TAX

Globalization and China's rise as the world's factory have affected Taiwan's efficiency-driven model of economic growth. The slower economic momentum has widened the income gap, reduced job opportunities, and caused salary levels to stagnate. As the new government seeks ways to reinvigorate the economy, one of its priorities should be to create a more favorable environment for the attraction and retention of outstanding professional talent, both Taiwanese and foreign. The Tax Committee joins the Human Resources Committee in stressing that a major component of that environment must be creation of a healthy tax policy, especially with regard to individual income tax. As we have done in previous White Papers, the Tax Committee wishes to highlight the need for effective tax reform as a means of ensuring Taiwan's economic health and competitiveness.

Suggestion 1: Revisit the current tax policy on foreign business' drop-shipment transactions in Taiwan.

Throughout Taiwan's crucial technology-oriented industries, from semiconductors to computer products, toll and contract manufacturing operations play a significant role. The current tax rules, however, are not favorable to these important economic activities. Income tax exemption is currently granted only to storage and simple processing that are carried out in a free trade zone and when at least 90% of the sales are for export. Only a few types of business can benefit from this incentive. The manufacturing, testing, and assembly activities typically performed by Taiwanese OEMs/ODMs, which usually involve extensive processing, are disregarded. Moreover, Ministry of Finance (MOF) ruling No. 10404572310 in 2015 made clear that such manufacturing, testing, and assembly activities are taxable to the foreign principals. The ruling has caused widespread industry concern, not only for foreign business, but also among Taiwan's OEMs/ODMs.

The Committee would like to make the following points:

a. Although most of the Taiwanese toll/contract manufacturers are independent from the foreign principals, the MOF ruling treats them as the business agents (BA) of the foreign principals, which imposes a heavy burden on the Taiwanese businesses. In practice, the Taiwanese OEMs/ODMs do not act for or represent foreign companies in sales, but rather only earn processing fees and follow the foreign companies' instructions to store products and ship them to customers. It is unreasonable for these OEMs/ODMs to bear tax-filing responsibilities for the foreign companies.

b. Under the ruling, foreign principals will be considered as generating Taiwan-sourced income from drop-shipment activities in Taiwan and should file corporate income tax returns and pay taxes in Taiwan. As a result, they need to appoint BAs to comply with these regulations. But due to the resistance from Taiwanese OEMs/ODMs, the foreign principals have difficulty complying with this ruling. Furthermore, the income derived from the manufacturing/processing has already been reported by the Taiwanese OEMs/ODMs. If the foreign principals are also considered subject to Taiwan taxes, the same income may be taxed twice.

As the current tax policy on drop-shipments is contrary to general taxation principles and to the practices of Taiwan's neighboring countries, the Committee urges the MOF to reconsider its ruling in the interest of both fairness and Taiwan's economic competitiveness.

Suggestion 2: Review Taiwan's tax policies with the aim of creating a favorable and competitive environment for attracting high-caliber professionals.

2.1 *Reduce the top-tier individual income tax rate and/or expand the individual income tax brackets.* Taiwan has had relatively high individual income tax rates and condensed tax brackets, leading to a heavy tax burden and challenges in attracting talent. Since the top tier individual income tax rate was raised last year from 40% to 45%, it has become even more difficult for Taiwan to attract and retain high-caliber personnel from abroad, as well as to keep outstanding domestic talent from giving priority to overseas job opportunities. In nearby countries with levels of economic development similar to Taiwan's, the individual income tax rate is much lower than in Taiwan – for example, 20% in Singapore and 17% in Hong Kong. As a result, both countries are more successful in terms of attracting international talent.

