

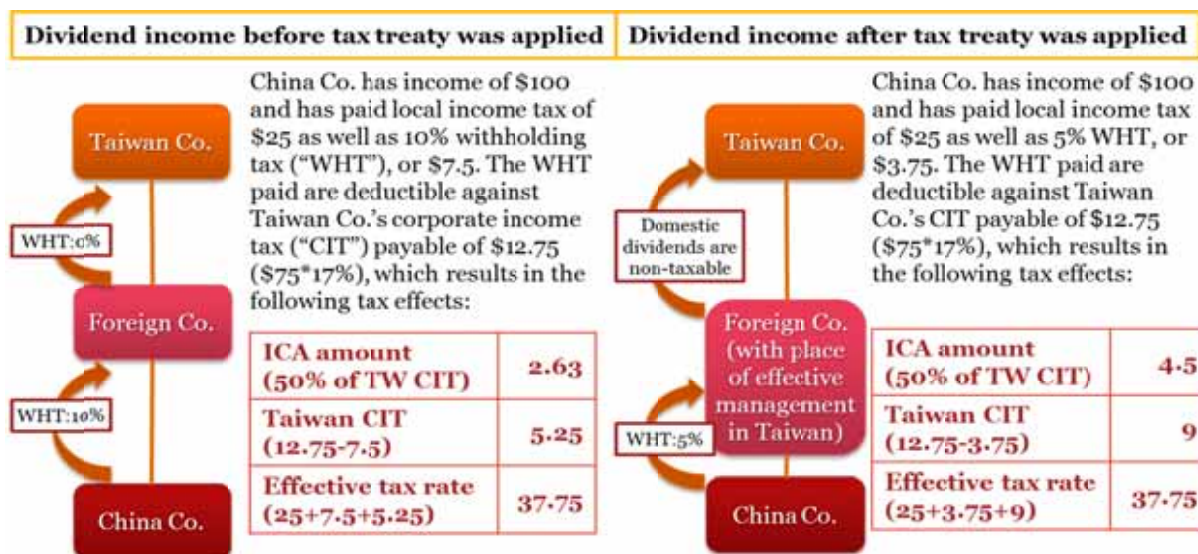
Taiwan Tax Update

September 2015

Possible Impact of “Place of Effective Management” Defined under the “Cross-Strait Agreement on Avoidance of Double Taxation and Enhancement of Tax Cooperation” on Taiwanese Companies

The Cross-Strait Agreement on Avoidance of Double Taxation and Enhancement of Tax Cooperation (“Cross-Strait Tax Agreement”) was finally signed on August 25, 2015. Given that the Cross-Strait Tax Agreement is not considered as an international tax convention, it will have to wait until the draft amendments to Article 25-2 of the Act Governing Relations between the People of the Taiwan Area and the Mainland China Area are sent to the Legislative Yuan for review and ratification, before it formally comes into force on January 1 of the following year after the date the Cross-Strait Tax Agreement was concluded.

