e-Tax alert

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Highlights of the Income Tax Act reform and KPMG observation

In view of the complexity of the current imputation tax system, the higher tax burden on dividends income faced by domestic shareholders and the tax burden difference between domestic and foreign investors, the Ministry of Finance ("MOF") has proposed to reform the current Income Tax Act in order to simplify the tax system, to adjust the tax rate structure of individual income tax ("IIT"), corporate income tax ("CIT"), and the surtax on undistributed earnings ("Surtax"), and to ease the income tax burden on wage earners and mid and low-income earners. The amendment to the "Income Tax Act " was passed by the Legislature on the 18th of January, 2018, after the third reading. The key points of the tax reform are summarized below:

For the IIT treatment on dividend income for individual residents (i.e. the domestic individual investors)

– Abolishment of the imputation tax system.

– Individual investors to choose between two options, whichever gives more favorable outcome:

- Option 1: Tax all dividend income as part of individual income, and individual investors may recognize 8.5% of the dividend income as tax deductible amount, (up to NT$80,000 as the maximum allowable deduction amount for each household).

- Option 2: The dividend will be taxed separately and not included as part of the individual income, the individual investor will be taxed on a flat rate of 28%, rather than the individual income tax rate.

For the withholding tax ("WHT") treatment on dividend income for non-residents (i.e. the foreign investors)

– WHT rate on dividend income is increased from 20 % to 21 % for foreign investors (individual resides outside of Taiwan and foreign company with head quarter outside of Taiwan).

– Surtax paid on undistributed earnings can no longer be used to offset against the WHT imposed on the dividend distributed to foreign investors.

For CIT

- The CIT rate is increased from 17 % to 20 %. However for companies with annual taxable income less than NTD 500,000, the CIT rate will be gradually increased from 18% to 20% for the three year period from 2018 ~ 2020 (i.e. 2018-18%, 2019-19%, 2020-20%).

- The surtax rate for undistributed earnings will be reduced from 10% to 5%.

- Companies will no longer be required to establish, record, calculate, and distribute Imputation Credits Account ("ICA") due to the abolishment of imputation tax system.

- Dividend received by domestic corporate shareholder from their investment in other domestic companies, will remain exempt from CIT.

- With respect to dividends paid to non-profit organizations by profit-making businesses, as the dividend would not be subject to further distribution by non-profit organization, for non-profit organizations that do not meet the tax exemption criteria, they would be subject to CIT on the dividends received.

- Sole-proprietorship and partnership are regarded as pass-through entities for tax purpose, as such, the income will only be subject to IIT at the sole proprietors and partners' level.

For IIT

- The 45% tax rate for net consolidated income bracket of higher than NTD 10 million will be changed back to 40%.
- Increase deductible amount for the following deduction items:

  - Standard deduction will be increased by NTD 30,000, from NTD 90,000 to NTD 120,000. The amount will be doubled for taxpayers with spouse.

  - Special deduction for income from salaries / wages and special deduction for disabled and handicapped will be increased by NTD 72,000, raised from NTD 128,000 to NTD 200,000, respectively.

  - Special deduction for pre-school-aged children will be increased by NTD 95,000, raised from NTD 25,000 to NTD 120,000.

The tax reform shall be effective in accordance with the following dates:

- Individual dividend income tax for domestic investors and individual income tax: Effective starting from January 1, 2018, i.e., applicable when filing FY 2018 individual income tax return in 2019.

- Dividend withholding tax for foreign investor: The raised withholding rate will take effect from January 1, 2018. Regarding the abolishment of creditable surtax, considering the levy of surtax is in the year subsequent to the CIT reporting, such new regime will take effect from January 1, 2019.

- Corporate Income Tax: The adjusted tax rate and new taxation regime for sole - proprietorship and partnership will be applicable upon filing FY 2018 corporate income tax return and surtax return. To work in conjunction with the new dividend income tax regime, the abolishment of ICA and tax on dividends received by non-profit organizations will take effect starting from January 1, 2018.

KPMG's Observations

As surtax for undistributed earnings for 2016 will be charged, companies have to choose whether to distribute such earnings in 2018. For the 2017's, 2018's earnings and beyond, companies have to decide whether to retain the earnings without making distribution, which would be subject to surtax, or make distribution in the subsequent year.

Assuming that a company's net profit before tax in 2016 is 100, the earnings are distributed in 2018 or after 2019 (surtax will be charged under both scenarios). Meanwhile, the net profit before tax for the company in 2017 and 2018 are both 100 and the earnings are distributed in 2018 and 2019 respectively (no surtax are charged), or after 2019 and after 2020 respectively (surtax are charged). The tax implications for domestic individual investors and foreign investors can be summarized as follows (it is assumed that the general personnel income tax rate for domestic individual investors is 40%, and the investors choose to report their dividend income separately with 28% tax rate):

Fiscal Year's earning	Domestic Individual Investor		Foreign Investor	
FY2016 earnings	Distribution for year 2018	Distribution after year 2019	Distribution for year 2018	Distribution after year 2019
CIT	17	17	17	17
Surtax	8.3	8.3	8.3	8.3
IIT	20.92	20.92	-	-
WHT	-	-	15.69	15.69
Creditable surtax	-	-	(3.74)	-
CIT	**46.22**	**46.22**	**37.25**	**40.99**
FY2017 earnings	Distribution for year 2018	Distribution after year 2019	Distribution for year 2018	Distribution after year 2019
CIT	17	17	17	17
Surtax	-	8.3	-	8.3
IIT	23.24	20.92	-	-
WHT	-	-	17.43	15.69
Creditable surtax	**40.24**	**46.22**	**34.43**	**40.99**
FY2018 earnings	Distribution for year 2019	Distribution after year 2020	Distribution for year 2019	Distribution after year 2020
CIT	20	20	20	20
Surtax	-	4	-	4
IIT	22.4	21.28	-	-
WHT	-	-	16.8	15.96
Creditable surtax	**42.4**	**45.28**	**36.8**	**39.96**

Based on the analysis above, our observations with respect to the tax reform are as follows:

- For corporations, whose majority shareholder are domestic individual investors, their 2016 earnings will be subject to the new tax regime whether they are distributed in or after 2018. Therefore, the tax burden remain the same. As for earnings for 2017 and beyond, since they are subject to the new tax regime, the overall tax burden will be lower if the earnings are distributed in the subsequent year.

- For corporations whose majority shareholders are foreign investors, 50% of the surtax previously paid on undistributed earnings as of 2016 will still be creditable if earnings are distributed in 2018. Therefore, the overall tax burden will be lower if the earnings are distributed in 2018 rather than later years. As for earnings for 2017 and beyond, as the surtax charged on undistributed earnings will no longer be creditable, distributing the earnings in the subsequent year will result in lower overall tax burden.

- Without taking the shareholder’s dividend tax burden into consideration, if a company choose not to distribute its earnings in the year after the profit year, its overall tax burden will be 25.3%(=17%+83%×10%) before the tax reform and 24% (=20%+80%×5%) after the tax reform.

- If the resident country of a foreign investor has entered into a tax treaty with Taiwan, the limitation on dividend withholding tax rate provided in the treaty will still be applicable and not affected by the increased withholding rate.

- Mid and low-income earners may choose to file their dividend income in the consolidated personnel income tax return and be entitled to certain amount of tax credit accordingly.

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