The United States is usually seen as a high-tax country. In the United States, the top tier individual income tax rate is 39.6% for a taxpayer with single filing status having income exceeding US$232,425 (equivalent to NT$7,437,600). In Taiwan, a 40% rate is applied to net income in the bracket starting at NT4,400,000 and the top-tier tax rate of 45% is applicable to net income exceeding NT$1 million. For an individual with net income of NT$10 million, the effective tax rate would be around 31.95% in Taiwan, compared to an effective rate of about 27.75% in the United States. With this comparatively condensed tax bracket and higher tax burden, it is difficult for Taiwan to attract high-caliber personnel from abroad and retain local talent. The tax policy also contributes to brain drain by encouraging outstanding local talent to pursue working opportunities overseas where they can enjoy a substantially lower tax payment.

The competition among countries to attract the best and brightest is becoming more and more acute. To help ensure that Taiwan's competitiveness does not fall behind, we encourage the Taiwan government to adjust the individual tax rate and consider expanding the tax bracket.

2.2 *Eliminate the cascade tax (also known as the "gross* *up" and "tax on tax") effect.* In 2010, the MOF issued Tax Ruling Tai Tsai Shuei No. 09804119811, stating that individual income tax paid by employers on behalf of foreign-national employees will be treated as the employees' "salary income" and can be deductible in the employer's corporate income tax, provided that the arrangement is stipulated in the employment contract. In effect, it means that the individual income taxes paid by the employer in the first year would be added onto the second year's annual salary to be taxed again, i.e. a tax on a tax. This "gross-up" practice to treat the remuneration received by the expatriates as an after-withholding-tax amount, together with the requirement to treat the individual income tax paid by the employer as the employee's "salary income" pursuant to the 2010 tax ruling, leads to an extremely high tax burden for multinational companies who bring high-caliber international talent to Taiwan. For a three-year expatriate assignment, for example, the effective individual income tax rate could reach as high as 77%, and the longer the assignment, the higher the tax burden.

The corporate income tax implications are even more onerous when taking into account the corporate income tax implications in cases where expatriates are seconded to Taiwan entities that act as a contract R&D provider and would apply a cost-plus markup on such individual income tax payments for corporate income tax purposes. To attract foreign talent to accept expatriate assignments to Taiwan, it is common practice for employers to provide a tax equalization clause in the secondment agreement to ensure that the foreign talent will not have to bear extra tax costs due to the relocation. Accordingly, the employers agree to pay the expatriate's individual income tax in the host country. Through this arrangement, the multinational companies are both increasing their commitment to invest in this market and are contributing to the development of a talent base in Taiwan. Under the aforementioned "gross-up" and "tax-on-tax" mechanisms, however, the cascade effect would cause a higher burden each year.

In recent years, expatriate assignments to Taiwan have been decreasing, depriving Taiwan not only of the related tax revenues but also of the knowledge and experience that professional foreign managers and specialists have to offer. Abolishing the gross-up and tax-on-tax requirements and designing a sounder tax policy would create a more encouraging environment for companies to bring in high-caliber overseas talent.

2.3 ***Implement a more tax-friendly incentive plan to attract high-caliber foreign professionals.*** Tax incentives are an important means to attract high-level talent from abroad or retain local talent to work in Taiwan. In this regard, Taiwan has provided less favorable conditions than nearby Asian countries such as Korea, Singapore, and even China. For instance, in Korea, foreign technicians receive a 50% tax exemption on their employment income for two years. In addition, foreign employees may elect to apply a flat 18.7% tax rate (without any exemptions, deductions, or credits) on their Korean-sourced employment income for their first five years in Korea. In Singapore, the marginal tax rate for individuals is just 22%, and in China expatriate employees' compensation in kind (for example, meals, laundry, and children's school tuition) is non-taxable.

Further, the amount of deductions available to foreign employees in Taiwan is less than in those neighboring countries. For instance, the deduction for school tuition for their children is only NT$25,000 per year, whereas the actual tuition paid to international schools may be as much as NT$500,000 per semester per child. Lastly, the individual income tax rate of 45% is quite high in comparison with Singapore and Korea. The high tax rate, combined with the lack of tax incentives, impedes the attraction and retention of top talent to work in Taiwan, with consequences for Taiwan's economic growth and industrial development. We urge the government to take these issues into consideration when amending its tax policies so as to create a friendlier and more competitive tax system.