Taiwan Tax Update

June 2016

Legislative Yuan Completed Preliminary Review of Draft Bill regarding Taiwan CFC and PEM rules

On 8 June 2016, the Finance Committee of the Legislative Yuan completed preliminary review of draft amendments (i.e. Article 43-3 and Article 43-4) to the Income Tax Act, which incorporates regulations concerning Controlled Foreign Company ("CFC") and Place of Effective Management ("PEM"), respectively.

According to news reports, the draft amendments are expected to come into force in 2018 at the earliest, under the premise that the China-Taiwan Cross-Strait Tax Agreement is effectuated, the Common Reporting Standard is executed, and relevant proposed bylaws have been adequately planned and properly advocated. Below we summarize the major impacts of the CFC rules and PEM regulations on domestic and multinational enterprises once implemented:

I. Controlled Foreign Company Rules (Article 43-3 of the Income Tax Act)

Percentage of shareholding>50%	If a domestic profit-seeking enterprise and its affiliates hold more than 50% of the shares of a CFC, or less than 50% of the shares but have significant influence on the CFC (i.e. personnel or financial decision power).
Low tax rate jurisdiction	If the tax rate of the jurisdiction where the CFC is located is less than 70% of Taiwan corporate income tax rate (i.e. <11.9%), or if the jurisdiction where the CFC is located does not impose tax on offshore income.
Exception	1. The CFC has commercial substance and operation. 2. The CFC does not have commercial substance and operation, but its profit level is under a certain threshold.
Tax Impact	Domestic profit-seeking enterprises are required to report CFC profits based on their shareholding percentage in the CFC as investment income in their annual corporate income tax return. The above is not applicable to individuals (note) and non-related party shareholders.
	Tax loss that is certified by a CPA and assessed by the tax authority can be carried forward for 10 years.
	When dividends are distributed in the future, tax will not be levied on the portion of CFC income which has previously been

	taxed. For withholding tax paid in foreign countries for such dividend distribution, foreign tax credit can be claimed within 5 years from the year in which such investment income is declared in the annual corporate income tax return.

Note: The Executive Yuan proposed in June 2016 that if Taiwan individuals, together with their spouse and second degree relatives, hold more than 10% shareholding of a CFC, the CFC income, which is defined as foreign sourced income, should be proportionately included in the calculation of alternative minimum tax in accordance with their shareholding percentage in the CFC.

II. Place of Effective Management (Article 43-4 of the Income Tax Act)

<table>
<tr><th>Applicable party</th><td colspan="3">A profit-seeking enterprise established under the laws of a foreign country, but having place of effective management within the territory of Taiwan.</td></tr>
<tr><th rowspan="2">Fulfillment of all three criteria</th><td>Place Where Decision is Made</td><td>Place Where Accounting Books are Retained</td><td>Place of Effective Operation</td></tr>
<tr><td>Major decisions on operation management, personnel matters, or finance are made by an individual residing within the territory of Taiwan (or a profit-seeking enterprise with headquarters within the territory of Taiwan), or place where major decisions are made are within the territory of Taiwan.</td><td>The place where financial statements, accounting books and records, board of director or shareholding meeting minutes are compiled and stored is located in Taiwan.</td><td>Main operating activities are effectively performed within the territory of Taiwan.</td></tr>
<tr><th>Tax Impact</th><td colspan="3">The foreign profit-seeking enterprise should be viewed as a profit-seeking enterprises having its head office within the territory of Taiwan, and shall be subject to the following:
1. Corporate Income Tax (“CIT”)
2. Alternative Minimum Tax (“AMT”)</td></tr>
</table>

	3. 10 % profit retention tax 4. Withholding tax obligations 5. Dividends distributed by the foreign profit-seeking enterprise from earnings realized in previous years before PEM came into effect are not deemed as Taiwan sourced income (rather, such income would be deemed as foreign investment income). If the beneficiary of the income is a domestic individual or profit-seeking enterprise within the territory of Taiwan, such income should be included in the AMT calculation or CIT calculation, respectively.

III. According to the draft bill, if the foreign company falls within the definition of a PEM and CFC at the same time, the PEM rules shall prevail.

IV. Sunrise clause

1. Effectuation of the China-Taiwan Cross-Strait Tax Agreement

2. Implementation status of the Common Reporting Standard

3. Completion of adequate planning and proper advocacy for relevant bylaws

PwC Observation:

I. There are still many items awaiting further interpretation and clarification in the draft anti-tax avoidance bill, such as:

1. When defining the CFC's tax rate, should the statutory tax rate or effective tax rate be used?
2. What constitutes commercial substance and operation of the CFC?
3. What are the more specific requirements of the three criteria defining PEM?
4. Should PEM status be determined annually for enterprises?
5. What is the definition of CFC income? Should CFC income include all types of income, or only passive income such as dividends, royalties, and interest income?

II. Does investment income only incorporate dividends distributed to the CFC from its investee company with commercial substance and operation, or does it directly incorporate CFC profit as shown on its financial statements, which should be included in the CIT calculation, even when the CFC has not received dividend distributions from its investee company with commercial substance and operation yet?

In sum, the draft bill regarding CFC and PEM rules are currently undergoing legislative procedures. PwC Taiwan will continuously focus attention and update developments in regards to the above.

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