

Taiwan issues amendments to free trade zone provisions

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Taiwan's Legislative Yuan passed amendments (the Amendments) to Article 29 of the *Act for the Establishment and Management of Free Trade Zones (FTZ)*, in an attempt to comply with the requirements of the *European Union Guidance on Harmful Tax Practices Caused by Tax Privileges Related to Special Economic Zones* and to eliminate discriminatory treatments between domestic and foreign entities.¹

Comparison between Before and After the Amendments

After the Amendments	Before the Amendments
Entities that are approved by the Free Trade Zone tax office will be exempt from corporate income tax on income from sales of goods, if the entity engages only in preparatory or auxiliary activities in Taiwan associated with the direct purchase, import, storage, or delivery of the goods in an FTZ or through FTZ enterprises.	Foreign entities or their branches in Taiwan that applied for an establishment or delegated FTZ enterprises to store and/or perform simple processing in the FTZ and sold the products in and out of Taiwan were exempt from corporate income tax. In the event that the annual domestic sales exceeded 10% of the total of annual domestic and export sales, the excess portion was subject to income tax.

Key features of the Amendments

- ▶ Before the Amendments, only foreign companies or their branches in Taiwan could access the income tax free regime offered by the FTZ incentive. After the Amendments, both foreign and domestic companies are eligible for the incentive, provided the conditions in the Act are met.
- ▶ In the past, the permissible tax-exempt activities in the FTZ were restricted to simply processing, which refers to relabeling, repackaging, testing, cutting and similar work. The new Act introduces the permanent establishment concept in the OECD² Commentaries as a threshold to determine whether the activities performed by enterprises in the FTZ would result in any taxability. The Act does not discuss what types of activities may constitute preparatory and auxiliary in nature; accordingly, a determination is based on facts and circumstances. For example, where an entity's core business is the manufacture of goods, the enterprise solely engages in storage, display or delivery of goods without executing primary activities (such as contract signing, production or manufacturing, or research and development activities) in the FTZ, the activities carried out by the enterprise in Taiwan would be considered preparatory or auxiliary in nature.

- ▶ The Amendments expand the tax-exempt income definition to cover income arising from sales to domestic customers and sales to foreign customers. The 10% domestic sale limitation is repealed.

Transaction treatment

The Amendments apply to taxable years beginning 2019. Tax exemptions granted prior to the Amendments remain effective until, at the latest, 31 December 2021. Where a tax exemption application has been submitted but not yet approved prior to the Amendments, it is treated in the following manner:

- ▶ Income earned on or before 2018: subject to tax under the prior regime.
- ▶ Income earned after 2018: subject to tax under the Amendments.

Endnotes

1. The Amendments were passed on 28 December 2018.
2. Organisation for Economic Co-operation and Development.

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