Taiwan Tax Updates

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Tax reform package proposes increase to tax revenues

In February 2014, the Executive Yuan presented the "Tax Reform Package" to the Legislative Yuan, which aims to increase tax revenues from both income tax and business tax perspectives, and addresses the budget deficit issue.

The salient points of the proposed Tax Reform Package are summarized as follows:

Types of taxes	Proposed amendments
Business tax	The gross business receipts tax ("GBRT") rate on revenues derived from core business operations of banks and insurance companies will increase from the current rate of 2% to 5%.
Corporate income tax	1. Tax implication on dividend distribution: • <u>Resident corporate shareholders:</u> No changes to tax implication on dividends distributed to resident corporate shareholders, which is exempt from corporate income tax assessment. • <u>Non-resident corporate shareholders:</u> The ceiling of 10% surtax that can be creditable against dividend withholding tax for non-resident shareholders will be reduced by one-half of the original amount (Ceiling of 10% surtax creditable against dividend withholding tax = Dividends distributed from retained earnings where 10% surtax has already been levied x 10% x 50%). 2. In order to encourage small and medium enterprises[1] ("SMEs") to hire additional employees, SMEs can recognize additional tax

[1] According to Article 2 of the *Standards for Defining Small and Medium Enterprises*, an SME is defined as follows:

- An enterprise in the manufacturing, construction, mining or quarrying industry which has paid-in capital of TWD 80 million or less, or which has regular employees of less than 200 people.
- An enterprise in industries other than those mentioned above which has sales revenue of TWD 100 million or less in the previous year, or which has regular employees of less than 100 people.

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Types of taxes	Proposed amendments
	deductible salary expenses up to 130% of the incremental salaries paid to employees newly hired in the current year. 3. Currently, enterprises may claim R&D tax credit of 15% of current year R&D expenses, with a ceiling of 30% of the income tax payable for the same year. However, any unused R&D tax credits cannot be carried forward. An alternative is introduced where enterprises may claim R&D tax credit of 10% of current year R&D expenses, which can be credited against income tax payable within three years (including the current year). Taxpayers may choose whichever alternative is more beneficial.
Individual income tax	1. "Special deduction for salaries or wages" will increase from TWD 108,000 per person to TWD 128,000 per person. 2. "Special deduction for the disabled or handicapped" will increase from TWD 108,000 per person to TWD 128,000 per person. 3. Currently, an individual with annual net taxable income over TWD 4.4 million is subject to a progressive tax rate of 40%. Under the proposed amendment, where an individual's annual net taxable income exceeds TWD 10 million, the applicable progressive tax rate will be increased to 45%. 4. Tax implication on dividend distribution: ● <u>Resident individual shareholders:</u> Taiwan operates an imputation tax system in relation to the taxation of dividend income for resident individual shareholders. That is, when a domestic enterprise distributes dividends to resident individual shareholders, income tax paid at the corporate level is treated as imputation tax credit, which can be fully offset against the resident individual shareholder's income tax liability. Under the proposed amendment, the imputation tax credit which can be offset against the resident individual shareholder's income tax liability will be reduced by one-half. ● <u>Non-resident individual shareholders:</u> Under the proposed amendment, the same tax treatment on dividend income will apply to non-resident individual and corporate shareholders. Please refer to item 1 under "Corporate income tax" section above.

Draft amendments to the *Assessment Rules Governing Income Tax Returns of Profit-Seeking Enterprises*

On February 27, 2014, the Ministry of Finance ("MOF") announced draft amendments to the *Assessment Rules Governing Income Tax Returns of Profit-Seeking Enterprises* ("Assessment Rules"). The salient points are summarized as follows:

Proposed amendments

1. Due to adoption of IFRS

(1) Income from reward points granted with the original sales transaction should be recognized in the same period the original sales transaction is booked, and cannot be deferred for tax purposes. (Article 15-3)

(2) To be in line with IFRS regarding revenue recognition for long term contracts, the cost recovery method has been added. For construction work that began before December 31, 2012 that have not yet been completed, the original revenue recognition method should be applied. (Article 24)

(3) Profit-seeking enterprises applying IFRS can recognize financial lease in accordance with criteria laid out in IFRS for tax purposes also, thereby aligning the accounting and tax treatment. (Article 36-2)

(4) Depreciation expenses of major components of fixed assets can be calculated separately using respective useful lives that are not shorter than the useful lives stipulated in the Fixed Asset Useful Life Schedule. (Article 95)

