正大聯合會計師事務所
Grant Thornton

Taiwan CFC Rules

Taiwan CFC rules became effective on 1 January 2023

CFC stands for controlled foreign corporation. In order to better protect Taiwan's tax base and follow international trends, Taiwan introduced CFC rules effective from 1 January 2023 to stop tax leakage from complex international tax planning.

Definition of CFC

A foreign enterprise registered in a low-tax burden country or jurisdiction and its paid-in capital is more than 50% owned by a Taiwan tax resident individual together with related parties or more than 50% owned by a Taiwan legal entity together with its related parties directly or indirectly. If the ownership percentage is less than 50% but the foreign enterprise is effectively controlled by a Taiwan tax resident individual together with related parties or controlled by a Taiwan legal entity together with its related parties directly or indirectly, then the foreign enterprise shall also be deemed to be a CFC.

Low–tax burden country or jurisdiction refers to any one of the following:

- Corporate income tax rate in the foreign country/jurisdiction is not more than 70 percent of the tax rate in Taiwan (20%*70%=14%). Taiwan Ministry of Finance has published a list of countries meeting this criteria as per Appendix 1.

- Foreign country/jurisdiction imposes taxes on a territorial basis (does not impose taxes on incomes derived from offshore, or imposes taxes only after incomes are remitted back). Taiwan Ministry of Finance has published a list of countries meeting these criteria as per Appendix 2.

Definition of related parties

The definition of related parties is broad. More details can be found in Article 3 of the Regulations Governing Application of Accrued Income from Controlled Foreign Company for Profit-Seeking Enterprises.

Scope

Article 43-3 of the Income Tax Act requires profit-seeking enterprises to incorporate the profits earned from CFCs for the purpose of computing taxable income for the year. However, for the purpose of computing interim corporate income tax payable, CFC income does not need to be included (Tax ruling 11204543460).

Any foreign corporation meeting the definition of CFC listed in the first paragraph of this article would be included. However, if CFC and PEM (Place of Effective Management) rules both apply then PEM takes precedence over CFC.

Please note that there is also a substance over form rule that applies to CFC. This means that

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shares owned through the use of nominees will need to be factored into account.

General Exemption

CFC rules can be exempted, if there are substantial operating activities in the CFC.

This means that there is a fixed place of business in its registered place and the CFC has employees carrying out actual operating business in the local area. Furthermore, passive income such as rent, royalty, and interest account for less than 10% of the sum of its operating income and non-operating income.

Please note that PEM (Place of Effective Management) takes precedence over CFC. Accordingly, if income has already been recognized under PEM then there is no need to report the same income under CFC rules.

Tax Computation (Individual)

CFC income shall be computed as follows:
CFC income = Income earned by CFC for the year - required legal reserve – losses from prior years

Taxable CFC income shall be computed based on the actual holding percentage and weighted average holding period.

If the computed total CFC income for a tax-filing household is less than TWD 1 million, then there is no need to report this income.

If the current-year earnings of a CFC is less than TWD 7 million, then there is no need to report this income. However, if there are a number of CFCs and all CFC income for a tax-filing household together exceeds TWD 7 million, then the full amount needs to be reported.

Computed CFC losses can be reserved for a period of up to 10 years if related proof is audited by a CPA. CFC losses can only be used to offset against CFC income from the same invested entity.

In the case of offsetting accumulated losses with paid-in capital in a CFC, the offset losses cannot be carried forward in the tax loss reserve computation.

Computed CFC income shall only be taxed once. There is no need to report this income again in the year of dividend distribution, unless if the amount distributed is higher than what has already been reported as CFC income.

In the case of capital gains earned from selling shares in a CFC, taxable income shall be computed as per below.

Taxable capital gains = Selling price - cost of the shares – residual CFC income already reported * percentage of disposal

Please note that CFC income for an individual is subject to AMT (Alternative Income Tax) computation.

