

Legal Alert



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Taiwan: New Anti-avoidance Rules

Taking advantage of the global anti-avoidance sentiment brought by the OECD BEPS action plans and recent Panama Papers incident, Taiwan's Ministry of Finance ("MOF") recently 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 finalise draft amendments to the Income Tax Act and would present it for legislation aiming to take effect starting 2017.

The New Rules

1. Controlled Foreign Corporations

Following the example of its neighboring jurisdictions, including Japan, Korea and China, the MOF proposed to adopt a new set of CFC rules. Currently Taiwan companies are only taxed in Taiwan upon distribution of dividends from its offshore subsidiaries. Many Taiwan companies take advantage of this rule and keep their offshore profits in various offshore holding companies so they can defer their Taiwan income tax liabilities on their overseas profits. With the introduction of the CFC rules, this deferral scheme will be limited.

It should be noted, however, that the CFC rules will only be applicable to Taiwan corporate taxpayers. Individual taxpayers are not included in the current proposal.

2. Place of Effective Management

Currently, only companies incorporated under Taiwan laws will be subject to corporate income tax in Taiwan. Foreign companies will not be taxed in Taiwan unless they maintain a fixed place of business or business agent in Taiwan. With the introduction of the PEM, foreign companies will be taxed in Taiwan if they are construed as having their place of effective management within Taiwan. Under current draft guidance, foreign companies will be deemed Taiwan tax residents if all of the following conditions are met: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 resident in Taiwan or incorporated in Taiwan; or such decisions are made within territory of Taiwan.

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

2.3 Main business activities are executed within Taiwan.

The above two new rules, if legislated and promulgated as scheduled, will take effect on January 1, 2017.

Possible Impact on Multinational Companies in Taiwan

1. Controlled Foreign Corporations

We expect the impact of this new CFC rules on multinational companies doing business in Taiwan to be minimal. Taiwan has not traditionally been a place of choice of a regional hub for multinational companies. There are many commercial and tax reasons associated with it, and one possible tax reasons is the lack of participation exemption to offshore dividends income. As a result, since very few multinational companies use Taiwan for its regional holding structure, this new CFC rule is unlikely to have a significant impact on multinationals. Instead, the target of the new CFC rule will be Taiwan companies.

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.

These rules will have significant impact on Taiwan citizens and companies, as well as the wealth management industry that caters to them. Moreover, multinational companies doing business in Taiwan may have some collateral damages.

2.1 To take advantage of no withholding tax on remittance of branch profit out of Taiwan, many multinational companies choose to set up nominal head offices in tax jurisdictions that don't tax on offshore income and set up branches in Taiwan to run their businesses in Taiwan. With introduction of PEM, such nominal head offices might be taxable in Taiwan if their PEMs are construed to be within Taiwan. Furthermore, dividends distribution from such nominal head offices might be characterized as Taiwan source income and thus subject to dividends withholding tax.

2.2 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 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.

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.

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