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Taiwan Tax Update

May 2023

Tax Incentive

Ministry of Economic Affairs announced draft implementation rules under Article 10-2 of Statute for Industrial Innovation covering "Investment Tax Credit of Corporations for Expenditure Incurred in Forward-looking Innovative R&D and Equipment used in Advanced Manufacturing Process"

1. The salient points of the tax incentive are as follows:

Applicable Entities	Companies that undergo technological innovation in Taiwan and assume critical position in global supply chain. All industries are eligible for below tax incentive assuming criteria are met.		
Criteria	A. **R&D expenditure reaches 6 billion TWD.** B. **R&D density reaches 6%** (R&D expenditure/net revenues; calculated based on standalone audited comprehensive income statement) C. **Equipment expenditure reaches 10 billion TWD**	D. **Effective tax rate** ● 12% for 2023; ● in principle 15% for 2024, but depending on actual circumstances, may report to Executive Yuan for adjustment to 12%; ● 15% from 2025 to 2029 (calculated based on amounts assessed by the tax authority)	E. Have not committed serious violation of environmental protection, labor, or food safety and sanitation laws in the past three years

Tax Incentives	**Investment tax credit ("ITC") for forward-looking innovative R&D expenditure** ● Should meet criteria **ABDE** on preceding page; ● ITC rate is 25%, can only be utilized in current year; ● ITC capped at 30% of CIT payable.
	ITC for purchase of equipment used in advanced manufacturing process ● Should meet criteria **ABCDE** on preceding page; ● ITC rate is 5% (no ceiling imposed on expenditure amount), can only be utilized in year of **equipment delivery**; ● ITC capped at 30% of CIT payable.
	● Unless otherwise provided by law, usage of aforesaid two ITCs, combined with ITCs obtained from other sources, shall not exceed 50% of CIT payable. ● CIT includes surtax levied on undistributed earnings
Period	Effective from 1 January 2023 to 31 December 2029

2. Definition of key terms:

Critical position in global supply chain: The products manufactured or services provided by the company have a certain amount of influence in the global market. As different industries may have different circumstances, the company should provide supporting documents and explanation when applying for tax incentives (e.g. global market share, ranking, import/export statistics of the company's products and/or services, and other items evidencing influential power). The Ministry of Economic Affairs ("MOEA") will set up a review team to evaluate all evidence provided.

Forward-looking innovative R&D: This refers to investing in leading domestic and overseas technologies that are not yet fully mature, but have future competitive advantage; or in terms of relatively mature technologies in the global market, this refers to investing in innovative application of R&D to produce leading technologies, or develop new applications of relevant technologies, etc. R&D includes development and design of prototypes, manufacturing process for new products and services, and development of new raw materials or components. R&D resulting in improvement of existing products, manufacturing process, raw materials or components do not constitute forward-looking innovative R&D.

Advanced manufacturing process: Refers to forward-looking leading technology that is not yet mature, but can be used for commercial mass-production in the future; or mature manufacturing technology that has reached commercial mass-production stage, which is further used in innovative applications.

Effective tax rate: Refers to CIT payable minus the following three items, and then divided by income before tax in the current year (calculated based on amounts assessed by the tax authority):

1. Foreign tax credit from income tax paid offshore on foreign-sourced income
2. Tax credit from income tax paid in China and other regions on China-sourced income
3. ITCs granted in accordance with regulations (calculated based on amounts actually credited in the current year).

3. Application procedures:

   1. A hardcopy application should be submitted to the MOEA three months prior to the start of the CIT return filing period till the due date for filing the CIT return (February 1 to May 31 for companies adopting calendar year end), to determine whether the company is eligible for the tax incentive. Applications submitted after the deadline will be disregarded.

   2. Together with the above application, the applicant shall submit an application covering ITC for forward-looking innovative R&D expenditure and provide documentary evidence, or submit an application covering ITC for purchase of equipment used in advanced manufacturing process, and provide documentary evidence and investment plan for advanced manufacturing process, etc.

   3. When filing annual CIT returns, relevant forms need to be filled out with required documents attached to utilize ITCs. If relevant deadlines are not met,

the company will not be eligible for ITC.

