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WHY LABUAN, MALAYSIA? (from a US perspective)

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1. INTRODUCTION

This paper focuses on corporate tax residence and compares the advantages and disadvantages of using a base company in a country with an extensive double tax treaty network, such as Malaysia, in relation to investment from the US. It should be noted at the outset, that the first step of outbound investment from the US using a base company, will often be achieved through a tax haven, which invariably will not have a treaty with the US. The benefits of treaties is then apparent between the base company country of residence, and the country of the source of the income. The relevant treaty will not then be likely to be in the form of the US Model treaty, but rather, most likely, the OECD Model.

Whilst Malaysia does not have a double tax treaty with the US, this paper also discusses how a Malaysian company owned by non-US persons can carry out electronic commerce business with the US without a US tax liability. The US requirement of a limitation of benefits article in all its treaties, makes "treaty shopping" into the US very difficult.

Malaysia has an extensive double tax treaty network with 60 or so countries including China, India, Canada and other Commonwealth countries, ASEAN countries and many EU and Arab countries (Appendix A).

Double tax treaty countries have significant advantages including the following:-

(a) a residence tie breaking Article which deems dual resident companies to be a resident solely of the Contracting State in which its place of effective management is situated (or place of incorporation under the US Model). Without treaty protection, the company is at risk of being a tax resident, and therefore taxable in both, or numerous, States, whereas dual residence companies are protected from taxation in the other Contracting State.

(b) Provided the non-resident does not have a "permanent establishment" in the other Contracting State:

   (i) "business profits" sourced in the other Contracting State are protected from source country tax;
   (ii) Interest, dividends and royalties are subject to a reduced rate of withholding tax.

Dividends distributed from a double tax treaty country are sometimes exempt from tax in the hands of corporate shareholders in the Other Contracting State i.e. a "participation exemption" dependent on a minimum level of tax in the source country[1], which is more likely be accepted due to the existence of a treaty.

By way of contrast, income which is properly subject to tax in non-double tax treaty countries may also be taxable in high tax countries. The absence of a double tax treaty has the consequence that numerous tax laws are capable of applying without necessarily the benefit of any double tax treaty relief. Unilateral credits may be available in the country of residence, but may be inferior to treaty relief[2].

1.1 Investment into the U.S.

Non-resident companies for US purposes, are those that are not incorporated in the US.

The US has one governing tax law, being the Internal Revenue Code of 1986 (and the regulations thereto). It provides for a more classical system of taxation i.e. taxation of corporate income at the company level, and taxation of dividends in the hands of individual shareholders[3]. Companies and individuals are taxed on taxable income, but capital gains[4] and dividends derived by individuals are generally taxed at a maximum rate[5] of 15%. Capital gains made by a company are treated as ordinary income.

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[1] Belgium, Luxembourg, Netherlands

[2] usually because a treaty will ensure that the country with the right to tax the income will be deemed to be the source of the income, so that the country of residence will have to accept that the foreign tax was on foreign source income, whereas under the domestic law, the income might be regarded as sourced in the country of residence, and therefore not have to provide a tax credit

[3] Shareholders that are corporations are entitled to a deduction against the dividend; 70% if shareholding is less than 80%, and 100% if shareholding is 80% or more: s243(a)-(b)(2)(A)

[4] That is, those from a holding of more than one year, often curiously referred to as "long term" holdings. Short term gains are taxed as ordinary income: s1222(3).

[5] That the rate is significantly less than the top marginal rate for individuals represents some integration of corporate and shareholder taxation.

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The headline tax rate for large corporations is 35%. There is also an Alternative Minimum Tax[6] of 20%, although small companies may not be caught by it. Foreign companies with a US trade or business representing 25% or more of their total income become additionally liable to the Branch Profits Tax (BPT) on their US taxable income not re-invested in the business[7]. The BPT may not be payable by a non-resident trading company which is a resident of a country which has a double tax treaty with the US, which contains a non-discrimination article.

Although the top marginal tax rate for individuals is now 39.6%, there is a hangover from the days when it was over 70%, being a regime to limit the attraction of domestic incorporation for closely held companies deriving passive income[8].

Under the domestic law, a non-resident trading company will only have a liability to US income tax on its trading if it carries on a "trade or business" which is "effectively connected" with the US. The selling of goods into the US on a "considerable, continuous and regular" basis[9] would certainly be a "trade or business" but the question is whether the level of activity in the US makes it a US trade or business[10] (***Handfield v Commissioner*** 23 T.C. 633 (Tax Ct. 1955). The solicitation of orders, the inspection of merchandise, and the purchase and sale of merchandise in the US by Argentine resident individuals, was enough for the "trade or business" to be "effectively connected" with the US in ***US v Balanovski*** 236 F.2d 298 (2d Cir. 1956). If the "trade or business" is effected even through an independent agent in the US, this may still be "effectively connected" with the US: ***Lewenhaupt v Commissioner*** 20 T.C. 151 (Tax Ct. 1953). This is a lower threshold than a treaty "permanent establishment" (PE) in the US, where a dependent agent still has to have and exercise an authority to contract on a habitual basis to constitute a treaty PE[11].

Whereas the application of a treaty is very valuable for a non-resident investor into the US, due to the universal use of Limitation of Benefits Articles in US treaties, a treaty will not usually be available by "treaty shopping" to an ultimate owner in a country that does not have a treaty with the US e.g. Malaysia. For taxpayers from such countries, knowledge of the US domestic rules may still allow for business with the US without a US tax liability, especially via electronic commerce[12]. Whilst there is no case on e-commerce, the case of the Mexican

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[6] s55
[7] s884. Designed to equate to the dividend withholding tax that would have been paid had the US business been conducted through a domestic corporation, and a dividend paid.
[8] The "Personal Holding Company" regime levies a 15% additional tax on such companies unless they distribute their income: s541. It is usually avoided by electing partnership treatment under the "check-the-box" regulations: Reg 301.7701-2(b). What is interesting for present purposes is the categorisation of certain royalties and services income of such a company (s543(a)(4) & (7) respectively), which has a broad parallel in the subpart F provisions in relation to US controlled foreign corporations, discussed later. Even more widely held companies that don't distribute profits unnecessary for investment, and have a *purpose* of avoiding shareholder taxation, can be liable to an "accumulated earnings tax" under s531.
[9] *Lewellyn v Pittsburgh, B&L.E.R. Co* 222 F. 177, 185-6 (3rd Cir. 1915)
[10] Also see Rev. Rul. 73-158, 1973-1 Cum. Bull 337
[11] However, trading in securities or commodities for the foreign taxpayer's own account even though a dependent agent and even if the taxpayer has an office in the US is excluded from being a US trade or business, as long as the taxpayer is not a "dealer". Even a "dealer" will not have a trade of business in the US as long as the taxpayer trades through an independent agent, as long as the taxpayer does not have an office in the US: s865(b)(2)(A)(i) &(ii), & 864(b)(2)(C).
[12] For a full analysis of the topic generally, see Polito, Anthony P., "Trade or Business Within the United States as an Interpretive Problem Under the Internal Revenue Code: Five Propositions". Hastings Business Law Journal, Vol. 4, Spring 2008; Suffolk University Law School Research Paper No. 08-08. Available at SSRN: http://ssrn.com/abstract=1092155

broadcaster into the US is a close parallel: ***Commissioner v Piedras Negras Broadcasting Co*** 127 F. 2nd 260 (5th Cir. 1942).

Under the domestic law, income not "effectively connected" to a non-resident company's US PE may still be subject to withholding tax, but is reduced by treaties in US Model form (where it applies) as follows:

	Domestic rate	US Model Treaty rate
Business income[13]	35%	0% (if no PE)
Related Party Interest[14]	30%	0%
Portfolio Interest[15]	0%	unaffected by treaty
Bank Interest[16]	0%	unaffected by treaty
Rents[17]	30%	unaffected by treaty
Royalties[18]	30%	0%
Dividends[19]	30%	5 or 15%
Realty gains[20]	30%	unaffected by treaty
Other capital gains[21]	0%	unaffected by treaty

2. TAXATION OF LABUAN COMPANIES

The International Business and Financial Centre ("IBFC") Island of Labuan, a Federal Territory of Malaysia, is strategically located in the South China Sea close to the Kingdom of Brunei. It was proclaimed a Federal Territory of Malaysia in 1984 by the Prime Minister, who said Labuan would be developed not only as a tourist port but as an important Freeport

[13] If effectively connected to a US trade or business. Note that whilst inventory is "personal property" referred to in s865(a), s865(b) excludes income from the sale of inventory from the general source rule for "personal property".
[14] s871(a) interest is the first referred to of the "fixed or determinable annual periodical gains, profits or income" (FDAP income). Deductibility of which may be affected by "earning stripping" rules i.e. thin cap
[15] That is, unrelated party lender: s871(h)
[16] s871(i)(2)(A)
[17] US sourced if in relation to land in the US. For which there is an election to be treated as effectively connected and taxed on a net basis
[18] s871(a) does not refer specifically to "royalties" but in addition to interest, dividends, rents etc, refers to other FDAP income, and Reg 1.871-7(b) specifies FDAP income includes royalties
[19] US sourced if paid by a US domestic company except from an "80-20 company" (refer under heading "US interest source rule" below).
Under the US Model, 5% where the shareholding is 25% or more, and 15% otherwise
[20]US sourced if the land is in the US. Including stock in companies rich in US land: s897(c)(2), commonly referred to by the acronym of the Act which introduced the provisions "FIRPTA". Note there is an election for such income and gains to be treated as effectively connected to a US trade or business (s882(d)), and therefore taxed on a net basis.
[21] Other capital gains taxed only in the country of residence (s865(a)), except for sales of intangible property where the consideration is dependent on use, in which case the source is the place of use, and sales of goodwill are treated as sourced in the country in which such goodwill was generated: s865(d). For most purposes US residence of an individual includes a citizen, and a person lawfully admitted to permanent residence: s7701(b). However, where a US citizen or resident alien has their tax home outside the US (330 or more days out of the US in a US tax year: s911(d)), their residence for determining source of income is their tax home: Reg 1.911-2(b) & s162(a)(2).

in ASEAN. The domestic law of Labuan remains the law of Sabah, the State of Malaysia situated in Borneo of which it formed part.

