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Taiwan's Far-Reaching Tax Reform Proposal

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Taiwan's Ministry of Finance on September 1 announced a tax reform proposal designed to establish a fair and competitive income tax regime that eases the income tax burden on wage earners, mid- and low-income earners, small and mediumsize enterprises, and start-ups. The proposal was drafted after evaluating international trends and public opinion.

The proposal takes the form of draft amendments to Taiwan's Income Tax Act. The Executive Yuan approved the amendments on October 12. Among other things, the amendments would increase standard and special deductions and allowances and eliminate the highest individual tax bracket. They also would raise the corporate tax rate while reducing the surtax on undistributed earnings, and establish a new tax mechanism for resident investors' dividend income while increasing the withholding tax rate on foreign investors' dividend income. The amendments were submitted to the Legislative Yuan (parliament) for review on October 13. If approved, they are expected to take effect on January 1, 2018.

The amendments' three main objectives are summarized below.

Ease Wage Earners' Tax Burden

The standard deduction would increase from TWD 90,000 (about $3,000) to TWD 110,000 for single taxpayers, and from TWD 180,000 to TWD 220,000 for married taxpayers. The special deduction for salary/wages and the disability allowance would also be increased, from TWD 128,000 to TWD 180,000.

Additionally, the current highest tax bracket of 45 percent for individuals with a net taxable income of more than TWD 10 million would be eliminated. The number of individual tax brackets would drop from six to five, with a top rate of 40 percent.

Ease SMEs' and Start-Ups' Tax Burden

Income earned by sole proprietorships and partnerships would no longer be subject to corporate tax. Instead, it would be passed through to the sole proprietor or each partner and be subject to individual income tax at the sole proprietor's or partner's individual income tax rate.

Establish Competitive Investment Income Tax

Eliminate Imputation Tax System

Taiwan adopted the imputation tax system in 1998. Under this system, taxpayers are subject to a 10 percent retained earnings tax (surtax) in addition to the 17 percent corporate tax. The levy is imposed on a Taiwanese company's after-tax earnings not distributed to its shareholders in the following year.

When a resident individual shareholder receives dividends from a Taiwanese company, the shareholder may credit a specified percentage of the corporate income tax and surtax paid by the company against personal income tax liability. For nonresident shareholders, up to 50 percent of the surtax paid by the company may be credited against the dividend withholding tax.

Taiwanese companies are required to keep an imputed credit account (ICA) in order to keep track of the amount of corporate income tax and surtax paid, as well as the amount of these taxes used by shareholders as tax credit against their withholding tax.

Over the years, this system has been criticized for its complexity and the administrative burden it creates. The amendments would eliminate the imputation tax system and the ICA to simplify dividend taxation and eliminate the controversial tax credit calculations. The surtax on undistributed earnings would also be reduced from 10 percent to 5 percent.

Establish New Dividend Tax Regime

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There are two options for calculating an investor's income tax liability on dividend income, and resident individual investors have the discretion to choose either.

Option 1 consolidates all dividend income as "other income" for calculating net taxable income and income tax liability. The investor may apply 8.5 percent of the dividend income (up to TWD 80,000) as tax credit (dividend credit) against income tax liability. The excess of dividend credit over income tax liability is refundable. This option is likely to be adopted by investors subject to the 5 percent, 12 percent, or 20 percent tax brackets.

Option 2 taxes dividend income separately at a flat rate of 26 percent, instead of the taxpayer's progressive individual rate. This option is likely to be adopted by investors subject to the 30 percent or 40 percent tax brackets.

Adjust Tax Rates

The amendments would increase the corporate tax rate from 17 percent to 20 percent.

Additionally, the withholding rate on dividend income payable to foreign investors would increase from 20 percent to 21 percent. However, if a foreign investor is from one of the 32 countries with which Taiwan has a tax treaty in force, preferential withholding rates provided under the treaty would apply.

Timeline for Implementation

The proposed changes to income tax and dividend income tax for resident individual investors are expected to apply to 2018 individual tax returns, filed in 2019.

The proposed change from 20 percent to 21 percent for foreign investors' dividend withholding rate is expected to take effect on January 1, 2018. Also, because the surtax on undistributed earnings is levied in the year following that in which the corporate tax return is filed (that is, the 2016 corporate income tax return should be filed in 2017, and the surtax is levied in 2018), the surtax credit would be eliminated January 1, 2019.

The proposed increase in the corporate income tax rate from 17 percent to 20 percent and the implementation of the new tax regime for sole proprietorships and partnerships are each expected to take effect in 2018 (that is, for the 2018 income tax returns filed in 2019). Furthermore, the imputation tax system and the ICA are expected to be eliminated January 1, 2018.

Observations

The proposed amendments could bring several benefits to wage earners, especially midand low-income earners. Among these benefits would be the raising of the standard deduction, the special deduction for salary/wages, and the special tax allowance for disability. Furthermore, the Ministry of Finance believes that eliminating the highest individual income tax bracket (45 percent) could help retain and attract talent and investments to Taiwan. However, because many factors besides the individual income tax rate affect a country's ability to retain and attract talent and investments, it remains to be seen whether the changes will have the anticipated effect.

The amendments could also encourage resident individual investment in the local equity market by offering two options for computing tax on dividend income. Because Option 2 provides a flat tax rate of 26 percent on dividend income, it should ease the tax burden on investors in the 30 percent and 40 percent tax brackets, encouraging local equity market investment.

Finally, the amendments seek to narrow the income tax burden gap between resident and foreign investors.

Currently, foreign investors are subject to a withholding tax of 20 percent on dividends received from Taiwanese companies while resident individuals are required to consolidate the dividend income into their taxable income and are subject to income tax at the progressive tax rate (up to 45 percent). The amendments would raise the dividend withholding tax rate from 20 percent to 21 percent for foreign investors and implement the new dividend income tax regime for resident investors. The Ministry of Finance hopes to reduce the gap in the tax treatment between resident investors and foreign investors. However, foreign investors from countries with which Taiwan has entered into a tax treaty that includes a preferential withholding tax rate would be unaffected by the withholding tax increase.