



Taiwan Tax Alert

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Guidance issued on eligibility for tax treaty benefits

The Ministry of Finance issued *Assessment Rules on the Eligibility for Income Tax Treaty Benefits* (Assessment Rules) on 7 January 2010, which provide guidance on the applicability of Taiwan's tax treaties and enable the tax authorities and taxpayers to better interpret treaty provisions. The Assessment Rules replace the *Assessment Criteria for Eligibility for Income Tax Treaty Benefits* (Assessment Criteria) and are effective as from the date of issuance.

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General principles

The Assessment Rules are based on the 2008 OECD Model Treaty and Commentary. They contain clear wording on the application of the substance-over-form principle with a view to eliminating double taxation and preventing tax avoidance (e.g. beneficial ownership, limitation on benefits, etc.). The Assessment Rules also set out the administrative procedures and documents required to apply for treaty benefits.

Tiebreaker rules: The Assessment Rules provide a clear definition of the tiebreaker rules to determine residence in Taiwan's treaties. However, the hierarchy of tests will vary depending on the treaty text.

Permanent establishment: The Assessment Criteria did not address the concept of a permanent establishment (PE), and similar terms could only be found in the Income Tax Law, which is also ambiguous. The Assessment Rules describe how a PE can arise and establish criteria in accordance with the OECD Commentary on the Model Treaty (i.e. the existence of a fixed place of business, a degree of duration and whether the place is at the disposal of the foreign company). The rules relating to construction sites/installation projects, service PEs and agency PEs in the Assessment Rules are basically similar to those in the OECD Model Treaty and Commentary.

However, the Assessment Rules appear to take a strict position on a service PE. According to article 9 of the Assessment Rules, where a foreign entity provides services by sending its personnel to Taiwan, the number of days the personnel stay in Taiwan will be crucial to the determination of a service PE. Days spent providing services outside Taiwan also will be taken into account if the tax authorities believe that the services rendered overseas are associated with the services provided in Taiwan. As a result, the issue of whether the services rendered outside and within Taiwan relate to each other could become controversial.

Documentation: The Assessment Rules specify the documents required to apply for treaty benefits and clearly state that reduced rates of withholding tax under tax treaties prevail over domestic rates.

The Assessment Rules also provide guidance for foreign institutional investors applying for treaty benefits, by specifying the documents needed to substantiate a fund's beneficial owners (e.g. tax residence certificates and list of beneficiaries). As a result, these rules are much clearer and easier for applicants to follow to enjoy treaty benefits.

Calculation of taxable income: The Assessment Rules stipulate that transfer pricing principles should apply when a foreign company attributes profits to a PE. Only the profits attributable to the PE should be taxed in the source country, but the PE is required to prepare transfer pricing documentation based on Taiwan's transfer pricing rules to demonstrate the reasonableness of the attributed profits.

Reporting methods and tax refunds: The reporting requirements and tax collection methods are basically the same as those under relevant Taiwan tax laws.

A PE's tax obligations can be met by either payment of withholding tax or the filing of an income tax return, depending on the source of the income. However, the deductibility of qualified costs and expenses from a PE's taxable income is allowed from a fairness perspective. If a PE of a foreign company is not a fixed place of business (FPB) or a business agent (BA) of the foreign company, the company may appoint an FPB or BA to file the return for profits attributable to the PE even if tax was withheld.

In general, a foreign company should appoint an FPB or BA for tax return filing purposes on a project basis. Nevertheless, based on discussions with officials from the MOF, in certain cases (e.g. where various projects are related), income attributed to associated projects could be reported on a single return, even though the Assessment Rules do not specify this in detail.

Tax refunds may be requested for overpaid tax for up to five years from the payment date provided the taxpayer submits appropriate documentation. Tax refunds also may be requested on an aggregate, rather than an individual, basis.

Other: In addition to clearly setting out the requirement for a tax residence certificate, an ultimate beneficial owner certificate or a certificate of tax paid to claim a foreign tax credit, the Assessment Rules provide guidance on information exchange and the mutual agreements procedure between the tax authorities in the relevant jurisdictions.

If not all beneficial owners of an investment fund are eligible tax residents of another country and qualify for treaty benefits, only the income distributed to the tax residents of the other countries will be subject to the reduced rate of withholding tax under a treaty.

Conclusion

The Assessment Rules are much clearer than the Assessment Criteria and provide simple guidance for both the tax authorities and applicants. Taiwan currently has 17 tax treaties: Australia, Belgium, Denmark, Gambia, Indonesia, Israel, Macedonia, Malaysia, Netherlands, New Zealand, Senegal, Singapore, South Africa, Swaziland, Sweden, the U.K. and Vietnam. The Assessment Rules will be a guide for qualified applicants to apply for treaty benefits, and will minimize disputes relating to the applicability of treaties and anti-avoidance.

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