The Island of Labuan is an established IBFC and Freeport by laws passed by the Malaysian Parliament since 1990 and as such, offers unparalleled advantages as a trading, investment, asset protection and/or e-commerce centre.

The Offshore Companies Act, 1990 provides for the incorporation of Labuan Offshore Companies ("LOC's"), which are required to have a registered office in Labuan, at least one resident director and a resident secretary. Unless exempted, Labuan offshore companies may only trade with non-residents of Malaysia or with other Labuan companies, and in a currency other than Malaysian ringgit[22].

The Labuan Offshore Business Activity Tax Act, 1990 ("LOBATA"), taxes offshore trading activities (excluding shipping and petroleum activities) carried on by an offshore company[23] at the rate of 3% on its audited offshore trading profits or, upon election, at a fixed rate of MR20,000 (Approximately US$5,250).

Offshore non-trading activity relating to investments in securities, stock, shares, deposits and immovable properties is not chargeable to tax on LOC's.

The Director General of Inland Revenue may require a person to furnish information for the purposes of LOBATA but such information under current legislation, shall be regarded as confidential, and shall not be communicated or disclosed to any person except for the purpose of the Act only. However, under pressure from the OECD and G20 forums, in April 2009 Malaysia agreed to amend its law to comply with new international standards of transparency[24].

The Income Tax Act, 1967 (Malaysia) provides an election for income derived by an offshore company from its offshore business activity to be taxable in Malaysia under either the Income Tax Act, 1967 or LOBATA.

Interest, royalties and management fees paid by an offshore company to a non-resident or another offshore company are not subject to withholding tax. An offshore company is not subject to stamp duty under the Stamp Duty Act, 1949. There is no Malaysian tax on dividends paid by a Labuan company in respect of dividends distributed out of income derived from offshore business activities or income exempt from income tax[25].

Labuan has excellent internet, IT, cable and telecommunications infrastructure. The local presence of many of the world's leading banks' offshore offices, as well as leading insurance and international accounting firms, means that issues pertaining to accounts, taxation and money movements can be securely arranged in cooperation with the client's preferred international financial institutions.

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[22] The Offshore Companies (Amendment) Act 2009 when Gazetted, will allow LOCs to transact business with a resident in a currency other than ringgit, provided that the Authority is notified within 10 working days.

[23] or foreign companies registering under the Labuan Offshore Companies Act 1990

[24] The Labuan Financial Services and Securities Act 2009, when it is Gazetted, amongst others Act, will re-enact most elements of the Offshore Banking Act 1990, but without s22 which dealt with bank secrecy.

[25] Income Tax (Exemption)(No 22) Order 2007

3. FRAMEWORK OF INTERNATIONAL TAXATION

3.1 Double Tax Agreements

Whilst each country has its own rulings concerning the taxation of international business, there are a number of "norms". These "norms" are also reflected in the various model double tax agreements. Those are the OECD model conventions (1963, 1977, 1992 and 2005), the UN model, the US model, the Andean model, and the ASEAN model.

Taxation treaties seek to achieve their purpose of avoiding double taxation by allocating the right to tax various types of income (and in some cases capital gain) to the country of residence only, or partly to the country of source with residual taxation to the country of residence. A country by its taxation treaties, limits its right to tax certain sources of income in the hands of the resident of the other country with which it has entered into the taxation treaty.

The UN model retains more taxing rights to the source country, whereas the US model favors the country of residence. The OECD model is in between.

3.2 Elimination of Double Tax

Where both countries' domestic law subjects the income to tax it is necessary to prescribe a method for relieving double taxation in the taxation treaty. The US's taxation treaties provide a credit basis for the relief of double taxation to be applied by the US and, in the other country, relief variously by credit and sometimes by deduction.

The "method for elimination of double taxation" article of Malaysian and the UK treaties generally provides that a resident shall be entitled to a credit for treaty country tax paid in accordance with the treaty, whether directly or by deduction, in respect of income derived by that person from sources in the treaty country.

3.3 DTA "Tie Breaker"

Many DTAs contain "tie breaker" provisions in Article 4 where a person (including a company) is a dual resident.

3.3.1 Malaysia/UK DTA

In the case of a company, Article 4(4) provides that the person –

> "*shall be deemed to be a resident solely of the Contracting State in which its place of effective management is situated*".

The same provision appears in the Malaysia/Australia DTA. After the decision in ***Smallwood v Revenue and Customs*** [2009] EWHC 777 (Ch) (08 April 2009), it is likely that "effective management" will continue to be equated with "central management & control".

3.3.2 Malaysia/India DTA

The equivalent provision of the Malaysia/India DTA provides:

"*shall be deemed to be a resident of the State in which its place of effective management is situate. If the State in which its place of effective management is situated cannot be determined, then the competent authorities of the Contacting States shall settle the issue by mutual agreement.*"
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3.3.3 Malaysia/China DTA

The equivalent provision of the Malaysia/China DTA provides:

"*shall be deemed to be a resident of the State in which its place of effective management is situate. However, if such a person has place of effective management in a Contacting State and a head office in the other Contacting State, the competent authorities of the Contacting States shall by mutual agreement determine the State of which the person in question is a resident.*"

3.4 Exclusion of LOC's taxed under LOBATA from Treaty Benefits

Generally Malaysia's double tax treaties do not exclude Labuan offshore companies from status as Malaysian residents for the purposes of those agreements. At present, of 60 or so Malaysian double tax treaties, only ten exclude LOC's carrying on offshore trading business subject to LOBATA. The ten do not include China, India and Canada.

Accordingly, Labuan companies are extremely useful for doing treaty protected business. It should also be noted that Malaysia's treaties do not contain "mutual assistance" provisions requiring Malaysia to enforce tax judgments obtained in treaty countries[26].

Since 1997, several of Malaysia's double tax treaty partners have moved to exclude entities taxed under LOBATA, from the benefit of those treaties: Australia, UK, Japan, Netherlands, Sweden, Norway, Finland, Indonesia, South Korea and Luxembourg.

LOBATA entities were not generally subject to the Malaysian Income Tax Act 1967 on their "offshore" income until an election was announced in the September 2007 Malaysian Budget.

This treaty exclusion only generally affected in-bound investment into those source countries, that is, to prevent access by the LOBATA entity to the exemption from source country tax on business profits derived without a PE in the source country, and to prevent access to reduced rates of withholding tax on dividends, interest, and royalties from the source country.

The exclusion was usually achieved by Protocols to the relevant treaties, specifying that by exchange of diplomatic notes, tax privileged entities could be identified, and thereby excluded from the benefit of the treaty. For instance, on 28 July, 2002 Malaysia and Australia signed a Second Protocol to their DTA.

Amongst other things, the 2002 Protocol denies Labuan offshore companies, with effect from 1 July, 2003, the benefit of protection from Australian tax on income sourced in Australia. The denial of protection by the double tax treaty means the Labuan company would become assessable in Australia on its Australian "business profits" even though it does not have a

[26] as is required between EU countries

"permanent establishment" in Australia, and denial of the lower rates of withholding tax on Australian unfranked dividends, interest and royalties provided by the treaty.

However, none of Malaysia's double tax treaties (including under the Second Protocol with Australia) exclude all residents of the territory of Labuan (corporate or otherwise) from status as Malaysian residents for the purposes of those agreements.

A response by clients affected by such exclusions was for the LOC to form an ordinary Malaysian subsidiary, though which to earn income sourced in treaty countries with the exclusion: the so-called "Malay satay".

This was possible as ordinary Malaysian companies are not taxed on foreign source income, even if remitted into Malaysia (other than companies carrying on a business of banking, insurance, shipping or air transport), and an exclusion from tax applies to dividends paid by the ordinary Malaysian company to its shareholders[27].

The downside is that ordinary Malaysian companies are subject to Malaysian exchange control, whereas LOBATA entities are not.

The September, 2007 Malaysian Budget announced that LOBATA entities would be entitled to irrevocably elect to become subject to the Income Tax Act 1967. This has now been legislated for[28], effective from 1 January, 2009. As the treaty exclusions were cast generally to catch entities benefiting from LOBATA, the LOC's which make the election should no longer be excluded from the benefit of the relevant treaties, and as they derive only foreign source income, will be no worse off as they won't pay Malaysian tax on that foreign source income. Nor will they become subject to Malaysian exchange control.

4. RESIDENCE

The determination of residence of taxpayers is fundamental to the concept of relief of double taxation pursuant to a treaty. The "residence" article generally defines "persons" as a resident of either treaty partner. "Person" is defined in the majority of treaties in the "general definitions" article as, "includes individual, a company and any other body of persons".

The "residence" article normally provides that a "person" who is a resident in one country for the purposes of the tax law of that country will be a resident of that country.

The test of residence for companies often depends upon the place of management of the company and/or the place of incorporation of the company.

