

CHAPTER VI

INTERNATIONAL TAXATION

I. Tax Agreements

A. Policy

The general policy of the ROC toward tax agreements is to avoid double taxation, prevent fiscal evasion, and strengthen substantive relations. The tax agreements that the ROC has entered into follow the OECD and UN models and take into consideration matters relating to the political and fiscal status, economic situation, and trade between the mutual parties.

B. List of Tax Agreements

As of 31st December, 2012, there were 25 comprehensive income tax agreements and 14 international transportation income tax agreements which had been signed and brought into force. All tax agreements are listed below:

1. Comprehensive income tax agreements which cover all income flows:

Australia, Belgium, Denmark, France, Gambia, Germany, Hungary, India, Indonesia, Israel, Macedonia, Malaysia, the Netherlands, New Zealand, Senegal, Singapore, South Africa, Paraguay, Slovakia, Swaziland, Sweden, Switzerland, Thailand, Vietnam, and the UK.

2. International transportation income tax agreements:

Canada, the European Union, Germany, Israel (no longer in effect), Japan, Korea, Luxembourg, Macau, the Netherlands (Shipping, Air Transport), Norway, Sweden, Thailand, and the USA.

C. Withholding Tax Rates for Non-Residents

The withholding tax rates for non-residents are as follows:

Type of Income	Withholding Rates	
	Profit-Seeking Enterprise with No Fixed Place of Business	Non-Resident Individual
Dividends Distributed by Companies and Profits Distributed by Co-Operatives	20%	20%
Commission	20%	20%

Interest	<p>(1) 20%;</p> <p>(2) 15%, to be taxed on interest from the portion of the pecuniary amount realized by short-term commercial papers at their maturity in excess of the selling price at their initial issuance;</p> <p>(3) 15%, to be taxed on interest from securities issued under the Financial Asset Securitization Act or the Real Estate Securitization Act;</p> <p>(4) 15%, to be taxed on interest from government bonds, corporate bonds, or financial bonds;</p> <p>(5) 15%, to be taxed on interest from repo (RP/RS) trade of the aforesaid bonds, securities or short-term commercial papers which shall be the net amount of the sale price at their maturity in excess of the original purchase price.</p>	<p>(1) 20%;</p> <p>(2) 15%, to be taxed on interest from the portion of the pecuniary amount realized by short-term commercial papers at their maturity in excess of the selling price at their initial issuance;</p> <p>(3) 15%, to be taxed on interest from securities issued under the Financial Asset Securitization Act or the Real Estate Securitization Act;</p> <p>(4) 15%, to be taxed on interest from government bonds, corporate bonds, or financial bonds;</p> <p>(5) 15%, to be taxed on interest from repo (RP/RS) trade of the aforesaid bonds, securities or short-term commercial papers which shall be the net amount of the sale price at their maturity in excess of the original purchase price.</p>
Rental	20%	20%
Royalties	20%	20%
Wages and Salaries		<p>(1) 5%, in the case of the portion of the total monthly payment exceeding NT\$30,000 for civil servants employed by the government to work abroad;</p> <p>(2) For individuals described other than in (1):</p> <p>(a) 6%, in the case of salaries not exceeding 1.5 times the monthly basic salary as assessed by the Executive Yuan</p> <p>(b) 18%, in the case of salaries exceeding 1.5 times the monthly basic salary as assessed by the Executive Yuan</p>
Awards or Prizes Obtained from Participating in Contests, Games, or Lotteries, Etc.	<p>(1) 20%;</p> <p>(2) 0%, in the case that the prize received is from lotteries sponsored by the government and is no more than NT\$2,000 per ticket</p>	<p>(1) 20%;</p> <p>(2) 0%, in the case that the prize received is from lotteries sponsored by the government and is no more than NT\$2,000 per ticket</p>
Reward for Information or Accusation	20%	20%

Income Derived from Property Transactions	20% of the reported amount	(1) 20% of the reported amount; (2) 15% of the reported amount, in the case that the income is derived from securities transactions as stipulated under the provisions of Article 4-1 of the Income Tax Act
Income Derived from International Transportation, Construction Projects, Furnishing of Technical Services, and Leasing of Equipment by a Foreign Profit-Seeking Enterprise Which Has Been Approved by the MOF to Fix a Rate Deemed as Profit According to Article 25 of the Income Tax Act	20% of the deemed profits as calculated by multiplying the ROC sourced revenue by a fixed rate as stated below: 1. 10%, for international transportation 2. 15%, for others	
Income Derived by a Foreign Motion Picture Enterprise Which Has Been Approved to Fix a Rate Deemed as Profit According to Article 26 of the Income Tax Act	20% of the deemed profits	
Other Income	20%	20%

However, with respect to dividends, interest, and royalties, reduced withholding tax rates ranging from 5%-15% are provided for by tax agreements.

