

## Asia Pacific Tax Update

### Taiwan

#### VAT on Cross-Border E-commerce

Facing mounting pressure brought by VAT leakage caused by cross border e-commerce, Taiwan's Ministry of Finance ("MOF") recently announced its intention to follow BEPS Action No. 1 by requiring foreign e-commerce companies to register in Taiwan for VAT collection.

Under current VAT law, Taiwan buyers are supposed to report and pay the VAT due on their online e-commerce expenditures purchased offshore. As can be expected this is not enforced in practice. With the online e-commerce business expanding, the MOF believes a significant amount of VAT has been lost under current VAT law and thus has decided to follow the recommendation of BEPS Action No. 1 to introduce extraterritorial VAT regime. The goal of the regime is to require cross border e-commerce operators to register for VAT in Taiwan, and for such operators to collect and pay VAT (instead of the buyers under current law).

The MOF called two meetings on August 17 and 25 to collect comments from scholars, e-commerce companies invited and relevant government authorities. No solid conclusion was reached after these two meetings. The MOF plans to present its first draft by the end of September with the aim to implement it starting January 1, 2017. Noteworthy discussions during these two meeting include:

1. The new VAT regime will be limited to B2C transactions. B2B transactions will still be taxed under the current reverse charge mechanism.
2. The new VAT regime should be as simple as possible so as to minimize foreign e-commerce companies' compliance cost.
3. Whether online transactions should be subject to Taiwan VAT based on place of consumption or residence of the buyers remains to be determined.
4. No input VAT credit may be allowed under the new VAT regime.
5. Whether there will be any income tax consequence to be triggered by the VAT registration remains to be clarified.

As each e-commerce company might have its industry specific issues, the MOF is open to engage in private discussions with interested companies before they complete their draft proposal.

Since there is less than four months left before the target date for implementation of the new law, foreign e-commerce companies should examine their operations to see whether there are any specific issues they

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would like to clarify with MOF before the new law is promulgated. Most important of all, companies should examine their MIS system, business process and legal documentation to determine whether or not they can meet the new law if it is implemented on January 1, 2017.

## **New Anti-avoidance Rules**

In response to the global anti-avoidance sentiment brought by the OECD BEPS action plans and recent Panama Papers incident, earlier this year Taiwan's Ministry of Finance ("MOF") resumed its proposal to introduce the long awaited anti-avoidance rules through amendments to the Income Tax Act. On April 28, 2016, the Executive Yuan announced its finalized draft amendments to the Income Tax Act and presented it for legislation. On July 12, 2016, the amendments were passed by the Legislative Yuan, but the effective date has not yet been determined. According to the Legislative Yuan, the controlled foreign company ("CFC") and place of effective management ("PEM") rules are to take effect after the promulgation of the cross-Strait tax arrangements, implementation of common reporting and due diligence standards ("CRS"), and enactment of related regulations.

### **The New Rules**

#### **1. Controlled Foreign Corporations**

The CFC rules have been amended into Article 43-3 of the Income Tax Act, which requires a Taiwan corporate taxpayer to include in its taxable income its pro rata share of the taxable profits of its CFC. A CFC for the purposes of Article 43-3 of the Income Tax Act is defined as a corporation established in low tax territories that is more than 50% owned (directly or indirectly) or dominantly influenced by a Taiwan business entity. Exemptions apply when the CFC has actual business activities in the jurisdiction of its incorporation or its profits do not reach the threshold prescribed by the Taiwan tax authorities (which is not yet available). The adoption of CFC rules would eliminate the deferral of taxation on those overseas profits and would discourage businesses from leaving earnings in foreign jurisdictions.

It should be noted, however, that the CFC rules are only applicable to Taiwan corporate taxpayers. Individual taxpayers are not included in the current amendment. To avoid individual taxpayers bypassing the CFC rules by operating the CFC under his or her own name, in June 2016 the Executive Yuan proposed to amend the Income Basic Tax Act (the so-called Alternative Minimum Tax or "AMT" Act) to cover the individual taxpayers. According to the proposed AMT Act amendments, a Taiwan individual taxpayer shall include in his/her AMT the pro rata share of the taxable profits of his/her CFC, provided (i) the Taiwan individual taxpayer directly or indirectly owns 50% or more of the CFC shares, or (ii) the Taiwan individual taxpayer's shareholding in the CFC, when combined with his/her spouse and relatives within the second degree of kinship, reaches 10% or more of the CFC shares AND such Taiwan individual taxpayer has dominant influence on said CFC.

#### **2. Place of Effective Management**

The PEM rules have been amended into Article 43-4 of the Income Tax Act. Before the amendment, only companies incorporated under Taiwan laws will be subject to corporate income tax in Taiwan, and foreign companies will not be taxed in Taiwan unless they maintain a fixed place of business or business

agent in Taiwan. With introduction of the PEM rules, foreign companies will be taxed in Taiwan if they are construed as having their place of effective management within Taiwan. According to Article 43-4 of the Income Tax Act, foreign companies will be deemed Taiwan tax residents if all of the following conditions are met:

2.1 Decision makers (individual and corporate) for significant operation management, financial management, and human resource management are residents in Taiwan or incorporated in Taiwan; or such decisions are made within the territory of Taiwan;

2.2 Creation and storage of financial statements, accounting records and shareholders/directors meeting minutes are within the territory of Taiwan; and

2.3 Main business activities are executed within Taiwan.

## Possible Impact on Individual Taxpayers in Taiwan Who Have Offshore Companies

### 1. Controlled Foreign Corporations

As the new CFC rules target on Taiwan companies having offshore CFCs, for now Taiwan individual taxpayers do not need to worry about the CFC implications. However, once the AMT amendments have been approved by the Legislative Yuan, the AMT liabilities for Taiwan individual taxpayer will be increased.

### 2. Place of Effective Management

This new rule is actually targeted at Taiwan citizens and companies who hold their portfolio through holding companies incorporated in tax havens such as British Virgin Islands. Such holding companies have effectively shielded the taxpayers from Taiwan income tax without the PEM rules. However, when the new PEM rules come into the picture, Taiwan citizens and companies, as well as the wealth management industry that caters to them, will inevitably be impacted.

It is a common practice in the world of wealth management that trust assets are transferred to an offshore holding company under a trust arrangement and the settlor maintains the authority over decision making of the underlying company. Prior to the introduction of PEM, such underlying companies are not taxable in Taiwan. However, with introduction of the PEM, such underlying companies might be taxable in Taiwan if all of the three conditions that constitute a PEM are met.

Taiwanese taxpayers and multinational companies doing business in Taiwan should closely monitor progress and content of these two new rules and endeavor to restructure businesses in Taiwan when necessary.

## New Tax Treaties

Over the year, Taiwan has managed to overcome its unique political standing in the world to enter into tax treaties with Japan, Canada, and Poland. The treaty with Japan has been effective since June 13, 2016 while the other two treaties are still pending for effective date.

In addition, the tax treaty with China is still pending. With the current tension between Taiwan and China, it is hard to predict when and whether the treaty will be effective.