Whilst clearly the place of incorporation of a company provides certainty for corporate taxpayers it has been described as arbitrary and unrelated to economic reality. However, the concept of placement of management or control as a test for residence of companies has been described as almost as susceptible to manipulation as the place of incorporation test. Most countries that use the place of management as a test of residence for companies consider central management to be located at the head office or corporate seat, for example, France, Germany and Japan, or in the place where the directors usually meet, for example, Canada and the United Kingdom. Only in exceptional circumstances will a foreign subsidiary

[27] ¶ 28 Sch 6 ITA 1967
[28] s3A LOBATA, s3B ITA 1967

corporation be considered to have its place of management or control in the country where its controlling shareholders reside.

The cases dealing with "central management and control" in the United Kingdom referred to below demonstrate the importance of the board of directors of the foreign subsidiary carrying out their duties properly in order that the foreign subsidiary be treated as a resident of the country where the board meets. Professor Arnold has said:

> *"If the foreign corporation is properly organised and its affairs are conducted by its own properly constituted board of directors, even though they simply act in accordance with the instructions of the controlling shareholder, corporation will be treated as a non-resident corporation. In effect, the place of management test is largely formal; it looks to de juri control of the foreign corporation. Consequently, the test can be easily avoided and is not effective in dealing with tax haven abuse.*
>
> *"Moreover, even if the place of management test is applied to treat every tax haven corporation as resident where its controlling shareholders are resident, there are serious difficulties in enforcing any domestic tax against the tax haven corporation. Assuming, as is quite likely, that the tax haven corporation does not have any assets within domestic jurisdiction, it will be necessary for the domestic tax authorities to collect the tax from the controlling shareholders".*

It is an international "norm" that the fact that a company resident in a particular country has a subsidiary in another country will not of itself make the subsidiary a permanent establishment of the parent company, in the country of residence of the subsidiary. See article 5(7) of the OECD model (1997), for example, which was adopted as articles 5(7) of the Malaysia/Australia, Malaysia/China, Malaysia/Canada, and article 5(8) of the Malaysia/India double tax agreements.

The classic general law central management and control test, which until 1988 was the sole test of company residence in the United Kingdom[29], was set out in the speech of Lord Loreburn in ***De Beers Consolidated Mines Ltd v Howe*** [1906] AC 455. Also see ***Unit Construction Co Ltd v. Bullock*** [1959] 3 All ER 831.

As can be seen from ***Swedish Central Railway Co v. Thompson*** [1925] AC 495, the central management and control of a company can be shared between two countries, such that the company can under the test, be a dual resident.

More recently, both ***Untelrab Ltd v McGregor (Inspector of Taxes)*** [1996] STC(SCD) 1 and ***R v Dimsey; R v Allen*** [2000] QB 744 referred to below, highlight the need to be fastidious in ensuring that the majority of the board of a Malaysia company is resident in Malaysia, and do in fact meet for the purpose of considering resolutions, rather than that an individual, for example, in the UK, whether a director or not, conduct the Malaysian company's board level decisions, on their own.

Malaysia determines corporate residence solely on the basis of "central management and control".

The United Kingdom and Australia are examples (there are many), of countries which now determine corporate tax residence on the alternative bases of:

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[29] see SP 1/90

(a) place of incorporation; or
(b) place of central management and control.

In contrast, the United States simply looks to the place of incorporation[30]. However, as we are focusing on investment from Malaysia to source countries other than the US, it is the residence of the "base" company which is relevant, in this case, Malaysia, and in this regard, the UK law will be highly persuasive.

In ***Wood v Holden (HMIT)*** [2006] EWCA Civ 26, the principle was confirmed, that the place where a board of directors exercises its duties (properly), will be the place of its "central management and control" (in that case, The Netherlands), even where the controlling shareholders, or advisers recommend, or even expect the board to reach certain decisions, and those persons are elsewhere (UK). After reviewing the authorities such as the Australian High Court decision in ***Esquire Nominees Ltd v FC of T*** (1973) 129 CLR 177, Lord Justice Chadwick, with whom the other two members of the court, so held.

The High Court of Australia in *Esquire Nominees* held that a company incorporated on Norfolk Island (then part of Australia but then only taxable on income sourced from the mainland), and all of whose board resided on Norfolk Island, indeed had its central management and control on Norfolk Island, notwithstanding the resolutions for board meetings were prepared in Melbourne by the ultimate shareholders' accountants. This was on the basis that the board meet to consider such resolutions, and it would not have passed them, had they been illegal, or not in the best interests of the company.

In *Untelrab*, the United Kingdom Inland Revenue asserted that the company incorporated in Jersey, with two Bermudian resident directors, and one director resident in Jersey, was nonetheless resident in the UK, where the parent company was resident. The Special Commissioners held that the company was resident in Bermuda and applied *Esquire Nominees*. What is interesting about the case is the depth of analysis of the evidence of the activities of the company over a six year period, including cross examination of the offshore directors.

The Inland Revenue had more success in criminal proceedings in *R v Dimsey*; *R v Allen* where the defendants unsuccessfully appealed their gaol sentences for "conspiracy to cheat the public revenue" and "cheating the public revenue" respectively.

The central allegation in those cases was that companies incorporated in Jersey and other havens, and of which Mr Dimsey was a Jersey resident director, were in fact centrally managed and controlled in the UK, such that the companies were liable to UK corporations tax. The evidence accepted by the jury was that Mr Dimsey's client in the UK (Mr Allen), who was not an actual director, was a shadow director, and was in fact actually managing and controlling the companies in respect of board level decisions. The result for the companies was that they were resident in the UK rather than Jersey.

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[30] However, if a Malaysian company is a CFC for US purposes, and its central management and control is exercised in the US, if US persons become involved in day-to-day management, it is more likely to have a fixed place of business in the US, such that its foreign source income may be "effectively connected", to a US "trade or business", and therefore taxed in the US: refer Reg 1.864-7(c).

The established principles were recently applied in UK Tribunal decision in ***Laerstate BV v Revenue & Customs*** [2009] UKFTT 209 (TC) (11 August 2009), where a Dutch company was found to be a tax resident of the UK. Again, the case demonstrated the detailed enquiry into the decision making process of directors (and for a period, a "shadow" director). *Esquire Nominees* was again referred to with approval. A somewhat more detailed emphasis was on whether the director who did now own the company had sufficient information before him to be able to make an informed decision.

The most relevant principles to be gleaned from the authorities are:-

(a) Effective management should be where the board of directors regularly meets to decide the policy, conduct and manage the strategic ("high level") decisions necessary for the business, and that each of them have sufficient information for that purpose; and

(b) A majority of the board should be residents of the jurisdiction the company is to be resident of.

The Australian Taxation Office has issued a tax ruling TR2004/15 which confirms these principles, and in addition, confirms (at ¶ 50) that if an Australian resident director participates by telephone or electronically, in a majority foreign board meeting overseas, the fact that the Australian resident is in Australia at the time does not upset the outcome[31].

5. SOURCE OF INCOME

There is a "source of income" article appearing in most of the Malaysia's taxation treaties. Most of those articles provide that income derived by a resident of one country which is permitted to be taxed in the other country in accordance with the taxation treaty, is deemed for all purposes of the treaty to be income arising from sources in the other country. This empowers each country to exercise taxing rights allocated to it by the treaty. Almost all treaties specify this to be the case for the purposes of providing tax credits, which ensures double taxation relief as intended.

Taxation treaties which do not contain a "source of income" article, other than one which is only for the purposes of the "relief from double taxation" article, invariably have limited source rules for particular types of income.

In contrast to the international norms concerning residence, there is more variation concerning what is regarded as domestic source income by various countries. Generally, for businesses carried on within a country, the income from the business will be considered to be domestic source income. Similarly, income from sources located within a country, such as real estate, is usually taxed as domestic source income. Whilst few countries have sophisticated source rules, the United States is a major exception. Often, questions concerning the source of income are resolved by tax treaties. For example, under most tax treaties, income is allocated to a taxpayer's foreign permanent establishment on the principle that it is treated as a separate entity dealing at arm's length with the taxpayer.

[31] This is in contrast to the commentators on the UK position, who now all caution against a UK resident director participating other than physically.

In relation to the domestic source of income generally, for the Common Law countries, the Privy Council on appeal from the Hong Kong Court of Appeal in ***Commissioner of Inland Revenue v. Hang Seng Bank Limited*** [1991] 1 A.C. 306 at 322 said :

> *"But the question whether the gross profit resulting from a particular transaction arose in or derived from one place or another is always in the last analysis a question of fact depending on the nature of the transaction. It is impossible to lay down precise rules of law by which the answer to that question is to be determined. The broad guiding principle, attested by many authorities is that one looks to see what the taxpayer has done to earn the profit in question. If he has rendered a service or engaged in an activity such as the manufacture of goods, the profit will have arisen or derived from the place where the service was rendered or the profit making activity carried on. But if the profit was earned by the exploitation of property assets as by letting property, lending money or dealing in commodities or securities by buying and reselling at a profit, the profit will have arisen in or derived from the place where the property was let, the money was lent or the contracts of purchase and sale were effected."* (per Lord Bridge) (underlining added)

That case concerned whether for Hong Kong tax purposes, profits from dealing in certificates of deposit were derived in Hong Kong, but the principles are equally applicable to whether a trade is carried on in the UK[32], or Australia[33].

Whilst we are not considering the base company in Malaysia investing into the US, it is still important to briefly compare the US source rules with the Anglo-Australian-Malaysian source rules, so that activities which could be in some way related to the ultimate US owners activities in the US, are not sourced in the US, or whilst foreign sourced, become effectively connected with a fixed base in the US of the CFC: see for example, ***InverWorld Inc v Commissioner*** T.C. Memo 1996-301 (US Tax Ct. 1996). This is important firstly, to avoid direct US taxation on that income, and secondly to ensure a foreign tax credit will be available for any foreign tax paid on the income in question, if it becomes taxable in the US on repatriation as a dividend, or on subpart F attribution.

