



Taiwan – Amendments to Transfer Pricing Rules

The Ministry of Finance (MoF) of Taiwan recently announced the amendments to the Assessment Rules Governing Non-Arm’s-Length Transfer Pricing for Profit-seeking Enterprises Income Tax (TP Assessment Rules)

It has been ten years since the promulgation of TP Assessment Rules on December 28, 2004 in Taiwan. To respond to the international development trends, increase audit effectiveness, simplify Advance Pricing Agreement (APA) application procedures and reduce double taxation risk of multinational enterprises, the MoF has recently amended the TP Assessment Rules.

I. Overview of major changes

The major changes introduced by the amended rules the MoF promulgated on March 6, 2015 (the Amendment) are highlighted below.

- The salient features of business restructuring rules that are based on Chapter 9 of the OECD Transfer Pricing Guidelines include:

1. Definition and transaction types of business restructuring (Article 4 of the Amendment);
2. Factors that shall be considered in evaluating profit allocations of enterprises engaged in business restructuring and identification of transactions actually undertaken (Article 9.1 of the Amendment); and
3. Additional documentation requirement (Article 22 of the Amendment)

More details on these rules can be found in section II of this article.

■ The revised rules concerning APAs include (Article 23 of the Amendment):

1. The thresholds for applying for APA are reduced by half to NTD 500 million of aggregated transaction amount or NTD 200 million of annual transaction amount;
2. The deadline for submitting the required documents and reports for APA application is extended to three months after receiving the acceptance letter from the tax authorities.
3. Enterprises have the option of applying to hold a pre-filing meeting with the tax authorities by submitting required documents to facilitate the tax authorities' assessment of whether to accept the APA application.
4. Enterprises applying for bilateral or multi-lateral APAs shall apply with Taiwanese competent authority to proceed with mutual agreement procedures with the competent authority of the other country based on the applicable tax treaties and relevant rules.

■ NCP, defined as operating profits divided by the sum of operating cost and operating expenses, is formally added as one of the prescribed profit level indicator under the Comparable Profit Method. The old ruling that initially introduced NCP is thus annulled. (Article 18 of the Amendment)

■ By reference to the OECD Transfer Pricing Guidelines, the Profit Split Method can also be applied where each participant to controlled transactions has made valuable and unique contributions to the controlled transactions. Previously, the Profit Split Method was only applicable where the activities undertaken by each participant in the controlled transactions are highly integrated such that it is not possible

to evaluate the transaction results of each participant on a separate basis. (Article 19 of the Amendment)

- TP Assessment Rules shall apply to final tax returns, in addition to regular tax returns. (Article 21 of the Amendment)
- In applying the safe harbor rules for TP documentation, controlled transaction amounts covered in an APA signed with the tax authorities shall not be taken into account. (Article 22 of the Amendment)
- For profit-making enterprises which did not or could not provide documentations concerning their revenue, where the tax authorities could not find the relevant information, the tax authorities are also allowed to assess the enterprises' income by applying the standard profit margin of the same industry to operating costs and operating expense. Previously, the tax authorities are only allowed to apply the standard profit margin of the same industry where enterprises did not or could not provide documentations concerning their costs or expenses. (Article 33 of the Amendment)

II. Detailed rules on business restructuring

Considering the business restructuring rules could lead to extensive implications, KPMG Taiwan has prepared the English translation set forth below for ease of reference.

■ Definition and transaction types of business restructuring

According to Article 4 Clause 12 of the Amendment, business restructuring refers to the situations where a multinational enterprise group is involved in such organizational structure adjustment activities as the redeployment of functions, assets and/or risks among related parties, and termination or renegotiation and transfer of contractual terms or arrangements. The restructuring transaction types include:

1. Conversion of full-fledged distributors into limited-risk distributors or commissionnaires;
2. Conversion of full-fledged manufacturers into contract-manufacturers (materials buy/sale or contract manufacturers) or toll-manufacturers;
3. Transfers of intangible property rights to a specific entity within the group to centrally manage, or spread out to other entities within the group
4. Downsizing or closure of operations;
5. Other arrangements announced by the MoF

■ Factors to consider in evaluating profit allocation

According to Article 9-1 of the Amendment, the profits allocation of profit-seeking enterprises engaged in business restructuring should be arm's length and the evaluation shall consider the following factors:

1. Special considerations for risks

- (1) Whether the contractual reallocation of risks among related parties in business restructuring is consistent with the economic substance of the transaction
- (2) Identifying the allocation of functions, assets and risks before and after the restructuring and whether the attributed profit is arm's length
- (3) Confirming whether the risk-bearer has the capacity to control the risk and the financial capacity to assume the risk

2. Arm's-length compensation for the restructuring

- (1) The business reasons for and the expected benefits from the restructuring
- (2) The rights and obligations of each participant in the business restructuring before and after the restructuring
- (3) Whether the transfer of profit potential and the reallocation of risk resulting from a business restructuring are commensurate
- (4) Whether there is an appropriate remuneration for the business restructuring involving transfer of tangible assets, intangible assets and activities
- (5) Whether there is an appropriate indemnification for the detriments suffered by participants in the business restructuring resulting from the termination or renegotiation of contract

3. Reasonable compensation or remuneration for post-restructuring controlled transactions

- (1) Conducting comparability analysis of post-restructuring controlled transactions in order to determine a transfer pricing method for the post-restructuring controlled transactions
- (2) Comparing the relationship between compensation for the business restructuring and remuneration for the operations before and after business restructuring

Where the tax authorities find out that the economic substance of the controlled transaction is inconsistent with its form after accurately identifying the controlled transactions actually undertaken according to the documents and information relevant to the business restructuring provided by the taxpayer, they shall make non-arm's length transfer pricing adjustments in regards to the actual transactions.

■ Relevant transfer pricing documentation requirement

According to Article 22 of the Amendment, the transfer pricing reports of enterprises involved in business restructuring shall include the following two additional items:

- The function and risk analysis for the pre- and post-business restructuring years; and
- The analysis to evaluate the arm's length nature of the profit allocation.

The second requirement above is applicable to profit-seeking enterprise tax returns for 2014 tax year and onwards, whereas the first requirement above is applicable starting from 2005 tax returns.

As for business restructurings that took place before 2014 tax year, the enterprises involved in the controlled transaction can provide, as a substitute, other transfer pricing documentations that can sufficiently substantiate the arm's-length nature of the profit allocation of business restructuring.

KPMG Observations

Taiwanese tax authorities would like to encourage enterprises to enter into APAs by lowering APA application threshold, introducing the pre-filing meeting mechanism, and extending the deadline for submitting the required documents in the Amendment. With this welcome move, APAs become a more accessible option of transfer pricing risk management and dispute resolution for many more enterprises. Enterprises conducting significant or complex controlled transactions can consider applying for APA to mitigate transfer pricing audit risks.

On the other hand, the official adoption of the OECD business restructuring rules in the Taiwan TP Assessment Rules signifies the strong emphasis Taiwanese MoF has placed on enhancing transfer pricing regime and enforcement. While it is yet to be observed how the relevant rules will be applied in

practice, business restructuring will likely become one of the focal areas of transfer pricing audit and another major source of tax dispute in Taiwan going forward. In light of this, profit-seeking enterprises planning on rearranging transactions/business models are advised to build economic substance for the restructuring, determine the appropriate compensation for the restructuring and prepare solid documentation to substantiate the arm's-length nature of the arrangements.

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