

# Derivatives: International Tax Handbook

## Introduction

In 1996, KPMG International conducted a survey of the taxation of derivatives in 25 countries. The survey focussed on the key features of each regime and highlighted territorial differences and similarities.

Now, some 12 years later, we have updated the survey in the form of this more broad ranging publication *Derivatives: International Tax Handbook*.

Covering 49 countries, this handbook contains commentary from KPMG member firms on corporate income tax, VAT, withholding taxes, and transfer tax issues for derivatives. For many jurisdictions, we have also included an example of a typical derivative transaction to try to further draw out the key principles in each regime.

What is clearly evident is that there is great variety in the tax treatment of derivatives around the world, and each jurisdiction has its idiosyncrasies. However, it is interesting to note that at a high level there are also a number of similarities across the different regimes. For example, many tax regimes have regard to factors such as:

- The nature of the taxpayer (e.g. trader versus non-trader)
- The type of derivative (e.g. option or swap)
- The purpose of entry into the derivative (e.g. hedging or speculation); and
- The accounting treatment of the derivative.

Most tax regimes also grapple with similar issues, including in relation to:

- Quantum of gain/loss (particularly with respect to foreign currency derivatives)
- Timing of income and expenses (e.g. cash/realisation basis or mark-to-market basis)
- Character (e.g. revenue versus capital); and
- Loss quarantining.

Some jurisdictions rely solely on general tax principles to deal with the taxation of derivatives, whilst other jurisdictions have enacted comprehensive legislation. In between these extremes are jurisdictions that rely on a mixture of general principles and special rules (based either in the legislation or on guidance issued by tax authorities). It seems that uncertain tax outcomes for derivatives are more likely to arise in jurisdictions that rely more heavily on general taxation principles, which perhaps struggle to keep pace with derivative innovation. In these cases, the attitude of the tax authorities and prevailing industry practice tend to play a greater role, and there may be divergent views on the correct tax position to adopt. Indeed, the tax outcomes in these jurisdictions may be a mere "accident of history", and there is potentially a greater risk of tax outcomes distorting the desired commercial objective.

Uncertainty of tax outcomes is often addressed by codification. In the jurisdictions that have introduced specific derivatives legislation, the tax code has tended to be heavily reliant on accounting principles. With the adoption of International Financial Report Standards, a move towards codification could ultimately also mean some level of convergence of the tax treatment of derivatives worldwide.

However, whilst global tax convergence for derivatives would be nice to see (in any area for that matter), it is, practically speaking, unlikely to occur in the foreseeable future. Thus, for the time being, taxpayers and advisers will need to continue to deal with the different derivatives taxation regimes of the world, and I trust this Handbook will be helpful in that task.

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KPMG's Global Banking Tax practice gives you access to our firms' professionals, they can be characterized by their entrepreneurial flair, commitment to national markets, and an understanding of the commercial and cultural differences between each country. The result is a focus on the issues that really matter.

Our banking tax professionals around the world advise banks, brokers, exchanges and other providers of financial services. From the biggest global players, down to niche domestic market participants KPMG member firms can advise on all aspects of taxation relevant to these institutions. Together, we work closely with our firms' accounting, regulatory and other advisory colleagues to provide practical advice tailored for the regulated environment in which KPMG member firms' clients operate. Our international network seeks to provide a truly international service to some of the most global businesses in the world.

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Information in this book is current to April 1, 2008.

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