

# e-Tax alert

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## New Calculation Method of Taiwan Sourced Income for Foreign Business Entities Engaging in Importing, Storage and Manufacturing in Taiwan

On April 17, 2018, Taiwan Ministry of Finance (MOF) announced a tax ruling to interpret the new calculation method of Taiwan sourced income derived by foreign business entities engaging in importing, storage, manufacturing and delivery of goods to domestic and foreign customers. According to the ruling, the profit standard rate and contribution rate (hereinafter called the “simplified calculation method”) could be adopted by foreign entities conducting the abovementioned activities and not limited to the areas of Free Trade Zones or bonded areas. Besides, the contribution rate is also reduced in order to achieve a more reasonable tax burden.

The transaction types eligible for this ruling are illustrated as below:

| Manufacturing Activities |     | Offshore    |            |
|--------------------------|-----|-------------|------------|
|                          |     | Yes (Note1) | No (Note2) |
| Onshore                  | No  | Type 1      | Type 3     |
|                          | Yes | Type 2      | Type 4     |

Note 1: The sales function may be performed onshore or offshore.

Note 2: The sales function should be performed offshore.

For Type 1 and Type 3 where the onshore manufacturing activities are not involved in the transaction flows, provided that the sales of goods are completed within the territory of Taiwan, the contribution rate to determine the contribution of the activities conducted in Taiwan over the entire transaction flows will be reduced from 12% to 3%.

On the other hand, for Type 2 and Type 4 where the onshore manufacturing activities are involved in the transaction flows, provided that the sales of goods are completed within the territory of Taiwan, then the contribution rate should be calculated based on the formula set forth under the ruling:

Contribution rate

$$= 3\% + \frac{\text{Costs and expenses of manufacturing and processing incurred onshore}}{\text{Total costs and expenses incurred onshore and offshore}}$$

\*the contribution rate cannot exceed 100%.

The “Costs and expenses of manufacturing and processing incurred onshore” (i.e. the numerator of the formula) includes the followings:

- The costs and expenses of procurement incurred onshore, such as salaries and other sales and administrative expenses related to the purchase of materials and semi-finished goods from onshore or offshore for manufacturing and processing purpose, but excluding the costs of materials and semi-finished goods (in the past, only the onshore procurement is qualified where the new tax ruling removes such restriction);
- The costs and expenses of manufacturing and processing, such as remunerations paid to Taiwan businesses who provide manufacturing and processing service;
- The costs and expenses of sales for Type 2, if the sales function performs onshore, such as salaries and other sales and administrative expenses incurred for sales of goods.

The “total costs and expenses incurred onshore” as indicated in the denominator of the formula, includes the followings that are incurred within Taiwan:

- The costs and expenses of importing, storage and manufacturing;
- The costs of onshore materials and semi-finished goods used for manufacturing and processing;
- The costs and expenses of delivery to customers onshore and offshore.

In addition, the “total costs and expenses incurred offshore” as indicated in the denominator of the formula, includes the customs value of the importation for (1) goods manufactured offshore by the foreign entity itself or purchased offshore, and (2) materials and semi-finished goods purchased offshore and used for manufacturing and processing onshore.

Please note, for Type 3 and Type 4, if the goods are not manufactured offshore by the foreign entity itself but purchased offshore, and the sales function is performed within Taiwan, the profit would be deemed generated mainly within Taiwan under this type of transactions, and thus the simplified calculation method under the new ruling cannot be applied. Instead of, the actual basis method should be adopted when calculating its taxable income sourced from Taiwan in this situation.

### KPMG Observation

The new tax ruling enlarges the scope of applicability of the simplified calculation method for foreign business entities engaging in importing, storage, manufacturing and delivery of goods to domestic and foreign customers. In addition, the contribution rate to determine the contribution of the activities conducted in Taiwan over the entire transaction flows is also reduced for the foreign entities who merely engage in logistics and manufacturing business. Therefore, this tax ruling should be beneficial to taxpayers. It is recommend that any foreign business entity who may qualify for this ruling should review its corporate income tax returns that are not yet assessed by the Taiwan tax authority and seek the opportunity to claim a tax refund in accordance with Paragraph 1 of Article 1-1 of Tax Collection Act, in order to secure a favorable tax treatment from the simplified calculation method.

In addition, one of the criteria to constitute Taiwan sourced income under each transaction type is that the sales of goods are completed within the territory of Taiwan. However, further clarification should be provided by MOF in relation to the detailed rules and applicable conditions to determine whether the sales of goods are completed outside of Taiwan.

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