



New amendment to TSI Guidance on Taiwan source income calculation for foreign corporations

Under the current Taiwan Income Tax regime, foreign companies without PE in Taiwan that derive Taiwan source income, under the category of service income or business profits, would be subject to withholding tax. The Taiwan companies, which makes the underlying payment to foreign companies, are obligated to make withholding if falling within the types of income subject to withholding tax regime.

While the relevant income tax rule allows foreign companies to claim costs/expenses incurred offshore, if the foreign company have been subject to income tax/withholding tax, however, in practice the tax authority tends to raise challenge against offshore expenses and subject to strict scrutiny.

On September 27, 2019, the Ministry of Finance (MOF) has announced an amendment to the TSI Guidance and allows the foreign companies to apply advance confirmation with the tax authority on income calculation under Article 15-1. Pursuant to such amendment, foreign companies without PE in Taiwan can now adopt a “deemed profit” approach to calculate their taxable Taiwan sourced income as an alternative option, instead of trying to claim actual costs and expenses incurred and apply for refund on the overpaid withholding tax afterwards. To utilize such treatment, foreign companies would need to first seek advance confirmation from the tax authority.

The detail rules on such application has also been announced under “*Directions for Foreign Profit-*

seeking Enterprises Applying for Issuance of Assessment Permission of Applicable Net Profit Ratio and Domestic Profit Contribution Ratio for Calculation of Income from Sources in the Republic of China” (“**Directions for Art. 15-1 TSI Guidance Application**”).

The aforementioned amendment is effective immediately and the main points are summarized below:

1 What is covered under Article 15-1 of TSI Guidance

In accordance with Article 15-1 of the TSI Guidance, foreign companies without PE in Taiwan, which derives Taiwan source income under the category of services income or business profit, can apply to the tax authority to adopt deemed profit ratio and contribution ratio to calculate its taxable income in Taiwan. To adopt such calculation of taxable income, foreign companies would need to make the deemed profit and contribution ratio application to the tax authority prior to receiving the income.

2 The calculation of Taiwan sourced income

In terms of the calculation of the taxable income, Article 15-1 allows the foreign companies to adopt a deemed profit ratio to calculate the taxable income rather than pay the withholding tax on the gross amount.

In addition, the tax regime also allows the foreign companies to claim a contribution ratio, which determines how much of revenue derived is attributable to onshore activities and offshore activities.

Please refer to the attachment for illustration of the calculation.

3 Documentations to be submitted in the application

Applicants are required to submit the following documents along with the application:

- a. the relevant underlying contract, which needs to be signed (with Chinese translation)
- b. explanation of the applicant's main business operation and relevant transaction flow/stages (both onshore and offshore transaction steps)
- c. Documents illustrating applicant's main business operation
- d. previous approval letter (within the three most recent years) issued by the tax authority on the use of deemed profit and contribution ratio (if previously granted)
- e. letter of authority (if applicant is appointing an agent to file the application)
- f. other supporting documents requested by the tax authority

KPMG Observations

1. Prior to the announcement of the Art. 15-1 of TSI Guidance, the tax authority tends to place strict scrutiny when reviewing the offshore costs/expenses claimed by taxpayers; this often creates practical difficulties for foreign companies to substantiate the offshore costs/expenses claimed for calculation of taxable income in Taiwan which defeats the original intent on TSI Guidance. With the new amendment and release of the Directions for Art. 15-1 TSI Guidance Application, it provides more flexible options for foreign companies to calculate the taxable income; furthermore, the use of deemed profit ratio also mitigate the uncertainty associated with substantiation issue and administrative burden of post payment refund process.

2. Among the different options of reducing the withholding tax costs, currently the more frequently used mitigation options are business profits exemption provided under treaty or the Article 25 of Income Tax Act for technical service fee (which is not applicable to China companies). While Taiwan has relatively limited treaty network, this new rule can apply to payments to foreign companies located in non-treaty countries, including China companies (where the double tax agreement still not yet effective and Article 25 treatment does not apply to China companies). So this offers an alternative option to reduce the withholding tax burden.

3. The utilization of the deemed profit ratio and contribution ratio stated in the Directions for Art. 15-1 TSI Guidance Application is an advance confirmation effective after the announcement and not applicable retroactively to payment already been subject to withholding tax. We suggest companies should revisiting the related payments for future period and submit the application with the tax authority to secure the reduced tax treatment going forward. Note that if the companies do not seek the advance approval, they are still eligible to claim the actual costs and expenses incurred and apply for withholding tax refund afterwards.

Calculation of taxable income

$$\text{Revenue} \times (\text{A}) \text{ deemed profit ratio} \times (\text{B}) \text{ contribution ratio} \times \text{tax rate} = \text{tax amount}$$

A Deemed profit ratio

1. Net profit ratio that is determined based on cost and expense accounting information provided, or
2. Where the supporting accounting documentation are not available, if applicant has previously obtain approval for deemed profit ratio within the three most recent years for similar transaction under contracts with similar terms , applicant can apply to adopt the average of the past three years' ratios, or
3. The taxpayers has not previously applied deemed profit ratio, taxpayers can apply to adopt the deemed profit rate of the same industry applicable to their main business operation

If the actual net profit ratio is deemed by the tax authority to be higher than the approved deemed profit ratio referred above, then the higher ratio will be adopted.

B Segregation of onshore/offshore contribution ratio

Actual contribution ratio

Provide supporting documentation such as CPA certification report, TP documents, work plan/report,

Or

Previously approved contribution ratio

If applicant has previously obtain approval for contribution ratio within the three most recent years for similar transaction under contracts with similar terms, applicant can adopt the average of the three years' ratios. If the actual onshore contribution ratio is deemed by the tax authority to be higher than the approved deemed profit ratio, then the higher ratio will be adopted.

If neither of the above two scenario applies, then the contribution ratio will be 100%

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