

e-Tax alert

Issue 156 – December 17, 2020



Avenues for reduce withholding tax on the cross-border service fee

General speaking, for services remuneration paid to foreign company for providing cross-border services to a Taiwan domestic company, the Taiwan company tends to regard such payment as foreign company's Taiwan source income and withhold 20% tax of the gross amount at the time of making payment to avoid potential penalty for failure to make withholding.

The amount of the payment subject to withholding tax (WHT) is usually the gross amount, as this method does not consider the location of the foreign services provider and relevant costs and expenses incurred during providing the services, this leads to increased tax burden for the foreign service provider.

Currently, there are several avenues that a foreign company could adopt in order to reduce the WHT burden. For example, if the concerned service is carried out entirely from outside of Taiwan and without any Taiwan parties' participation and assistance, then the foreign service provider could claim that the service remuneration received as being non-Taiwan sourced income (TSI) and exempted from WHT.

However, in practice, whether a Taiwan individual or company has involved in the process of providing services is subject to case-by-case review by tax authority without a general set of guidelines, thus the position of claiming non-TSI is relatively difficult to established.

Apart from claiming non-TSI, there are other possible reductions and exemption avenues which can effectively reduce the foreign company's Taiwan WHT burden. The commonly used approaches, scope of application, procedures and effective tax rates are summarised as follows:



Applications	Applicable Scope	Effective tax rate	Action Required
Directions for TSI guidance application	(1) All Non-TSI (Services conducted offshore without domestic tax residence participation)	Exempted	Ruling confirmation is recommended; can seek refund for paid WHT
	(2) Partial Non-TSI (Deemed profit rate and contribution rate)	Assuming 20% deemed profit rate and 50% onshore contribution rate $20\% \times 50\% \times 20\% = 2\%$	Pre-approval from tax authorities required
	(3) Deductions for costs and expenses	Assuming 90% of cost/expense incurred $10\% \times 20\% = 2\%$	WHT needs to be paid first and then seek refund
Article 25	Technical services (Deemed 15% of revenue derived in Taiwan as taxable income)	$15\% \times 20\% = 3\%$	Pre-approval from tax authorities is required; can seek refund for paid WHT
Treaty	Business Profits	Exempted	Pre-approval from tax authorities is required; a retroactive claim within 5 years from the date of WHT is paid

If the foreign service provider is a tax resident of a country that has signed a tax treaty with Taiwan, then the qualified business profit earned could enjoy exemption under the applicable tax treaty; or, if the foreign company is a non-tax treaty country tax resident, but the service provided is deemed as “technical service”, then the foreign company could consider applying for Article 25 of the Income Tax Act (ITA) to reduce its effective tax rate to 3%. In addition, if the criteria of above two approaches cannot be met, the foreign company still can try to claim the actual incurred costs/expenses deduction in accordance with Direction for Article 15 of TSI Guidance stipulated under the Article 8 of the ITA and apply for overpaid WHT refund afterwards.

However, for foreign company who does not have a fixed place of business in Taiwan, it could still be difficult for the foreign company to maintain a separate set of bookkeeping record and to clearly distinguish the costs/expenses committed to its operations in Taiwan. Moreover, the complicated procedures of paying WHT first and claiming refund later also deters foreign companies from pursuing this approach.

Consequently, in order to alleviate foreign taxpayer’s tax burden and reduce the workload for both tax authority and taxpayers, the Ministry of Finance announced an amendment to the TSI Assessment Guidance in September of 2019, Article 15-1, which permitted foreign companies (without fixed place of business in Taiwan) to apply the deemed profit and contribution ratio (hereby, called “Pre-approval Profit Ratio”) from the tax authorities to calculate its taxable income, prior to receiving payment. For Pre-approval

Application requirements, please refer to [e-Tax alert Issue 134 on Oct 4, 2019](#).

