

The “Cross-Strait Agreement on Avoidance of Double Taxation and Enhancement of Tax Cooperation”

Ministry of Finance

1. The necessity to conclude the “Cross-Strait Agreement on Avoidance of Double Taxation and Enhancement of Tax Cooperation” (hereinafter referred to as “Cross-strait Tax Agreement”)

Over the past two decades, approved investment contributed by Taiwanese enterprises to the Mainland has amounted to 148.6 billion US dollars, almost 62% of the total Taiwanese global investment. Moreover, the Mainland ranks first for Taiwan exports (18% of total Taiwanese exports) and ranks third for Taiwan imports (10% of total Taiwanese imports). In this regard, Taiwan has a huge trade surplus with the Mainland, indicating that cross-strait investment and trade are highly interconnected. Since tax administrations on both sides levy taxes on income received by people and enterprises of the other side based on their respective tax laws, the risks for double taxation are growing significantly. To solve this problem, concluding an income tax agreement to eliminate double taxation, lower the tax burden, and minimize tax audit risks will form a favorable taxation environment for bilateral trade and investment, as well as personnel exchange therefore creating a win-win situation for both sides.

2. Progress of the work

- (1) Since 2009, the Ministry of Finance has cooperated with the Mainland Affairs Council, collecting comments from any stakeholder for reference and negotiating with the Mainland on the Cross-Strait Tax Agreement on the principles of equality, dignity, and reciprocity. After several rounds of negotiation for six years, this Agreement provides a more preferential tax treatment and more complete extent for information protection to meet people's and enterprises' needs.
- (2) Since August 2013, the Ministry of Finance has visited 29 legislators and explained to and communicated the benefits and essence of the Agreement with 1,051 accountants, 76,531 business

persons or students in Taiwan, and 1,653 Taiwanese entrepreneurs in the Mainland. The Ministry of Finance also followed the terms of the draft of the “Cross-Straight Agreement Supervisory Bill” to complete two stages of national security review. After assuring them national security concerns were addressed, the Ministry of Finance held three rounds of public hearings in northern, central, and southern Taiwan, in order to enlarge public participation and enhance transparency of this Agreement.

- (3) After these efforts, the Cross-strait Tax Agreement was finally signed in the Eleventh round of Cross-Straight High-Level Talks on August 25, 2015.

3. The content of the Cross-strait Tax Agreement

The Agreement is based on international model conventions. The source area will provide appropriate reductions or exemptions on income taxes which originally should have been levied in accordance with its tax laws, and the resident area will provide tax credits or deductions to eliminate double taxation on a reciprocal basis. The content of the Agreement is briefly shown as follows from Taiwanese residents’ perspective (These tax measures apply reciprocally to the Mainland’s residents.):

(1) Persons covered:

This Agreement applies to residents of one or both sides. Residents refer to persons who are residents according to tax laws of one or both sides, including individuals and enterprises. However, in the case that Taiwanese enterprises invest in the Mainland indirectly through companies established in third areas (around 75% of the amount of the Taiwanese investment in the Mainland is indirect investment), theoretically speaking, the third-area companies are not entitled to apply for this Agreement. However, this Agreement allows the third-area companies which have places of effective management (PEM) in Taiwan and pay taxes as residents in accordance with Taiwanese income tax laws to be considered as Taiwanese residents; therefore, they may apply for this Agreement.

(2) Taxes covered:

In principal, this Agreement applies to income taxes only. However, business tax levied on the revenue from shipping and air transport is also covered.

(3) Tax relief measures:

- i. “Business profits” derived by a Taiwanese enterprise not through a permanent establishment situated in the Mainland are exempted from income tax. For example, Taiwanese enterprises establishing distribution centers, undertaking construction not exceeding 12 months, or providing services for a duration not exceeding 183 days in the Mainland do not constitute permanent establishments and are eligible to apply for a tax exemption in the Mainland.
- ii. “Dividends” received by a Taiwanese resident from the Mainland shall not be taxed by the Mainland more than 5 per cent of the gross amount of the dividends if the beneficial owner is a company which holds directly at least 25 per cent of the capital of the company paying the dividends, and shall not exceed 10 per cent of the gross amount of the dividends in all other cases.
- iii. “Interest” received by a Taiwanese resident from the Mainland shall not be taxed by the Mainland more than 7 per cent of the gross amount of the interest, and certain interest (such as interest paid to the government of either side) is exempted.
- iv. “Royalties” received by a Taiwanese resident from the Mainland shall not be taxed by the Mainland more than 7 per cent of the gross amount of the royalties.
- v. “Income from alienation of shares or other rights of the Mainland companies” received by a Taiwanese resident principally is exempted in the Mainland. However, if the shares derive more than 50 per cent of their value directly or indirectly from immovable property situated in the Mainland, the Mainland may tax the income from alienation of such shares.
- vi. “Corresponding adjustment” mechanisms are provided to eliminate double taxation caused by transfer pricing auditing between associated enterprises by the tax administrations of both sides.

(4) Dispute resolution mechanisms:

If residents of both sides encounter taxation disputes when applying this Agreement, such as those over transfer pricing corresponding adjustments or bilateral advance pricing agreements, they may apply to their competent authorities at the central level of the governments of both sides, the Ministry of Finance of Taiwan and the State Administration of Taxation of the Mainland, for endeavoring to solve these problems. Residents of both sides encountering any cross-strait taxation problems may also take the mechanisms as platforms to provide their opinions thereby minimizing divergence between tax administrations and taxpayers.

(5) Prevention of tax evasion measures:

In order to illuminate the spirit of avoidance of double taxation of this Agreement, the provisions of exchange of information in this Agreement are quite restricted in criteria and scope. Both sides agreed to exchange information if it is for implementing this Agreement or for enforcement of income tax laws, and both parties are obliged to confidentiality of information. The Agreement contains “Four-No Principles” as follows:

- i. No retroactivity: The provisions apply only to information that relates to taxation years beginning on or after the first day of January following the year of the entry into force of this Agreement. For example, if this Agreement becomes effective this year (2015), the competent authorities will only exchange information for year 2016 or after.
- ii. No criminal usage: Either side receiving information according to this Agreement shall not use it for criminal purposes.
- iii. No other purposes except for taxation: Either side receiving information according to this Agreement shall use it only for assessment, collection, enforcement, and administrative remedies of the income tax.
- iv. No provision if not a concrete case: Either side does not have any obligation to exchange information automatically and spontaneously. Exchange of information shall be made only on request.

4. Supporting measures and implementation plans

After signing the “Cross-Strait Tax Agreement,” this Agreement along with “the Amendment to Article 25-2 of the Act Governing Relations between the People of the Taiwan Area and the Mainland Area” will be presented to the Legislative Yuan for examination. The earlier the legislative procedures can be completed, the earlier Taiwanese people and enterprises can enjoy the benefits of this Agreement. For this reason, the Ministry of Finance will cooperate actively with the Mainland Affairs Council to facilitate the legislative process so as to promote the Agreement entering into force as soon as possible. Also, the Ministry of Finance will prepare the related regulations and modify the Regulations Governing the Application of Tax Agreements for the Avoidance of Double Taxation with respect to Taxes on Income so as to provide a clear guideline for taxpayers to apply for the tax benefits stipulated in Tax Agreements. Most importantly, the Ministry of Finance will continue to discuss with the State Administration of Taxation of the Mainland on the application details to ensure that both sides will carry out tax measures in compliance with this Agreement thereby guaranteeing its benefits.