3.4 Source of Trading Income

Anglo trading income source rule

In Anglo-Australian jurisprudence the source of income from the sale of trading stock by a simple merchant is the place where the contract of sale was entered into.[34] The source of income where the taxpayer's business involves a range of activities, such as extraction, manufacture/processing and sale is apportioned between the places at which the various activities are carried out.[35] For example, that part of the trade which is manufacturing is carried on where the manufacturing takes place[36].

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[32] See *Yates v GCA International Ltd* [1992] STC 723 at 729; source of profit on the sale of shares can be complicated: see *Australian Machinery and Investment Co Ltd v DCT* (1946) 8 ATD 81

[33] In Australia, the question of source has been referred to as “a practical, hard matter of fact”: *Nathan v FC of T* (1918) 25 CLR 183; *Thorpe Nominees Pty Ltd v FC of T* (1988) 19 ATR 1834. It should be noted that subsequent Hong Kong cases have said they were applying the *Hang Seng* case, but first strayed from the “transactions” test to a broader “operations” test, and by 2007, reverted to back to “transactions”: see *ING Baring Securities (Hong Kong) Limited v CIR* (2007) HKRC ¶ 90-195.

[34] *Grainger & Son v Gough* [1896] AC 325; *Lovell & Christmas Ltd v C of T* [1908] AC 46; *C of T (WA) v D & W Murray Ltd* (1929) 42 CLR 332

[35] *C of T v Meeks* (1915) 19 CLR 568; *C of T v Kirk* [1900] AC 588

[36] *Firestone Tyre and Rubber Co Ltd v Llewellin* (1957) 37 TC 111

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For UK purposes, two forms of activity do not amount to trading in the UK, and the position in Australia should be no different:

(a) Purchasing goods or services in the UK for use in the business abroad[37];
(b) Representative offices, sales promotion, or after-sale services provided the contracts of sale and other trading activities are make or carried on abroad[38].

An intending purchaser may inspect sample goods in, for example, the Australian warehouse of an agent for an overseas manufacturer. However, if the purchaser then orders goods from the overseas manufacturer the place of the contract of sale is where the manufacturer posts a letter of acceptance: for an exposition of the rules which determine where a contract is made see the judgment of Denning LJ in ***Entores Ltd v Miles Far Eastern Corporation*** [1955] 2 QB 327 at 332-4.

The precise mechanism which brings a contract into existence may be significant. Sending a catalogue from overseas to potential buyers, for example, in Australia is not a legal offer, it is an invitation to treat: ***Granger & Son v. Gough*** [1896] AC 325. As a result, an order from a purchaser is an offer and the contract will be made where the acceptance is received. In *Entores Ltd v. Miles Far Eastern Corporation* Denning LJ stated that where the offeror and the offeree are located in different countries and communication is not by post, but telephone, telegram, telex or some instantaneous means of communication, acceptance will only be effective when it is received – not at the moment of transmission – "and the contract is made at the place where the acceptance is received".

The decision in *Entores v Miles Far Eastern Corporation* was applied by the New South Wales Supreme Court in ***Mendelson-Zeller Co Inc v T & C Providores Ltd*** [1981] 1 NSWLR 366.

For a general overview of income source considerations in electronic commerce, see Gary D. Sprague and Michael P. Boyle, "Taxation of income derived from electronic commerce", General Report – in 2001 IFA Cahiers, Vol. A, pp 21-63. Also see OECD discussion draft, "Are the current treaty rules for taxing business profits appropriate for e-commerce?" (26 Nov 2003), which concluded that unless evidence emerged that the existing rules weren't working, they should be left alone. For a more Australian specific discussion, see Bill Cannon, "A Practical Look at E-Commerce & Source Rules", 4th World Tax Conference, Sydney 25-27 February, 2004.

For Australian purposes, the Electronic Transactions Act 1999 (C'wth) provides that if the parties to the contract agree that the contract is accepted in a particular place (s 14(5)), that will bind the parties for the purposes of Australian federal law e.g. Australian income tax. This particular provision of the Electronic Transactions Act follows the UNCITRAL Model Law on Electronic Commerce 1996 Art 14(5), which has been adopted in many countries, including China, Malaysia[39], and many US States and Canadian Provinces.

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[37] *Sulley v A-G* (1860) 2 TC 149

[38] *Greenwood v FL Smidth & Co* (1922) 8 TC 193 HL. However, where the contract is entered into in the UK with UK persons, to perform services outside the UK, the trade will still be carried on in the UK: *Erichsen v Las*t [1881] 8 QBD 414 at 418 (concerning contacts to transmit telegraphic messages from the UK, and comparing contracts entered into in the UK to carry persons from a UK port abroad).

[39] s23 Electronic Commerce Act 2006

The observation has been made that the significance of the *Entores v Miles Far East Corporation* and *Mendelson-Zeller Co Inc v T & C Providores Ltd* cases is limited to determining the source of income where the place of the contract is the most important factor in determining the source. However, the place of entry into of the contract is always a factor in determining source, even though its significance may depend upon other factors.

The “common law” source rules in any particular country may be modified by statute. For instance, in Australia, under the domestic law the source of income from the sale of goods was dependent upon goods being sold in Australia, or where any person in Australia was instrumental in bringing about the sale of goods to an Australian resident party: ss38-43 ITAA 1936 repealed in September, 2006. These specific rules were considered effectively inoperative due to the over-arching discretion to determine source under the anti-transfer pricing provisions of Div 13 ITAA 1936 (specifically s136AE(7)).

Notwithstanding the domestic source rules, a relevant double taxation agreement precludes the source country from subjecting the vendor of the goods to source country taxation unless the vendor has a “permanent establishment” in the source country with which the income is “effectively connected”.

<u>US trading income source rule</u>

In relation to inventory, the source rule depends on whether the inventory is purchased or manufactured.

The source of income from the sale of purchased inventory is where the sale takes place, which for US purposes, is where the title passes[40], not where the contract is entered into. So a purchase outside the US and its sale within the US is US source gross income[41], and a purchase within the US and its sale outside the US is foreign source gross income[42].

The source of income from the sale of manufactured inventory is allocated between the place of manufacture and the place of sale[43]. By regulation, the gross income is apportioned 50/50 between production activities and sales activities[44]. Where the production activities are entirely within the US or entirely outside the US, the source of the production activities is the location of the production assets[45]. The source of the sales activity is as for purchased inventory[46].

Accordingly, a foreign company selling goods into the US without an agent in the US, nor office or other fixed place of business in the US, should not have US source income from the sale of goods provided title passes outside the US. If title must pass in the US, the use of a foreign website to effect sale of the goods to US parties should assist avoiding the income being effectively connected with a US trade or business[47].

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[40] Reg 1.861-7(c)
[41] s861(a)(6)
[42] s862(a)(6)
[43] s863(b)
[44] Unless an election is made to use the Independent Factory Price (IFP) method, based on sales to wholly independent distributors
[45] Reg 1.863-3(c)(1)
[46] Reg 1.863-3(c)(2)
[47] Refer Polito *op cit*

3.5 Source of services income

Anglo service income source rule

The source of services income derived by a company will take into account:

1. where the work is performed[48];

2. where the contract to perform the work is negotiated and executed; and

3. where payment is made[49].

Were the work is performed, is often the most important factor in determining source of services income.

However, consultancy source income may not be where the work is performed, if the work can largely, be performed anywhere[50], at least in cases where it is the provision of, for example, a written legal report, accounting statement, or architectural drawings, which is what the client ultimately pays for. In those cases, the place of entry into of the contact will be perhaps, more important in determining source.

US service income source rule

The Code expressly refers to "personal services" and specifies that services performed in the US have a US source, but with a $3,000 *de minimus* exemption for certain non-resident alien individuals[51]. Apportionment is required where the services are performed partly within and partly without the US[52]. Reg 1.861-4(b)(1) makes it clear that where a company provides the services of its employee, it is where the employees perform the services that is relevant[53], and that the payroll of the relevant employees performing services in particular countries compared to the total payroll, may provide a basis for apportionment. Where services are provided without any attendance in the US, it appears that none of the income would have a US source[54]. Where the contract is negotiated and executed, or where payment is made, are not relevant[55].

3.6 Source of interest

Anglo interest source rule

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[48] *IRC v Brackett* [1986] STC 521 at 540, [1986] 60 TC 124 at 149; *C of T (NSW) v Cam & Sons Ltd* (1936) 4 ATD 32 at 34; *FC of T v French* (1957) 98 CLR 398; *FC of T v Efstathaskis* (1979) 9 ATR 867

[49] *Evans v FC of T* 81 ATC 4512

[50] *FC of T v Mitchum* (1965) 113 CLR 401; (1965) 9 AITR 559

[51] The threshold hasn't changed since 1954, and so is now almost meaningless. The individual must be present in the US for less than 90 days during a taxable year, and the payor is not entitled to a US tax deduction: s861(a)(3)

[52] s863(b)(1)

[53] Also see *Bank of America v United States* 680 F.2d 142 (Ct Cl. 1982) re "negotiation commissions"; *Commissioner v Hawaiian Philippine Co* 100 F. 2d 988 (9th Cir. 1939)

[54] *Cook v United States* 599 F. 2d 400 (Ct. Cl. 1979), which dealt with the source issue, but also confirmed that the delivery of the non-resident artist's work into the US was regarded as "earned income" for the purposes of s911, rather than the sale of goods

[55] As to the sometimes difficult difference between services and royalties, see *Karrer v United States* 152 F. Supp. 66 (Ct. Cl. 1957); *Boulez v Commissioner* 83 T.C. 584 (US Tax Ct. 1984)

HMRC in the UK, having considered the so-called "Greek" case (***National Bank of Greece v Westminster Bank Executor and Trustee Co (Channnel Islands) Ltd*** (1970) 46 TC 472, conclude that four factors must all be considered[56] to decide the source of interest income, none of which alone will be decisive:

(a) The residence of the debtor;
(b) the source from which the interest is paid;
(c) where the interest is paid; and
(d) the nature and location of any security.