List of the Withholding Tax Rates of Dividends, Interest, and Royalties
Under the Respective Tax Agreements

Income Items Country	Dividends (%)	Interest (%)	Royalties (%)
Non-Agreement	20	20, 15	20
Australia	10, 15	10	12.5
Belgium	10	10	10
Denmark	10	10	10
France	10	10	10
Gambia	10	10	10
Germany	10	10, 15	10
Hungary	10	10	10
India	12.5	10	10
Indonesia	10	10	10

Israel	10	7;10	10
Macedonia	10	10	10
Malaysia	12.5	10	10
The Netherlands	10	10	10
New Zealand	15	10	10
Paraguay	5	10	10
Senegal	10	15	12.5
Singapore	40*	Nil	15
Slovakia	10	10	5, 10
South Africa	5, 15	10	10
Swaziland	10	10	10
Sweden	10	10	10
Switzerland	10, 15	10	10
Thailand	5, 10	10, 15	10
The UK	10	10	10
Vietnam	15	10	15

*The tax shall not exceed an amount that together with the corporate income tax payable on the profits of the company paying the dividends constitutes 40% of the part of the taxable income out of which the dividends are declared.

D. Regulations Governing the Application of Agreements for the Avoidance of Double Taxation with Respect to Taxes on Income

To improve the effectiveness of tax administration with regard to double taxation agreements, the MOF issued “The Regulations Governing the Application of Agreements for the Avoidance of Double Taxation with Respect to Taxes on Income” on 7th January, 2010. The Guidelines include detailed guidance for the determination of residency status, the issuance of a resident certificate and income tax statement, the exclusion of a joint-filing requirement, the application of limited tax rates and tax exemptions, the refund of overpaid taxes, the reporting of foreign tax credits, and the procedures for mutual agreement and exchange of information.

II. Transfer Pricing

A. Article 43-1 of the Income Tax Act

In order to deal with the problem of transfer pricing and to realize fair and legitimate taxation in the field of controlled transactions made between a profit-seeking enterprise and its related parties, a provision relating to transfer pricing was enacted into Article 43-1 of the Income Tax Act in 1971. In addition, similar transfer pricing provisions were included in Article 50 of the Financial Holding Company Act and Article 42 of the Business Merger and Acquisition Act in 2001 and 2002, respectively.

Article 43-1 of the Income Tax Act addresses the adjustment of income necessary for enterprises with non-arm's length transactions. This article authorizes the collection authority-in-charge to adjust the calculation of the income of an enterprise in order to accurately determine its taxable income and tax liability. However, this adjustment can only be done with the prior approval of the MOF and in pursuance of the arm's length principle. The application of Article 43-1 is invoked when a profit-seeking enterprise, with other enterprises within or outside the territory, has an affiliated relationship with, or is directly or indirectly owned or controlled by another enterprise, and allocates revenue, costs, expenses, and profits and losses among its related businesses which are incompatible with the arm's length principle, and with the intention to avoid or reduce its income tax liabilities in the ROC.

Article 43-1 of the Income Tax Act governs transfer pricing activities both within domestic enterprises as well as multinational enterprises. Therefore, when the collection authority-in-charge perceives profit-seeking enterprises as having transactions with their related enterprises, (i.e., controlled transactions), which are incompatible with the arm's length principle, the authority may start the process of investigation and adjustment as long as the requirements prescribed in Article 43-1 of the Income Tax Act have been met. As for Article 50 of the Financial Holding Company Act and Article 42 of the Business Merger and Acquisition Act, the investigation and adjustment undertaken by the collection authority-in-charge in accordance with the arm's length principle shall apply to the transactions conducted by any company subject to those acts with its related enterprises, individuals, or non-profit organizations, (i.e., controlled transactions), and shall also apply to the transactions with its unrelated parties which are considered as non-arm's length.