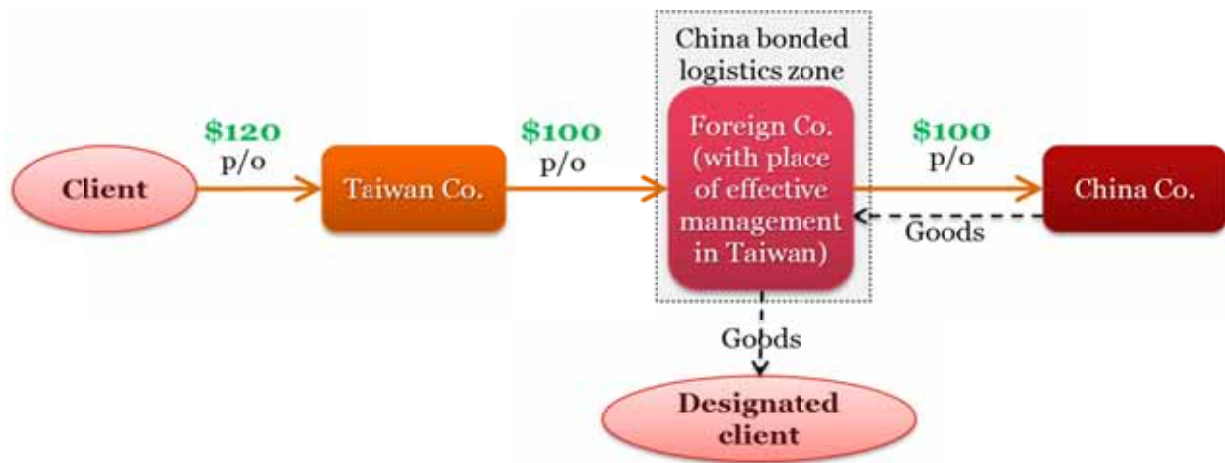
The Cross-Strait Tax Agreement provides tax relief on various types of income paid across the Taiwan Strait, eliminates double taxation and offers mechanism to resolve tax disputes and maintain fairness of taxation. Although Article 43-4 of the Taiwan Income Tax Act, which regulates “Place of Effect Management”, has not yet been passed by the Legislative Yuan, the Cross-Strait Tax Agreement has already included provisions to regulate “place of effective management”. Taiwanese companies which indirectly invest in China through another jurisdiction will be given more flexibility on future application of tax relief under the Cross-Strait Tax Agreement. Provided below is an example illustrating the tax impact brought by “place of effective management” in an investment structure:



Income from property transaction before tax treaty was applied	Income from property transaction after tax treaty was applied																								
<p>Scenario 1: Taiwan Co. disposes China Co. indirectly China tax office considers income of \$100 from disposal of China Co. is without reasonable commercial purpose and imposes 10% tax. The tax effect is as follows:</p> <table border="1" data-bbox="432 562 791 674"> <tr><td>ICA amount</td><td>8.5</td></tr> <tr><td>Taiwan CIT</td><td>17</td></tr> <tr><td>Effective tax rate</td><td>27</td></tr> </table> <p>Scenario 2: Foreign Co. disposes China Co. Income of \$100 from disposal of China Co. is imposed 10% WHT by China tax office, which is not deductible in Taiwan.</p> <table border="1" data-bbox="432 837 791 972"> <tr><td>ICA amount</td><td>7.65</td></tr> <tr><td>Taiwan CIT (90*17%)</td><td>15.3</td></tr> <tr><td>Effective tax rate</td><td>25.3</td></tr> </table>	ICA amount	8.5	Taiwan CIT	17	Effective tax rate	27	ICA amount	7.65	Taiwan CIT (90*17%)	15.3	Effective tax rate	25.3	<p>Scenario 1: Taiwan Co. disposes China Co. indirectly Income of \$100 qualifies for safe harbor rules for indirect disposal of China Co. prescribed by China tax laws. The tax effect is as follows:</p> <table border="1" data-bbox="1038 544 1398 656"> <tr><td>ICA amount</td><td>8.5</td></tr> <tr><td>Taiwan CIT</td><td>17</td></tr> <tr><td>Effective tax rate</td><td>17</td></tr> </table> <p>Scenario 2: Foreign Co. disposes China Co. Income of \$100 from disposal of China Co. is not subject to 10% WHT imposed by China tax office if "Place of Effective Management" under the tax treaty is applied.</p> <table border="1" data-bbox="1038 860 1398 972"> <tr><td>ICA amount</td><td>8.5</td></tr> <tr><td>Taiwan CIT</td><td>17</td></tr> <tr><td>Effective tax rate</td><td>17</td></tr> </table>	ICA amount	8.5	Taiwan CIT	17	Effective tax rate	17	ICA amount	8.5	Taiwan CIT	17	Effective tax rate	17
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As seen in the above examples, once the Cross-Strait Tax Agreement comes into effect, the reduced withholding tax rate of 5% can apply to dividends remitted by a Chinese subsidiary to its parent company in Taiwan (including its offshore parent company with place of effective management in Taiwan), which gives the parent company flexibility in the use of funds in the current year. Moreover, since the amount of additional taxes to be paid in Taiwan will increase as a result of reduced withholding tax rates, while the total effective tax rate remains the same, shareholders can receive greater imputation tax credit benefits. Taiwanese companies will also benefit from reduced risk of double taxation on capital gains under the Cross-Strait Tax Agreement.

