax treaties often play a critical role in cross-border transactions. Investors want to maximize profits in a tax-efficient manner without leaving too much cash trapped in the jurisdictions where the investments are located. Thus, investors should understand the tax implications for profit repatriation and potential future capital gain on the investment.

Some of the typical checklist issues to consider include:

- whether paying dividends (or other profit repatriation measures) will attract withholding tax in the host jurisdiction (that is, the jurisdiction of the entity that is making the payments);
- whether the receipt of foreign dividends or other foreign-source income by the investor will be subject to tax in the investor's home jurisdiction;
- whether mechanisms can be put in place to minimize the effect of double taxation; and
- the capital gains tax impact on a future divestment.

With all of these concerns, investors should analyze applicable tax treaties to determine whether taxes can be minimized. If the investor is a U.S. resident, he should see whether the U.S. has concluded a tax treaty with the host jurisdiction. Without a tax treaty, the taxes in the host jurisdiction and the investor's jurisdiction may result in double taxation on any profits.

> *Example:* A U.S. company invests in Indonesia. Upon earning profits, the Indonesian entity distributes dividends. The withholding tax rate for dividends to a nonresident of Indonesia is 20 percent. Thus, if the dividend payment is $100, the Indonesian entity must withhold $20 and send $80 to the U.S. investor. Upon receipt of the net $80 in dividends, the investor must also pay U.S. tax.

Fortunately, under the U.S. tax treaty with Indonesia, the maximum withholding tax rate for dividends is 15 percent. As a result, Indonesia's 20 percent withholding tax is reduced to 15 percent.[1]

If the U.S. investor sells its shares in the Indonesian entity, the gain (if any) would be taxed at Indonesia's 25 percent ordinary income rate. However, the Indonesia-U.S. tax treaty exempts the U.S. investor from paying tax on capital gains in Indonesia. The result is that only the U.S. may impose tax on the gain.[2]

Most tax treaties contain clauses providing relief from double taxation. In general, if the U.S. imposes tax on the same income that was subject to tax in the foreign jurisdiction, a tax credit is generally permitted to provide relief from double taxation.[3] A list of U.S. tax treaties in effect is available at http://www.irs.gov/Businesses/International-Businesses/United-States-Income-Tax-Treaties—-A-to-Z.

Administrative Hurdles

Many jurisdictions in Asia with U.S. tax treaties do not provide benefits automatically. Indonesia, for example, requires foreign investors to complete relevant forms and detailed questionnaires and to submit them to the Indonesian tax authorities.

Vietnam requires notification to the tax authorities that the foreign investor is claiming entitlement under a tax treaty. Moreover, the investor must obtain a tax residency certificate from tax authorities in the investor's home jurisdiction. In some countries, there are timing constraints, too, with treaty benefits conceivably being lost because the foreign investor is not timely in making requisite treaty benefits claims.

An investor can risk being denied treaty benefits if any significant procedural matter is ignored. In addition, some jurisdictions have antiavoidance rules that may give tax authorities discretion to deny treaty benefits if the authorities determine that the recipient is not the true beneficial owner of the payments. This latter danger can sometimes loom large with complex structures.

Direct or Indirect Holdings

There are many reasons a U.S. investor may decide not to hold an interest in a foreign company directly. The U.S. investor may want to employ an intermediary foreign entity. With emerging Asian economies, a typical intermediary company would be located in either Singapore or Hong Kong.

Both Singapore and Hong Kong offer tremendous tax benefits for offshore investments. For one thing, the receipt of foreign dividends by the investor generally does not trigger taxation (subject to certain conditions). Hong Kong notably provides that all foreign-source income is not subject to tax.

Another tax benefit is that neither Singapore nor Hong Kong has a capital gains tax. There are operational tax advantages, too. Corporate income tax rates in Singapore (17 percent) and Hong Kong (16.5 percent) are relatively low when compared with other developed jurisdictions. Both jurisdictions are stable, predictable, and easy to navigate.

