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Taiwan: Proposed BEPS-related Tax Measures

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Proposed BEPS-related tax measures would cause both Taiwanese and foreign investors to re-evaluate their tax liabilities and subsequently rearrange their business structures in order to mitigate or avoid potential tax disadvantages.

I. Recent Developments

Anti-tax-avoidance has become an important issue among tax authorities in almost every jurisdiction, not least of all in Taiwan. The Ministry of Finance ("MoF") has formed various task forces to study the 15 action plans published by the OECD for the Base Erosion and Profit Shifting Project ("BEPS"). In line with the international tax regime and to mitigate tax avoidance, the MoF has adopted certain measures including amending tax regulations and developing new taxation platforms that are recommended by the OECD.

II. Incorporation of the CFC and PEM Rules

In early 2016, the MoF proposed amendments to the Income Tax Act to include two important international tax rules: the Controlled Foreign Corporation ("CFC") rule, and the Place of Effective Management ("PEM") rule (jointly, the "ITA Amendment"), and submitted the ITA Amendment for the Legislative Yuan's review and approval.

The Legislative Yuan completed the first of three readings of the ITA Amendment on June 8, 2016. In light of the offshore corporate tax avoidance trends exposed by the Panama Papers scandal, the last two readings of the ITA Amendment will likely be accelerated and completed by the end of 2016.

The key points of the ITA Amendment, including the background of the amendments, their impact on Taiwanese and non-Taiwanese investors/corporations, and the proposed effective date, are explained below.

A. CFC Rule

1. Background

Under Taiwan's current tax system, income received by Taiwanese corporations from their foreign subsidiaries is taxed when such income is repatriated to Taiwan in the form of dividends, which often results in corporations deferring repatriation of income generated by their foreign subsidiaries to Taiwan. To stop Taiwanese corporations from keeping their earnings in low-tax jurisdictions, the ITA Amendment incorporates the CFC rule into the ITA.

2. Key Points of CFC Rule

(a). Definition of CFC

Offshore subsidiaries that are (i) more than 50% owned (directly or indirectly) or controlled by Taiwanese corporations, and (ii) established in low-tax jurisdictions (jurisdictions where the corporate income tax rate is lower than 11.9% or taxes are levied only on domestic-source income) will be defined as CFCs of their Taiwan parent corporations.

(b). Safe Harbors Rule

The CFC Rule will not apply to the following CFCs:

(i) CFCs that have substantial overseas operations; and
(ii) CFCs that have earnings below a certain level (to be determined by the MoF).

(c). Taxation under CFC Rule

The Taiwan parent corporations should declare their pro rata share of their CFCs' taxable profits as their investment income in their annual tax returns.

(d). Avoidance of Double Taxation

After the adoption of the CFC rule, when the earnings of the offshore subsidiaries are distributed to the Taiwanese parent corporations in the form of dividends, such dividends will not subject to Taiwan income tax again. In other words, there will be no double taxation issue.

3. Impact of CFC Rule

The adoption of the CFC rule into Taiwan's tax laws ("ITA") should eliminate the deferral of taxation on earnings generated by the offshore subsidiaries of Taiwanese corporations and should encourage them to regularly distribute their retained earnings to the Taiwanese parent corporations in the form of dividends.

In light of the tax impact under the CFC rule, investors (whether Taiwanese or non-Taiwanese) whose current business structures involve Taiwanese corporations with offshore subsidiaries should re-evaluate the necessity of having subsidiaries located in low-tax jurisdictions, and may need to consider adjusting their corporate structures accordingly.

B. PEM Rule

1. Background

Under the current tax laws, offshore corporations are subject to Taiwan income tax only on their Taiwan-sourced income. As such, some investors established offshore companies in low-tax jurisdictions, yet have their primary business operations in Taiwan. In order to combat this tax-avoidance tactic, and to ensure that such offshore corporations are properly subject to Taiwan's tax system, the ITA Amendment incorporates the PEM rule into the ITA.

2. Key Points of PEM Rule

(a). Definition of PEM

PEM refers to the place where the substantive management and commercial decisions of the corporations are made. More specifically, corporations in the following situations will be deemed as having their PEM in Taiwan:

(i) corporations whose major business decision-makers are Taiwanese residents, whose head offices are located in Taiwan, or whose major business decisions are made in Taiwan;
(ii) corporations whose financial statements, accounting books, board resolutions, and/or shareholder resolutions are produced and/or stored in Taiwan; and
(iii) corporations whose main business operations are in Taiwan.

(b). Taxation under PEM Rule

Corporations incorporated in low-tax jurisdictions with their PEM in Taiwan will be regarded as Taiwanese corporations for income tax purposes. Such corporations will be taxed in accordance with the

Taiwan Income Tax Act and relevant tax regulations, making them subject to taxation on a worldwide income basis at the rate of 17%.

(c). PEM Rule supersedes CFC Rule

Offshore corporations with their PEM in Taiwan will be subject to the PEM rule instead of the CFC rule.

3. Impact of PEM Rule

The PEM rule should discourage Taiwanese corporations from forming subsidiaries in low-tax jurisdictions simply to avoid Taiwan income tax.

It is also worth noting that the PEM rule will likely have a favorable impact on the Taiwanese companies to which it applies since such companies may be entitled to benefits under the treaties that Taiwan has signed with other tax jurisdictions. For those investors (whether Taiwanese or non-Taiwanese) that formed an offshore subsidiary as a vehicle for doing business with China, once the Cross-straits Agreement between Taiwan and China takes effect (which is now pending the Legislative Yuan's approval), investors to which the PEM rule will apply will be able to enjoy the tax benefits under the Cross Strait Agreement. The Cross Strait Agreement provides more favorable benefits than other tax treaties that China has signed with other countries.

C. Effective Date of the CFC and PEM Rules

In order to give corporations time to make the necessary adjustments after the passage of the ITA Amendment, the lawmakers will likely authorize the Executive Yuan to determine the effective date of the ITA Amendment. The Executive Yuan confirmed that it will take the following factors into consideration before setting the effective date of the CFC and PEM rules:

(i) the effective date of the Cross-straits Agreement;
(ii) the implementation date of the OECD's Common Reporting Standards (CRS), formally referred to as the Standards for the Automatic Exchange of Financial Account Information in Tax Matters; and
(iii) the establishment of rules for the enforcement of the CFC and PEM rules.

According to the MoF, the ITA Amendment, once passed, would unlikely be enacted before 2018.

III. Amendments to Business Tax Laws

The MoF placed great emphasis on the OECD's Action Plan No. 1, "Addressing the Tax Challenges of the Digital Economy", and is in the process of amending its business tax laws. The MoF's amendments are expected to be in line with the OECD's suggestions on Action 1, i.e., requiring foreign e-commerce corporations engaging in business in Taiwan (selling goods or providing services to Taiwan customers) to register with Taiwan tax authorities. The amendments will likely be submitted to the Legislative Yuan for review and approval in September 2016.

Moreover, under current regulations, any import of goods with a value of under NT$3,000 (approx. $100) is exempt from business tax (also known as value added tax or VAT), which has caused many importers to subdivide the goods that they purchased from offshore vendors into small packages, so that the value of each package is under NT$3,000 and thus not subject to the 5% VAT. The MoF proposed amending the Customs Act to remove such VAT exemption for those who import goods (i) more than twice a month, or (ii) six times in six months ("Customs Amendment"). The Legislative Yuan completed its first reading of the Customs Amendment on June 22, 2016 and is expected to complete the second and third reading by the end of 2016.

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