

# Taiwan Tax Update

August 2021

## Income Tax

### Amendment to “Regulations Governing Application of Agreements for the Avoidance of Double Taxation with Respect to Taxes on Income”

In response to OECD’s Base Erosion and Profit Shifting (“BEPS”) final reports released in 2015 and model tax convention and commentaries released in 2017, the Ministry of Finance (“MOF”) announced amendments to “Regulations Governing Application of Agreements for the Avoidance of Double Taxation with Respect to Taxes on Income” on August 12, 2021. Salient points of the amendment are as follows:

Subject	Highlights of Amendment
<b>Prevention of Tax Treaty Abuse</b>	Incorporation of Principal Purpose Test (“PPT”)
<b>Taiwan Tax Residency</b>	Identification of educational, cultural, public welfare, charitable organizations/institutions, government agencies, and entities owned / controlled by the government, etc. as Taiwan tax resident for treaty purposes.
<b>Sole Tax Residency Status</b>	<ul style="list-style-type: none"> <li>● Individual: tax residency status is primarily determined by “permanent domicile”, which refers to a place of residence owned, rented or arranged by an individual, and is at his/her disposal for use at any time, or consecutively for up to 183 days.</li> <li>● Business Entity: tax residency status can be determined by place of effective management.</li> </ul>
<b>Fixed Place PE</b>	Adoption of geographical and commercial coherence concept with respect to business activities carried out in a particular location to determine fixed place PE.
<b>Profit Obtained from International</b>	Incorporation of OECD model tax convention and

<b>Transportation</b>	tax rulings issued by the MOF to clarify definition of profit obtained from international transportation.
<b>Royalties</b>	Incorporation of OECD model tax convention and Taiwan Copyright Act to clarify definition of royalties.
<b>Income Categorization Principles</b>	If an income concurrently qualifies as business profit and definition of income stipulated under other articles of a tax treaty, the latter shall take precedence, with any remaining income subsequently categorized as business profit.
<b>Cross-Border Electronic Service Providers can Avail of Treaty Benefits</b>	Amendment to business profit tax exemption filing clause, to reinforce that cross-border electronic service providers are also eligible for treaty benefits.

**PwC View:**

Highlights of the amendment include incorporation of PPT to determine eligibility for treaty benefits, Coherence concept in determining fixed place PE, as well as new guidelines for definition and applicability of certain income categories, including international transportation and royalties:

**1. Principal Purpose Test**

Under the PPT, if foreign enterprises undergo fragmentation of onshore economic activities or secondment of personnel in Taiwan, or split one large contract into numerous smaller contracts, necessity to do so from economic substance and commercial rationale perspective should be evaluated, in order to determine eligibility for treaty benefits.

For instance, Foreign Enterprise A, which is a resident of a treaty state, undertakes a construction project in Taiwan, where the construction period meets the construction PE threshold in Taiwan. Consequently, profits of Foreign Enterprise A associated with construction project in Taiwan shall be taxable in Taiwan pursuant to the treaty. If the Taiwan counterparty agrees to split the said construction contract into two smaller contracts, where the construction period of both contracts do not meet the construction PE threshold in Taiwan, from a form perspective, Foreign Enterprise A may be eligible for business profit tax exemption treatment in Taiwan. However, if PPT is taken into

consideration, the tax authorities shall assess relevant facts and circumstances to determine whether the principal purpose of the aforementioned arrangement is to obtain treaty benefits, or whether there is commercial rationale for such arrangement. If after assessing all relevant aspects, in the absence of facts and circumstances showing otherwise, the tax authorities may conclude that the aforementioned arrangement is made for the principal purpose of obtaining treaty benefit, and deny usage of business profit tax exemption treatment accordingly.

## **2. Fixed Place PE Guideline**

The amendment introduces the concept of geographical and commercial coherence with respect to business activities carried out in a particular location to determine fixed place PE. In other words, whether a foreign enterprise has a fixed place PE in Taiwan will depend on whether there is a fixed site on which the foreign enterprise continuously carries out business activities or provides relevant service.

