

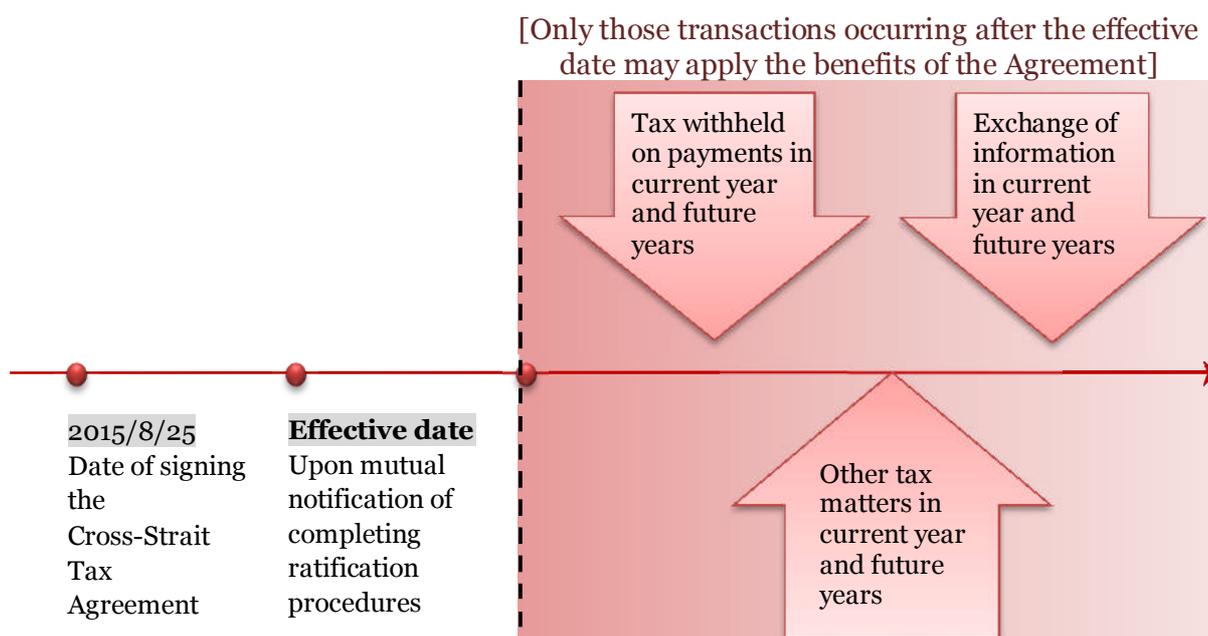
Taiwan Tax Update – Special Edition

August 2015

China and Taiwan formally signed the “Cross-Strait Tax Agreement”

The Cross-Strait Agreement for Avoidance of Double Taxation with respect to Taxes on Income (“Cross-Strait Tax Agreement”) was signed on August 25, 2015, which is yet another milestone demonstrating closer ties between China and Taiwan. Key points of the Agreement are summarized as follows:

- 1. Timing for application of reduced withholding tax rates, provisions for other taxes and exchange of information**



- 2. Tax implications on Taiwanese enterprises and employees before and after the Cross-Strait Tax Agreement came into force:**

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Tax Implication of Taiwanese Companies and Employees		Before	After	Key Tax Impact
Income derived in China	Business profit	Subject to corporate income tax assessment	Exempt from corporate income tax assessment, if certain conditions are met	Assist in flexible usage of Taiwanese enterprises' fund and increase shareholders' imputation tax credit
	Dividends, interest and royalties	Subject to withholding tax (10%)	Reduced withholding tax rates (5%, 7%, 7%)*	
	Capital gain from securities transaction	Subject to corporate income tax assessment	Exempt from corporate income tax assessment, unless certain conditions are met**	
	Income derived from personal services	Subject to individual income tax	Exempt from individual income tax assessment, if certain conditions are met	Taiwanese employees sent to China for short-term business trips (i.e. less than 183 days within any 12 months period), with costs borne by Taiwan entity, may be exempted from China individual income tax assessment
Problems encountered in China	Double taxation from transfer pricing adjustments	Unable to resolve problem	Able to resolve problem systematically	Assist in minimizing the impact of double taxation on Taiwanese enterprises
	Inconsistent tax opinion between local, regional and national tax authorities	Unable to resolve problem	Resolve problem through mutual discussion across the Taiwan Strait	

* Reduced withholding tax rate on dividends applies only to shareholders who own 25% or more of the shares of the investee company. When applying reduced withholding tax rates on interest and royalties involving transactions with related parties, the reasonableness of the transfer price shall be taken into consideration.