Moreover, Singapore — and to a lesser extent Hong Kong — has concluded tax treaties with most emerging Asian economies. Many of Singapore's tax treaties include a favorable clause with respect to capital gains. Under a typical provision, only the state in which the transferor is a resident (that is, Singapore) is allowed to impose capital gains tax on the transaction.[4] This is significant because, as noted, Singapore does not impose any capital gains tax.[5]

> *Example:* A U.S. investor uses a Singapore intermediary to acquire a company in Vietnam. Under Vietnam's tax law, the payment of dividends by the Vietnamese entity to the Singapore intermediary is not subject to withholding tax in Vietnam. In addition, dividends received by the Singapore intermediary are not taxable in Singapore.

[1] *See* Convention for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with respect to Taxes on Income, Indonesia-U.S., article 11, July 11, 1988.

[2] *Id.*, article 14(2).

[3] *See* U.S. model income tax convention, article 23, Nov. 15, 2003.

[4] *See* Convention for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with respect to the Taxes on Income, Singapore-Thailand, article 13(3), Apr. 27, 1976; Agreement for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with respect to Taxes on Income, China-Singapore, article 13(6), July 11, 2007; Agreement for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with respect to Taxes on Income, Singapore-Vietnam, article 13(5), Mar. 2, 1994, amended by the second protocol, Sept. 12, 2012.

[5] *See* https://www.iras.gov.sg/IRASHome/Individuals/Locals/Working-Out-Your-Taxes/What-is-Taxable-What-is-Not/Gains-from-Sale-of-Property-Shares-and-Financial-Instruments; *see also* Singapore Income Tax Act, section 10(1) (imposing income tax on profits that are income in nature, not capital in nature).

What if the Singapore entity sells the investment in Vietnam at a gain? Normally, there would be a capital gains tax in Vietnam. However, the Singapore-Vietnam tax treaty permits only Singapore to tax the gains (as long as the Vietnamese company does not principally hold immovable property).[6] As a result, Vietnam is not allowed to impose *any* tax on the sales transaction, and Singapore does not have a capital gains tax.

Despite this impressive example, one should use caution with intermediary companies in Singapore, Hong Kong, and other countries. One should also consider the tax consequences under the U.S. controlled foreign corporation rules.[7] They would capture subpart F income of the intermediary company.

Of course, under U.S. law, there would generally be an immediate tax on the income in the U.S. With proper U.S. tax planning (such as check-the-box rules), the risks imposed by the CFC rules can often be mitigated. But one must plan ahead to avoid unpleasant surprises.

Another word of caution is that both Singapore and Hong Kong adhere to a general antiavoidance stance. Neither wants to be seen as a tax haven. An investor should not employ a mere conduit or shell company in Singapore or Hong Kong to take advantage of tax treaty benefits. The transaction and the entity should always have economic substance. Economic substance may include having operational activities, having employees, filing tax returns, having a physical office, and so forth.

BIT Considerations

Another consideration for U.S. investors is the investment protection of their interests in foreign jurisdictions. Such concerns are often palpable, particularly in an emerging market where the rule of law may not be consistently applied. Investment protection typically comes in the form of a bilateral investment treaty (BIT).

A BIT is meant to encourage investments between signatory countries and to protect the investment interests of the foreign investor. A BIT generally includes clauses relating to national treatment. A foreign investor must be treated fairly and in the same manner as a domestic investor. For example, article 3 of the U.S. model BIT provides that:

> 1. Each Party shall accord to investors of the other Party treatment no less favorable than that it accords, in like circumstances, to its own investors with respect to the establishment, acquisition, expansion, management, conduct, operation, and sale or other disposition of investments in its territory.
>
> 2. Each Party shall accord to covered investments treatment no less favorable than that it accords, in like circumstances, to investments in its territory of its own investors with respect to the establishment, acquisition, expansion, management, conduct, operation, and sale or other disposition of investments.[8]

A BIT also includes a clause limiting expropriation by the foreign government.[9] The U.S. has concluded BITs with many countries, though curiously very few are in Asia (a full list of BITs concluded by the U.S. is available at http://www.state.gov/e/eb/ifd/bit/117402.htm).