Tax Computation (Profit Seeking Enterprise)

CFC income shall be computed as follows:
CFC income = Income earned for the year - required legal reserve – losses from prior years

Taxable CFC income shall be computed based on the actual holding percentage and weighted average holding period.

If the current-year earnings of a CFC are less than TWD 7 million, then there is no need to report this income. However, if there are a number of CFCs and all CFC income together exceeds TWD 7 million, then the full amount needs to be reported.

Computed CFC losses can be reserved for a period of up to 10 years if related proof is audited by a CPA. CFC losses can only be used to offset against CFC income from the same invested entity.

In the case of offsetting accumulated losses with paid-in capital in a CFC, the offset losses cannot be carried forward in the CFC loss reserve computation.

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Computed CFC income shall only be taxed once. There is no need to report this income again in the year of dividend distribution, unless the amount distributed is higher than what has already been reported as CFC income.

In the case of capital gain earned from selling shares in a CFC, taxable income shall be computed as per below.

Taxable capital gain = Selling price - cost of the shares – residual CFC income already reported * percentage of disposal

Implications of Non-Compliance

In the case of tax evasion in excess of TWD 10 million, individuals can be penalized under Article 41 of the Income Tax Collection Act and can be subject to a fine of TWD 10 million ~ TWD 100 million and imprisonment of 1~7 years.

In the case of profit-seeking enterprise, the responsible person can be penalized under Article 41 of the Income Tax Collection Act and can be subject to a fine of not more than TWD 5 million and imprisonment of not more than 5 years.

Our Approach

In the past, tax heaven companies are often used as part of an international tax planning scheme. However, with the introduction of CFC rules, it is possible that one's current group structure may no longer be tax efficient.

We can help clients evaluate whether the existing group structure is still appropriate in view of the coming CFC rules. If in doubt, please do not hesitate to contact any member of our tax team.

Contact

Jay Lo
Managing Partner
T +886 2 2789-0887 ext. 1314
E jay.lo@tw.gt.com
www.grantthornton.tw

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Appendix 1 – Countries with Corporate income tax rates lower than 70% of Taiwan’s income tax rate

- Andorra
- Anguilla
- Bahamas
- Bahrain
- Barbados
- Bermuda
- Bonaire, Sint Eustatius and Saba
- Bosnia and Herzegovina
- British Virgin Islands
- Bulgaria
- Cayman Islands
- Democratic Republic of Timor-Leste
- Guernsey
- Hungary
- Ireland
- Isle of Man
- Jersey
- Kosovo
- Kyrgyzstan
- Liechtenstein
- Macao
- Marshall Islands
- Mauritius
- Moldova
- North Macedonia
- Palau
- Paraguay
- Qatar
- Republic of Cyprus
- Turks and Caicos Islands
- Vanuatu

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Appendix 2 - Foreign countries/jurisdictions that impose taxes on a territorial basis

- Belize
- Bolivia
- Botswana
- Brunei Darussalam
- Chad
- Costa Rica
- Curacao
- Democratic Republic of the Congo
- Djibouti
- El Salvador
- Eritrea
- Eswatini
- French Guiana
- French Polynesia
- French Republic
- French Southern Territories
- Georgia
- Gibraltar
- Guadeloupe
- Guatemala
- Guinea-Bissau
- Honduras
- Hong Kong
- Kenya
- Kuwait
- Libya
- Malawi
- Malaysia
- Martinique
- Mayotte
- Micronesia
- Monaco
- Namibia
- Nauru
- New Caledonia
- Palestine
- Republic of Nicaragua
- Republic of Niger
- Republic of Panama
- Reunion
- Saint Barthelemy
- Saint Martin (French Part)
- Saint Pierre and Miquelon
- Saint Vincent and The Grenadines
- Seychelles
- Singapore
- Syrian Arab Republic
- Tuvalu
- United Arab Emirates
- Uruguay
- Wallis and Futuna

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