In Australia, the place where the loan contract was entered into, and the place where the funds where advanced were considered important in concluding that the source of the interest was the Cook Islands in ***FC of T v Spotless Services Ltd*** 95 ATC 4775 (Full Federal Court – that issue was not appealed to the High Court).

US interest source rule

Interest is US sourced if paid by:

(i) a US domestic payor[57] except from
- a foreign branch of a US bank;
- an 80-20 company[58]

(ii) a foreign payor if paid by a US branch[59].

3.7 Source of royalties

Anglo royalties source rule

In the UK, the place of registration, or the forum for protection of the rights, determines source. In ***Curtis Brown Ltd (as agents for Stella Brown) v Jarvis*** (1929) 14 TC 744 the source of the copyright royalty was held to be the UK, as that is where the literary work "subsisted", even though the authors lived and worked abroad.

In relation to know-how, the High Court of Australia has held that royalties were sourced in the USA were the contract to supply the know-how had been entered into and the know-how was to be used: ***FC of T v United Aircraft Corporation*** (1943) 68 CLR 525.

US royalties source rule

Royalties have a US source if use of the property in the US[60]. Whilst this could create a "cascading royalty" problem where IP is licensed and sub-licensed, the Court in ***SDI Netherlands NV v Commissioner*** 107 T.C. 161 (US Tax Ct.1996) found that the royalties

[56] Tax Bulletin 9 (1993)
[57] s861(a)(1)
[58] Being a domestic company which has more than 80% of its gross income from foreign sources. However, if the interest is paid to a related person, then that part of the interest that relates to the US source income of the 80-20 company is US source interest: s861(c)(2). The 80-20 company may be abolished under Obama proposals
[59] s884(f)
[60] s861(a)(4). *CIR v Wodehouse* 337 US 369 (1949), confirmed that an agreement for use inside and outside the US that does not specify the fee split will not be capable of apportionment

paid by a Netherlands sub-licensor of IP from a Bermudan licensor related to royalties received by the Netherlands company from the US, was not US source income.

If property is created for a customer, in which a copyright subsists, then the consideration for the work and the vesting of the copyright, will be for services. If ownership of the property in which copyright subsists remains with the creator, but a party is licensed to make copies and distribution them to the public, the consideration would be a royalty[61]. However, where an article such as a music CD is for the use only of the purchaser, the consideration is for "goods"[62]. The same result as for the sale of a music CD should follow for own use copyrighted material downloaded from the internet.

6. PERMANENT ESTABLISHMENTS

The "business profits" article of most Double Tax Treaties provide that the business profits of a resident of one treaty country are taxable only in that country unless it carries on business in the other country through a permanent establishment. Under these circumstances, the profits of the enterprise which are "attributable" or "effectively connected" to the permanent establishment may be subject to tax in the treaty country in which the permanent establishment is located. The subject of attribution of profits to permanent establishments was comprehensively dealt with in IFA Cahiers Vol 91b (2006). It should be noted that it is also the subject of revised draft commentary to Article 7 of the OECD model treaty (2007).

Where a treaty country in which the permanent establishment exists subjects the permanent establishment's profits to tax, the country of residence of the enterprise is required to avoid double taxation by providing a credit against its tax payable or an exemption from tax on the permanent establishment's profits.

The term "permanent establishment" is defined in the "permanent establishment" article as a fixed place of business through which the business of an enterprise is wholly or partly carried on. The OECD commentary suggests that the concept requires a specific geographical place with some degree of permanence (even though it may have existed only for a short time e.g. because of investment failure). The concept of "permanent establishment" is of crucial importance for determining the taxation liability of an enterprise of one contracting state in the other contracting state. The concept was considered in Australia in ***Unysis Ltd v FC of T*** (2002) 51 ATR 386, under the US/Australia treaty[63]. Recently, it was considered by the Supreme Court of India in ***DIT (International Taxation) v Morgan Stanley & Co Inc*** [2007] 292 ITR 416 (SC), under the US/India treaty.

The OECD model definition of PE is similar to the US model, and also the Malaysian model[64]. However, as the format of the "permanent establishment" article of taxation treaties is subject to significant variations, at least with developing countries, where the UN model is influential[65], it is necessary to examine each particular taxation treaty carefully in this regard.

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[61] Reg 1.861-18(c)(2)
[62] See Reg 1.861(1)(c)(ii) dealing with "shrink-wrap" computer software. The same result should follow re music CDs. In Australia, this is the case: see TR93/12 ¶ 32-34.
[63] also see TR2001/11
[64] On the OECD definition, see generally, "Is there a permanent establishment?", IFA Cahiers Vol 94a (2009)
[65] The UN model, in addition to the familiar provisions from the OECD and US models, extends the concept of PE to services provided by personnel of an enterprise of the other contacting state where they are present for more than 6 months within any 12 month period, and has more elaborate agency principles.

The "permanent establishment" article in Malaysian model includes in the term; a place of management; a branch; an office; a factory; a workshop; a mine, an oil or gas well, a quarry or any other place of extraction of natural resources; a building site, a construction, assembly or installation project, or supervisory activities in connection therewith (but usually only where that site or project or those activities continue for a period or periods aggregating more than 183 days within any 12 month period).

The concept of "office" is always important. The office need not be exclusively for the use of the taxpayer, but must be available for its occupation[66], for example, a party regularly being found at a market[67], even if the stall that is occupied is not the same stall on each market day. If the taxpayer does not lease its own office in the country of incorporation, it will certainly have a registered office address at a trust company, lawyers or accountants offices, which will be where the directors hold their meetings, and transact the company's business in the country of incorporation. It is also where the company can be found in its country of incorporation by virtue of its "holding out" on stationary, advertising, and signage at that office[68].

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[66] Refer ¶ 4.1 OECD commentary on model DTA. The Canadian cases of *Sunbeam Corp. (Canada) Ltd v MNR* [1963] SCR 45, *Shanmoon v MNR* 75 DTC 275 (TRB), *Fiebert v MNR* 86 DTC 1017 (TCC), *American Income Life Insurance Company v The Queen* 2008 TCC 306, and *Knights of Columbus v The Queen* 2008 TCC 307, indicate that whether the space used in Canada by the non-resident can be a PE may depend on whether the space is paid for by the non-resident.
[67] Consistent with ¶ 4 OECD commentary reference to "pitch in a market place". This is certainly consistent with the Canadian Tax Court case of *Fowler v MNR* 90 DTC 1834. However, other Canadian authority might be regarded as contradictory e.g. *Toronto Blue Jays Baseball Club v Minister of Finance (Ontario)* 2005 DTC 5360 (Ont.CA). The UK case of *Dunlop Pneumatic Tyre Company, Limited v Actien-Gesellschaft Für Motor Und Motorfahrzeugbau Vorm. Cudell & Co* [1902] 1 KB 342 on presence in the jurisdiction for service (at a place of business of the company in the UK), where the employee of the defendant was at an exhibition for only nine days, also supports the OECD reference. However, the OECD commentary on Art 5 at ¶ 42.6 inserted in 2003 clarifies that human activity is unimportant if it is not actually necessary for the business, perhaps following the landmark German pipeline decision (BFH, 20 Oct 1996, II R 12/92, BStBl II 1997). Also see 26.1 re pipelines & cables, and ¶ 10.9 re vending & gaming machines operated by the owner in the other country .

[68] *Unisys Corporation v FC of T* [2002] NSWSC 1115 found that there was insufficient repetition of contractual activity for USI as the general partner of the UAL limited partnership, to constitute a PE in the US of UAL, as USI did not "habitually" enter into contracts on UAL's behalf (at ¶ 74). UAL only did business with one associated company. It did not seek business from anyone else. In the current case, the company will be seeking business from the world at large, and will record its location for that purpose. The "holding out" of the office as a place where the taxpayer can be found was important in the Canadian Board case of *Panther Oil & Grease Manufacturing Co of Canada Limited v MNR* 57 DTC 494 (ITAB), aff'd 61 DTC 1222 (Ex. Ct. Can.). There, the sales manager amongst other things, used a letterhead identifying his residence as the address of the employer company. The use of a letterhead alone will not be enough to constitute a PE: see the US tax case of *Consolidated Premium Iron Ores Ltd v Commissioner of Internal Revenue* 57 DTC 1146 at 1162 (TC US), aff'd 59 DTC 1112 (US 6th Cir). However, where there is some business activity combined with the holding out that the company can be found at a particular place, the UK cases on presence in the jurisdiction for service (at a place of business of the company in the UK), support the holding out as sufficient: *Re Oriel Limited* [1985] 3 All ER 216, *A/S Dampskib "Hercules" v Grand Trunk Pacific Railway Company* [1912] 1 KB 222, *South India Shipping Corporation Limited v Export- Import Bank of Korea* [1985] 1 WLR 585, *Lord Advocate v Huron & Erie Loan & Savings Company* [1911] SC 612. As to whether a Delaware company "carried on business in Australia" for the purpose of s21 of the Corporations Act 2001, the use of an Australian PO box, telephone and fax number were sufficient "holding out" in *Starport Futures Trading Corporation, Re* [2009] QSC 94 at ¶ 11, 12, 19. Whilst sales may take place on an internet site and so the company is not found at the physical address by most customers, suppliers to the company will seek it out at its registered office.