Thus, a U.S. investor that plans to invest directly into a region where no BIT has been concluded (for example, Southeast Asia) would not be guaranteed certain investment protection afforded under BITs to which the U.S. is a signatory.

Intermediary BIT Shopping

In some cases, one can invest through another entity in a jurisdiction that has concluded a BIT with the host country. An investor may consider the ASEAN Comprehensive Investment Agreement (ACIA).

The ACIA is a type of BIT among the ASEAN countries to protect foreign investments in industries such as manufacturing, agriculture, fishery, forestry, mining, and quarrying, as well as other types of investments to which the member states agree.[10] The ACIA includes clauses regarding national treatment[11] and expropriation[12] similar to the U.S. model BIT provisions.

Although taxation is not explicitly addressed in the ACIA, it may be applied indirectly. For example, the national treatment clause would require the foreign jurisdiction to treat domestic and foreign investors in

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[6] *See* Agreement for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with respect to Taxes on Income, Singapore-Vietnam, article 13, Mar. 2, 1994, amended by the second protocol, Sept. 12, 2012 (providing in part that):

> 4. Gains derived by a resident of a Contracting State from the alienation of shares, other than shares of a company quoted on a recognized stock exchange of one or both Contracting States, deriving more than 50 percent of their value directly or indirectly from immovable property situated in the other Contracting State may be taxed in that other State.
>
> 5. Gains from the alienation of any property other than that referred to in paragraphs 1, 2, 3 and 4 shall be taxable only in the State of which the alienator is a resident.

[7] IRC sections 951-964.

[8] 2012 U.S. model bilateral investment treaty, article 3.

[9] *Id.*, article 6(1).

[10] ASEAN Comprehensive Investment Agreement, article 3, Feb. 26, 2009.

[11] *Id.*, article 5.

[12] *Id.*, article 14.

the same manner. Arguably, that nondiscrimination would include application of the tax laws.

Domestic Tax Considerations

There is much talk today of prevailing corporate tax rates. To attract more foreign investment, many emerging markets in Asia have recently reduced their corporate income tax rates. Some of the emerging markets offer additional tax incentives in an effort to compete with more stable and developed Asian economies, such as Singapore and Hong Kong.

Thus, U.S. investors should not be focused solely on tax treaties and BITs. Understanding the domestic tax landscape is important, too. Different jurisdictions may have different tax incentives that could be attractive.

One notable incentive offered by some jurisdictions in Asia is the regional operating headquarters (ROH) incentive. Multinational corporations tend to focus their regional headquarters in Singapore or Hong Kong because of attractive tax benefits. These include low corporate income tax rates, no capital gains tax, and an exemption on foreign-source income.

There are changes occurring here, too. In an effort to remain competitive and to lure foreign companies to establish headquarters there, Thailand implemented a comprehensive ROH regime.[13] It offers tax incentives to foreign investors designed to make Thailand competitive with other regional hubs.

Malaysia has a comparable ROH regime referred to as the principal hub tax incentive regime. It provides tax incentives to companies using Malaysia as a base for conducting regional and global operations.[14]

Another incentive some jurisdictions offer is tax exemption for projects located in lesser-developed areas. For example, Vietnam has moved to encourage investments in rural and economically disadvantaged areas. The government provides attractive tax incentives for investors into such regions for a stated length of time.[15]

In Myanmar, economic development stalled for over six decades because of military dictatorships. However, the country has recently opened to foreign investment. Myanmar now offers tax incentives for new investments approved by the Myanmar Investment Commission.[16]

Cambodia may also be an attractive alternative as it provides tax incentives for projects that meet certain investment thresholds. Curiously though, the tax incentives are not available for investments on a so-called negative list. If an otherwise qualifying investment is covered by the proscribed negative list, then the project would not be qualified for the tax incentives regime.[17]

Good, Bad, or Ugly?