After the new amendment has taken effect, foreign companies from non-tax treaty countries, such as those located in China, the United States and Korea; or foreign companies which provided “non-technical services”, have utilized the Pre-approval Profit Ratio to effectively reduce its tax burden in Taiwan. However, in consideration of a short enforcement period of the amendment and lack of precedent references from the competent tax authorities, we summarized several key points to be noted as follows:

Deemed profit rate

- Most of the foreign companies are unable to provide complete bookkeeping record to verify the relevant costs and expenses, and thus they usually apply for the Pre-approval Profit Ratio by providing supporting documents, such as the underlying service contracts and detail description of the transaction flow. Note that if the signed contract is in English, a Chinese translation would be requested by the tax authorities.
- The content of the application letter must specify applicant’s scope of the business, the content of the provided services, calculation method of the fee charge and standard deemed profit rate of the same trade which proposed by the applicant.

Note that if the contract involves multiple service types, the tax authorities would also request the applicant to clearly distinguish service types and fee charge for each identified service, as well as

advocate an appropriate deemed profit rate based on each service item.

- Regarding the payment amount agreed in the contract, tax authorities usually assess whether the service provided is in consistence with the contract term; and request relevant cost and expense composition (e.g. fixed or variable costs), specific pricing method and billings/invoices.

Since a pre-approval is required in order to use the Pre-approval Profit Ratio, the withholding agent (Taiwan company, as the payer) should confirm with the applicant (foreign service provider) whether an approval has obtained in order to prevent from being penalized for tax omission by the tax authorities.

Contribution ratio

- Foreign companies generate TSI is eligible to apply Contribution Ratio if the services provided or business activities are carried out simultaneously both within or outside of Taiwan. In general, the contribution ratio is based on the actual input working hours or costs/revenue attributed to the service etc. However, to verify how much of revenue is attributable to onshore and offshore activities, the applicant must present a valid proof of documents which could distinguish the proportions. (E.g. Certified CPA report, TP report and job logging etc.)
- Note that if the applicant claims that provided services are deliver thorough e-mail, conference call or any other online serve etc., then tax authorities may further request specific service evidence to prove the ratio of participation.
- Due to lack of a set of clear criteria for assessing domestic contribution ratio, apart from requiring the applicant to present the abovementioned supporting documents, the tax authority would also conduct individual review and ask further information based on the circumstances of each case. If the applicant cannot justify the rationality of the contribution ratio, then it's likely the tax authority would deem the contribution ratio (for onshore activities) as being 100%.

deduction approach under Direction for Article 15 of TSI Guidance, these approaches often caused foreign companies shifted their WHT burden onto Taiwanese companies.

Under Article 15-1 of the TSI Assessment Guidance, it permits foreign companies (without fixed place of business in Taiwan) which have difficulties in preparing bookkeeping record to follow similar WHT mitigation avenue available to cross-border e-service provider, to apply the Pre-approval Profit Ratio from tax authorities and calculate its Taiwan taxable income before receiving services remuneration or business profit.

Based on KPMG's experience, although most of the applications have been deemed with 100% onshore contribution ratio by the tax authority, the result of Pre-approval Profit Ratio could still substantially reduce the foreign companys' WHT burden in Taiwan, even if the tax authorities only approved the industry-standard profit ratio.

For instance, if the deemed profit ratio of the same industry according to the provided service that is awarded by the tax authority is 21%, in result, the WHT rate could effectively reduce from 20% to 4.2% ($21\% \times 100\% \times 20\% = 4.2\%$). Hence, KPMG recommends foreign companies and the domestic service purchaser to proactively evaluate the feasibility of adopting the tax relief stated under Article 15-1 of TSI Assessment Guidance, to avoid uncertainty of foreign services provider's tax cost and burdensome tax refund procedures and mitigate tax cost through approved measures.



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KPMG Observations

Due to the specific requirements of the Article 25 of ITA or applicable restrictions of the tax treaties and time-consuming implementation on the cost/expense



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