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Global Tax Alert

Taiwan amends Taiwan-source income recognition regulations

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Executive summary

The Taiwan Ministry of Finance (the MOF) amended the Taiwan-source income recognition regulations of Article 8 of the *Income Tax Act* (the Amendment) on 26 September 2019 to provide foreign companies with an option to calculate Taiwan-source income tax liabilities using deemed profit and onshore contribution ratios.

This Alert summarizes the key aspects of the Amendment.

Detailed discussion

A foreign company with no fixed place of business or business agent in Taiwan is required to pay withholding tax of 20% on Taiwan-source service income or business profits. Withholding agents have routinely withheld the 20% tax on the gross payment, even though the foreign company can technically claim a deduction for expenses incurred in providing the services or generating business profits. To be eligible to claim a deduction, however, the foreign company must file a refund claim for overwithheld tax, resulting in significant administrative burdens and taxpayer uncertainty.

A withholding tax liability may also be eliminated or reduced under a treaty's business profits article or Article 25 of the *Income Tax Act*,[1] although not all types of remuneration qualify.

Building a better working world

The Amendment provides an alternative for foreign companies to calculate Taiwan-source income tax liabilities based on both a deemed profit and an onshore contribution ratio.[2] Pre-approval by the tax authority of the ratios is required.

Deemed profit ratio

The deemed profit ratio is determined under one of the following methods:

- Based on the foreign company's records of actual costs and expenses connected with the remuneration
- A three-year average deemed profit ratio, if previous approval for transactions in the past three years with identical contracts exists
- A standardized deemed profit ratio (based on the taxpayer's main business)[3]
- A higher deemed profit ratio by the tax authority if the actual deemed profit ratio is higher than the amount determined under the average deemed profit ratio or the standardized deemed profit ratio method

Onshore contribution ratio

The onshore contribution ratio is determined under one of the following methods:

- Based on documentation evidencing the proportion of onshore and offshore contributions
- A three-year average contribution ratio, if previous approval for transactions in the past three years exists; the tax authority may, however, adopt the actual contribution ratio if it is higher than the average
- 100% contribution ratio

Endnotes

1. Article 25 applies a reduced withholding rate of 10% for international transportation and 15% for rental, construction and technical services. General marketing services, administration support and administration management fees do not qualify for Article 25 treatment.
2. Tax liability = income x deemed profit ratio x contribution ratio x 20% tax rate.
3. Every year the MOF will announce a standardized deemed profit ratio for different industries.

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