There are so many different tax incentives in the ASEAN region that the hopscotch can at times seem random. The changing patterns clearly prove the importance of understanding the local tax landscapes when investing there.

From a tax viewpoint, not all countries are created equal. Moreover, some jurisdictions may have larger international exposure than others. In addition, one jurisdiction may have specific incentives that are not available in neighboring countries.

Thailand

An ROH in Thailand is a type of corporate entity established to provide managerial, administrative, and technical support services to other affiliated companies operating in the region. The operations of an ROH are limited to:

- organizing administration and managing business planning;
- sourcing of raw materials, parts, and finished products;
- research and development activities;
- providing technical support;
- marketing and sales promotion;
- regional human resources training and development;
- business advisory services (such as financial management, marketing, accounting, and so forth);
- investment feasibility studies and economic and investment analysis; and
- credit management and control.

The following incentives are offered to an ROH:

- tax exemption on service income from related companies and branches of the ROH outside Thailand for 10 years;
- tax exemption on dividend income received from all related companies and branches of the ROH for 10 years;
- withholding tax exemption on payment of dividends to any related companies outside Thailand; and
- 15 percent flat tax rate on salaries paid to expatriate employees in Thailand for eight years and tax exemption on salaries paid to expatriate employees outside Thailand.

[13] *See* Royal Decree No. 405 (2001).

[14] *See* Malaysia 2015 budget.

[15] *See* Circular No. 78/2014/TT-BTC (2014), as amended and supplemented by Circular No. 96/2015/TT-BTC (2015).

[16] *See* Foreign Investment Law, Union Parliament Law No. 21 (2012).

[17] *See* Law on Taxation (1997, as amended in 2003); Sub-Decree No. 111 (2005).

Certain requirements must be met to benefit from these incentives. For example, the ROH must have an investment capital of at least THB 10 million (approximately $300,000). In addition, the ROH must provide services to at least one affiliate during its first and second years of operation.

There are also ongoing requirements. During its third and fourth years of operation, the ROH must provide services to at least two affiliates. Thereafter, in the fifth and subsequent years of operation, the ROH must provide services to at least three affiliates.

Malaysia

Malaysia provides tax incentives for principal hub companies. A principal hub company is defined as a locally incorporated company that uses Malaysia as a base for conducting its regional and global businesses and operations. The company's main activities are to manage, control, and support key functions, including management of risks, decision-making, strategic business activities, trading, finance, management, and human resources.

A company that has been approved by the Malaysian Investment Development Authority as a principal hub is eligible for a tax incentive rate of either 0 percent (tier 1), 5 percent (tier 2), or 10 percent (tier 3). The rate depends on which tier the company falls under based on the level of business spending, the number of high-value jobs created, the value-added functions, and the number of countries served.

The tax incentive rate is applicable for five years. However, this term may be extended for an additional five years if certain conditions regarding job commitment and business spending are satisfied. To be eligible for the principal hub tax incentive, the following conditions must be met:

- incorporation in Malaysia;
- paid-up capital of more than MYR 2.5 million (approximately $700,000);
- minimum annual business spending of MYR 3 million (approximately $850,000);
- minimum annual sales of MYR 300 million (approximately $85 million) (additional requirement for goods-based applicant companies);
- provisions to serve and control network companies in at least three countries outside of Malaysia;
- provisions for at least three qualifying services, one of which must be related to strategic services (that is, planning and development, corporate advisory, brand and intellectual property management, senior-level talent management);
- significant use of Malaysia's banking and financial services and other ancillary services and facilities (for example, trade and logistics services, legal and arbitration services, finance and treasury services); and
- employment and business spending requirements based on the applicable tier.

Vietnam

Vietnam encourages investors to fund projects located outside major urban areas. There is a decided focus on stimulating capital inflows and infrastructure in historically poor and rural areas. Tax incentives, including preferential income tax rates, tax exemption, and tax reduction, are available as shown in the table.