B. Regulations Governing Assessment of Profit-Seeking Enterprise Income Tax on Non-Arm's Length Transfer Pricing

For determining arm's length pricing or the profit of controlled transactions in a fair and reasonable way, the MOF promulgated "The Regulations Governing Assessment of Profit-Seeking Enterprise Income Tax on Non-Arm's Length Transfer Pricing" on 28th December, 2004. These regulations provide the following information:

1. The types of transactions governed by these regulations include the following:
 - a. Transfer of tangible assets;
 - b. Use of tangible assets;
 - c. Transfer of intangible assets;
 - d. Use of intangible assets;
 - e. Rendering of services;
 - f. Use of funds; and
 - g. Other types of transactions prescribed by the MOF.
2. Arm's length principles to be followed by taxpayers and tax authorities

When profit-seeking enterprises and the collection authority-in-charge evaluate whether the result of a controlled transaction is at arm's length, or determine the arm's length result of a controlled transaction, the following principles shall be followed:

- a. The comparability principle;
- b. Adoption of the most applicable transfer pricing method;
- c. Evaluation of separate transactions;
- d. Use of current year data;
- e. Adoption of an arm's length range;
- f. Analysis of reasons for losses;
- g. Separate evaluation of revenues and expenditures; and
- h. Other arm's length principles prescribed by the MOF.

3. Transfer pricing methods

Presently the following transfer pricing methods can be used to evaluate whether the result of controlled transactions is at arm's length, or to determine their arm's length result:

- a. Traditional transaction methods, including the comparable uncontrolled price method, the uncontrolled transaction method, the resale price method, and the cost-plus method;
- b. Profit methods, including the comparable profit method and the profit split method.

These regulations also define the applicable methods depending on the types of transaction. The profit-seeking enterprises undertaking controlled transactions are not required to check each transfer pricing method to determine the one which is most appropriate, instead, they may select one or more of a choice of transfer pricing methods to ascertain the most appropriate one for their circumstances based on the comparability or similarity between the controlled transactions and their comparables, and on the reliability of the adjustments made to eliminate the differences.

4. Requirements for disclosing information

When filing income tax returns, profit-seeking enterprises, except for those which enjoy different tax treatments from their related parties and have a turnover amount and controlled transaction amount under the disclosure threshold established by the MOF, shall disclose information regarding their related parties, and the controlled transactions between the enterprises and their related parties. The enterprises which are required to disclose information shall fill out the relevant form including an organization chart, a brief description of the related parties, a simple summary of the controlled transactions, and other related information.

5. Requirements for preparing transfer pricing documentation

- a. When filing income tax returns, profit-seeking enterprises shall prepare a “transfer pricing report” in regard to their controlled transactions and other related documents, such as a complete organization structure, summaries of controlled transactions, etc., commencing with and including the taxable year 2005. However, in order to alleviate the taxpayers’ burden and compliance costs, the MOF established a safe harbor rule on 30th December, 2005, revised on 6th November, 2008, and applied starting from the fiscal year of 2008. The profit-seeking enterprises of which controlled transactions meet the requirements regulated under the safe harbor rule may replace their transfer pricing report with other evidentiary documents which are able to sufficiently prove that the results of such transactions are at arm’s length.
 - b. The term “transfer pricing report” is a report to record all the procedures regarding a transfer pricing analysis under the regulations. Such report shall at least contain:
 - (1) An industry and economic analysis;
 - (2) A functional and risk analysis of all the participants of the controlled transaction;
 - (3) A description of the nature of the compliance with the arm’s length principle;
 - (4) A description of the search for comparables;
 - (5) A description of the selection of the most appropriate transfer pricing method and the related comparability analysis;
 - (6) The transfer pricing methods adopted by the other related participants; and
 - (7) A description of the application of the most appropriate transfer pricing method to evaluate whether the result of the controlled transactions is at arm’s length and also its conclusion, including selected comparables, difference adjustments and their assumptions, arm’s length range, the conclusion of the evaluation, and the transfer pricing adjustment in the case that the controlled transactions are not at arm’s length.
6. Applications for Advance Pricing Arrangements
- a. Requirements for application for an Advance Pricing Arrangement (APA):

Profit-seeking enterprises undertaking a controlled transaction, which meets certain requirements, may apply for the possibility of an APA. The main requirements are as follows:

 - (1) The total amount of the transactions being applied for under APAs shall be no less than NT\$1 billion; or, the annual amount of such transactions no less than NT\$500 million;
 - (2) No significant tax evasions were committed in the past three years; and
 - (3) Documentation required for an APA application, such as a business overview, relevant information of the related parties and controlled transactions, transfer pricing reports, etc., shall be provided within the time limit.

b. Procedure for filing applications and review

Taxpayers deemed as qualified to apply for an APA should file an application before the end of the first fiscal year covered by the APA. The collection authority-in-charge shall review and reach a conclusion within one year. Under special circumstances, the review period may be extended for a further period of six months. If necessary, another six-month extension may be allowed. When reaching a decision after reviewing the APA application, the collection authority-in-charge will discuss such decision with the applicant. At the time of an agreement being reached between the two sides, an APA shall be signed between the collection authority-in-charge and the applicant with an obligation on the part of both sides to follow the terms of the agreement.

