



Taiwan: National Tax Bureau of Taipei (“NTBT”) initiates tax audit on representative offices

Generally, a foreign company may choose to set up different types of entities in Taiwan for the purpose of carrying out different levels or types of activities in Taiwan. Depending on the purpose and type of activities intended for, the common types of entities set up can include a subsidiary, branch office or a rep office and they are subject to different rules and restrictions from both regulatory and tax perspectives.

From its recent tax audits, the NTBT observes that there are cases where the activities carried out by the entities set up by foreign companies exceeds the scope that the tax rules permitted. In order to ensure compliance, NTBT recently has initiated tax audits on VAT reporting obligations for representative offices.

The activities and tax compliances requirements of Representative offices

Under Article 386 of Company Act, if a foreign company does not intend to set up a Taiwan branch to carry out business activities, it can register with the regulatory authority to set up a representative office with designated representative person to carry out legal activities in Taiwan. Furthermore, the MOEA issued a ruling in 2003 to identify the said "legal activities" as including: signing contracts, bidding, procurement, fee quoting, price negotiation.

According to Tax ruling #7558643 and #7586964, if a foreign company's rep office only conducts legal activities of procurement, quality check, and contact window for its foreign head office without carrying out business activities in Taiwan, the fund received by the rep office will be regarded as operating fund for the rep office's operation and not subject to Taiwan VAT and income tax. The

rep office is not required to register with the tax authority for VAT reporting purpose and can be exempt from VAT and corporate income tax.

However, if the rep office foreign company conducts other business activities and derives revenue, it is still required to file and pay corporate income tax.

From the rules stated, the function of a representative offices is limited to carry out legal activities and not allowed to operate business in Taiwan. Further, the activities that the tax authority views as non-business are limited only to procurement, quality check, and contact window which are very limited.

NTBT 's tax audit focus

It has come to NTBT's attention that many representative offices have performed activities beyond the procurement or contact window and also provide different level of support to its foreign head office such as marketing, back office and sales support, customers support for technical issues raised by the customers. The tax authority considers these activities as exceeding the scope that are allowed by the representative offices and can lead to potential tax implications as well as regulatory consequences. As such,

- The foreign company needs to set up a branch or a subsidiary to carry out these activities in Taiwan
- If a rep office conducts business activities such as sales supportive services etc., the fund received by the rep office from the foreign

company should be regarded as service fee and subject to Taiwan VAT and corporate income tax.

- There can also be penalty imposed on the rep offices for underpaid VAT and income tax for all tax years within the 7 years statute of limitation period.

KPMG Observation

There are very limited functions that can be carried out by representative offices without triggering VAT and corporate income tax implications. In the past the tax authority has not been focusing on the audit of representative offices because they are not required to file VAT and income tax returns. With the investigation of other tax audit, the NTBT has become aware of the non-compliance of representative offices and direct its audit focus in this area.

Based on the audit practices, the NTBT may screen its targeted entities from the following indicators by issuing letters to representative offices for collecting information on activities carried out:

- Business model and type of trades of the foreign head office
- Number of employees working in the rep offices
- Activities carry out by the representative offices
- Funding received by the representative office from its foreign head office.
- Other public information about the operation of the foreign company in Taiwan

Once the representative offices receives the letters from the NTBT, it indicates that the tax audit is officially started. The tax authority can request the representative offices to pay the underpaid taxes as well as impose penalty in the event of incompliance occur. In preparing for the tax audit and avoid the potential tax exposure, we suggest companies taking the following actions:

- Review its current operation in Taiwan by checking against the potential indicators listed above;
- Should the activities conducted be beyond the permitted scope, the company should take remedy actions to correct the current non-compliances from both tax and regulatory perspectives
- Should the company already received the letter from the NTBT, the company should be well prepared to answer the questions raised by the tax authority and prepare supporting documents to defense or reduce the tax exposures

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