Other incentives are also available for projects in certain industries. These include agriculture, livestock, manufacturing, and the exploration of natural resources.

Myanmar

Myanmar is transitioning from a military dictatorship to a democracy. In an effort to encourage foreign investors, Myanmar passed the Foreign Investment Law

Tax Incentives in Vietnam

Types of Income	Preferential Tax Rate	Tax Exemption	50% Tax Reduction
Income from new investment projects located in areas facing extreme difficulties in socio-economic conditions	10% for 15 years from the year of generating income	4 years from the first year of generating profit	9 years following the tax exemption period
Income from new investment projects located in areas facing extreme difficulties in socio-economic conditions that engage in social sectors, such as education, vocational training, healthcare, culture, sports, and environment	10% for the entire project	4 years from the first year of generating profit	9 years following the tax exemption period
Income from new investment projects located in areas facing difficult socio-economic conditions	20% for 10 years from the year of generating income (to be reduced to 17% beginning 2016)	2 years from the first year of generating profit	4 years following the tax exemption period

in 2012. This law provides attractive incentives for foreign investors who receive approval from the Myanmar Investment Commission in connection with their projects.

Some of the tax benefits a foreign investor may enjoy under the Foreign Investment Law include:

- five years' exemption from corporate income tax;
- 50 percent income tax reduction for exports;
- exemption from income tax for profits reinvested in Myanmar within one year;
- import duty exemption on machinery, equipment, tools, and parts during the construction period;
- three years' import duty exemption on raw materials; and
- commercial tax exemption on products manufactured for exports.

The importance of Myanmar's Foreign Investment Law of 2012 cannot be overstated. Since its passage, Myanmar has seen an unprecedented level of foreign direct investment. Its GDP growth continues to surpass many of its neighboring countries. Myanmar is being viewed as the darling of ASEAN from a foreign investment perspective.

Cambodia

Cambodia provides tax incentives for qualified investment projects. In general, these are projects that reach a certain investment threshold (ranging from $200,000 to $2 million, depending on the type of project). But Cambodia excludes from these perks the types of projects listed on its own negative list.

Cambodia's negative list includes:

- commercial activities (import, export, wholesale, and retail);
- transportation activities, except the railway sector;
- restaurants and entertainment facilities;
- tourism services;
- casino and gaming activities;
- financial services;
- media;
- professional services;
- production of wood products;
- complex resorts, such as hotels, theme parks, and zoos;
- hotels below three-star grade; and
- real estate and warehouse facilities.

The tax incentives in Cambodia for a qualified investment project include income tax exemption for up to nine years. There is also an import duty exemption on certain machinery and equipment. Understandably, foreign investors may find this alluring.

Yet due to nuances in Cambodia's domestic tax law, payment of dividends by a qualified investment project would trigger taxation to the investor. Thus, careful tax planning is key to avoiding it. In addition, Cambodia has not concluded a tax treaty with any country.

There is usually a mixture of considerations, and benefits one may receive from one hand may be taken away by the other. Since the environment can change quickly, there is an inevitable focus on the timeline for an investment. There must be some recognition that in emerging economies and changing legal environments, things change.

Conclusion

Direct, indirect, wholly owned, or fractional joint venture? However and wherever one does it, dipping a toe into a foreign jurisdiction can be exciting. Even relatively small investments can yield significant profits for an investor.

Still, planning and local knowledge are key. If the investment is not carefully planned from a tax perspective, the consequences may be unimpressive, perhaps even disastrous. The very nature of cross-border transactions involves multiple sets of laws often laced together with tax and other treaties. Investors should consult savvy tax advisers and be wary of paths that appear to be too well worn.

Yet they should also be careful about going down paths that have never been trodden. And wherever possible, investors should make contingency and repatriation plans. Legal, political, and tax matters can change quickly, and being nimble pays dividends. If they observe these rules, investors can earn handsome returns on their investments in emerging economies. ◆