In terms of transaction models, if Taiwanese companies apply to treat an offshore company as having its place of effective management in Taiwan under the Cross-Strait Tax Agreement, it can prevent such offshore company from being deemed as Taiwanese companies' permanent establishment in China as shown in the example illustrated below. Where "Place of Effective Management" provision could not be applied previously without the Cross-Strait Tax Agreement, the Foreign Co. located in China bonded logistics zone will be deemed as Taiwan Co's PE in China, as Taiwan Co. is carrying out business operations through the Foreign Co. within the territory of China. However, with "Place of Effective Management" provision, Taiwan Co. can apply to treat the Foreign Co. as having its place of effective management in Taiwan, where the Foreign Co. will be deemed as a Taiwan tax resident entitled to more beneficial terms defining PE. Furthermore, where the taxable profit of a Chinese subsidiary of the Taiwanese company is increased by way of a transfer pricing adjustment, the Taiwanese company may seek for corresponding decrease to its tax liability from the Taiwan tax authority. If corresponding adjustment cannot be made, the Taiwanese company may initiate the mutual agreement procedure under the Cross-Strait Tax Agreement to resolve the tax dispute by inviting China and Taiwan tax authorities to initiate corresponding discussions.



PwC Observation:

1. Currently, the administrative procedures and application form for treating an offshore company as a Taiwan tax resident company has not yet been announced; however, we believe that the competent tax authority may refer to existing tax regulations and rulings governing application of Taiwan tax residency and necessary application form to make further amendments.
2. Given that Article 43-4 of the Income Tax Act has not yet been passed, even though the offshore company is able to meet Taiwan tax residency requirement defined under the Cross-Strait Tax Agreement, further observation is required in order to understand their Taiwan tax compliance obligations, which includes applying for tax registration, withholding tax obligation, GUI issuance obligation, preparation of transfer pricing report, etc.
3. If, in the future, the China tax authority conducts tax adjustments for related party transactions of the Chinese subsidiary of a Taiwanese company, which supporting documents should be prepared to satisfy the requirements of Taiwan tax authority for corresponding adjustment will become an important issue for Taiwanese companies. If a Taiwanese company wishes to submit a request to initiate a mutual agreement procedure, the Taiwanese company will have to ensure relevant information provided to tax authorities of Taiwan and China entail consistent transfer pricing policy to avoid double taxation.

PwC Contacts:

Corporate Income Tax / Other Tax

Howard Kuo
886-2-2729-5226
Howard.Kuo@tw.pwc.com

Tony Lin
886-2-2729- 5980
Tony.Lin@tw.pwc.com

Jason C Hsu
886-2-2729- 5212
Jason.C.Hsu@tw.pwc.com

Rosamund Fan
886-2-2729-6077
Rosamund.Fan@tw.pwc.com

Sam Hung
886-2-2729-5008
Sam.Hung@tw.pwc.com

Li-Li Chou
886-2-2729-6566
Li-Li.Chou@tw.pwc.com

Jack Hwang
886-2-2729-6061
Jack.Hwang@tw.pwc.com

International Tax Services

Elaine Hsieh
886-2-2729-5809
Elaine.Hsieh@tw.pwc.com

Wendy Chiu
886-2-2729-6019
Wendy.Chiu@tw.pwc.com

Patrick Tuan
886-2-2729-5995
Patrick.Tuan@tw.pwc.com

Albert Chou
886-2-2729-6626
Albert.Chou@tw.pwc.com

Transfer Pricing

Lily Hsu
886-2-2729-6207
Lily.Hsu@tw.pwc.com

Elliot Liao
886-2-2729-6217
Elliot.Liao@tw.pwc.com

Financial Services

Richard Watanabe
886-2-2729-6704
Richard.Watanabe@tw.pwc.com

Jason C Hsu
886-2-2729- 5212
Jason.C.Hsu@tw.pwc.com

M&A Tax

Wilson Wang
886-2-2729-6666 ext 35101
Wilson.Wang@tw.pwc.com

Elaine Hsieh
886-2-2729-5809
Elaine.Hsieh@tw.pwc.com

General Accounting and Relevant Out-Sourcing Services

Lucy Ho
886-2-2729-5218
Lucy.Ho@tw.pwc.com

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