

Tax treatment of computer software purchases

Understanding Taiwan's Tax Regulations

In order to provide more consistent and authoritative guidance, the Ministry of Finance (MOF) issued an interpretation note on 11 April 2007 clarifying the issue of taxation relating to software purchases and, at the same time, also released a new set of tax assessment rules relating to advance ruling applications

Background

The applicability of withholding tax on payments for purchases of computer software from foreign suppliers was the subject of much confusion and ongoing debate prior to April 2007. While some argued that software purchases fell under Article 8-6 of the Income Tax Act and that royalty withholding tax should apply to payments made to foreign suppliers, many others insisted that such payments constitute product purchases and, thus, no withholding tax should apply.

In order to provide more consistent and authoritative guidance on the matter, the Ministry of Finance (MOF) issued an interpretation note on 11 April 2007 clarifying the issue of taxation relating to software purchases and, at the same time, also released a new set of tax assessment rules relating to advance ruling applications under Article 25 of Taiwan's Income Tax Act. These tax announcements have a significant impact on the software industry. The rules relating to computer software outlined in these announcements can be summarized as follows:

Packaged software and shrink-wrapped software

The Ministry of Finance ruling dated 11 April 2007 states that standard, unmodified software sold directly by foreign suppliers to Taiwan customers (including via Internet downloads) that Taiwan customers are not authorized to modify, copy, or resell are deemed as sales of a product. Tax on such software sales shall follow general international trading rules. This means that Taiwan customers can continue to pay foreign suppliers for packaged software purchases without having to pay withholding tax. Taiwan customers must only obtain the supporting documentation prescribed by Article 45-1 of the Income Tax Audit Regulations to back up the payments. These supporting documents include:

- import declaration form
- commercial invoice
- bank remittance advice

The Ministry of Finance pointed out that this ruling would bring the tax treatment of packaged software sales in line with international practice.

Tailor-made/customized software

In accordance with Article 8-1-2 of the tax assessment rules for Article 25 applications, payments for the right to use a system, application software, or source code shall be deemed as payments for royalty grants. The royalty withholding tax rate applies to such payments. If the system supplier has the right to charge Taiwan customers based on units produced or percentage of sales amount, the fee so charged is also deemed a royalty charge.

However, if a Taiwan customer owns a tailor-made system (or jointly owns the system with the supplier) and does not need to pay for the right to use the system in the future, then payments for development work carried out by the foreign supplier can be deemed to be payments made for technical services rather than royalties. In such cases, Taiwan customers can apply for an advance ruling under Article 25 of the Income Tax Act to reduce the withholding tax rate to 3%.

Technical consulting, system maintenance, testing, and training

In accordance with Article 8-1-2(3) of the Tax Assessment Rules Dealing with Article 25 Applications, technical consulting, system maintenance, testing, and training work carried out by foreign suppliers are considered to be technical services in nature. As such, Taiwan customers can apply for an Article 25 advance ruling to reduce withholding tax on these transactions to 3%.

EDP-related data processing or usage of an area network

In accordance with Article 8-1-1(2) of the Tax Assessment Rules Dealing with Article 25 Applications, in the case of electronic data processing (EDP) or usage of an area network, if billing is computed based on usage, cost allocation, or reasonable cost plus, work carried out can be deemed as technical services. In such instances, Taiwan customers can apply for an

advance ruling under Article 25 of the Income Tax Act to reduce the withholding tax rate to 3%.

Human resource agency work

If a foreign supplier only performs human resource agency work in substance, then in accordance with MOF Ruling 09504530470, the contract cannot qualify for Article 25 approval.

In deciding whether a foreign supplier performs human resource agency work or technical service work, the Taxation Administration takes the following factors into consideration:

- Whether the person sent to Taiwan needs to follow instructions from the Taiwan customer when performing duties
- Whether the person sent to Taiwan is supervised or evaluated by the Taiwan customer
- Whether the foreign supplier is responsible for any damages caused by the person sent to Taiwan
- Whether the person's scope of work is clearly defined in the contract
- Whether the Taiwan customer has the right to pre-approve the person who will come to work in Taiwan prior to the commencement of the contract
- Whether the foreign supplier only performs administrative and agency roles and does not provide technical support

These tax announcements are significant, especially for companies in the software industry, and they are likely to reduce disputes between taxpayers and the Taxation Administration. Grant Thornton Taiwan's tax team can help companies to stay compliant with related regulations as well as capitalize on planning opportunities to reduce tax burdens.

Contact



Jay Lo

Managing Partner

T +886 2 2789-0887 ext. 1314

E jay.lo@tw.gt.com

www.grantthornton.tw