For instance, a consultant of a foreign consulting firm provides customized services under unrelated contracts to several unrelated clients in the same office building. Due to the lack of commercial coherence with respect to the services performed (i.e. unrelated services provided to unrelated clients), the office building should not be deemed a fixed place PE of the foreign consulting firm. However, if the duration of foreign consultants providing services in Taiwan exceeds the service PE threshold defined in applicable tax treaties, e.g. 183 days in any given 12-months period, the foreign consulting firm may still be seen as having a service PE in Taiwan, in which case eligibility for business profit tax exemption treatment may be affected.

## **3. Scope of International Transportation Profit**

Profits derived from international transportation activities of a foreign international transportation enterprise should be eligible for treaty benefits, provided that applicable treaty articles are in place. Nevertheless, in practice, determination of income categorization and scope is an area often triggering dispute in Taiwan during a tax audit. The amendment incorporates OECD commentaries and tax rulings issued by the MOF to clarify the definition/scope of international transportation profits, to allow taxpayer and tax authority to comply accordingly.

## **4. Definition of Royalties**

There is a difference between definition of royalties provided under tax treaties and Taiwan Income Tax Act. Due to common dispute between taxpayer and tax authority in

terms of income categorization of royalties, this has led to diverse perception and interpretation of the same. According to the amendment, if a Taiwan business entity purchases computer software from an overseas supplier, and uses, operates or duplicates the software merely for its own enjoyment, or for entertainment or file backup purposes, where it does not use/reproduce, or have the right to use/reproduce the computer program copyright, this should not be considered royalties; instead, such payment should be viewed as business profits.

#### **5. Facilitate Foreign Enterprises' Tax Compliance and Risk Assessment**

The amendment provides additional guidance to taxpayers and tax authority when applying tax treaties in terms of determining compliance with relevant tax regulations, which facilitates foreign enterprises to obtain certainty in terms of tax compliance, and risk assessment associated with Taiwan business operations.

#### **Exemption from 2021 provisional income tax filing for profit-seeking enterprises impacted by COVID-19**

On August 6, 2021, the MOF announced that profit-seeking enterprises impacted by COVID-19 that meet any of the following criteria during the period Special Act for COVID-19 remains in effect (January 15, 2020 to June 30, 2022) can be exempt from provisional income tax filing in 2021:

1. Receiving relief from competent authorities under Special Act for COVID-19; or
2. Experiencing significant decrease in revenues within a short period of time as a result of COVID-19 (e.g. beginning January 2020, if the monthly average revenues of any two consecutive months or revenue of any month is at least 15% less than the average revenues of "corresponding periods of any year after 2018" or "from July 2019 to December 2019", or other conditions indicating significant decrease in revenues).

#### **Procedures to apply for exemption from provisional income tax filing**

1. Profit-seeking enterprises impacted by COVID-19 should submit an application letter along with other relevant supporting documents to the tax office within the deadline for provisional income tax filing (September 1, 2021 to September 30, 2021 for companies adopting calendar year end).
2. Profit-seeking enterprises impacted by COVID-19 meeting any of the following criteria may be exempt from 2021 provisional income tax filing without submitting any application:
  - 1). Exempt from 2020 provisional income tax filing; or
  - 2). Obtained approval from the tax authority to i) defer or pay taxes due in installments (for CIT, VAT, Commodity Tax, Tobacco and Alcohol Tax, Specifically Selected Goods and Services Tax); or ii) obtain refund of excess VAT paid.

**PwC Reminder:**

Profit-seeking enterprises that demonstrate a decrease in revenues, but who do not meet the criteria for being impacted by COVID-19, and thus are not eligible for exemption from 2021 provisional income tax filing, may consider to calculate provisional income tax based on taxable income for first six months of current tax year. Where CPA certification of income tax return is required for calculating provisional income tax based on taxable income for first six months of current tax year, relevant testing procedures, e.g. physical inventory count, should be conducted as soon as possible. Additionally, the aforementioned ruling for 2021 provisional income tax filing exemption is also applicable for business enterprises that do not adopt calendar year end, if their 2021 provisional income tax filing deadline is before June 30, 2022.

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