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Global Tax Alert

Taiwan releases draft regulations on undistributed earnings tax exemption for substantive investments

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Taiwan's Ministry of Finance published[1] the draft *Regulations on Deduction of Undistributed Earnings and Application for Tax Refund for Substantive Investment Made by a Profit-seeking Enterprise or a Limited Partnership*[2] (the draft Regulations).[3] The draft Regulations provide details of the undistributed earnings tax exemption[4] and qualifying investments. The Government is requesting public comments.

The draft Regulations are expected to be enacted before the end of 2019.

Requirements for the exemption from undistributed earnings tax

Taxpayers[5] are required to satisfy all of the following requirements to be entitled to the full exemption from the 5% undistributed earnings tax:

- The after-tax earnings used to make a qualified investment are generated in taxable years ending on or after 31 December 2018.[6]
- A minimum of TWD1 million (US$33,000) of undistributed earnings is spent on the qualified investment.
- The qualified investment must be made within three years after the earnings are generated.[7]
- If the qualified investment is held for less than three years, recapture of the exemption will apply.[8]

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Qualified investments

Qualified investments include buildings, software, hardware and technology that are used by the taxpayer internally or for business purposes but excludes land or other items that can be expensed in the year of acquisition.

Endnotes

1. The draft Regulations were issued on 1 October 2019.
2. A Taiwan limited partnership is not a pass-through entity for income tax purposes unless it is a qualified venture capital limited partnership approved by the Taiwan Taxation Administration.
3. Pursuant to article 23-3 of the *Statute for Industrial Innovation*.
4. Under current rules, current year earnings that are not distributed by taxpayers in the subsequent fiscal year are subject to an undistributed earnings tax of 5%. Article 23-3 of the *Statute for Industrial Innovation* provides an incentive that if taxpayers make substantial qualified investments using current year after-tax earnings, the substantial qualified investment amount is excluded from the undistributed earnings tax base.
5. Taxpayer refers to resident companies and limited partnerships, who are subject to the undistributed earnings tax in Taiwan.
6. The taxable year is generally the calendar year, 1 January to 31 December. However, a taxpayer may elect to adopt a different taxable year.
7. For example, if a company uses the earnings generated in 2018 to invest in buildings, equipment, or software and technology, the investment must be made by the end of 2021 in order to qualify for the tax incentive. If the investment is completed in 2019, then the qualifying investment amount can be exempt from the undistributed earnings tax which is payable in May 2020. If the investment is completed in 2021, then the company can file a refund claim for the undistributed earnings tax paid in May 2020.
8. If a taxpayer has claimed the full exemption but subsequently disposes, transfers, rents out, or returns the assets within three years, recapture of the exemption will apply and undistributed earnings tax is required to be paid.

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