** For sale of shares, where over 50% of the value of the shares is directly or indirectly reflected by the value of real property located in the other territory, capital gain from sale of the shares may be taxed in that other territory.

3. Applicable Companies:

Any Taiwanese company wishing to be entitled to the aforementioned preferential tax treatments under the Cross-Strait Tax Agreement shall fulfill the following conditions:

- (1) It shall, in principle, be a resident company defined under local tax regulations. However, based on the Cross-Strait Tax Agreement, a company incorporated in a third country may also be deemed as a resident company if its place of effective management complies with the following requirements:
 - i. The person making major decisions on business operations, finance management and personnel management is an individual residing in Taiwan, or the place or premise where such decisions are made is located in Taiwan.
 - ii. The place or premise where the financial reports, accounting books and records, meeting minutes of resolutions of Board of Directors or resolutions of Shareholders are prepared or maintained is located in Taiwan.
 - iii. The place or premise where the principal business activities are carried on is located in Taiwan
- (2) A resident company must also be the beneficial owner of relevant dividends, interest or royalties to be eligible for reduced withholding tax rates under the Cross-Strait Tax Agreement.

For example, if a Chinese enterprise pays dividends, interest or royalties to a Taiwanese company, the Taiwanese enterprise will have to prove to the China tax authorities that it is a Taiwan resident company and meets the definition of beneficial owner outlined in China tax laws and regulations, in order to be eligible for enjoying reduced withholding tax rates.

4. Preferential definition of permanent establishment and individual income tax filing obligation

- (1) A building site, a construction or installation project, or supervisory activities in connection with a building site or construction or installation project will not constitute a permanent establishment if such site or project lasts for a period of less than 12 months.
- (2) Taiwanese employees sent by a Taiwanese enterprise to China to provide short-term (i.e. less than 183 days in any 12 months period) consulting services will not constitute a permanent establishment in China.
- (3) Salary income of Taiwanese employees sent to China for short-term (i.e. less than 183 days in any 12 months period) business trips will be exempted from China

individual income tax assessment.

- (4) The term “permanent establishment” defined under the Cross-Strait Tax Agreement excludes the use of facilities solely for the purpose of storage and delivery inside China bonded logistic zones, and the maintenance of a place solely for the purpose of purchasing goods, collecting information, advertising, providing information or performing scientific research, unless the activities performed constitute the core business operations of the Taiwanese enterprise.

5. Revenues and profits derived by Taiwanese enterprise from operating in shipping and air transportation business will be exempted from China income tax and business tax assessments.

PwC Observation

1. Given the Cross-Strait Tax Agreement has merely been signed and the definitive time for China and Taiwan to mutually confirm ratification procedures is unknown, the effective date for reduced withholding tax rates, provisions for other taxes and exchange of information to come into force can only be decided until further actions are taken by the competent authorities of China and Taiwan.
2. Once the Cross-Strait Tax Agreement becomes effective, Taiwanese enterprise may have opportunities to initiate negotiation and signing of a Bilateral Advance Pricing Agreement (“BAPA”) with the tax authorities of China and Taiwan, to significantly reduce uncertainties arising from future transfer pricing audits. On the other hand, Taiwanese enterprises that have not signed any BAPA, but have already been selected by the China tax authorities for transfer pricing audits, and are currently subject to special tax adjustments, may also request for “Mutual Agreement Procedures (MAP)” in the future to claim corresponding adjustments in Taiwan, which can also successfully alleviate the burden of double taxation.
3. Guidelines governing the definition of Taiwan resident, especially for enterprises having places of effective management located in Taiwan, still needs to be further clarified with competent authorities. Our preliminary view is that enterprises with places of effective management situated in Taiwan can be regarded as tax residents if they can prove that their place of effective management is in Taiwan, and they have paid taxes in accordance with relevant Taiwan tax regulations, to allow the Taiwan tax authority to issue certificates of tax residence to them. Nevertheless, further observation is required in order to understand the competent authorities’ attitude in both China and Taiwan toward the application procedure for reduced withholding tax rates and recognition of tax residency.

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