

# Taiwan CFC Rules

Taiwan CFC rules will become effective from 1 January 2023

CFC stands for controlled foreign corporation. In order to better protect Taiwan's tax base and follow international trends, Taiwan will introduce CFC rules effective from 1 January 2023. This is meant to prevent tax loopholes that result from complex international tax planning via CFCs.

## Definition of CFC

A controlled foreign corporation (CFC) is defined in Taiwan as a foreign enterprise registered in a low-tax burden country or jurisdiction, with more than 50% of paid in capital owned by a Taiwan individual together with related parties, or more than 50% of paid in capital is owned by a Taiwan legal entity together with its related parties directly or indirectly. If the paid in capital ownership percentage is less than 50% but the foreign enterprise is effectively controlled by a Taiwan individual together with his/her 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.

A low-tax burden country or jurisdiction is defined as meeting any one of the following criteria:

- Corporate income tax rate in the foreign country/jurisdiction is not more than 70 percent of the tax rate in Taiwan ( $20\% \times 70\% = 14\%$ )
- The foreign country/jurisdiction imposes taxes on a territorial basis (does not impose

taxes on income derived from offshore, or imposes taxes only after income is remitted back onshore).

The Ministry of Finance will announce a reference list of low-tax burden countries in due course.

## Definition of related parties

The definition of related parties is broad. It refers any one of the following criteria:

1. A profit-seeking enterprise directly or indirectly holding 20% or more of the total outstanding voting shares or capital stock in another profit-seeking enterprise.
2. 20% or more of the total outstanding voting shares or capital stock in one or more profit-seeking enterprises are directly or indirectly owned or controlled by the same person.
3. A profit-seeking enterprise holds the highest percentage of total outstanding voting shares or capital stock in another profit-seeking enterprise and such percentage reaches 10% or more.
4. One half or more of the executive shareholders or directors of a profit-seeking

enterprise and those of another enterprise are the same.

5. The aggregate number of directors appointed by one profit-seeking enterprise and the number of directors appointed by one or more other enterprise(s) in which it directly or indirectly holds over 50% of the total outstanding voting shares or capital stock in another profit-seeking enterprise reaches one half or more of the total number of directors of the latter profit-seeking enterprise.
6. The chairman, general manager, or its equivalent or supervisor of one profit-seeking enterprise is that of another enterprise, or has the relation of a spouse or blood relation within the second degree with that of another profit-seeking enterprise.
7. A profit-seeking enterprise directly or indirectly controls the personnel, finance, or business operations of another profit-seeking enterprise
8. Profit-seeking enterprises that have entered into a joint venture agreement with one another, or an agreement to conduct business jointly.
9. Other circumstances whereby a profit-seeking enterprise has control or major influence over the personnel, finance, business operations, or management decisions of another profit-seeking enterprise.

## Scope

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 precedent over CFC.

Please note that there is also a substance over form rule that applies to CFC. This means that shares owned through use of nominee 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 country/jurisdiction and the CFC has employees carrying out actual operations and business there locally. 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 takes precedent 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 the CFC for the year - required legal reserve - losses from prior years

Taxable CFC income shall be computed based on actual holding percentages and weighted average holding periods.

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

If the current-year earning 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 CFC's and all CFC income for the 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 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 actual holding percentages and weighted average holding periods.

If the current-year earning 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 CFC's 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.

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 gains 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 None 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 a 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 haven 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 to evaluate whether existing group structures are still appropriate in view of the coming CFC rules. If in doubt, please do not hesitate to contact any member of our tax team.

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