If a person other than an independent agent acts in one country on behalf of an enterprise of the other country, that person is likely to be a permanent establishment if he or she has and habitually exercises an authority to conclude contracts on behalf of his or her principal. Independent agents, being brokers, general commission agents or any other type of agent acting in the ordinary course of the business which the agent carries on, do not constitute a permanent establishment of the principal: ***Taisei Fire & Marine Ins Co Ltd v CIR*** 104 T.C. 535 (1995).

Importantly, the OECD model commentary at ¶ 42.10 says a foreign resident enterprise will not have a PE in the customer's country solely by virtue of making sales of trading stock through a website hosted by a customer country resident internet service provider[69]. The advice concerning the US is generally more cautious i.e. for the non-resident selling into the US to use a foreign server if possible.

The US also occasionally adopts a provision of the UN model in agreements with developing countries, being a "service PE", which includes where an individual is present in the other state for 183 days or more during a 12 month period and during the time present more than 50 % of the gross active business revenues of the enterprise consists of income derived from the services performed by the individual. That provision is also contained in the 5th protocol to US/Canada treaty signed in 2007 (and also in the Australia/New Zealand agreement signed in 2009).

7. HIGH TAX COUNTRIES' USE OF CFC LEGISLATION

A number of countries have a "territorial" system of taxation such that it is only income sourced in that country which is subject to tax there. Good examples in the Asia Pacific region are Malaysia and Hong Kong. Such countries are not concerned from a tax perspective about residents setting up offshore companies to derive foreign source income, as they don't tax such income anyway[70].

However, most countries tax residents on domestic and foreign source income, but non residents only on domestic source income, and so several high tax countries have complex rules designed to attribute to resident taxpayers, income derived by entities resident outside that country, but controlled by a resident. The rules are designed to prevent the deferral that would otherwise apply until the controlled entity paid a dividend to the resident. The controlled foreign corporation (CFC) and their related foreign investment fund[71] and

[69] The ATO accepts this position in TD2005/2. It is worth considering all the OECD commentary on electronic commerce in Art 5, at ¶ 42.1-42.10. The UK Inland Revenue by press release of 11 April 2000 specified that even a server in the UK will not of itself represent a UK PE. The US Technical Explanation on the 2006 US model article on PE doesn't say anything about the issue. It is worth noting that in the Australian case of *Gebo Investments (Labuan) Ltd v Signatory Investments Pty Ltd* [2005] NSWSC 544, the issue arose whether the use of a Malaysian server could allow a Labuan company to be regarded as "carrying on business in Australia" for the purpose of the Corporations Law. Interesting at ¶ 34, whether material was uploaded to the website from Australia, or queries to the website were dealt with from Australia were specified as questions on which there was no evidence, but which may have been relevant. In the context of the PE article of a treaty, as the OECD model commentary doesn't mention those issues, they should not be relevant to the question under the PE article of a treaty.

[70] Singapore taxes Singapore companies on foreign source income of remitted into Singapore, which has borne less than 15% foreign tax.

[71] FIFs in Australia, in the UK, the Overseas Funds regime in s756A ff ICTA 1988, in both countries being where the fund is not controlled, *contra* a CFC, but may or may not be trading. In the US the equivalent is a

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transferor[72] trust rules, are usually designed to attribute passive income, or income from transactions with associates ("tainted income"). Countries with CFC rules include USA, Canada, the UK, Germany, France, Sweden, Norway, Japan, Australia and New Zealand. For a general overview of the operation of such regimes, see Brian J Arnold and Patrick Dibout, "Limits on the Use of Low-Tax Regimes by Multinational Businesses: Current Measures and Emerging Treads", General Report – 2001 IFA Cahiers, vol.B, pp 21-89.

Concerned at existing US holding companies "inverting" their group into a group with a foreign holding company, in 2003 the US introduced provisions which go as far as deeming such foreign holding companies to be domestic companies[73].

7.1 Investment from the US

The CFC provisions of the US tax law are designed to deal with unacceptable deferral of US tax by US companies forming controlled "base" companies[74] in countries where the customers are not in that country, and not declaring dividends back to the US[75].

Control

Whether a foreign company is a CFC which can attribute income to a "US shareholder" or not generally depends on whether US shareholders directly or indirectly controls more than 50% voting or value in the foreign company[76].

A "US shareholder" is one with a least a 10% voting interest[77]. Accordingly, a foreign company will be a CFC for example, if 5 or fewer US shareholders control more than 50% of the voting.

It is worthy of note that the US CFC provisions deem a branch of a CFC in a third country to itself be a CFC, if the rate of tax paid by the branch is less than 90% of the tax rate paid in the country of residence of the CFC: s954(d)(2) & Reg 1.954-3(b)(1).

CFC Attribution

Non-US sourced business profits derived by a CFC (say, in Labuan, Malaysia) will generally only be potentially attributable to its US shareholders if the income derived by it is so-called

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Passive Foreign Investment Corporation (PFIC –s1297) which may or may not be controlled, but only covers funds with predominately passive income. [note business trusts are treated as companies in the US: *Morrissey* case 296 US 344 (1935); *Hynes v Commissioner* 74 TC 1266 (1980).

[72] In the US, like provisions are called the "Grantor Trust" rules: s679. In the UK, the "settlor interested trusts" regime in s619 ff ITTOIA 2005, and the "transfer of assets abroad" provisions in ss714-751 ITA 2007

[73] If 80% or more of stock of foreign holding company is owned by same persons who owned stock in US holding company: s7874

[74] Note "check-the-box" regulations have since 1997 allowed the likes of a Labuan company, not being a *per se* corporation, to elect to be treated as transparent for US purposes, which would defeat any tax deferral benefit. Whilst the "check-the-box" regulations have allowed much tax arbitrage, it goes beyond the scope of this paper to go into the opportunities.

[75] Except where the income of the CFC is subject to tax of at least 90% of the US rate: s954(b)(4)

[76] s957. Note that there a stricter rules in relation to insurance CFCs: s953(c)

[77] s951(c)

"subpart F income". For attribution, there is a *de minimus* where the subpart F income, is less than 5% of gross income of the CFC[78].

However, even if the CFC does not have any subpart F income, to avoid disguised dividends from the CFC, earning or profits of the CFC which are invested in US property are deemed to be subpart F income: s951(a)(1)(B) & s956.

Subpart F Income

Subpart F Income is constituted by two principal categories of income:

1. insurance income[79];
2. foreign base company income[80]

Foreign Base Company Income

Foreign Base Company Income consists of:

1. Foreign personal holding company income[81]
2. Foreign base company sales income[82];
3. Foreign base company services income[83];
4. Foreign base company oil related income;

Foreign personal holding company income

"Foreign personal holding company income" includes (i) dividends, interest, rents and royalties; (ii) net gains from the sale or exchange of property which gives rise to such income; & "personal services contract income";

Importantly, royalties will be "foreign personal holding company income" of a company except where the following conditions are satisfied[84]:

(a) the royalties are derived in the course of a business carried on by the company; and

(b) at the time the royalties were derived, the entity liable to pay the royalties was not a related person[85];

However, the regulations[86] are more specific about when the CFC will derive the royalties in the course of a business:

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[78] Or $1,000,000, which ever is the lesser: s954(b)(3)(A)
[79] s952(a)(1)
[80] s952(a)(2)
[81] s954(c)
[82] s954(d)
[83] s954(e)
[84] s954(c)(2)(A)
[85] However, there is an exemption where the related person and the use is in the same country as the payor: s954(c)(3). Further in 2006 a wider exemption was introduced, where the related person (which may be in a different country) themselves received royalties under a sub-licence which were not subpart F income, the CFC's receipt of royalties under the head-lease is deemed not to be subpart F income (so called "Look-Thru Rule"), although this may not be extended past its 2010 sunset: s954(c)(6).

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(i) the property was developed, created, or produced by the company, or if acquired, only if it has added substantial value to it, but only so long as the company is regularly engaged in the development, creation or production of, or the acquisition of and addition of substantial value to such property; or
(ii) the property licensed is a result of the performance of a marketing function by such licensor, through its own officers or staff located in the foreign country through an organization in that country that is substantial in relation to the amount of the royalties derived[87].

"Personal services contract income" arises where the CFC provides the services of its 25% or greater shareholder and the person paying for the services has the right to designate the individual who will perform the services[88].

Foreign base company sales income

"Foreign base company sales income" consists of income from property purchased from[89] or sold to a related person if the property is manufactured outside *and* sold for use outside the CFC's country of incorporation.

Foreign base company services income

"Foreign base company services income" consists of income derived from performing services outside the CFC's country of incorporation for or on behalf of a related person.

Branch of a CFC

Because branches of CFCs in a third country may be treated as themselves CFCs, dealings between the CFCs head office in one country, and the branch in another country, can give rise to subpart F income.[90].

Disclosure Regime

It should be noted that there are harsh penalties for failure to disclose ownership of a CFC, even if there is no attributable income[91].

7.2 Capital Gain On Disposal Of Labuan Company

"US shareholders" selling stock in the Labuan CFC will be subject to US tax on the sale, but the shareholders basis in the stock will be increased to the extent of the subpart F income not distributed to the shareholders[92].

