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International Information for International Business



July 2017

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# Court Ruling in Taiwan—A Question of POEM



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Before the regulation concerning the place of effective management (“POEM”) in the Taiwanese Income Tax Act takes effect, the Taiwanese Supreme Administrative Court (“the SAC”) has adopted the concept of POEM in several judgments in the past few years. The SAC reaffirms its position in its judgment (Case No.: 106-Pan-Zi-94) on February 23, 2017 (“the Judgment”), as discussed below.

## **Facts**

A natural person (the “taxpayer”) developed and sold computer programs, known as “Alcohol 120%” (“the software”), on the “www.alcohol-soft.com” website (“the website”) which was managed by himself, and used the IP address “211.21.98.6” which was registered in the taxpayer’s name in Taiwan, to send e-mails to customers regarding the accomplishment of the transactions. In addition, to sell the software, the taxpayer set up a company named “Alcohol Soft” by way of a sole proprietorship in the British Virgin Islands (“the BVI company”), in which he was the sole shareholder and responsible person. Then, the tax-

payer, on behalf of the BVI company, opened an offshore banking unit (“OBU”) account in a Taiwanese bank.

## **Tax Authority’s Opinion**

As the taxpayer used the IP address registered in his name in Taiwan to complete the transactions, the tax authority was of the view that such sales of software amounted to business conducted in the territory of Taiwan. Furthermore, the tax authority ruled that the taxpayer set up the BVI company for the purpose of using its OBU account to receive remittances from foreign agents or sales representatives for the sale of the software.

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Accordingly, the tax authority regarded the taxpayer as a business entity that set up a fixed place of business (fixed IP) in Taiwan, but failed to apply for a business registration according to Taiwanese tax laws. Thus, the tax authority determined the taxpayer's deemed profits based on the collected information, and assessed the taxpayer's annual income and tax payable in accordance with "the profit standard of the same trade concerned" issued by the Taiwanese Ministry of Finance, as well as imposed a delinquent surcharge on the taxpayer. The taxpayer did not accept the tax authority's decision, which led to the administrative litigation.

## Issues

There are two major issues in the judgment:

- (i) Whether the taxpayer can be deemed to have conducted business in Taiwan by selling the software through the website.
- (ii) Whether the remittances to the BVI company's OBU account should be deemed as business profits of the taxpayer's service.

## Taiwanese Supreme Administrative Court: Opinion

### The Taxpayer Should be Deemed to Have Conducted business in Taiwan by Selling the Software Through the Website

- (1) The Taiwanese Supreme Administrative Court ("SAC") held that the BVI company's entire business operation was controlled by the taxpayer in Taiwan, for the following reasons:
  - (a) The taxpayer's IP address "211.21.98.6" was registered in the territory of Taiwan.
  - (b) The IP address' server was used by the taxpayer for the purpose of sending the serial number of the software sold to the customers and the e-mails concerning the transaction and the confirmation of successful payments, which encompassed the important parts of e-commerce activities.
  - (c) The registered name of the website was the same as the name of the BVI company, and the website performed the functions of "a transaction platform" and "collecting payment and delivering software."
  - (d) The main marketing channel of the BVI company (i.e. the website) was controlled by the taxpayer, and the taxpayer was the actual superintendent of the name of the website.

According to the spirit of the Principle of Substance over Form, although the BVI company was set up in an offshore tax haven, as the BVI company's general management functions took place in Taiwan, the BVI company would be deemed as a Taiwanese resident company and be subject to tax on its worldwide income.

(2) On the other hand, the SAC held that even if the BVI company could be deemed as a non-Taiwanese resident company, as the BVI company's entire sales and payment process were all controlled by the tax-

payer, the BVI company would be deemed to have a fixed place of business (i.e. the "permanent establishment" in the definition of international tax law) to have conducted business activities within the territory of Taiwan. Therefore, if the BVI company obtained any income from foreign customers and such income was related to the use of resource of the fixed place of business in Taiwan, after deduction of the cost and expenses which the BVI company incurred for earning the income, such income would be deemed the BVI company's Taiwan-sourced income under Article 8(9) of the Taiwanese Income Tax Act.

(3) Therefore, the SAC supported the tax authority's decision that the taxpayer indeed had sold the software through the website, and the taxpayer therefore had conducted business in Taiwan.

### The Remittances to the BVI Company's OBU Account Should be Deemed as Business Profit of the Taxpayer's Service

(1) The SAC held that the taxpayer had the ability to adjust, select, and control the BVI company's OBU account and its funds for the following reasons:

- (a) The taxpayer had set up the BVI company by the way of a sole proprietorship in the BVI.
- (b) The taxpayer acted as the sole shareholder and responsible person of the BVI company.
- (c) The taxpayer opened an OBU account in a Taiwanese bank on behalf of the BVI company.

(2) In addition, the BVI company's OBU account, set up by the taxpayer, has received remittances from the foreign agents or sales representatives and such remittances should be considered as the income of the trade commission and agency fees that were related to the sales of the software.

(3) Hence, the SAC approved the tax authority's decision that the remittances which were received in the BVI company's OBU account should be considered as the income generated from the remuneration for providing service (i.e. developing the software) and the sales of the software by the taxpayer.

## Observation

The Taiwanese administrative courts have continually updated and adjusted the rules for determining (a) whether an offshore company should be constructed as having a POEM in Taiwan as well as (b) whether an offshore company conducting cross-border e-commerce transactions would be deemed as having conducted business in Taiwan. Therefore, before deciding on the trading structure and business model, it is advisable for an offshore company to seek the advice of local tax experts to reduce the risk of being taxed.

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