c. Applicable period of an APA

Once signed, the APA will be effective for a period of from three to five years. In the case of there being no substantial change in the conditions described in the APA, an applicant who has fully complied with all the terms of the APA may apply for an extension for another five years.

d. Examinations of compliance with the APA

During the applicable period of the APA, the applicant shall submit an annual report on the execution of the APA to the collection authority-in-charge with the income tax return.

e. Advantages of the use of an APA, including the following:

- (1) Simplified documentation requirement, i.e., no need to prepare an annual transfer pricing report, and
- (2) Certainty for tax liabilities. The collection authority-in-charge will reduce the probability of auditing and shall assess the taxable income in accordance with the APA.

7. Investigation, assessment and corresponding adjustments

a. Investigation

When perceiving profit-seeking enterprises as having non-arm's length transactions with their related parties, the collection authority-in-charge may start the process of investigation. The authority may conduct different procedures based on whether the enterprises being audited provide the transfer pricing documentation as required. In the first instance, in the case that an enterprise provides adequate transfer pricing documentation, the authority may assess its taxable income based on such documentation. In the second instance, if an enterprise fails to provide such documentation, the authority may assess the taxable income based on information gathered from internal and external data sources.

b. Assessment

For both of the above instances, the taxable income of the taxpayer is assessed in accordance with these regulations. However, subject to the second instance, in the case that there is a failure to collect information regarding comparables, (e.g., on royalty payments), the collection authority-in-charge may assess such taxable income based on the standard profit margins regulated by the MOF.

c. Corresponding adjustments

If a collection authority-in-charge has conducted a transfer pricing investigation of a profit-seeking enterprise undertaking controlled transactions pursuant to these regulations, and the arm's length adjustments made by the authority have been approved by the MOF, the authority shall make corresponding adjustments to the taxable income of the counterpart of the enterprise which in the first case has been deemed to be itself subject to adjustments in taxable income if both parties are liable to the income tax obligation of the ROC. Furthermore, in the case that the arm's length adjustment is resultant from an income tax assessment of a foreign tax jurisdiction under the tax agreement framework, the collection authority-in-charge in the ROC shall also make a corresponding adjustment to the taxable income of the counterpart which is liable to the income tax obligation of the ROC in the case where such adjustment is perceived as reasonable by the collection authority-in-charge in the ROC.

8. Penalties

Where the profit-seeking enterprise fails to comply with these regulations thereby resulting in a reduction of tax liability, and the collection authority-in-charge has made adjustments and assessed the taxable income of the enterprise in accordance with the Income Tax Act and these regulations, Article 110 of the Income Tax Act shall apply to the following situations of specific tax omission or under-reporting commencing with and including the taxable year 2005:

- a. The reported price of the controlled transaction is two times or more than the arm's length price as assessed by the tax administration; or 50% or lower than the arm's length price.
- b. The increase in taxable income of the controlled transactions as adjusted and assessed by the collection authority-in-charge is 10% or more of the annual taxable income of the enterprise; and 3% or more of the annual net business revenue.
- c. A profit-seeking enterprise cannot provide a transfer pricing report or other documents evidencing that the result of transactions is at arm's length.
- d. Other *de facto* tax shortfall discovered by the collection authority-in-charge.

III. Thin Capitalization

A. Article 43-2 of the Income Tax Act

The amendments to the Income Tax Act which introduce provisions of thin capitalization became effective as of the fiscal year 2011.

According to the provisions in Article 43-2 of the Income Tax Act, if the proportion of related party debt to equity of a profit-seeking enterprise exceeds a specified ratio, excess interest expense will not be tax deductible. Further, a profit-seeking enterprise will be required to disclose the debt-to-equity ratio and other relevant information in its annual profit-seeking enterprise income tax return.

- B. The provisions regarding Article 43-2 of the Income Tax Act will not apply to banks, credit co-operatives, financial holding companies, bills finance companies, insurance companies, or securities firms.
- C. The MOF promulgated “The Regulations Governing the Assessment of Interest Expenditure on the Debts Owed by a Profit-Seeking Enterprise to a Related Party in Accordance with the Condition that the Related Payments Shall Not be Considered as Expenses or Losses” on 22nd June, 2011. The excess interest expenditure on the debts owed directly or indirectly by a profit-seeking enterprise to a related party shall not be considered as expenses or losses if the proportion of related party debt to equity of a profit-seeking enterprise exceeds the ratio of 3:1 as stipulated by the regulations.