(5) Where fixed assets or intangible assets have been reclassified into other types of assets for first time adoption of IFRS, such assets should continue to be depreciated or amortized based on their original asset categories. (Article 104)

2. To be in line with other regulations and tax rulings

(1) In addition to group life insurance premium, group health and injury insurance premiums paid by a company for the benefit of its employees up to a certain limit will not be deemed as taxable salaries of the employees. (Article 83)

(2) Additional guidance is provided for recognizing luxury tax paid by the profit-seeking enterprise as tax deductible costs or expenses, except where sales of land is involved. (Article 90)

(3) Where trip rewards are provided by profit-seeking enterprises to customers or distributors who achieve pre-agreed sales/purchase amount or volume, such expense should be treated as other expense. Further, non-withholding tax statements should be filed for payment of trip rewards to customers or distributors. (Article 103)

3. To define required supporting documents

(1) Additional supporting documents can be used for recognition of travel expense: i) for domestic lodging expense: receipt issued by travel agent with detailed breakdown, ii) for international flights: where the boarding pass has been lost, copies of the passport of the employee showing evidence of departure from Taiwan, and iii) for domestic transportation expense: highway toll paid via electronic toll stations can be substantiated by evidence of

Proposed amendments
payment signed off by the employee. (Article 74) (2) For disposal of fixed assets that have reached their useful lives as stipulated in the Fixed Asset Useful Life Schedule, CPA certification report, evidential documents issued by the competent authority for surveillance of the disposal process, or prior approval from the tax authority is no longer required. (Article 95) (3) Where a profit-seeking enterprise invests in an overseas company that has no actual operation, if lower-tier investee companies of such overseas company have incurred loss from actual operations, and supporting documents evidencing the same are available, overseas investment loss is tax deductible. (Article 99)

Draft amendments to the *Regulations Governing R&D Tax Credit Available to Profit-Seeking Enterprises*

On January 24, 2014 and February 11, 2014, the Ministry of Economic Affairs ("MOEA") announced draft amendments to the *Regulations Governing R&D Tax Credit Available to Profit-Seeking Enterprises* ("Regulations"). The salient points are summarized as follows:

	Proposed amendments
1	Where companies repeatedly violate regulations covering environmental protection, labor, food safety etc., and the violations are deemed significant by the competent authorities, the central competent authorities shall not review the application of the company to determine whether its R&D activities are eligible for R&D tax credits in the current year. If R&D tax credits have already been filed and used by the company, the tax collection authorities shall disallow the usage of such tax credits.
2	The original Regulations stipulate that R&D tax credits may be denied by the tax authorities for "companies who falsely report R&D expenditures". In order to conform with Article 48 of the Tax Collection Act, the above criteria for denying R&D tax credits has been revised to "companies who evade significant taxes".
3	In order to accommodate the nature of cultural and creative industries, some wordings in the Regulations have been amended to avoid potential dispute.
4	Where a company has no R&D department, but has full-time R&D personnel exclusively engaged in R&D activities, and expenditure incurred for R&D activities can be clearly segregated from non-R&D activities, R&D tax credits should be approved by the tax authority based on relevant documents.

Annual business tax audit commencing from April 1, 2014

From April 1, 2014, the tax authority will conduct an annual business tax ("VAT") audit focusing especially on the following circumstances:

1. Business entities not solely engaged in sales of taxable goods or services (subject to either 5% or 0% VAT) who did not pay and file VAT for purchase of foreign services.

2. Business entities which claim input VAT deductions for personal consumption, non-deductible items, or fake Government Unified Invoices ("GUIs").

3. Business entities which claim significant input VAT with low value-added percentage.

4. Business entities which report tax-exempt sales that is higher than usual.

5. Business entities which claim significant deductible VAT, or which is continuously in a deductible VAT position.

6. Business entities which primarily engage in sales to tourists, who fail to issue GUIs, who issue GUIs with insufficient sales amount, or who use illegally installed offshore credit card machines.

7. Business entities who fail to issue GUIs, or who issue GUIs with insufficient sales amount for internet transactions.

8. Business entities who file taxable sales as zero-rated sales.

9. Business entities who fail to issue GUI on taxable sales, and who falsely report zero-rated sales.

10. Business entities who file zero-rated sales, and who use fake GUIs bearing input VAT to claim VAT refund.

<u>PwC Observation</u>

The aforementioned annual business tax audit is part of the tax collection authority's routine assessment process. Business entities should conduct a self-check to determine whether they have any violations, voluntarily make up the tax shortfall and file amended returns, if any, to rectify the said violations in order to avoid potential penalties.

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