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[86] Reg 1.954-2(d)(1)
[87] Reg 1.954-2(d)(2)(ii) specifies substantial marketing function by expenses being 25% or more of adjusted licensing profit.
[88] s954(c)(1)(H), so-called "rent-a-star" companies. There is a domestic parallel in s543(a)(7).
[89] Reg 1.954-3(a)(4)(iii). If raw material is purchased from a related party and processed by the CFC, then the property sold is not the same as purchased, so the income will not be FBCSI. Whether contract manufacturing qualifies as manufacturing by the CFC has given rise to great uncertainty: s954(d)(1).
[90] For a time the IRS even argued that an unrelated contact manufacturer could be a branch. After losing *Ashland* 95 T.C. 348 and *Vetco* 95 T.C 579 the IRS now concedes that a contract manufacturer cannot automatically be considered a branch for the purpose of s954(d)(2) -Rev. Rul. 97-48, 1997-2 C.B. 89.
[91] s6038(b) provides for a $10,000 p.a. penalty just for failure to file the required notice

Corporate shareholders pay tax on capital gains as ordinary income. Note that non-corporate shareholders who might otherwise have only paid only 15% on capital gains are deemed to receive that part of their gain that represents the CFCs earnings and profits as ordinary income: s1248

7.3 Thin Capitalization

The US "earnings stripping" rules are usually only applicable to inbound investment[93]. Rather than being a broad thin cap rule, they focus on limiting a deduction for interest where the interest expense is too high (more than half the cash available); the interest is paid to a related party (or an unrelated party but guaranteed by a related party); and withholding tax paid by the lender is not at 30% (usually due to a DTA), or the lender is a US tax exempt body. The rough rule of thumb is that a foreign company can only gear its US subsidiary at the ratio of 1.5:1 debt to equity[94].

Accordingly, the "earnings stripping" rules aren't generally applicable to a US owned domestic corporation's investment in a CFC as an "outbound investment", as local interest paid to a US bank will be fully taxable to the lender in the US.

There is no motivation to use any debt funding from the parent company's own money to a Labuan subsidiary, as it will only give a deduction in Labuan against a maximum 3% tax rate, but interest paid to the US parent will be taxed at 35%. However, it may pay to borrow from a US bank to subscribe for the share capital needed in the Labuan company.

The US also has complicated interest expense allocation rules which to date[95] have a mechanical operation to allocate interest paid by a domestic corporation, to deduct against foreign and domestic source income based on ratio of foreign to domestic asset cost bases[96], but not looking through stock in a foreign corporation to the corporation's underlying assets i.e. a "water's edge" approach[97]. This means that borrowing by the foreign subsidiary from a foreign bank is ignored in allocating interest paid by the US parent, usually disadvantaging such borrowings by the foreign subsidiary[98]. The reason is that the more foreign source income of the US parent (by larger foreign dividends due to no foreign borrowing in the subsidiary), the higher the potential foreign tax credit, and hence a lower US tax bill[99].

7.4 Transfer Pricing

The US transfer pricing rules (s482 and numerous regulations there under) as they related to trading don't feature largely in the current case, as the Labuan company won't be dealing with customers in the US, nor with associated parties. This assumes the employment of arm's

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[92] s961
[93] s163(j)
[94] These "earnings stripping" rules also apply to the US branch of a foreign corporation [reference, check]
[95] s864(e)
[96] Or by election, market values
[97] A common law approach is usually to trace the use of the borrowed funds e.g. to purchase a particular income producing asset.
[98] From 31 Dec 2010 s864(f) will allow an election to have regard to world-wide borrowings.
[99] Unlike countries with full imputation systems e.g. Australia, in the US there is no incentive to maximizing the amount of US tax as a proportion of world-wide tax.

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length personnel to staff the operation outside the US, and the foreign business has not previously been conducted by a US company[100].

If the tax haven company's business is partly effected by US personnel being employees of the company for the purpose of doing the company's business, whilst separately being employed by a US company that continues to carry on the US business, gives rise to some issues.

Clearly s482 will require them to be paid a market wage for what they do, which will be taxed to them in the US[101]. If they are not employed directly, the parent company in the US will have to make an arm's length charge for the provision of their services.

Clearly any staff so engaged will need to refer any board level issues back to the board, to ensure the central management and control of the company is in Malaysia.

The US resident employees should not transact business for the Labuan company from the US. On the basis that a US company is to do the US business, all the US source income should all be derived by the US company, and none by the Labuan company.

Some of the most difficult transfer pricing issues will relate to intellectual property[102].

8. DIVIDENDS FROM LABUAN

Unlike several EU countries[103], and even Australia, the US subjects to tax, all dividend from foreign companies, with a credit[104] for foreign withholding tax only, in the case of individuals and trusts. US companies owning a non-portfolio interest (10%) in foreign companies are also entitled to a proportionate credit for underlying foreign tax (the so-called "indirect tax credit"[105]).

That is, the use of a Labuan subsidiary in those circumstances[106], would only achieve tax deferral for as long as dividends are not paid to the US holding company, or the subsidiary's profits are invested in US property[107].

9. USE OF LABUAN COMPANIES

[100] Where there is a transfer of existing property from a US company to a foreign related company, s367(a) may deny the usual roll-over relief. It should be noted that the high tax countries general "push back" from the threat of globalisation resulting in the restructuring of business away from high tax countries, has intensified the interest in transfer pricing provisions as a tool to "claw back" lost revenue. For example, see OECD "Transfer Pricing Aspects of Business Restructurings Discussion Draft for Public Comment (Sept 2008)". It has also led to more difficult rules than traditionally applied (s877) about individuals ceasing to be US persons for tax reasons: s877A

[101] If such US person has their tax home outside the US, then only the payment referable to services performed in the US will be taxed in the US.

[102] Refer IFA Cahiers "Transfer pricing and intangibles" Vol 92a (2007).

[103] The Netherlands, Denmark, Belgium, Germany, Italy, Switzerland, Sweden. New Zealand is about to introduce a participation privilege. The UK is also moving to introduce a participation privilege, at least for large business

[104] s901

[105] s902

[106] Where there is no subpart F income

[107] s956

From the analysis above, it will become apparent that for US owned Labuan companies, to avoid attribution under the US CFC the income should not be passive income, or certain related party base company income.

To illustrate the diversity of uses of Labuan companies, we set out some over simplified examples, in each referring to the US client as “USco” and its offshore subsidiary company as “Offshoreco”. Clearly no two situation are alike, and are unlikely to be as simple as examples suggest. The examples should be read subject to the reservations expressed throughout the paper. In each case, USco:

- wants to keep the cost of doing offshore business down; preferably in English; in a country with a recognisable legal system; that is reasonably politically stable
- realises that a website will allow clients to find it, rather than the other way around
- wants to choose an international base that will allow it maximum flexibility for potential customers in many jurisdictions
- is prepared to employee at least one Malaysian resident individual to staff the operation

10.1 Trading in Goods

- USco is in the business of buying goods in or outside the US, and selling them in and outside the US
- USco is looking for more suppliers and customers
- USco accepts that sales in the US are probably best effected through USco, but wants to make sales outside the US though Offshoreco, to enhance its international reputation
- If Offshoreco is formed under the Labuan regime, if the source of its income will be from Offshoreco purchasing goods either in or outside the US from unrelated suppliers, and selling the goods to unrelated customers outside the US, none of that income will be attributed back to USco as the holding company under the CFC regime i.e. the income will not be “foreign base company sales income”

10.2 Manufacturer “Offshoring”

- USco is in the business of manufacturing goods in the US with raw material sourced in or outside the US, and selling the finished product in or outside the US
- USco is looking for more customers
- USco wants to engage an unrelated contract manufacturer in China, due to its significantly lower costs
- USco accepts that sales in the US are probably best effected through USco, but wants to make sales outside the US though Offshoreco, to enhance its international reputation
- If Offshoreco is formed under the Labuan regime, then as the source of its income will be from Offshoreco buying raw materials from unrelated suppliers and selling the goods to unrelated customers outside the US, none of that income will be attributed back to USco as the US holding company under the CFC regime i.e. the income will not be “foreign base company sales income”.

10.3 Provider of Services

10.3.1 Computer Services

- USco is in the computer services business
- So far, it has only done work for US resident clients
- USco is looking to do work for clients overseas at a lower cost that in the US

- If Offshoreco is formed under the Labuan regime, then as the source of its income will be from providing services to clients outside the US, none of that income will be attributed back to USco as the holding company under the CFC regime i.e. the income will not be “foreign base company services income”

10.3.2 Architectural Drafting

- USco is in the architectural drafting profession
- So far, it has only done work for US resident clients
- USco is looking to do work for clients overseas at a lower cost that in the US
- If Offshoreco is formed under the Labuan regime, then as the source of its income will be from providing services to clients outside the US, none of that income will be attributed back to USco as the holding company under the CFC regime i.e. the income will not be “foreign base company services income”

10.4 Royalties

10.4.1 Software Licensing

- USco is in the computer software writing business[108]
- USco is looking to license clients overseas
- USco wants to license its programs to overseas clients though an offshore company (Offshoreco), to enhance its international reputation, and to lower its costs
- If Offshoreco is formed under the Labuan regime, and writes new programs from there, then as the source of its income will be royalties from carrying on business with unrelated clients outside the US, none of that income will be attributed back to USco as the holding company under the CFC regime i.e. the income will not be “foreign personal holding company income”

10.4.2 Franchisor

- USco is in the business of creating franchise businesses[109]
- USco is looking to license clients overseas
- USco wants to license its franchises to overseas franchisees though an offshore company (Offshoreco), to enhance its international reputation and to lower its costs
- If Offshoreco is formed under the Labuan regime, and creates new franchise concepts from there, then as the source of its income will be royalties from carrying on business with unrelated clients outside the US, none of that income will be attributed back to USco as the holding company under the CFC regime i.e. the income will not be “foreign personal holding company income”

Each of the royalty examples is dependent on Offshoreco “carrying on a business” of dealing with the IP, which is a question of fact[110].