4. Scope of expenditure:

Forward looking innovative R&D	● **R&D department expenditure:** 1. Salaries of full-time employees dedicated to R&D work. 2. Expenses incurred for consumable equipment, raw materials, and samples used exclusively for research by R&D department. 3. Current year expenditure or amortization of patent, proprietary technology, and copyright purchased or used exclusively for R&D purpose. 4. Expenses incurred for purchase of professional or special database, software program, and system used exclusively for R&D purpose. 5. Expenses incurred by full-time employees dedicated to R&D work for education and training covering R&D professional knowledge (scope of expense includes ❶ hourly rate and travel expense of teachers, ❷ travel expense of trainees and fees paid to entities providing training, ❸ training material fees, insurance expense, meal expense and venue fees for training sessions). ● **Outsourced R&D fees**: Fees paid to domestic and foreign colleges, universities or research institutions to perform research, or fees paid to full-time teachers of domestic and foreign colleges and universities, or fees paid to research personnel of research institutions. ● **Joint R&D fees**: Expenses incurred by R&D department for joint R&D performed with domestic and foreign companies, colleges/universities, or research institutions.
Equipment used in advanced manufacturing	● Equipment purchased from others: Purchase price of equipment or machinery, along with associated freight and insurance fee. ● Equipment manufactured in-house: Actual costs incurred to

process	manufacture the equipment or machinery. ● Equipment commissioned to others for manufacturing: Fee paid to contract manufacturer, along with associated freight and insurance fee, and production costs borne by the company itself.

5. Limitation on use:

Forward looking innovative R&D	● R&D activities have to be performed in Taiwan to enjoy tax incentive, with the exception of Outsourced R&D or Joint R&D fees paid, where a portion of the R&D work is performed by foreign companies, colleges/universities, or research institutions. ● In principle, R&D activities are performed to establish the company's own R&D capabilities (except for R&D plans where it is necessary for part of the R&D work to be commissioned to others). The company also needs to establish a dedicated R&D department. ● In principle, products or technologies undergoing R&D should be exclusively for the company's own use. If the products or technologies are provided to others for manufacturing or use, appropriate royalties or compensation should be obtained. If appropriate royalties or compensation are not received, transfer pricing documentation should be in place to evidence appropriate allocation of profit.
Equipment used in advanced manufacturing process	● The equipment purchased is limited to brand new hardware for the company's own use. The location for installation of the equipment should be either self-owned manufacturing facilities of the company in Taiwan, or manufacturing facilities rent by the company. However, industries with unique characteristics are not subject to this restriction (e.g. the science/industrial park where the company is located has regulations prohibiting designated manufacturing activities). If the location of

	equipment installation changes within 3 years, a notification application should be filed with the tax authority.
Restriction applicable to both tax incentives	● Patents, proprietary technology, copyrights, professional or special databases, software programs and systems which are used solely for forward-looking Innovative R&D, or brand new machinery or equipment used in advanced manufacturing process are prohibited from being loaned out, rent, sold, returned, installed at alternative locations, or altered from original intended usage within 3 years of purchase. Otherwise, underpaid taxes will need to be made up with interest levied thereon. However, transfers due to merger, spin-off, or acquisition in accordance with the M&A Act, or due to force majeure event are not considered a violation.

6. Rejected application can be amended and resubmitted to enjoy other tax incentives:

   Within one month from the next day following receipt of the assessment result from the competent authority, applications that are rejected due to not meeting necessary criteria can be amended and resubmitted to the tax authority to apply R&D ITCs under Article 10 of the Statute for Industrial Innovation ("SII"), and Smart Machinery ITCs under Article 10-1 of the SII, with the MOEA also being notified by the applicant. The MOEA plans to reassess the original application based on the amended application scope, whereby online filing of Smart Machinery ITC application is not compulsory.

7. Duplicate usage of tax incentives is not allowed:

   For companies that are approved to use ITCs for expenditure incurred for forward-looking innovative R&D and equipment used in advanced manufacturing process, all R&D expenditure of the current year are no longer eligible for other R&D related income tax incentives granted under the SII or other regulations; furthermore, purchase of equipment in the current year are no longer eligible for other equipment purchase related income tax incentives granted under the SII or other regulations.

PwC Reminder

1. The criteria of R&D expenditures reaching 6 billion TWD and R&D density reaching 6% (R&D expenditure/net revenues) are based on the company's standalone audited comprehensive income statement of the current year. With regards to R&D expenditure, except for approved R&D work commissioned to or jointly developed by foreign companies, colleges/universities, or research institutions, the underlying forward-looking innovative R&D expenditures should be related to R&D work performed in Taiwan. In addition, the effective tax rate calculation should be based on amounts assessed by the tax authority. However, if at the time of submitting the application, the income before tax and CIT payable amount of the current year have not yet been assessed by the tax authority, the self-assessed tax filing amount disclosed in the CIT return may be temporarily used for calculation purpose. When calculating the effective tax rate, income taxes paid overseas by foreign branches of the Taiwan company shall not be included in the numerator, since relevant taxes are not paid in Taiwan.

2. Within one month from the next day following receipt of the assessment result from the competent authority, applications that are rejected due to not meeting necessary criteria can be amended and resubmitted to apply R&D ITC under Article 10 of the SII, and Smart Machinery ITC under Article 10-1 of the SII (application can be submitted using hard copies, and does not need to be resubmitted online).

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