[108] Even is closely held, if the provisions of s543(d) are met, royalty income can escape “personal holding company” treatment, the most difficult hurdle being that deductions relating to software royalties must be 25% or more of gross ordinary income, excluding compensation for personal services of the five largest individual stockholders (each of whom hold at least 5% of the company’s stock) .

[109] Most likely trade mark royalties in the domestic business will be “personal holding company income” if the company is closely held, and only copyright royalties might escape such domestic treatment under s543(a)(4), the most difficult hurdle being that deductions relating to copyright royalties must be 25% or more of gross ordinary income, excluding compensation for personal services of individual stockholders.

[110] Refer to the Regs cited under heading “Foreign Personal Holding Company Income”

Also, each of the examples may involve transfer pricing issues which will need to be carefully considered. Perhaps the most important thing to note, is that whilst the OECD Transfer Pricing Guidelines specify that the arrangement must be arm's length when it is entered into, "without using hindsight" [111], the US "super royalty" regime (Reg 1.482.4(f)(2)(i)) is clearly out of step with the OECD, of which it is a member, and controversially requires periodic adjustment of royalties to reflect profitability from use of the IP.

10. COMPARISON WITH HONG KONG AND SINGAPORE

Hong Kong IRD Practice Note 21 (reviewed March, 1998) concerning the "Territorial Source Principle of Taxation" interprets "Hong Kong sourced profits" very broadly, so Hong Kong tax rates of currently 17.5% are increasing likely to apply. IRD Practice Note 21 at ¶ 29 says it will "'only be in rare cases that a taxpayer with a principal place of business in Hong Kong can earn profits which are not chargeable to profits tax under s14' (TVBI)". In order to prove that the profits from trading in goods bought and sold outside Hong Kong does ***not*** have a source in Hong Kong, the Hong Kong company must prove that substantial activity of the company was effected outside Hong Kong, thereby putting the Hong Kong company at greater risk of being taxable on its profits in the high tax jurisdictions in which it makes sales: see ***CIR v HK-TVB International Limited*** (1992) 1 HKRC ¶ 90-064, ***CIR v Euro Tech Far East Ltd*** (1995) 1 HKRC ¶ 90-076 and Board of Review cases ***D28/86 and D47/93 (Case D24)*** (1994) 1 HKRC ¶ 80-274); but compare ***CIR v Magna Industrial Co Ltd*** [1996] HKCA 542 and ***ING Baring Securities (Hong Kong) Limited v CIR*** (2007) HKRC ¶ 90-195.

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Singapore's ordinary company tax rate is currently 18%, and the ability to get a special 10% tax rate requires Ministerial approval, which usually requires an expensive office set up with employment of high wage staff. As Singapore companies are taxable on income accruing in or derived from Singapore (and foreign source income remitted into Singapore, which has not borne at least 15% foreign tax), the difficulties described above for companies trading in goods through Hong Kong, also arise in Singapore[112].

The Hong Kong tax problems which arose in cases such as *HK-TVB*, *Euro Tech* and D28/86 and D47/93 do not arise in Labuan, where the 3% tax rate (or flat tax of RM20,000 (US$5,250)) encourages Labuan offshore companies to be taxable on their trading activities "carried on in or from Labuan … with non-residents". Thus, there is greater flexibility in relation to trading in goods, thereby reducing the risk of assessment to Offshoreco in the high tax jurisdictions with which Offshoreco trades.

12. General Anti-Avoidance Doctrines

In order to examine the question of the potential application of any of the US judicial anti-avoidance doctrines it is necessary to have some factual background. Assume the following:

- USco prefers to set up the offshore company in the south-east Asian region. Accordingly, the area under consideration spans, China, South Korea, Japan, Hong Kong, Thailand, Vietnam, Malaysia, The Phillipines, Singapore, India & Indonesia

[111] ¶ 6.32, although the ability to re-negotiate may be part of the arm's length bargain, see ¶ 6.34.
[112] *TTT Pte Ltd v Comptroller of Income Tax* [1995] 2 MSTC 5189

- USco wants to keep the costs of its offshore company down
- USco prefers to set up in a country with a British Common Law background as this is the legal system it understands
- USco prefers to deal with staff and customers, to the extent possible, in English
- USco prefers as stable as possible political climate
- USco wishes to incur the least possible overseas taxes on its world-wide income. This requires as low a possible offshore tax rate and an extensive network of double tax agreements to minimise source country tax

Discussion

- Based on these considerations, it narrows its choice down to three jurisdictions, Hong Kong, Singapore & Malaysia[113]
- The cost of doing business in Hong Kong is high
- Whilst Hong Kong has no tax on foreign source income, as its only has a few double tax treaties[114], most third country source income tax may be payable in those non DTA countries for sales made by Offshoreco if it was resident in Hong Kong.
- The cost of doing business in Singapore is nearly as high as Hong Kong, but Singapore has an extensive list of double tax treaties. However, its ordinary company tax rate is currently 17%, and the ability to get a special 10% tax rate requires Ministerial approval, which usually requires an expensive office set up with employment of high wage staff.
- Labuan, Malaysia has excellent telecommunications including Broadband internet, a modern airport serviced by several 737 jet flights per day, extensive port facilities, and cheap but reliable mail and courier services.

These facts provide both the subjective and objective purpose of the choice to use a Labuan company to transact the overseas business.

The sham transaction doctrine is that the transactions, while actually being effected, for instance, to generate a loss, there is no loss for tax purposes as the taxpayer's risk was taken away by another transaction, which was part of the same deal i.e. the loss was not really incurred: ***Yosha v Commissioner*** 861 F. 2d 494 (7th Cir. 1988).

The business purpose test is a subjective inquiry into the motives of the taxpayer, that is, whether the taxpayer intended the transaction to serve some useful nontax purpose: ***Helvering v Gregory*** 69 F. 2d 809 (2d Cir. 1934), aff'd 293 US 465 (1935); ***Rice's Toyota World*** 752 F. 2d at 89; ***ACM Partnership v Commissioner*** 157 F. 3d 231 (3rd Cir. 1998).

The economic substance doctrine is interrelated with the business purpose test and the sham transaction doctrine, and was described by the Tax Court:

> "The tax law … requires that the intended transactions have economic substance separate and distinct from economic benefit achieved solely by tax reduction. The doctrine of economic substance becomes applicable, and a judicial remedy is

[113] Traditionally, investment into India has often been structured using the India / Mauritius DTA, but there is now significant political pressure to change that DTA, especially since the recent protocol to the India / Singapore DTA. Mauritius sitting out in the Indian Ocean, is not as convenient an all purpose base company location compared to the three jurisdictions chosen, for the reasons identified.

[114] It has a DTA with China, but using a Hong Kong company to do business in China without a PE is invariably going to make the Hong Kong company subject to Profits Tax in HK on the Chinese profits.

> warranted, where a taxpayer seeks to claim tax benefits, unintended by Congress, by means of transactions that serve no economic purpose other than tax savings": *ACM Partnership v Commissioner* 73 T.C.M. 2189, 2215, aff'd in part and rev'd in part 157 F 3d 231 (3rd Cir. 1998)

The concept of substance over form doctrine is that the tax results of an arrangement are better determined based on the underlying substance rather than an evaluation of the mere formal steps by which the arrangement was undertaken: ***Minnesota Tea Co v Helvering*** 302 US 609, 613 (1938); ***Coltec Industries Inc v United States*** 454 F. 3d 1340 (Fed.Cir. 2006). However, where the Code is very formalistic to attract a particular benefit, the doctrine may be inappropriate.

An extension of the substance over form doctrine, is the step transaction doctrine, which "treats a series of formally separate 'steps' as a single transaction if such steps are in substance integrated, interdependent, and focused towards a particular result": ***Penrod v Commissioner*** 88 T.C. 1415, 1428 (1987); also see ***Del Commercial Properties Inc v Commissioner*** 251 F. 3d 210 (D.C. Cir. 2001).

Provided the reasons for the use of the Labuan company are substantiated, and sufficient substance is present in its operations, the general judicial anti-avoidance doctrines should not be relevant.

DISCLAIMER

This paper does not constitute advice. It should not be relied on as such. Persons wishing to explore these opportunities further should seek professional advice.

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Appendix A - Treaties have also been initialled with Brunei, Oman, Qatar, and Yemen. *Shipping & Air profits only treaty. +excludes Labuan Offshore companies taxed under LOBATA. # net yet effective

MALAYSIAN DOUBLE TAX AGREEMENTS

Albania	Indonesia+	Romania
Argentina*	Ireland	Russia
Australia+	Italy	Saudi Arabia Seychelles
Austria Bahrain	Japan+	Singapore South Africa South Korea+ Spain
Bangladesh	Jordan Kazakhstan#	Sri Lanka Sudan
Belgium Bosnia& Herzegovina#	Kyrgyztan Kuwait Lebanon Luxembourg+	Sweden+
Canada Chile #	Malta	Switzerland Syria
China Croatia	Mauritius	Thailand
Czech Republic	Mongolia Morocco	Turkey
Denmark	Myanmar #	United Arab Emirates
Egypt	Namibia	United Kingdom+
Fiji	Netherlands+	United States of America*
Finland+	New Zealand	Uzbekistan Venezuela #
France	Norway+	Vietnam
Germany	Pakistan	Zimbabwe #
Hungary	PapuaNew Guinea	
India	Philippines	
Iran #	Poland	